

The Benefits of Greater Meaning and Purpose in Charitable Trusts, DAFs, and Family Foundations

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Have you ever noticed that there seem to be cycles or fads which occur in the world of taxation and estate planning? Within the life cycle of a tax technique we will often find each of the following elements: the good (that which should be refined and preserved); the bad (that which if not thoughtfully weighed and counterbalanced may lead to unintended consequences) and the ugly (that which will truly lead to serious harm or disappointment).

In the late 1980's and throughout the 1990's we saw an explosion in the use of charitable split-interest trusts and family foundations. We also witnessed the birth of the Donor Advised Fund (DAF) as a popular alternative to family foundations. The supporting organization, a sophisticated cousin of the DAF, began to rise in popularity and its proliferation so alarmed Congress that we saw legislation in 2006 which would create new rules governing both supporting organizationsⁱ and donor advised funds.ⁱⁱ

During the last fifteen to twenty years large financial organizations have routinely encouraged their financial consultants and financial planners to demonstrate the tax savings power of Charitable Remainder Trusts (CRTs). Virtually every client working with an investment banking firm which also provided wealth management services would send me an illustration of the "magic" of CRTs as a device to help the founder of a business retain the value of that enterprise by reducing the immediate blow of a capital gain tax.

Whenever a planning fad begins to generate too much visibility in terms of how it can be stretched to reduce our legal obligation to pay income taxes, it is likely to gain the attention of the IRS and/or Congress.

I believe the planning fever surrounding CRTs led Congress to conclude the CRT was being exploited as a tax savings tool. The legislative reaction was to create the 10% minimum remainder value test.ⁱⁱⁱ The purpose of that test is to insure there would be at least a significant value in the CRT which would eventually pass to charity.

While the use of CRTs has declined since these rules were enacted I believe the decline in the use of the CRT probably has a lot more to do with the diminished tax deduction they generate during periods of low interest rates than it does with the requirement that charities are actuarially projected to receive at least ten percent (10%) of the fair market value of the assets contributed to the CRT.

Since the start of the 21st century we have witnessed an almost unprecedented drop in interest rates. When interest rates drop Charitable Remainder Annuity Trusts wane in their

attractiveness but Charitable Lead Annuity Trusts become very attractive. So a new wave has started. It isn't being pushed as hard by the brokerage houses and other financial planning machines. But there is no question that the number of CLATs being created has risen dramatically in the last ten years.

So just a little over a year ago the IRS proposed new regulations which would require that a provision in the governing instrument of a Charitable Lead Trust (CLT) creating an ordering rule for the source out of which charitable payments are to be made must have economic effect independent of income tax consequences if it is to be respected for federal tax purposes.^{iv} Several commentators have not only questioned the IRS' authority to issue such proposed regulations but argue persuasively that the effect of such a regulation would be detrimental to existing CLTs and would discourage the use of CLTs in the future. These proposed regulations may not be the final effort to impose additional requirements on CLTs.

The risk of Congressional reaction isn't the only danger when a tax technique gets hot and begins to move through the good and bad stages of a planning cycle to the ugly results Congress calls abuse.

I believe there are two other dangers which we don't talk about enough. The first is the danger that clients will become mesmerized by the siren call of tax savings and misunderstand or forget the other purposes and consequences of a tax savings strategy. The second is the human impact of wealth transfer planning and income tax minimization strategies which have lost any purpose and meaning other than the tax savings itself.

Client Memory Loss and Charitable Remainder Trusts

I wonder how many of you have had a similar experience to the one I experienced a few years after I had joined Holme Roberts & Owen LLP as a partner. I got a call from a client who I really didn't know very well. Just before I had joined the firm this client had created a CRT in connection with a liquidity event at the company he had helped found. He had just left a meeting with his CPA discussing his taxes and was distressed to learn that the CRT had not saved him any taxes that previous year. So the client summed up the purpose of his call to me in these words: "Since we have harvested all of the income tax benefit we are going to get out of that trust, it's time to dismantle it and move on to something that will be more effective going forward."

I have often reflected on those words and wondered how it was possible that such an intelligent professional could have missed the point of the CRT? Was it possible that the only purpose he saw in the creation of the CRT was the tax savings it generated?

The anger and frustration he expressed when I explained to him that the CRT couldn't come back to him in a lump sum now that its "tax benefits" had been realized were real. He had forgotten all of the details around the form and substance of this technique.

In that experience the seed was planted which has grown into the ideas I want to share with you in this article. The ideas will be revolutionary but there are much more powerful voices than mine which support these concepts. Hopefully, you will allow these thoughts to germinate in your practice and use the examples I will give as the “first shadow” of what exciting possibilities lie ahead of you as you strive to assist clients to achieve their charitable and legacy purposes.

