A Guide to Creative Gift-Planning Arrangements

Contents

- Types of Outright Gifts 3
  - Gifts of Cash 3
  - Gifts of Appreciated Assets 3
  - Bargain Sale 4
  - Tangible Personal Property 4
  - Gifts of Closely Held Stock Followed by Redemption 5
- Gifts That Pay Income 5
  - Background 5
  - Gift Annuity 6
  - Immediate-Payment Gift Annuity 6
  - Deferred-Payment Gift Annuity 7
  - Charitable Remainder Trust 8
  - Unitrust 9
  - Income-Only Unitrust 10
  - "Flip" Unitrust 11
  - Annuity Trust 11
  - Charitable Trust Payments Taxed as Long-Term Capital Gain 12
  - Charitable Education Trust: Meeting College Expenses 12
  - Pooled Income Fund 13
- Other Gift-Planning Arrangements 13
  - Gift of a Remainder Interest in a Residence or Farm 13
  - Charitable Lead Trust 14
  - Grantor Lead Trust 15
  - Nongrantor Lead Trust 15
- Gifts That Cost Nothing in Your Lifetime 16
  - Planned Gifts Through Wills 16
  - Charitable Bequest 16
  - Income for a Beneficiary 17
  - QTIP: Flexibility for Family Contingencies 18
  - Provide for Estate Taxes 18
  - Gifts of Qualified Retirement-Plan Benefits and Other IRD Items 19
  - IRA Charitable Rollover, etc. 20
  - Planned Gifts of Life Insurance 21
  - Tips on Timing Charitable Gifts 23
- Gifts to Fund the Future 23

The making of appropriate, significant charitable contributions is an art. And like any art, it is a living, creative process that adapts to the changing needs and wishes of the donor.

Each year thousands of people contribute their time, talents, and money to America's charitable religious, educational, cultural, service, and health care organizations. Indeed, private philanthropy is a defining characteristic of our nation, for the nation's laws recognize the role of charitable organizations in meeting public needs. As a result, these laws provide incentives to encourage charitable gifts. Thoughtful donors plan their contributions to minimize the after-tax costs while securing allowable benefits for themselves and their families.

The Tax Cuts and Jobs Act passed at the end of 2017 ushered in significant changes in the American tax system beginning in 2018. Some aspects of the tax code have been dramatically altered, including the reduction or elimination of long-standing deductions, exemptions, and credits.

Nevertheless, the charitable deduction emerged relatively intact in the new tax law. While philanthropically minded taxpayers will want to seek the advice of informed counsel, the traditional benefits of thoughtful charitable planning have been preserved. As in the past, gift planning enjoys an enhanced role in ordering one's affairs to obtain both charitable and financial goals. Depending on the specific arrangement, donors can expect some or all of the following benefits of thoughtful charitable planning.

Benefits:

- Satisfaction from providing the means for favored charities to fulfill their purposes.
- Income-tax savings through the charitable deduction allowed for the gift.
- Avoidance of capital-gain tax on contributions of appreciated long-term capital-gain property with respect to certain gifts.
- Retained income for the life of a donor and/or other beneficiary(ies).
- The possibility of increased cash flow from the asset.
- Elimination of federal estate tax on the value of the interest in property passing to charity upon the donor's death.
- Reduced estate-settlement costs.

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This gift-planning guide discusses only the federal tax incentives for making charitable contributions. In many cases, state income-, estate-, and gift-tax savings will enhance the advantages of proposed arrangements.

We strongly urge you to consult your own tax and legal advisors for a full discussion of the tax implications of your gift planning.

The following discussion of income- and estate-tax savings that result from making charitable gifts is not meant to imply that these are reasons to make a gift. Rather, this guide is intended to provide guidance in selecting the most beneficial way to fulfill your charitable objectives.

Note: The allowable deductions for charitable gifts other than outright gifts are subject to monthly revision in accordance with Treasury Regulations. The charitable deductions shown in various examples in this gift-planning guide reflect a representative rate and are for illustrative purposes only. We would be glad to assist you and your advisors in determining the exact deduction for a gift you may be considering.

> To give away money is an easy matter and in any man's power. But to decide to whom to give it, and how large and when, and for what purpose and how, is neither in every man's power nor an easy matter.
>
> —Aristotle

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Types of Outright Gifts

Gifts of Cash

Simplicity and ease of delivery are the major factors that make cash the most popular type of charitable gift. A gift of cash is considered made on the date it is hand-delivered or postmarked. So a year-end contribution made with a check that is mailed in late December is deductible for that year even though the charity does not receive it until January.

Because of the charitable deduction, the net cost to the donor who makes a cash contribution will be lower than the face value of the gift.

For example, the net cost of a $1,000 cash gift to a donor in the 28 percent tax bracket who itemizes is only $720. For a donor in the highest federal income-tax bracket (37%), the cost is only $630. Gifts of cash are deductible up to 60 percent of a donor's contribution base (generally equal to adjusted gross income [AGI]). Any excess can be carried over for five years.

Gifts of Appreciated Assets

A viable alternative to a cash gift is a gift of appreciated assets. With careful planning, charitable gifts of certain types of assets will provide even greater tax benefits to donors than gifts of equivalent value in cash.

The most favorable tax benefits are generated by contributions of appreciated securities and real estate owned long-term (more than one year). **Reason:** In addition to receiving a charitable deduction for the full fair-market value of such a gift, the donor escapes any potential tax on the capital gain in the property given to charity as well as any sales commission that would be payable upon the sale of the asset.

Additional tax savings for high-income donors—Many taxpayers pay a rate of 15 percent on capital gains and qualified dividends. Some with lower incomes pay no tax at all on such income. However, taxpayers with higher taxable income ($425,800 for single filers and $479,000 for married couples filing jointly in 2018) pay 20 percent.

In addition, those with higher incomes also pay a 3.8 percent surtax on investment income. The threshold for this surtax is $200,000 of taxable income for singles and $250,000 for married couples filing jointly. Consequently, high-income donors realize larger tax savings from gifts both of cash and appreciated property.

Example: Mrs. A, whose annual income is $800,000, contributes $100,000 cash to support our work. Her federal income-tax savings total $37,000, and the net cost of her gift is $63,000.

Suppose Mrs. A contributed stock with a fair-market value of $100,000 and a cost basis of $40,000. If she had sold the stock, she would have paid $14,280 tax on the capital gain [(20% + 3.8%) X $60,000]. Her combined tax savings would be $51,280 ($37,000 + $14,280), and the net cost of her gift would be only $48,720.

The full fair-market value of gifts of long-term capital-gain securities and real estate is deductible up to 30 percent of a donor's contribution base. Any amount in excess of the 30 percent ceiling can be carried forward for five years.

If you are considering a gift of an asset that has depreciated in value, you would be better off selling the asset and then contributing the proceeds to us. This procedure ensures recognition and deductibility of the loss in addition to a charitable deduction.

Gifts of appreciated long-term securities and real estate are deductible up to 30 percent of a donor's adjusted gross income, and again any excess can be carried forward for five more years.

Special election: If you are enjoying a year of unusually high income and are also interested in obtaining the maximum benefit from a charitable deduction, the tax code allows you to elect to deduct a gift of long-term appreciated property up to 50 percent of your contribution base. That provision was not changed by the Tax Cuts and Jobs Act. But the IRS exacts a price: You must forgo the appreciation when computing the charitable deduction. In other words, the deduction is limited to your basis. **Note:** This election will generate the best tax results when the appreciation is relatively small and you are experiencing an exceptional high-income year.

Bargain sale—If you want to recover a portion of the value of property that you wish to contribute to us, you may consider entering into a bargain-sale transaction with us. In effect, a bargain sale is a sale of property to charity for less than its fair-market value. The bargain-sale price may be any amount mutually acceptable to the charity and the donor. Some donors are willing to sell the property for an amount equal to their cost basis. In this manner, they recover their investments and get deductions for the appreciation element. The tax law states, however, that the recovered portion cannot be treated wholly as basis but rather as part basis and part reportable capital gain.

Example: Mrs. B owns real estate appraised at $200,000, which we are interested in for future expansion purposes. Her basis in the property is $60,000, and she offers to sell it to us for $100,000. As a result:

- Mrs. B receives $100,000 from us.
- She can deduct the contributed portion of $100,000 for income-tax purposes.
- She must also report a capital gain of $70,000. (The reportable capital gain is arrived at by dividing the sale price of $100,000 by the fair-market value of the property—$200,000—and multiplying the result by the gain—$140,000.)
- The capital-gain tax is more than offset by the tax savings from the deduction.

