Important Year-end Charitable Giving Strategies:
The Strategies and the "Words That Work" in Conversations

Russell James

Our changing charitable world

At the moment, both donors and advisors are facing a changing charitable world. Some opportunities will definitely be lost. Others may or may not be lost depending upon the success of proposed legislation and market changes.

We expect these definite losses at the end of the year

- Eliminating 100% of taxable income with giving will disappear.
- Above the line $300/$600 charitable deduction will disappear.
- Any current year (2021) tax benefits (as always) will disappear.

These other benefits may or may not disappear, but at a minimum they are at some risk of loss

- The specter of immediate or retroactive tax legislation changing call into question what might be allowed with: Donor Advised Funds, stepped up basis at death, Fair Market Valuation of gifts of appreciated assets, Charitable Remainder Trust without upfront gain recognition, Roth conversions, estate tax avoidance strategies, etc.
- Rising interest rates may result in lowering tax benefits for grantor Charitable Lead Trusts, non-grantor Charitable Lead Trusts, retained life estates, and increased taxation of Charitable Gift Annuity payments.

"No" is not the enemy. "Later" is the enemy.

Guessing what tax changes will come in advance of legislation is always an uncertain and perilous task. However, even the discussion of various changes can be helpful for advisors and fundraisers because it can motivate clients to act. Thus, the most important impact of "proposed" legislation may be motivating your client or donor to act now! It is especially important to keep in mind that during the last round of tax changes occurring in 2018 many of the rule changes were applied retroactively. Thus, it may be much safer to complete any transactions before the end of the year, rather than hoping that new legislation will not be applied retroactively to the beginning of the following tax year.

Behavioral economics: Financial loss motivates more than financial gain

Avoiding the feeling of loss is powerful in financial decisions. A long history of research shows this.[1] That's why donating from a windfall gain feels easier. The cost doesn't change, but it doesn't feel like a loss. It feels like a slightly smaller gain.

[1] Abdellaoui, M., Bleichrodt, H., & Paraschiv, C. (2007). Loss aversion under Prospect Theory: A parameter-free measurement. *Management Science, 53*, 1659-1674; Tversky, A., & Kahneman, D. (1991). Loss aversion in riskless choice: A reference-dependent model. *The Quarterly Journal of Economics, 106*(4), 1039-1061.

© 2021 Russell James

Instead of being a loss, a donation can also be described as *avoiding* a loss. A temporary financial match can mean "lost money" if no gift is made. Jay Steenhuysen promotes asset gifts this way:

"Describe not giving assets as *losing* a 25% tax benefit."[2]

The interest rate for complex gift deductions changes monthly. The section 7520 rate is used to calculate charitable deductions for complex gifts such as charitable remainder trusts, charitable lead trusts, charitable gift annuities, and retained life estates in homes and farmland. Donors can use the current month's rate or either of the previous two month's rates. Thus, it is actually the interest rate from the month before last that expires each month. However, if this offers a more favorable tax result, then failing to act by the deadline can be described as creating a loss. This can mean *losing* valuable deductions if the deadline is missed. Or gift annuity rates may be about to drop. Either way, the message is

"Act now or lose money!"

Or maybe the donor is age 72 or older. Then this message can be

"Donate from your IRA or lose money when they force you to take it out!"

End-of-year tax deadlines can also help. This message can be

"Give now or lose the deduction for a year!"

The point here isn't that people don't like losing money. That's obvious. The point is that the same circumstances can be described using either loss framing or gain framing. When attempting to motivate financial actions, loss framing is often much more powerful. Examples of the two types of framing include.

Loss framing
- Act now or suffer a loss!
- This is your last chance because this disappears in a few weeks!
- Everything is uncertain and once it's gone, it's gone!
- I'm concerned because you may lose out on this tax benefit if we don't act now.

Gain framing
- You can get this great benefit.
- It's a nice bonus if you want to use it this year.
- These are good benefits you can take advantage of now.

Last chance "definitely" disappearing opportunities in 2021

The "magic" 2021 charitable tax deduction for non-itemizers will be disappearing.
- This is limited to $300 per person
- This is limited to $600 for a married couple. Note that this is different than the rule last year. In 2020 this was limited to only $300 for each taxpaying entity, thus for married couple this was limited to $300 in total, not $300 per person.

