

WEALTH MANAGEMENT

# Philanthropy & Wealth Stewardship for Affluent Families

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# Charitable Gifts of Difficult Assets: Creating a Win-Win for Charity and Donors

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## GIFT ACCEPTANCE POLICIES

### Charities need to have good policies in place

- Clarifies process so that neither charity nor donor/advisors waste valuable time and resources
- Signals to donors and their advisors that this organization can handle challenging assets

### Gift acceptance policies are a must

- Helps fundraisers to understand parameters
- Gives fundraisers easier way to say “no” to potential bad gift
- Creates discipline in intake and administration of gifts
- Educates staff and board about issues triggered by certain gifts
  - *e.g., costs associated with certain gifts*

### Policies help board members understand and appreciate the nuances of planned giving

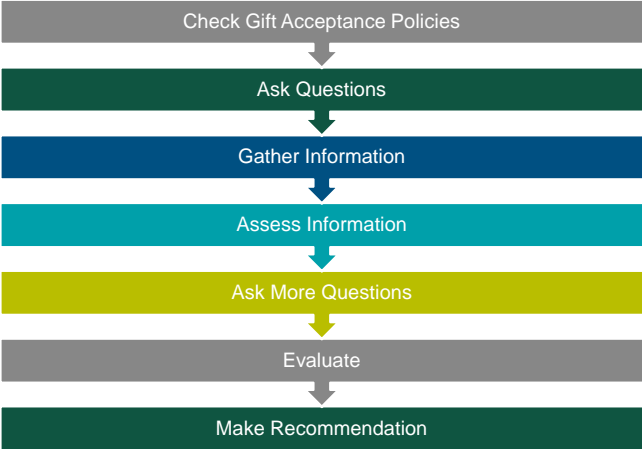
- May even motivate board members to do their own planned gift

## GIFT ACCEPTANCE POLICIES

### Policies lead to better consistency and more objectivity

- Allows decision-making to be made in methodical and objective way when seemingly attractive gift opportunity is being considered
- Less subject to personal opinion and experience
- Creates less confusion for donors
  - *Less mixed signals*
  - *Less mistakes for organization but also less mistakes for donors who may have unsophisticated advisors*

WHEN AN UNUSUAL GIFT IS OFFERED



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# Going “Negative” on Real Estate

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## CASE STUDY #1: DONOR PROFILE & GOALS

**Profile** Mrs. U is widowed, 91, no kids

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Lives in Malibu on an 11.5 acre residential property on a bluff overlooking the Pacific Ocean

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This property is her only major asset and she is finding it difficult to maintain

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She is in need of additional income

**Goals** Mrs. U wants to remain in her home for the rest of her life

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Needs additional funds to pay off obligations and provide living expenses

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Needs assistance in maintaining the property.

Actual gift scenario. Used for illustrative purposes only

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## SOLUTION: RETAINED LIFE ESTATE WITH CHARITABLE GIFT ANNUITIES

### Retained Life Estate:

Allows donor to remain in the home for her lifetime

- Exception to the partial interest rules
- The older the retained life estate holder, the greater the value of remainder interest
- Simple to create
  - *Deed retaining life estate, remainder to charitable organization*
  - *In CA no reassessment for property tax purposes*
- Prudence dictates having a Maintenance, Insurance and Tax Agreement (MIT) to manage expectations of the parties (donor and charity)
- If life estate holder needs to move out of the property (e.g., to go to a nursing home)
  - *Can rent the home (Life Estate holder retains all rental income)*
  - *Can join in a sale with Charity to sell to third party and split the proceeds based on the actuarial value of the interests at the time of the sale*

### Charitable Gift Annuity:

A gift of the remainder interest used to fund three charitable gift annuities (CGAs)

- 1 current CGA
- 2 deferred CGAs
- Under CA law, charity will need to set aside liquid assets (not the residence) into a segregated account as added security to the annuitant
- Remember, the charity is coming out of pocket during the lifetime of the donor to pay the annuities because it cannot sell the property to provide the annuity

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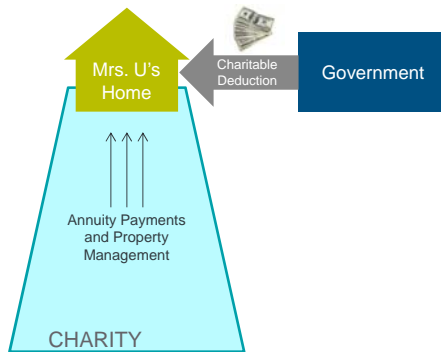
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## CASE STUDY: PERSONAL RESIDENCE REMAINDER INTEREST GIFT