Tangible personal property—As with gifts of long-term capital-gain securities and real estate, a donor benefits from a charitable deduction for a gift of long-term appreciated tangible personal property—such as works of art, rare books, stamp or coin collections, etc. (**Note:** The top capital-gain tax rate on such assets is 28 percent—or 31.8 percent if you are subject to the Affordable Health Care surtax.) The extent of the allowable deduction for such a gift is dependent upon the standard known as "related use.''

Here is how the standard of related use is applied: If the use of the contributed asset is related to the exempt purposes of the charity *(e.g., a painting to a museum or rare books to a library)*, the donor is entitled to an income-tax charitable deduction for the full fair-market value of the asset—subject to a 30 percent ceiling and the normal five-year carryover period.

If the use of the contributed asset is unrelated to the exempt purposes of the charity *(e.g., a stamp collection to a hospital which sells it and uses the proceeds)*, then the donor is entitled to a charitable deduction for the lesser of fair-market value and his or her basis in the asset.

Note: When the donor is the creator of the contributed tangible asset, his or her deduction is limited to the actual cost of producing the asset.

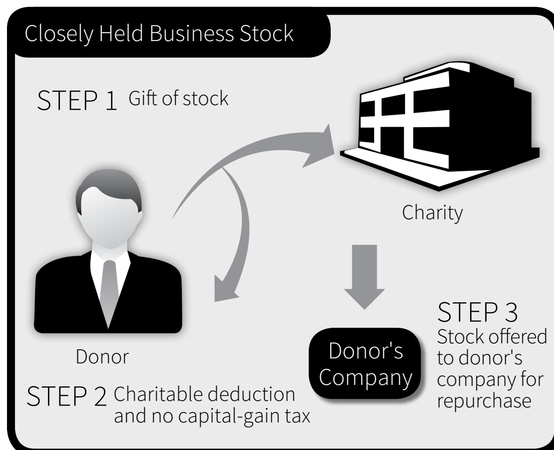
Benefits of giving tangible personal property:

- Produce tax savings.
- Avoid capital-gain tax and receive a deduction for market value of property given for a related use.
- Provide a meaningful gift to charity.
- Enjoy seeing your gift in action during your lifetime.

Gifts of tangible personal property by bequest: The related-use standard does not apply. Your estate will be entitled to an estate-tax charitable deduction for the full fair-market value of the property.

Gifts of closely held stock followed by redemption—If you are a business owner who wishes to contribute closely held C corporation stock to us, you will be allowed a charitable deduction for the fair-market value of the stock. In addition, both you and our organization will escape potential capital-gain tax on any appreciation in the value of the stock.

Subsequent to the gift, the corporation could purchase the stock from the charity for cash. This not only enables the donor to retain complete control over the company, it also makes cash available to the charity for its current needs. As long as the charity is not obligated to sell the stock to the corporation, the transaction should produce no adverse tax results.



Example: Mr. H contributes 50 shares of his company's stock. The appraised value of the shares is $50,000. Not only does he avoid tax on the capital gain (and potentially the 3.8 percent Affordable Health Care surtax), but he also receives a charitable deduction of $50,000, which could save him up to $18,500 in federal income tax (37% of $50,000). He gives up no income because the stock was paying no dividends, so he actually increases his cash flow by the amount of the tax savings.

At a later time, the corporation may agree to purchase the stock and the charity may agree to sell the stock for $50,000 or whatever the value is determined to be at that time. Alternatively, other shareholders might be willing to purchase the stock.

Since 1998 an outright gift of S corporation stock to a charity does not result in the loss of the corporation's S status. The benefits of the above example will be available to a donor of stock. However, unlike gifts from a C corporation, S corporation income attributable to its shares will be taxable to the charity. The gain from the shares will also be taxed to the charity when the shares are sold. Nevertheless, such gifts can be beneficial to a charity and are welcomed.

Caution: A gift of S stock to a charitable remainder trust or pooled income fund will continue to result in the automatic termination of S status and reversion to a C corporation.

Gifts That Pay Income

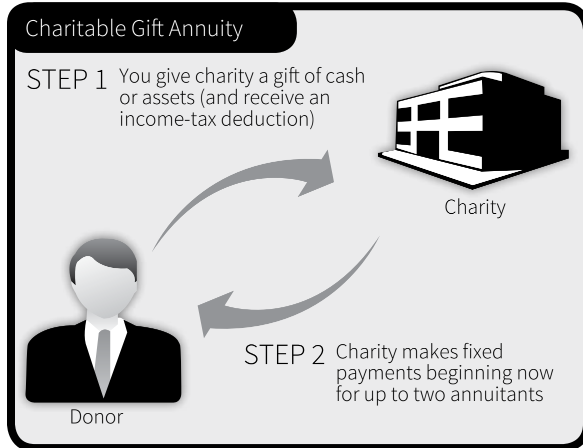
Background

A *life-income plan* is a generic term that encompasses various planned-gift arrangements where a donor irrevocably transfers assets for the ultimate benefit of a qualified charity but retains the right to an income stream for a period of time, usually for life. The beneficiary can be the donor and/or a spouse or anyone else so designated by the donor.

There are two categories of life-income plans: gift annuities and charitable remainder trusts. The fundamental distinction between them is that a gift annuity is a gift arrangement directly between the donor and the charitable organization, whereas a charitable remainder trust is an arrangement between the donor and the trust. The trust is a separate and independent legal entity. Both of these life-income plans allow the donor to give up the headaches of owning assets while retaining the benefits.

Gift Annuity

Gift annuities in the United States date to the 1830s. The first issuers were Yale, Princeton, and the American Bible Society. By the early part of the 20th century, the gift annuity was established as one of the most popular ways for philanthropically inclined individuals to make a deferred gift to a qualified charity. It is a simple arrangement whereby in exchange for a transfer of cash, marketable securities, or possibly other assets, a charity contractually agrees to pay a specified annuity to a donor and/or another beneficiary.



ONE BENEFICIARY		TWO BENEFICIARIES	
Age	**Rate**	**Ages**	**Rate**
60	4.4%	60–60	3.9%
65	4.7%	65–65	4.2%
70	5.1%	70–70	4.6%
75	5.8%	75–75	5.0%
80	6.8%	80–80	5.7%
85	7.8%	85–85	6.7%

Immediate-payment gift annuity—The American Council on Gift Annuities—a representative body of a variety of philanthropic organizations—suggests payout rates for gift annuities. The annuity rate depends on the age(s) of the beneficiary(ies), and it is the same for both males and females. It is actuarially designed to result in a gift of at least 50 percent of the value of the initial transfer at the death of the beneficiary(ies). The rates are revised periodically to reflect changes in interest rates and mortality experience.

The table below left shows representative rates that apply to both men and women.

You may claim a current charitable deduction for the portion of the transfer that represents the charitable gift element—the amount by which the value of the asset transferred to us exceeds the present value of the annuity received. **Another important tax benefit:** As with other types of annuities, a portion of each annuity income payment is treated as a return of the original principal and is not subject to income tax over the life expectancy of the annuitant. The tax-free portion is greatest when the annuity is funded with cash.

The following representative table shows annuity rates and payment amounts resulting from a cash contribution of $10,000. Also shown are the tax-free portion, the amount taxable, and the allowable charitable deduction. Payments are assumed to be made quarterly. (Rates change periodically, but rate changes apply only to new annuities.)

Age	Annuity Rate	Total Payout	Tax-Free Portion	Taxable Portion	Charitable Deduction
60	4.4%	$440	$288	$152	$3,064
65	4.7%	$470	$321	$149	$3,613
70	5.1%	$510	$365	$145	$4,195
75	5.8%	$580	$432	$148	$4,650
80	6.8%	$680	$524	$156	$5,075
85	7.8%	$780	$633	$147	$5,698

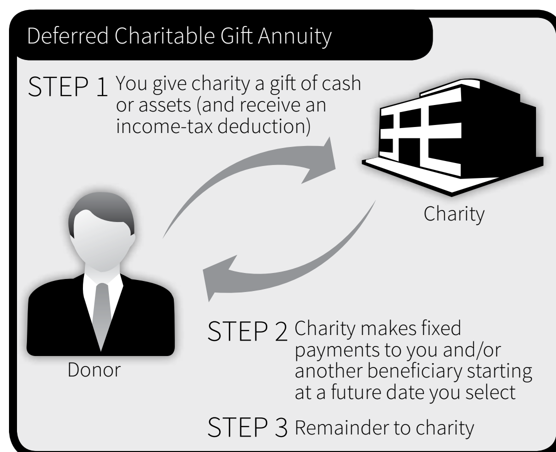
Example: Mrs. M, 70, transfers $10,000 cash to our organization in exchange for a gift annuity that pays $510 a year for her life. Of this amount, $365 will be treated as a tax-free return of principal for the next 16 years (her life expectancy) and only $145 will be taxed as ordinary income. Thereafter, the $510 from the annuity will be treated as ordinary income. In addition, Mrs. M realizes a current charitable deduction of $4,195 that, in her 24 percent bracket, generates a net tax savings of $1,007.

