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Using the J.E.D.I. Partnership for Charitable Giving

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Traditional Benefits of FLPs and FLLCs

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- Centralized Management
- Economies of Scale
- Succession Planning
- Avoids fractionalization of property interests
- Avoids mortality risks
- Protects family members from divorces of other family members
- Charging Order Protection
- Potential for Valuation Discounts

Purpose of the JEDI Partnership

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- Integrate charitable vehicles with flexible business entities, such as FLPs and FLLCs.
- Combine planned giving goals with tax and estate planning goals.
- Partners/Members include family trusts and charitable entities, including charitable trusts and private foundations

Items that Influence Planning

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- Desire for Control
- Current Annual Giving
- Age of donor
- Estate taxes v. income tax as a motivator
- Income tax event, such as a bonus, sale or option exercise

A New Hope – the JEDI Partnership

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- **J**urisdictionally Superior
  - Legislative and Case Law History
  - State Taxation
  - Asset Protection and Charging Order
- **E**fficient
  - Gifting of partial interests
  - Reduced costs of administration; economies of scale
  - Assets that are difficult to transfer
- **D**iscountable
  - Valuation discounts are still available
  - In certain cases, discounts are not preferable
- **I**mmortal
  - Additional estate tax planning opportunity
  - Family harmony
  - Continuity
  - Family private equity fund model

Structuring of the JEDI Partnership

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- LP or LLC
- Preferred LP
- Series LLC
- Tiered Entities
- Voting and Non-Voting Units
- Profits Interest Partners
- Non-Equity Member

Preferred LPs or LLCs

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- Face value initially based on capital contributed
- Other characteristics
  - Rate
  - Liquidation Preference
  - Reinvestment Rights
  - Conversion Rights
- Compliance with Section 2701
  - 10% Minimum Coverage
  - Cumulative return
  - Vertical slice
- Preferred Freeze / Reverse Freeze
- Use as currency when cash flow is an issue
- Contrast with guaranteed payments
- Facilitate cash flow to cash-demanding partners (CLAT/GRAT) without having to make pro rata payments to all partners

The Outer Entities

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- CLAT
- CRUT
- NIMCRUT
- Private Foundation
- Public Charity
- Dynasty Trust
- Insurance Trust
- GRAT

Planned Giving Vehicle Considerations

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A. Variety of ways to give to charity:
   1. Outright transfers
   2. Charitable lead trusts (CLTs).
   3. Charitable remainder trusts (CRTs).
   4. Charitable gift annuities.
   5. Donor Advised Funds and Private Foundations

