



# Your Bottom Line

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*Navigating a clear course toward your financial security.*



Warren Mackensen

## Charitable Trusts .....

If you intend to make a significant charitable donation, you should become acquainted with charitable trusts.

There are two major types of charitable trusts: charitable remainder trusts and charitable lead trusts. The trust type is determined by when the charity receives the benefit of your gift.

In addition to helping charity, the main benefit of a charitable lead trust is a reduction of the donor's gift and estate taxes. The donor gifts appreciated property that is expected to generate income and the trust makes annual payments to a named charity or charities for a specific period, such as 10 or 20 years, or lifetime. When the period ends, the remaining trust assets pass to the trust's beneficiaries, usually with gift or estate tax savings. Obviously, this type of charitable trust is for donors who do not need current income from the assets and who want to make an immediate gift to charity.

Charitable lead trusts come in several variations. A charitable lead annuity trust (CLAT) pays out a fixed dollar amount to the charity set at the time of transfer of assets to the trust. There is no required minimum amount, but the amount will affect the size of the charitable deduction. The

trust may need to dip into principal should the income be insufficient to make the fixed payments. In contrast, charitable lead unitrust (CLUT) payouts are based on a fixed percentage of the fair market value of the assets, recalculated annually.

These versions are further modified depending on whether it is a grantor trust or a non-grantor trust. With a grantor trust, a portion of the assets may revert to the donor. The donor can take an upfront income-tax deduction, but has to pay taxes annually on all trust income paid out to the charity.

With a non-grantor trust, the income generated by the trust is taxable to the trust, not the donor, but the trust receives a charitable deduction. The donor receives a charitable gift-tax deduction based on the value of the payments and how long the assets are to remain in the trust. Also, future appreciation of trust assets is removed from the donor's estate and any gift or estate taxes due at the time of the trust termination may be reduced through a discount.

Charitable remainder trusts are essentially mirror images of charitable lead trusts. They are designed for people who need current income or worry about running out of income during their lifetime, and who need income-tax deductions more than they need estate tax savings.

The donated assets, which can be sold by the charity without a capital gains tax to the donor, typically are invested in diversified income-generating assets and the income is paid out to the donor. When the trust terminates, the remaining assets pass to the charity. The donor receives an upfront income tax deduction for the gift based on the donor's age and the amount expected to ultimately go to the charity or charities. If you name someone else besides yourself or your spouse as income beneficiary, the donation may be subject to gift tax.

As with the charitable lead trust, a charitable remainder trust comes in two flavors, but with very important differences. The annuity version, a charitable

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## Medicare Part D Prescriptions .....

Medicare recipients need to carefully review the Medicare Prescription Drug Plan (Part D coverage). Open enrollment for the program starts on November 15, 2005, and ends on May 15, 2006. A late enrollment penalty applies after May 15, 2006. You may start to use the Plan for prescriptions on January 1, 2006. If we may be of assistance in helping you sort out your options, please call our office to schedule an appointment. ❖



David A. Batchelder

## Student Financial Aid .....

Some college students miss out on valuable financial aid every year simply because they mistakenly believe they will not qualify for aid or they are intimidated by the process. Applying for financial aid can make the difference between affording the school you want to attend, or attending the school you can afford.

A study released in October of this year by the American Council on Education found that in the 1999–2000 school year, half of all undergraduate students enrolled at colleges that participated in the federal financial aid program did not bother to apply for aid.

While some students would not have qualified because they had sufficient financial resources, many left money on the table. The study concluded that 850,000 low-income students would have qualified for federal Pell Grants, which is money that students do not have to pay back.

The first key is to understand exactly what “financial aid” means. Aid is actually a mixture of loans, grants, scholarships, and work-study. To calculate how much aid your student qualifies for, start with the total cost of attending a particular school: tuition and fees, books, room and board, transportation, and miscellaneous expenses. The school then determines how much of that total cost your family can reasonably be expected to pay, known as the expected family contribution (EFC).

Typically, the calculation of the EFC starts with completion of the

Free Application for Federal Student Aid, known as the FAFSA. This assesses the student’s and parents’ income, investments, and other financial resources, and arrives at an EFC number. Additionally, some colleges, particularly private, gather additional information to see if the student qualifies for non-federal (institutional) financial aid. Theoretically, the shortfall between what the family is expected to pay and the total cost of that institution is made up by financial aid.

Don’t assume that because you are a middle-income or affluent family you will not qualify for aid. Twenty-two percent of families making \$100,000 or more are receiving financial aid. Also, while you might not qualify for aid from a lower-cost college, you might qualify for aid from a more expensive school.

The majority of financial aid comes in the form of loans that have to be paid back. The loans are often subsidized, meaning you do not have to pay interest or principal on the loan until after the student graduates. Many colleges, particularly private schools, kick in grants or merit scholarships from endowments.

Aid packages can vary substantially among schools, and even region to region, so compare them carefully. Do not consider the packages written in stone. Sometimes errors are made or important financial information is left out. Just because you did not qualify for aid one year does not mean you will not the next. We can help you sort out which options are best for your particular circumstances. ❖

## Charitable Trusts (continued) ...

remainder annuity trust (CRAT), must annually pay out an amount equal to at least five percent of the value of the initial donation. The percentage can be higher than what you will get from a commercial annuity, though if it is too high you will disqualify the trust.

The unitrust version, a charitable remainder unitrust (CRUT), has a set percentage at the outset, but the trust value is recalculated every year, so the payout value will vary year to year.

A variation of the CRUT is a NIMCRUT—net income with make-up charitable remainder unitrust. That mouthful means the trust must pay out all net income generated by the trust, and if it does not pay it all out in a given year it has to make up the shortfall in subsequent years.

Ultimately, the selection of the trust type is governed by your charitable intentions. As with all charitable giving, the charitable intent must exceed the desire for tax reduction or the approach will probably not work for you. ❖

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