Charitable Times

Quarterly Newsletter

June 2001 | *Issue I*

From a tax and planned giving perspective, 2001 is shaping up to be decisive year.

Welcome to the inaugural issue of CTAI's newsletter, *Charitable Times*. Our intent with this quarterly publication is to keep you current on tax and planning issues that impact your legacies. We think the timing couldn't be better.

Important new legislation is pending in Congress that aims to amend the tax code for charitable contributions. Also, recent changes have been made by the IRS to restrict the tax-free status of certain transactions made under the aegis of charitable remainder trusts. And, wonder of wonders, earlier this year the Treasury Department liberalized distribution regulations for IRAs, which will make them a more nimble vehicle for use as a bequest to charitable remainder trusts. These new distribution regulations have also made IRAs more attractive for non-charitable bequests.

2001 may well be a watershed year from an estate and tax planning perspective. Right now, the status of proposed estate tax reform remains unclear. We have enclosed as an insert a brief summary of some of the provisions of the new law that President Bush signed on June 7th. The ink is not even dry—and tax professionals are starting to debate the real tax savings. As the new law unfolds, we'd value you feedback on topics you'd like to see covered in future issues.

New Issues on the Horizon: The "Neighbor to Neighbor Act"

On March 1, 2001, Representative Jennifer Dunn (R-WA) introduced H.R. 824, the "Neighbor to Neighbor Act." We are pleased to see such progressive tax legislation in the wings, and urge you to encourage its passage. If enacted into law, this Act would amend the Internal Revenue Code to provide the following new tax incentives to promote charitable giving:

· IRA account owners would be permitted to make distributions from their IRAs directly to charities. This could be accomplished either outright or in exchange for a charitable gift annuity, a charitable remainder trust or a pooled income fund.

· Donors who make charitable contributions but do not itemize their federal income tax deductions would still be entitled to a "direct" charitable contribution deduction.

· The deduction for gifts of long-term capital gain property to public charities would be increased—subject to an annual limit of 50% of adjusted gross income instead of the current 30% limitation. In addition, the carryover period for charitable deductions that cannot be fully used in a given tax year due to the applicable percentage limitation would be increased from the current five years to 10 years.

· The charitable deduction would be excluded from the 3% reduction rules affecting high bracket taxpayers.

· A taxpayer could deduct, for the current year, charitable contributions made at any time up to the time for filing the taxpayer's federal income tax return for that tax year (April 15th).

Action Plan

· Write letters to members of the House Ways and Means Committee as well as your Senators and Representatives to encourage the inclusion of this provision in this year's tax relief provisions.

· Write a thank-you letter to Representative Dunn and the co-sponsors in appreciation for their introduction of the bill.

· Encourage other people you know who are active in their churches, synagogues, and other non-profit organizations to write to their Representatives.

· Read and study the bill. A copy of can be found on the web at: http://thomas.loc.gov/cgi-bin/query/z?c107:H.R.824:

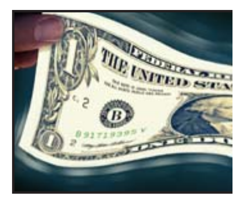
"Abusive" Use of Charitable Trusts Curtailed by New IRS Regulations

The IRS, as always, is on the prowl for what it perceives as abuses of the tax code. Charitable remainder trusts (CRTs) have recently come under scrutiny. In January, the Service issued final Regulations that are designed to prevent what has been perceived as inappropriate tax avoidance by CRTs. Dated January 5, 2001, the Regulations modify how distributions from a CRT are characterized. These Regulations apply to all distributions made by a CRT after October 18, 1999.

The point made by the IRS, we think, is that charitable remainder trusts, although sanctioned as tax shelters, were being abused by many tax and financial planners to the extent that they had lost their identity as charitable vehicles. In certain cases, CRTs were being utilized virtually exclusively as a means for the donors to avoid paying taxes. For those of you who currently utilize CRTs and intend for them to significantly benefit the charities you value, the new regulations will most likely have little or no impact, as you are not "abusing" the system.

The abuses these regulations attempt to correct have occurred when appreciated assets in the CRT were converted to cash and the non-charitable beneficiary received a cash distribution characterized as a tax-free return of principal. Under this scenario, non-charitable beneficiaries were off the hook in terms of paying capital gains taxes.

Under the final regulations, there are significant modifications that have to do with deemed sales, unrelated business income, and annuity/unitrust payments. Under a deemed sale, certain distributions will be regarded as having arisen from a sale by the CRT, and a pro rata sale approach will be used to determine what portion of the distribution will be subject to taxes.



