

CHARITABLE GIVING STRATEGIES

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What Are the Benefits of Charitable Giving?

- Personal satisfaction of assisting your favorite charity
- Recognition for having helped the organization
- Current income tax deduction for the fair market value of the gift
- Possible avoidance of capital gains tax on donation of appreciated assets
- Possibility of increased income to donor [split-interest gifts]
- Possible reduction in estate liquidity needs
- No federal gift tax (although in some cases a gift tax return is still required)
- Reduction of federal estate tax (both the gifted asset and future appreciation on that asset removed from the taxable estate) & possibly lower probate expenses

Types of Charitable Gifts

Outright Gifts to Qualified Charities

1. *Contributions of cash*

Donations are tax-deductible up to 60% of AGI, with a 5-year carryforward.

2. *Donations of **tangible assets**, both real and personal property:*

- a. IRS allows an income tax deduction based on fair market value (an appraisal may be required) if the gift is “use-related” (e.g., donating art to a museum). If the gift is not “use-related” (i.e., if the charity will sell the donated asset rather than keep it and use it) your deduction normally is limited to your cost basis.
- b. There are annual limits on deductible contributions (maximum of 30% of AGI); 5-year carry-forward for contributions exceeding that limit in the year of the gift.

- c. ***Donation of appreciated assets avoids the capital gains tax!***
Example: Donor wants to donate \$10,000 to charity. Donor has publicly traded stock worth about \$10,000, but with a cost basis of \$2,000. Selling the stock would result in an \$8,000 taxable capital gain and capital gain taxes of \$2,664, leaving only \$5,336 to reinvest or donate. Donating the stock directly to charity yields a full \$10,000 deduction, and the charity gets to keep the full amount realized by selling it.
- d. Donation of capital **loss** items is unwise; it is better to sell the asset, donate the cash, and claim a deduction for the loss.
- e. Donation of real property will require an appraisal to claim the deduction.

- 3. ***Bequests*** of cash or assets in your will or living trust:
 - you can give a fixed dollar amount or specific asset(s) to charity.
 - you can give a specified percentage of your estate to charity.
 - you can give the “residue” of your estate to charity.
 - you can structure your estate to leave the taxable portion to charity & eliminate any estate tax if your estate exceeds the amount excluded from estate tax.
 - If you’re over 70 ½, you can donate your annual *required minimum distribution* directly to charity and avoid paying income tax on the distribution.
 - you can establish a testamentary charitable remainder trust [see below].

Deferred Beneficiary Designation Gifts

- 1. ***Designate a charity as beneficiary of a retirement plan*** (IRA, Keogh, 401(k), 403(b), etc.):
 - avoids income taxation on the account (charity is tax-exempt); if you plan to make a gift to church or charity, using a tax-deferred account as the source of the funds is the most tax-effective means of making such a gift.
 - charity can be a *primary* beneficiary or a *contingent* beneficiary.
 - charity can be named to receive all or part of the account value (i.e., a percentage).
 - such designations should be coordinated with charitable gifts made through one’s will or trust – to the extent that the charitable gift is not fully funded out of the tax-deferred account, the balance of the intended amount can be distributed from your estate by your executor or successor trustee.
- 2. ***Designate a charity as beneficiary of a life insurance policy (or annuity):***
 - you can assign ownership of an existing policy to charity and designate the charity as beneficiary.
 - you can purchase a new policy naming the charity as beneficiary (if you also make the charity the owner of the policy, you can take a charitable deduction for the annual premium payments).
 - you can make the charity a primary or contingent beneficiary of an existing policy (either sole beneficiary, or beneficiary of a set dollar amount or percentage).
- 3. ***Designate a charity as beneficiary on U.S. Savings Bonds:***

-- avoids the income tax on the accrued interest when the bond is cashed in.

