



**Steve Marken, Esq., C.S.P.G.,
Vice President
Foundation for Christian Stewardship**

Prior to joining FCS, Steve served the past 4 ½ years as Director of Gift Planning at the Orange County Community Foundation. During his tenure, more than \$120 million in gifts were facilitated for charity while OCCF assets more than doubled from \$51 million in 2004 to over \$120 million today. It was further estimated an additional \$40 million in deferred gifts were identified and put into place for the benefit of local non-profit organizations.

Steve is a licensed attorney who practiced law for seven years with an established firm in Orange County. He then left the practice of law and went to work at the corporate offices of Pacific Life and ING Advisors as an advanced markets consultant, training and assisting some of the top financial advisors throughout the Country with the conceptualization and implementation of sophisticated financial and estate plans. Prior to entering into the community foundation field, Steve also helped to successfully establish and implement a planned giving program for a local hospital.

Steve earned his Bachelors degree from Arizona State University and his Juris Doctorate degree from Southwestern University School of Law in Los Angeles, California.

Steve is recognized by the American Institute of Philanthropic Studies as a Certified Specialist in Planned Giving and previously held NASD Series 7 (General Securities) and NASD Series 66 (Registered Investment Advisor) registrations. He is a board member of the Orange County Planned Giving Round Table and is actively involved in a number of professional associations including the Orange Coast Estate Planning Council; the Trust and Estate as well as the Elder Law sections of the Orange County Bar Association; the South Orange County Estate Planning Council; and the Financial Planning Association of Orange County. Steve and his family are also members of Grace Church in Laguna Niguel.

GEORGE and MARTHA MADISON

Pillars of the local community, George and Martha Madison (both age 80) truly represent the American spirit at its best. Married some 60 years ago, George and Martha fondly recall their humble beginnings and remind you that although neither was formally educated, being raised through the great depression provided them with lessons money could never buy.

Extremely hardworking throughout their lives, George worked most of his career for Abco electronics as an electronic parts salesman. Through diligent savings, George and Martha were able to realize the American dream of home ownership when in 1959 they purchased the Huntington Beach home in which they currently reside. As George neared retirement back in 1985 they purchased a small vacation home in the local mountains which, due to their advancing age and the busyness of their extended family, is now mostly used as a seasonal rental.

Although having worked a wide variety of jobs through the years, Martha will tell you her crowning achievement was raising their two children, Abe and Betty, who, she will proudly share, have produced even better grandchildren.

Although George and Martha love their children and grandchildren dearly, they have been careful not to deprive the family of the lessons they learned through their depression era education. Although Abe (a University professor) seems to have taken these lessons to heart, to their dismay, Betty (a successful attorney) seems to have forgone mom and dad's lifestyle of contentment and, as George and Martha characterize it, "is always eager to acquire the latest and greatest." George and Martha commonly express concern to you as to what effect Betty's lifestyle may have on their grandchildren and future great grandchildren.

Modest in manner and attire, since retiring 15 years ago, George and Martha have actively been involved in their Church and community and give generously of their time. They commonly muse of their desire to give more financially to the philanthropic causes they care about but feel unable to do so due to the uncertainty of health care and its related costs.

You know that both George and Martha have retirement accounts which supplement their Social Security income. George and Martha have expressed nervousness as to what has been occurring in the financial world and commented that they are now even nervous about the money in the bank which in the past had always provided them with an income they could count on.

Questions:

- 1) What are some issues / opportunities you see here?
- 2) What other information would you like to know and why?
- 3) What are some lessons George and Martha may have learned by living through the depression?
- 4) Discuss the retirement accounts.
- 5) Discuss the vacation and family homes.
- 6) How does the financial nervousness impact the planning?
- 7) How does George and Martha's concern over Betty's lifestyle impact the planning?
- 8) What are some next steps?

CHERYL L. BARRETT is a Partner with the law firm of Ferruzzo & Ferruzzo, LLP. She was born in Santa Ana, California. She was admitted to the California bar in 1979. She received her bachelors degree from California State University, Fullerton in 1974 and her juris doctor degree from Pepperdine University School of Law in 1978.

Ms. Barrett's practice is devoted entirely to estate and gift tax planning, preparation of trusts and wills, probate and trust administration. She is experienced in planning estates of all sizes, drafting simple to complex plans, including revocable living trusts, charitable trusts, life insurance trusts, qualified personal residence trusts and special needs trusts. Her trust administration experience includes the settlement of trusts and on-going administration of charitable, revocable and minors' trusts. She has represented both institutions and individuals in probate matters.

