Frazer Ryan
Goldberg &
Arnold LLP

Jonathon M. Morrison, Esq., Senior Partner
Frazer Ryan Goldberg & Arnold LLP
(602) 277-2010
jmorrison@frgalaw.com

The Charitable Super-IRA

Executive Summary: Similar to 401(k) or IRA – but "Super" since (i) up to 30% of annual income may be contributed, pre-tax, without income phaseouts, (ii) no tax on contributions "going in" (like 401(k)) *or* distributions "coming out" (like Roth IRA), (iii) assets may be gifted to family members, free of gift tax, (iv) assets are not subject to estate tax at death, and (v) assets protected from creditors and divorce. Primary drawback – no access for *minimum* 25 years until account termination (but contributor controls investments at all times). Charitable gifts required to be paid from account each year (benefits greatly amplified for contributors already giving, but arbitrage still exists for those not giving at all). Vehicle codified in Tax Code since 1969; all aspects of strategy have been approved by IRS. Must be funded now while interest rates are low (rate locked in upon creation).

Client Profile (*should meet at least one of the below criteria*):
- High-income earner (min. $400k annual income) seeking tax deductions / asset protection
- Individual experiencing large income recognition event seeking maximum tax benefits:
    - Sale of business
    - Exercise of non-qualified employee stock options (NSOs)
    - Conversion of Traditional IRA to Roth IRA
- Philanthropic individual making large consistent gifts every year (>$25k annually)

Objectives (*at least one of the below should be a primary objective*):
- Significantly reduce federal and state income taxes
- Protect assets from creditors & divorce
- Give to charity at potentially zero economic cost (*if planning to give to charity, regardless of using this strategy or not, virtually always better off using this strategy*)
- (Optional) Transfer wealth to children at zero gift tax or estate tax cost

Similarities and Differences to Traditional IRA
- Similarities:
    - Claim income tax deduction equal to 100% of contributed amount
    - Assets are immediately protected from creditors and divorce
    - No personal use of contributed funds
    - No access to contributed funds for a number of years (at least 25+ years required)

- Differences (& Super-IRA Advantages):
    - Account may be funded on pre-tax basis with up to 30% of annual income, without phaseouts
    - Contributor does not recognize any income when assets are received back from the account (*"no tax in (like Traditional IRA); no tax out (like Roth IRA"*)
    - Account assets may be passed on to children, free of any gift taxes
    - Account assets exempt from estate taxes, even if death occurs before trust termination

How it Works

- Create Trust Account. The contributor creates a special type of trust known as a "charitable lead annuity trust" or "CLAT". This type of trust has been authorized by the Tax Code since 1969 and has historically been used by wealthy families to fund their private foundations and minimize *gift/estate* taxes; however, the Charitable Super-IRA strategy utilizes this trust primarily to minimize *income* taxes.

- Fund Account & Claim Tax Deduction. The contributor funds the trust account with cash or securities, and claims an income tax deduction equal to 100% of the amount contributed to the account. Assuming the contributor is in a 50% combined federal/state income tax bracket, the avoidance of tax on contribution gives the contributor *twice* as much money to compound and invest going forward. Like a self-directed IRA, the contributor continues to possess full control of the investment of the assets.

- Delay Charitable Payments While Investing Assets for Growth. To qualify for an upfront income tax deduction, the Tax Code requires annual payments (an "annuity") to be made from the trust account to one or more public charities (which can include the contributor's donor advised fund) over a term of years selected by the contributor. The total annuity payments must equal 100% of the amount contributed to the account plus interest accruing on the outstanding annuity balance using a rate determined by the IRS (see below).

  Critically, the bulk of the charitable annuity payments that justify the upfront tax deduction may be delayed for decades, at little economic cost to the contributor. The reasons are that (i) there is no maximum limit on the number of years that the annuity must be paid, (ii) charitable annuity payments can vary in their amount, and (iii) the charitable annuity's IRS-set interest rate (*which is currently only 2.4% per year*) is fixed as of the month of account funding and does not depend on the length of the charitable annuity term.

  To maximize the benefits to the contributor, the charitable annuity term should be a minimum of 25 years and charitable payments should be minimized in the earlier years to the greatest extent possible (with larger payments made in later years). Together, this maximizes the time that the contributor can invest the assets inside the account before significant charitable annuity payments become due. **Even though payments to charity are considerable, this strategy works because of the timing mismatch between when the contributor benefits from the tax deduction (*today*) and when payments are made to charity (*many years from now*). The benefits are further maximized due to the current prevailing historically low interest rates. Because the contributor has twice as much money to invest on a compounded basis for many years before actually paying the bulk of the pledged charitable gifts (which bear a low interest rate accrual), the Charitable Super-IRA assets can appreciate well beyond what the contributor would otherwise have had if he had simply paid income tax and invested the after-tax proceeds without making charitable gifts at all.**

- <u>After Charitable Annuity Paid in Full, Remaining Account Balance Returned to Contributor Without Income Tax Recognition</u>. At the end of the charity's annuity term, any remaining balance in the account is paid back to the contributor (without income tax recognition). Alternatively, the trust can be set up to pay the remaining balance to children or other family members, free of gift tax or estate tax.

<u>Sample Illustration</u>

Below is a sample illustration of the estimated benefits of (i) a $100,000 contribution to a Charitable Super-IRA returning 7% per year[1], versus (ii) status quo investing (paying income tax on the $100,000 of income, investing the after-tax proceeds at 7% per year, and making the same charitable contributions that would be made from the Charitable Super IRA account):

	A	B	C	D	E	F
	Status Quo Account Value at Term	**Super-IRA Account Value at Term**	**Additional Wealth at Term** **(B - A)**	**Death Tax Saved if Super-IRA Left to Children** **(B x 40%)**	**Total Benefit of Super-IRA** **(C + D)**	**Charitable Gifts Made Under Either Scenario**
25 year term	$153,374	$306,748	$153,374	$122,699	**$276,073**	**$160,946**
30 year term	$245,405	$490,811	$245,405	$196,324	**$441,730**	**$180,828**
35 year term	$379,908	$759,816	$379,908	$303,927	**$683,835**	**$203,436**
40 year term	$575,266	$1,150,533	$575,266	$460,213	**$1,035,479**	**$227,660**

-Additional assumptions: (i) maximum backloaded charitable payments (20% step-up per year), (ii) contributor in 50% combined federal/state income tax bracket, (iii) Super-IRA created in May 2017 (IRS Section 7520 rate = 2.40%), (iv) income tax deduction claimed for charitable gifts made under status quo scenario
-Illlustration does not consider income taxes paid on assets in either account scenario

Below is the same illustration, but assumes that <u>*zero*</u> charitable contributions would be made under the status quo scenario:

	A	B	C	D	E	F
	Status Quo Account Value at Term	**Super-IRA Account Value at Term**	**Additional Wealth at Term** **(B - A)**	**Death Tax Saved if Super-IRA Left to Children** **(B x 40%)**	**Total Benefit of Super-IRA** **(C + D)**	**Charitable Gifts with Super-IRA**
25 year term	$271,372	$306,748	$35,377	$122,699	**$158,076**	**$160,946**
30 year term	$380,613	$490,811	$110,198	$196,324	**$306,522**	**$180,828**
35 year term	$533,829	$759,816	$225,987	$303,927	**$529,914**	**$203,436**
40 year term	$748,723	$1,150,533	$401,810	$460,213	**$862,023**	**$227,660**

-Additional assumptions: (i) maximum backloaded charitable payments (20% step-up per year), (ii) contributor in 50% combined federal/state income tax bracket, (iii) Super-IRA created in May 2017 (IRS Section 7520 rate = 2.40%)
-Illlustration does not consider income taxes paid on assets in either account scenario

[1] A 7% annual rate of return is not inconceivable given (i) the long term of the strategy, (ii) the historic returns of the S&P 500, and (iii) the growth-oriented objective that should be applied to the assets.

As illustrated above, the Charitable Super-IRA results in a significant increase in wealth even if the contributor is not charitably-inclined and would not have otherwise made any gifts to charity. In addition, these illustrations indicate that the longer the contributor is willing to wait to have access to the funds (by using a longer-term Charitable Super-IRA), the greater the tax and economic benefit to the contributor and his family.

Risks and Considerations

- Charity Has "First Bite" at Super-IRA Assets. First and foremost, this is a charitable trust, not a qualified retirement vehicle (like an IRA). To enjoy the upfront deduction, charity must be paid first, in full (similar to a "first lien" on the assets). If the assets do not perform well enough during the annuity term, there is a possibility that there may be little or no assets payable to the contributor at the end of the term.

- Long Term Horizon. Like any retirement vehicle, the Charitable Super-IRA is designed to be a long-term strategy, particularly since the assets may not be withdrawn or borrowed until the charity's pledge is paid, in full. Early termination of the Charitable Super-IRA is possible with a court order (*which usually requires the consent of the charity and all persons entitled to the account assets after the charitable term*) but in most cases substantially all of the economic benefits of the strategy are forfeited.

- Contributor's Payment of Income Taxes During Charitable Term. Unlike an IRA or 401(k), the contributor is responsible for payment of the account's annual income taxes. Therefore, the contributor must be willing to pay the taxes associated with trust account's annual income for 25+ years (although the benefit is that the contributor may receive the assets back at the end of the charitable pledge without income tax, similar to a Roth IRA).

