TELEMUS®

Charitable Giving & Your **Financial Legacy**

When you pass away, your wealth will go to taxes, your loved ones, and the organizations you care about. In this whitepaper, we show you how charitable giving can help maximize the financial legacy you leave behind.

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www.telemus.com

Why do we give?

We give because we can. We give because we want others to benefit from the blessings in our lives. We give to show our gratitude. We give so that our success can have a greater meaning. We give to strengthen our bonds within our community, to leave a meaningful legacy for future generations of our families.

There are a number of reasons why we give. Telemus Charitable helps people create a charitable strategy to maximize the impact of their giving and leave a financial legacy they can be proud of.

Charitable giving is one of many ways you can use your wealth. And like any other intended use for your wealth, your charitable giving ties back to your overall financial strategy and goals.

At Telemus, we practice Financial Life Management, an approach that embodies how your entire life works with your current and future financial resources. We believe that helping our clients reach their financial goals means integrating all areas of their financial life, and charitable giving is a key facet of the broader wealth management solutions we build for our clients.

How to use this whitepaper

In this whitepaper, we explore a variety of different approaches to charitable giving and explain how you can utilize these strategies to maximize the value of your philanthropic efforts.

Please note that the assumptions within this whitepaper are based on rates at the time of writing and the specific needs of the client. These factors change with market environments and family dynamics, and we invite you to consult with an Telemus advisor for a personalized recommendation.

Meet the Johnson Family

Throughout this whitepaper, we will demonstrate the real-world application of various charitable giving strategies using a hypothetical family: the Johnson family. We will share a bit about their financial life, then show how charitable giving has helped them create a financial and philanthropic legacy that will endure long after they are gone.

George Johnson *(age 69)* & Mary Johnson *(age 68)*

George and Mary Johnson are both retired. George spent 45 years at a major mechanical engineering company, eventually rising to the rank of COO, while Mary worked in corporate law. **They have two children (ages 37 and 42), as well as three grandchildren (ages 10, 13, and 15).**

Assets

George and Mary have a combined net worth of over $26 million. George's salary at his former employer included a generous executive compensation package, and the value of his company stock has grown substantially over the years. Mary's portfolio also has substantial gains, thanks to early investments in Apple and John Deere.

The couple has IRA accounts worth a combined $4 million, and they have determined that they do not need the income from these accounts to fund their retirement.

George & Mary also own two homes and four rental properties free of all debt.

Financial Goals

George and Mary have four major financial goals:

1. **Give a significant gift towards education-oriented charities**
2. **Secure a meaningful financial legacy for future generations of their family**
3. **Completely eliminate their estate tax burden**
4. **Secure an annual income of $300,000, with regular increases to account for inflation**

A Multi-Pronged Approach

George and Mary's financial goals are ambitious. Given their high net worth, reaching these goals requires a careful and considered approach to ensure they meet their philanthropic objectives and preserve wealth for their children and grandchildren, while still retaining enough money to remain financially comfortable for the rest of their lives.

We worked with George and Mary to craft a custom strategy with their unique objectives in mind. Our approach combined a variety of different philanthropic and estate planning strategies that allowed us to check off each item on their list of objectives while minimizing their estate tax burden and maximizing the impact of their giving.

Charitable Remainder Trust

Since George and Mary have a significant amount of wealth in appreciated real-estate assets (their rental properties) that are free of all debt, we helped the couple establish a Charitable Remainder Trust (CRT). In a CRT, donors contribute cash or other assets to the trust, and the trust makes annual payments to non-charitable beneficiaries—George & Mary, in this case—throughout the life of the trust. Upon their death or the dissolution of the trust, the remaining value will be donated to the charitable organization(s) of their choosing.

Under normal circumstances, if the Johnsons sold their rental properties rather than contributing them to the trust, the sale could potentially be subject to capital gains tax, and any prior tax deductions they received for depreciation on those properties could be "recaptured" as ordinary income. However, real estate that has been donated to a charitable trust can be sold without being subject to taxation on sale.

The terms of the CRT are as follows:

Trust term: Life

Initial funding amount: $6,000,000 in highly-appreciated real estate

Potential charitable deduction: $2,300,000

Annual rate of payout to George & Mary: $300,000

Assuming a 5% annual growth rate and assuming George and Mary both live for another 20 years, here is how that $6 million will have been allocated upon their passing:

Total amount paid to beneficiaries: $6,000,000

Remainder donated to charity: $6,000,000

Long-term capital gains tax savings: $450,000

Total income tax savings from deductions: $821,623[1]

IRA Maximization

George and Mary have determined they do not need the IRAs (worth a combined $4,000,000) to fund their retirement. However, they would prefer not to leave the IRAs to their children; inherited IRAs are taxed as ordinary income, and combined with estate taxes, that could mean their heirs would be taxed at a rate of 70% or more on the inherited IRAs.

