THE ACADEMY OF ELECTRICAL CONTRACTING

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FINANCIAL PLANNING – *A Wealth of Choices*

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As successful electrical contractors, we spend the majority of our professional lives making critical choices. We select key personnel to help run our company. We decide how and where to invest our hard-earned dollars. Each time we face a decision, the cognitive process is the same. We mentally run through all of the possible scenarios because our primary concern is that we make the right choice for both the short- and long-term.

One area in which we "run the numbers" over and over is retirement and estate planning. Our goals are to live comfortably throughout our retirement years, to take care of our family members, to effect an orderly transition of our company from one generation of management to the next, and to leave something of ourselves as a legacy that will be remembered and honored – either in a public way or very privately.

I would like to take this opportunity to present one option that can have a marked impact on your retirement. I am referring to a trust instrument called the Charitable Remainder Trust or CRT. The concept is very straightforward. Take an asset and place it into a trust. The trust provides benefits to an individual, or even two individuals, for a set time period. At the end of that time, whatever amount is "left", the remainder, is distributed to the charitable organization you have pre-selected.

If you plan a CRT carefully, you will see several positive results. You can generate tax-savings deductions, avoid any capital gains tax on the assets paper profit, and maintain income benefits for yourself while setting up a significant gift to a charitable organization.

A Simple Process

We often avoid trust instruments because we think the process will be complicated and/or expensive. That is not the case. Yes, there are certain federal requirements that your CRT must meet. I recently learned that the Internal Revenue Service will supply sample forms you can use to establish the trust. If you follow the guidelines IRS provides, there is every expectation that the trust will be approved quickly and without complications.

The process is quite simple. You begin by naming a trustee who must accept the responsibility to invest, manage, and distribute the CRT asset in accordance with the terms of the trust document. You also name the beneficiary (usually yourself, but it can be anyone). If you choose, you can name a second beneficiary (usually your spouse) who will receive payments from the Trust.

There are several appealing aspects about charitable trusts. Each trust is set up as its own individually-designed account with its own trust document. Your funds and your instructions are specific. Each trust is then administered according to the terms of that written agreement. There are no surprises and no one can change the terms that you select. You customize your own charitable giving program to meet your needs, to help ensure your family's well being, and to help support one or more charitable organizations of your choice.

The CRT can be set up with payments that last a lifetime or payments for a maximum of 20 years. The choice is yours, subject to certain IRS rules and regulations.

Benefit Payment Choices

On to another choice. You may like the idea of a fixed amount paid annually, as long as it is at least equal to a minimum of five percent of the initial value of the trust's assets. This is known as a charitable remainder **annuity trust**. No matter how well or how poorly the trust does in the investment arena, you will be guaranteed your fixed amount of funds each year. No guessing. You'll know exactly what funds to expect.

If you prefer a variable payment, it must also represent at least five percent of the trust's corpus, but the payout will change each year as the trust gains or loses strength. This is known as a charitable remainder **unitrust**. Let's say that you have set up a trust with an initial asset worth $250,000. In the first year, you would receive a 5% benefit of $12,500. Now, if the CRT asset grows at 8%, it will be worth a total of $270,000 in year two. Now, your variable 5% payment will be $13,500. Think of a unitrust as a hedge against inflation.

A few more things about the unitrust. If I set up my Charitable Remainder Trust in this fashion, I can make provisions to allow for future additional contributions to the trust. It will be a big savings of time and expense if I decide to add another asset to the unitrust. Also, the IRS now has specific allowances that take into account a gift asset that may be difficult to market for a number of years. For example, if I gave mountain property to the trust, it may take several years for the trustee to find a buyer and convert the real estate asset into one that has a greater potential yield for growth and income. There are other rules that allow me to defer payout from the trust as the asset grows and then "make up" the income that had been deferred while the asset built up.

Again, many choices. All of them require the right expertise to help you make the right decisions for your retirement and estate plan.

The Tax Implications

When setting up a charitable trust, you will get a current tax deduction based upon the *present* value of the remainder that will eventually go to the charity. The IRS, and your own tax advisor, will look at several variables to determine what the deduction will be. The questions to be answered include the following:

- What is the current value of the asset you are putting into the trust?
- How many beneficiaries are there (1 or 2)?
- How old are the beneficiaries?
- Is the payment option you select for a lifetime or for a specific number of years?
- What payout rate will be used for the annual distribution?
- Is the payment fixed (annuity) or variable (unitrust)?