When a gift annuity is funded with long-term appreciated securities, a portion of the capital gain is not taxed and the remainder of the capital gain is spread out over the donor-annuitant's actuarial life expectancy. If the donor is not an annuitant, this entire taxable portion of the capital gain is recognized in the year of the gift.

Benefits of an immediate-payment gift annuity:

- A meaningful gift to charity.
- Increased spendable income.
- Significant income-tax savings.
- Portion of payment usually tax-free.
- Capital-gain tax avoided on a portion of appreciation; the balance is spread over your life expectancy.
- Annuity payments guaranteed by our assets.
- Simple to establish and no administrative fees.
- Dependents and/or other beneficiaries provided for.
- Relief from management responsibilities.

Deferred-payment gift annuity—The deferred-payment gift annuity is a variation of the traditional gift annuity. It appeals to charitably motivated younger donors 40 to 60 years old who have a high current income, can benefit now from a current tax deduction, and are interested in augmenting potential retirement income on a tax-favored basis. It also works well when a parent wishes to provide retirement security for an adult child or other younger beneficiary.



The deferred-payment gift annuity generally involves the current transfer of cash, marketable securities, or possibly other assets to a charity in exchange for an annuity starting at a future date—usually at retirement. The donor might establish a single deferred annuity or a series of annuities during high-income years.

The donor realizes an immediate charitable deduction for the gift portion of each transfer. When the payments begin, a portion of each income payment will normally be a tax-free return of principal over the annuitant's life expectancy. When appreciated long-term capital-gain securities are transferred, any reportable capital gain is spread out over the donor-annuitant's life expectancy.

Example: This year and then for the next 15 years, Dr. N, 52, decides to make annual cash contributions of $10,000 to us in exchange for deferred-payment gift annuities. Income payments are to begin upon her retirement in 16 years and will continue for the rest of her life.

Assuming no change in gift annuity rates and the IRS rate for calculating deductions, the tax and financial benefits of her arrangement are as follows:

- Dr. N will receive annual income of $10,390, of which $5,184 is tax-free over her life expectancy, to begin when she reaches the age of 68 and to continue for the rest of her life.
- She will be allowed charitable deductions that could total more than $69,000 over the next 16 years—which represents about 43 percent of her total contributions of $160,000.
- Her contributions for a gift annuity are not subject to the restrictive limits required by qualified retirement plans.

Benefits of a deferred-payment gift annuity:

In addition to those of an immediate gift annuity:

- Enables you to accumulate more for retirement on a tax-favored basis.

Flexible deferred-payment annuity—At the age of 52, Dr. N might not know when she may want to retire. It could be later than the age of 68 if she remains in good health and enjoys her practice; or it might be earlier due to ill health and a desire to pursue other interests. She could elect a *flexible* deferred annuity that would allow her to decide later when to start payments. The older she is when payments begin, the larger the payments will be. Including the flexible option in the gift annuity agreement usually results in a somewhat smaller deduction and somewhat more of the payments being tax-free.

Benefit of a flexible deferred annuity:

In addition to those listed above for a traditional annuity:

- The right to determine when to start receiving annuity payments *(e.g., any date between the ages of 60 and 75)*.

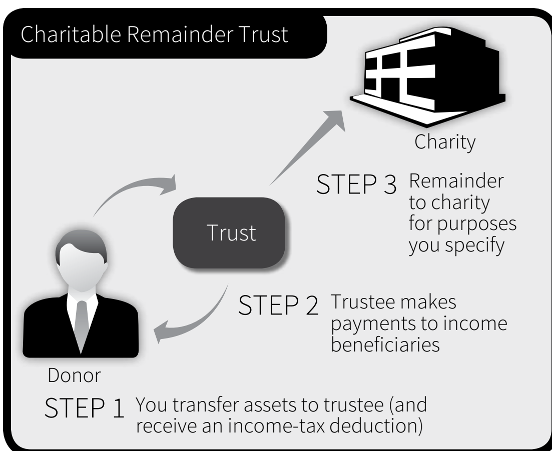
Charitable Remainder Trusts

Introduced by the Tax Reform Act of 1969, *charitable remainder trusts* have become increasingly popular because of the financial- and estate-planning opportunities they afford.

The charitable remainder trust is similar to other types of trusts except that the amount distributed at its termination (*the remainder* in legal parlance) is paid to a charitable beneficiary or beneficiaries. A donor (grantor) transfers assets irrevocably to a trust and specifies:

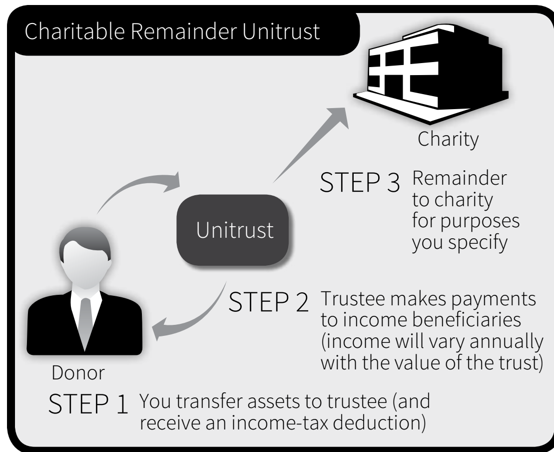
- The trustee who is to manage the trust.
- The amount of the payments to be distributed and to whom they are to be paid.
- The duration of payments *(a period of years or the beneficiary's lifetime)*.
- The charity or charities that will receive the remainder.

These trusts may become effective through outright transfers during the donor's lifetime or through transfers at death under the owner's will. To qualify for the charitable deductions available under federal tax law, the plan must conform to the requirements of a *charitable remainder unitrust* or a *charitable remainder annuity trust*. Both of these arrangements offer independent features that can be used effectively to achieve financial- and estate-planning objectives.



These trusts offer an escape from the age-old investment dilemma of the "locked in" position: An investor may want to dispose of an investment position for various reasons *(e.g., to protect a profit, to diversify investments, to reinvest for a higher yield)* but is inhibited by potential capital-gain tax on the appreciation.

Funding a charitable remainder trust with appreciated long-term capital-gain securities or real estate can augment the available tax benefits: In addition to receiving an income-tax deduction, the donor can avoid the potential capital-gain tax that would result from an outright sale of the property. Avoidance of capital-gain tax coupled with a current charitable tax deduction can substantially reduce the cost of such a transfer.



Unitrust—The primary feature of the unitrust is that it provides income to the beneficiary of an amount that may vary. The income must equal a fixed percentage of the net fair-market value of the trust assets as valued annually. The donor determines the fixed percentage—at least 5 percent but not more than 50 percent—when creating the unitrust. Depending on financial-planning objectives, the donor may either emphasize the *charitable deduction and potential income growth* by choosing a lower rate or emphasize *current income* by selecting a higher rate.

The income from the unitrust must be paid out at least annually but may be paid at more frequent intervals such as semiannually or quarterly. The unitrust may be set up for the lives of the beneficiaries or for a term of years not exceeding 20. The amount paid to beneficiaries each year is determined by multiplying the payout rate by the value of the trust assets. For example, a 6 percent unitrust valued at $100,000 its first year will pay out $6,000. If the trust assets are valued at $110,000 in its second year, the payout will be $6,600. The variable nature of the unitrust payments may provide a hedge against inflation—assuming a growth in value of its assets comparable to the inflation rate.

The donor is allowed a charitable deduction equal to the "present value" of the charity's remainder interest in the unitrust. The present value is calculated according to IRS valuation tables and is determined by reference to the following factors: the fair-market value of the assets on the date transferred to the trust, the payout rate chosen, either the age and number of beneficiaries or the term of years, and a federal discount rate that is set on a monthly basis.

Example: Mr. and Mrs. D, both 70, own $100,000 worth of mutual fund shares that they purchased years ago for $30,000. This particular fund has emphasized growth, and the dividend yield is a modest 1 percent. They would like more money to spend during their retirement years but hesitate to sell their shares and reinvest for income because of capital-gain tax they would pay.

