WEALTH MANAGEMENT

Philanthropy & Wealth

Stewardship for Affluent Families

Prepared for: Arizona Planned Giving Conference
Phoenix, AZ
May 16, 2016

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Charitable Gifts of Difficult Assets:

Creating a Win-Win for Charity and Donors

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GIFT ACCEPTANCE POLICIES

Charities need to have good policies in place

- Clarifies process so that neither charity nor donor/advisors waste valuable time and resources
- Signals to donors and their advisors that this organization can handle challenging assets

Gift acceptance policies are a must

- Helps fundraisers to understand parameters
- Gives fundraisers easier way to say "no" to potential bad gift
- Creates discipline in intake and administration of gifts
- Educates staff and board about issues triggered by certain gifts
  - *e.g., costs associated with certain gifts*

Policies help board members understand and appreciate the nuances of planned giving

- May even motivate board members to do their own planned gift

GIFT ACCEPTANCE POLICIES

Policies lead to better consistency and more objectivity

- Allows decision-making to be made in methodical and objective way when seemingly attractive gift opportunity is being considered
- Less subject to personal opinion and experience
- Creates less confusion for donors
  - *Less mixed signals*
  - *Less mistakes for organization but also less mistakes for donors who may have unsophisticated advisors*

WHEN AN UNUSUAL GIFT IS OFFERED

Check Gift Acceptance Policies
↓
Ask Questions
↓
Gather Information
↓
Assess Information
↓
Ask More Questions
↓
Evaluate
↓
Make Recommendation

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Going “Negative” on Real Estate

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CASE STUDY #1: DONOR PROFILE & GOALS

Profile	Mrs. U is widowed, 91, no kids
	Lives in Malibu on an 11.5 acre residential property on a bluff overlooking the Pacific Ocean
	This property is her only major asset and she is finding it difficult to maintain
	She is in need of additional income
Goals	Mrs. U wants to remain in her home for the rest of her life
	Needs additional funds to pay off obligations and provide living expenses
	Needs assistance in maintaining the property.

Actual gift scenario. Used for illustrative purposes only

SOLUTION: RETAINED LIFE ESTATE WITH CHARITABLE GIFT ANNUITIES

Retained Life Estate:
Allows donor to remain in the home for her lifetime

- Exception to the partial interest rules
- The older the retained life estate holder, the greater the value of remainder interest
- Simple to create
  - — *Deed retaining life estate, remainder to charitable organization*
  - — *In CA no reassessment for property tax purposes*
- Prudence dictates having a Maintenance, Insurance and Tax Agreement (MIT) to manage expectations of the parties (donor and charity)
- If life estate holder needs to move out of the property (e.g., to go to a nursing home)
  - — *Can rent the home (Life Estate holder retains all rental income)*
  - — *Can join in a sale with Charity to sell to third party and split the proceeds based on the actuarial value of the interests at the time of the sale*

Charitable Gift Annuity:
A gift of the remainder interest used to fund three charitable gift annuities (CGAs)

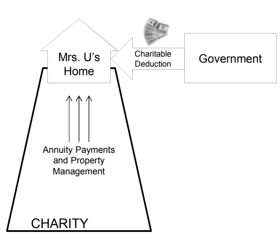
- 1 current CGA
- 2 deferred CGAs
- Under CA law, charity will need to set aside liquid assets (not the residence) into a segregated account as added security to the annuitant
- Remember, the charity is coming out of pocket during the lifetime of the donor to pay the annuities because it cannot sell the property to provide the annuity

CASE STUDY: PERSONAL RESIDENCE REMAINDER INTEREST GIFT

Starting Situation: Mrs. U needs funds for living expenses & other obligations. Residence is extremely valuable but she wishes to continue living in it.

Solution: Mrs. U transfers remainder interest in property to charity, receives charitable deduction & remains in home.

- Mrs. U receives 1 gift annuity & 2 deferred gift annuities
- Charity voluntarily maintains property
- Upon Mrs. U's death, home passes to charity



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Getting a Donor Out of an LLC Without Getting Stuck In It

