Using Your Assets to Promote your Values

Review of Several Charitable Planning Techniques

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Incentives for Charitable Giving

- Charitable Motivation. The primary reason for charitable giving comes from the human heart. Unless the spark of philanthropy is there, no amount of tax driven estate planning advice will convince a client to part with significant assets. It is the estate planner’s responsibility to determine the client's personal family financial philosophy and facilitate its implementation.

Cash Gifts

- Advantages:
  - Simple and Quick
  - Gift to Public Charity deductible up to 50% of AGI with five year carryover
  - Gift to Private Foundation up to 30% of AGI
  - Charities Love Cash
- Disadvantages:
  - May deplete your cash
  - Often cash is earned after paying tax

Gifts of Securities and Real Estate Held Long Term

- Deductible at the full present fair market value regardless of basis
- Gift to Public Charity deductible up to 30% of AGI with five year carryover
  - Same rule for Donor Advised Fund and Supporting Organization
- Gift to Private Foundation deductible up to 20% of AGI at cost basis
- Fair Market Value of closely held business interests and real estate require qualified appraisal

Gifts of Securities and Real Estate Held Short Term

- Includes Property the sale of which would result in ordinary income
- Deduction at cost basis only up to 50% of AGI for gift to Public Charity

Tangible Personal Property

- Art, Antiques, Books, Stamps, Coins, Vehicles, etc.
- Related Gifts Require Substantiation and Reporting by both Donor and Charity
  - Deduction for present fair market value, with no capital gain on appreciation is allowable only if gift is related to donee's exempt function. Deduction allowed for up to 30% of adjusted gross income. A five year carryover allowed for any "excess."

Bargain Sales

- Deduction allowed for difference between fair market value and sales price for bargain sale for long-term securities and real estate. Cost basis of property must be allocated between portion of property “sold” and portion of property “donated” to charity on basis of fair market value of each. Appreciation allocable to sale is subject to capital gains tax. Outright gift of mortgaged property is treated as a bargain sale.

Gift of Remainder Interest in Residence or Farm

- The entire fair market value of a remainder interest in a personal residence, including vacation homes or farms, is deductible if given to charity. An option given to the charity to take the proceeds from the sale of the property instead of the property itself is adequate to support the deduction.

Charitable Gift Annuities

- The purchase of an annuity by a charitable donor from a charitable organization for a sum in excess of the value of the purchased annuity results in a contribution deduction for the value of the excess amount.

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Charitable Gift Annuities

- A donor irrevocably transfers money or property to a qualified organization in return for its promise to pay the donor, another or both, fixed and guaranteed payments for life. In essence, the transfer is part charitable gift and part purchase of an annuity.
- Periodic Payment. Payments may be paid monthly, quarterly, semi-annually or annually. Payments must be fixed from the beginning. The older the annuitant at the annuity starting date, the larger the annual payments. If there is more than one annuitant, the payments are less than if there is one annuitant. A portion of each annuity payment is excludable from gross income for the period of the annuitant's life expectancy.

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Charitable Gift Annuities

- Calculation of Charitable Deduction. The charitable contribution for a gift annuity is the difference between the amount of the initial contribution and the value of the annuity. The tables used to value the income interest in a charitable remainder annuity trust are also used to calculate the actuarial value of charitable gift annuities.

Charitable Gift Annuities

- State Regulation
- Gift Annuity payments are backed by all of the charity's assets
- Taxation of Payments.
  - A percentage of each payment is excludable for a period of the annuitant's life expectancy.
  - Percentage determined when annuity is created and remains constant.
  - Exclusion Ratio: Actuarial Value of Annuity/Expected Return (annual annuity multiplied by life expectancy)

Charitable Gift Annuities

- Bargain Sale. Appreciated property transferred in exchange for a gift annuity is deemed to be a bargain sale. The gain is computed by allocating the cost basis of the transferred property between the gift portion and the actuarial value of the annuity. The gain is the difference between the value of the annuity and cost basis allocated to the value of the annuity. The gain is generally reported ratably over the life expectancy of the donor.

Gifts of Undivided Interests

- Real Estate or Intangible Personal Property
  - A deduction is permitted if the donated interest represents a fraction of the donor's entire interest in the property.
    - FMV – Qualified Appraisal – Discounts for Fractional Interest, etc.

Conservation Easements

- A donor may deduct the reduction in the value of real property by an irrevocable and permanent conservation or historic easement given to charity. A contribution to a charitable organization of a perpetual easement with respect to real property is not subject to gift or estate taxes whether or not the interest meets the conservation purpose requirements for the purposes of the income tax deduction.

Charitable Remainder Trusts

- An irrevocable trust created inter vivos or upon death in which a non-charitable beneficiary or beneficiaries receives an interest for life or lives or over a period of not more than twenty years and a charity receives the remainder. Donor may reserve right to change charity. Not subject to income tax but subject to UBTI.

Charitable Remainder Trusts

- Donor who makes outright lifetime charitable gift gets double benefit — an income tax charitable deduction plus, for all practical purposes, an estate tax charitable deduction because gifted property is removed from the gross estate prior to death.
- Many charitably inclined individuals must forgo an income tax charitable deduction and just receive an estate tax charitable deduction for a testamentary charitable gift because they cannot afford to give away property during lifetime.
- Donor can create an inter vivos trust, retain life income for anyone donor chooses, get an income tax charitable deduction for the remainder interest, and have the same estate tax savings as for a charitable gift by will.

