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**Is The  
Death Tax  
Really Dead?**

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**SPECIAL ISSUE**

# Reflections on the Economic Growth and Tax Relief Reconciliation Act of 2001

with Debra Ashton, Reynolds T. Cafferata, Laura H. Peebles, Conrad Teitell & Craig C. Wruck

- 1) On June 7, 2001, President Bush signed into law H.R. 1836, The Economic Growth and Tax Relief Reconciliation Act of 2001. What is your overall opinion of this new law?

Debra Ashton: Overall, this is a real mess. Instead of simplifying the tax code, the new law presents us with complete uncertainty, which will hinder families and businesses from being able to make permanent plans for the distribution of their assets without all kinds of alternate provisions depending on the year of death.

If the sunset provision is extended, the tracking of capital gain on property transfers at death will be nearly impossible. Planning which of the decedent's assets to distribute to a spouse versus other beneficiaries will generate big problems, e.g., the "cherry picking" assets that get a stepped-up basis going to some heirs and passing assets with a built-in income tax liability to others.

Reynolds T. Cafferata: The new law is disappointing because it does little for charity except the eventual phase out of the limitation on itemized deductions, which sometimes impacts the charitable deduction. Overall, the income tax provisions are a positive development because they lower taxes without adding complexity to the tax code. The law expands the usefulness of the 1997 Tax Act by making the education IRA and state tuition plans a real help in paying for costly education. The qualified plan rule changes will help most participants. The estate and gift tax provisions are a big disappointment. Regardless of whether you favor the repeal of the estate tax, the uncertainty created by the sunset provision of the bill, which will repeal the repeal of the estate tax after one year, creates significant complexity and uncertainty in planning. It would have been far better tax policy to include only as much estate tax relief as could be agreed to by all parties on a permanent basis.

Laura H. Peebles: My opinion of the new law is not very high, I'm afraid. It did little towards fixing the alternative minimum tax, nothing for charitable giving, nothing about payroll taxes for working families (and, need I say it) and nothing towards reducing the complexity of the tax code. Yes, there's a modest short-term stimulus to the economy, slightly lower income tax rates and some

long-overdue increases in IRA and 401(k) limits, but overall, as back-loaded as the benefits are, I don't think of it as a great bill. Oh, yes, and they lowered the estate tax rates, and promised to repeal them for a year: 10 years from now.

Conrad Teitell: When asked his position on whiskey, a legendary politician replied:

*If*, by whiskey you mean the devil's brew that has wrecked millions of marriages, taken the bread from the mouths of hungry children, and toppled countless men and women from the pinnacle of righteousness, then I am against it!

*But*, if by whiskey you mean the oil of convivial conversation, the traditional expression of Christmas cheer, the source of millions of tax dollars for orphans, disabled children and the blind, then I am for it!

This is my firm stand, and I will not compromise!

Without getting into the pros and cons of the controversial new tax law, I'm saddened by the legislative legerdemain—with all the phase ins, phase outs, cop outs and then a sunset provision that tosses out the whole ball of tax in 2011. And, I'm unhappy that charities were once again left standing at the altar.

Craig C. Wruck: It is either the first step toward significant tax reform, or a marvelous political illusion. Whichever, it will not really have much impact on the average taxpayer once he or she has spent the tax refund this summer. The interesting thing will be to see how the public reacts when they realize how little immediate effect this tax act will have.

- 2) The repeal of the estate tax will take 10 years. With the slow phase in of repeal, how long do you think it will take for this law to have an impact on charitable giving?

Ashton: Many of the people who already have charitable provisions in their estate plans will elect to keep these provisions for the immediate future. Considering the motivation of donors that I

have worked with in the past decade, most of them have specific dollar bequests intending to establish named endowed funds in order to permanently link their names to the charity. For those people, it is hard for me to believe that they will decide to change these charitable provisions, especially because the minimum gift requirements for named endowed funds are set by the charity. There is more motivating these people than just avoidance of tax. But that's the biggest problem, motivation, since many donors have heard the word, "repeal," they assume Congress has solved all of their estate planning problems by getting rid of the tax. Donors are already skittish about planning for the future; now they've got more reasons to continue procrastinating.

For others who have not yet finalized their plans, but who are in discussions with charities about bequests, I suspect that it will be business as usual for a while. In addition, the growing concern of the super wealthy not to give children or grandchildren too much wealth so as to make them unproductive may balance the potential elimination of the estate tax.