Ms. Barrett has often been quoted by financial editors of the Orange County Register and the Los Angeles Times, was a recent guest on KABC talk radio, and is a frequent speaker on the subject of estate planning to such groups as the Metropolitan Water District of Southern California, Goodwill of Orange County, Downey Savings, Arthritis Foundation, Parents Without Partners, various churches, and classes at University of California Irvine Extension.

Active in the charitable community, Ms. Barrett is the current President of the Board of Directors for the Partnership for Philanthropic Planning Orange County and is Secretary of the Executive Committee for the Board of Directors of Goodwill Industries of Orange County. She has been recognized with a Spirit of Volunteerism Award by the Volunteer Center of Orange County and the Orange County Register. She has also been honored as one of California State University Fullerton's 50 Women of Distinction.

Ms. Barrett resides in Mission Viejo, with her husband, Geoffrey, and is the mother of a university student.

PEGGY KENNEDY

Peggy Kennedy, 80, is a loving and giving woman. She was married for 45 years to George and he lovingly provided her with a comfortable estate of approximately \$2.5 million when he died. The estate is comprised of her \$900,000 home, a beautiful and cozy lakeside vacation home in Vermont, which, although rarely used now that George is gone, is worth approximately \$300,000, securities worth approximately \$500,000, and cash accounts which exceed \$600,000.

Peggy now devotes much of her love and affection to her two grandchildren, Ian and Megan. Ever since the twins were born, Peggy has smothered the two with attention, gifts and sweets. Although Ian and Megan are now 17 years old, Peggy still bakes them cupcakes for their birthdays and knits sweaters for them for Christmas.

As seniors in high school, Ian and Megan are applying for college. They both want to attend Ivy League universities in the fall. As an Ivy League alumna, Peggy is thrilled. However, Peggy is amazed at the prices for tuition, room and board these days. The projected cost for four years of tuition, room and board for the twins is \$150,000 each, or \$300,000 for both of the twins.

Taking into account the rising cost of higher education and the limited resources of the twins' parents, Peggy wants to "take care of it all". However, she does have some reservations.

Although Peggy takes great pride in her grandchildren's many talents and interests, secretly she is a little worried about Ian. Ian has a habit of changing his mind and interests on a daily basis. For example, earlier this year, before opting for the university path, Ian wanted to be a professional snowboarder or tattoo artist, and last year he was torn between becoming a film director or actor. Moreover, Ian is known to spend money very freely.

Peggy loves Ian very much and wants him to succeed in life, but she is not interested in underwriting a tattoo salon or paying for acting lessons. She wants to support Ian's academic educational goals only. Prepaying university tuition for the grandchildren is therefore, not an option in which Peggy is interested.

1. Are there opportunities for charitable planning here? What planning techniques might Peggy consider?
2. If Peggy avails herself of any planning techniques, will there be any gift tax consequences to her? If so, will Peggy have to file a 709 Gift Tax Return?
3. If Peggy establishes a charitable trust, is there a way to assure her that the trust payouts will not be squandered on tattoo ink? Is there any way she can control the trust disbursements?
4. If Peggy establishes a charitable trust, what might be the best assets with which to fund it?
5. If Peggy funds the trust with the lakeside home, what issues need to be addressed?
6. If you were Ian, what tattoo would you suggest for grandma?

BROWN & STREZA^{LLP}

Attorneys at Law

ESTATE PLANNING
BUSINESS PLANNING
INCOME TAX PLANNING
CHARITABLE SECTOR
MERGERS & ACQUISITIONS

8105 IRVINE CENTER DRIVE
SUITE 700
IRVINE, CALIFORNIA 92618

TELEPHONE: 949.453.2900
FACSIMILE: 949.453.2916

E-MAIL: m.brown@brownandstreza.com

WEB: www.brownandstreza.com



MATT BROWN
PARTNER

Matt Brown is a partner with the Orange County, California law firm of Brown & Streza LLP. Matt is an estate planning attorney, but his estate planning niche is more narrowly focused than most. He primarily counsels business owners and philanthropists on the more complex income tax and estate tax issues that arise in the areas of business planning and charitable planning.

In both 2008 and 2009, Matt was named a “*Southern California SuperLawyers-Rising Star*” by *Los Angeles Magazine* – a distinction recognizing just 2.5% of attorneys under age 40 for excellence in the practice of law.