Charitable Remainder Trusts

- Annuity Trust: Fixed dollar amount to income beneficiary. May not accept additional contributions.
- Unitrust: Pays fixed percentage of FMV of Trust Assets revalued annually.
  - Standard
  - Net Income - NICRUT
  - Net Income with Make-Up – NIMCRUT
  - FlipCrut- Begins as NICRUT or NIMCRUT

Charitable Remainder Trusts

- Donor can avoid capital gains tax on changing investments in order to get a higher yield needed for retirement income.
- Opportunity to have income taxed more favorably to the beneficiary than presently taxed on income earned by assets.
- By adding savings of income taxes to estate tax savings, and avoidance of capital gains tax on changing appreciating investments, substantial charitable gifts can often be made at a much lower cost than initially imagined.
- Probate costs are reduced.
- Professional money management.
- Intangible benefit of making a substantial charitable gift while alive.
- A testamentary charitable remainder trust can reduce or eliminate estate taxes and provide life income and money management for a survivor. Investments in the trust can be managed freely without capital gains taxes to trust.

Qualifying as a CRT

- IRC Sec. 664
  - Fixed amount or a fixed percentage must be paid to a noncharitable beneficiary at least annually.
  - Periodic payment must be no less than 5% of value of trust property, determined upon creation for CRAT and Annually for CRUT.
  - Periodic payments cannot exceed 50% of FMV initially for CRAT and annually for CRUT

Qualifying as a CRT

- Individual noncharitable beneficiaries must be living upon creation of trust and identified by name. May be identified by class if term is expressed in years.
- Payments must be made for term of years (maximum 20) or beneficiary's life.
- Value of remainder passing to charity must be no less than 10% of initial FMV of property in CRAT and for CRUTs at least 10% of contributed value on dates of contributions. Calculations using 7520 rate.

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Qualifying as a CRT

- Five Percent Probability Requirement:
  - IRS takes position that no charitable deduction will be allowed for funding a CRT unless the possibility that the trust will not have any assets left to distribute to charity after the noncharitable interests have expired is so remote a to be negligibile. Rev. Rul. 77-374 provides that a 5% probability or less is considered negligible.
  - In low interest rate environment it is very difficult for CRAT to meet this test. 7520 rates have very little impact on CRUTs.

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Funding the CRT

- Securities with low basis and high appreciation
- Appreciated C Corp stock
- Appreciated unencumbered Real Estate
- Retirement Plan assets
  - Withdraw from plan
  - CRT named as plan beneficiary
- Life Insurance
  - Cannot use trust income to pay premium in life of donor or donor's spouse (grantor trust issue). Possible jeopardy investment (private foundation rules apply)
- Farm Property with zero basis
  - No deduction - no self employment taxes on distributions

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Avoid These Assets for CRT

- Assets Trustee is Obligated to Sell
- Tax-exempt Bonds – Could convert tax free income to either ordinary income or capital gains
- S Corporation Stock
- Partnership Interests – Potential for UBTI
- Personal Residence
- Encumbered Real Estate
- Tangible Personal Property

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Tax Consequences to CRT

- Income Taxation of CRT
  - Normally not subject to tax at trust level because income is either distributed and taxed to income beneficiary or accumulated for distribution to a charity. CRT is not subject to 3.8% net investment income tax but distributions to individual beneficiary may consist of net investment income.
  - UBTI is taxed at 100% rate! $1,000 exemption. Distribution to noncharitable beneficiary treated as ordinary income!

Tax Consequences to CRT

- Private Foundation Excise Taxes
  - Self dealing transactions
  - Failure to distribute income
  - Excess Business Holdings
  - Jeopardizing Investments
  - Taxable Expenditures

Tax Consequences to Donor

- Income Tax Consequences
  - No gain recognition
  - Income Tax Deduction AGI Limits
    - 50% possible if charitable beneficiary is required to be a public charity, otherwise 30%
    - 30% AGI limit for appreciated assets
  - Additional deduction for transfer of income interest to charity after trust is created. When interest rates are lower than when trust created the value of the additional deduction is higher.

Tax Consequences to Donor

- Net Investment Income
  - Taxpayers are subject to the 3.8% tax on lesser of their net investment income or excess of Modified AGI over $250,000 for joint filers ($200,000 for single filers). Transfer of assets to a CRT may stretch the net investment income over a longer period which could keep AGI below the threshold.

Tax Consequences to Donor

- Gift Tax Consequences
  - Taxable gift of income interest to noncharitable beneficiary other than donor or donor's spouse.
- Estate Tax Consequences
  - Estate Tax charitable deduction for value of charitable interest
- GST Tax Consequences
  - Unless donor's GST exemption is allocated to the trust, GST tax will be due when DRT makes payment to a noncharitable beneficiary who is a skip person. No automatic allocation for a CRT.

Tax Consequences to Noncharitable Beneficiary

- Tier System of Allocating Distributions
  - Ordinary income
  - Capital gain
  - Nontaxable income
  - Principal

CRT Planning Strategies

- Wealth Replacement Trust funded with life insurance
  - When plan participant dies, the plan beneficiary pays income tax on distributions and value is included in decedent's taxable estate. Plan assets are subject to both income and estate tax.

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CRT Planning Strategies

- Funding a CRT with Retirement Plan Assets
  - By naming CRT rather than a charity as plan beneficiary the annuity or unitrust interest can provide income for the grantor or grantor's beneficiaries during their lives.

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CRT Planning Strategies

- Accumulation of Retirement Savings with NIM-CRUT
- Funding NIM-CRUT or FLIP-CRUT with hard to sell assets

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Charitable Lead Trusts

- Provides an income interest to a charitable beneficiary for a period of time, after which the property reverts to the grantor or a noncharitable beneficiary
- No minimum or maximum annual payout
- Grantor or Non-Grantor
- Not Tax Exempt
- Minimizing Value of Remainder Interest
- Zeroed-out CLAT using low 7520 rates

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