To achieve their objectives, they contribute the shares to a unitrust and select a 6 percent payout rate. Their distributions immediately increase from $1,000 to $6,000 per year and will grow over time if trust assets appreciate in value.

Moreover, the gift yields a charitable deduction of $34,759 that, in their 32 percent tax bracket, translates into a net tax savings of $11,123. In addition, they avoid a potential capital-gain tax of $13,160 (18.8%* x $70,000) on the initial transfer of the shares to the unitrust. Thus the total tax savings amounts to $24,283, reducing the net cost of the gift to $75,717. Based on the net cost, the $6,000 they receive is equivalent to a 7.9 percent yield.

*Their capital-gain tax rate is 15 percent plus the 3.8 percent Affordable Health Care surtax on gain.

The unitrust can be funded with cash or—ideally—with long-term appreciated securities or real estate. The governing instrument of any unitrust may include a provision to permit additional contributions. The attraction of this feature is that the grantor need not establish a new trust each time he or she wishes to make an additional gift.

Benefits of a charitable remainder unitrust:

- Significant future gift to charity.
- Substantial income-tax savings.
- Avoid capital gain on initial transfers.
- Provide professional management of assets.
- Diversification of a portfolio that may be overly concentrated (with no resulting taxation to the trust).
- Increase spendable income.
- Avoid probate.
- Possible hedge against inflation.
- Relief from management responsibilities while retaining benefits of ownership.

Income-only unitrust—A variation of the standard unitrust arrangement described above is the *income-only unitrust*. Under this version, the unitrust provides for distribution to the beneficiary of either the net income of the trust or the fixed percentage specified in the agreement, whichever is less.

The income-only unitrust may include a "make up provision" so that in any subsequent year in which income exceeds the stipulated percentage, the trust may distribute such excess income to make up for any deficiencies that may have occurred in prior years. A deficiency in any year is the difference between the stated percentage and the net income. As the following example illustrates, this variation of the standard unitrust can be a potent financial retirement-planning tool.

Example: Ms. E, 60, a successful attorney, owns growth stocks currently valued at $200,000 that she purchased some years ago for $100,000. The stocks yield an annual dividend of about $2,000 (a yield of about 1 percent of their current market value). Given her 37 percent tax bracket, her spendable income from the dividend is minimal.

Upon retirement in about ten years, Ms. E plans to sell the stocks and reinvest the proceeds to maximize income. Her personal and financial objectives are to:

- Generate deductions to reduce taxes in her peak-earning years.
- Provide substantial retirement income for herself.
- Avoid capital-gain tax.
- Make a gift to support our work.

If the stocks grow in value and are worth $360,000 in ten years, their sale would result in a capital-gain tax of $61,880 (20 percent tax rate on gain of $260,000 plus the 3.8 percent Affordable Health Care surtax on the $260,000). This means Ms. E would realize 83 percent of the sales proceeds after paying from them the tax on the capital gain.

After discussing her long-range objectives with her advisors, Ms. E determines that she can best accomplish her objectives by establishing a 5 percent income-only unitrust with a "make up provision." She funds it with the $200,000 in stocks.

As a result:

- Ms. E realizes a charitable deduction of $76,364, which in her 37 percent bracket can mean a tax savings of $28,255.
- Assuming the unitrust does grow to $360,000 at Ms. E's retirement, the sale of the assets by the trustee will not trigger capital-gain tax, and the full proceeds will be available to the trustee for reinvestment.
- If the trust assets yield 6 percent, the unitrust will generate an annual return of $21,600. This amount exceeds the $18,000 (5% of $360,000) annual payment specified in the unitrust agreement; thus the extra $3,600 in this year and excess earnings in future years can be distributed to Ms. E until all prior deficiencies are made up.

“Flip” unitrust—The IRS has approved a hybrid version of the unitrust, one that may provide a practical solution to what has been a difficult implementation dilemma.

For example, a net-income unitrust *(with or without make-up)* is the vehicle of choice if you wish to use illiquid assets *(e.g., closely held stock, non-income-producing real estate, etc.)* to fund a life-income plan. **Reason:** The trustee is under no obligation to make distributions when there is no income (as there would be with a regular unitrust).

But what to do if you prefer the regular unitrust to the income-only versions?

The flip unitrust to the rescue: Regulations issued by the Treasury Department permit you to initially create an income-only unitrust and then switch to the straight version the year following the occurrence of a permissible triggering event such as:

- The sale of unmarketable assets.
- A specific date *(e.g., the age of 65 or any other age in planning for retirement, the age of 18 or any other age in planning for a child’s or grandchild’s education).*
- A specific event (such as marriage, divorce, death of a beneficiary, or birth of a child).

In the previous example, Ms. E could have included a provision that would flip the income-only unitrust to a straight unitrust at the specific future date she expects to retire. At that time, the unitrust would start distributing 5 percent of its *annual value*—revalued each year—to Ms. E for her life, regardless of how much income the trust generates.

By including a provision in the trust that allocates postcontribution capital gain to income, the trustee might liquidate some appreciated securities and pay out realized gain to the extent of the deficiency. This would have to be done before the flip trust converts to a regular trust because the deficiency account evaporates upon the conversion. Although this could provide a large distribution to the beneficiary, it would reduce the income following the conversion.

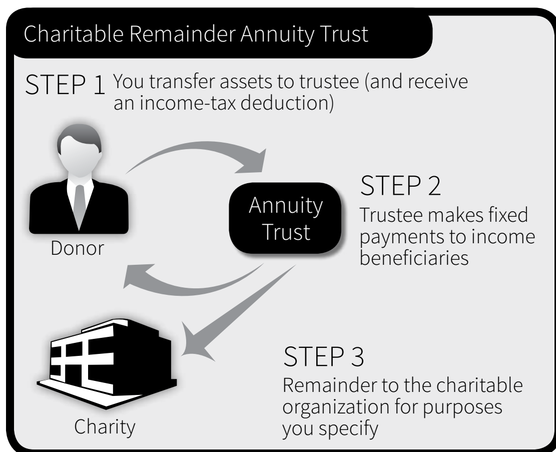
Benefits of a flip unitrust:

- Conversion from a payment stream that relies solely on trust income to one based on the entire value of all trust assets.

Annuity trust—The annuity trust shares many common features with the unitrust; the principal difference is the manner of calculating the payment to the beneficiary. Whereas the unitrust provides for a *payout that may vary*, the annuity trust provides for a *fixed payout*. This amount must equal a *sum certain* of not less than 5 percent but not more than 50 percent of the initial fair-market value of the gift in trust. Another difference is that an annuity trust cannot permit additional contributions. **Note:** Income-producing securities and cash are most suitable for funding an annuity trust.

A deduction for the present value of the charitable remainder interest and avoidance of capital-gain tax on the transfer of appreciated long-term capital-gain assets are among the benefits available to the grantor of an annuity trust. The fixed-payout feature of the annuity trust may make it particularly suitable to meet the financial needs of an older beneficiary who needs the security of a guaranteed stream of income.

Example: Mr. F supplements his 84-year-old mother’s annual income with $7,200 of his own after-tax earnings. In his 32 percent income-tax bracket, he must earn almost $10,600 to net the $7,200 he gives his mother each year.



Instead of continuing these payments with after-tax dollars, he transfers $125,000 of securities to an annuity trust and directs that the trustee pay his mother a sum certain of $8,000 per year for life. Even if she must pay a modest income tax, her cash flow will increase.

Mr. F also increases his own spendable income. While he gives up the dividends earned by the securities (currently $1,500 per year), he keeps the larger amount he had been paying to his mother each year. Moreover, he realizes a charitable deduction of $78,349 that saves $25,072 in income tax, and he avoids capital-gain tax on the securities' appreciation.

The present value of his mother's annuity interest of $46,651 ($125,000 less $78,349) is treated as a gift from Mr. F. Any potential gift tax could be offset by the annual gift-tax exclusion and Mr. F's lifetime gift-tax exemption.

Note: Income-producing securities and cash are most suitable for funding an annuity trust.

Benefits of a charitable remainder annuity trust:

- Significant future gift to our organization.
- Substantial income-tax savings.
- Avoid capital gain on initial transfer of appreciated property to trust.
- Predictable income stream.
- More spendable income than the contributed asset was generating.
- Avoid probate.
- Provision for professional management for trust assets.

Charitable Trust Payments Taxed as Long-Term Capital Gain

It is possible to invest a charitable remainder trust so that distributions to the beneficiary are taxed largely as capital gain. This option is attractive because the tax rate on capital gain is lower than the rate on ordinary income. In choosing investments, the trustee may seek both a good return and favorable taxation of payments.