*Starting Situation: Mrs. U needs funds for living expenses & other obligations. Residence is extremely valuable but she wishes to continue living in it.*

**Solution: Mrs. U transfers remainder interest in property to charity, receives charitable deduction & remains in home.**

- Mrs. U receives 1 gift annuity & 2 deferred gift annuities
- Charity voluntarily maintains property
- Upon Mrs. U's death, home passes to charity



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# Getting a Donor Out of an LLC Without Getting Stuck In It



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## CASE STUDY #2: DONOR PROFILE, GOALS & SPECIAL ISSUES

### Profile

Mrs. R is 78, a long-time supporter of charity and has been involved in a family business for many years

Wants to retire from her duties as staff "matriarch"

Business is held in Limited Liability Co. form

Assets are orange groves, oil wells, golf course and undeveloped property

### Goals

Mrs. R wants to exit without paying substantial capital gains tax

Doesn't want to burden the LLC with a buyout which will drain capital and cause financial stress

Wants to make substantial gift to charity

Wants an assured, fixed income

### Special Issues

LLC's income is by nature, unrelated business taxable income, and back then precluded use of a CRT. Now, all UBTI in CRT is taxed at 100%

LLC is a closely held business and as such Charity is concerned about the ability to sell a gift of any interest in the LLC

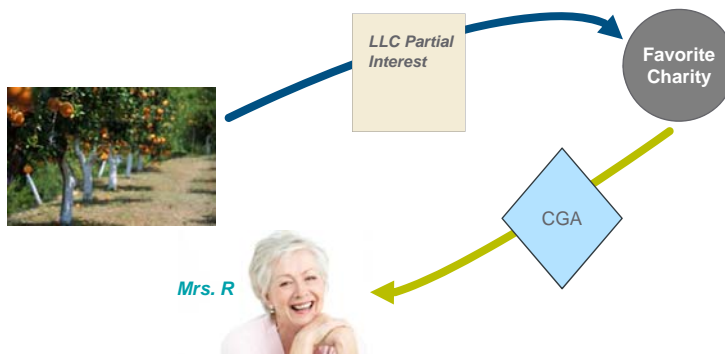
Rest of family is not interested in having charity as a partner

Actual gift scenario. Used for illustrative purposes only  
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## MRS. R & THE LIMITED LIABILITY COMPANY

*Starting Situation: Mrs. R is part-owner in a family business organized as an LLC which owns oil wells, orange groves, land, and a golf course. Mrs. R wants to step down as the matriarch and convert her illiquid asset into an income producing asset for her retirement years.*

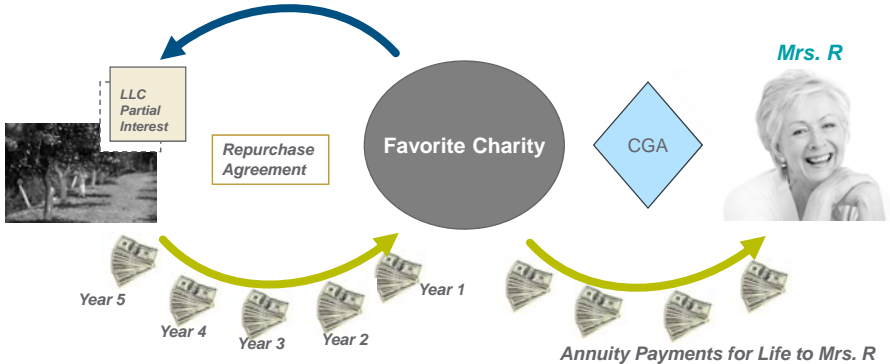
1. Other LLC partners can't afford to buy out Mrs. R's interest
2. Instead, Mrs. R. donates her share of the LLC to Charity in exchange for a CGA which will provide a steady, guaranteed income.



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MRS. R AND THE LIMITED LIABILITY COMPANY (CONT'D.)