Recognized for his deep technical expertise, Matt is routinely consulted nationally by other financial professionals, including estate planning attorneys, CPAs, and financial planners regarding complex tax, business, and philanthropic planning solutions. He has been quoted twice in the *Wall Street Journal*, twice in the *Orange County Register*, and in various other publications. Matt also routinely speaks on advanced tax and philanthropy issues to audiences of attorneys and other financial professionals around the country.

Matt received his undergraduate degree in Finance from the University of California at Davis and his Juris Doctor degree, *cum laude*, from Southern Methodist University Dedman School of Law, where he was a member of the Southern Methodist University Law Review. Matt spent several years practicing in the Tax Department of Thompson & Knight LLP, a national law firm that boasts one of the nation’s top tax practices, before joining Brown & Streza in 2003.

Matt lives in Ladera Ranch, California with his wife, Julie, and their three sons Michael, Ryan, and Kevin. The entire family attends Pacific Coast Church in San Clemente, California.

TAXATION LAW PRACTICE AREAS

Income Tax Planning, Estate Planning, Planned Giving, Exempt Organizations

- Charitable and Noncharitable Income-Tax-Deferral and Tax Mitigation Techniques
- Life Insurance Techniques for Income Tax, Estate Tax, and Charitable Planning
- Representation of Exempt Organizations

General Representative Transactions

Creation, representation, and utilization of:

- Income Tax Deferral Techniques
- Captive Insurance Companies
- International Philanthropy
- For-Profit/Nonprofit Joint Ventures
- Churches
- Ministries
- Supporting Organizations
- Public Charities
- Trade Associations
- Private Foundations
- Community Foundations
- Donor-Advised Funds
- Charitable Remainder Trusts
- Charitable Gift Annuities
- Charitable Lead Trusts
- Leveraged Charitable Lead Trusts
- Charitable Trust Reformations
- Pooled Income Funds
- Charitable Gift Annuities
- Endowment Funds

Specific Representative Transactions

- Structured \$100 Million gift of closely held stock to charitable remainder trust to defer taxation on sale proceeds from \$205 Million business sale
- Structured \$200 Million gift of closely held stock to a private foundation, successfully avoiding excess business holdings challenges
- Routinely structure onshore and offshore captive insurance companies to provide tax-advantaged private casualty insurance to private employers and risk sharing arrangements among nonprofit organizations
- Structured tax-deferred \$100 Million business sale by implementing complex multi-tiered partnership structure
- Converted for-profit nursing home into nonprofit corporation using tax-exempt housing bonds
- Created multi-tiered partnership holding company structure designed to split royalty income of a renowned author among the author, a charitable remainder trust, and a supporting organization while avoiding assignment of income issues
- Converted \$12 Million S-Corporation into nonprofit publishing company, avoiding liquidation tax, minimizing UBIT during conversion period, and ultimately eliminating UBIT entirely
- Converted \$32 Million C-Corporation into nonprofit publishing company, avoiding liquidation tax and ultimately eliminating all corporate level taxes
- Structured private foundation's investment in foreign for-profit bank designed to provide microenterprise lending to the poor as a program related investment instead of a taxable expenditure or jeopardizing investment
- Structured supporting organization designed to secure government financing for renovation of distressed housing with profits going to local charities
- Created supporting organization subsidiary of a national community foundation to accept and direct international gifts
- Created supporting organization subsidiary of a national community foundation to accept and direct gifts of real property

PROFESSIONAL BACKGROUND

- Brown & Streza LLP, Irvine, California – Partner – 2008-Present
- Brown & Streza LLP, Irvine, California – Associate – 2002-2008
- Thompson & Knight LLP, Dallas, Texas – 2000-2002
 - Practiced in the Exempt Organizations section of one of Texas' largest law firms and one that boasts one of the nation's top Tax, Estate Planning, and Exempt Organizations sections
- Winstead, Dallas, Texas – 1999-2000
 - Complex tax planning for wealthy individuals
- Juris Doctor, *cum laude*, Southern Methodist University School of Law – 1999
 - Southern Methodist University Law Review: Member
 - Phi Delta Phi Legal Honor Society: Member
- Bachelor of Science, Finance, University of California at Davis – 1996
- Licensed to practice law in both Texas (Inactive) and California

