How Working with The Dayton Foundation Can Benefit Clients Who Are Small Business Owners

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Tax and estate planning can be a very satisfying and rewarding career, especially when your efforts benefit not only your clients but also the local community. The opportunity to do charitable gift planning presents these dual rewards, and working with the professionals at The Dayton Foundation makes the charitable planning component a much easier challenge.

Case Example
In my 30 years of tax and estate planning, I have had many opportunities to work with clients in evaluating their charitable giving goals. Such a case arose when I was approached by a client (we’ll call him Ted) who was interested in selling his business after a long and successful career.

Ted’s business was still very profitable and had a bright future, but there was no viable succession plan other than a sale. He was 68 years old and his wife (we’ll call her Tina) was 65. They had two children, Susan, age 36 and a stay-at-home mom, and Bill, age 38 and a middle manager in a large corporation. Ted and Tina (the Turners) were very interested in evaluating their charitable giving options.

The Turners did not have an allegiance to any single charity, so using The Dayton Foundation and benefiting the local community through the Foundation appealed to them. We contacted the professionals of The Dayton Foundation to help us sort through the various options available to the Turners.

Our discussions focused on three primary vehicles: charitable remainder trusts (CRTs), a charitable lead annuity trust (CLAT) and The Dayton Foundation’s Family Foundation Plus-Advised, which is a private foundation alternative.

Weighing Options
With respect to CRTs, we explained to the Turners that they could establish either a Charitable Remainder Annuity Trust (CRAT) or a Charitable Remainder Unitrust (CRUT).

A CRAT would provide Ted and Tina with a fixed-dollar payment for their joint lives. With a gift of $1 million into the CRAT and a $50,000 (5%) annual annuity, the Turners would receive an immediate tax deduction of slightly over $264,000.

A CRUT, on the other hand, would allow the 5% annuity payment to the Turners to fluctuate with the value of the assets in the CRUT. If the asset value increased, the annuity would increase by 5% of the increased value, and if the value decreased, the annuity would decrease by 5% of the decrease in value. This option provides for more risk, since there is a potential for the annuity to decrease. The same $1 million contribution to the CRUT would result in an immediate tax deduction of slightly over $253,000.

Benefits of CLATs
We then moved on to discuss the merits of a CLAT. Under the CLAT option, the Turners would get no annual annuity payable to them, but the annual annuity would be payable to a vehicle that they would establish at The Dayton Foundation. If they funded a CLAT with $1 million, a 5% payout and a 2% Section 7520 rate, which is the February 2009 rate, for 15 years, The Dayton Foundation would receive $50,000 per year for 15 years, for a total of $750,000. The Turners would have the CLAT assets pass to their children at the termination of the CLAT.

If the assets of the CLAT would grow at a 6% rate, the children would receive over $1.2 million at the end of the 15-year term. At an 8% growth rate, they would receive over $1.7 million. One cost of this option is that the Turners would be making a gift to their children at the inception of the CLAT of approximately $353,000.

If the same CLAT were established with a 20-year term, The Dayton Foundation would receive $1 million over the 20-year payout period, and the gift to the children would be approximately $176,000 at the inception of the CLAT. With a 6% growth rate, the CLAT would leave the children over $1.3 million, and with an 8% growth rate, they would receive over $2.3 million.

CLATs can be either grantor or nongrantor trusts. If the 15-year CLAT were a grantor trust, the Turners would receive a charitable deduction of approximately $647,000. For the 20-year CLAT, it would be almost $824,000. The disadvantage of a grantor CLAT is that the Turners would have to pay tax on the future income of the CLAT without receiving any cash.

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from the CLAT. In effect, they would be recapturing part or all of the tax saved from the initial charitable contribution deduction. For a nongrantor CLAT, there would be no charitable deduction at inception, and no requirement for the Turners to pay tax on the annual income of the CLAT.

Private Foundations and The Dayton Foundation Alternative

The Turners always had been intrigued with the idea of having their own private foundation. This option would have required them to hire an attorney to draft the foundation documents. They then would have to apply for exempt status with the IRS, file annual Forms 990-PF; be exposed to an annual 1% to 2% excise tax and be subjected to an annual payout requirement of 5% of net investment assets, not to mention several other administrative issues.

The Dayton Foundation’s Family Foundation Plus-Advised (FF+A) service provides essentially all of the advantages of a private foundation without the disadvantages listed above. (The Foundation does suggest, however, that donors consult their own independent legal and financial counsel prior to opening such a fund.) The FF+A option appealed to the Turners.

Since the Turners did not need the security of a CRT, they decided to pass on that option. However, they did establish a FF+A fund, and prior to the sale of the company, they donated $1 million of their company stock to The Dayton Foundation for their FF+A fund. They received an immediate tax deduction for the $1 million donation and ultimately saved $280,000 in taxes. The stock donation required a valuation that cost approximately $10,000, but this was a small price to pay for the tax that was saved by the charitable donation and for the added benefit of pegging an approximate fair market value for the sale of their company.

When the company was sold, The Dayton Foundation sold the donated company stock to the buyer – and the Turners avoided $210,000 of federal and state taxes on its sale. In addition, they established a 15-year nongrantor CLAT with their FF+A fund as the charitable beneficiary and their children as the recipients of the assets at the end of the CLAT term. They contributed $1 million to the CLAT and provided for a 5% payout at a time when the Section 7520 rate was 2%. During the term of the CLAT, their FF+A fund would receive $750,000, and at the end of the term the children would receive between $1.2 million and $1.7 million, assuming a rate of return between 6% and 8% on the CLAT’s investments. The CLAT also resulted in an immediate gift to the children of approximately $335,000.

When Ted retired from the company, he rolled his 401(K) into an IRA. We made Tina the IRA beneficiary and their FF+A fund as the charitable beneficiary. If Ted pre-deceased Tina, she would have several options, including using the IRA money for herself, disclaiming it to their FF+A fund, making their FF+A fund her beneficiary or making the children her beneficiaries.

The charitable planning in the Turners’ case satisfied a desire to save taxes, as well as providing a benefit to the local community for many years to come.

Note: Solutions will differ from case to case. The above does not constitute professional advice.

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