



# Philanthropic Estate Planning

By Ronald D. Philgreen

## Four “Charitable Bucket”™ Alternatives to the Outright Sale of Appreciated Assets \*

These days, most financial service representatives are familiar with the charitable remainder unitrust as an alternative to the outright sale of low-basis, highly appreciated assets. However, many are finding that clients are resistant to committing 100 percent of that asset to an irrevocable charitable trust. Are there some additional alternatives that you might want to consider with your clients? The answer is absolutely, yes.

The first question you should always ask is “What is the problem we’re trying to solve?” In this case, we have a \$10,000 cost basis in “ye ole family farm” that’s situated across the street from the proverbial \$50 million shopping center. The farm is now worth \$10 million, with developers circling the property with cash in hand. How do you find this kind of a person? You stand in the parking lot of the nearest shopping center—and look for cows!

What’s the problem we’re trying to solve here? There would be \$2,597,400 of potential long-term capital gains taxes if the landowner sold the property outright. What’s left over is \$7,402,600 after tax values and working capital. And more and more holders of appreciated assets are reluctant to simply bite the bullet and pay that tax.

This strategy is the classical response to the client with highly appreciated, low-basis capital assets. With this charitable remainder unitrust, the client would transfer 100 percent of his low-basis, highly appreciated capital asset into an irrevocable, charitable remainder unitrust, *i.e.*, what I call the “Charitable Bucket.”™ This is certainly one option that should be considered. It would be appropriate to do this if the asset represented less than 50 percent of the total estate assets. On the other hand, if this asset represented 80 percent of the estate (which is quite common when the asset is a closely held family corporation), the 100% Asset Rollover Strategy is probably not the right strategy to implement.

If this 100% Asset Rollover Strategy is used, focus on what John and Jan R. Donors own after the implementation. They own (1) the taxes saved from the \$3,302,200 PVFG (present value future gift) charitable income tax deduction—tax savings estimated at \$1,485,990, and (2) the joint life unitrust income stream—what I call the “Spigot Income”™—which is actuarially worth \$6,697,800 according to IRS tables. So the value of what they own totals \$8,183,800. Compare that to the value of what they would have owned on Chart 1 had they sold the property outright—\$7,402,600 after taxes.

But how much capital is working for John and Jan for the rest of their lives? The answer is \$1,485,990 outside the Charitable Bucket plus \$10 million inside the Charitable Bucket, for a total of \$11,485,990. Compare that to how much capital would be working for John and Jan in Chart 1—\$7,402,600. That’s an increase of 55 percent more capital working for them for the rest of their lives, and they make a \$10 million +/- deferred charitable gift to their Family Foundation when “the Bucket turns upside down at their deaths.” If they live to their actuarial life expectancy with a “Five-Percent Spigot” and an average yield over 23 years of 12 percent, the deferred gift will have grown to \$44,304,017. You can run whatever yield assumptions you choose, but \$7,402,600 of working capital will never catch \$11,485,990.

So is that it? Is that the only alternative for John and Jan R. Donors to consider?

Instead of transferring 100 percent of the land irrevocably to the Charitable Bucket, how about if they transferred a 75-percent undivided interest (which would rollover tax-free inside the “Bucket”) and kept

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a 25-percent undivided interest to be sold outside, subject to long-term capital gains tax accrual. In this 25-percent/75-percent split transaction, for every one dollar of long-term capital gain accrued, *i.e.*, \$2,497,500, they would own approximately one dollar of PVFG charitable income tax deduction, *i.e.*, \$2,476,650, which could be used to offset the long-term capital gains taxes.

**Caveat.** The accrued long-term capital gains might be taxed in one year, or if the outright sale was a 20-year installment contract, the long-term capital gains might be spread over 20 years. The earned PVFG charitable income tax deduction is usable up to 30 percent of their adjusted gross income with a five-year carryforward on the unused portion. So the offset may or may not be in the same time frame, and this “quick look” doesn’t take into account AMT (alternative minimum tax) considerations, tax

preferential treatment on charitable gifts and other taxable income.

If John and Jan used this “Split Sale & Asset Rollover” strategy, what would they own? They would own approximately \$2,490,618 outside the Bucket from the net cash after taxes and a Spigot that is actuarially worth \$5,023,350, for a total value of \$7,513,968. And how much capital would be working for John and Jan for their rest of their lives? They would have \$2,490,618 outside the Bucket and \$7.5 million inside the Bucket, for a total of \$9,990,618, working for them. Compare these numbers to Chart 1 had they sold the asset outright.