Partial interest ("split interest") gifts (gifts that benefit both donor and charity)

1. ***Remainder interest in a personal residence or farm.***

Donor retains life interest (or for a term of years); the charity receives the asset outright at death of the life estate holder. The value of the remainder interest gift to charity (actuarially determined) is tax deductible to the donor.

Advantages: Donor gets a current income tax deduction without giving anything away until death; donor continues to have right to live on the property, but pays the property taxes and other expenses; the property will not be taxed in donor's estate.

Disadvantage: The property ownership passes to the charity at donor's death, so no part of the property passes to family or other heirs.

2. ***Charitable gift annuity.***

A contract between donor and charity similar to standard insurance annuity. Donor gives cash or assets to charity and charity pays a stipulated amount to the donor or to donor's designated beneficiary for life. The charity keeps what's left at death of beneficiary. Gift annuities can be **immediate** or **deferred** (the older you are when you start taking payments, the higher the payout rate will be).

Advantages:

- Simple to do – many large charities offer them.
- Higher payout rate than most interest-earning assets (part of which is tax-free as a return of principal).
- Works with smaller dollar amount gifts (as low as \$5,000).
- Donor gets a current income tax deduction for the value of the remainder interest passing to charity.
- Donor receives a fixed income guaranteed for life
- if appreciated assets are used to fund the gift annuity, the donor avoids capital gains tax on the assets.

Disadvantages:

- Only larger charities offer gift annuities.
- Some charities pay more than others.

Payout rates tend to change over time, and different charities may offer different annuity rates. To find the current “suggested charitable gift annuity rates” as set forth by the American Council on Gift Annuities, check their web site at www.acga-web.org.

3. ***Pooled Income Fund*** (*available through many larger charities*)

Operated by the charity. Common pool for donations from multiple donors; income for the year is paid out pro rata to the donors or their designated beneficiaries; at the death of an individual donor, that donor's share of the pool principal is paid out to the charity. Payout rate is typically a rolling 3-year average of the annual total return on the fund's investments.

Advantages: Very simple for the donor.

Disadvantages: Only benefits one charity; the donor has no control over the payout amount; no guaranteed rate of return.

4. ***Donor Advised Fund (DAF).***

A donor advised fund allows you to make a tax-deductible gift but retain the privilege of providing advice to the Foundation or fund managers regarding the amount, timing and recipient of distributions from the fund. The funds are invested and continue to grow until you determine the timing and amount of the distributions. You can specify one or more charities as beneficiaries, and you can decide when and how much to distribute from the fund to each charity.

Local Community Foundations offer donor advised funds; Vanguard and Fidelity (mutual fund companies) also now offer donor advised funds, as does Charles Schwab.

5. ***Charitable Remainder Trusts***

Income from donated assets is paid to donor and/or named beneficiary for life; the remainder passes to charity outright at the death of the last income beneficiary. There are two main types:

- (1) *Charitable remainder unitrust:* pays out a stated percentage of value of assets in the trust each year (minimum payout must be 5%; assets are revalued annually -- if the value goes up, so does the payout).
- (2) *Charitable remainder annuity trust:* pays out a fixed dollar amount annually (minimum 5% of original trust corpus); no increase in payout amount, even if value of trust continues to grow.

Special advantages: Donor can determine the payout rate; donor can name multiple charities as remainder beneficiaries with specified percentages; donor can retain the right to change the designated charities; donor can designate their church or smaller charities as beneficiaries (smaller charities may not be able to offer gift annuities or pooled income funds).

Disadvantages: More costly to set up; requires a trustee; annual federal and state income tax returns are required (cost paid by the trust).

Simply put, a charitable remainder trust pays an income stream, at least annually, to one or more named persons either for their lifetime(s) or for a specified term of years, with the remainder interest irrevocably assigned to a qualified charity. The donor can be the income beneficiary, or the donor can designate someone else as the income beneficiary.