- Early Death. If the contributor dies before the end of the charity's annuity term, his estate is required to pay taxes on income equal to the unpaid annuity balance. However, there are some offsetting tax benefits such as (i) the trust may begin claiming charitable deductions, and (ii) the account assets are still excluded from estate tax. Thus, mortality is not a material risk of this planning.

- Timing. As interest rates rise, the Charitable Super-IRA becomes less and less attractive from an economic point of view (since a larger portion of the Charitable Super-IRA assets would need to be paid to charity, leaving less for the contributor). Because rates are currently low and can be locked in at the outset, clients are urged to act quickly. Once rates increase to more than 4%, it is unlikely that the Charitable Super IRA will be a viable retirement strategy (except for those clients with existing Charitable Super IRAs who are unaffected by future rate increases). However, despite higher rates, the Charitable Super IRA will likely will remain a viable strategy for consistent annual donors.

FAQ

1. **Has this strategy been approved by the IRS?** Yes – this strategy has been codified in the Tax Code since 1969. In addition, every single one of the facets of this planning have been either formally or privately approved by the IRS and/or enacted to law by Congress or the U.S. Treasury. (In fact, the current IRS Commissioner John Koskinen himself implemented a similar strategy in 1998 to fund his alma mater, Duke University). The IRS has also provided a sample form trust agreement that it has approved for this type of planning.

2. **Why have I not heard about this?** It is well-documented that this strategy – known as a "CLAT" – is misunderstood. Simply put, a good number of tax advisors do not understand the mechanics or benefits of a CLAT – most likely because interest rates have never been this low. Contrast this with charitable remainder trusts ("CRTs") which make economic sense in high interest rate environments (such as the past several decades). Many advisors are comfortable with the CRT strategy – the IRS reports that of the 122,541 charitable trusts that filed charitable returns in 2009, CRTs comprised approximately 90% of those returns…CLATs only comprised 5%.

   Another reason is that the strategy described herein is a very specialized variant of the traditional CLAT. This strategy has four differentiating features that produce the compelling economic results indicated above (specifically (i) "grantor trust" status, (ii) an extended charitable term, (iii) a 20% graduated (back-loaded) charitable payment schedule (the maximum back-loading authorized by the IRS), and (iv) a "zeroed-out" remainder to maximize the tax deduction and avoid any gift taxes). These features are designed to maximize the benefits to the donor and the donor's family, but without reducing the amount of the gift to charity.

3. **Can the donor change the charity at any time?** No; however, an independent Trustee (i.e. someone who is not a relative or employee of the donor) may possess discretion over which charity receives the payments. In practice, a donor advised fund is usually named as the charitable beneficiary to maximize control and flexibility.

4. **Can the charitable payment be satisfied using appreciated assets held in the trust?** Yes, although the IRS took the position in a (non-legally binding) 2009 private letter ruling that this transfer gave rise to a deemed sale of the transferred asset, resulting in taxable gain. The ruling has been widely-criticized by many practitioners as incorrect given the grantor trust nature of the CLAT. (Note that a taxpayer taking a contradictory position to the 2009 letter ruling must specifically state the contradictory position on his or her tax return.)

5. **Why is it important to act now?** The interest rate applicable to the charity's annuity is at an all-time low. Unlike other tax planning strategies (again, a GRAT/QPRT), this strategy allows a donor to lock in today's rate, for as long as desired, with little mortality risk.

Frazer Ryan
Goldberg &
Arnold LLP

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By: Jonathon M. Morrison, Senior Partner, Frazer Ryan Goldberg & Arnold LLP

Subject: Leveraging the Charitable "IOU" Deduction to Give *and* Increase Wealth

In the world of philanthropic giving, it might seem preposterous that a donor could give assets away to fund philanthropic objectives and also *increase* personal wealth as a result of making charitable gifts. After all, these two objectives appear to be completely contradictory. As explained below, however, there is one charitable trust strategy that does just this. So the one question for the philanthropically-minded is: why not get paid to give?

EXECUTIVE SUMMARY OF STRATEGY

Most charitable clients oftentimes have a plan to give a certain amount away to charity each year during life and also make a substantial gift at death. These gifts may even be pursuant to signed pledges with certain charities. Wouldn't it be nice if there were a way for a donor to enjoy an immediate income tax deduction, this year, to receive credit for all of the donor's future planned gifts? This way, the donor could save income taxes today and have more money to invest leading up to the time when the pledged charitable gifts actually become due.

Although it is not widely-known, for nearly 50 years, the Tax Code has permitted a donor to claim an immediate charitable income tax deduction based on the promise to make charitable gifts in the future (referred to below as the "charitable IOU"). Using a "grantor charitable lead annuity trust" (or "CLAT"), a donor may enjoy an immediate "charitable IOU deduction" (limited to 30% of the donor's adjusted gross income ("AGI")) without parting from any money at all, so long as sufficient funds are set aside in trust to satisfy the pledged charitable IOU.

Because the donor saves income taxes *today* and invests those tax savings on a compounded basis for many years before actually paying the bulk of the pledged charitable gifts, this strategy allows the donor to make charitable gifts at no economic cost *and* increase the donor's wealth beyond what the donor would otherwise have had if a charitable donation were never made at all.

DETAILED EXPLANATION OF STRATEGY

- Immediate Income Tax Deduction in Exchange for IOU to Charity. This strategy allows a donor to enjoy a charitable income tax deduction by giving charity a promise to pay (an "IOU") where the actual transfer of the donation to charity is spread out and delayed over many years...and, more commonly, decades. The charity may be any public charity, a donor advised fund, or even a private foundation (although the latter reduces the AGI limit from

30% to 20%). (Most commonly, a donor advised fund is named to maximize the donor's control and flexibility *and* allow the donor to enjoy the larger 30% AGI limitation.)

- <u>Assets Equal to Deduction Amount Must Be Set Aside in Trust to Pay IOU</u>. In order to receive the upfront deduction, the IRS requires *more* than just a mere promise to pay: in the year that the deduction is claimed, the donor must actually transfer and set aside sufficient assets in a trust[1] until the IOU is paid off in full (see below for "Payment Terms of IOU"). Nevertheless, after paying off the IOU, the donor (or the donor's family) receives back whatever assets remain in the trust (as explained on page 3). For example, if the donor claims a $100,000 deduction based on charitable IOU gifts totaling $100,000,[2] then assets valued at $100,000 must be set aside by the donor in a trust account until the charity receives full payment. Usually cash or securities are used to satisfy the deposit to the trust; however, the deposit may be satisfied with virtually any type of property.[3] Consider the following regarding the trust account:

    - *Donor's Retained Right to Invest Assets…But No Access until IOU Paid Off.* The donor cannot access the trust assets until after the charity's IOU is paid off; however, the donor can usually serve as Trustee of the trust and continue to control to invest the assets. Although the IRS requires the donor to invest the trust assets in a "prudent manner," the donor possesses broad discretion with respect to investments of the trust assets. Thus, the trust assets may be invested in virtually any manner (including concentrated positions, alternative investments, hedge funds, private equity, etc.)

    - *Trust's Income Taxes Paid by Donor*. Until the charity's IOU is paid off, the donor is liable for paying all of the income tax associated with the trust assets…just like if the donor continued to own the assets himself or herself. The donor may not be reimbursed from the trust account for taxes paid. However, these taxes may be minimized by investing the assets for growth, purchasing "muni-bonds," or engaging in tax planning (such as loss harvesting, Section 1031 exchanges for real property, etc.) The silver lining is that the donor's payment of the trust's taxes allows the trust assets to grow and appreciate tax free. This can result in a larger amount passing to the donor's family (gift and estate tax free) should the donor elect for his or her family to receive back the remainder after paying off the charity's IOU (see page 3). Moreover, when the assets are received back by the donor (or his family) after the charity's IOU has been paid in full, there is no income tax on receipt of the assets. Income tax payments also reduce the donor's taxable estate at death.

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[1] The technical name for this trust is a "grantor charitable lead annuity trust" or simply a "CLAT".

[2] Plus an interest component discussed below.

[3] In fact, there can be added economic and tax benefits depending on which asset(s) are deposited into the trust (particularly, if funded with a "fully paid-up" cash value life insurance policy (which is permanently exempt from income tax) or a partial, discounted interest in investment real property or family LLC/partnership).

- *Trust Assets Insulated from Creditors and Divorce*. Assets contributed to the trust account are *immediately* exempt from the donor's creditors. For some clients, this can be a very important side benefit of the planning.

- *Irrevocability*. Early termination of the trust is difficult and cannot occur without obtaining a court order. Upon termination by court order, the charity's unpaid IOU must be satisfied in full (without discounts) – thus, early termination may also forfeit some of the tax and economic benefits to the donor and the family. Before proceeding, the donor must be comfortable with the lack of access to the trust assets and responsibility for income taxes.