PROFESSIONAL RECOGNITION

- 2008 and 2009 “Southern California SuperLawyers-Rising Star”
 - Published by *Los Angeles Magazine* and *The Journal for Law & Politics*. Only 2.5% of Southern California lawyers in Los Angeles and Orange Counties receive this prestigious honor.
- As seen in June 30, 2008 **Forbes Magazine**: Brown & Streza LLP was selected Top Ten of The Most Dependable Lawyers (Trusts & Estates) for 2008
- Member, Society of Trust and Estate Professionals (STEP)
- Member, Phi Delta Phi Legal Honor Society

PUBLICATIONS

- Fat-Free Fat: Nontax Considerations for Discussing Philanthropy With Your Clients
 - The WealthCounsel Quarterly, January 2009
- Conservation Easements – How to Give Your Land Away but Still Use It, 2009
 - Sole author of above-titled chapter in book entitled WealthCounsel Estate Planning Strategies: Collective Wisdom, Proven Techniques
- Orange County Business Journal “Keys to Wealth Management” Supplement, June 30, 2008
 - **The Life Cycle of the Entrepreneurial Business: Wonder, Blunder, Thunder, Plunder**

MEDIA MENTIONS

- Advancing Philanthropy Magazine, December 2007
 - **Life Settlements: Giving While Living**
 - Primary source for technical information related to life settlements and charitable giving; extensively quoted
- World Vision - The Advisor, November 2007
 - **Helping Clients See the “Big Picture”**
 - Interview with Matt Brown regarding how advisors can assist clients to integrate philanthropy into their estate planning
- Wall Street Journal, March 21, 2007
 - **Deconstructing a New Capital-Gains Strategy: ‘Structured Sales’ Aim to Ease Tax Bit, but Returns Are Slim And Benefits Aren’t Ensured**
 - Primary source for technical information related to tax deferral using structured sales; briefly quoted
- Orange County Register, December 29, 2006
 - **Samueli Disputes \$2.9 Million IRS Bill**
 - Primary source for technical analysis of IRS tax court case filed against Henry Samueli; briefly quoted

- Orange County Register, December 3, 2006
 - **IRS Yet to Rule on Product**
 - Primary source for technical analysis of new installment sale tax deferral product; extensively quoted
- Research Magazine, January 2004
 - **Optimizing Charitable Giving**
 - Quoted extensively as an expert on charitable planning
- Wall Street Journal, December 8, 2003
 - **Pritzkers Made a 'Tax-Driven' Deal**
 - Quoted as charity and trust law expert opining on private foundation stock redemption issues

SPEAKING ENGAGEMENTS

- Bank of the West Wealth Management Group, July 21, 2009
 - **Exiting Your Business Without Taxing Yourself**
 - Client-centered presentation on income tax planning for business owners
- Trinity Financial Partners, June 30, 2009
 - **Charitable Planning Update**
 - Continuing professional education presentation delivered to CPAs
- Bank of the West Wealth Management Group, May 16, 2009
 - **Taming the Tax Tiger: Wealth Retention and Tax Strategies for Today's Economy**
 - Client-centered presentation delivered to CPAs and their clients
 - Co-Presented with Jerome Hesch, graduate tax law professor at University of Miami Heckerling School of Law
- FMC Financial Group, May 11, 2009
 - **Advanced Planning Workshop**
 - Advanced planning workshop delivered to high-level tax and financial advisors
- Bank of the West Wealth Management Group, April 30, 2009
 - **Taming the Tax Tiger: Wealth Retention and Tax Strategies for Today's Economy**
 - Continuing professional education presentation delivered to CPAs
- Planned Giving Round Table of Los Angeles, April 23, 2009
 - **The Advisor's Role in Philanthropy**
 - Presentation to attorneys, financial advisors, CPAs, and planned giving officers
- Planned Giving Round Table of Los Angeles, April 23, 2009
 - **Estate Freezes: The Basics and the Math**
 - Presentation to attorneys, financial advisors, CPAs, and planned giving officers
- Wealth Counsel, March 1-2, 2009
 - **Planning in a Low Interest Rate Environment**
 - Continuing legal education course taught to a nationwide audience of practicing estate planning attorneys
- Financial Planning Association of Orange County, February 18, 2009
 - **Beyond the Stretch IRA Trust: Advanced IRA Distribution Planning**
 - Continuing education presentation delivered to CPAs and financial planners
- Orange County Bar Association Trusts & Estates Section, February 11, 2009
 - **Estate Freezes: The Basics and the Math**
 - Continuing legal education presentation delivered to attorneys
- Estate Planning and Trust Council of Long Beach, November 20, 2008
 - **The Advisor's Role in Philanthropy**
 - Presentation delivered to group of attorneys, CPAs, and financial planners specializing in estate planning
- Hawaii Tax Institute, October 21, 2008, Honolulu, Hawaii
 - **The Use of Captive Insurance by Closely Held Enterprises – Income Tax and Transfer Tax Implications and Opportunities**
 - Presentation delivered to one of the country's premier tax institutes organized to provide continuing legal education to tax attorneys from around the nation
- California Society of CPAs, Orange County/Long Beach Chapter Financial Planning Interest Group, October 16, 2008
 - **Advanced Income Deferral**