It is hard to know whether the immediate increase in the lifetime exemption to \$1 million next year will change the behavior of people who were going to provide a bequest to charity. However, the fact that the gift tax and estate tax are no longer unified will affect how people behave. People may want to make sure that they give away the \$1 million to non-spouses during lifetime, or they will have a sense of having missed an opportunity.

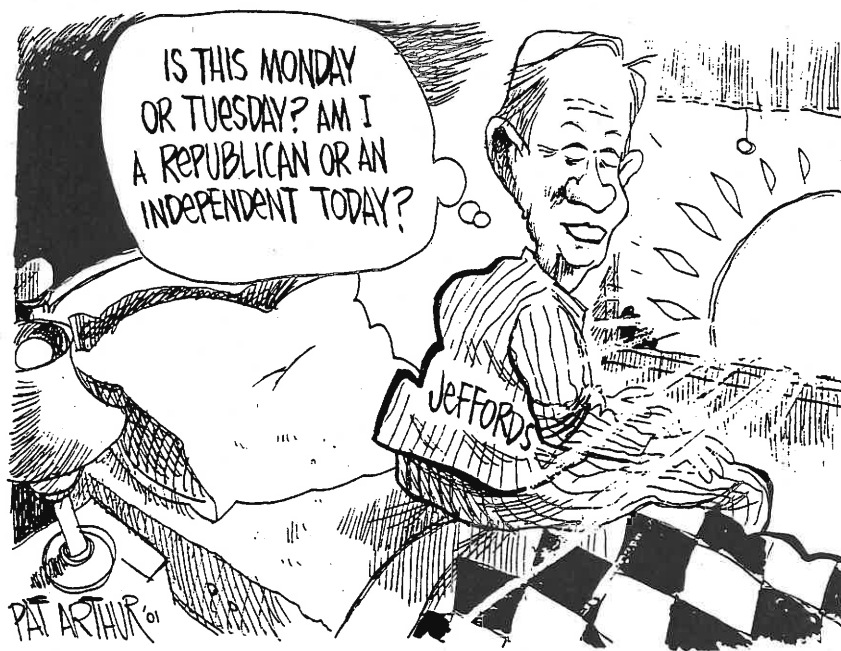
Cafferata: The uncertain potential of repeal of the estate tax has already had an impact on all planning, including charitable planning, by creating uncertainty and causing taxpayers to delay

planning. The law perpetuates this uncertainty for the next 10 years because of its sunset provision. Regardless of the ultimate impact of an estate tax repeal on charitable giving, the general adverse impact of the law on planning will probably immediately have some adverse impact on charitable giving. Donors who are unable to plan for their families because of the uncertain rules will have a hard time focusing on charitable giving plans.

Peebles: I don't expect a major effect on the amount of charitable giving. First, my experience is that tax law drives the "how" of charitable giving, not the "how much." Assuming repeal actually takes effect, different techniques will become useful, some old standards will be less useful. In my experience, charitable giving is driven by the desire to change the world, pay back society for opportunities received, the desire to avoid spoiling children and ego. Depending on the donor, there's a different mix of those factors. Tax laws change none of these. Also, much inter vivos charitable giving is driven by income tax considerations, and these rates are dropping even more slowly than the estate tax rates.

I expect there to be a pause while everyone (donors, planners and donees alike) digests the bill. Then, everyone will get back to planning. There will just be one more question to ask: Does this plan still make sense in light of the new law? I expect the answers will be "yes" in most cases.

Teitell: The estate tax law has not been repealed, but rather suspended for the year 2010. Before then, the rates go down a bit over the years and the exemption goes up substantially—mainly at the tail end. Keep in mind that the gift tax hasn't been "repealed" and that the gift tax exemption is frozen at \$1 mil-



lion. In my mind, the question is not "how long do you think it will take this law to have an impact (presumably negative) on charitable giving," but *will* it have an impact on charitable giving? In the short run, it will stir up interest in financial and estate planning—attendance at charities' seminars and a greater interest in charities' development publications. And gifts result from that.

For the long run, who knows? But what you see now is not likely to be what you'll get in 2010 or even before. We'll have four Congressional elections and two Presidential elections in the interim. And this Congress is already talking about revisions.