B. The Charitable donation can be by a lifetime transfer or at death (a gift or a bequest)

C. If a split interest trust is used, it can be an "annuity" trust or "unitrust"

D. The age of the donor can influence the choice of the structure to use (i.e., impact of the donor's life expectancy)

E. The effect of the interest rate environment, the §7520 rate

The CLAT - Basic Structure

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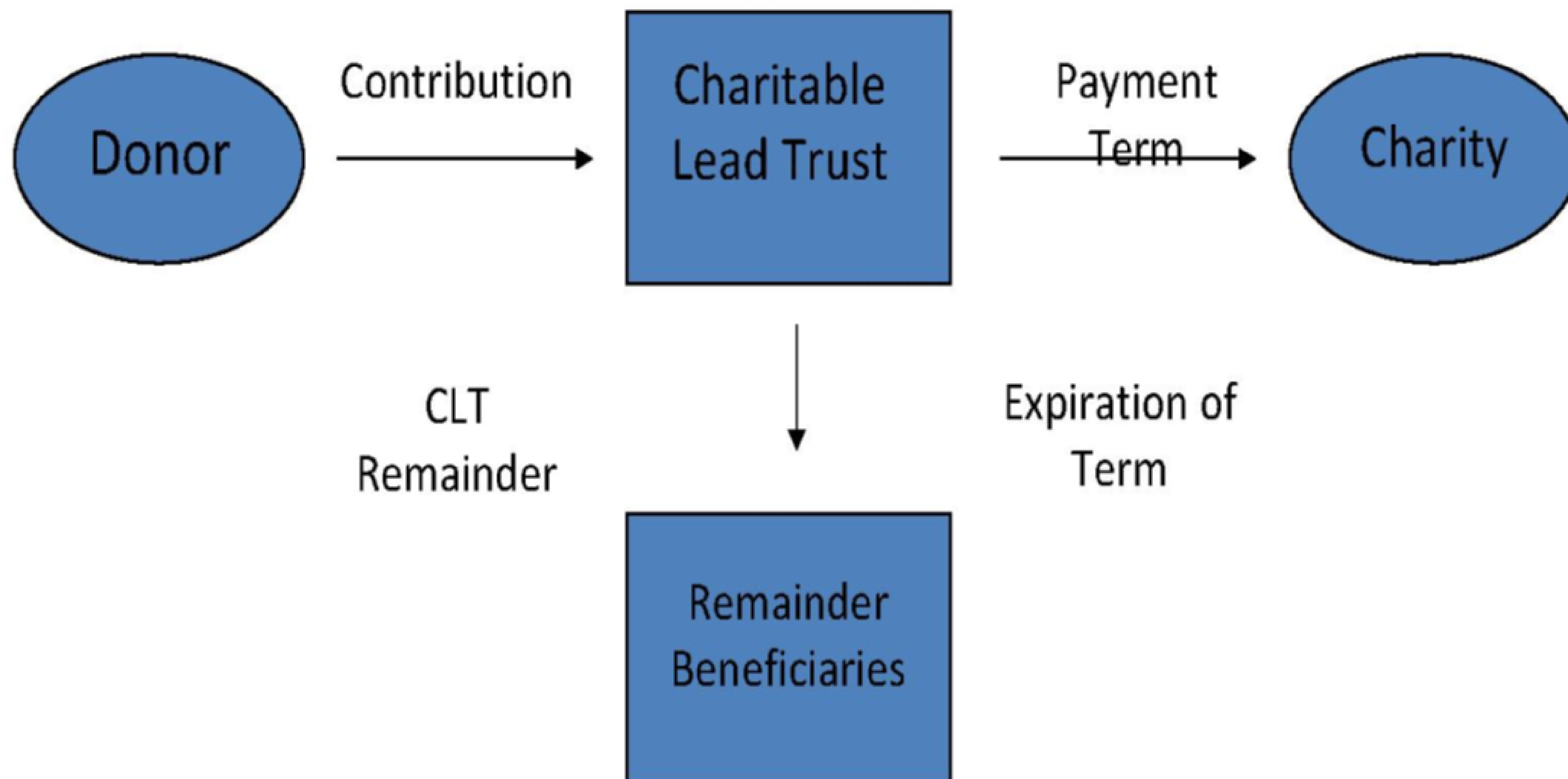

- Income tax deduction(s)
- Transfer tax savings

Charitable Lead Trusts (CLTs)

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1. Can be a unitrust or an annuity trust
2. Can be a grantor trust or a complex trust
3. Can be for life or for a term certain
4. Can be intervivos or testamentary

What determines these 4 decisions?

1. Unitrust or annuity trust?
   a. Unitrust – Annual distributions are a predetermined percentage of the value of trust principal,
      i. Must value trust principal each year
      ii. Annual distributions can decrease or increase with changes in value of trust principal
   b. Annuity trust – annual distributions fixed at time of formation
      i. Annual distributions are not effected by changes in value of trust principal

Charitable Lead Trusts (CLTs)

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2. Charitable income tax deduction
   a. Grantor trust: Donor gets immediate charitable income tax deduction Donor reports all future trust taxable income
   b. Complex trust: Donor has no charitable income tax deduction and does not report trust income
3. Why a lifetime CLT should never be for life, but only be for a fixed term?
   - Example: Donor age 70; 14.2 year life expectancy is used to value lead interest given to charity. Although good possibility donor will live far longer, use of required mortality tables do not take that possibility into account. Thus, can give more than 14.2 years of payments to charity.

Other Factors Affecting CLATs

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- Low interest rate environment
  - low interest rate environment is beneficial for annuity techniques like CLAT and GRAT and Grantor CLAT
  - In a higher interest rate environment we would still expect investments to outperform government-proscribed rates
- Discounting to further leverage the tax benefits of annuity techniques which effectively lowers the “hurdle”

Compare a GRAT to a CLAT

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- Both work the same way:
  - Discounted values
  - Financial leverage
  - Compound the actual income in excess of the §7520 rate over a long period of time
  - Shift future appreciation in value to the remainder interest
  - Zeroed out CLAT and GRAT are the same if use a fixed term

Advantages of the CLAT over a GRAT

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- Can be for a longer term as no §2036 exposure if death occurs during the term of the lead interest
- Back loading for CLAT is greater as GRAT can only increase 20% a year.
  - [Use of “shark fin” CLAT]
- Ability to continue the transfer tax free compounding after death
  - Example: A donor age 90 can create while living a 20-year CLAT
- The TCLAT - cannot have a TGRAT

CLAT - Planning Considerations

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- Type of CLAT – level, backloaded or shark-fin
- Income tax status of CLAT – Grantor or Non-Grantor
- Income beneficiary – use of DAFs v. Private Foundations
- Remainder beneficiary – dynasty trust, NAPT, ricochet
- Age – use of life versus term of years
- Estate taxes or income tax – to discount or not to discount
- 5-year carry over
- Donor has until December 31st to execute
- Private foundation rules – excess business holdings and self dealing