Charitable Education Trust: Meeting College Expenses

The motivation for taxpayers to engage in income splitting—a technique to shift income to a lower-bracket taxpayer such as a child or grandchild—has been severely discourage in the past by tax provisions that cause virtually all unearned income of a child under 18 (or under 24 if a full-time student) to be taxed at the parents' rate. Changes in 2018 now make such income subject to the rates for estates and trusts—also an unattractive option. One attractive way to fund a college education is a Section 529 plan. Another is a charitable remainder trust if the tax on unearned income can be managed. The latter, used for college expenses, is sometimes called the "charitable education trust."

Example: Mr. and Mrs. L have a granddaughter who will be enrolling in college soon, and they expect her to pursue a graduate degree. To help with her tuition and other basic expenses, they transfer stock having a market value of $200,000 and a cost basis of $60,000 to a charitable remainder trust that will continue for a period of eight years. During each of these eight years, their granddaughter will receive payments of $16,000 each year. They name our organization to receive the principal at the end of the eight-year term. Here are the benefits to the respective parties:

- Mr. and Mrs. L's granddaughter receives semi-annual payments totaling $128,000 for her education.
- They receive a charitable tax deduction of $85,022 and avoid paying $26,320 of federal tax on $140,000 of gain (assuming their capital-gain tax rate is 15 percent plus the 3.8 percent Affordable Health Care surtax).
- Our organization eventually receives approximately $179,000 if the trust earns a consistent 7 percent return on investments.
- Mr. and Mrs. L report a taxable gift but do not expect any out-of-pocket cost, due to their lifetime exemption for taxable gifts.

Pooled Income Fund

Some charities have established pooled income funds that offer several of the same benefits as a charitable remainder trust—income to individual beneficiaries, a charitable deduction, avoidance of tax on capital gain when appreciated assets are transferred to the fund, and a future gift to the charity.

However, it differs from a charitable remainder trust in these respects:

- Instead of each donor establishing his or her individual trust, all contributions are combined in a single trust and pooled for investment purposes. For this reason, it is sometimes called a mutual fund of charitable giving.
- Instead of paying a formula amount like a charitable remainder trust, it pays to beneficiaries their pro rata share of the fund's net income.

Because all contributions are pooled, they can be smaller than the amount that would normally be required for the separately managed charitable remainder trust. Thus pooled funds appeal to donors who may want to either contribute a modest amount now or make a series of smaller contributions over time, and reduce income tax. Younger donors might prefer the pooled income fund instead of a gift annuity because the amount of payments is not age-dependent.

Other Gift-Planning Arrangements

Gift of a Remainder Interest in a Residence or Farm

An important exception to the requirement that all split-interest charitable gifts be in the form of a unitrust or annuity trust is a gift of a remainder interest in a residence or farm while retaining the right to continue to use the property.

The owner of a *personal residence* or farm may give the property to a charity while retaining the right to occupy the residence or operate the farm. Such a gift provides a charitable tax deduction for the present value of the remainder interest, enabling the donor to retain money that would have otherwise been needed for income tax without causing any disruption in lifestyle. In addition, this plan permits the donor to escape potential capital-gain tax on the built-in appreciation unless there is a mortgage on the property.

The term *personal residence* is broadly defined in the tax regulations to include any property used by the taxpayer as a personal residence even though it is not used as the donor's principal residence. A single-family dwelling, condominium, vacation home, or stock owned by the donor as a tenant-stockholder in a cooperative housing corporation qualifies as a personal residence if used each year by the donor. The term *farm* includes any land used by the donor or the donor's tenant for the production of agricultural products or for the sustenance of livestock.

Benefits of a gift of your home with retained life estate:

- Substantial future gift to charity.
- Immediate and significant income-tax savings.
- No change in lifestyle as a result of gift.
- Simple to accomplish.

Example: Mrs. O, 75 and recently widowed, has lived in her present home for 25 years and has no plans to move. She has included a provision in her will that leaves her home to us, but that arrangement results in no current income-tax savings. To obtain present tax relief without altering her lifestyle, Mrs. O gives her home to our organization while retaining the right to live there for life.

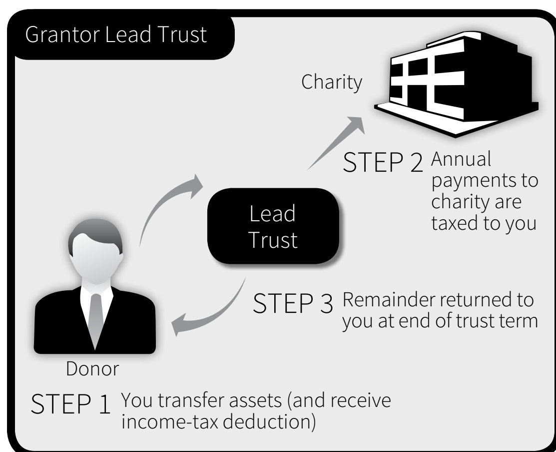
At the time of the gift, her residence is appraised at $300,000. This gift arrangement will provide a charitable tax deduction of $203,258 (the value of our remainder interest). Because Mrs. O's tax bracket is 35 percent, her total tax savings will be $71,140 (35% of $203,258). This is the amount by which her income tax will be reduced over the period she reports the deduction.

In the event Mrs. O decides to move, she will have several options: rent the property and collect the rent, give her life interest in her home to us in exchange for a stream of income for life, or simply give her life interest outright and receive another charitable deduction.

Charitable Lead Trust

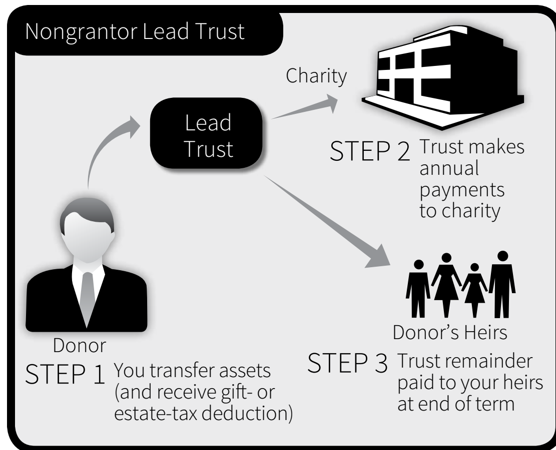
The *charitable lead trust* is the reverse of the charitable remainder trust in that it provides for a gift of payments from property to a charity for a term of years—of any duration—after which the property either reverts to the donor or passes to a noncharitable beneficiary designated by the donor.

There are two types of charitable lead trusts: the grantor lead trust and the nongrantor lead trust.



Grantor lead trust—A *grantor lead trust* provides the donor with an immediate income-tax charitable deduction for the present value of the payments the charity is to receive from the trust for a specified period of time. At the end of the trust term, the assets are returned to the donor. The donor, who is considered to be the owner of the trust for tax purposes, continues to be taxed on the income earned by the trust each year—including the amounts distributed to the charity. However, the up-front tax savings from a large deduction often outweigh the tax the donor pays on interest, dividends, and realized gain from the contributed asset.

Nongrantor lead trust—While a *nongrantor lead trust* created during life does not provide the donor with an income-tax charitable deduction, the donor is not taxed on any of the income earned by the trust. At the end of the specified trust term, the assets remaining in the trust are distributed to heirs, usually to children or grandchildren.



In addition to providing payments to charity, the primary purpose of the nongrantor lead trust is to transfer assets to heirs at greatly reduced gift and estate tax. That is because a gift-tax charitable deduction or an estate-tax charitable deduction (depending on whether the trust is established during or at the end of life) is allowed for the present value of the payments to the charity. That deduction can be quite large, sometimes even large enough to eliminate gift or estate tax entirely. That is especially true when a person establishes a charitable lead annuity trust (one that makes fixed payments to the charity) and the IRS interest rate for calculating deductions is very low, as it is now. By increasing the amount and period of payments, one can also enlarge the deduction. And most important, any appreciation of the value of the trust will avoid gift and estate taxes (the transfer taxes) when trust assets are eventually received by the beneficiary. To qualify for a charitable deduction, the payments to the charity must be a fixed amount or be a fixed percentage of the value of the trust property, determined annually. The former, the charitable lead annuity trust, is much more common.

A nongrantor charitable lead trust may be established either during the donor's life or at death. It can be especially appealing to high-net-worth individuals whose family members can afford to forgo payments for a while in exchange for reducing the tax on the amount they will eventually receive.