- <u>Payment Terms of IOU</u>. The charity must receive annual payments from the trust account in satisfaction of the IOU. The amount of the annual payments need not be the same each year, but they must be fixed by the donor at the outset and may not be altered. Consider:

  - *Low IOU Borrowing Rate*. Because the charity does not receive immediate payment of the entire charitable donation, the IRS requires that the charity receive an annual rate of return on the unpaid balance. This "Section 7520" rate is set by the IRS each month and is currently only 1.4% for November 2016 planning. Critically, this low rate can be locked in at the outset *regardless of the length of the payment term* (the IRS has privately approved a 108 year CLAT). This is the primary reason why CLAT planning makes so much sense in this low interest rate environment.

  - *No Limit on Payment Term.* There is no limit on the number of years that the donor can delay to pay back the charity's IOU. In fact, the longer the delay, the better the tax and economic benefits to the donor and the donor's family (since the donor has more time to invest his or her assets and the charity's IOU balance accrues interest at a low 1.4% rate). The donor can also elect to have the charity's IOU paid off at his or her death in the event that death occurs prior to the end of the fixed payment term.

  - *Payments May Be Back-Loaded.* Although payments to charity must be made at least annually, payments are typically "back-loaded" so that larger payments are made in later years. This way, the donor continues to invest more of the trust assets in earlier years while making small payments to charity. Thus, back-loading increases the value of the trust that will ultimately be paid to the donor (or the donor's family) after paying charity.

- <u>Donor (or Donor's Family) Keeps Remaining Assets in Trust Account After IOU Paid</u>. After the charity's IOU is paid in full, the donor (or the donor's family) receives back whatever is left in the trust account (the "remainder").

  - Since the charity's IOU payments are structured to return only 1.4% per year, the donor (or the donor's family) will usually receive back the bulk of the assets that were initially deposited and invested in the trust account (particularly if the trust assets are invested for growth and the charitable payments are back-loaded over a large number of years).

- o If the donor elects for his family to receive back the remainder, there are no gift taxes and the entire remainder is exempt from federal estate tax at the donor's death. For clients with large estates, this feature amplifies the benefits of the strategy tremendously (as illustrated in the example on the following pages).

- Compounded Investment of Immediate Tax Savings. In addition to receiving back the remainder after paying the charity's IOU, do not forget about the donor's income taxes that were saved in the initial year – and all of the appreciation that occurs on those assets until the charity's IOU is paid off. It is these assets that make the charitable IOU planning worthwhile from a pure economic standpoint since the donor benefits today, but without making any cash outlay to charity for many years.

CASE STUDY

Joe is an executive making $2,000,000 of W-2 wage income this year. Joe gives to charity on an annual basis and plans to do so until his death. Joe would like to (i) minimize income taxes today by enjoying a tax deduction based on his future charitable gifts, (ii) protect his assets from creditors, and (iii) minimize federal estate taxes at death.

To meet all of his objectives, Joe will pledge $600,000 to charity (30% of Joe's AGI) payable over the next 30 years under terms described below. By pledging the $600,000 IOU, the Tax Code allows Joe to enjoy an *immediate* $600,000 income tax deduction based on his promise to pay in the future (thereby giving Joe an *additional* $270,000[4] in approximate income tax savings to invest). To claim the $600,000 IOU deduction this year, the IRS requires Joe to set aside assets valued at $600,000 into a trust (technically known as a "charitable lead annuity trust" or "CLAT") to be used to make the required IOU payments to charity over the next 30 years. Although Joe could theoretically set aside virtually any type of investment assets valued at $600,000 for this purpose, Joe simply deposits $600,000 cash into the charitable trust account which he immediately invests in growth stocks. Joe will use the investments inside the trust account to make the IOU payments through year 30.

The IRS permits Joe (or any other persons or charity) to receive the entire balance in the trust account that remains at year 30 (known as the "remainder"), free of gift or estate taxes. Because the remainder can be passed on to Joe's family free of gift or estate taxes, Joe structures the trust so that his wife and children will receive the remainder *in a continuing trust* (with Joe as Trustee). Joe also likes that all of the investment assets inside the trust will be *immediately and permanently* removed from the reach of his and his family's creditors and divorcing spouses.

In structuring the IOU payment terms, Joe wants to maximize what his family will receive back from the trust account, so he selects a long 30-year term with "maximum back-loaded" payments in later years.[5] By delaying payment to charity for a very long time, Joe maximizes the amount of time that he can invest the trust assets for his family in earlier years (since the remainder will

[4] Assumes 45% blended federal & Arizona ordinary income rate.

[5] To back-load the payments, the annual payments are set very low in the initial years and increased by 20% each successive year (20% is the maximum increase permitted by the IRS).

ultimately be payable to Joe's wife and children, in further trust, after the charity's IOU is paid off by year 30). Exhibit A (page 7) illustrates the value of the trust and payments on a year-by-year basis (assuming assets return 8% per year). A few observations:

- By year 30, charity will have received $850,962 in total payments…but approximately $500,000 of the $850,962 total payments is not paid until the final six years (due to back-loading). This allows the trust assets to grow exponentially in the earlier years with little cash outlay to the charity.

- The total charitable payments of $850,962 are greater than the $600,000 deduction that Joe received this year. This is due to the 1.4% rate of return that the IRS requires to be paid to charity on the IOU in order for Joe to immediately benefit from the tax deduction this year.

- In year 30, $4,673,712 (the remainder) is payable to a continuing trust for the benefit of Joe's wife and children (free of gift and estate taxes). Joe structures the continuing trust so that Joe is the Trustee, thereby allowing him to continue to manage the remainder assets until his death. If Joe needs access to the funds inside this trust, Joe (as Trustee) can borrow from the trust assets so long as Joe pays adequate interest and secures repayment with Joe's other assets. This way, Joe can indirectly enjoy access to the remainder during his lifetime – but without causing inclusion of the trust assets in his taxable estate at his death.

Below is a comparison of the results at Year 30 if Joe either (i) does no planning, pays the income tax today, and invests the after-tax proceeds, or (ii) implements the charitable IOU planning described above (assuming an 8% annual rate of return on all assets which is not inconceivable given (i) the long term of the CLAT trust, (ii) the historic returns of the S&P 500, and (iii) the growth-oriented objective that should be applied to the CLAT assets):

	Pay Tax & Invest			**IOU Planning**	
Starting Value	$	600,000			
Less: Income Tax	$	(270,000)	Starting Trust Value	$	600,000
Investable Amount	$	330,000	Charitable Payments	$	850,955
Future Value at Year 30	$	3,320,677	Remainder at Year 30	$	4,673,712
Less: Estate Tax	$	(1,328,271)	Less: Estate Tax	$	-
Net to Heirs	**$**	**1,992,406**	**Net to Heirs**	**$**	**4,673,712**
Payments to Charity	**$**	**-**	**Payments to Charity**	**$**	**850,955**

As illustrated above, Joe's heirs receive approximately $2.7 million more than if Joe gave nothing to charity – put another way, for every one dollar that Joe gives to charity, his family receives three *additional* dollars[6]. The reason this works is that, despite making an $850,955 charitable gift, there was no income tax paid upfront on the $600,000 with the IOU planning… by compounding this amount for many years before charity is paid, there is a greater

[6] $2,700,000 (additional wealth to Joe's heirs) divided by $850,955 (amount given to charity).

amount left in year 30 (net of the charitable gift). In addition, none of the $4,673,712 remainder assets are subject to estate taxes (here, a $1,328,271 tax benefit).

Before Joe implements the IOU planning, Joe's advisor cautions him that (i) he and his family cannot access the trust account until the remainder is paid in year 30, and (ii) between now and year 30 when the IOU is paid off, Joe will be responsible for paying the annual income taxes generated by the trust's income. Joe is fine with paying the trust's income taxes because (i) Joe would have paid income taxes anyway (albeit less income taxes) had he retained the $600,000 that he put into the trust account and not enjoyed the $600,000 IOU deduction, (ii) the investments inside the trust account (which ultimately will be paid to Joe's family, free of gift and estate tax) can grow and appreciate without payment of income taxes, and (iii) Joe's income tax payments ultimately reduce his own federal estate tax at death.

Joe may duplicate this strategy *each and every successive tax year* (so long as Joe is willing to continue pledging an *additional* $600,000 IOU each year).