- Continuing professional education presentation delivered to CPAs
- Utah Captive Association Annual Conference, September 19, 2008
 - **The Use of Captive Insurance Companies in Estate Planning**
 - Continuing legal education presentation delivered to national audience of tax attorneys
- Business Enterprise Institute, Inc. – 2008 National Conference, August 15, 2008
 - **Exit Planning and Charity**
 - Presentation delivered to group of attorneys, CPAs, and financial planners specializing in advising clients on business sale activities
- WealthCounsel Advisors Forum National Teleconference, August 13, 2008
 - **The Use of Captive Insurance in Estate and Business Planning**
 - National teleconference presentation on key issues related to captive insurance companies delivered to audience of attorneys, CPAs, and financial advisors
- WealthCounsel Advisors Forum National Teleconference, May 14, 2008
 - **Income Tax Rules Every Wealth Planner Should Know**
 - National teleconference presentation on income tax rules relevant to wealth transfer planning delivered to audience of attorneys, CPAs, and financial advisors
- Association of Fundraising Professionals, Orange County Chapter, January 23, 2007
 - **Donor Outlook for 2007: Accountability; Your Donors are Watching You – Will They Like What They See?**
- Planned Giving Round Table of Orange County, Irvine, California, October 5, 2006
 - **Funding CRTs with Debt-Encumbered Assets: Hazards and Heroics**
- Institute for Christian Gift Planning Counsel, Orange County, California, April 27, 2006
 - **The Tax Economics of Noncharitable Tax Deferral Techniques: Serious Competition for the CRT or Marketing Fluff?**
 - Continuing legal education presentation to a nationwide audience of Christian estate planning attorneys
- Institute for Christian Gift Planning Counsel, Orange County, California, April 27, 2006
 - **Funding CRTs with Debt-Encumbered Assets: Hazards and Heroics**
 - Continuing legal education presentation to a nationwide audience of Christian estate planning attorneys
- Inland Empire Planned Giving Round Table, Redlands, California, July 21, 2005
 - **Funding Split-Interest Trusts with Difficult Assets**
- The Financial Planning Association Orange County Chapter, Irvine, California, May 18, 2005
 - **Estate Planner's Toolbox**
- Planned Giving Round Table of Orange County, Irvine, California, May 5, 2005
 - **Debunking the Myths of the Private Annuity Trust: How Not to Sell Appreciated Assets**
- Estate Planning Council of South Orange County, Mission Viejo, California, April 5, 2005
 - **Debunking the Myths of the Private Annuity Trust: How Not to Sell Appreciated Assets**
- Planned Giving Round Table of Southern California, Glendale, California, April 22, 2004
 - **Taking Zero-Tax-Planning to the Next Level**
- Estate Planning Council of South Orange County, Mission Viejo, California, April 6, 2004
 - **Creative Uses of Preferred Partnerships and LLCs**
- Planned Giving Round Table of Orange County, Irvine, California, March 4, 2004
 - **Taking Zero-Tax-Planning to the Next Level**
- Foundation for Christian Stewardship, Irvine, California, December 5, 2003
 - **Advanced Planning Tools Seminar**
- Public Charities in Texas, Dallas, Texas, September 21, 2001
 - **Charitable Trust Reformation**
- Frequent seminars presented to attorneys, CPA, and financial planners on income tax planning, estate planning, and charitable planning

