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Best regards,

A handwritten signature in black ink, appearing to read 'D. Holaday'.

David W. Holaday, ChFC, CAP

CHARITABLE GIFT OF REMAINDER INTEREST IN RESIDENCE WITH FAMILY TRUST PURCHASE

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OVERVIEW

Many families have homes or vacation properties that they want to keep in the family. These properties may increase substantially in value exasorbating the estate tax problem.

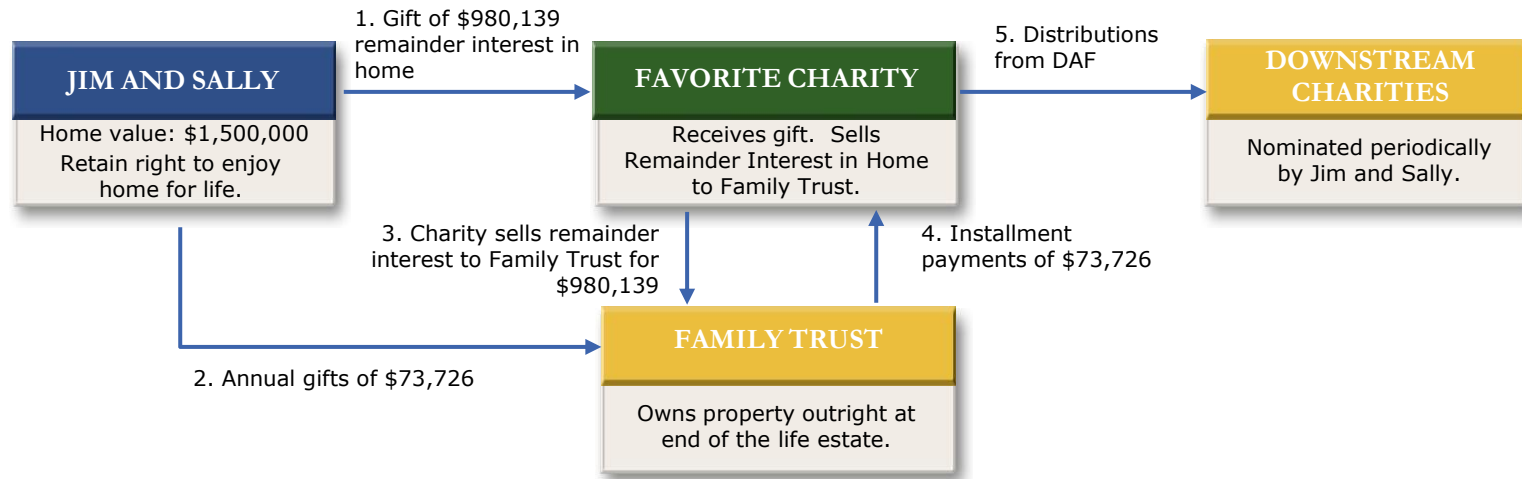
- ♦ A Qualified Personal Residence Trust ("QPRT") may be an attractive option but it has a risk of failure if the client does not outlive the term. Moreover, some clients are uncomfortable with losing control over the property during the lifetime.
- ♦ A charitable gift of the residence (subject to the client retaining the right to use the property for life) followed by a purchase by a Family Trust of the charity's interest in the property may be a better alternative than the QPRT.
- ♦ Upon making the contribution, the donor receives a charitable income tax deduction equal to the present value of the remainder interest to charity.
- ♦ The charity, after receiving the gift of the remainder interest in the home, could sell its interest at fair market value to a Family Trust under the installment sale method.
- ♦ The client would need to make gifts to the Family Trust to enable it to make the annual installment payments to charity.
- ♦ If the charity offers a Donor Advised Fund ("DAF") program, the annual payments made by the Family Trust to charity could be deposited in the client's DAF account and ultimately pass to downstream charitable recipients nominated by the donor.

BENEFITS

- ♦ **Create an immediate charitable income tax deduction**
- ♦ **Move appreciating property out of taxable estate**
- ♦ **Preserve a family property for enjoyment by future generations**
- ♦ **Make or continue current cash gifts to charity**

HOW IT WORKS

A HYPOTHETICAL EXAMPLE PREPARED FOR JIM AND SALLY COVEY



1. The client makes a gift of Covey Cove to charity subject but retains the right to enjoy the property for life. This contribution may generate a charitable income tax deduction of approximately \$980,139.

2. The client creates a new irrevocable Family Trust designed to ultimately own Covey Cove. The client makes annual gifts to the trust to enable it to purchase the remainder interest in the property from charity.

