



Gift Planning Now

A Newsletter for Berkeley's Donor Advisors

Spring 2012

Planning for Retirement Through Charitable Gifts

A concern facing some younger Baby Boomers is the long-term health of Social Security. But do tax-favored options exist for those already contributing the maximum to IRAs, 401(k)s and other qualified retirement plans? There are two plans that couple philanthropy with retirement income:

Deferred Payment Charitable Gift Annuities

Clients can arrange a series of charitable gift annuities, an arrangement in which a donor irrevocably contributes an asset in exchange for set lifetime payments, to begin at some future time. They receive an immediate charitable deduction for a portion of their gifts. The chart shows the tax and financial benefits of such an arrangement established by a 55-year-old donor

who funds a \$25,000 gift annuity annually for five years. The donor will receive income of \$7,500 annually starting at age 65, as well as combined charitable deductions of \$34,522.

Donors who don't know exactly when they'll retire can choose a flexible start date. If they elect to start the annuity at the earliest date in a range, annual payments will be lower. Postponing the start date results in larger annuity payments.

(continued on page 2)



Benefits of Creating Gift Annuities Each Year Starting at Age 55

Year	Contribution	Deduction	Payout rate	Payout at age 65
2012	\$25,000	\$6,555	6.4%	\$1,600
2013	25,000	6,725	6.2	1,550
2014	25,000	6,899	6.0	1,500
2015	25,000	7,079	5.8	1,450
2016	25,000	7,264	5.6	1,400
Total	\$125,000	\$34,522	6.0%	\$7,500

(using current ACGA rates assuming quarterly payments and a \$7520 rate of 1.6%)

Magnes Collection of Jewish Art and Life Joins Berkeley

The January 22nd opening at 2121 Allston Way in Berkeley featured food and exhibitions of contemporary artists' projects as well as highlights from The Magnes' permanent collection of precious art, rare books, and objects. The nearly 15,000-item collection includes The Magnes's Western Jewish Americana archives, the world's largest collection of letters, diaries, photographs, and documents relating to the Jewish settlement of the West. Throughout the year, educational and public programs at The Magnes will include tours, lectures, artist talks, and scholarly symposia, as well as collaborations with local cultural and performing arts institutions. (Website: magnes.org)

Planning for Retirement *(continued from page 1)*

Charitable Remainder Unitrusts

The “retirement unitrust” can be a useful planning tool for many individuals. A charitable remainder unitrust is an arrangement under which a donor irrevocably contributes an asset to a trust and receives payments based on the annual trust value. The tax laws do not specifically allow deferred payment charitable remainder trusts, but it is possible to approximate such an arrangement through a net-income-with-makeup unitrust that also contains a “flip” provision. Such a trust could provide:

- An income tax deduction;
- Deferral of much of the trust income until the grantor retires;
- Payment of substantial income after retirement, reflecting potential rapid growth of principal within a tax-exempt trust – and perhaps make-up of payment deficiencies during years when grantor was receiving little or no trust income;
- An important gift to the grantor’s charity when the trust ends.

Example: Mr. King, age 50, transfers assets worth \$500,000 to a flip unitrust that will pay him the lesser of the trust’s net income or 6% annually. In the year he sets up the trust, Mr. King can deduct a charitable contribution of about \$104,000. The trustee invests in stock that is expected to appreciate by 5% a year but provide minimal (1%) payments to Mr. King until his projected retirement date: his 70th birthday. By then, if it performs as intended, the trust will have grown to \$1,326,500. The following year it will “flip” to become a standard unitrust paying 6% of \$1,326,500. Mr. King will enjoy retirement income of nearly \$80,000 a year, some of which will be taxed at long-term capital gain rates.

If Mr. King wishes, he could suggest that the trustee sell some growth stock in the year he turns 70. If the unitrust has a “makeup” provision and the trust document has defined capital gain as income, Mr. King can receive a significant one-time payment that makes up for part or

all deficiencies from the 6% payout amount in prior years. If Mr. King wishes, he can add more each year to his “retirement unitrust” – \$25,000, for example – and receive additional deductions and even more income.