Wruck: This really is the best possible outcome. The slow fade away of the estate tax will allow individuals plenty of time to think through their options, weigh their alternatives, and make decisions about what is most important. We've worried for a long time about the impact of repeal of the estate tax, but this is much better than a precipitous repeal like we would have seen under last summer's proposal.

3) In terms of marketing planned gifts, how would you suggest that gift planners accommodate a tax scheme that is on a 10-year phase-in basis?

Ashton: Due to the continuing desire of donors to avoid both the income tax and the capital gain tax, I would expect that the advantages of charitable remainder trusts (CRT) and gift annuities will continue to motivate donors to make inter vivos gifts to these life income plans. Combined with a wealth replacement life insurance policy that potentially could go to the heirs free of estate tax (eventually, without the need for a life insurance trust and Crummey powers), I suspect that lifetime charitable giving will be alive and well. In any case, it gives us an excuse to go see donors and update them on the changes.

Cafferata: Gift planners first should focus on the primary reason for giving: Mission and the donor's desire to use his or her resources to further the charity's mission. Donors also will need to be educated about the provisions of the law, particularly the sunset provision. While anything can happen, most people would be best advised not to count on a permanent (or even temporary) repeal of the estate tax.

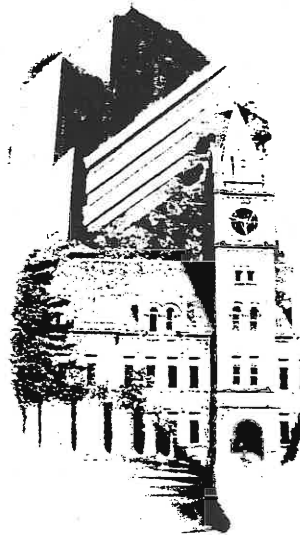
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Peebles: If the plan structure makes economic and philanthropic sense were the donors to die tomorrow, and also makes sense if the donors die after full repeal, then it's the right plan. If it's a testamentary plan that only makes sense if the donors die before full

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*As far as those who have not yet planned their estates, it would seem to me that this law, creating a tax climate of uncertainty, would encourage more people to procrastinate. In addition, it will take some time for a new set of common sense strategies to evolve in the financial planning community.*

*-Debra Ashton*

repeal, then it might be appropriate to consider alternative plans along with the original. As far as marketing, estate tax benefits are only a small piece of the presentation. Current income tax benefits are fine, but support of the charity's mission is the most important selling point (with a little ego satisfaction thrown in). Every donee can offer the same tax benefits. Marketing is about being different: If you're with an institution, focus on the good the donation will do; if you're not, market how the planned gift fits with the rest of the potential donor's family wealth planning.

Teitell: I suggest business as usual. Continue to emphasize the important work that charitable organizations do. For the vast majority of donors, estate taxes play a small role in their charitable giving decisions. And the glorious benefits for lifetime charitable giving remain. A potential loss to a donor of an estate tax benefit could motivate him or her to make a lifetime gift to seize the income tax benefits. I see the joy of my law firm's clients when they make outright charitable gifts and create inter vivos charitable remainder trusts. Not one client, however, has reported back on what it's like to make a testamentary charitable gift.

Wruck: We ought to focus on the mission of our charitable organizations, and the interests and values of our donors and clients. The vast majority of Americans were not affected by the estate tax under previous law, and yet they still wrote wills and they still made charitable bequests. We should begin to sharpen our discussions about the favorable treatment of capital gain property contributed to a charitable remainder trust since, beginning in 2010, heirs will no longer enjoy a step up in basis, but we ought to remember that's nine years from now and it vanishes a year later.

- 4) Do you think there will be a mad rush by donors to change their estate plans, or do you think that those who have waited to create their estate plans because of uncertainty will now act?

Ashton: Couples who have already split their assets into two revocable trusts with

formulas to further split the assets on the death of the first may not do anything for a while. For example, my parents have a plan that funds the credit shelter trust on the death of the first with an amount equal to the lifetime exemption for the year of the first death. That strategy will still be valid, depending on the size of the estate, for many years.

As far as those who have not yet planned their estates, it would seem to me that this law, creating a tax climate of uncertainty, would encourage more people to procrastinate. In addition, it will take some time for a new set of common sense strategies to evolve in the financial planning community. Therefore, I do not anticipate a mad rush to do anything. Just the opposite may happen.