EXHIBIT A

TRUST ACTIVITY

Year	Beginning Principal	8% Growth	Charitable Payment	Ending Balance
1	$ 600,000	$ 48,000	$ 720	$ 647,280
2	$ 647,280	$ 51,782	$ 864	$ 698,198
3	$ 698,198	$ 55,856	$ 1,037	$ 753,017
4	$ 753,017	$ 60,241	$ 1,244	$ 812,015
5	$ 812,015	$ 64,961	$ 1,493	$ 875,483
6	$ 875,483	$ 70,039	$ 1,792	$ 943,730
7	$ 943,730	$ 75,498	$ 2,150	$ 1,017,078
8	$ 1,017,078	$ 81,366	$ 2,580	$ 1,095,865
9	$ 1,095,865	$ 87,669	$ 3,096	$ 1,180,438
10	$ 1,180,438	$ 94,435	$ 3,715	$ 1,271,158
11	$ 1,271,158	$ 101,693	$ 4,458	$ 1,368,393
12	$ 1,368,393	$ 109,471	$ 5,350	$ 1,472,514
13	$ 1,472,514	$ 117,801	$ 6,420	$ 1,583,896
14	$ 1,583,896	$ 126,712	$ 7,704	$ 1,702,904
15	$ 1,702,904	$ 136,232	$ 9,244	$ 1,829,892
16	$ 1,829,892	$ 146,391	$ 11,093	$ 1,965,191
17	$ 1,965,191	$ 157,215	$ 13,312	$ 2,109,094
18	$ 2,109,094	$ 168,728	$ 15,974	$ 2,261,848
19	$ 2,261,848	$ 180,948	$ 19,169	$ 2,423,627
20	$ 2,423,627	$ 193,890	$ 23,003	$ 2,594,514
21	$ 2,594,514	$ 207,561	$ 27,603	$ 2,774,473
22	$ 2,774,473	$ 221,958	$ 33,124	$ 2,963,307
23	$ 2,963,307	$ 237,065	$ 39,748	$ 3,160,623
24	$ 3,160,623	$ 252,850	$ 47,698	$ 3,365,774
25	$ 3,365,774	$ 269,262	$ 57,238	$ 3,577,799
26	$ 3,577,799	$ 286,224	$ 68,685	$ 3,795,337
27	$ 3,795,337	$ 303,627	$ 82,422	$ 4,016,542
28	$ 4,016,542	$ 321,323	$ 98,907	$ 4,238,958
29	$ 4,238,958	$ 339,117	$ 118,688	$ 4,459,387
30	$ 4,459,387	$ 356,751	$ 142,426	**$ 4,673,712**
			$ 850,955	

Total charitable payments: $850,955

Remainder to Joe's wife & children (free of gift/estate tax): $4,673,712

FAQ

1. **Has this strategy been approved by the IRS?** Yes – this strategy has been codified in the Tax Code since 1969. In addition, every single one of the facets of this planning have been either formally or privately approved by the IRS and/or enacted to law by Congress or the U.S. Treasury. (In fact, the current IRS Commissioner John Koskinen himself implemented a similar strategy in 1998 to fund his alma mater, Duke University). The IRS has also provided a sample form trust agreement that it has approved for this type of planning.

2. **Why have I not heard about this?** It is well-documented that this strategy – known as a "CLAT" – is misunderstood. Simply put, a good number of tax advisors do not understand the mechanics or benefits of a CLAT – most likely because interest rates have never been this low. Contrast this with charitable remainder trusts ("CRTs") which make economic sense in high interest rate environments (such as the past several decades). Many advisors are comfortable with the CRT strategy – the IRS reports that of the 122,541 charitable trusts that filed charitable returns in 2009, CRTs comprised approximately 90% of those returns…CLATs only comprised 5%.

   Another reason is that the strategy described herein is a very specialized variant of the traditional CLAT. This strategy has four differentiating features that produce the compelling economic results indicated above (specifically (i) "grantor trust" status, (ii) an extended charitable term, (iii) a 20% graduated (back-loaded) charitable payment schedule (the maximum back-loading authorized by the IRS), and (iv) a "zeroed-out" remainder to maximize the tax deduction and avoid any gift taxes). These features are designed to maximize the benefits to the donor and the donor's family, but without reducing the amount of the gift to charity.

3. **Can the donor change the charity at any time?** No; however, an independent Trustee (i.e. someone who is not a relative or employee of the donor) may possess discretion over which charity receives the payments. (In practice, a donor advised fund is usually named as the charitable beneficiary to maximize control and flexibility.)

4. **Can the charitable payment be satisfied using appreciated assets held in the trust?** Yes, although the IRS took the position in a (non-legally binding) 2009 private letter ruling that this transfer gave rise to a deemed sale of the transferred asset, resulting in taxable gain. The ruling has been widely-criticized by many practitioners as incorrect given the grantor trust nature of the CLAT. (Note that a taxpayer taking a contradictory position to the 2009 letter ruling must specifically state the contradictory position on his or her tax return.)

5. **What if the donor dies before the IOU is paid off?** The donor's estate is required to "recapture" as ordinary income an amount equal to the unpaid IOU balance. Critically, however, the CLAT automatically converts into a separate taxpaying trust (non-grantor trust) as a result of the donor's death and the CLAT may thereafter deduct the remaining charitable contributions against its own taxable income. Moreover, unlike other strategies (such as a "GRAT" or "QPRT"), the estate tax benefits of the strategy are not lost due to death since the assets inside the CLAT trust account are excluded from the donor's taxable estate. Thus, in most cases, death has little adverse effect on the planning.

6. **Why is it important to act now?** The interest rate applicable to the charity's IOU is at an all-time low. Unlike other tax planning strategies (again, a GRAT/QPRT), this strategy allows a donor to lock in today's rate, for as long as desired, with little mortality risk.

Creative Charitable Lead Trust Strategies

Jonathon Morrison, Esq.
Senior Partner, Tax and Family Wealth Planning
jmorrison@frgalaw.com

Frazer, Ryan, Goldberg & Arnold
3101 N. Central Avenue, #1600
Phoenix, Arizona 85012
(602) 277-2010

Frazer Ryan Goldberg & Arnold LLP

Brief Review of Charitable "Building Block" Concepts

- AGI Limitations
- What is a Donor Advised Fund
- Grantor Charitable Lead Annuity Trust ("CLAT")
- "Zeroed Out" Grantor CLAT

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Adjusted Gross Income ("AGI") Limitation on Charitable Deduction

	Cash	**LT Gain Property**
Public Charity/DAF	50%	30%
Private Foundation	30%	20%**
Charitable Remainder Trust (Payable to Public Charity/DAF)	50%	30%
Charitable Lead Trust (Payable to Public Charity/DAF)	**30%**	**30%**

* 5-year carryforward for unused deductions.
**Generally, the contribution amount for long-term gain property donated to a private foundation is reduced from market value to cost basis, except for publicly-traded securities.

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What if You Don't Know Which Charity to Name? Use a Donor Advised Fund.

- **A Donor Advised Fund ("DAF") is an alternative to a PF, but (i) is easier to create and manage, (ii) requires less money to administer, and (iii) unlike a PF, qualifies for the higher 50%/30% AGI limits with no market-to-cost "haircut" on long-term appreciated property contributions.**
- How they work:
  - A DAF invests your donations and makes grants to charities you support, pursuant to the terms of the fund agreement created by the donor and the administrator at the time of the DAF's creation
  - DAF's are administered by existing entities such as community foundations
  - A donor or professional advisor can act as the DAF's advisor to assist the DAF in making donation/grant decisions, but the DAF is not legally required to follow your suggestions (although it is likely to do so for practical reasons)
  - Grants can be made in the donor's name or anonymously
  - Gifts to DAF's generate **an immediate income tax** deduction

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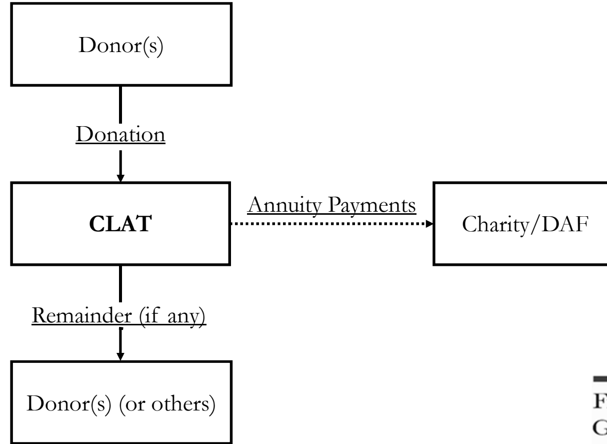
Grantor Charitable Lead Annuity Trust

Steps
1. Assets donated to CLAT and Donors claim income tax deduction equal to value of annuity payments discounted by 7520 Rate
2. Acting as Trustee, Donors continue to invest CLAT assets
3. Annuity is paid to charity for term of years selected by Donors at outset
4. After final annuity payment made, any remaining assets revert to Donor (or may be gifted to Donor's children or third party beneficiary)



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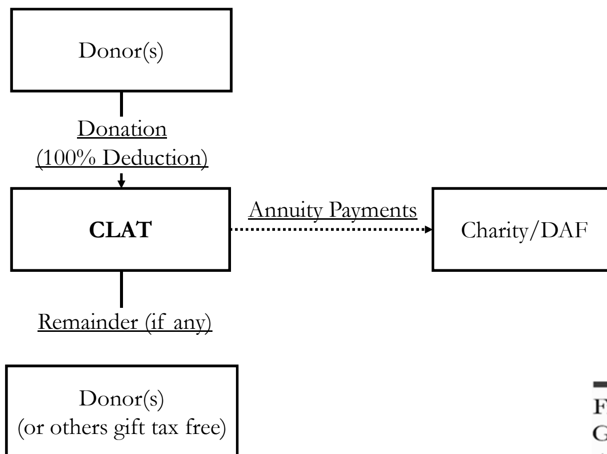
"Zeroed Out" Grantor Charitable Lead Annuity Trust

Steps
1. Assets donated to CLAT and Donors claim income tax deduction equal to 100% of contribution (since charity's annuity payments discounted by 7520 Rate are structured to equal the contribution amount.)
2. Acting as Trustee, Donors continue to invest CLAT assets
3. Annuity is paid to charity for term of years selected by Donors at outset
4. After final annuity payment made, any remaining assets revert to Donor (or may be gifted to Donor's children or third party beneficiary free of gift tax)