[2] Steenhuysen, J. (2017, February 8). *Major gifts: Bigger, better, sooner*. AFP/NCPGC Joint Luncheon, Washington, D.C. http://ncgpc.org/documents/n/national-capital-gift-planning-council/downloads/steenhuysenpresentationfeb8.pdf

© 2021 Russell James

The ability to offset 100% of your income with charitable deductions will be disappearing

- This benefit will be available for 2021 only and likely will not extend to 2022.
- This is allowed only for cash given to an operating public charity.
- However, this is not available for gifts to traditional donor advised funds.

How can we leverage the expiring 100% limitation benefit? Matching with Roth conversions

Converting a traditional IRA to a Roth IRA is often a powerful financial planning strategy. Once converted withdraws from the Roth IRA are tax free. This applies both to the amount converted and to any growth on the amount converted. However, the conversion itself creates immediate income. Any amount converted is added to AGI. Many clients may be even more interested in making this conversion this year as there have been legislative discussions surrounding limiting these conversions.

However, this year only a donor could choose to eliminate any part of this added income with charitable gifts of cash. Thus, for example, accelerating a multi-year pledge by writing a larger check now can fit with a Roth conversion.

How can we leverage the expiring 100% limitation benefit? Using a Charitable Gift Annuity.

Some donors may find a new attraction to Charitable Gift Annuities simply because of the low interest rate environment. If the donor can't use charitable deductions, lower interest rates mean a larger share of the annual payments will be considered tax-free return of the original investment.

For those donors who can use the deduction, if funded with cash, the deduction for a Charitable Gift Annuity should be able to eliminate 100% of income in 2021. However, this does not appear to apply to the use of a Charitable Remainder Trust. The statute indicates that a "qualified contribution" requires "(i) such contribution is paid in cash during calendar year 2020 to an organization described in section 170(b)(1)(A)". Thus, to break it down, a "qualified contribution" is a deductible "contribution" that is

- "paid in cash"
- "during calendar year 2020"
- "to an organization described in section 170(b)(1)(A)" (i.e., a public charity).

With a Charitable Gift Annuity, the public charity gets cash immediately. In essence a Charitable Gift Annuity can be thought of as a poorly priced annuity, meaning that the donor pays more for the annuity than its actuarial value, with the difference being a charitable gift. Thus, buying a Charitable Gift Annuity is a bit like paying $1,000 for a dinner event worth $95. It is a kind of a "bargain sale." The Charitable Gift Annuity is not a "split-interest gift" because the donor retains no rights in the gifted property. In the same way that the $905 deductible cash gift arising from paying $1,000 for a dinner event worth $95 should qualify for the 100% income giving limitation, so too should a Charitable Gift Annuity. Unfortunately, with such ephemeral legislation there is no time for the normal judicial or administrative processes that would provide certainty to such

 © 2021 Russell James

applications of the statute, but such an approach appears to be in keeping with the goal of the legislation which was to get immediately usable cash to operating public charities. In most states, the deductible portion of a Charitable Gift Annuity can be used immediately should the charity desire to do so.

However, this same logic does not apply to a gift of cash to a Charitable Remainder Trust. The Charitable Remainder Trust itself receives immediate cash but it does not qualify as a section 170(b)(1)(A) organization. The ultimate beneficiary may indeed be a section 170(b)(1)(A) organization, but that organization receives no cash in calendar year 2021. Thus, such a gift would appear not to comply with the text or then intent of the legislation. (The contrary argument is that one can comply with the statute simply by making a gift that is "paid in cash during calendar year 2021" and that the post-mortem transfer "to" the public charity qualifies to fulfill the requirement of "to an organization described in section 170(b)(1)(A)".)

An obscure strategy you can use to get 100% tax deductions even after 2021

Although the 100% income giving limitation will be disappearing after 2021 there is a little used strategy that has long been available to access that limitation in a special circumstance. This strategy is for a client capped out on their income limitations with little or no expectation of being able to use those deduction in the five following tax years. Typically, this occurs with wealth donors give from assets, but have relatively little reportable income.