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CASE STUDY #2: DONOR PROFILE, GOALS & SPECIAL ISSUES

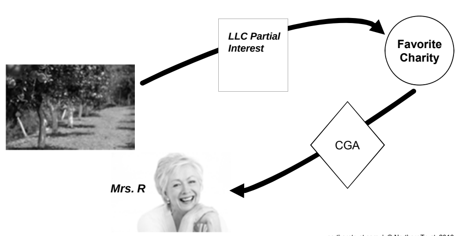
Profile	Mrs. R is 78, a long-time supporter of charity and has been involved in a family business for many years
	Wants to retire from her duties as staff "matriarch"
	Business is held in Limited Liability Co. form
	Assets are orange groves, oil wells, golf course and undeveloped property
Goals	Mrs. R wants to exit without paying substantial capital gains tax
	Doesn't want to burden the LLC with a buyout which will drain capital and cause financial stress
	Wants to make substantial gift to charity
	Wants an assured, fixed income
Special Issues	LLC's income is by nature, unrelated business taxable income, and back then precluded use of a CRT. Now, all UBTI in CRT is taxed at 100%
	LLC is a closely held business and as such Charity is concerned about the ability to sell a gift of any interest in the LLC
	Rest of family is not interested in having charity as a partner

Actual gift scenario. Used for illustrative purposes only

MRS. R & THE LIMITED LIABILITY COMPANY

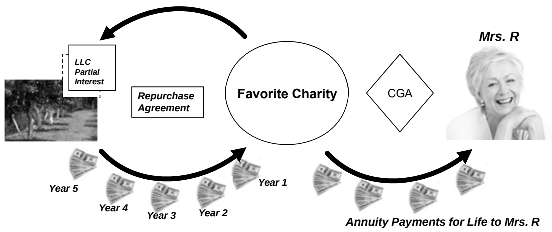
Starting Situation: Mrs. R is part-owner in a family business organized as an LLC which owns oil wells, orange groves, land, and a golf course. Mrs. R wants to step down as the matriarch and convert her illiquid asset into an income producing asset for her retirement years.

1. **Other LLC partners can't afford to buy out Mrs. R's interest**
2. **Instead, Mrs. R. donates her share of the LLC to Charity in exchange for a CGA which will provide a steady, guaranteed income.**



MRS. R AND THE LIMITED LIABILITY COMPANY (CONT'D.)

3. **Final Situation: Mrs. R receives regular income from Charity via CGA. Meanwhile, the LLC repurchases Mrs. R's former interest back from Charity through a 5-year note**



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When a Donor's Neighbor Keeps a Parking Slot for the EPA Auditor

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CASE STUDY #3: DONOR PROFILE, GOALS & DUE DILIGENCE ISSUES

Profile	Mr. F, aged 85, is a retired bachelor
	He has made a request for proposal for a Charitable Gift Annuity, funded with commercial property located on Ventura Blvd. in Sherman Oaks, a prime retail/office location
Goals	Mr. F is exclusively interested in a CGA
	He is willing to accept a payout amount which will be substantially less than the current income stream generated from rents
Due Diligence	Major tenant's lease was about to expire
	Adjacent property is defunct gas station with visible underground storage tank caps. Tanks and contaminated soil had been removed, but case was still open for groundwater contamination
	Other adjacent property is operating car wash. Suspect for solvent use

Actual gift scenario. Used for illustrative purposes only

CHARITABLE GIFT ANNUITY USING PROPERTY WITH APPARENT ENVIRONMENTAL ISSUES

Starting Situation: Mr. F contacts Charity and makes a request for CGA proposal using his prime commercial property in Sherman Oaks. Mr. F is 85, retired, and a bachelor.

Unless we're talking CGA, I don't want to even hear about it!

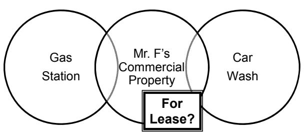
Mr. F's Commercial Property

CHARITY'S FINDINGS DURING DUE DILIGENCE

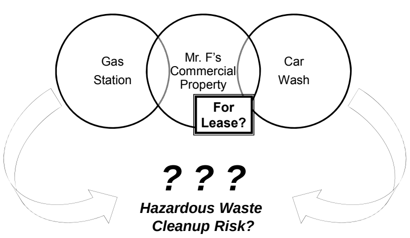
The major tenant's lease was about to expire.

Adjacent neighbors are:

- **A defunct gas station with visible UST caps**
  - — *USTs and contaminated soil have been removed, but case is still open due to groundwater contamination*
- **A working car wash**
  - — *Suspect for solvent use*



WOULD YOU TAKE THIS GIFT?



RESEARCH FINDINGS ON RESPONSIBILITY OF AND RISK TO ADJACENT PROPERTY OWNERS

PROS	CONS
• Environmental Protection Agency (EPA) will not sue buyers of contaminated property in certain cases (1993 Fed Register Article) • EPA policy statement offers relief to "innocent" owners of land overlying contaminated aquifers (1995) • Local agencies offer statements of comfort of non-pursuance • An environmental insurance company opines that liability is unlikely • Legislative trends favor protection of adjacent landowners	• EPA advises to NOT acquire the property

CHARITY DID.