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Focus on the Zeroed Out Grantor CLAT

For the purpose of this presentation we will focus <u>only</u> on Zeroed Out Grantor CLAT's which offer the greatest income tax & estate tax planning opportunities:

- **<u>"The Critical Mismatch"</u>:** Only a zeroed out grantor CLAT offers an **<u>immediate</u> 100% income tax deduction based on the promise to make <u>delayed</u> payments to charity**. This mismatch allows for creative opportunities for planning.
- **<u>Donor Reaps Full Benefit of Any Upside on CLAT Assets</u>**. The charity's annuity payments are fixed at the outset (based on a very low interest rate) – so any upside on the CLAT assets passes to the donor (or the donor's family).
- **<u>CLATs Perform Best In Low Interest Rate Environment</u>.** As explained above, the charity's annuity is fixed based on an IRS-set interest rate. The applicable "7520 rate" is presently near all time lows (app. 2%), meaning that the charity's annuity bears interest at a very low rate (maximizing what is left for the donor and the donor's family at the end of the annuity term)
- **<u>Flexible Term and Payment Schedule</u>.** Unlike a CRT:
  - A CLAT can be "zeroed-out" meaning (i) no gift of remainder to the donor's family, and (ii) the upfront income tax deduction equals 100% of contribution amount.
  - There are no minimum or maximum (i) term of years, or (ii) payout amounts set by IRS rules

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Creative Strategy #1: The "Charitable IOU" Deduction

Donor enjoys *<u>immediate</u>* income tax deduction by simply doing two things:
(i) converting the donor's future charitable gifts to an *irrevocable* pledge, and
(ii) setting aside (*pre-funding*) the pledge gifts in a trust account until they are paid

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Creative Strategy #1: The "Charitable IOU" Deduction

Overview

Profile Client: Charitably-inclined donors who are donating large amounts ($25k+), consistently, every single year, and intend to do so for at least 10+ years.

What is it? Grantor CLAT allows donors to claim a tax deduction today based on the irrevocable pledge to make donations to charity in the future. (*The donors were going to give in the future anyways – why not benefit from a deduction today*?)

Why is it important? Most charitable donors are missing out on a lot of money, and without any cost to the charity.

- With a CLAT, donors can take a deduction today (during high income producing years) based on future pledged gifts to charity. This deduction reduces the donors' current year income tax, while endowing their CLAT with the savings.
- By setting up a CLAT while interest rates are low, the tax deduction (which is a present value calculation) is near dollar-for-dollar compared to the actual amount of future pledged gifts.

What is required? All that is required from the Donor initially is to establish and fund the CLAT with enough assets to fund the future pledges; gifts to charities will be made at annual intervals, as though donor had made the annual gifts themselves (*the donor can set the payment schedule to match the gifts that he/she already planned to make*).

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Creative Strategy #1: The "Charitable IOU" Deduction

Case Study

- **Profile**
  - Husband and Wife (Mid-40's)
  - High Earners (Athlete and Business Executive, respectively)
  - $2,000,000 2017 W-2 Income (top combined fed/AZ tax bracket of 48%)
  - **Annual giving: $35,000 per year**
- **Objectives**
  - Plan to continue giving $35,000 per year for at least another 20 years
  - Minimize income taxes
- **Solution: Transfer $550,000 to CLAT based on the pledge to pay $35,000 each year for 20 years (totaling $700,000 based on May 2017 2.4% 7520 rate).**
  - H & W enjoy $550,000 deduction in 2017, resulting in immediate tax savings of $270,000…effectively giving them $270,000 more to invest today
  - At year 20, any assets remaining in CLAT are paid right back to donors (or donors' children, free of gift/estate tax)

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Creative Strategy #1: The "Charitable IOU" Deduction

For "apples to apples", let's compare two alternate scenarios:

1. **Status quo: pay 48% income tax on $550,000 of income (leaving $286,000), and then set aside that amount in an account earning 3% to make the $35,000 charitable gifts**

2. **CLAT planning: pay no tax on the $550,000 (since a full $550,000 deduction is enjoyed this year) and setting aside the full $550,000 in a CLAT account earning 3% to make the same $35,000 charitable gifts**

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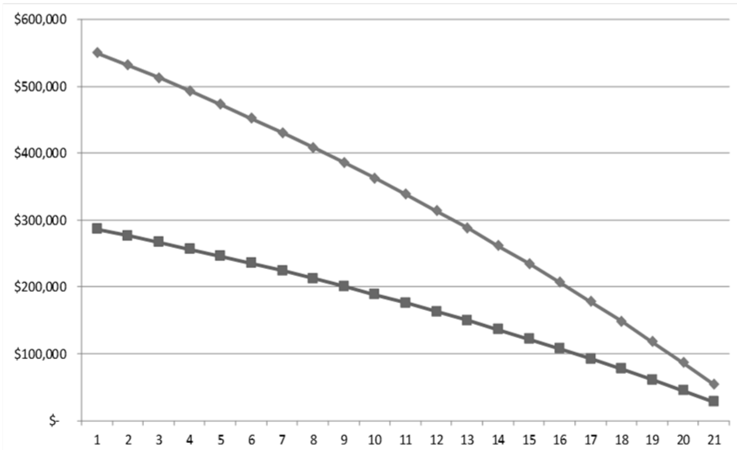
Creative Strategy #1: The "Charitable IOU" Deduction

20-year CLAT returning 3% annually

	CLAT		Pay tax & invest difference	
Year	CLAT	Charitable Payments	No CLAT	Charitable Payments
0	**$ 550,000**		**$ 286,330**	
1	$ 531,551	$ 34,949	$ 276,726	$ 34,949
2	$ 512,550	$ 34,949	$ 266,833	$ 34,949
3	$ 492,977	$ 34,949	$ 256,644	$ 34,949
4	$ 472,818	$ 34,949	$ 246,149	$ 34,949
5	$ 452,054	$ 34,949	$ 235,339	$ 34,949
6	$ 430,667	$ 34,949	$ 224,205	$ 34,949
7	$ 408,639	$ 34,949	$ 212,737	$ 34,949
8	$ 385,950	$ 34,949	$ 200,925	$ 34,949
9	$ 362,580	$ 34,949	$ 188,759	$ 34,949
10	$ 338,508	$ 34,949	$ 176,228	$ 34,949
11	$ 313,715	$ 34,949	$ 163,320	$ 34,949
12	$ 288,178	$ 34,949	$ 150,026	$ 34,949
13	$ 261,875	$ 34,949	$ 136,332	$ 34,949
14	$ 234,783	$ 34,949	$ 122,228	$ 34,949
15	$ 206,878	$ 34,949	$ 107,701	$ 34,949
16	$ 178,136	$ 34,949	$ 92,737	$ 34,949
17	$ 148,531	$ 34,949	$ 77,325	$ 34,949
18	$ 118,038	$ 34,949	$ 61,451	$ 34,949
19	$ 86,631	$ 34,949	$ 45,100	$ 34,949
20	**$ 54,282**	$ 34,949	**$ 28,259**	$ 34,949
		$ 698,970		$ 698,970



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Creative Strategy #1: The "Charitable IOU" Deduction

What about 6% annual return (in both alternate scenarios)?

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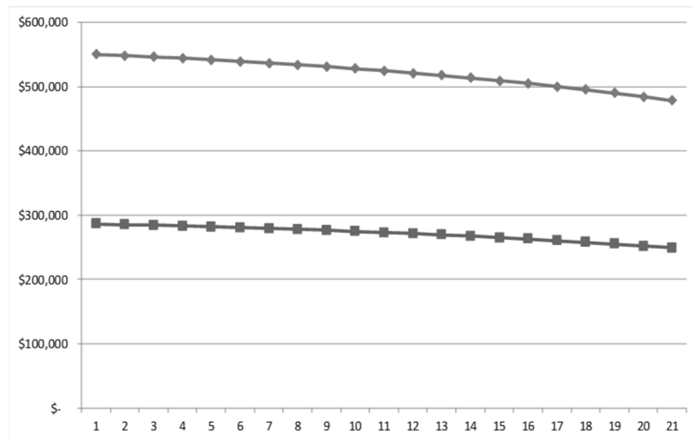
Creative Strategy #1: The "Charitable IOU" Deduction

20-year CLAT returning 6% annually

	CLAT		Pay tax & invest difference	
Year	CLAT	Charitable Payments	No CLAT	Charitable Payments
0	**$ 550,000**		**$ 286,330**	
1	$ 548,051	$ 34,949	$ 285,316	$ 34,949
2	$ 545,986	$ 34,949	$ 284,240	$ 34,949
3	$ 543,797	$ 34,949	$ 283,101	$ 34,949
4	$ 541,476	$ 34,949	$ 281,892	$ 34,949
5	$ 539,016	$ 34,949	$ 280,612	$ 34,949
6	$ 536,409	$ 34,949	$ 279,254	$ 34,949
7	$ 533,644	$ 34,949	$ 277,815	$ 34,949
8	$ 530,715	$ 34,949	$ 276,290	$ 34,949
9	$ 527,609	$ 34,949	$ 274,673	$ 34,949
10	$ 524,317	$ 34,949	$ 272,959	$ 34,949
11	$ 520,828	$ 34,949	$ 271,143	$ 34,949
12	$ 517,129	$ 34,949	$ 269,217	$ 34,949
13	$ 513,208	$ 34,949	$ 267,176	$ 34,949
14	$ 509,052	$ 34,949	$ 265,012	$ 34,949
15	$ 504,646	$ 34,949	$ 262,719	$ 34,949
16	$ 499,977	$ 34,949	$ 260,288	$ 34,949
17	$ 495,027	$ 34,949	$ 257,711	$ 34,949
18	$ 489,780	$ 34,949	$ 254,979	$ 34,949
19	$ 484,218	$ 34,949	$ 252,084	$ 34,949
20	**$ 478,323**	$ 34,949	**$ 249,015**	$ 34,949
		$ 698,970		$ 698,970