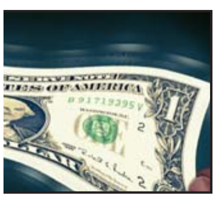
The subject of unrelated business taxable income is also addressed by the new final regulations. Unrelated business taxable income (UBTI) should be avoided at all costs in CRTs. In the case of CRTs, any UBTI is tantamount to a poison pill—it will trigger the loss of the CRT's tax-exempt status for the year in which the UBTI is earned. In this event, and for the entire year, all of the CRT's income will be subject to income tax.

In terms of the changes regarding the distribution of cash from the CRT, the new regulations give CRT trustees a bit of leeway in making payments to beneficiaries—provided they meet certain conditions.

You may have noted that we haven't gone into an extraordinary degree of fine print in describing these new regulations. The degree of detail you'd like to hear is best left up to you. Please contact us if you'd like to know more; and please rest assured that our first move is always to contact you immediately when new regulations and legislation arise that impact your charitable planning.

Good News: New IRA Distribution Regulations a Boon to Charitable Gift Planning

The IRS has recently issued new rules that make sweeping changes in how "Minimum Required Distributions" from IRAs are calculated. In doing so, they've removed what was formerly one of the biggest negatives about designating a charity, over the lifetime of an account holder, as a beneficiary of some or all of a retirement account. These changes potentially affect everyone who now takes required minimum distributions from an IRA or other retirement plan. This includes most individuals over age 70 1/2, as well as individuals who have inherited an IRA or retirement plan.



You may or may not be familiar with the term "stretch-out" IRA. This refers to the benefits that can accrue to the holder of an inherited IRA. Under the new distribution regulations, the stretch-out IRA can produce extraordinary tax savings for heirs, as it now can be distributed over the life expectancy of the beneficiary, not the original account holder, so long as the charity's share is cashed out by the end of the year following the year the account holder dies.

Surprisingly, the changes are almost all good. The necessary calculations have become simpler and the new methods produce smaller required distributions for most, based on longer life expectancies. For employers, the changes make retirement plans easier (and thus less expensive) to administer.

If you are age 70 1/2 or older, and you own an IRA, you are required to take a distribution from your IRA every year. You probably know how to calculate your 2001 required distribution, using the old rules. However, you may use the new rules for this year, if the new rules give you a more favorable result (i.e. a smaller required distribution, and fewer taxes to pay).

Under the new rules, everyone uses a new "Uniform Table" to calculate his or her required distributions. With the new system, it no longer matters (for purposes of calculating your lifetime distributions) who is named as your beneficiary, with one exception: If your sole beneficiary is your spouse and your spouse is more than 10 years younger than you, then you calculate your distributions using the "joint life and last survivor expectancy" of you and your spouse. This will produce an even smaller required distribution than the Uniform Table.

What to do now

Here are the steps we recommend at this time:

Individuals

Talk to your financial planner, accountant, attorney, or whoever advises you on your personal finances.

· If you are currently taking required distributions from your IRA or other retirement plan, we recommend not taking your required distribution for 2001 until you have checked out whether the new rules are available to you and provide you with a more favorable result.

· If you are taking a distribution as a beneficiary from a retirement plan or IRA you inherited, we recommend not taking your 2001 distribution until you can determine whether the new rules will apply to your 2001 distribution, and if so, how.

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· If you are past age 70 1/2, and have been constrained in your choice of a beneficiary for your retirement plan because of the restrictions imposed by the old rules, contact an attorney to review your estate plan, including your beneficiary choice.

Charitable Remainder Trusts

Because charitable remainder trusts are exempt from income tax, they offer many tax advantages as a beneficiary of taxable distributions from a retirement plan account. A distribution from an IRA or qualified retirement plan account directly to a CRT does not trigger any income tax to the CRT, the estate or the estate's beneficiaries. The income these plans produce is included in the tier 1 ordinary income of the CRT, and is subject to tax only when the non-charitable beneficiaries receive distributions from the CRT.

Using a charitable remainder trust as a beneficiary of a retirement plan account is not workable in at least two situations. Obviously, if the transfer does not produce the minimum 10% charitable deduction, the CRT would no longer meet its legal criteria. The second situation occurs if there is estate tax associated with the transfer to a CRT. This is most likely to occur if a person with a large estate intends to use retirement plan assets to fund a charitable remainder trust that will benefit someone other than a spouse—in other words, if there are estate tax liabilities to take into account.

Relocation of Corporate Headquarters

Effective July 9, 2001, we will relocate our corporate headquarters to 111 W. Ocean Blvd., 23rd Floor, Long Beach, California 90802. This move will allow us to expand our services to the Southern California area. We will maintain our Redding, California office as our Northern California branch. Chuck McLucas will be residing in Orange County. As always, we urge you to call with any questions or concerns you may have, both about recent and pending changes to the tax code, and about the positive changes taking place within our firm.