The Vision and Purpose of a Charitable Remainder Trust

I believe one of the greatest untapped opportunities out there is the opportunity to ask a client to focus on what are the “non-tax” objectives they hope to accomplish with the charitable gift which will be made following their death.

In my experience with CRTs in a post-mortem setting there is often a “memorial” service of sorts if the gift is large enough. The family members, or at least a few of them, show up at the charity or some other appropriate spot and some token of appreciation which has been thoughtfully created or purchased by the Planned Giving Professional is presented to a family representative. And then most often the proceeds from liquidation of the CRT are deposited into the charity’s investment pool where they will be considered unrestricted funds.

I have a much different vision of what is possible if the client, like Ebenezer Scrooge, can look back to look forward. You would think that someone who had been up all night with visitations from his deceased business partner and three ethereal ghosts would wake up exhausted or at least “ghost hung-over.” Instead, Scrooge throws up the shudders and experiences exhilaration and immediately commences to change the course of his life.

I am not suggesting that if you use a “visioning” process with your clients as I routinely do that they will all experience life-changing mindshifts. However, I think you will acknowledge after you have done this that the clients are energized and that it does transform the planning process from one that has a singular focus on how much taxes we will save to one where the client will really remember the deeper WHY behind the CRT. Hopefully, the first opportunity you have to try this experiment won’t—as so often happens—come at year end when the dark shadow of the last business day of the year is hovering over you and the client and the financial planner who has recommended the CRT starts the conversation with this question: “How quickly can you get the document drafted?”

Here is a sample question I use in the first meeting we have where we are really getting serious about the creation of the CRT:

“Imagine for a moment that you could experience a ‘Heaven Can Wait’ opportunity like Warren Beatty did in that movie and you get to come back after your death to accomplish some unfinished business. And pretend that the unfinished business is the realization of the full potential of the Charitable Remainder Trust. Let’s say, using the

numbers we are talking about today that there is a million dollars that goes to the charity or charities of your choice upon your death. What is the positive difference that sum of money might make? If you were able to see like Warren Beatty did five or ten years after your death what good had come from your gift, what are the things which would excite you to observe happening as a result of your gift?"

I would suggest you ask for the client's permission to use a digital recorder to record what they "see" as they participate in this visioning process. Don't interrupt the moment with the attempt to take notes. Listen attentively and focus on them. Give them the comfortable space of silence. And resist forming your next question as you listen to them. All of these suggestions are things I have been taught by someone here in Colorado who is acknowledged nationally as one of the great experts in communications in the client experience realm. They don't come naturally for me. I have had to practice them and I continue to remind myself of the importance of each of those steps.

After the client finishes let there be as big a pause as there was in the early moments when you wondered the first time if they would ever go anyplace with this exercise. After you have done this once you will know to support the moment with your positive mental energy and the expectation that you are witnessing the birth of purpose and meaning.

You might then ask:

"Is there anything else you would hope might happen as a result of your gift?"

Don't assume that silence means "no." Allow the client to continue to probe their heart and mind for the vision of other possibilities. I have witnessed a visioning exercise where the listener used one form or another of that "anything else" question at least five times and each time the thinking that was reflected in the client's answer was almost as powerful, if not more powerful, than the preceding expressions.

If it feels appropriate, before I ask that "is there anything else" question I may offer a heart-felt affirming statement. You might be surprised at how that positive emotional energy enriches the client's thinking. Here are some examples of how you might consciously affirm what you have heard the client express in their heart-felt words:

"Wow, that is really a powerful vision"

Or if you aren't inclined to be so positive here is a more sedate affirming statement:

"The vision you describe could really make a difference."

Before I go to the second step of the visioning exercise I will try to capture, in the client's own words to the best of my ability the essence of what I've heard. Here is an example of what that might sound like:

“I believe I heard you express the hope that your gift might lead to a breakthrough in cancer research. You would be excited to know that somebody’s mother survived the cancer that took your mother’s life. It would make you feel so good to see that someone who survived cancer because of the research your gift supported could go on for twenty or thirty years making a difference in the lives of the children they teach at school, or among their own family.

Depending on how the first part of the visioning exercise has gone, I sometimes take the client to a second visioning question:

“Please imagine for another moment that you are in this ‘Heaven Can Wait’ experience. As you are observing all of the things which have happened as a result of your gift, what are some of the things which might take place which would greatly disappoint you or which you wish you could have somehow prevented?”