Together, we decided that the best approach was to use the value of the IRAs to purchase a $10 million "second-to-die" life insurance policy. With this policy, the $10 million death benefit will be paid to George & Mary's children—tax-free—after both spouses have died, which is a huge step towards securing a meaningful financial legacy for future generations of their family.

Charitable Lead Trust

The significantly appreciated stock in George & Mary's portfolios presents a tax planning challenge, since cashing out their shares now would create a significant capital gains tax hit. And since George & Mary expect their stock to only continue increasing in value, we decided to set up a Charitable Lead Trust (CLT) to maximize the benefits of their appreciated stock.

The structure of a CLT is essentially the same as that of a CRT, with two key differences. A Charitable Remainder Trust means the charitable organization receives the remainder of the trust's value upon the dissolution of the trust; in a Charitable Lead Trust, however, the charity of their choice receives the annual payouts, and the remaining amount goes to the non-charitable beneficiary. More importantly, unlike CRTs, CLTs are subject to income tax: the grantor or trust must pay taxes every year.

[1] Assumes George & Mary are in the 35% marginal tax bracket

By donating their appreciated assets to the CLT, George & Mary create an opportunity for the value of those securities to continue to grow while in trust. Best of all, George & Mary can use their gift tax exemption to cover the value of the beneficial interest, which means that any excess appreciation will not count as part of their estate and can be passed to the next generation without incurring estate taxes.

The terms of the CLT are as follows:

Trust Term: 20 years

Funding amount: $2,000,000

Annual Rate of Payout to Charity: 5%

IRS Section 7520 Interest Rate: 3.8%[2]

First Year Payment to Charity: $100,000

In addition, the couple used part of the annuity payout to fund premiums on an additional $1 million life insurance policy, payable to the trust upon the death of the second spouse.

Total amount paid to charity: $2,201,900[3]

Amount left to family: $3,440,380 *(includes $1,000,000 insurance death benefit)*

Long-term capital gains tax savings: $150,000

Total income tax savings from deductions: $273,874[4]

Donor Advised Fund

The previous year, George and Mary had an unprecedented high-earning year, and to help reduce their tax burden, we helped them set up a Donor Advised Fund.

Donor Advised Funds (DAFs) offer a way to use your estate to support philanthropic causes. DAFs are funded with cash, securities, and other assets, and contributing to a DAF allows you to take a tax deduction at the time of the contribution. Upon your death, the assets are donated to the charity of your choosing.

[2] As of August 2022
[3] Assuming 5% annual growth
[4] Assumes George & Mary are in the 35% marginal tax bracket

With a DAF, you can deposit assets to be donated to charity over time. The account is managed by a sponsoring organization, and as the donor, you recommend how to invest those assets and where they should be donated (almost any IRS-qualified public charity can be a recipient).

The couple donated $500,000 of appreciated stock to the DAF, with plans to donate $50,000 in subsequent years. By doing so, they were able to bolster their charitable giving while avoiding recognizing a capital gain on the stock and lowering their effective tax rate for the year.

In 20 years, here are the estimated results of their donations to the DAF:

Annual rate of payout to charity: 5%

Total contributions: $1,500,000

Income tax savings through charitable deduction: $525,000

Total grants to charity: $1,179,206

Investment growth: $1,655,745[5]

Total amount available to grant: $2,834,950

Creating a DAF lowered the couple's tax burden by an average of $26,250 per year[6], and investment growth could nearly double the amount they ultimately donate to charity.

After creating the DAF, George & Mary decided they wanted greater flexibility in how their charitable donations can be allocated than a DAF can offer. As a result, they plan to set up a private family foundation in the near future, which will give them many of the same benefits of a DAF, but with a greater degree of control over how the funds are managed and to whom grants are issued.

[5] Assuming 5% annual growth
[6] Does not include capital gains tax savings on appreciated assets.

The Results

After implementing all these strategies, the Johnsons' net worth was reduced to $14 million. The couple also plans to set up a family LLC as a vehicle to gift more assets to their children, and between now and the end of 2025, they intend to gift enough assets to bring their net worth below the estate tax exemption threshold. And with the CRT paying an annual income of $300,000, the rest of their net worth will go towards enhancing their strategic goals and protecting against inflation.

Thanks to some patient planning and strategic use of charitable vehicles, George & Mary are now in a position to live out their remaining years to the fullest, secure in the knowledge that they have achieved all four of their major financial goals.

Closing Thoughts

Although hypothetical, the Johnson family's goals and financial picture are representative of the clients we work with: high-net-worth individuals and families who have worked hard to build their wealth and want to leave a robust financial and philanthropic legacy for future generations.

Telemus Charitable works with you to help you define your philanthropic and financial legacy goals. With strategic planning and a careful approach, we can help you maximize the benefits of your charitable giving — not just for the charities you support, but for your family as well. If you're ready to discuss your charitable planning strategy, we encourage you to get in touch with our team.

Your financial legacy can be a powerful force for good. *Telemus Charitable can help you build it.*

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