3. Favorite Charity independently enters into an agreement to sell the remainder interest of the property to the trustee of the Family Trust. This illustration assumes an installment sale. The price of the remainder interest will be negotiated by charity and trustee.

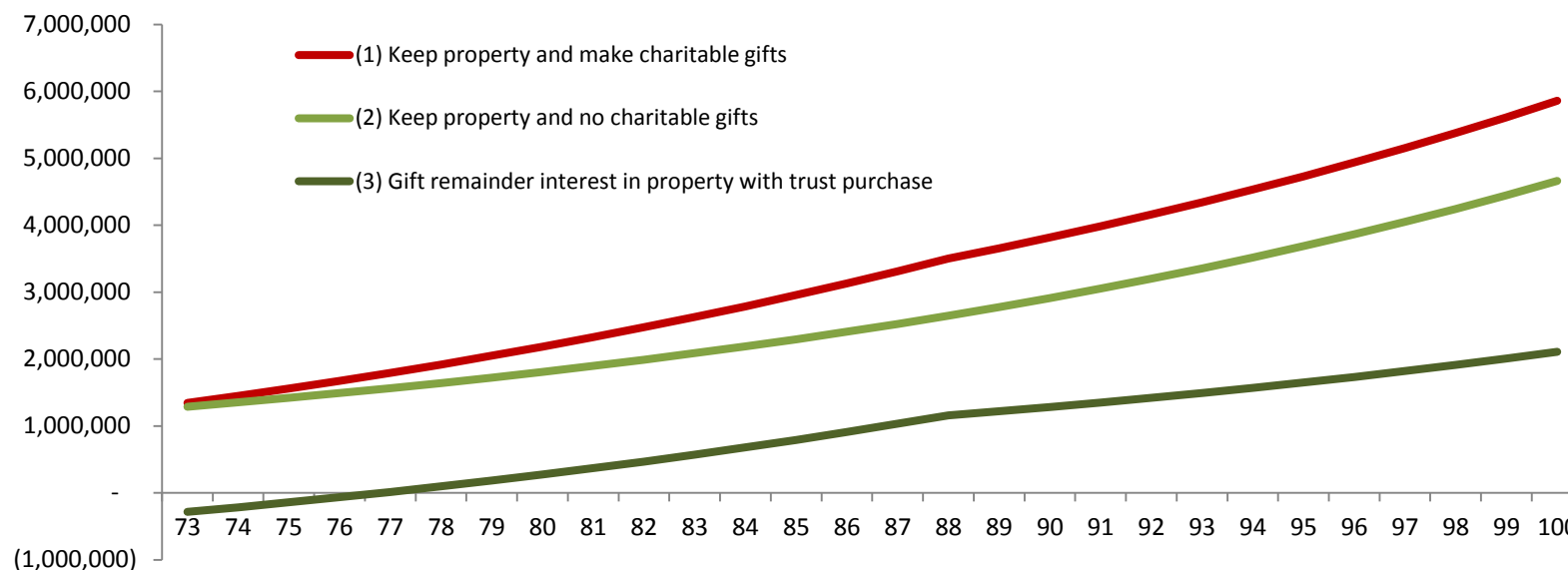
4. The trustee of the Family Trust makes payments to charity according to the terms of the purchase agreement. This illustration assumes installment sale payments of \$73,726 based on an interest rate of 3.00% and principal amortized over a term of 15 years.

5. If Favorite Charity offers a Donor Advised Fund ('DAF') program, it could allocate the installment payments to a DAF established for the client. Favorite Charity could then may make distributions from the DAF to charities nominated by the client.

See Assumptions and Pro Forma pages for details. This is a hypothetical illustration only. Actual results will vary.

COMPARISON OF COSTS TO TRANSFER PROPERTY

This illustrates the potential cumulative costs of each scenario if the client died in any year.



This graph illustrates the potential cumulative cost of several alternatives. Costs consist of annual outlays such as real estate taxes, charitable gifts and gifts to the Family Trust. These net after tax outlays have a cumulative affect on client net worth. In addition, there is a single expense of the estate tax. The lines on the graph represent the sum of the cumulative costs plus the estate tax cost if the client dies in any given year. Since this graph compares costs, a lower line indicates a lower cost and better result.