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Creative Strategy #1: The "Charitable IOU" Deduction

Our donors like this "CLAT idea"… and they want to see what happens if they are willing to pledge <u>30</u> years of $35,000 donations, versus only <u>20</u> years…

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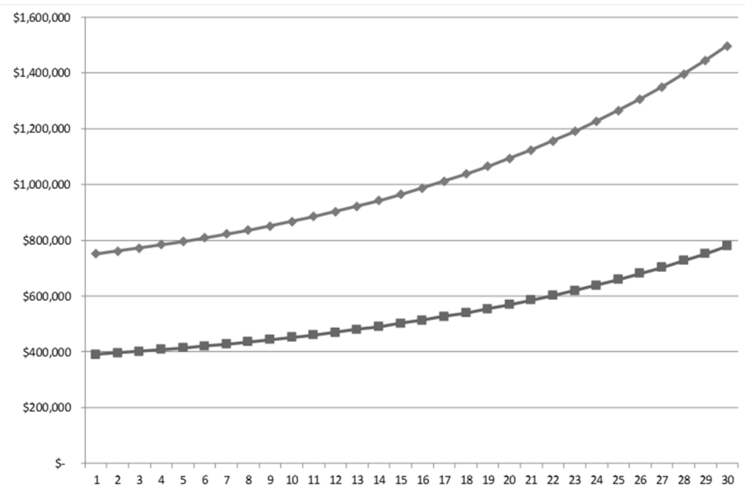
Creative Strategy #1: The "Charitable IOU" Deduction

30-year CLAT returning <u>6%</u> annually

	CLAT		Pay tax & invest difference	
Year	CLAT	Charitable Payments	No CLAT	Charitable Payments
0	$ 742,424		$ 386,506	
1	$ 751,969	$ 35,000	$ 391,475	$ 35,000
2	$ 762,088	$ 35,000	$ 396,743	$ 35,000
3	$ 772,813	$ 35,000	$ 402,326	$ 35,000
4	$ 784,182	$ 35,000	$ 408,245	$ 35,000
5	$ 796,233	$ 35,000	$ 414,519	$ 35,000
6	$ 809,006	$ 35,000	$ 421,169	$ 35,000
7	$ 822,547	$ 35,000	$ 428,218	$ 35,000
8	$ 836,900	$ 35,000	$ 435,690	$ 35,000
9	$ 852,114	$ 35,000	$ 443,610	$ 35,000
10	$ 868,240	$ 35,000	$ 452,006	$ 35,000
11	$ 885,335	$ 35,000	$ 460,905	$ 35,000
12	$ 903,455	$ 35,000	$ 470,339	$ 35,000
13	$ 922,662	$ 35,000	$ 480,338	$ 35,000
14	$ 943,022	$ 35,000	$ 490,937	$ 35,000
15	$ 964,603	$ 35,000	$ 502,173	$ 35,000
16	$ 987,480	$ 35,000	$ 514,082	$ 35,000
17	$ 1,011,728	$ 35,000	$ 526,706	$ 35,000
18	$ 1,037,432	$ 35,000	$ 540,087	$ 35,000
19	$ 1,064,678	$ 35,000	$ 554,271	$ 35,000
20	$ 1,093,559	$ 35,000	$ 569,307	$ 35,000
21	$ 1,124,172	$ 35,000	$ 585,244	$ 35,000
22	$ 1,156,623	$ 35,000	$ 602,138	$ 35,000
23	$ 1,191,020	$ 35,000	$ 620,045	$ 35,000
24	$ 1,227,481	$ 35,000	$ 639,027	$ 35,000
25	$ 1,266,130	$ 35,000	$ 659,147	$ 35,000
26	$ 1,307,098	$ 35,000	$ 680,475	$ 35,000
27	$ 1,350,524	$ 35,000	$ 703,083	$ 35,000
28	$ 1,396,555	$ 35,000	$ 727,047	$ 35,000
29	$ 1,445,348	$ 35,000	$ 752,448	$ 35,000
30	**$ 1,497,069**	$ 35,000	**$ 779,374**	$ 35,000
		$ 1,050,000		$ 1,050,000



Creative Strategy #1: The "Charitable IOU" Deduction

Bottom Line

Irrespective of the (i) term of years of the pledge, or (ii) asset performance, the donor in a 50% tax bracket using a CLAT will always have *twice* as much money (or more) at the end of the term than if they made the same contributions to charity without a CLAT.

AND the longer the term of the pledge, the greater the benefits.

So…why aren't donors doing this?

They don't know what they are missing because we aren't telling them!

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Creative Strategy #2: The "Charitable Super-IRA"

This is the *single-largest retirement planning opportunity* permitted by the Tax Code…and apparently nobody has stumbled upon it.

It allows a high-earner to set aside up to 30% of their annual income without income tax and with creditor protection (*just like a 401(k) or IRA*), give a significant gift to charity, and end up with *more money than if they never gave at all.*

This strategy must be funded now while interest rates are low.

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Creative Strategy #2: "Charitable Super-IRA"

Overview

Profile Client: High-earners (*even those without charitable intent as a primary objective*) seeking a way to (i) set aside 30% of their income without tax (*just like a 401(k) or traditional IRA*), (ii) enjoy creditor protection of the contributed assets (*again, like a 401(k) or IRA*), and/or (iii) transfer wealth to spouse/children, free of gift and estate taxes.

- Athletes
- Physicians, attorneys, accountants & other high-liability professionals
- Business executives
- Roth IRA conversions
- Executives exercising stock options

Why is it important? This is probably the single-largest income tax deduction opportunity available to high-earners that is not being used. It also allows our clients to give to charity at zero economic cost.

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Creative Strategy #2: "Charitable Super-IRA"

How Does This Work?

- **Donor May Contribute Up To 30% AGI – Every Single Year – Regardless of The Size of the Donor's Income**. A donor may contribute up to 30% of earned income to a CLAT, each year, and enjoy a 100% income tax deduction (like a "super-IRA").

  Assuming a donor is in a 50% tax bracket, this deduction gives the donor twice as much money to invest today…and without giving anything away today.
- **Charity's Payments Back-loaded, Allowing For Maximum Compounding of Investments In Early Years**. The charity's annuity accrues interest at the modest 2.4% 7520 rate. Over a long-enough investment horizon and by backloading the charity's payments, the donor can literally *make money by giving*.
- **Exempt from Estate Taxes.** If donor elects to pass remainder to trusts for spouse/children, the contributed assets are instantly removed from the donor's taxable estate.
- **Creditor Protection.** A CLAT is exempt from the donor's personal creditors since the assets are set aside for charity, and the remainder can be paid into a creditor-exempt trust with indirect retained access by the donor via loans.

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Creative Strategy #2: "Charitable Super-IRA"

Similarities to Traditional IRA / 401(k)

- **Donor contributes assets & claims 100% income tax deduction**
- **Donor may not access assets for many years (absent court order)**
- **No personal use of assets**
- **Assets protected from personal creditors**

Differences

- **30% AGI max with no income phase-out**
- **Charity must receive initial contribution + 2.4% interest accrual on unpaid balance (balance retained by donor & donor's family)**
- **Donor responsible for annual income taxes generated by assets – *but* no income tax when assets are ultimately withdrawn**
- **Balance of assets may be passed on to children, free of estate tax**

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Creative Strategy #2: "Charitable Super-IRA"

Case Study

- **Background**
  - Husband and Wife (Mid-40's)
  - High Earners (Athlete and Business Executive, respectively)
  - $2,000,000 2017 W-2 Income (top combined fed/AZ tax bracket of 50%)
  - $15,000,000 Net Worth
  - Have already maxed out 401(k), DB plan, etc.
  - Not giving to charity…but willing to give if tax/economic benefits
- **Objectives**
  - Need income tax deductions!!
  - Creditor protection
  - Reduce estate tax burden at survivor's death
- **Solution**: Transfer $600,000 (30% AGI) to a 30-year CLAT