You can anticipate that the amount allowable for the remainder deduction is proportional to the factors listed above. Younger beneficiaries (longer life expectancy) who select a higher payout percentage (more money in their pocket each year) will receive a far lower charitable income tax deduction than a 74-year-old who elects a five percent fixed return.

A second key tax consideration is the capital gains issue. If you fund the trust with an asset you have held for a long time, such as securities or real estate, you can completely avoid paying capital gains tax on the paper profit. This is a win-win situation for you as the donor and for the charitable organization that gets the benefit of the appreciated asset. You meet both objectives – providing ongoing income for your named beneficiary and providing for the charity of your choice.

Calculating Your Deduction

For this example, we are comparing the *approximate* tax deduction allowed on a charitable trust commitment of $100,000. The calculations also take into account the federal discount rate. Since that fed rate changes monthly, this example uses 8 percent across the board so that we can compare apples to apples. *(See Table 1, below.)*

For a person age 60 who selects a 7% fixed annual return, the tax deduction when the trust is established is about $4,000 greater than for the person of the same age who opts for a 7% variable return. It's a question of choice – security of the

Table 1: Calculating Your Deduction

	ANNUITY TRUST *(Fixed dollar amount)*		**UNITRUST** *(Variable return)*	
Annual Pay Rate	5%	7%	5%	7%
Age at which trust is established	Tax Deduction		Tax Deduction	
50	47,043	25,860	30,244	20,353
60	53,917	35,483	42,220	31,516
70	62,840	47,976	55,846	45,520
80	73,382	62,735	70,036	61,522

annual fixed payment or the potential to achieve a greater annual payback through the variable unitrust.

Valuable Expertise

There are quite a few unfamiliar terms and acronyms connected with trust instruments. You will learn about CRAT (annuity trust), CRUT (unitrust), NIMCRUTs and NICRUTS, FLIP trusts, make-up strategies, and the list goes on. There are many Internet sites from which you can gain valuable knowledge about how trusts can benefit your retirement years and your estate plan. You can review the federal rules governing these trusts in Internal Revenue Code Section 664, also available on-line.

I do recommend that you read as much as you can about CRTs but **the formal process of setting up a charitable trust should be accomplished in consultation with an experienced estate planning team, including your attorney and tax advisor**. This Paper for the NECA Academy is not intended to serve as legal advice, but as a general guideline for my fellow contractors to begin to consider the wide variety of options available through planned giving instruments.

The Electrical Contracting Foundation is taking the lead in offering its services as Trustee for any formal plan that you may wish to establish. Draft trust documents are available for you to review and modify, in consultation with your personal advisors. The Foundation will select and work with a trust Custodian who

- has expertise in managing and administering trust accounts,
- can provide current and timely information on investments and distributions,
- has access to investment instruments that meet the needs of each Trust.

You can establish a charitable trust naming as many ultimate beneficiaries as you wish. As your Trustee, the Electrical Contracting Foundation will ensure that all of the specific charitable organization beneficiaries you select receive their proper share of the Trust. This is not a program that just benefits the Electrical Contracting Foundation.

The Decision Power is Ours

Most of us assume that our assets will go to our spouse, children, grandchildren, other family, and/or friends we name in our will. For too many of us, not paying attention to assets during our lifetime makes those assets subject to estate taxes (unless and until this is changed by Congress).

The choice is simple. Do you want to decide which individuals and organizations will benefit for years to come from your efforts and hard-earned dollars? Or do you want the tax authorities to decide what portion is forfeited in taxes and what portion stays as part of your legacy?

For many contractors, in many different life stages, charitable trusts can be very advantageous and are most definitely worth our understanding and consideration.

Fellow Academy members, it is my firm belief that we have an obligation to return some of what we have earned from this electrical industry to help ensure that the Legacy of Excellence for Electrical Contractors continues.

Richard W. McBride, President of Southern Contracting Company, first became involved with NECA in 1966. His company has held memberships in the San Diego County Chapter and the Western Line Constructors Chapter for more than three decades. He has served as Chapter Governor and Chapter President, and has been active on a national level on the Council on Industrial Relations. In August 1999, Richard and Darlene McBride provided a substantial grant to The Electrical Contracting Foundation's Center for Academic Excellence to establish "The Darlene and Richard McBride Legacy Initiative Honoring the San Diego County Chapter of NECA and the Electrical Contracting Industry." He is the recipient of the 1999 Wendt Award for Exemplary Leadership and Service to the Electrical Industry.