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BUSINESS EXIT STRATEGIES: ADDING PHILANTHROPY TO THE MIX

Northern California Planned Giving Council

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- OUR FOCUS
- THE BASICS
- SOME ADVANCED PLANNING TECHNIQUES
  - Charitable Remainder Trust
  - Charitable Lead Trust

- CHARITABLE INCOME TAX DEDUCTION ISSUES
- PUBLIC CHARITY OPTIONS
- PRE-ARRANGED SALES
- APPRAISAL ISSUES
- UNRELATED BUSINESS INCOME TAX (“UBIT”)

CHARITABLE INCOME TAX DEDUCTION ISSUES

- Must donate to public charity to get deduction equal to fair market value of closely held business interest
- Public Charity Options
  - Operating Charity
  - Donor Advised Fund
    - Watch Excess Business Holdings
  - Supporting Foundation
  - Charitable Remainder Trust ("CRT") or Charitable Lead Trust ("CLT")
    - Charitable beneficiaries must be public charities

- Push: Make a gift to charity as close to liquidity event as possible
  - Will also increase value of gift
- Pull: Need to avoid the pre-arranged sale problem
- What is the issue?
- What is the legal test of a pre-arranged sale?
  - At the time of the gift, is the donee legally obligated to sell the interest?
  - At the time of the gift, is the liquidity event substantially certain to occur?

- Qualified Appraiser Requirements
  - Qualified Appraiser
  - Date Range
  - Submit with income tax return
- How does pending transaction affect value?

- Definitions: what is UBI?
  - S Corporation Stock
  - LLCs/LPs Operating An Active Business
  - LLC/LP's Owning Debt-financed real estate
- Why do we care?
  - Must run the numbers to see if it is more advantageous to gift business interests or sales proceeds (cash) if gift will be of anything other than C Corporation Stock
  - CRTs are not permitted S Corp shareholders
  - The negative tax effects of any UBI are quite substantial for CRTs and non-grantor CLTs (explained below)

THE BASICS

- Unitrust / Annuity Payment to Family Members
- Charitable Remainder Beneficiary
- Why a CRT?
- Calculating the Charitable Income Tax Deduction
- Use a NIMCRUT to Deal with Cash Flow Issues
- Caution: Avoid UBI!
- More Tips and Traps Later

- The opposite of a CRT
  - Charitable Lead Payments for Term of Years
  - Remainder to Heirs
- Why a CLT?
- Irrevocable Future Gift to Heirs (Gift Tax Consequences) and to Charities (May Be Deductible)
- Two Flavors
  - Grantor
  - Non-Grantor

GRANTOR TRUSTS:

- Grantor Gets Charitable Income Tax Deduction
  - Equal to Present Value of Stream of Annuity Payments to Charity
  - Recapture
- Grantor Pays Capital Gain on Sale of Business Interests
  - And on Net Income of Trust Thereafter
  - A Way to Increase Remainder Going to Heirs

NON-GRANTOR TRUSTS:

- No Charitable Deduction for Grantor
- Trust Is Separate Taxpayer
- Unlimited Charitable Deduction
  - Up to Total Income for Year <u>Minus</u> Unrelated Business Income
  - No Carry Forward

CASH FLOW / TIMING ISSUES:

- Don’t want to have to pay annuity with business interests
- Therefore, hold off on gift
- Assignment of income not a problem
- But: valuation issues push towards early gift

WHAT'S THE PROBLEM?

- CLTs and CRTs Subject to Some Private Foundation Rules
- With Few Exceptions, Can't Enter Into Transactions with "Disqualified Persons"
  - Donor
  - Family Members
  - 35% Owned Business

- PRACTICAL APPLICATIONS
  - Sale of business Interests and exit strategies
  - Donor’s binding pledge
  - Appraisal adjustment issues
  - Company’s payment of salary to disqualified person
    - Only if CRT / CLT Controls the Company

- Think about philanthropy early in the process
- There is no substitute for “running the numbers” for various alternatives
- Only engage in philanthropic planning if the family is motivated by philanthropy
  - Tax-savings motivation alone is never sufficient
- Be sensitive to desires of family members to engage – or not engage—in philanthropy