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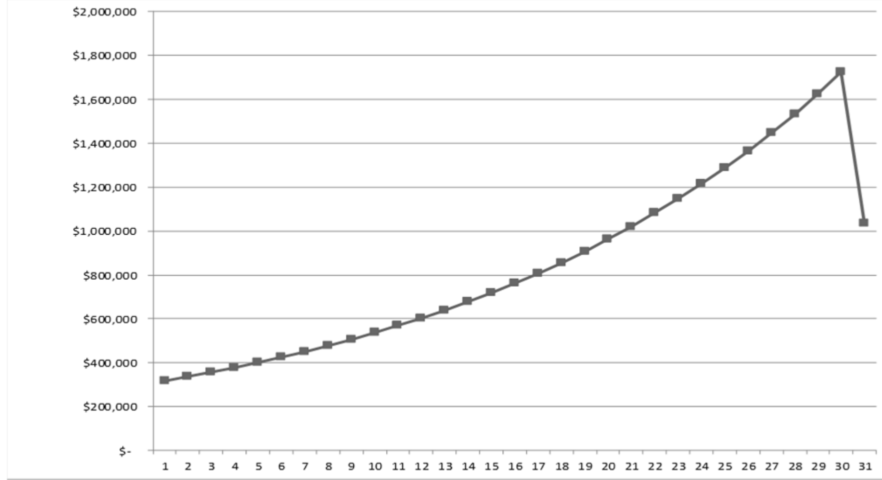
Creative Strategy #2: "Charitable Super-IRA"

Investment of $300k ($600k after 50% income tax) returning 6%

Year		No CLAT		Charitable Payments
0	$	**300,000**		
1	$	318,000	$	-
2	$	337,080	$	-
3	$	357,305	$	-
4	$	378,743	$	-
5	$	401,468	$	-
6	$	425,556	$	-
7	$	451,089	$	-
8	$	478,154	$	-
9	$	506,844	$	-
10	$	537,254	$	-
11	$	569,490	$	-
12	$	603,659	$	-
13	$	639,878	$	-
14	$	678,271	$	-
15	$	718,967	$	-
16	$	762,106	$	-
17	$	807,832	$	-
18	$	856,302	$	-
19	$	907,680	$	-
20	$	962,141	$	-
21	$	1,019,869	$	-
22	$	1,081,061	$	-
23	$	1,145,925	$	-
24	$	1,214,680	$	-
25	$	1,287,561	$	-
26	$	1,364,815	$	-
27	$	1,446,704	$	-
28	$	1,533,506	$	-
29	$	**1,625,516**	$	-
30	$	**1,723,047**	$	-
Estate tax	$	**(689,219)**		
	$	**1,033,828**		



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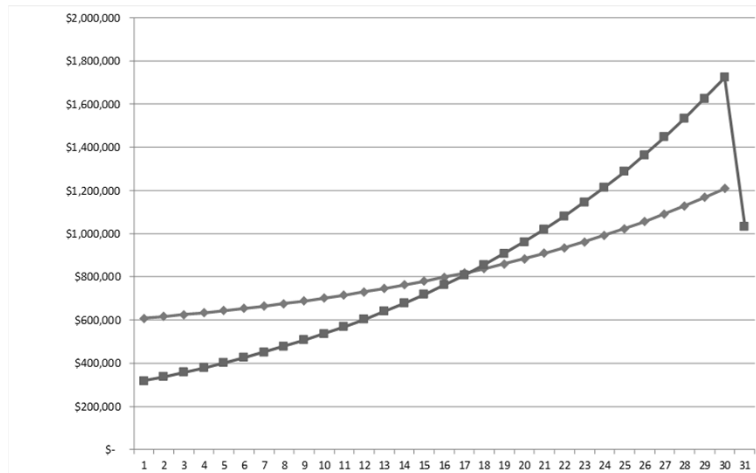
Creative Strategy #2: "Charitable Super-IRA"

Comparison to 30-year CLAT with flat charitable payments returning 6%

	CLAT				Pay tax & invest difference			
Year		CLAT		Charitable Payments		No CLAT		Charitable Payments
0	$	**600,000**			$	**300,000**		
1	$	607,714	$	28,286	$	318,000	$	-
2	$	615,891	$	28,286	$	337,080	$	-
3	$	624,559	$	28,286	$	357,305	$	-
4	$	633,747	$	28,286	$	378,743	$	-
5	$	643,486	$	28,286	$	401,468	$	-
6	$	653,810	$	28,286	$	425,556	$	-
7	$	664,752	$	28,286	$	451,089	$	-
8	$	676,352	$	28,286	$	478,154	$	-
9	$	688,647	$	28,286	$	506,844	$	-
10	$	701,680	$	28,286	$	537,254	$	-
11	$	715,495	$	28,286	$	569,490	$	-
12	$	730,139	$	28,286	$	603,659	$	-
13	$	745,662	$	28,286	$	639,878	$	-
14	$	762,116	$	28,286	$	678,271	$	-
15	$	779,557	$	28,286	$	718,967	$	-
16	$	798,045	$	28,286	$	762,106	$	-
17	$	817,642	$	28,286	$	807,832	$	-
18	$	838,415	$	28,286	$	856,302	$	-
19	$	860,434	$	28,286	$	907,680	$	-
20	$	883,774	$	28,286	$	962,141	$	-
21	$	908,515	$	28,286	$	1,019,869	$	-
22	$	934,740	$	28,286	$	1,081,061	$	-
23	$	962,539	$	28,286	$	1,145,925	$	-
24	$	992,005	$	28,286	$	1,214,680	$	-
25	$	1,023,240	$	28,286	$	1,287,561	$	-
26	$	1,056,348	$	28,286	$	1,364,815	$	-
27	$	1,091,444	$	28,286	$	1,446,704	$	-
28	$	1,128,644	$	28,286	$	1,533,506	$	-
29	$	1,168,077	$	28,286	$	1,625,516	$	-
30	$	**1,209,876**	$	28,286	$	**1,723,047**	$	-
			$	848,572		[illegible]	$	-
Estate tax	$	-		**Estate tax**	$	**(689,219)**		
Net to heirs	$	**1,209,876**			$	**1,033,828**		



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Creative Strategy #2: "Charitable Super-IRA"

But what if we backload the charity's payments?

(The IRS has approved a 20% annual "step increase" in the charity's payments, just like a GRAT)

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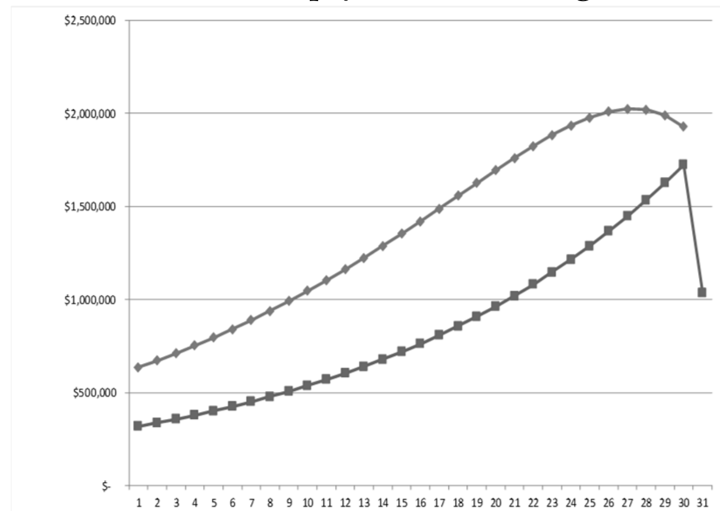
Creative Strategy #2: "Charitable Super-IRA"

30-year CLAT with maximum backloaded charitable payments returning 6%**

	CLAT		Pay tax & invest difference	
Year	CLAT	Charitable Payments	No CLAT	Charitable Payments
0	$ 600,000		$ 300,000	
1	$ 635,082	$ 918	$ 318,000	$ -
2	$ 672,085	$ 1,102	$ 337,080	$ -
3	$ 711,089	$ 1,322	$ 357,305	$ -
4	$ 752,168	$ 1,586	$ 378,743	$ -
5	$ 795,394	$ 1,904	$ 401,468	$ -
6	$ 840,833	$ 2,284	$ 425,556	$ -
7	$ 888,542	$ 2,741	$ 451,089	$ -
8	$ 938,565	$ 3,289	$ 478,154	$ -
9	$ 990,932	$ 3,947	$ 506,844	$ -
10	$ 1,045,651	$ 4,737	$ 537,254	$ -
11	$ 1,102,706	$ 5,684	$ 569,490	$ -
12	$ 1,162,048	$ 6,821	$ 603,659	$ -
13	$ 1,223,586	$ 8,185	$ 639,878	$ -
14	$ 1,287,179	$ 9,822	$ 678,271	$ -
15	$ 1,352,623	$ 11,786	$ 718,967	$ -
16	$ 1,419,637	$ 14,144	$ 762,106	$ -
17	$ 1,487,843	$ 16,972	$ 807,832	$ -
18	$ 1,556,747	$ 20,367	$ 856,302	$ -
19	$ 1,625,711	$ 24,440	$ 907,680	$ -
20	$ 1,693,926	$ 29,328	$ 962,141	$ -
21	$ 1,760,367	$ 35,194	$ 1,019,869	$ -
22	$ 1,823,757	$ 42,233	$ 1,081,061	$ -
23	$ 1,882,503	$ 50,679	$ 1,145,925	$ -
24	$ 1,934,638	$ 60,815	$ 1,214,680	$ -
25	$ 1,977,738	$ 72,978	$ 1,287,561	$ -
26	$ 2,008,829	$ 87,574	$ 1,364,815	$ -
27	$ 2,024,270	$ 105,088	$ 1,446,704	$ -
28	$ 2,019,620	$ 126,106	$ 1,533,506	$ -
29	$ 1,989,470	$ 151,327	$ 1,625,516	$ -
30	**$ 1,927,245**	$ 181,593	**$ 1,723,047**	$ -
		$ 1,084,967	[illegible]	$ -
Estate tax	$ -	**Estate tax**	$ (689,219)	
Net to heirs	**$ 1,927,245**		**$ 1,033,828**	



Creative Strategy #2: "Charitable Super-IRA"

But what if the assets return 8% per year?