What if John and Jan said to you, “We would like to do something now for our favorite charities, as well as build future funds downstream.” This strategy developed from a client of mine who had already given a block of stock outright to a charity, and was looking for a way to enhance the strategy.

Chart 1  
The “Sell It Outright & Bite the Bullet” Strategy™

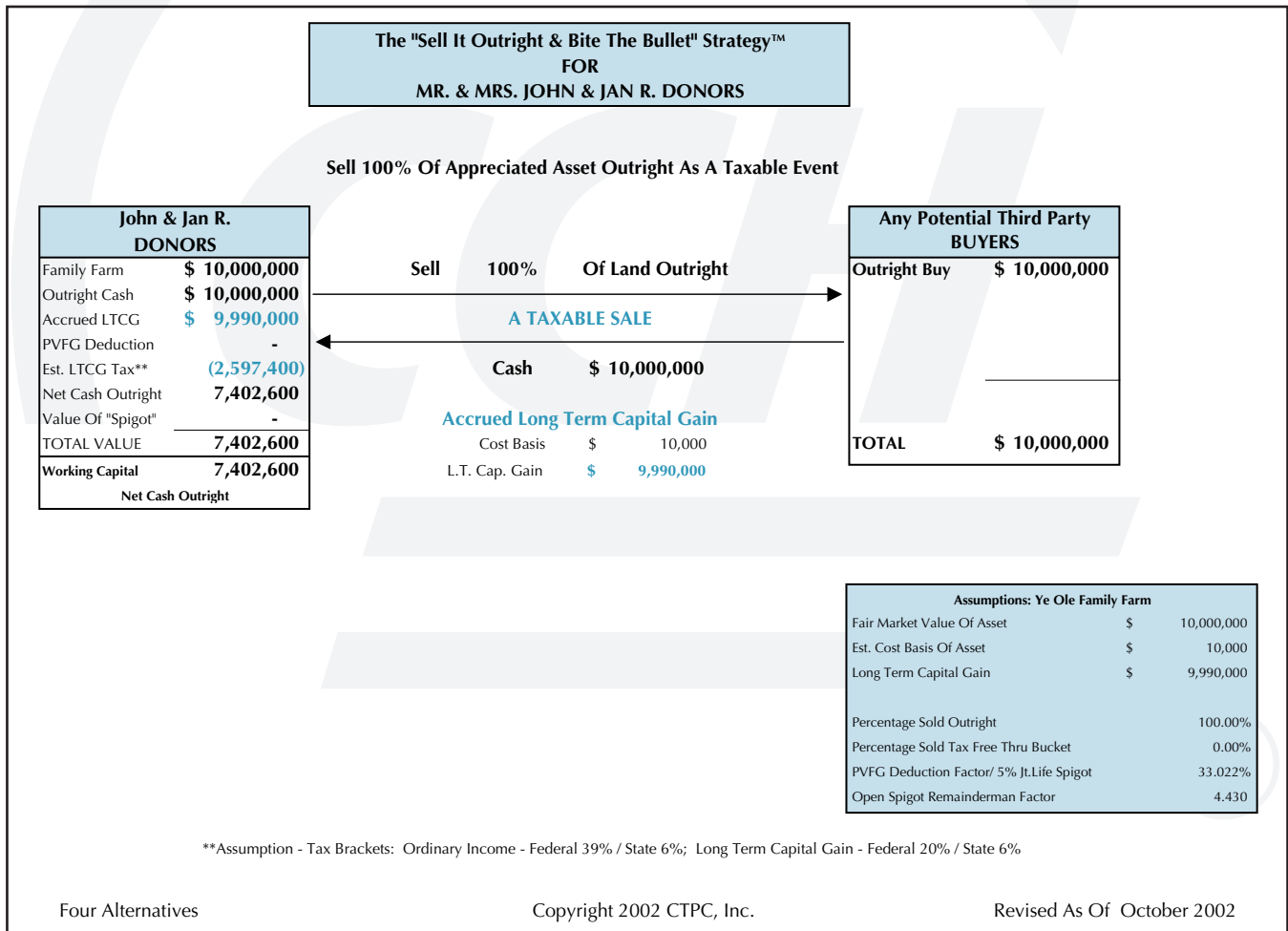
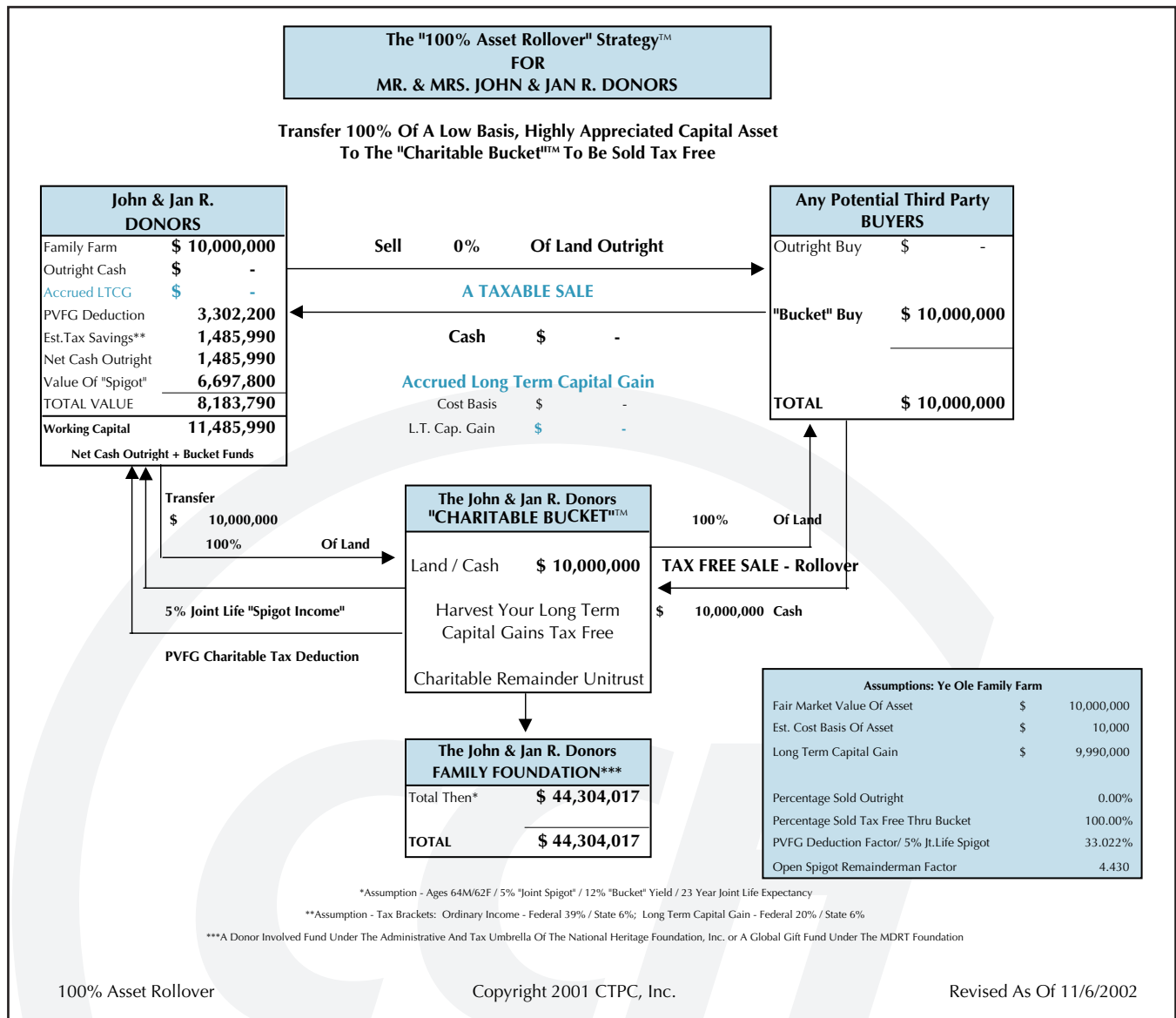