Cafferata: I suspect that some people who have put off planning will now move forward with that planning. All charities and advisors will need to make an effort to educate their donors and clients that even if the estate tax is ultimately repealed, there are many non-tax reasons for continuing with the planning process. In fact, without an estate tax, there will be significant trust planning opportunities. Most kinds of lifetime giving programs will likely be on hold until it is finally determined whether or not we will have a permanent repeal of the estate tax. Wealthy individuals would be wise to hedge their bets that the estate tax ultimately will be repealed by using wealth transfer techniques that do not involve the payment of gift tax for the next several years, so that if estate the tax is not ultimately repealed, they have not lost the opportunity to transfer wealth. That being said, it seems to be human nature to want to put off planning, and the uncertainty created by the law will no doubt allow many people to rationalize doing just that.

Peebles: Yes, but only a small rush. There are some people who were waiting for the law to change, and will treat the law as if it were the final answer. (If they're very elderly, that may be correct.) They will revise their estate plans to cope with both a pre- and post-repeal scenario.

A much larger group, I expect, will wait until one to two years before repeal before paying their professionals to revise their plans. That may not be a good idea, since many estate planning documents have definitions tied to various tax definitions. Some plans may still "work" under the new law, but produce a different result than intended by the drafter or the testator. If not reviewed and revised, these plans will breed confusion and potential litigation.

Teitell: Clients are rarely in a mad rush. But they should wander on down to their lawyer's offices soon. Marital and credit shelter trusts are keyed to formulas. Major distortions to an individual's wishes will often result if the new, higher estate tax exemptions aren't taken into account. Also, some testamentary charitable lead trusts have formulas that might distort a donor's estate plan unless the higher exemptions and "repeal" are taken into consideration. With the higher estate tax exemptions, and estate tax suspension for one year (or real repeal if the sunset provision is, itself, repealed), disclaimers should play a bigger role in estate plans. They provide flexibility and the ability to deal with a tax picture that changes depending upon the time of an individual's death. Bottom line: Estate plans should generally be reviewed (not necessarily always changed) whenever there are major tax law changes. There are, of course, other reasons for review; change in an individual's financial and personal circumstances is high on the list. As for the question, "Will those who have waited because of uncertainty now act?" They should.

Wruck: Neither. There's really not much in this bill to trigger a mad rush. In fact, some of the planning scenarios (for example, trying to figure out how to use a marital trust plan when the unified credit keeps changing, then vanishes, then returns) are going to take a considerable amount of time to fully explain to donors and clients. On the other hand, those frustrating folks who refuse to decide because there might be another tax law change around the corner now have proof positive that procrastination pays: The tax laws shift about every two years for the next decade!

5) Besides the repeal of the estate tax, what other provisions, if any, will affect charitable gift planning?

Ashton: Not much else will affect charitable giving in the immediate future. The gradual drop in the income tax rates through 2006 would probably not be enough to change the motivation for making charitable gifts, especially when the combined benefit of income and capital gain tax savings for charitable gifts of long-term appreciated assets still exists.

If we get to 2010 with no changes in the bill, and if the sunset provision is extended, then we find ourselves in a new planning climate that is different than anything we've had in recent history. There is no prior behavior under such conditions to evaluate and predict 10 years hence. People will be obsessed with the capital gain issues and will be structuring their estates, making gift

decisions, and transferring property so as to avoid as much of the capital gain tax as possible at death.

People considering a gift of a primary residence to charity with retained life tenancy might have greater incentive in 2010 to leave such real estate to heirs because of the new ability of the heir (or the estate) to claim the same lifetime exemption on the property's appreciation as did the owner.

Since there is still no charitable deduction for nonitemizers, perhaps some of the people benefiting from the higher standard deduction for married taxpayers would become nonitemizers. Would this change charitable giving behavior for the smaller donor?

Cafferata: In states that do not have high state income taxes, the phase out of the limit on itemized deductions probably will be a significant positive development for charitable giving. The lower marginal tax rates somewhat reduce the tax incentive to give, but charity survived the reduction in capital gains rates a few years ago. I doubt the rate changes will have much impact on giving.