Example: Mr. R creates a charitable lead trust, funding it with securities currently valued at $1,000,000 (purchased for $600,000), and directs that the trust is to pay our organization $60,000 annually for 15 years. At the termination of the trust, the assets are to be distributed to his children. Based on IRS tables and a representative discount rate, the present value of the stream of income the charity is to receive from the trust (which is not deductible by the donor for income-tax purposes) is valued at $737,450 and the children's remainder interest is valued at $262,550 ($1,000,000 less $737,450).

Assume that at the end of the 15-year term the trust assets have appreciated to $1,500,000. Nevertheless, for purposes of determining his transfer-tax liability, only the value of the gift to the children at the time the trust was created ($262,550) will be taken into account. The balance of $1,237,450 ($1,500,000 less $262,550) will escape transfer tax. Had Mr. R not established the lead trust, the entire amount transferred to the children would have been included in his estate.

Should the children sell the assets, their basis in the property is $600,000 for purposes of computing capital gain. If the trust had been set up at Mr. R's death, then the children's basis would be the date-of-death value of assets in the trust.

A donor who is considering a charitable lead trust is encouraged to discuss this subject with tax and legal advisors.

Benefits of a charitable lead trust:

- Significant immediate gift to us during the term of the trust.
- Professional management for trust assets.
- Substantial assets passed to heirs at reduced or no transfer-tax costs (nongrantor trust).
- Income-tax deduction (grantor trust).

Gifts That Cost Nothing in Your Lifetime

Planned Gifts Through Wills

"I direct that a court-appointed administrator distribute my estate in accordance with the intestacy statutes as enacted by the state legislature, with the greatest amount of taxes paid to the state and federal governments."

Unfortunately, such is the "legacy" left by the majority of people in this country who die without a written will. By not executing valid wills, they leave to the state a privilege that is rightfully theirs.

A will is a very powerful instrument. It affords an individual many benefits.

Benefits:

- The right to specify which property is to be distributed to whom.
- The right to direct when such distributions are to be made.
- The right to choose the individual or institution to carry out the wishes of the decedent.
- The right to select a guardian for minor children.
- Preservation of as much of one's estate as possible through the judicious use of tax-saving devices and opportunities.

Charitable Bequests

Each year thousands of individuals, exercising the privilege of determining the final distribution of their estates, designate that a portion of their assets be used for the benefit and support of America's charitable organizations. Gifts by will have become an integral part of the American philanthropic tradition because such gifts enable a person to make significant contributions that may not have been possible during life.

Bequests can take various forms. The following sample language for several types of bequests is included for your advisor's consideration in preparing your will.

General bequest: A general bequest is one of the most popular ways to make a charitable gift by will. You simply leave a specified dollar amount to a designated charity.

Sample: I give [DOLLAR AMOUNT] to XYZ Charity, to be used for its tax-exempt purposes.

Specific bequest: A specific bequest is another popular type of charitable bequest. With this bequest, you designate that a charity is to receive a specific asset.

Sample: I give [DESCRIPTION OF ASSET] to XYZ Charity, to be used for its tax-exempt purposes.

Residuary bequest: A residuary bequest is used to give a charitable organization all (or a portion thereof) of an estate owner's assets after all debts, taxes, expenses, and other bequests have been paid.

Sample: I give to XYZ Charity all [or STATED PERCENTAGE] of the rest, residue, and remainder of my estate to be used for its tax-exempt purposes.

Percentage bequest: A bequest can be expressed as a percentage of the entire estate as well as a percentage of the residuary estate.

Sample: I give [THE DESIRED PERCENTAGE] of my estate to XYZ Charity, to be used for its tax-exempt purposes.

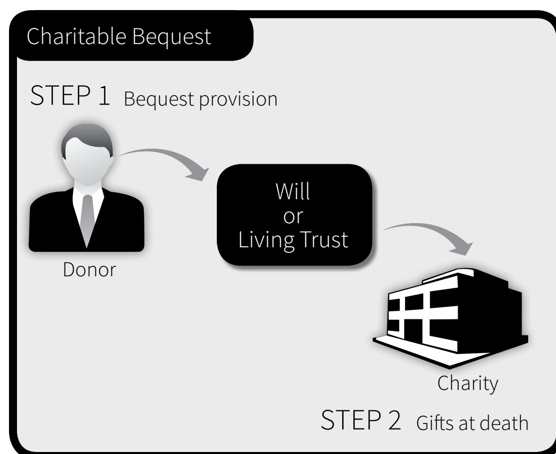
Contingent bequest: When writing your will, it is important to plan for the situation in which the beneficiary of a bequest dies before you or disclaims the asset. In anticipation of such an occurrence, you may name a charitable organization as the alternate or contingent beneficiary. This will ensure that the asset will pass to the designated charity rather than to unintended beneficiaries.

Sample: If [NAME OF BENEFICIARY] predeceases me or disclaims any interest in [DESCRIPTION OF ASSET], I give such asset to XYZ Charity, to be used for its tax-exempt purposes.

Restricted bequest: The bequest-provision language suggestions above are designed to provide unrestricted gifts. However, you may prefer to restrict your bequest for a specific purpose. For example, if you wish to memorialize a family member or an honored colleague, you can establish a named fund that will provide support for a program in which you (or the honored person) are particularly interested.

A restricted bequest should usually be made in the broadest terms possible consistent with your interests. This guards against the possibility of the purpose of your gift becoming obsolete (such as the elimination of a specific department or program).

Sample: After stating the amount and type of bequest, say: This gift may be merged with any of the investment assets of XYZ Charity, but it shall be entered in the charity's books and records as the [PERSON'S NAME] Endowed Fund. The principal shall be held as a permanent fund, and the distributed income shall be used to support the [SPECIFIC PURPOSE FOR WHICH THE GIFT IS TO BE USED].



If it should become impossible, inadvisable, or impractical to use this gift for the specified purpose, then the board or administration of XYZ Charity may use the income of the fund for other tax-exempt purposes of XYZ Charity, adhering as closely as possible to the original wishes of the donor.

Income for a beneficiary—A charitable bequest can also be arranged to provide income for a selected beneficiary by directing that the bequest be used to establish a gift such as a charitable remainder annuity trust or unitrust or a charitable gift annuity. Most of these approaches to charitable giving have been discussed in the context of lifetime gifts. If a trust is established by will (a testamentary trust), the principal will pass to the charitable organization only after both the donor and the beneficiary have died. If a gift annuity is established by will, the charity will receive the principal when it is distributed by the executor, but the charity normally will not use any of it until the payment obligation to the beneficiary has terminated.

When creating a testamentary trust, it is necessary to specify:

- The property or amount to be placed in the trust.
- The type of vehicle to be used.
- The term of the trust *(a period of years or the lifetime of the beneficiary)*.
- The payments to be made and their frequency.
- The beneficiary(ies) of the trust.
- The provisions for the eventual distribution of principal.

The payments from a testamentary gift annuity will be the amount given to the charity multiplied by the annuity rate then paid by the charity to a person of the beneficiary's age at the time of the donor's death.

In addition to the personal satisfaction of making a philanthropic bequest, there are definite tax benefits that you may realize as well. You may take an estate-tax charitable deduction for the full value of an outright bequest. Reduced estate-settlement costs may also result from careful planning.

If your bequest is directed to a charitable remainder trust, your estate will be allowed an estate-tax charitable deduction for the present value of the charitable remainder interest. If the bequest establishes a gift annuity, an estate-tax charitable deduction will likewise be allowed for a portion of the distribution.

If an individual creates a testamentary charitable remainder trust in his or her will and the only noncharitable beneficiary is the donor's spouse, the decedent's estate will be allowed both a marital deduction for the value of the spouse's income interest and a charitable deduction for the value of the charity's remainder interest and no federal estate tax will be imposed. **Note:** The same result occurs if the plan is created during the donor's life and the only noncharitable beneficiaries are the donor and his or her spouse. Likewise, when a gift annuity is created under a will or during life for a spousal beneficiary, no part of the contribution will be subject to estate tax.

Example: Mr. S has an estate that will be subject to the federal estate tax. His will directs that $500,000 be placed into a charitable remainder unitrust that will pay his wife 6 percent of the annual value of the trust. Upon Mrs. S's death, the trust principal will pass to our organization. As a result of this arrangement, Mr. S's estate will be allowed an estate-tax marital deduction for the value of Mrs. S's income interest and a charitable deduction for the value of the remainder interest. At Mrs. S's death, the full value of the unitrust will pass to us free of federal estate tax.