3. Final Situation: Mrs. R receives regular income from Charity via CGA. Meanwhile, the LLC repurchases Mrs. R's former interest back from Charity through a 5-year note



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# When a Donor's Neighbor Keeps a Parking Slot for the EPA Auditor

# CASE STUDY #3: DONOR PROFILE, GOALS & DUE DILIGENCE ISSUES

<b>Profile</b>	Mr. F, aged 85, is a retired bachelor
	He has made a request for proposal for a Charitable Gift Annuity, funded with commercial property located on Ventura Blvd. in Sherman Oaks, a prime retail/office location
<b>Goals</b>	Mr. F is exclusively interested in a CGA
	He is willing to accept a payout amount which will be substantially less than the current income stream generated from rents
<b>Due Diligence</b>	Major tenant's lease was about to expire
	Adjacent property is defunct gas station with visible underground storage tank caps. Tanks and contaminated soil had been removed, but case was still open for groundwater contamination
	Other adjacent property is operating car wash. Suspect for solvent use

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# CHARITABLE GIFT ANNUITY USING PROPERTY WITH APPARENT ENVIRONMENTAL ISSUES

*Starting Situation: Mr. F contacts Charity and makes a request for CGA proposal using his prime commercial property in Sherman Oaks. Mr. F is 85, retired, and a bachelor.*

Unless we're talking CGA, I don't want to even hear about it!



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## CHARITY'S FINDINGS DURING DUE DILIGENCE

The major tenant's lease was about to expire.

Adjacent neighbors are:

- **A defunct gas station with visible UST caps**
  - USTs and contaminated soil have been removed, but case is still open due to groundwater contamination
- **A working car wash**
  - Suspect for solvent use



## WOULD YOU TAKE THIS GIFT?



## RESEARCH FINDINGS ON RESPONSIBILITY OF AND RISK TO ADJACENT PROPERTY OWNERS



### PROS

- Environmental Protection Agency (EPA) will not sue buyers of contaminated property in certain cases (1993 Fed Register Article)
- EPA policy statement offers relief to "innocent" owners of land overlying contaminated aquifers (1995)
- Local agencies offer statements of comfort of non-pursuance
- An environmental insurance company opines that liability is unlikely
- Legislative trends favor protection of adjacent landowners

### CONS

- EPA advises to NOT acquire the property

## CHARITY DID.

*11 reasons why...*

1. No known contamination under property
2. No known contamination by current or historical owners
3. Property improvements have covered soil since 1924
4. Prior and current uses are "clean"
5. "Dirty" neighbors are deep pockets
6. Not a superfund site
7. EPA and RQWB practice indicates stance of non pursuance
8. Availability of affordable liability insurance
9. Area is low priority for regulators
10. Property is valued at almost \$1MM. Expect quick sale
11. Title will be isolated to a supporting organization

# DAFs, Private Foundations and CLTs: When to Use and Why

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## VEHICLES USED BY HNW DONORS

### \$3M-\$25M net worth segment

Typical planned giving vehicles

- CRTs
- CGAs
- CLTs
- Outright Gifts (with restrictions usually)

### \$25M +



Typically do not use planned giving vehicles (except CLTs)

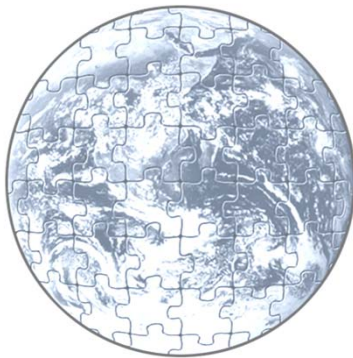
- Private Foundations
- Donor-Advised Funds
- Combination of the two

# A Quick Primer on the World of Charities

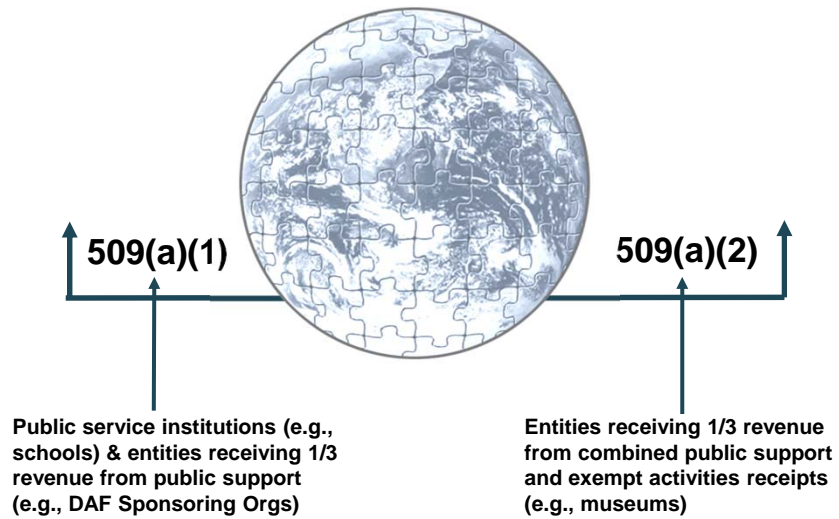
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## WORLD OF CHARITIES