Scenario (1) assumes the client keeps the property for life. The property is included in the estate. Scenario (1) assumes the client makes annual charitable gifts equal to the installment payments made in Scenario (3). The estate tax required is higher because, not only is the property in the estate, but the funds needed for

estate tax are also in the estate and themselves subject to estate tax. Scenario (2) assumes the client keeps the property for life. The property is included in the estate but the client makes no charitable gifts. Therefore, for comparison purposes, the estate is not reduced by any charitable giving.

Scenario (3) assumes the client gives a remainder interest in the property to charity. The charity independently sells the remainder interest at fair market value using an installment sale to a Family Trust. The client makes annual gifts to the trust as needed to cover the installment payments. The cost is lower in the early years due to income tax savings from the charitable income tax deduction.

SUMMARY OF ASSUMPTIONS

Client Information

Client 1 age	72
Client 2 age	71

Charitable Gift Subject to Life Estate

Fair market value of building	\$	750,000
Useful life		45
Salvage value of building		75,000
Land value		750,000
Remainder interest		65.34%
Remainder interest value		490,070
Retained life estate		34.66%
Retained life estate value		259,931
Estimated income tax savings at 40%		196,028

Terms of Installment Purchase from Charity

Price of remainder interest	\$	980,139
Interest rate on installment note		3.0%
Principal amortized over term		15
Annual payment		73,726

Tax Rates and Other Factors

Ordinary income tax rate	40%
Estate tax rate	45%
Section 7520 rate	1.4%
Growth of property	4.0%
Cost of money for impact on net worth	4.0%

WHO SHOULD CONSIDER THIS IDEA?

- ♦ Individuals age 40-80
- ♦ Desire to make gifts to charity
- ♦ Want to reserve the right to enjoy their property for life
- ♦ Want to keep the property in the family
- ♦ Want to address the escalating estate tax problem of keeping the property in their estate