The following requirements apply to all charitable remainder trusts:

- The maximum term of the trust is the lifetime(s) of the income beneficiary(ies) or a fixed period not exceeding 20 years.
- There may be more than one income beneficiary. Payments may be made concurrently to multiple beneficiaries, or a payment can be made jointly to two individuals (such as spouses) and then continued for the life of the survivor.
- The charity receives the trust principal (the remainder interest) upon the death of the last income beneficiary.
- The income tax deduction allowed to the donor depends on the age of the income beneficiary and is calculated using tables and a formula provided by the IRS. The older the beneficiary, the higher the income tax deduction.
- The donor may act as trustee of the trust if he or she so chooses, although only with some very specific limitations. The charity can act as trustee, or an independent trustee can be named.

Charitable Remainder Annuity Trust

- funded with one-time contribution only.
- annual distribution amount is set as a *fixed dollar amount* equal to at least 5% of the initial trust assets.
- trust assets are appraised only once, upon creation of the trust.
- fixed-dollar distribution is paid out annually, even if trust income was less than the payout amount (requiring invasion of principal).

Charitable Remainder Unitrust

- may be funded with a single contribution or multiple contributions over time.
- annual distribution amount is set as a *fixed percentage* (5% minimum) of the current market value of the trust assets.
- an annual reappraisal of the value of the trust assets is required.
- If income to the trust is insufficient to meet the specified payout, principal less may be invaded to make up the difference, or payout may be limited to net income only, with shortfalls made up in later years where income exceeds the required payout.

(The *Unitrust* provides better protection against inflation; the *Annuity Trust* provides a guaranteed income even if the value of the trust principal declines.)

6. ***Charitable lead trust.***

Income from lump-sum donation goes to the charity for a term of years. At the end of the specified term, the trust principal is returned to donor or passed on to persons named by donor to receive the remainder. Can be an effective estate tax minimization strategy for wealthier donors.

Advantages: Allows donor to minimize estate taxes on assets that ultimately pass to heirs; immediate benefit to charity; donor gets an income tax deduction in the first year.

Disadvantages: Donor will be responsible for income taxes (if any) on the income generated by the trust and paid out to the charity; donor & heirs have no beneficial use of the trust assets until the trust ends.

7. ***Private Foundations and Supporting Organizations.***

These are complex, privately created entities that qualify for certain tax benefits normally available to nonprofits; these entities in turn make annual distributions to various charities or charitable causes.

Advantages: Donor (or donor's heirs) retains some control; donors (or heirs) can act as directors or other paid staff; donated assets generally avoid capital gains tax; donated assets qualify for income tax deduction and are not included in donor's taxable estate.

Disadvantages: Many complex rules and restrictions; expensive to set up and maintain; generally not practical for anyone other than the very wealthy.

Be sure to seek your accountant's guidance when planning any kind of split-interest charitable gifts; in some cases, annual tax returns are required.

GENERAL ADVICE:

- Review your will or trust – make sure these are up to date and reflect your wishes.
- If you don't have a will or trust, get this done without further delay. IF YOU DIE WITHOUT A WILL, THE STATE OF CALIFORNIA DECIDES WHO GETS YOUR ESTATE, AND THEIR DEFAULT "PLAN OF DISTRIBUTION" WILL NOT INCLUDE ANY GIFT TO CHURCH OR CHARITY.
- Review your life insurance policies, annuities, IRAs and other tax-deferred accounts. Make sure you know who you have named as the designated beneficiaries. Consider naming your church or charity as a beneficiary (primary or contingent), even if it is just for a small percentage.
- Make sure that your gifts to charity are done correctly:
 - Verify the correct name of the charity.
 - Include the charity's address.
 - If the gift is to be used for a specific purpose, check with the charity in advance to verify that they will accept the gift for that purpose. Ask for their help in wording the bequest. This is especially important for creating any sort of endowment fund.
 - If you plan to donate real property (buildings, land) to charity, check with the charity ahead of time to make sure they will accept it.
 - Have a contingency plan in case the charity ceases to exist or changes its mission.
- Contact your favorite charity and ask what gifting alternatives they have available.