## THE MAJORITY OF PUBLIC CHARITIES ARE...

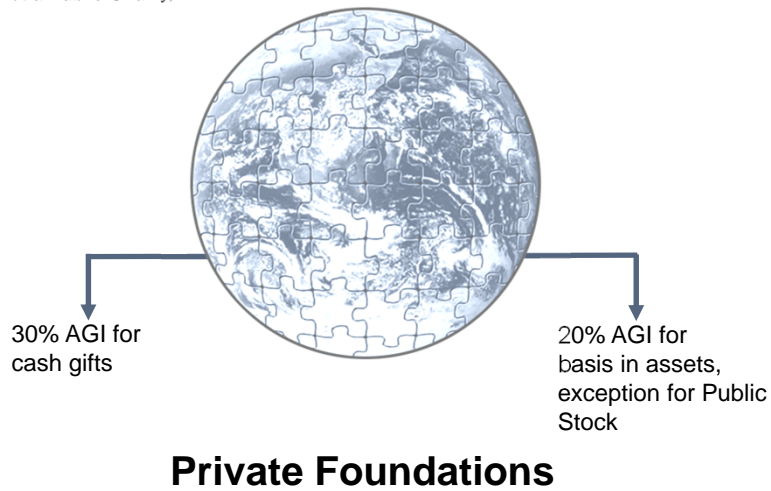


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## IRC SECTION 509(A) DEFINES PUBLIC CHARITIES

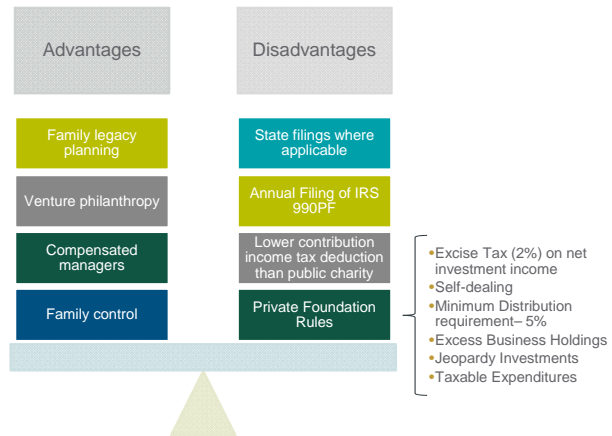
*If it is not a Public Charity, then it is a Private Foundation.*



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## ADVANTAGES & DISADVANTAGES OF PRIVATE FOUNDATIONS



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## DONOR ADVISED FUNDS FEATURES

- **Simple to administer: No start-up costs, no excise taxes, no IRS tax filings, no required payouts**
- **Name account after their family, company, in memory of someone, or after a specific cause**
- **Immediate tax deduction, maximum tax benefit**
- **Flexible grant-making – can receive recognition or make anonymous grants**
- **The potential to give more over time – e.g., delaying distributions provides time for investment returns to accumulate**
- **Ability to create a legacy**
- **Can only recommend grants and investments**

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## DONOR ADVISED FUNDS



- Irrevocable contribution of a minimum amount (typically \$5,000 to \$50,000 in cash or marketable securities); subsequent contribution typically of \$5,000 or more.
- Immediate tax deduction.

- Recommend grants to qualified charities. (Minimum: Generally, \$250 per grant)

Note: Contributions to DAF Sponsoring Organization are irrevocable, and DAF Sponsoring Organization has final approval over all donor grant recommendations. Grant and investment recommendations are subject to the terms and conditions of DAF Sponsoring Organization's articles of incorporation and bylaws. DAF Sponsoring Organization's Board of Trustees reserves the right to modify the program at any time.