COMMUNITY INVOLVEMENT

- University of California, Irvine - Center For Investment and Wealth Management – Charter Member
- Kingdom Advisors – Charter Member
- Ronald Reagan Presidential Library Foundation Professional Advisory Committee – Charter Member
- Pacific Coast Church – Member
- Society of Trust and Estate Professionals (STEP) – Member
- Planned Giving Round Table of Orange County – Past President; Member
- Orange Coast Estate Planning Council – Member
- Orange County Council on Philanthropy – Member
- Crown Financial Ministries – Planned Giving Advisory Board
- Ocean Institute – Planned Giving Advisory Board
- National Partnership for Philanthropic Planning – Member
- American Bar Association – Member
- California Bar Association – Member
- Texas Bar Association – Member (Inactive)
- College of the State Bar of Texas – Member

PPP CASE STUDY

Joe is a 70-year-old real estate investor. About three months ago, Joe discovered a great investment property. It was a "fixer-upper" commercial building in a great area. While other nearby buildings sold for over \$2 million, the seller needed to sell quickly and was asking just \$1 million.

The condition of the building turned many buyers away. It was being sold "as-is." But Joe saw great potential with the building and knew it would not take much to get it to market condition. So he swooped in, bought the building for \$1 million, and instantly hired contractors to refurbish the place.

In the end, Joe invested \$250,000 in the building, bringing his total investment in the property to \$1.25 million. One month after the completion of the work, Joe was contacted informally by a company that wanted to buy the building for \$2 Million.

Unfortunately, Joe had only held the property for four months, meaning the gain from the sale would be short-term capital gain. In other words, the marginal tax rate would be 35% instead of 15% (closer to 42% instead of 22% in California). Joe did not want to lose 42% of his gain to taxes. But Joe also did not want to risk holding the property any longer lest the real estate market drop.

Joe also has three children. His youngest, Cheryl, has a very successful blog that generates substantial advertising revenue. His oldest, Steve, is a highly regarded bankruptcy attorney, thriving in a struggling economy. His middle child, Matt, has issues. Matt spends most of his time playing his guitar and writing books on government conspiracy theories. Neither activity has ever produced income. Matt's inconsistent and bizarre behavior unfortunately prevents him from holding a steady job. Joe suspects Matt was deprived of oxygen at birth, but Matt's mother thinks Joe just spoiled Matt too much as a teenager.

1. Can Joe sell the building and bypass the tax on the sale of the property?
2. Would Joe receive an income tax deduction if he used a charitable vehicle?
3. Who can/should serve as trustee of any trust that Joe might create?
4. What if Joe had a \$100,000 mortgage on the property? How would this affect your planning?
5. If Joe can receive an income tax deduction, how would he substantiate the deduction?
6. How can Joe maximize his cash proceeds from the sale and eliminate current taxation?
7. What are some other structural considerations to your plan (e.g., approaches that benefit donors versus approaches that benefit charity)?
8. What should Joe do to care for his children Cheryl, Steve, and Matt? Are there any special considerations necessary for Matt?
9. Are there any property tax considerations?

SOLUTION TO QUESTION 1

Based upon Joe's situation and goals, a FLIP CRUT was an excellent option. Prior to any binding sale agreement, Joe could transfer his property into the FLIP CRUT. In this case, the potential buyer merely expressed an interest in the property. Because there was no legally binding agreement between Joe and any buyer, there was no prearranged sale problem.

Once the property was transferred into the FLIP CRUT, the trust would list and sell the property. Even if the property sold for \$2 million, the trust would owe no taxes on the sale because the trust was exempt from income taxes. Therefore, the FLIP CRUT met Joe's first goal - avoiding an immediate 42% bite out of his short-term capital gain.

Next, the trust would reinvest the full sales proceeds of \$2 million (minus selling costs). Pursuant to Joe's goals, the trust would likely invest for income. It could invest in bonds, dividend paying stocks or even rental property. This met Joe's second goal.

So far, Joe was very pleased with the FLIP CRUT option. It looked like the perfect solution. However, there were two potential downsides to this plan. The two remaining issues were as follows: 1) What was the charitable income tax deduction for gifts of short-term capital gain property? and 2) What were the tax characteristics of the FLIP CRUT payouts to Joe?

SOLUTION TO QUESTION 2

First, pursuant to IRC Section 170(e), Joe would receive a charitable income tax deduction based upon the cost basis in the property not its fair market value. Section 170(e) does not allow a donor to claim a charitable income tax deduction for a property's ordinary income element.