11 reasons why...

1. No known contamination under property
2. No known contamination by current or historical owners
3. Property improvements have covered soil since 1924
4. Prior and current uses are "clean"
5. "Dirty" neighbors are deep pockets
6. Not a superfund site
7. EPA and RQWB practice indicates stance of non pursuance
8. Availability of affordable liability insurance
9. Area is low priority for regulators
10. Property is valued at almost $1MM. Expect quick sale
11. Title will be isolated to a supporting organization

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DAFs, Private Foundations and CLTs:
When to Use and Why

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VEHICLES USED BY HNW DONORS

$3M-$25M net worth segment

Typical planned giving vehicles

- CRTs
- CGAs
- CLTs
- Outright Gifts (with restrictions usually)

$25M + ←

Typically do not use planned giving vehicles (except CLTs)

- Private Foundations
- Donor-Advised Funds
- Combination of the two

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A Quick Primer on the World of Charities

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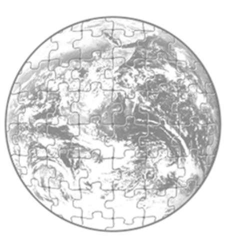
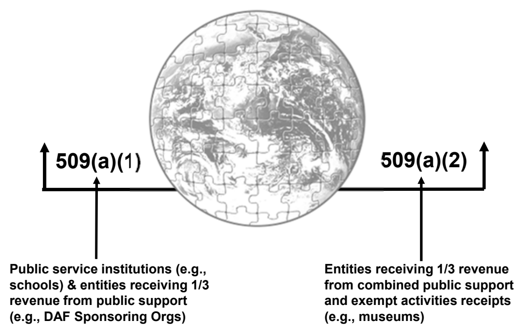
WORLD OF CHARITIES

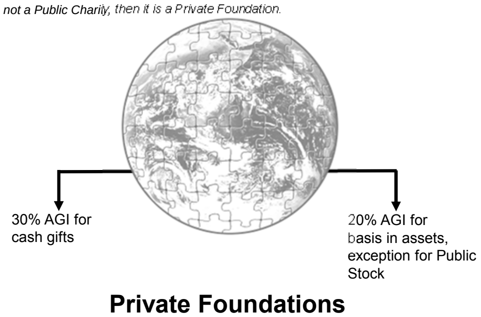


THE MAJORITY OF PUBLIC CHARITIES ARE…

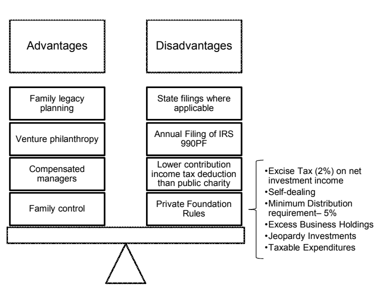


IRC SECTION 509(A) DEFINES PUBLIC CHARITIES

If it is not a Public Charity, then it is a Private Foundation.



ADVANTAGES & DISADVANTAGES OF PRIVATE FOUNDATIONS



DONOR ADVISED FUNDS FEATURES

- **Simple to administer: No start-up costs, no excise taxes, no IRS tax filings, no required payouts**
- **Name account after their family, company, in memory of someone, or after a specific cause**
- **Immediate tax deduction, maximum tax benefit**
- **Flexible grant-making – can receive recognition or make anonymous grants**
- **The potential to give more over time – e.g., delaying distributions provides time for investment returns to accumulate**
- **Ability to create a legacy**
- **Can only recommend grants and investments**

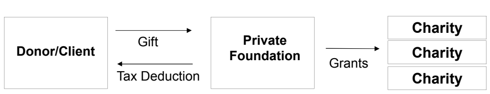
DONOR ADVISED FUNDS

- Irrevocable contribution of a minimum amount (typically $5,000 to $50,000 in cash or marketable securities); subsequent contribution typically of $5,000 or more.
- Immediate tax deduction.

- Recommend grants to qualified charities. (Minimum: Generally, $250 per grant)

Note: Contributions to DAF Sponsoring Organization are irrevocable, and DAF Sponsoring Organization has final approval over all donor grant recommendations. Grant and investment recommendations are subject to the terms and conditions of DAF Sponsoring Organization's articles of incorporation and bylaws. DAF Sponsoring Organization's Board of Trustees reserves the right to modify the program at any time.