## PRIVATE FOUNDATIONS



- Irrevocable contribution of marketable securities or cash. Other assets –donor limited to basis as measure of income tax deduction so donors don't usually contribute to private foundations.
- Lower AGI limitations for gifts to Private Foundation
- Immediate tax deduction.

- Annual filing of 990PF
- Excise tax of 1-2% of net investment income
- Minimum distribution of 5% of value of investment assets annually
- Restrictions on transactions between PF and disqualified persons

- Control of grant-making and investments

## DONOR ADVISED FUND VS. PRIVATE FOUNDATION

	DONOR-ADVISED FUND	PRIVATE FOUNDATION
<b>Immediacy</b>	On average, can be established within a week	On average, a month or greater
<b>Start-up Expenses</b>	None	Significant legal fees and other start-up expenses
<b>Excise Taxes</b>	None	1–2% of net investment income annually
<b>Tax Deductions for Cash Gifts</b>	FMV at 50% of AGI	FMV at 30% of AGI
<b>Tax Deductions for Stock or Property</b>	30% of adjusted gross income (or basis up to 50% of AGI at the donor's election)	20% of AGI (FMV for marketable securities, basis for all other non-cash contributions)
<b>Required Payout</b>	None	5% of net asset value annually
<b>Privacy</b>	Donor's identity can be kept confidential if desired	Must file detailed and public tax returns on grants, fees, salaries, etc.

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## WHY WOULD A FAMILY USE A DAF OVER A PRIVATE FOUNDATION?

### Too busy to run another “business”

- Desires simplicity
- May have a need for greater privacy
- Funding asset issues for Private Foundation
  - Lower AGI limitations for PF v. DAF
  - Measure of Deduction lower if non marketable securities or cash used to fund PF
- Can build up the DAF over time without requirement of 5% distribution
- No administrative duties
- Administrative cost for DAF is less than costs for Private Foundation

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## WHY WOULD A FAMILY CHOOSE A PRIVATE FOUNDATION OVER A DAF?

- **Control, Control, Control**
- **Private Foundation can last in perpetuity—many DAFs have a limit on how long the fund can last**
- **Ability to manage investments**
  - *Although some DAF sponsoring organizations allow donors to use personal investment advisors*
- **Flexibility in grant “investments”**
  - *Mission and Impact Investing*

## CHARITABLE LEAD TRUSTS

- **Charitable lead trusts are the reverse of charitable remainder trusts, because the charity is the upfront beneficiary**
- **Under a charitable lead trust**
  - *Payments are made from the trust to the charity for a set term of years or for the life of a family member*
  - *Followed by distribution of the balance of the trust property at the end of the term or on the family member's death to non-charitable beneficiaries (family members, friends)*

## CHARITABLE LEAD TRUSTS

**Charitable lead trusts are used when the non-charitable beneficiaries will not need trust assets now.**

**Charitable lead trusts are attractive if the property has great appreciation potential.**

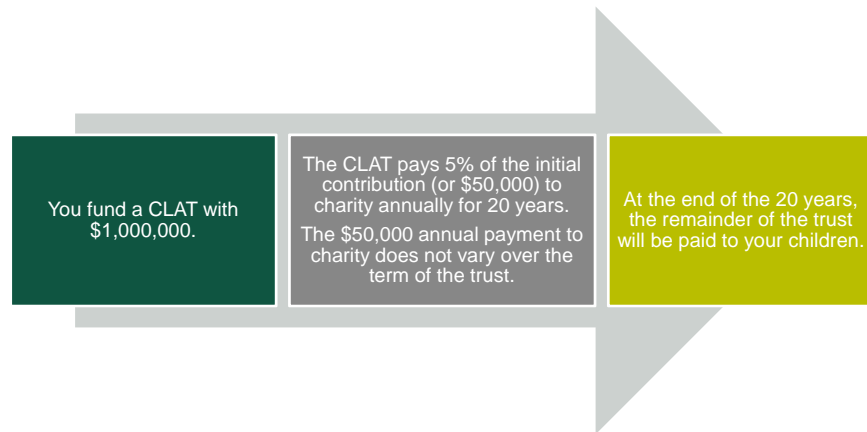
**Charitable lead trusts are almost exclusively an estate planning tool to move assets inter-generationally at a lower transfer tax cost.**