QTIP: Flexibility for Family Contingencies

Married individuals naturally want a surviving spouse to have sufficient income for various financial needs. A person who has children by a previous marriage will probably want to provide for them as well—and perhaps also leave something for charity. An instrument called a Qualified Terminable Interest Property ("QTIP") Trust, which was approved by legislation in the 1980s, can enable a person to meet these various objectives. The legislation revised the traditional rule that terminable interests—interests subject to being cut short on the occurrence of some contingency—do not qualify for the marital deduction.

Suppose, for example, that Mr. T provides through his will that $1,000,000 fund a QTIP trust. His surviving spouse will be entitled to all of the income and may receive some distributions of principal, if necessary for certain special needs. At the death of the surviving spouse, the QTIP trust assets will be distributed to Mr. T's children. Thereby, he ensures support for his surviving spouse and ensures a gift to his children. An estate-tax marital deduction will be allowed for the assets transferred to the QTIP trust. The assets in the trust will be included in the estate of the surviving spouse, but there will be no tax—provided that her total estate is below the exemption amount.

If Mr. T does not need to provide for children through the QTIP trust, he could name a charity to receive the trust remainder. Then all of the assets would qualify for an estate-tax charitable deduction at the death of the surviving spouse. Some people prefer a QTIP trust to a testamentary charitable remainder trust because the surviving spouse can receive not only income but also distributions of capital if necessary.

Provide for Estate Taxes

Because the rate or transfers subject to federal estate or gift tax is 40 percent, charitable gifts can produce significant tax savings. In order to preserve the estate-tax savings made possible by charitable gift plans, care

must be taken in providing for payment under your will of taxes that may be due. More than one donor has been unable to leave all that was intended to charitable beneficiaries because the will's tax clause was poorly worded.

If this tax clause allocates payment of any taxes to the charitable gift portion, for example, it would reduce the gift and increase the tax, which in turn further reduces the gift. This spiral calculation may result in substantial reduction of the charitable gift—with the tax collector as the real beneficiary.

To avoid this result, it is important that you review with your legal advisor the provision in your will for payment of any estate taxes.

Another thing to take into consideration when providing for possible estate taxes is the portability of the lifetime estate-tax exemption. If the lifetime exemption of the first-spouse-to-die is not fully used, the unused portion can be used by the surviving spouse. In 2018 the lifetime exemption for federal estate tax is $11,200,000. If $8,000,000 of this is used on the decedent spouse's estate-tax return, the additional $3,200,000 could be added to the exemption of the surviving spouse. This makes it possible for a married couple to pass to heirs double the individual exemption. In addition, all charitable bequests and other end-of-life charitable gifts are fully deductible when determining any estate tax. Taxable transfers in excess of the equivalent exemption are taxed at 40 percent.

Gifts of Qualified Retirement-Plan Benefits and Other IRD Items

Qualified retirement-plan benefits represent a major portion of the average person's estate. Due to special tax considerations that apply to such benefits, they make an excellent choice for funding a testamentary charitable gift. These retirement plan benefits are, in federal-tax parlance, income in respect of a decedent (IRD), which refers to income that a decedent was entitled to but was not properly includible on his or her final income-tax return for the year of death. Other items of IRD are accrued unpaid salary, deferred compensation, unpaid bonuses, interest on U.S. savings bonds, and deferred gain in commercial deferred variable annuities. All of these items (except for a Roth IRA) are subject to income tax. If a person's estate exceeds the exempted amount, they would also be subject to federal estate tax and to state estate tax, if the owner resided in a state with a state estate tax in the case of a larger estate.

Although the beneficiary of taxable retirement plan benefits can deduct for income-tax purposes any federal estate tax on those assets, chances are that most of the retirement funds received by a beneficiary, as well as other IRD assets, will be subject to income tax. In contrast, the capital gain in securities, real estate, and tangible personal property received by those beneficiaries will not be subject to income tax. That is because beneficiaries of these assets receive a step-up in basis. This means that they are not taxed on any gain accruing prior to the death of the owner.

Therefore, from a tax standpoint, the best strategy for individuals who want to provide for both heirs and charities is to name charities as beneficiaries of some or all of the IRD assets and to give other types of assets to heirs. Because charities are tax-exempt, they will pay no income tax on the IRD assets they receive.

Example: Mrs. V has a substantial estate, including qualified retirement-plan benefits worth $1,000,000, and wants to leave $1,000,000 to her favorite charity and the balance to her son David.

Regardless of the asset she uses to fund her charitable gift, her estate will qualify for a $1,000,000 estate-tax charitable deduction. Assuming that she has an estate of $14,000,000, which is well above the current exemption of $11,200,000, the federal estate tax attributable to this amount would be $400,000 (40% of $1,000,000).

If David received the retirement-plan benefits, he would pay income tax on $1,000,000 less the amount of the federal estate tax attributable to the inclusion of the IRD in his mother's estate. The federal estate tax attributable to the IRD is $400,000, so David would pay income tax on $600,000 ($1,000,000 less $400,000)—$222,000 in his 37 percent income-tax bracket—leaving a net inheritance of $378,000 from the retirement account ($1,000,000 less $400,000 less $222,000).

Because Mrs. V decides instead to make a charitable gift to us of her retirement-plan benefits, neither our organization nor her son will have to pay any income tax as a result of the IRD—*saving him the $222,000 that would have otherwise been consumed by income tax*.

Benefits of a testamentary charitable gift from your qualified retirement plan or IRA:

- Provide a significant gift to support our work.
- Avoid federal income tax and potentially avoid estate tax.

A charitable remainder trust for a loved one: Retirement-plan benefits can also be used to fund a qualified charitable remainder trust at the death of the owner. If the surviving spouse is the designated beneficiary of the trust payments for his or her life, then the entire value of the trust, regardless of its size, will be deductible for estate-tax purposes. And because a qualified charitable remainder trust is a tax-exempt entity, it does not have to pay any income tax on the receipt of these benefits. Thus the full value of the benefits will be available to provide payments to the surviving spouse.

If a beneficiary other than a surviving spouse is named, an estate-tax charitable deduction will be available for the charity's remainder interest in the trust. (See Income for a beneficiary discussion on page 17.)

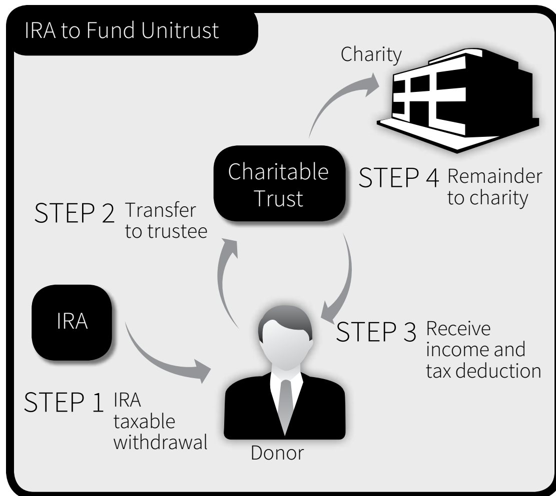
The distributions from the trust will be subject to income tax as received by the beneficiary.

Planning for nontaxable estates: Even if an estate is not subject to federal estate tax, planning with IRD can produce significant savings. An estate valued at or less than the applicable exclusion would not generate any federal estate tax—but if it contained any elements of IRD such as qualified retirement-plan benefits, the ultimate recipient would have to recognize such amounts for income-tax purposes. Thus a $100,000 charitable gift funded with qualified retirement-plan benefits, in contrast to other assets, would save a noncharitable beneficiary in the 32 percent federal income-tax bracket $32,000.

Lifetime planning: Generally, qualified retirement-plan benefits enjoy tax deferral on both contributions and earnings during lifetime. This enables such funds to grow much more rapidly than funds that are taxed currently. However, when benefits are received, 100 percent of the distribution is subject to tax. In fact, additional penalty taxes can apply if funds are taken out too soon or too late. *(This discussion does not apply to Roth IRAs because contributions are not deductible and distributions are tax-free.)*

IRA Charitable Rollover, Etc.

In 2006 legislation was enacted that allowed an individual, who was over the age of 70½, to transfer directly from an IRA up to $100,000 during the year to one or more charities. (The $100,000 is a maximum for all charitable transfers combined, not $100,000 per charity.) The amount transferred is not included in taxable income, and it does count towards the mandatory distribution from the IRA. No charitable deduction is allowed because the amount transferred was never subject to tax. The transfers cannot be made to a donor advised fund, a supporting organization, or a private foundation.



This direct tax-free rollover is commonly known as the IRA charitable rollover. It had been regularly renewed, but often not until late in the year.