There are a number of advantages to saving for retirement through deferred payment charitable gift annuities and unitrusts:

- There is no maximum contribution, as there is with an IRA, 401(k) or qualified plan.
- Both the gift annuity and the unitrust may be funded with appreciated assets, offering capital gains tax advantages.
- Payouts can be postponed for gift annuities or minimized for unitrusts beyond age 70½.
- A portion of each payout may be tax-free return of principal or long-term capital gain rather than ordinary income.
- Clients can reduce or avoid estate taxes and income tax on income in respect of a decedent.

Tax Planning Pointer

Individuals are not the only donors who can establish charitable remainder trusts. A corporation with an unneeded asset such as real estate can fund a trust, retain income for up to 20 years and claim a charitable deduction [Code §§664(d)(1)(A), (d)(2)(A)]. If the company is an S corporation, the deduction passes through to the shareholders according to their respective interests, to be claimed on their personal income tax returns [Code §1366(a)(1)(A)].

A Reminder for Californians: Leave Will Drafting to the Professionals

Irving Duke prepared a holographic will in 1984, specifically disinheriting certain family members. The will provided that if he and his wife should die at the same time, the estate was to be divided in equal shares for the City of Hope (COH) and the Jewish National Fund (JNF). The document also included a no-contest clause. Duke’s wife died in 2002 and he died in 2007, leaving no children. His estate was valued at more than \$5 million.

The charities jointly filed a petition for probate and the appointment of an administrator. Seymour and Robert Radin, Duke’s nephews, filed a petition to remove the administrator. They acknowledged that the will was valid, but argued that the condition under which COH and JNF were to take under the will – that the couple died at the same time – had not occurred. The will did not address what was to happen if Duke survived his wife by several years. The two argued that, as a result, the

entire estate was to pass by intestacy. COH and JNF said that the court should consider extrinsic evidence of Duke's intent, noting that he had established several charitable gift annuities after his wife's death and told representatives of the charities that he was leaving his entire estate to the organizations.

The Radins said that because the will was unambiguous, extrinsic evidence was not appropriate. The trial court agreed. The California Court of Appeal upheld the trial court, noting that while a will is to be construed according to the intention of the testator and so as to avoid intestacy, a court may not write a will that the testator did not. The court also noted that the no-contest clause in the will cannot operate to prevent heirs at law from taking under the statutory rules of intestacy. Duke's will simply made



no disposition of property in the event he survived his wife.

The court noted that after leaving specific gifts to the charities, it was unlikely that he intended the bequests to take effect only if he and his wife died at the same time. However, evidence of Duke's actions could not be used to establish a latent ambiguity in the will. "Perhaps, the rule regarding the admission of extrinsic evidence should be more

flexible when a testator's conduct after an event that would otherwise cause his will to be ineffective brings into question whether the written word comports with his intent," suggested the court, adding that it might be time for the state Supreme Court "to consider whether there are cases where deeds speak louder than words when evaluating an individual's testamentary intent." *Radin v. Jewish National Fund*, B227954.

Transfer Instructions Made Foundation a Beneficiary

Hamilton James had a custodial arrangement with a bank that required the bank to transfer assets when so directed by James. As he had done several times before, James instructed the bank to transfer shares of a particular mutual fund as a charitable gift to his family foundation.

Instead of sending the letter of instruction to the mutual fund company, the bank sent it to the foundation's broker. The mistake was not discovered for about two weeks. Share prices had dropped, resulting in a sale price that was more than \$1.6 million lower than the value at the time James gave the instructions.

The foundation trustee sued the bank, claiming breach of contract. The trial court granted the bank's motion for

summary judgment, ruling that the foundation lacked standing. The Massachusetts Appeals Court disagreed, pointing to the Restatement (Second) of Contracts, which recognizes the right of an intended beneficiary to sue for its enforcement or breach of an agreement. James intended to give the foundation the benefit of the promised performance – transfer of the shares – noted the court. He had an ongoing arrangement with the bank to transfer assets at his instruction. Once the instruction was given, it supplemented the agreement and identified the bank's obligations with respect to the assets to be transferred.