## TYPES OF CHARITABLE LEAD TRUSTS

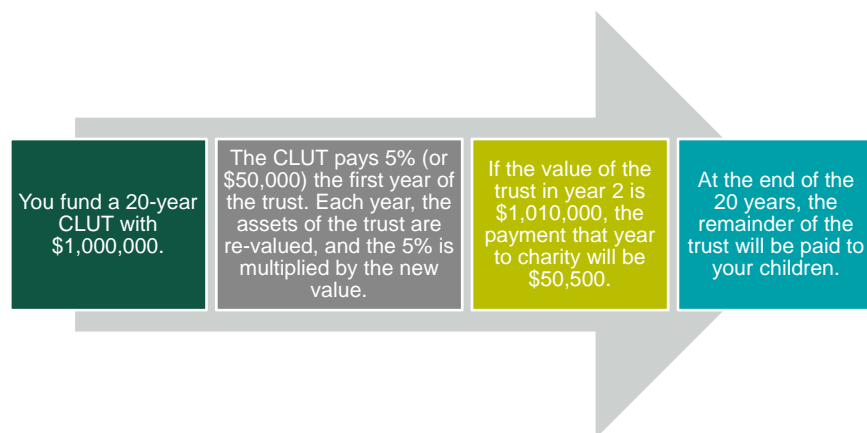
**Charitable Lead trusts can be either:**

- Annuity trusts setting a fixed amount for the annual distributions (or payments) to charity ("CLATs")
- Unitrusts paying a percentage of the annually revalued trust assets to charity ("CLUTs"). Variable payments as opposed to fixed payments.

## CHARITABLE LEAD ANNUITY TRUST EXAMPLE



## CHARITABLE LEAD UNITRUST EXAMPLE



## NON-GRANTOR LEAD TRUSTS

- Grantor does not receive an income tax charitable deduction.
- Grantor is not taxed on the income of the trust.
- Estate planning tool: trust designed to pass wealth to next generation with less transfer tax because the value of the remainder is based on the applicable federal rate, which assumes very limited appreciation of the trust's assets. The taxable gift is thus assigned a discounted value.

## GRANTOR LEAD TRUSTS

- **Grantor receives an income tax charitable deduction upon creation of the trust based on the value of the charitable lead interest**
- **Grantor retains a power over or right in the trust which causes him/her to be treated as owner of the trust's income for tax purposes**
  - Grantor retains reversionary interest
  - Grantor retains certain administrative powers:
    - *Right to substitute trust assets*
    - *Right to borrow from the trust*
- **Grantor is taxed on the trust's income without receiving any distributions (i.e., "phantom income")**
- **Even better estate planning tool because it gives the grantor an income tax charitable deduction up front... if donor doesn't mind paying tax on phantom income**
- **"Free gift" to remainder beneficiaries**

## CHARITABLE LEAD TRUSTS - TYPES

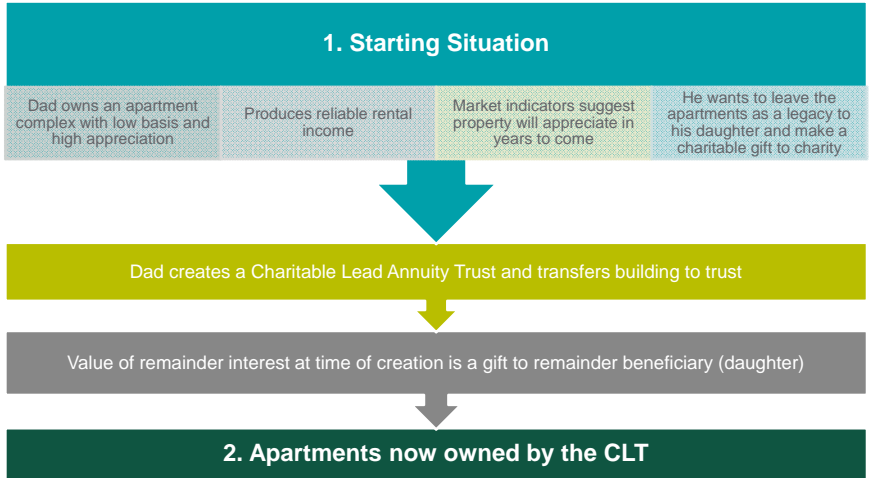
	Charitable Lead Annuity Trust	Charitable Lead Unitrust
<b>Grantor</b>	Income tax deduction Income taxed to Grantor	Income tax deduction Income taxed to Grantor
<b>Non Grantor</b>	No income tax deduction Income taxed at trust level, but trust offsets income with a charitable distribution deduction for annuity payments	No income tax deduction Income taxed at trust level, but trust offsets income with a charitable distribution deduction for unitrust payments
<b>GST Allocation</b>	Inclusion ratio determined at termination of trust	Inclusion ratio calculated at inception of trust
<b>Payment Amount Determined By</b>	Fixed % of asset value as of date of creation	Fixed % of value of assets revalued annually; no net income provision allowed
<b>Minimum Payout %</b>	None	None
<b>Maximum Payout %</b>	None	None