The Economic Growth and Tax Relief Reconciliation Act of 2001

Over the Memorial Day weekend, Congress passed The Economic Growth and Tax Relief Act. This far-reaching legislation purports to form the largest tax cut in more than 20 years. Because of the phase-in structure of many of the provisions, only time will tell if the tax cuts will prove to be as significant as their hype. The following summary covers some of the major provisions that might be of interest.

Income Tax Provisions

2001 Refund. Effective July 1, 2001, a new tax rate of 10% will be added. This reduction will provide a refund check (scheduled to be issued on 10/01/01) of $300 for single filers and $600 for most joint filers.

New Tax Rates. The Act provides a reduction of all income tax rates as set forth in the following table:

Calendar Year	28% Rate Reduced to:	31% Rate Reduced to:	36% Rate Reduced to:	39.6% Rate Reduced to:
2001[1]-2003	27%	30%	35%	38.6%
2004-2005	26%	29%	34%	37.6%
2006 and later	25%	28%	33%	35%

[1] Effective July 1, 2001

Because of these rate reductions, the spread between capital gains rates and ordinary income rates will range from only 5 to17%. This may have the effect of decreasing a major incentive to create significant planned gifts—avoidance of capital gains taxes.

Elimination of Phase-outs of Itemized and Standard Deductions. The Act gradually eliminates the phase-out of itemized deductions for higher-bracket taxpayers—and also eliminates the phase-out for personal exemptions for these taxpayers. Both of these limitations will be scaled back by one-third in 2006 and 2007, reduced by two-thirds in 2008 and 2009, and completely eliminated in 2010.

Increased IRA Contribution Limits. The Act increases the maximum contributions for individual retirement accounts:

Year	Contribution Limit
2002-2004	$3,000
2005-2007	$4,000
2008 and beyond	$5,000

For individuals over age 50, an additional contribution is allowed—to make up for those years in which they didn't make maximum contributions to their plans. From 2002 to 2005, these individuals can contribute an additional $500 beyond the other applicable limits. In 2006 and after, these individuals can contribute an additional $1,000.

Estate Tax Elimination and Subsequent Reversal. It is important to note from the outset that the entire Act, including the below listed estate tax decreases, will be repealed as of December

31, 2010. This means that in 2011, all of the provisions of the new law will revert back to the rules in effect in the year 2000.

The estate and generation skipping tax is gradually reduced as follows:

Calendar Year	Estate and GST Tax Transfer Exemption	Highest Estate and Gift Tax Rates
2002	$1 million	50%
2003	$1 million	49%
2004	$1.5 million	48%
2005	$1.5 million	47%
2006	$2 million	46%
2007	$2 million	45%
2008	$2 million	45%
2009	$3.5 million	45%
2010	N/A (taxes repealed)	Top individual rate under the bill (gift tax only)
2011	Rules prior to 2001 apply	55%

Time will only tell if these reductions will be modified at some point in the next 10 years, and if Congress will have the good sense to remedy the estate planning catastrophe currently on the books for 2011.

Modified Carryover Basis. The plot thickens. In 2010, once estate taxes are fully repealed, a modified carryover basis rule will immediately go into effect. Virtually overnight, income taxes will further cloud the picture. Rather than being stepped up to fair market value at the date of death or alternate valuation date, as is now the law, the basis of assets received from a decedent will carry over from the decedent.

With proper planning, two exceptions will save many estates:
- $1.3 million of cost basis will be allowed to be applied to certain qualifying assets; and
- $3 million of cost basis will be applied to assets transferred to a surviving spouse.

Pension Reform. More than one-third of the Act is focused on pension reform. The modifications are designed to increase contribution limits, ease administration burdens and provide more flexibility to plan participants who change employers.

The increased benefits for qualified plans are summarized below:

Plan Type	Current Limit	Increase	Phase-in Period
Defined Contribution	$35,000	$40,000	2002
Defined Benefit	$140,000	$160,000	2002
Elective Deferral 401(k), 403(b), SEP	$10,500	$11,000-$15,000	2002-2006
SIMPLE	$6,500	$7,000-$10,000	2002-2005
457	$8,500	$11,000-$15,000	2002-2006

The amounts listed above are all indexed for inflation at $500 or $1000 increments—after reaching their corresponding limits. Another change: The option of taking plan loans will now be available to owner employees.

There's far more to this bill's 85 major provisions than the measures detailed above. Other areas addressed by the Act include: Marriage penalty relief, a doubling of the child tax credit, expanded educational tax credits, and changes to the corporate estimated tax.