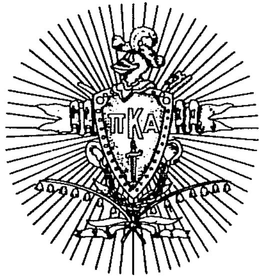

Horizons

AN EXCLUSIVE PUBLICATION FOR LOYAL SUPPORTERS OF THE PI KAPPA ALPHA EDUCATIONAL FOUNDATION

More Cash in Your Pocket

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The sweeping changes effected by the Tax Reform Act of 1986 have significantly enhanced the role of "planned giving" in tax, financial and estate planning. Under current law, donors can still achieve some or all of the traditional financial and philanthropic benefits of sophisticated charitable planning. In fact, this law has created opportunities that make the use of charitable planning even more attractive in conjunction with other personal and family objectives to attain multiple goals.

A Wealth Replacement Trust Arrangement is one such planning opportunity which can provide multiple benefits to you and your family as well as to the Pi Kappa Alpha Educational Foundation. These benefits include:

- *income tax savings generated by the deduction for charitable contributions based on the value of the gift;*
- *avoidance of income tax on the capital gain otherwise payable on appreciated long-term capital gain property contributed;*
- *retained income rights for your life or the life of your wife and/or other beneficiaries;*
- *the possibility of increased spendable income with certain arrangements;*
- *elimination of federal estate tax on the value of the interest in property passing to the Foundation and the appreciation on such property;*
- *reduced estate settlement costs during the administration of your estate;*
- *the ability at death to provide your beneficiaries with an amount of cash equal to or greater than the value of the property contributed;*
- *providing a source of liquid funds at your death which can be used to pay estate taxes and settlement costs;*
- *avoidance of federal estate tax on such cash; and,*
- *the possibility of savings on state income tax, inheritance tax, estate tax and gift tax.*

A wealth replacement trust arrangement is really a combination of two trusts commonly used in financial and estate planning — a Charitable Remainder Trust and an Irrevocable Life Insurance Trust. Used in tandem these two trusts can accomplish rather remarkable results.

A charitable remainder trust is similar to other types of trusts which provide an income stream to one or more beneficiaries, except that at its termination the remaining assets of the trust are distributed to the Foundation. An irrevocable life insurance trust is a special trust established to own one or more life insurance policies, usually on the donor and/or the donor's spouse. The beneficiaries of this trust are most often children or grandchildren, although other beneficiaries can be selected.

A typical wealth replacement trust arrangement would provide for a gift to the Foundation of appreciated property such as securities or real estate. The best candidate for this gift is property with a low income tax basis (unrealized high capital gain) and continued future appreciation potential.

The dilemma typically associated with this type of property is that the investor is locked-in. Although he or she may wish to sell the property to protect a profit or reinvest for higher yields, the potential capital gain to be realized on such property is a great disincentive, particularly in view of the high rate at which capital gains are now taxed.

By contributing appreciated capital-gain property to the Foundation, the income tax detriment associated with a sale can be avoided and a current federal income tax deduction can be obtained. Consequently,