PRIVATE FOUNDATIONS



- Irrevocable contribution of marketable securities or cash. Other assets –donor limited to basis as measure of income tax deduction so donors don't usually contribute to private foundations.
- Lower AGI limitations for gifts to Private Foundation
- Immediate tax deduction.

- Annual filing of 990PF
- Excise tax of 1-2% of net investment income
- Minimum distribution of 5% of value of ~~investment~~ assets annually
- Restrictions on transactions between PF and disqualified persons

- Control of grant-making and investments

DONOR ADVISED FUND VS. PRIVATE FOUNDATION

	DONOR-ADVISED FUND	PRIVATE FOUNDATION
Immediacy	On average, can be established within a week	On average, a month or greater
Start-up Expenses	None	Significant legal fees and other start-up expenses
Excise Taxes	None	1–2% of net investment income annually
Tax Deductions for Cash Gifts	FMV at 50% of AGI	FMV at 30% of AGI
Tax Deductions for Stock or Property	30% of adjusted gross income (or basis up to 50% of AGI at the donor's election)	20% of AGI (FMV for marketable securities, basis for all other non-cash contributions)
Required Payout	None	5% of net asset value annually
Privacy	Donor's identity can be kept confidential if desired	Must file detailed and public tax returns on grants, fees, salaries, etc.

WHY WOULD A FAMILY USE A DAF OVER A PRIVATE FOUNDATION?

Too busy to run another "business"

- Desires simplicity
- May have a need for greater privacy
- Funding asset issues for Private Foundation
  - — *Lower AGI limitations for PF v. DAF*
  - — *Measure of Deduction lower if non marketable securities or cash used to fund PF*
- Can build up the DAF over time without requirement of 5% distribution
- No administrative duties
- Administrative cost for DAF is less than costs for Private Foundation

WHY WOULD A FAMILY CHOOSE A PRIVATE FOUNDATION OVER A DAF?

- **Control, Control, Control**
- **Private Foundation can last in perpetuity—many DAFs have a limit on how long the fund can last**
- **Ability to manage investments**
  - — *Although some DAF sponsoring organizations allow donors to use personal investment advisors*
- **Flexibility in grant "investments"**
  - — *Mission and Impact Investing*

CHARITABLE LEAD TRUSTS

- **Charitable lead trusts are the reverse of charitable remainder trusts, because the charity is the upfront beneficiary**
- **Under a charitable lead trust**
  - — *Payments are made from the trust to the charity for a set term of years or for the life of a family member*
  - — *Followed by distribution of the balance of the trust property at the end of the term or on the family member's death to non-charitable beneficiaries (family members, friends)*

CHARITABLE LEAD TRUSTS

Charitable lead trusts are used when the non-charitable beneficiaries will not need trust assets now.

Charitable lead trusts are attractive if the property has great appreciation potential.

Charitable lead trusts are almost exclusively an estate planning tool to move assets inter-generationally at a lower transfer tax cost.

TYPES OF CHARITABLE LEAD TRUSTS

Charitable Lead trusts can be either:

- Annuity trusts setting a fixed amount for the annual distributions (or payments) to charity ("CLATs")
- Unitrusts paying a percentage of the annually revalued trust assets to charity ("CLUTs"). Variable payments as opposed to fixed payments.

CHARITABLE LEAD ANNUITY TRUST EXAMPLE

You fund a CLAT with $1,000,000.

The CLAT pays 5% of the initial contribution (or $50,000) to charity annually for 20 years.

The $50,000 annual payment to charity does not vary over the term of the trust.

At the end of the 20 years, the remainder of the trust will be paid to your children.

CHARITABLE LEAD UNITRUST EXAMPLE

You fund a 20-year CLUT with $1,000,000.

The CLUT pays 5% (or $50,000) the first year of the trust. Each year, the assets of the trust are re-valued, and the 5% is multiplied by the new value.

If the value of the trust in year 2 is $1,010,000, the payment that year to charity will be $50,500.

At the end of the 20 years, the remainder of the trust will be paid to your children.

NON-GRANTOR LEAD TRUSTS

- Grantor does not receive an income tax charitable deduction.
- Grantor is not taxed on the income of the trust.
- Estate planning tool: trust designed to pass wealth to next generation with less transfer tax because the value of the remainder is based on the applicable federal rate, which assumes very limited appreciation of the trust's assets. The taxable gift is thus assigned a discounted value.