Peebles: If we actually get the repeal of the phase out of itemized deductions starting in 2006, that will help. Although we didn't get the IRA rollover for charitable purposes provision in this bill, the removal of the phase out would accomplish the same benefit for small or moderate contributions from IRAs. Donors could then withdraw from their IRA, make the donation, and not be out of pocket for the tax on the various "phase outs." Of course, the cost for this repeal is almost \$25 billion through 2011, so we may never see it.

Teitell: If the estate tax is really eventually repealed, it is to be replaced by a capital gains tax on an heir's sale of inherited appreciated assets (after some exemptions). That's because carryover basis rules would replace the current stepped-up basis rules. Presumably, that would make both inter vivos and testamentary charitable remainder trusts benefiting family members even more attractive because—as everyone knows—in most instances, charitable remainder trusts can sell appreciated property for reinvestment without being hit with capital gains taxes.

Wruck: As we noted above, there's the opportunity to work with capital gains tax savings, but not for several years. Beyond that, we'll have to count on people's generous nature...just like, ultimately, we always have.

6) The new law contains the following provision, "To ensure compliance with the Congressional Budget Act of 1974, the conference agreement provides that all provisions of the bill generally do not apply for taxable, plan or limitation years beginning after December 31, 2010." Since the repeal doesn't take full effect until 2010, how much will this new law really accomplish?

*I certainly hope that within a reasonable period of time before 2010, Congress will make up its mind whether it really wants to repeal the estate tax, and will either make the repeal permanent or will eliminate the actual repeal, perhaps freezing everything at the rates and credits available in 2009.*

*-Reynolds Cafferata*

**Ashton:** The immediate increase of the lifetime exemption for estate tax purposes to \$1 million will provide relief to many taxpayers and will make the estate tax problem moot for many people who, otherwise, would be worrying about the fact that they are over the current limits. However, as long as we still have an estate tax and a gift tax (even if the two have different exemptions in the future), there is still a lot of planning for people to do.

If we really knew that there would be no estate tax after 2009, some people might elect to transfer \$1 million to their children (\$2 million for couples) currently, and watch to see how the kids handle the money. Then, perhaps, depending on how responsible the children have been, the parents could consider later whether to provide more for them in their estate plans or provide more to charity.

As far as the reduction in income tax rates, the reduction is so gradual in most cases that it will have virtually no meaningful affect on people's behavior. For example, does it really matter that the tax rate goes from 39.6% this year to 38.6% next year? Will people in the 39.6% rate today change their behavior next year? It will still be beneficial to make inter vivos charitable gifts.

When the state death tax credit is fully phased out, (or possibly before it is completely phased out), there will be new death tax considerations if states begin enacting new state inheritance laws.

**Cafferata:** I certainly hope that within a reasonable period of time before 2010, Congress will make up its mind whether it really wants to repeal the estate tax, and will either make the repeal permanent or will eliminate the actual repeal, perhaps freezing everything at the rates and credits available in 2009. If Congress does not change the law, it may be the repeal of the generation skipping transfer tax for the one year that has the most impact, resulting in a frenzy of direct skip gifts that year. Overall, a one-year repeal of the

estate tax would create a verity of unhealthy pressures.

**Peebles:** As the bill is currently written, there is a relatively short period in which there is carryover basis and no estate tax. That is sufficient to force everyone to plan for four possibilities: 1) the repeal is made permanent by a future Congress; 2) the repeal is delayed by a future Congress; 3) the repeal is undone by a future Congress; or 4) the law stays as it is all the way through 2011. (This last alternative seems somewhat unlikely.) Until this is resolved, the planning must be done under three alternative dates of death: during phase out, during the repeal window and after reinstatement.

So, it's not that the law does nothing—it has added significantly to complexity, uncertainty and professional fees. Also, I don't think people realize how much paperwork the carryover basis will be. People who believe that we will have full repeal should start assembling their basis records now for their heirs—everything from forks to Ford stock. In all fairness, the bill does have some significant benefits in the generation-skipping area, rate reduction and increase in exemption amount. Those are all good things for taxpayers.

**Teitell:** Accomplish for whom? The estate tax exemption goes up to \$1 million next year (instead of in 2006) and it eventually increases to \$3.5 million, which means that less than 1% of estates will be taxable. So even if the estate tax isn't repealed, but only suspended, poorer-wealthy people (the comfortable, but not filthy rich) won't have their estates taxed.