After you have listened attentively, you may want to consider a follow-on question such as:

“Is there anything else you can think of that we might have said or done which would either avoid that negative outcome or greatly minimize the risk it might happen as a result of your gift?”

I find that clients have a much more difficult time with this question. So I am often prepared to offer what Scott Farnsworth calls a “Hidden Waterfall” story at this point if it appears appropriate. Here is one such Hidden Waterfall story:

“I am aware of a very difficult experience another family had over the sizable charitable gift. The first problem was that the parents had never told them about the gift. I’m not sure why. But in any event it came as a total shock. One of the children confided in their trusted advisor, ‘I just wish my parents would have told me the WHY behind this gift. I can’t help but feel that they didn’t trust me. Or they thought I would blow the money rather than making sure it would accomplish something great. It would have felt totally different if I would have been in on this gift. Perhaps I could have even played some role in helping to make sure my parents’ wishes were carried out. Now I don’t even know what they really wanted other than to give a whole bunch of money to XYZ.’

After I share that story, or something similar, I will ask:

“Do you see a way those parents might have avoided that problem?”

And then I may go on to ask:

“Is there anything you can think of that you might do to avoid having your children feeling disconnected from this gift or being afflicted with doubts over whether you trusted them?”

Depending on the dynamics of the family situation, you may need to judiciously shape that question to gently steer the client towards the most positive outcome possible. If it becomes apparent that there is a serious challenge within the family system, give strong consideration to bringing in a specialist who could either counsel with you and your client or assist them in implementing some intra-family communication and preparation that might avoid the result in the Hidden Waterfall story above.

What can result from such a visioning exercise? Here is an example of a clause which appeared in a text box at the beginning of a CRT and which served to explain why this woman created this trust:

My Purposes In Creating This Trust

I want my sons to understand why I have created this Charitable Remainder Unitrust. Ever since my mother died of cancer when I was a young teenager I've always wanted to do whatever I could to support cancer research. Over the years my tithing commitment has always come first. But I've tried to make small but consistent gifts to the American Cancer Society to support research. While I realized there was a possibility because of my genetic legacy that I could personally benefit from the eradication of cancer, the much stronger motivation for me has been the possibility that perhaps someday you, or your children if you get to experience the joys of parenthood, might benefit from such research. I hope you and your future families are spared the heartache I experienced. It would sadden me greatly if somehow you felt I was doing this because I didn't trust you or because I valued charity more than you. Please remember that love can't and shouldn't be measured by money or the size of your inheritance.

This trust seemed to be the best way to accomplish two important goals: maintain my financial security and make a significant gift for cancer research. I don't ever want to be a financial burden on either of you. So structuring a gift that helps me maintain my financial independence is important. But this trust also gives me an intangible benefit I can't measure in dollars and cents: it is a strong sense my mother would greatly appreciate what I'm doing in her memory. If you ever make a gift for cancer research do it in memory of the grandmother you never knew but realize as you do so that you are honoring me with that gift, whether it is great or small.

Nothing could make me happier down the road if I knew that not only had this gift been of some small benefit to you or someone you cherish but that you had begun to feel the stirrings I've had to do everything I could to make a difference through support of cancer research. I hope you will both continue to cultivate the compassion I have witnessed you have for those who have lost a loved one to cancer. Whether you choose to put your philanthropic support behind the American Cancer Society or some other cause that you feel passionate about, I would be so happy and proud of whatever you do. I love you. Mom

What does such a purpose clause accomplish? This clause might erase any question her children had about whether she trusted them. It could serve to remind her sons of the model she had been for caring deeply about a philanthropic cause. How could her sons not feel her love and concern for them, and their future posterity?

The Benefits of Purpose Clauses for Charitable Bequests, DAFs, and Family Foundations

Purpose clauses can be used in connection with any charitable or non-charitable trust or gifting vehicle. One of the greatest dangers in the area of charitable gifts is the drift away from donor intent.

In 1961, answering President Kennedy's plea to "ask what you can do for your country," Charles and Marie Robertson gave one of the largest gifts ever made to higher education. In 2002 their heirs filed a lawsuit against Princeton University trying to take it back. This is perhaps the largest lawsuit alleging gross deviations from donor intent. When the case was settled at the end of 2008, Princeton ended up with keeping most of the endowment. One of the questions the Robertson v. Princeton litigation raises is whether the Robertson family might have been much more successful in their lawsuit if the original gift agreement had contained much more explicit statements of purpose and intent.