Chart 2  
The "100% Asset Rollover" Strategy™



How about if John and Jan R. Donors were to give 10-percent undivided interest in the land outright to their Family Foundation, which could roll over tax-free because the seller is a tax-exempt charitable foundation (one rollover), and then transfer 90-percent undivided interest in the land into their Charitable Bucket, which could then also roll it over tax-free (the second rollover)? I call this the "Double Rollover" Strategy.

This provides two charitable tax deductions, \$1 million for the outright gift today to the Family Foundation and \$2,971,980 for the PVFG charitable income tax deduction on the transfer to the Charitable Bucket. If they could use up the \$3,971,980 of charitable income tax deductions over a six-year period, that would save

them approximately \$1,787,391 +/- in income taxes. They would also own a Spigot that is actuarially worth \$6,028,020, so their total value owned would be approximately \$7,815,411. How much capital would be working for John and Jan for the rest of their lives? \$1,787,391 outside the Bucket and \$9 million inside the Bucket, for a total of \$10,787,391, and they made a current gift outright today for \$1 million.

This is a powerful strategy that most charitable tax planning practitioners have never considered for their clients. With many of my clients sitting on the boards of directors of colleges, hospitals and churches, the pressure is always on for them to make substantial current gifts today. The solution in many cases is the Double Rollover Strategy.

It's fairly easy once you understand the first three alternative strategies to do a little of all three—sell some outright and accrue the long-term capital gain, transfer some into the Charitable Bucket and give some outright to charity as well.

So if John and Jan sold 20 percent outright, transferred 70 percent into the Charitable Bucket and gave 10 percent outright today to their Family Foundation, what value would they own? They would own \$2,591,093 in taxes saved and a Spigot worth actuarially \$4,688,460, for a total value of \$7,279,553. How much capital would be working for John and Jan for the rest of their lives? \$2,591,093 outside the Bucket and \$7 million inside the Bucket, for a total

of \$9,591,093, and they made a current gift outright today of \$1 million.

One other point that should be made is that these strategies might be an undivided interest in one capital asset—i.e., the farm—or they might involve one asset being sold outright, another asset being transferred into the Charitable Bucket and a third asset being given outright to charity.

In my practice, I always lay all four of these alternative strategies in front of each client who is faced with the long-term capital gains tax exposure on the outright sale of low-basis, highly appreciated capital assets, and then I let him decide. Why don't you try it with your clients too?