COMPARISON OF SCENARIOS

		(1) Cost to Keep Residence and Make Charitable Gifts							(2) Cost with No Charitable Gifts			(3) Cost of Charitable Gift and Family Trust Repurchase				
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
			Current	Gifts to	Net Cost	Reduction of	Other Assets	Cumulative	Reduction of	in Estate	Cumulative	Charitable	Gift to	New	Net Cost	Reduction of
		Value of	Property	Charity	of Taxes	Net Worth	in Estate	Costs of	Net Worth	Required for	Costs of	Income	Family	Property	of Taxes	Net Worth
		Residence	Taxes		and Gifts	Due to	Required for	Gifts and	Due to	Estate Tax	Estate Tax	Tax	Trust	Taxes	and Gifts	Due to
Year	Age				to Charity	(2)+(3)+(4)	Estate Tax	= (5)+(6)	(2)	Without Gifts	= (8)+(9)	Deduction			to Charity	(14)
1	73	1,560,000	12,150	100,000	67,290	67,290	1,276,364	1,343,654	12,150	1,276,364	1,288,514	980,139	100,000	12,150	(284,766)	(284,766)
2	74	1,622,400	12,636	73,726	51,817	121,799	1,327,418	1,449,217	25,272	1,327,418	1,352,690	-	73,726	12,636	81,308	(214,848)
3	75	1,687,296	13,141	73,726	52,121	178,792	1,380,515	1,559,306	39,424	1,380,515	1,419,939	-	73,726	13,141	81,611	(141,831)
4	76	1,754,788	13,667	73,726	52,436	238,379	1,435,736	1,674,115	54,668	1,435,736	1,490,404	-	73,726	13,667	81,926	(65,578)
5	77	1,824,979	14,214	73,726	52,764	300,678	1,493,165	1,793,843	71,069	1,493,165	1,564,234	-	73,726	14,214	82,255	14,053
6	78	1,897,979	14,782	73,726	53,105	365,811	1,552,892	1,918,702	88,694	1,552,892	1,641,586	-	73,726	14,782	82,596	97,211
7	79	1,973,898	15,374	73,726	53,460	433,903	1,615,007	2,048,910	107,615	1,615,007	1,722,623	-	73,726	15,374	82,950	184,050
8	80	2,052,854	15,989	73,726	53,829	505,088	1,679,607	2,184,695	127,909	1,679,607	1,807,516	-	73,726	15,989	83,319	274,731
9	81	2,134,968	16,628	73,726	54,213	579,504	1,746,792	2,326,296	149,653	1,746,792	1,896,445	-	73,726	16,628	83,703	369,424
10	82	2,220,366	17,293	73,726	54,612	657,296	1,816,663	2,473,959	172,932	1,816,663	1,989,596	-	73,726	17,293	84,102	468,303
11	83	2,309,181	17,985	73,726	55,027	738,614	1,889,330	2,627,944	197,835	1,889,330	2,087,165	-	73,726	17,985	84,517	571,552
12	84	2,401,548	18,704	73,726	55,458	823,617	1,964,903	2,788,521	224,452	1,964,903	2,189,356	-	73,726	18,704	84,949	679,363
13	85	2,497,610	19,453	73,726	55,907	912,469	2,043,499	2,955,969	252,883	2,043,499	2,296,382	-	73,726	19,453	85,398	791,935
14	86	2,597,515	20,231	73,726	56,374	1,005,342	2,125,239	3,130,582	283,229	2,125,239	2,408,468	-	73,726	20,231	85,865	909,477
15	87	2,701,415	21,040	73,726	56,860	1,102,416	2,210,249	3,312,664	315,598	2,210,249	2,525,847	-	73,726	21,040	86,350	1,032,207
16	88	2,809,472	21,881	73,726	57,365	1,203,877	2,298,659	3,502,536	350,103	2,298,659	2,648,762	-	73,726	21,881	86,855	1,160,350
17	89	2,921,851	22,757	-	13,654	1,265,686	2,390,605	3,656,291	386,864	2,390,605	2,777,469	-	-	22,757	13,654	1,220,418
18	90	3,038,725	23,667	-	14,200	1,330,514	2,486,229	3,816,743	426,006	2,486,229	2,912,235	-	-	23,667	14,200	1,283,435
19	91	3,160,274	24,614	-	14,768	1,398,502	2,585,679	3,984,181	467,660	2,585,679	3,053,338	-	-	24,614	14,768	1,349,541
20	92	3,286,685	25,598	-	15,359	1,469,801	2,689,106	4,158,907	511,964	2,689,106	3,201,070	-	-	25,598	15,359	1,418,881
21	93	3,418,152	26,622	-	15,973	1,544,567	2,796,670	4,341,237	559,065	2,796,670	3,355,735	-	-	26,622	15,973	1,491,610
22	94	3,554,878	27,687	-	16,612	1,622,962	2,908,537	4,531,498	609,115	2,908,537	3,517,651	-	-	27,687	16,612	1,567,886
23	95	3,697,073	28,795	-	17,277	1,705,157	3,024,878	4,730,035	662,274	3,024,878	3,687,152	-	-	28,795	17,277	1,647,879
24	96	3,844,956	29,946	-	17,968	1,791,331	3,145,873	4,937,204	718,711	3,145,873	3,864,584	-	-	29,946	17,968	1,731,761
25	97	3,998,754	31,144	-	18,686	1,881,671	3,271,708	5,153,379	778,604	3,271,708	4,050,312	-	-	31,144	18,686	1,819,718
26	98	4,158,705	32,390	-	19,434	1,976,371	3,402,577	5,378,948	842,138	3,402,577	4,244,714	-	-	32,390	19,434	1,911,941

DISCUSSION

- ◆ Upon making the gift, the donor may qualify for a charitable income tax deduction equal to the present value of the future gift to the charitable beneficiary. This deduction is usable up to 30% of the donor's adjusted gross income. Any unused deduction can be carried over for an additional five years.
- ◆ The Family Trust will need a reliable source of cash to make the installment payment to charity. This illustration contemplates that the cash will come from client although many other methods of generating the required funds may be possible. If the trust fails to make a payment, the charity may attempt to foreclose on the remainder interest.
- ◆ This strategy contemplates that the client has sufficient annual gift tax exclusions to shelter the gifts made to the Family Trust.
- ◆ There is a risk that the IRS may attempt to characterize this strategy as a "step transaction" on the basis that it was prearranged. This could result in adverse tax consequences. This risk may be reduced to the extent that the following factors are true:
 - The trustee of the Family Trust must negotiate independently with the charity to purchase the property.
 - There can be no guarantee that the parties will be able to agree on the price and terms illustrated.
 - No assurances can be given to the donor that charity will be willing to sell.
 - The trust should use as much of its own capital as possible to purchase the property while minimizing its reliance on gifts from the client to make the payments to charity.
- ◆ A similar legal separation must also exist with respect to contributions to Donor Advised Funds and the donors' subsequent ability to give advice regarding future distributions from the DAF.
- ◆ It may be advisable to include a means for the Family Trust to have sufficient capital after it owns the property to be able to pay for ongoing taxes and maintenance costs. Life insurance may be a good way to provide for this need.
- ◆ If the donors die before the Family Trust makes all the payments to charity to purchase the remainder interest, the Family Trust may need another source of cash to make future payments.