In this case, a fair market value calculation on \$2 million would produce a tax deduction of \$1,360,000. However, due to the short-term capital gain on the property, Joe would instead use \$1,250,000 for the calculation. As a result, his tax deduction would be \$850,000. This first bit of "bad news" does not concern Joe whatsoever. Given his estimated AGI over the next several years, he would not have been able to deduct the full \$1,360,000. On the upside, Joe can deduct the full \$850,000 over the next 5 years. With estimated AGI of \$350,000 each year, Joe may deduct up to 50% of his AGI each year or \$175,000. The 50% AGI limit applies in this case, not the 30% AGI limit, because Joe's tax deduction was based on cost basis only.

Next, Joe discovered that the short-term capital gain of \$750,000 from the sale of the property might be distributed to him over time. While it was true the FLIP CRUT would not owe any tax, the trust would report the \$750,000 of short-term capital gain in tier two pursuant to the four tier accounting rules. Therefore, it is possible that Joe's future trust payouts may be characterized as short-term capital gain.

Again, Joe was not dissuaded with this information. First, as someone accustomed to lease income, Joe assumed most of his trust payouts would be ordinary income. So, this was not bad news. Second, given the benefit of the 15% tax rate on qualified dividends, the trust desired to invest heavily in dividend-paying stocks. As a result of this investment choice, 15% type tier one income would flow out prior to any 35% type tier two short-term capital gain. This would diminish the amount of tier two income short-term capital gain realized over Joe's life.

In the end, the positives clearly outweighed the negatives. Joe moved confidently forward and wrote another happy ending to another successful investment outing.

SOLUTION TO QUESTION 3

There are two general courses of action Joe and the charity may take. First, the charity can request that Joe serve as trustee of the FLIP CRUT until the property is sold. Once the property is sold, then the charity may take over as trustee. This is an excellent and inexpensive solution. It keeps the charity (as trustee) from ever appearing in the property's chain of title. Therefore, charity should not have liability for any environmental problems. Just as importantly, it allows Joe to handle the sale of the property. Since Joe is most familiar with the property, many times this produces the best sales result.

Second, the charity can elect to serve as trustee. If so, the charity should follow the usual safety steps for accepting gifts of property. For instance, the charity can request an EIS before accepting the property as trustee. After the safety steps are completed, the real estate may be transferred to the FLIP CRUT with the charity serving as trustee. The downsides of this course of action are the associated costs, time and potential liability risk.

Note: With the potential unlimited liability associated with environmental federal and state laws, a charity must carefully review any gifts of real estate prior to acceptance. In some instances, a charity should simply refuse a gift of real estate if the environmental risks outweigh the financial benefits.

SOLUTION TO QUESTION 4

Joe's situation is not an uncommon one. Indeed, the majority of real estate is encumbered by some amount of debt. Unfortunately, mortgaged real estate and CRTs generally do not mix well. The transfer of debt-encumbered property into a CRT triggers two potential problems: 1) grantor trust status that results in disqualification of the trust, and 2) debt-financed income which destroys the trust's tax-exempt status for the year.

If the debt obligation is solely against the property, the debt is termed "non-recourse." If the obligation is against both the property and the owner personally, the debt is termed "recourse." The IRS states that the transfer of recourse debt into a CRT will reclassify the trust as a grantor trust. See PLR 9015049. Since a CRT cannot be a grantor trust, the trust

will cease to qualify as a CRT.

If the debt is deemed nonrecourse, then there is no personal liability under Sec. 677 and, accordingly, no grantor trust status problem. Thus, in the event of nonrecourse debt, it should be permissible to transfer the real estate into the CRT without disqualifying the trust.

However, in nearly all cases real estate debt is recourse. Nevertheless, it is important to verify the nature of the debt. After contacting his lender, Joe learns that he is personally liable for the debt, *i.e.* recourse debt. Therefore, he knows this poses a significant problem since his FLIP CRUT cannot safely accept the gift of real estate now.

Even if the debt were nonrecourse, to avoid a debt-financed income problem to the CRT it is imperative that the mortgaged property pass the "5 and 5" rule. Simply put, the nonrecourse debt needs to be more than five years old and the property owned for more than five years. (For a review of the "5 and 5" rule, see GiftLaw Pro 2.1.2.) If the "5 and 5" rule is not met, then the CRT may have debt-financed income (*i.e.* UBIT) upon sale of the property. If this occurs, then the CRT is fully taxable. Because UBIT is subject to a 100% excise tax, this would largely deplete the trust. Accordingly, debt-financed income inside a CRT should be avoided at all costs.