Chart 3  
The "Split Sale & Asset Rollover" Strategy™

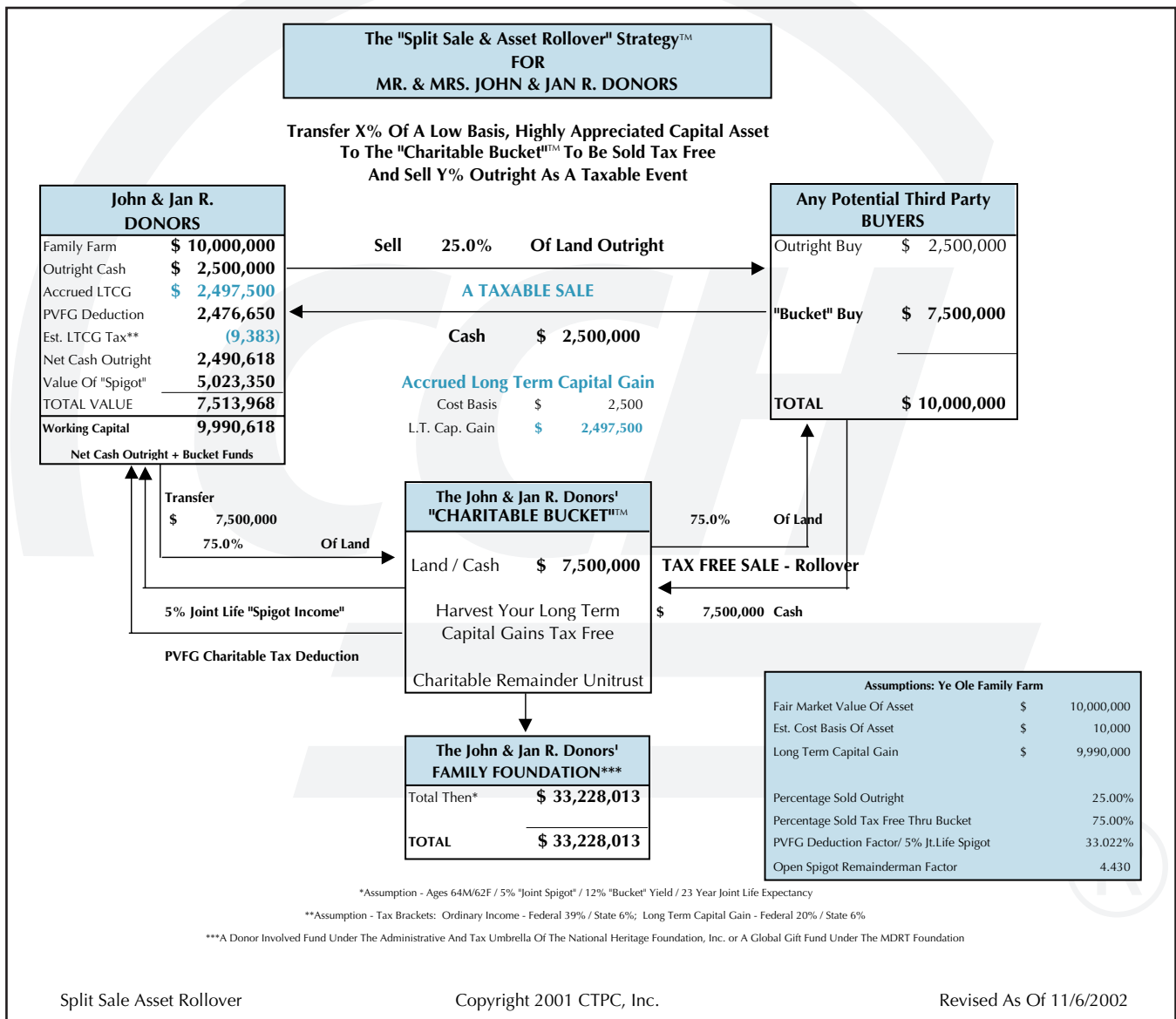
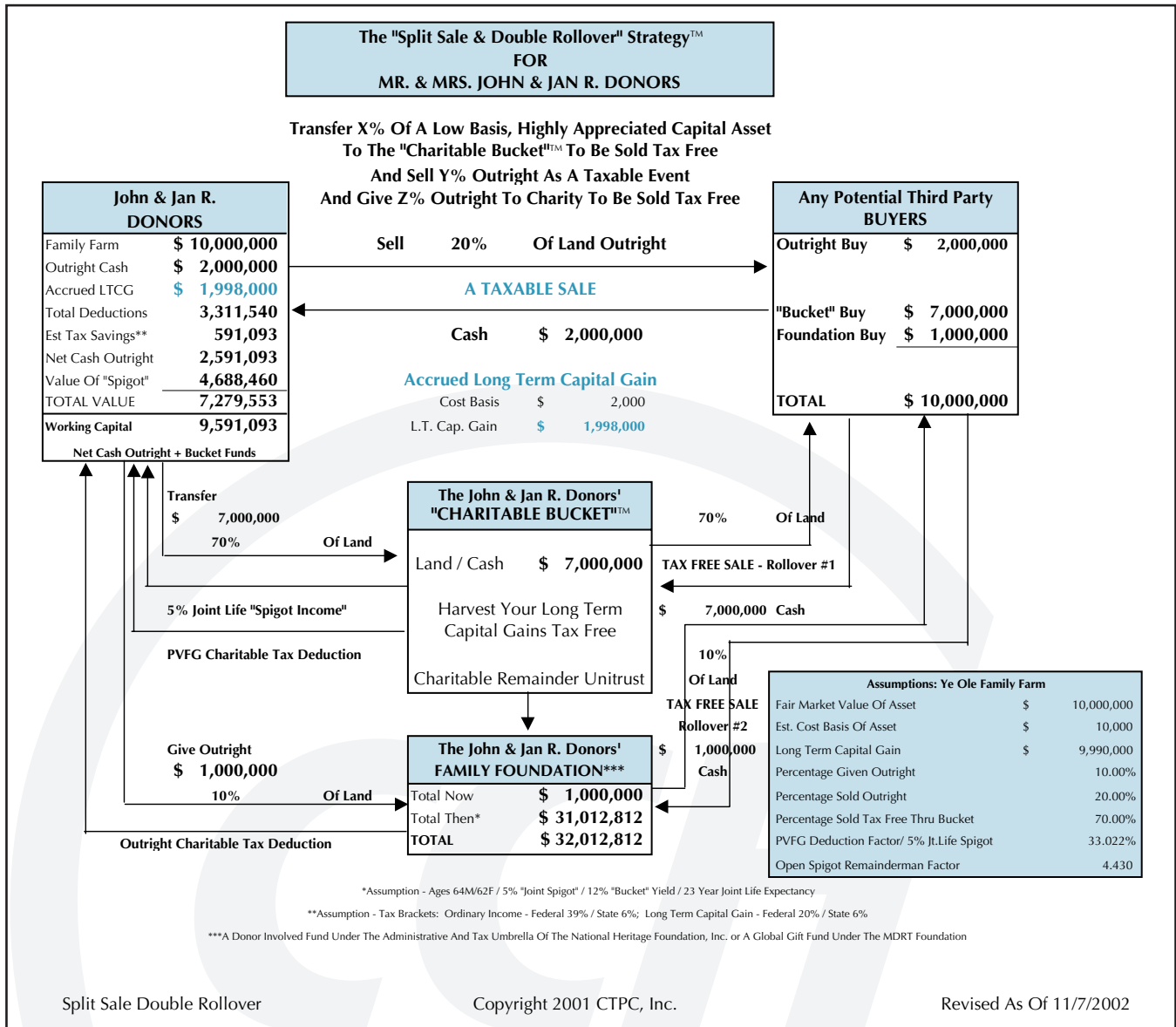




Chart 5  
The "Split Sale & Double Rollover" Strategy™



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