GRANTOR LEAD TRUSTS

- **Grantor receives an income tax charitable deduction upon creation of the trust based on the value of the charitable lead interest**
- **Grantor retains a power over or right in the trust which causes him/her to be treated as owner of the trust's income for tax purposes**
  - Grantor retains reversionary interest
  - Grantor retains certain administrative powers:
    - — *Right to substitute trust assets*
    - — *Right to borrow from the trust*
- **Grantor is taxed on the trust's income without receiving any distributions (i.e., "phantom income")**
- **Even better estate planning tool because it gives the grantor an income tax charitable deduction up front… if donor doesn't mind paying tax on phantom income**
- **"Free gift" to remainder beneficiaries**

CHARITABLE LEAD TRUSTS - TYPES

	Charitable Lead Annuity Trust	**Charitable Lead Unitrust**
Grantor	Income tax deduction Income taxed to Grantor	Income tax deduction Income taxed to Grantor
Non Grantor	No income tax deduction Income taxed at trust level, but trust offsets income with a charitable distribution deduction for annuity payments	No income tax deduction Income taxed at trust level, but trust offsets income with a charitable distribution deduction for unitrust payments
GST Allocation	Inclusion ratio determined at termination of trust	Inclusion ratio calculated at inception of trust
Payment Amount Determined By	Fixed % of asset value as of date of creation	Fixed % of value of assets revalued annually; no net income provision allowed
Minimum Payout %	None	None
Maximum Payout %	None	None

MORE ABOUT THIS VEHICLE

Who needs Charitable Lead Trusts?

- Donor who wants to make transfer to next generation at low transfer cost (usually a non-grantor trust)
- Donor who needs an income tax deduction for a "bubble year" of income (Grantor Trust)
- Donor who has desire to make charitable gifts but has maxed out his/her percentage limitation for charitable gifts
- Donor who has asset that is likely to appreciate over the term of the trust in excess of the 7520 rate
- Donor who has an asset that is not designed to sell, but to move to next generation

HOW A CHARITABLE LEAD TRUST (NON-GRANTOR CLT) WORKS AS A WEALTH TRANSFER TRUST

1. Starting Situation

Dad owns an apartment complex with low basis and high appreciation	Produces reliable rental income	Market indicators suggest property will appreciate in years to come	He wants to leave the apartments as a legacy to his daughter and make a charitable gift to charity

Dad creates a Charitable Lead Annuity Trust and transfers building to trust

Value of remainder interest at time of creation is a gift to remainder beneficiary (daughter)

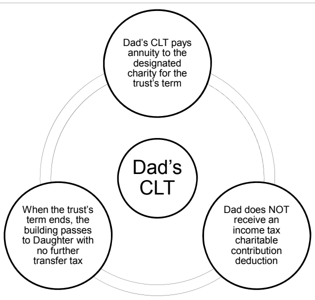
2. Apartments now owned by the CLT

Note: For illustrative purposes only. Not legal or tax advice

HOW A CHARITABLE LEAD TRUST (CLT) WORKS

3. Dad's CLT manages the apartments and pays income to the designated charity.

Charity



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Thank You.

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NORTHERN TRUST BIOGRAPHY

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Claudia B. Sangster is the Director of Family Education and Governance in Wealth Management at the Northern Trust Company. In this role she designs the firm's advisory capabilities in financial education, family decision-making, and relationships around money and wealth. Claudia collaborates with clients, their advisors and Wealth Planning partners in identifying and establishing appropriate educational programs and governance structures for multi-generational families in order to prepare family members to steward the wealth, to enhance family unity and to help sustain all aspects of the family's capital—financial, intellectual, human and social. She works with families to create their legacy of wisdom, wealth and giving through multiple generations.

Claudia has over 30 years of experience in advising individuals and families in financial education, family governance and philanthropy. Prior to joining Northern Trust, Claudia was with CTC myCFO, where she served as the Director of Philanthropy, Estate and Trust Services. She was also instrumental in establishing the Harris myCFO Foundation, and its successor, the BMO Charitable Fund Program, a donor-advised fund sponsored by the National Philanthropic for clients seeking a simple, tax efficient vehicle for their philanthropic giving.

Claudia is a frequent speaker and author on topics including values, finance and family legacy, as well as trends in family education, governance and philanthropy.

Claudia earned a Bachelor's degree, Summa Cum Laude, from Pepperdine University, and a JD, Magna Cum Laude, from the University of Houston, College of Law. She is a Founding Partner of Social Venture Partners in Los Angeles, current Board Chair of the Associated Women for Pepperdine, current board member of the Prostate Cancer Research Institute of Los Angeles, Advisory Board member of the Preston Robert Tisch Brain Tumor Center at Duke University Medical Center and Chairperson of the Board of Trustees of the Nicholas Endowment.

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