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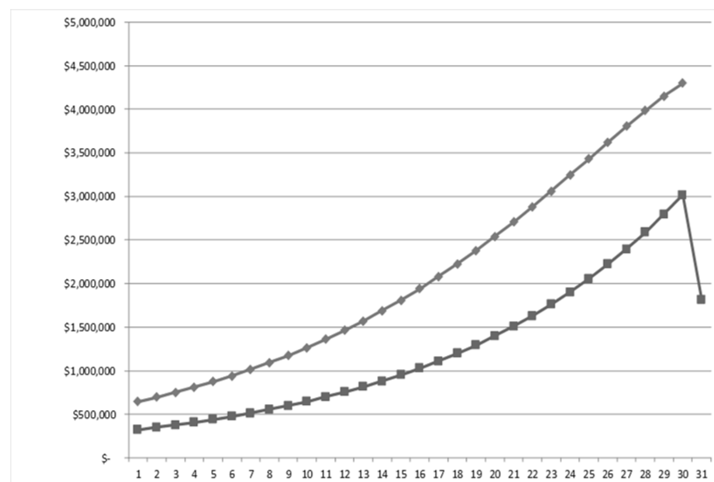
Creative Strategy #2: "Charitable Super-IRA"

30-year CLAT with maximum backloaded charitable payments** returning 8%

	CLAT			Pay tax & invest difference	
Year	CLAT	Charitable Payments		No CLAT	Charitable Payments
0	$ 600,000			$ 300,000	
1	$ 647,082	$ 918		$ 324,000	$ -
2	$ 697,747	$ 1,102		$ 349,920	$ -
3	$ 752,245	$ 1,322		$ 377,914	$ -
4	$ 810,838	$ 1,586		$ 408,147	$ -
5	$ 873,802	$ 1,904		$ 440,798	$ -
6	$ 941,421	$ 2,284		$ 476,062	$ -
7	$ 1,013,994	$ 2,741		$ 514,147	$ -
8	$ 1,091,824	$ 3,289		$ 555,279	$ -
9	$ 1,175,223	$ 3,947		$ 599,701	$ -
10	$ 1,264,504	$ 4,737		$ 647,677	$ -
11	$ 1,359,980	$ 5,684		$ 699,492	$ -
12	$ 1,461,958	$ 6,821		$ 755,451	$ -
13	$ 1,570,730	$ 8,185		$ 815,887	$ -
14	$ 1,686,566	$ 9,822		$ 881,158	$ -
15	$ 1,809,705	$ 11,786		$ 951,651	$ -
16	$ 1,940,338	$ 14,144		$ 1,027,783	$ -
17	$ 2,078,592	$ 16,972		$ 1,110,005	$ -
18	$ 2,224,513	$ 20,367		$ 1,198,806	$ -
19	$ 2,378,034	$ 24,440		$ 1,294,710	$ -
20	$ 2,538,948	$ 29,328		$ 1,398,287	$ -
21	$ 2,706,870	$ 35,194		$ 1,510,150	$ -
22	$ 2,881,187	$ 42,233		$ 1,630,962	$ -
23	$ 3,061,002	$ 50,679		$ 1,761,439	$ -
24	$ 3,245,068	$ 60,815		$ 1,902,354	$ -
25	$ 3,431,695	$ 72,978		$ 2,054,543	$ -
26	$ 3,618,657	$ 87,574		$ 2,218,906	$ -
27	$ 3,803,061	$ 105,088		$ 2,396,418	$ -
28	$ 3,981,200	$ 126,106		$ 2,588,132	$ -
29	$ 4,148,368	$ 151,327		$ 2,795,182	$ -
30	$ 4,298,645	$ 181,593		$ 3,018,797	$ -
		$ 1,084,967			$ -
Estate tax	$ -		Estate tax	$ (1,207,519)	
Net to heirs	$ 4,298,645			$ 1,811,278	



Creative Strategy #2: "Charitable Super-IRA"

What about a 40-year CLAT returning 8%?

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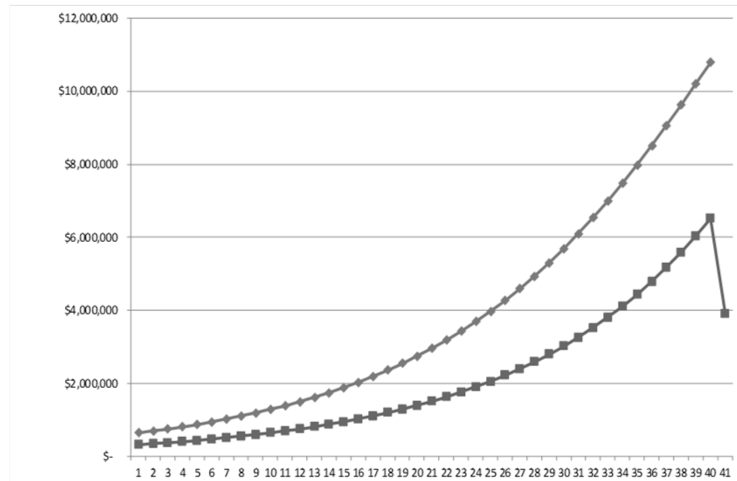
Creative Strategy #2: "Charitable Super-IRA"

40-year CLAT with maximum backloaded charitable payments returning 8%**

	CLAT		Pay tax & invest difference	
Year	CLAT	Charitable Payments	No CLAT	Charitable Payments
0	$ 600,000		$ 300,000	
1	$ 647,814	$ 186	$ 324,000	$ -
2	$ 699,416	$ 223	$ 349,920	$ -
3	$ 755,101	$ 268	$ 377,914	$ -
4	$ 815,188	$ 321	$ 408,147	$ -
5	$ 880,017	$ 386	$ 440,798	$ -
6	$ 949,956	$ 463	$ 476,062	$ -
7	$ 1,025,397	$ 555	$ 514,147	$ -
8	$ 1,106,762	$ 666	$ 555,279	$ -
9	$ 1,194,504	$ 800	$ 599,701	$ -
10	$ 1,289,104	$ 960	$ 647,677	$ -
11	$ 1,391,081	$ 1,152	$ 699,492	$ -
35	$ 7,978,588	$ 91,554	$ 4,435,603	$ -
36	$ 8,507,011	$ 109,864	$ 4,790,452	$ -
37	$ 9,055,735	$ 131,837	$ 5,173,688	$ -
38	$ 9,621,989	$ 158,205	$ 5,587,583	$ -
39	$ 10,201,902	$ 189,845	$ 6,034,589	$ -
40	$ 10,790,240	$ 227,815	$ 6,517,356	$ -
		$ 1,365,958	[illegible]	$ -
Estate tax	$ -	Estate tax	$ (2,606,943)	
Net to heirs	$ 10,790,240		$ 3,910,414	



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Creative Strategy #2: "Charitable Super-IRA"

Maximizing Benefits of Strategy

- Maximize growth of assets
  - Create long-term CLAT (IRS has approved a 108-year CLAT!)
  - Use CLAT for growth asset "bucket"
  - Backload payments to charity
- Super-fund the strategy with 150% AGI to lock in today's low 7520 rate
- Name a Donor Advised Fund to retain flexibility over charitable recipients
- Satisfy charitable payments using appreciated assets (*although IRS privately ruled against this in 2009, most experts consider the ruling incorrect*)
- Fund CLAT with tax-advantaged assets:
  - Discounted fractional interests in real estate
  - Discounted FLP interests
  - Paid-up life insurance
- Use in conjunction with traditional estate tax planning (IDGT; GRAT; QPRT) to reduce tax on phantom income from those vehicles.

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Creative Strategy #2: "Charitable Super-IRA"

Perceived Downsides

Donor Pays Taxes on CLAT Income. The CLAT is required to be a grantor trust to enjoy the upfront deduction. Thus, during the annuity term, donor is responsible for paying income tax on "phantom income" generated by CLAT asset. But keep in mind:

- Unlike IRA, no tax when the remainder is paid to the donor (or trusts for the donor's spouse/children)
- Tax reduces donor's estate tax liability & allows CLAT to grow on pre-tax basis
- To minimize "phantom income," invest in muni-bonds & growth asset; tax loss harvesting

No Access to CLAT Assets Until End of Charitable Term.

- This is why this is considered a *retirement* strategy!
- CLAT can be terminated early with court order (but the remaining pledge to charity must be paid in full).

If Donor Dies, Estate Recognizes Recapture Income Equal to Unpaid Pledges. However:

- CLAT may claim unlimited Section 642 deduction against its income for remaining charitable payments.
- Unlike GRAT/QPRT, the benefits inside CLAT continue (growth on assets; exempt from estate tax).

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QUESTIONS?

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