To make matters worse, Joe also fails the "5 and 5" rule. For instance, the debt is not even one year old, much less five years old. Thus, Joe is dealing with a second significant problem since debt-financed income will subject the trust to huge taxation.

Joe has at least five solutions to the debt and FLIP CRUT problem.

1. Payoff - If possible, Joe may have the resources to pay the debt and then transfer the real estate to the FLIP CRUT.
2. Release - If there is a parcel of land that may be divided under zoning rules or there are multiple deeds to the parcel, it may be possible to obtain a release on some of the property, leaving the debt on the balance. The released property may then be transferred to the FLIP CRUT.
3. Bridge Loan - Joe may borrow funds on other property, pay the debt on the existing property and transfer an undivided interest into the trust. When the property is sold, the undivided portion retained by Joe is used to pay the bridge loan.
4. Charity Purchase - The charitable organization may be willing to purchase part of the real property from Joe. Following this purchase, Joe has funds to pay off the debt and transfer the balance of the real property into the trust.
5. Personal Guarantee - While the Service has not approved this method, some counsel have transferred an undivided percentage of encumbered property into a CRT. When the property is sold, the balance of the asset is used to pay the debt. The donor gives a personal guarantee that the trust will not be required to pay debt. So long as the transaction works as contemplated, the theory is that the issue

is moot after the sale and debt repayment. This is an aggressive strategy not without risk.

Donors generally should proceed through these five potential steps in order. The technical and practical challenges increase with the latter methods. Given his choices, Joe quickly elects option 1 - payoff the debt. With the simple removal of the \$100,000 debt, the UBIT and grantor trust status issues disappear. Furthermore, the future sale of the real estate will return the \$100,000 "pay off amount" back to Joe. Joe is happy once again knowing that his FLIP CRUT plan is back on track.

SOLUTION TO QUESTION 5

Joe needs an appraisal of the real estate to be prepared by a qualified appraiser. If Joe only gifts a portion of the real estate, he will also need to seek a fractional interest discount study (at a likely cost of \$3,500 or more over the real estate appraisal). Theories abound regarding ways to eliminate the fractional interest discount, such as a simultaneous sale out of the FLIP CRUT and a revocable living trust trustees by the same party, but none appear particularly solid.

SOLUTION TO QUESTION 6

Based upon Joe's situation and goals, a "Sale and FLIP CRUT" would be an excellent option. Prior to any binding sale agreement, Joe could transfer an undivided interest in his property into the FLIP CRUT. In this case, the potential buyer merely expressed an interest in the property. Because there was no legally binding agreement between Joe and any buyer, there was no prearranged sale problem.

Once the undivided interest in the property was transferred into the FLIP CRUT, the trust would list and sell the property. It would be advisable for the trust to handle the sale of Joe's portion as well.

The trust would owe no taxes on the portion of the property it sold because the trust would be exempt from income taxes. Accordingly, the FLIP CRUT would meet Joe's first goal - avoiding an immediate 1/3 tax bite. However, Joe would have taxable income from the sale of his portion of the property. Thus, the goal was to use the FLIP CRUT charitable deduction to offset any taxable income from his sale of the property.

The key question for Joe was what percentage to transfer to the FLIP CRUT and what percentage to retain. Pursuant to IRC Section 170(e), Joe would receive a charitable income tax deduction based upon the cost basis in the property, not its fair market value. Section 170(e) does not allow a donor to claim a charitable income tax deduction for a property's non-long term gain element. In this case, all of the gain on the property would be short term capital gain, so Section 170(e) would apply. The reduced deduction would ultimately affect the zero tax calculation.

Based upon these considerations, Joe decided to transfer 45% of his property into the FLIP CRUT and retain 55% of the property. Upon the sale of the property for \$2 million, the trust received \$900,000 ($\$2M \times 45\%$) and Joe received \$1,100,000 ($\$2M \times 55\%$). Joe's deduction was \$424,401 and saved him about \$148,540. The deduction was subject to the 50% AGI limitation since it was a basis deduction. But, given Joe's enormous AGI for this year, the limitation would not pose a problem.

Joe owed \$144,375 as a result of the sale of his portion of the property. However, Joe's \$148,540 of tax savings from his charitable deduction fully offset his \$144,375 tax liability resulting in a zero tax sale. Exactly what he wanted! The zero tax sale plan clearly met all of Joe's objectives. In the end, Joe walked away with \$1,100,000, a \$900,000 FLIP CRUT and no tax payment to the government. He thought, "Not bad for only 4 months' work!"