## MORE ABOUT THIS VEHICLE

### Who needs Charitable Lead Trusts?

- Donor who wants to make transfer to next generation at low transfer cost (usually a non-grantor trust)
- Donor who needs an income tax deduction for a "bubble year" of income (Grantor Trust)
- Donor who has desire to make charitable gifts but has maxed out his/her percentage limitation for charitable gifts
- Donor who has asset that is likely to appreciate over the term of the trust in excess of the 7520 rate
- Donor who has an asset that is not designed to sell, but to move to next generation

# HOW A CHARITABLE LEAD TRUST (NON-GRANTOR CLT) WORKS AS A WEALTH TRANSFER TRUST



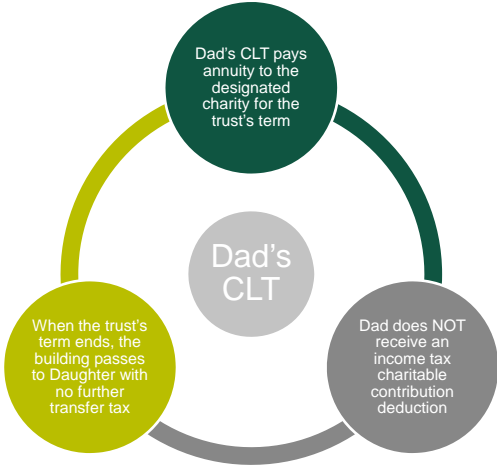
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# HOW A CHARITABLE LEAD TRUST (CLT) WORKS

## 3. Dad's CLT manages the apartments and pays income to the designated charity.



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# Thank You.



## BIOGRAPHY



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"Families who successfully maintain shared wealth over multiple generations do things differently; they are intentional in fostering good communication, trust and preparing their heirs."

### EXPERTISE

Claudia B. Sangster is the Director of Family Education and Governance in Wealth Management at the Northern Trust Company. In this role she designs the firm's advisory capabilities in financial education, family decision-making, and relationships around money and wealth. Claudia collaborates with clients, their advisors and Wealth Planning partners in identifying and establishing appropriate educational programs and governance structures for multi-generational families in order to prepare family members to steward the wealth, to enhance family unity and to help sustain all aspects of the family's capital—financial, intellectual, human and social. She works with families to create their legacy of wisdom, wealth and giving through multiple generations.

### EXPERIENCE

Claudia has over 30 years of experience in advising individuals and families in financial education, estate planning, family governance and philanthropy. Prior to joining Northern Trust, Claudia was with CTC | myCFO, where she served as the Director of Philanthropy, Estate and Trust Services.

### EDUCATION

Claudia earned a Bachelor's degree, Summa Cum Laude, from Pepperdine University, and a JD,

Magna Cum Laude, from the University of Houston, College of Law.

### CREDENTIALS

Claudia is a frequent speaker and author on topics including values, finance and family legacy, as well as trends in family education, governance and philanthropy.

### COMMUNITY INVOLVEMENT

Claudia is a Founding Partner of Social Venture Partners in Los Angeles, current Board Chair of the Associated Women for Pepperdine, current board member of the Prostate Cancer Research Institute of Los Angeles, Advisory Board member Emeritus of the Preston Robert Tisch Brain Tumor Center at Duke University Medical Center and Chairperson of the Board of Trustees of the Nicholas Endowment.

### 3 THINGS PEOPLE ASK ME

- How and when do I talk to my children about our wealth?
- How do I raise my children in wealth without fostering entitlement?
- What does our family need to do to maintain our family business over multiple generations?

## DISCLOSURE

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