**Wruck:** As many commentators have noted during the last few months, this tax bill is not the last step. Hopefully the immediate refund will provide some stimulus, but in the long run the most lasting impact of this tax bill may be just to help frame the debate for tax bills in the future.

7) Since Senator Jeffords decided to become an Independent and the



Democratic Party is now in the majority, do you see any more significant tax bills or changes in the code in our immediate future?

Ashton: The only thing that I can say in answer to this question is that the bill is not the end of the story. Given the shift in power in the Senate, any future tax initiatives will be driven by a different group of people, i.e., Ted Kennedy and John Kerry instead of Jesse Helms and Trent Lott. Therefore, I would imagine that we will end up with some form of estate tax, not complete repeal, and that the exemption will settle in somewhere between \$1 million and \$3.5 million.

Cafferata: Tax relief is not a priority of the Democrats, and if they are controlling the legislation coming from the floor, significant tax changes do not seem likely. Furthermore, it would appear that for the short run, Congress has used all of the funds that it is willing to devote to tax relief, and further changes would have been unlikely even if Jeffords had remained a republican. None of this will be helpful to NCPG's continued efforts to get the IRA rollover for charitable purposes passed.

Peebles: Well, the Democrats are only a majority in the Senate, so that is more likely a recipe for gridlock than anything else. There might be another bill with changes for business taxes (i.e., the research and development credit), but nothing specific on the horizon for charitable planning.

Teitell: That's an easy one. There'll always be tax law changes. After the mammoth 1986 tax law, the then Ways and Means Committee Chairman Dan Rostenkowski (before he started collecting stamps) said he was hanging a "gone fishing" sign on the Committee's door. But that sign, as we know, has been ignored. Of course, there will be changes. Why serve on the House Ways and Means and the Senate Finance Committees unless you have fish to fry?

Wruck: As with all things political, there's just no percentage in predicting the future.

My sense is that we're tired of tax policy discussion for now, and aren't likely to see much enthusiasm for major tax legislation at least until the next Congress in 2003.

8) Bottom line, will the repeal of the estate tax help, hurt or make no difference to charitable gift planning?

Ashton: That depends. If we get past 2010 and the bill, as enacted, is still in force, my prediction is that we will still have charitable giving. People could take advantage of charitable giving opportunities that they might not create today. For example, with no estate tax and with a gift tax exemption of \$1 million, a donor could set up an inter vivos charitable remainder trust for a sibling. After 2009, people may be motivated to give away up to \$1 million during lifetime (other than gifts qualifying for the annual gift tax exclusion); therefore, the income interest in a CRT or other life income plan could be given to a friend or non-spouse family member. Knowing that the rest of the estate will pass tax free on death would afford people the freedom to use up their \$1 million gift tax exemption while they are alive. As long as their CRT meets the 10% charitable deduction rule, perhaps donors would be more likely to set up inter vivos CRTs for children. A CRT could also be excellent as an inter vivos plan to support an elderly parent.

Cafferata: If we have an actual permanent repeal of the estate tax, with the impact of carryover basis and the significant additional available dollars in large estates, charity will be able to find sources of support. So a permanent repeal of the estate tax probably will not hurt charities in the long run. The uncertainty created by the current bill, however, may be a drag on charitable giving until there is definitive legislation on the future of the estate tax. Unfortunately, this issue probably won't get resolved until at least another election cycle, and possibly not until there is a new administration.

Peebles: If people start postponing or ignoring estate planning overall, because of confusion or skepticism about the repeal,

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*-Craig Wruck*



charitable planning overall will be hurt. Otherwise, I believe it will remain about the same. Remember that some of the largest private foundations were established before there was an income tax, let alone an estate tax. If the media continues to focus on the sunset provision in 2011, I think the message will get across that the repeal is anything but a "done deal." People may indeed become frustrated with the need to maintain a dual estate plan—one to deal with estate tax and another one to deal with carryover basis. Of course, if their estate plans are "a fixed dollar amount to my children and the remainder to charity" that works just fine under either scenario (but they still need to review their documents).

**Teitell:** He who lives by the crystal ball is bound to eat glass.

**Wruck:** It's an opportunity to visit again our donors, clients and prospects, and to talk to them about the importance of charitable giving and how it can fit into an overall financial and estate plan. From that perspective, it's a positive. But because of the long phase out and the general skepticism about eventual repeal, I don't think we'll see a real impact on charitable giving. ☐



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