Charitable Remainder Trusts (CRTs)

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Income tax benefits

- Current charitable income tax deduction for value of charitable remainder interest (min of 10%)
- Can offset up to 60% of adjusted gross income. Compare to 30% limit for a CLT
- No income tax on CRT's gain from sale of appreciated asset (tax exempt)

Example

- Senior owns stocks, basis 0, value $1,000,000. Income tax on the gain 20%
- Compare the ability to receive the income for the rest of Senior's life on the investment of $1,000,000 versus the investment of $800,000
- And, Senior has a current charitable income tax deduction in excess of $100,000

Benefits of Private Foundation

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- Donor may contribute (appreciated) publicly traded stock and continue to vote the shares (with family members)
- Good for significant shareholders in smaller public companies (founders)
- Donor and family retain control over investments
- Legacy planning and family harmony
- Family members working together for common goal

<u>Considerations</u>

- 30% limitation (AGI) on cash
- 20% limitation on Capital Gain Property
- Appreciated long term CG property deduction limited to basis (publicly-traded stock exception)
- 2% excise tax in investment income (can be reduced to 1% in certain cases)
- Tax and Accounting Compliance (initial forms and annual, 1023, 990-PF)
- Start up costs
- 5% annual payout requirement

Benefits of Donor Advised Fund

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- 60% limitation (AGI) on cash gifts
- 30% limitation on LTCG property
- No basis limitation on gifts of appreciated property
- No excise tax on investment income
- No (5%) minimum payout requirements
- Minimal tax and accounting compliance and start up costs

<u>Considerations</u>

- Investments may be limited depending on sponsor of charity
- Sponsor of charity is not bound by recommended charities suggested by donor

Combining Charitable & Non-Charitable Vehicles – Considerations

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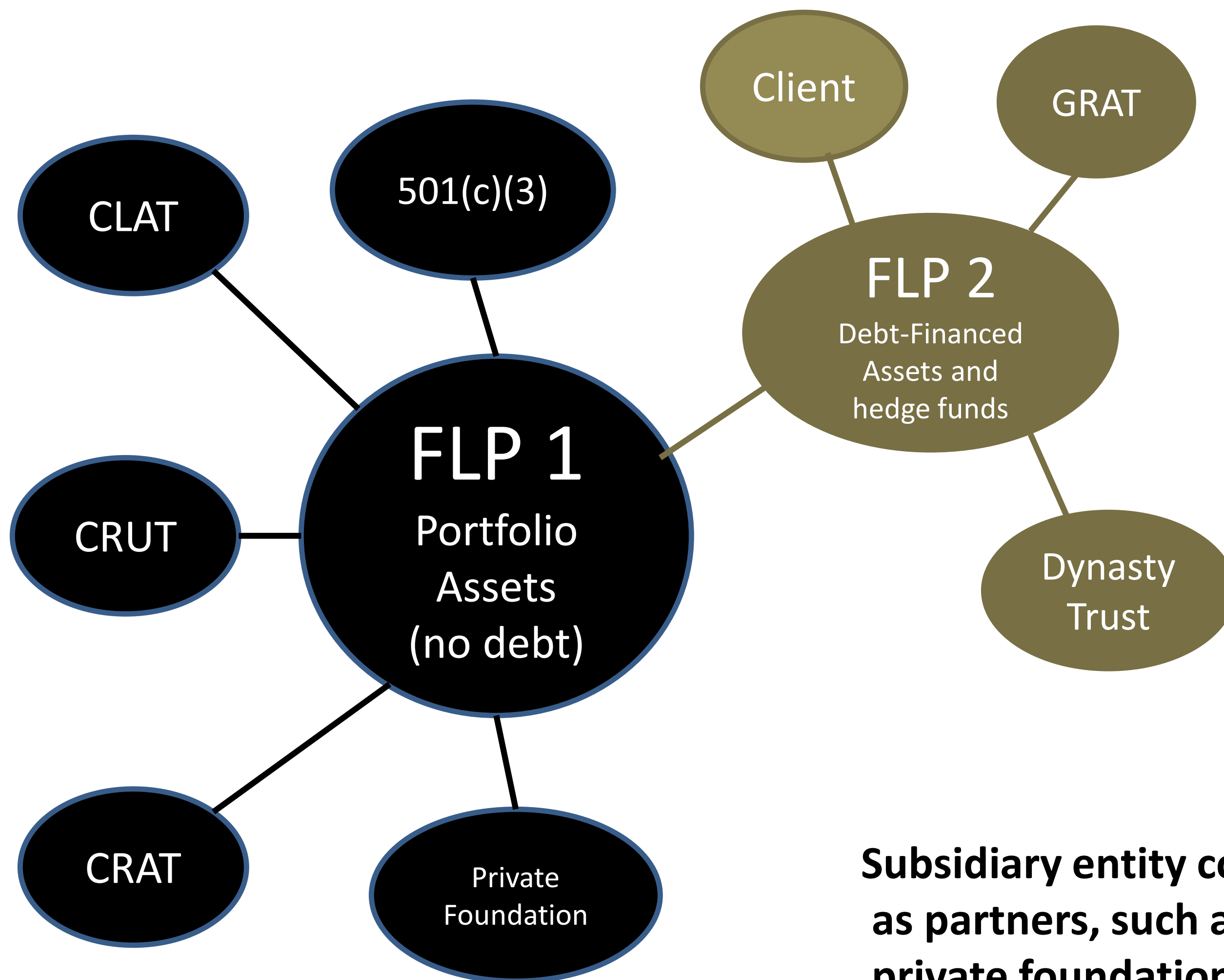
- UBTI
  - Debt financed investments
  - Inventory or operating businesses (other than C corps)
- Private Foundation Rules
  - Excess Business Holdings
  - Jeopardy Investments
  - Political Contributions
  - Self Dealing (Indirect in the case of an LP or LLC)
    - Indirect Self Dealing- where the charitable entity has no voting power and LP assets are well in excess of the capital account of the charitable entity