The instructions James gave "clearly and definitely" identified the foundation

(continued on page 4)

Did You Know...

Admissions applications for the 2012-13 freshman class increased 16.5 percent over last year to a total of 61,661. Academic performance such as test scores and grade point averages remain as high as previous years.

Chancellor Robert J. Birgeneau has announced that he is stepping down at the end of 2012 as Chancellor of the University of California, Berkeley. When he leaves office on Dec. 31, he will have served more than eight years as head of the world's premier public research and teaching university. The internationally distinguished physicist plans to remain at UC Berkeley to teach and conduct research.

Transfer Instructions . . . (continued from page 3)

as the recipient and stated that the purpose was to make a charitable gift. It makes no difference, said the court, that the foundation was not identified as an intended beneficiary at the

time James and the bank originally entered into the agreement. The court added that its ruling dealt only with the question of the foundation's standing, not whether the bank's

actions breached the agreement or caused the foundation any loss. *James Family Charitable Foundation v. State Street Bank & Trust Co.*, No 10-P-1616.

Easements Were Not Charitable

One day after purchasing parcels of land in Colorado, three owners conveyed conservation easements to The Greenlands Reserve, a Colorado conservation group. All three agreements provided for extinguishment of the easements by judicial proceeding or "by mutual written agreement of both parties," if future circumstances rendered the purpose of the easement impossible to accomplish. The IRS disallowed the deductions, saying that the easements had not been granted in perpetuity, as required under Reg. §1.170A-14(g)(6)(i).

The Tax Court questioned whether the contributions were made exclusively for conservation purposes, a requirement for a deduction.

Under Reg. §1.170A-14(g)(6)(i), if continued conservation use is made impossible or impractical by a change in conditions, a conservation purpose can still be treated as protected in perpetuity if the restrictions are extinguished by judicial proceedings and all of the proceeds from a subsequent sale or exchange of the property are used by the charity "in a manner consistent with the conservation purposes of the original contribution." The IRS argued the easements were not protected in perpetuity because the

easements could be extinguished by "mutual agreement." The taxpayers said that the donations created charitable trusts or restricted gifts, which, under cy pres rules, would require a judicial proceeding to extinguish.

The court determined that, under state law, conservation easements could be extinguished by mutual consent of the parties. The transfers to Greenlands did not create charitable trusts, said the court, because there was no manifestation of an intent to create such a relationship. The transfers were restricted gifts, in that they were conditioned on the use of the property in accordance with the donors' instructions. However, for cy pres to apply, the donors must have "manifested a more general intention to devote the property to a charitable purpose."

The court agreed with the IRS that cy pres was not applicable to the restricted gifts because the donors did not manifest a more general intention to devote the property to charitable purposes. While the easement required that the property be "retained forever predominantly in a natural, scenic and open space condition," the taxpayers retained all rights over the property not specifically granted to Greenlands. They therefore did not manifest a general

charitable purpose and cy pres is not applicable, said the court.

There is no guarantee that the conservation purposes will be protected in perpetuity, said the court, due to the ability to terminate the easements by mutual agreement. The transfers were not qualified conservation contributions and the IRS's motion for summary judgment was granted (*Carpenter, et al. v. Comm'r.*, T.C. Memo. 2012-1).

University of California, Berkeley Foundation Office of Gift Planning

2080 Addison Street #4200
Berkeley, California 94720-4200

Telephone: 510.642.6300

Toll Free: 800.200.0575

Fax: 510.643.8066

E-mail: ogp@berkeley.edu

Web: planyourlegacy.berkeley.edu

To subscribe to our electronic version, please contact ogpm@berkeley.edu and provide us with your e-mail address.

Gift Planning Now is designed to provide accurate and authoritative information in regard to the subject matter covered. It is published with the understanding that neither the publisher nor the authors are engaged in rendering legal, accounting, or other professional service. If legal advice or other expert assistance is required, the services of a competent professional person should be sought. (From a Declaration of Principles jointly adopted by a Committee of the American Bar Association and a Committee of Publishers.)

©2012 by The Regents of the University of California.