In legislation known as Protecting Americans from Tax Hikes (PATH) enacted by Congress and signed into law on December 18, 2015, this law was made permanent beginning retroactively to January 1, 2015. Now individuals over the age of 70½ who want to make a charitable gift from their IRA know in advance that it is possible and can make the transfer anytime during a year.

The tax-free direct transfer can only be made from an IRA. If retirement funds are in a 401(k), 403(b), or other plan, it would be necessary to transfer them to an IRA before making the rollover gift. Individuals who are younger than 70½ but older than 59½ could use any retirement plan to make a gift by withdrawing funds and then contributing them to charity. The funds withdrawn would be added to income, but a deduction would be allowed for the contribution. If the deduction can be fully used and the added income would not affect a person's overall tax situation, the deduction would offset the taxable income, resulting in a "wash."

It is also possible to use retirement-plan benefits to fund a gift that provides a stream of income, such as those discussed earlier in this gift-planning guide. While a deduction generated by such a gift will not offset all of the distribution, it will shelter some of that amount from tax and produce a stream of income for the donor.

Example: Mr. W, 70, would like to make a significant gift to our organization during his lifetime. In order to make the kind of gift he has in mind, Mr. W plans to use $100,000 from his IRA account. He also feels he will need income from the gift.

He decides to use the IRA distribution to fund a charitable remainder unitrust that will pay 6 percent of its annual value to him. He will have to recognize $100,000 of income because of the distribution, but he will also get a deduction of more than $46,600 as a result of his gift.

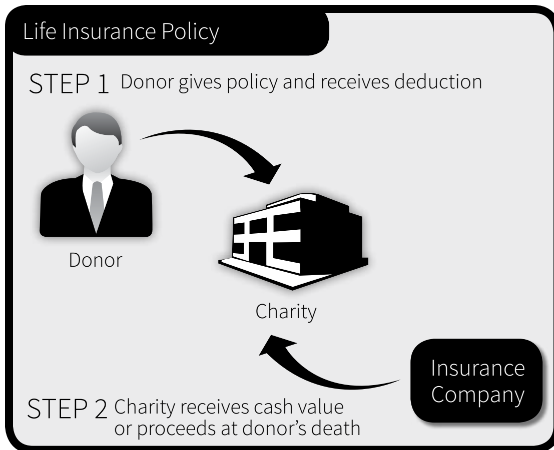
Planning pointer: To avoid any out-of-pocket tax cost, Mr. W might retain enough of the distribution to cover the tax and contribute the balance.

A charitable remainder trust or a gift annuity to provide income to a survivor could be funded with assets remaining in a retirement plan. There would be no income tax on the distributions for the trust or annuity, so the entire amount would be available to generate income to the survivor.

Planned Gifts of Life Insurance

Many if not most people own some form of life insurance. The principal reason is its unique ability to meet the varied protection needs of an increasingly sophisticated society.

An important but frequently overlooked role of life insurance is the one it can play in charitable gift planning. Life insurance itself can be the direct funding medium of a gift, permitting the donor to make a substantial gift for a relatively modest annual outlay. Life insurance can also be used to replace an asset that has been given to a charitable organization.



A charitable organization as beneficiary: A donor can name a charitable organization as the primary beneficiary of a life insurance policy. The donor retains ownership of the policy and has access to the policy's cash value. Although the face value of the policy will be includible in the donor's gross estate, no federal estate-tax liability will result from the inclusion of the policy because of the charitable deduction.

Because the donor retains ownership of the life insurance policy, no income-tax charitable deduction is allowed for its value upon designation of the charitable organization as the beneficiary or for subsequent premium payments.

A donor can also name a charitable organization as a successor beneficiary to receive the proceeds in the event the primary beneficiary(ies) is no longer living. Once again, should the proceeds be paid to the charity, the donor's estate will be allowed an estate-tax charitable deduction.

A charitable organization as owner: A donor who wishes for more immediate tax benefits may consider the irrevocable assignment of an insurance policy to a charitable organization. Upon such an assignment, the donor generates an immediate federal income-tax charitable deduction for the lesser of the policy's value and the adjusted cost basis. Income-tax deductions for contributions to enable the charity to pay subsequent premiums are also allowed.

Example: A number of years ago, Mr. Y purchased a $50,000 whole-life policy to ensure funds for his children's education. The annual premium for the policy is $1,000. His children have graduated and are now financially independent. The policy, which he still owns, has a fair-market value (usually very close to the policy's cash value) of $25,000, and the adjusted cost basis (total net premiums paid) is $22,000.

Mr. Y assigns the policy to our organization. In his 32 percent tax bracket he realizes an immediate tax savings of $7,040 (32% of $22,000). In future years Mr. Y increases his annual gifts by $1,000 per year to us, and in turn we pay the insurance premium. Mr. Y realizes an annual tax deduction of $1,000, based on his annual gifts for that purpose. He would get the same deduction if he made the premium payments directly to the insurance company.

In order to obtain an income-tax charitable deduction for an assignment of life insurance to a charitable organization, the donor cannot retain any rights *(such as the right to change the beneficiary)* in the policy.

Wealth-replacement option: One of the most important and sophisticated roles of life insurance in gift planning is its potential use in replacing the value of an asset that has been given to charity. How it works: After a donor makes a gift to a charitable organization, the tax savings produced by the charitable deduction are given by the donor to his or her children or to an irrevocable trust to purchase and pay the premiums on a life insurance policy on the donor's life. The children are named as beneficiaries of the policy, and the proceeds they receive replace for them the value of the asset given to charity. Such an arrangement can ensure that the interests of family beneficiaries will not be adversely affected.

Benefits of a charitable gift of life insurance:

- A substantial future gift to charity.
- Simple to accomplish.
- Income-tax savings if charity is owner and irrevocable beneficiary of policy.

Tips on Timing Your Charitable Gifts

Your gift by check: The effective date of your contribution is the day you mail or hand-deliver the check, provided you have placed no restrictions on the cashing of the check. Your check dated December 31 and mailed and postmarked on that date is deductible in that year. It does not matter that the charity receives your check in the new year and that it is actually charged to your account in January. However, if your check is mailed in December but postdated so that it cannot be cashed until the next month or if it is dated in December but not mailed or handed to the charity until January, it cannot be deducted on your prior year's return.

Your gift of securities: Securities are among the most popular assets for making charitable gifts. The rules for transferring securities, while not complicated, are strict. If you plan to take a deduction on this year's return, you will want to exercise care to ensure that you execute your transaction so as to complete the gift this year.

Remember that the amount of your deduction depends on the value of the securities at the time your gift is completed. Choosing the date to complete your gift can make a difference in the amount of your deduction. *Here are some practical tips to help you*.

- If you hand-deliver a properly endorsed stock certificate or an unendorsed stock certificate and a properly endorsed stock power, your gift is effective on the date the charity receives it.
- If you deposit these documents in the mail, the postmark constitutes the date of your gift. It is important to send the stock certificate and the stock power separately when sending securities through the mail.
- If your securities are held in a brokerage account, ask the broker to call for instructions and transfer stock from your account to a temporary account in the charity's name. Your gift is effective when the stock is transferred from your account. After receiving instructions, a broker can usually complete the transfer electronically.
- The broker must call the charity for instructions on handling the stock, in order to ensure that the valuation of the gift—and your charitable deduction—takes effect on the proper date.

Gift of mutual funds: By letter or by completing a form provided for vouchers, you as the donor instruct the fund's transfer agent to transfer all or "x" shares to an account established for the charity. Your signature should be guaranteed. The date of the gift is the date the shares are credited to the charity's account.

Gift of real estate: In most states your gift is complete on the day the signed deed is delivered or mailed to the charity. However, in certain states the transaction is considered to be complete on the date the deed is recorded. Although the actual execution of a deed can be delayed until the very end of the year, the gift should be put in motion earlier, as the charity will need to determine the acceptability of the gift. Also, in most cases an appraisal will precede the gift.

We are here to help: If you have questions about the proper way to transfer any kind of property, please don't hesitate to contact us. We will be happy to assist you in making an effective transfer to ensure your deduction in the current year. All inquiries are kept strictly confidential.

Gifts to Fund the Future

The purpose of this guide is to highlight the wide variety of gift-planning options available to individuals who wish to include their favorite charitable organizations in their financial and estate planning.

We invite your inquiries and would be pleased to discuss with you and your advisors how a planned gift may be arranged to meet your personal objectives.

The information contained herein is offered for general informational and educational purposes. The figures cited in the examples and illustrations are accurate at the time of writing and are based on federal law, as well as IRS discount rates that change monthly. State law may affect the results illustrated. You should seek the advice of an attorney for applicability to your own situation.

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