Tiered Partnership Structure



- **Parent entity can invest in UBTI and debt financed Investments**
- **Parent can create charitable trusts or engage in estate planning transactions**

Subsidiary entity contains tax exempt orgs as partners, such as CRTs, subject to private foundation rules and investment restrictions

Case Study #1 – What would you say?

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- Dave is a 51-year old in the entertainment business. He is married almost 20 years and has three children. He is also close with both of his mother's sisters who have urged him several times to seek better tax advice. Never changes a thing. The week ends the week begins.

- Several years ago, in a particularly high income year, he created a 20-year backloaded grantor CLAT that is now having trouble making the annual payments. The CLAT was funded with high dividend paying stock, but not enough to cover future cash demands. Additionally, there always seems to be a last minute "Crash" by the CLAT trustee at year-end to figure out which charity to send the money. In addition to the CLAT, he has a life insurance trust that holds high yield bonds and an insurance policy that was paid up last year. He supports a number of charitable endeavors including environmental initiatives and farm aid. Dave also makes significant political contributions. On your way back from lunch you see Dave's "aunts marching" him into your conference room.

- So much to say, so much to say, so much to say

Case Study #2

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- Ben Kenobi is a retiree living in Boca Vista Pointe Del Rio Gardens, originally from Brooklyn. He has a net worth of approximately $40,000,000. He is 78 years old and has been married for 50 years, has two children and five grandchildren.
- He only has basic estate planning documents and a family limited partnership that his son-in-law set up. He wants to give his grandchildren what he calls a profits interest in the FLP. He has a bond portfolio that throws off approximately $500,000 per year and generally gives $100,000 to charity annually. His health is okay but he has had issues in the past. While having a pastrami sandwich at Flakowitz, he overheard someone discussing how much their tax advisor saved them.

Case Study #3

- Han is a 39-year old entrepreneur recently divorced with one child and living in east Delray. He sold a vaporizer business to a public company for $30,000,000 last week and has decided to seek tax advice now. He gives a some money to a local charity and plans to give something more substantial in the future (distant future). He is concerned that any estate planning will result in some loss of control. He has an attention span of 1.3 seconds and only communicates by text or email after midnight. He did his will from a form he found online and cannot decide which is worse, paying taxes or legal fees. Yesterday while on his phone, he came across an article on estate planning for Gen X-ers written by some guy named Goldglantz that discusses the use of charitable trusts for income tax deductions…

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Partnership Tax Considerations

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- Section 721(b) – Investment Company Rule
- Section 704(c)(1)(B) and Section 737 – Mixing bowl rules
- Section 707 – Disguised Sales
- Section 706 –Varying interest rule

Assignment of Income Versus Varying Interest Rule

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Anticipatory assignment of income

Ferguson v. Comm'r, 108 T.C. 244 (1997), aff'd

Rauenhorst v. Comm'r, 119 T.C. 9 (2002)

- Planning on the eve of a disposition event
- Donee could be "compelled" to complete the sale (disposition event)- charity is bound to complete (Ferguson)
- Facts and circumstances, whether sale (or other disposition event) "ripened to a practical certainty" (Rauenhorst)
- Nonbinding Letter of Intent
- Contingencies such as regulatory approval (SEC, FCC), zoning versus ministerial tasks

- IRC Section 706

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