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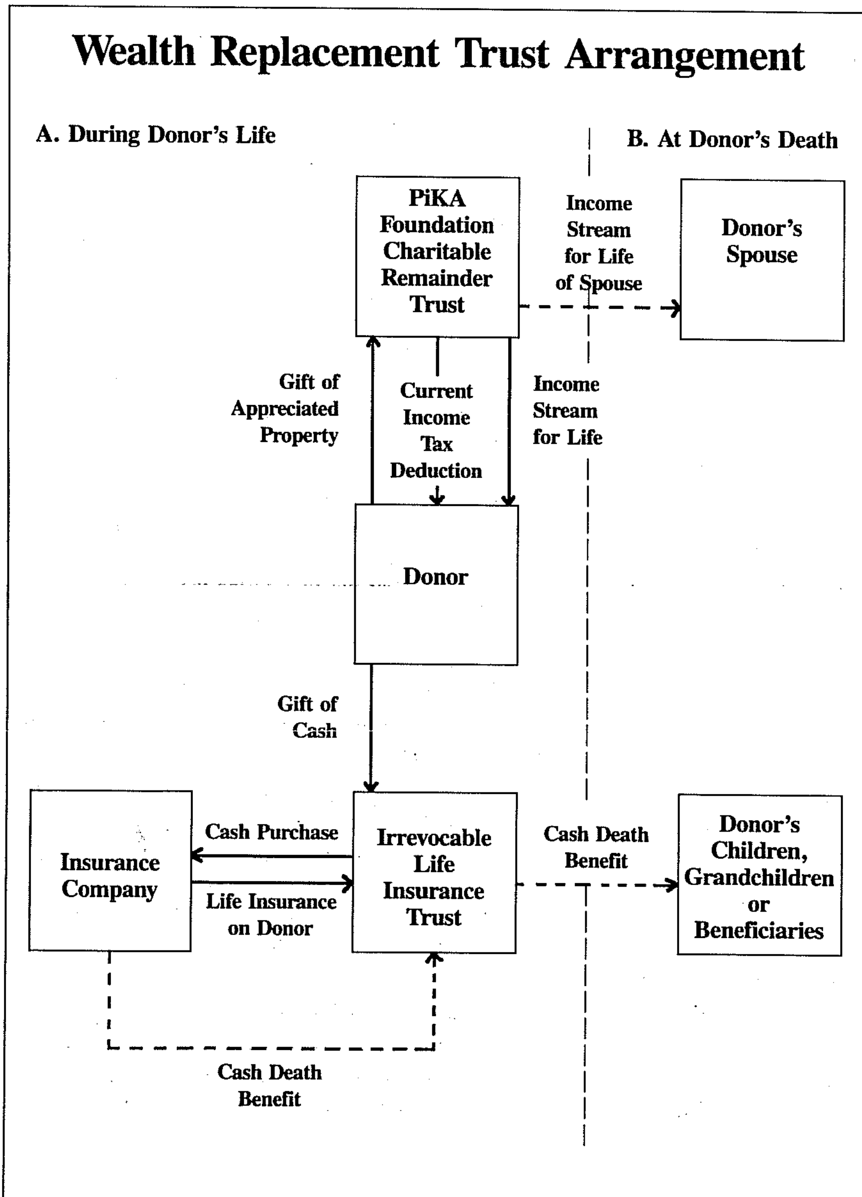
you and/or your family can receive an enhanced income stream from the trust. This is accomplished by having the Foundation sell the appreciated property and reinvest in higher yield property with the resulting income stream paid to you. *(See diagram at bottom).*

For example, you may own publicly-traded common stock which was purchased over five or more years ago. Generally, the purchase price including commissions constitutes your income tax basis. If the market value of the stock is now $82.00 per share, and your purchase price was $20.00 per share, you are a prudent or fortunate investor staring down the barrel of a $62.00 per share capital gain. If you sell this particular stock outright, you are likely to pay federal income tax of approximately $20.00 per share in addition to any state income taxes assessed, leaving you with less than $42.00 of your $62.00 potential per share profit. To make matters worse, the capital gain income also increases your federal adjusted gross income, which determines the threshold limitations on itemized deductions resulting in reduced deductions on your federal Schedule A. Incidentally, such income will also reduce your state deductions in certain states.



Alternatively, ***a gift of your common stock to the Foundation via a charitable remainder trust will avoid imposition of any capital gain tax.*** In fact, you will have more cash in your pocket, because the gift qualifies as a charitable contribution deductible on your federal Schedule A. Perhaps the best part, however, is that all $82.00 of your money is still available to reinvest and generate an enhanced cash stream for you and your family paid by the trust.

The cash generated from the charitable deduction or enhanced cash flow would then be used to purchase a life insurance policy owned by your irrevocable insurance trust. Because the trust would hold only life insurance, no annual income taxes are incurred and any appreciation in the value of an investment-grade insurance contract would also escape income taxes. This result is obtained because qualified life insurance by statute is generally not subject to income tax and the value of property held in a properly designed irrevocable trust is not included in the estate of the person who establishes and funds the trust.

The compelling aspect, however, of the arrangement is that the value of the insurance held in this trust will not be subject to the 55% top estate tax rate. Consequently, you can provide a large sum of cash to your beneficiaries equal to or greater than the amount of your charitable gift to the Foundation. This feature names the arrangement; your wealth has been replaced via the irrevocable life insurance trust after making a gift via the charitable remainder trust.

The expected end result of the wealth replacement trust arrangement is that ***you will have accomplished your tax, financial, estate, and philanthropic objectives while enjoying enhanced current income, income tax-free and estate tax-free growth of your family estate, and reduced estate taxes and settlement costs.***

You can make a substantial charitable gift to the Foundation, enabling it to mre effectively assist Pi Kappa Alpha's student brothers; your family can receive exactly the same total assets at your death with lower estate taxes and costs; and you and your family can enjoy enhanced income and cash flow during your life. ***This arrangement can be a WIN-WIN-WIN under the right circumstances and should certainly be considered as part of any comprehensive financial and estate planning analysis.*** If you are interested in making a charitable gift of this sort, please consult with your financial advisor and/or your attorney as well as Educational Foundation Executive Director Jeff Abraham.

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