The failure of trusts to expressly state a grantor's intent can be a serious problem if a court is ever called upon to construe that document. I have had many lawyers I highly respect question the wisdom of my suggestions that we capture the client's intent and purposes through direct quotes which are skillfully edited from a legal standpoint to avoid ambiguity. I often ask them to consider how many lawsuits end up being filed because of the instrument failure to adequately express the client's most important purposes. I also ask them to consider the overwhelming support from fiduciaries who tell us that the greater the expressions of intent and purpose the easier it is for them to administer a trust.

This language from an introductory note in the Restatement of Trusts 3rd on Trust Purposes confirms the critical importance of purpose clauses in trusts:

"Throughout not only this Chapter but this entire Restatement, reference is regularly made to 'the purpose(s) of the trust' and to the importance of trust 'purposes' in the handling of specific issues. Unfortunately, the purposes of a given trust are often not stated in the trust provisions, especially with precision or in comprehensive terms. As a result, the ascertainment or clarification of settlor purposes is frequently difficult and left to some speculation. Whatever identification and understanding of trust purposes is possible is often the result of inferences drawn from the nature and terms of the various beneficial interests created by the settlor. **More thoughtful guidance by drafters would often be helpful to trustees, beneficiaries, and courts in seeking to understand trust purposes and to carry out settlor intentions. Yet, it is important to note as well that hasty, casual, or rote expressions of trust objectives are often incomplete and can even be seriously misleading, and are thus likely to do more harm than good.**"^v

With regard to Donor Advised Funds and Family Foundations there are many opportunities for the draftsman to skillfully assist the founder in stating with precision their vision and intent for this charitable gift. As the quote from the Restatement of Trusts 3rd points out “more thoughtful guidance” would be of great help in making sure that the founder’s intent is carried out. The visioning exercise suggested for a CRT can be easily adapted to a DAF or Foundation.

The Paying It Forward Moment

As this visioning exercise draws to a close, or at the end of the client conference if we are going to discuss other concepts or points before closing, I like to end with what I call the “paying it forward” moment. I begin that moment in words like these:

“As I listened to you express all of the positive impact your charitable gift might have, there was one vision that popped into my mind that I’d like to share with you and let you savor for a moment. I imagined one of those cancer survivors who was so touched by the gift of life and the care she received that she asked her doctor ‘what can I do to pay back this marvelous gift I have received.’ And her doctor might say, ‘you can do what so many others have done. You can contribute to cancer research.’ And then that individual might spend many years writing annual checks for cancer research or perhaps even some day create a charitable remainder trust to support cancer research. Wouldn’t it be wonderful if your gift could result in a never ending chain of others paying it forward?”

That introduction to the “paying it forward” moment needs, of course, to be tailored to what you have heard your client express. In this example, I have chosen to follow on the situation we described above.

The “paying it forward” moment is much more than just the expression of that dream that this CRT might result in a marvelous fusion of charitable action. I’d encourage you to think about purchasing a copy of the movie *Pay It Forward* and watch it if you haven’t already done so. Even if you have seen that amazing film, take the time to watch it again and be looking for this moment in that film, when Haley Joel Osment playing the role of 12 year old Trever McKenney says:

“I guess it's hard for people who are so used to things the way they are - even if they're bad - to change. 'Cause they kind of give up. And when they do, everybody kind of loses.”

I have written that line down on a 3 x 5 card. When we finish this visioning exercise I like to give my client a copy of *Pay It Forward* with that quote. And then I would say something like this: “If you haven’t watched this movie, please watch it and look for the moment when the boy makes this statement. If you own this already, please think of someone and an appropriate moment when you might share this movie with someone else who could make a difference in the world. I’m just so privileged to have clients like you who haven’t given up. And because of clients like you I know that eventually the world will be a better place.”

If you and your client don't share that "paying it forward" moment as you are in the heart of helping them create their charitable remainder trust you have missed a tremendous opportunity. It's my hope that you will feel the power behind searching for the deeper meaning and purpose that should be a part of every CRT, CLT, DAF or Family Foundation and that you will experience the joy of moments when clients get truly energized about their planning and express their appreciation to you for the wisdom and guidance you have offered in their pursuit of their estate planning goals.

ⁱ See, e.g., IRC §§ 509(f), 4942(g)(4), and 4943(f).

ⁱⁱ See, e.g., IRC §§ 170(f)(18), 4943(e), and 4966.

ⁱⁱⁱ IRC § 664(d)(1)(D) and (d)(2)(D).

^{iv} Prop. Treas. Reg. § 1.642(c)-3, 73 Fed. Reg. 34670 (June 18, 2008); Prop. Treas. Reg. § 1.643(a)-5, 73 Fed. Reg. 34670 (June 18, 2008).

^v Restatement of Trusts 3rd, Part 3, Chapter 6, "Trust Purposes," Introductory Note. Emphasis added by author.