

## 24. Planning Opportunity With Charitable Gifts

Each year generous Americans give billions of dollars to charitable organizations, A growing percentage of people making these gifts use techniques such as charitable remainder trusts and charitable gift annuities that provide special tax advantages as well as lifetime benefits to themselves.

This article discusses some of the popular techniques for making gifts to charities and how they can be used in specific situations. If you feel a responsibility to your community and want to make gifts that make good financial sense, these strategies may appeal to you.

### Ways of Making Charitable Gifts

***Outright Gift*** An outright gift to a charity has no strings attached. If your gift is to a "qualified charity" you are entitled to an income tax charitable deduction if you itemize deductions, and to a gift tax charitable deduction.

***Bequest*** A charitable bequest is simply a gift to a charity made at your death under your Will or revocable trust. The full value of a bequest is deductible for estate tax purposes.

***Charitable Remainder Unitrust.*** A charitable remainder unitrust is a special type of trust that benefits one or more noncharitable beneficiaries for a term and then is distributed to one or more charities. The term can be the lifetime of the noncharitable beneficiary or beneficiaries or it can be a term of up to twenty years. In the most common form of charitable remainder unitrust, a fixed percentage (at least 5%) of the value of the trust assets, revalued each year, is paid out to the beneficiaries (who could be you and your spouse) during the term of the trust. For example, if the payout rate is 6% and you contribute \$100,000 on January 1, your payment for the first year would be \$6,000. If the value of the trust principal increases to \$105,000 by the beginning of the second year, the payment for that year would be 6% of \$105,000, or \$6,300. When the trust terminates upon the death of the last surviving beneficiary or the expiration of the term of years, the property remaining in the trust passes to the charity or charities specified in the trust document. Under a special set of IRS rules, contributions to a charitable remainder unitrust are partially deductible for income tax and gift tax purposes. If appreciated property, such as stock, is used to fund the trust, there are potential capital gains tax savings as well. If you are the noncharitable beneficiary, the assets remaining in the trust at your death are included in your estate for estate tax purposes but your estate is entitled to an estate tax charitable deduction for the entire value of the assets distributed to the charity

***Charitable Remainder Annuity Trust*** This type of trust is very similar to the charitable remainder unitrust discussed above, (except that the annual payment to the beneficiary or beneficiaries is a fixed dollar amount each year, rather than a fixed percentage of the trust value. This amount (as specified in the trust agreement) must be at least 5% of the initial value of the trust assets. A charitable remainder annuity trust has the same income, gift, capital gains, and estate tax benefits as a charitable remainder unitrust

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***Charitable Gift Annuity.*** Some charities offer charitable gift annuities. This is an annuity paid by the charity for the life of one or two beneficiaries, usually the donor or donors, in return for the transfer of property to the charity. The value of the property you transfer to the charity is greater than the value of the annuity. The difference in value is a gift, and you are entitled to an income tax and a gift tax charitable deduction for this value. A charitable gift annuity is a contract between you and the charity rather than a trust. Gift annuities are regulated by the insurance commissioner in many states, including Washington.

### **Pooled Income Fund**

Most charities have a minimum amount they will accept for a separately managed charitable remained unitrust or annuity trust, and often for charitable gift annuities as well. However, for a smaller gift, a charity may offer a pooled income fund. All contributions to the fund are commingled into an investment pool. When a donor makes a gift to the fund, he or she (or another named beneficiary) is assigned a number of units based on the market value of the gift. The income from the pool is then prorated and paid to the beneficiaries on the basis of the number of units they own. When a beneficiary dies, his or her pro rata share of the fund is withdrawn from the pool and distributed to the charity. You are entitled to an income tax and a gift tax charitable deduction for a portion of the value of the property you transfer to the pooled income fund. If you transfer appreciated property to the fund, you will not recognize any capital gain when the property is sold by the fund manager.

### **Strategies for Gifts of Different Types of Property**

***Cash*** You may always give cash as part of your charitable giving strategy. However, gifts of other types of property may yield better tax or investment results.

**Marketable Securities.** Publicly traded stocks and bonds are appropriate for any type of charitable gift. If you give securities that have appreciated in value and have been held more than the long-term capital gains holding period, you will usually receive a double tax benefit—an income tax deduction based on the fair market value of the securities and capital gains tax savings.

Let's say you own stock in the XYZ Corporation worth \$2,000 today that you purchased 10 years ago for \$10. You want to make a gift to your favorite charity of \$2,000. If you sell the stock and give cash to the charity, you will have to pay tax on the gain realized over your original cost and you will have only the net proceeds left for your gift. If instead you give the stock directly to the charity you will be able to give (and deduct) the full \$2,000 and you will not have to pay tax on the gain.

**Real Estate.** Most charities will accept real estate as an outright gift. A gift of real estate to a charitable remainder unitrust can enable you to convert appreciated real estate into a regular income source. If you transfer vacant land or low-income-producing property to the trust, the trust instrument normally will include a "net-income" provision that allows the trust to pay the lesser of the fixed percentage or the actual net income from the property. Prior to the sale of the property, of course, there will be little or no income. Later, when the property is sold and the proceeds are reinvested, the trust instrument can allow for payment of any excess earnings to beneficiaries to make up for prior deficiencies, or the trust can switch to paying the fixed percentage amount beginning with the year after the sale.

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A real estate gift that provides no income, but does offer you a current income tax deduction, is a gift of your personal residence or farm to a charity while retaining a life estate. The retained life estate means that you continue to use and possess the residence or farm for your life, but at your death it goes to charity. This plan is appealing because it allows you to continue to live in your accustomed lifestyle with the knowledge that you have saved money and made a significant gift to charity. Upon your death, the full value of the residence or farm is included in your estate, but your estate is entitled to a charitable deduction for 100% of the value, including all of the appreciation that occurred after the date of the transfer,

**Closely-Held Stock.** A shareholder in a closely-held corporation can donate stock to a charity. Such stock can subsequently be redeemed by the corporation or sold to another individual. If the charity is not legally bound, or cannot be compelled by the corporation, to surrender the shares for redemption, the stockholder will receive a

charitable deduction for the full value of the stock and will not be taxed on the redemption proceeds.

Another option is to fund a charitable remainder trust with closely-held stock. In this case, the corporation purchases the stock from the trust. The trustee then invests the proceeds to make payments to the beneficiaries of the trust. Here, the donor converts stock that paid no dividend to an income-producing asset and receives a deduction in the process. Redemption of the stock by the corporation could under certain circumstances be a prohibited act of self-dealing, but this problem can usually be avoided if handled properly.

In addition to the techniques above, there are numerous other more specialized techniques available. Your estate planning advisors or representatives of the charities can provide additional details on techniques such as:

- Charitable lead trusts (the reverse of a charitable remainder trust, i.e., benefits to charity now and family members later).
- Gifts of life insurance to charity.
- Creation of a private foundation for more substantial gifts.
- Interest free loans to charity.
- Gifts of an undivided interest in an asset, e.g., a piece of artwork.

### **Conclusion**

Charitable giving offers many opportunities to obtain tax advantages. Whether or not any of the strategies mentioned will work for you depends entirely on your individual facts and circumstances. Next time you are considering a charitable gift, stop and think a moment before you write a check. Is there a better way to make this gift? You may be surprised at the overall benefits that can be achieved both for yourself and for the charity of your choice.