For such donors who plan to continue donating, they may still take advantage of offsetting future income with future donations in this way. First, the donor moves an income-producing asset into a non-grantor Charitable Lead Trust. The non-grantor Charitable Lead Trust then makes annual gifts to a charitable organization. The non-grantor Charitable Lead Trust is its own tax paying entity. Thus, it will pay taxes on any income produced by the asset. However, any gifts going to the charity can be deducted from this income up to 100% of the income. Thus, charitable giving can offset all income inside the non-grantor Charitable Lead Trust. Indeed, the non-grantor Charitable Lead Trust can also be drafted to pay out any income in excess of the planned annuity or unitrust amount to keep the income taxes at $0.

How to take advantage of low interest rates BEFORE THEY DISAPPEAR! The non-grantor Charitable Lead Trust

Although the non-grantor Charitable Lead Trust can be used for income tax planning as described above, it is primarily a tool for avoiding gift and estate tax. The benefit of the non-grantor Charitable Lead Trust comes because Gift taxes are paid on the present value of the PROJECTED remainder going to the heirs, but no gift or estate taxes are paid on the ACTUAL remainder that eventually goes to the heirs. Thus, if the ACTUAL amount is higher than the PROJECTED amount, this part goes to the heirs tax free. The non-grantor Charitable Lead Trust can be structured so that the PROJECTED amount going to heirs is $0, resulting in no gift or estate taxes.

 © 2021 Russell James

Whether zeroed out or not, the PROJECTED remainder assumes the investment will grow at the INITIAL §7520 rate. If actual growth is greater than the §7520 rate, the ACTUAL remainder will be greater than projected. Consequently, this tool is much more useful whenever the §7520 rate is low relative to expectations of the growth in the value of the asset over the period during which the non-grantor Charitable Lead Trust will operate. If the charitable gift (or bequest) was already planned, the zeroed-out non-grantor Charitable Lead Trust (or zeroed-out testamentary non-grantor Charitable Lead Trust) provides a no cost chance at tax-free transfers to family.

In the last year §7520 rates reached their all-time historic lows (0.4%) and have since started to rise (1.0% in October). Thus, donors may want to lock in the relatively low §7520 rates now before any additional increases make these instruments somewhat less attractive. As an example, the PROJECTED remainder of $10,000,000 at a 0.4% §7520 rate with $521,266/year charitable payments for 20 years is $0. Thus, transferring this amount to a non-grantor Charitable Lead Trust results in $0 gift taxation. However, if actual growth is 8%, the ACTUAL remainder will be $22,755,415. This entire amount of excess growth goes to heirs completely free of gift and estate taxation. At 1% §7520 rate the zeroed-out non-grantor Charitable Lead Trust would use $554,153 payments leaving $21,250,442 to the heirs, again free of gift and estate taxation.

How to take advantage of low interest rates BEFORE THEY DISAPPEAR! The grantor Charitable Lead Trust

Although similar in name, the grantor Charitable Lead Trust is a different entity used for different purposes. The grantor Charitable Lead Trust does not transfer assets to heirs. Instead, the asset placed in the grantor Charitable Lead Trust typically returns to donor – or at least what is left of it after making the intervening charitable gifts. Further, the grantor Charitable Lead Trust is not a taxpaying entity. The asset is treated as an asset of the donor. However the benefit is that all gifts planned to go to charity during the life of the grantor Charitable Lead Trust can be immediately deducted by the donor. Thus, if the donor establishes a grantor Charitable Lead Trust scheduled to make 20 years of payments to a charity, the donor can immediately take a tax deduction for all 20 years of that giving.

The amount of this deduction is not the face value of the future gifts, but rather that face value discounted to a present value using the current §7520 rate. Thus, a grantor Charitable Lead Trust generates much larger deductions if funded in a low interest rate environment. For example, funding $10,000 per year gifts through a 20-year grantor Charitable Lead Annuity Trust creates an immediate deduction of $191,840 at a 0.4% initial §7520 rate but only $98,181 at an 8% initial §7520 rate. The key distinction of the grantor Charitable Lead Trust that separates it from, for example, a Donor Advised Fund or non-grantor Charitable Lead Trust is that the donor gets the asset back at the end of the term (or at least that part left after paying for the planned donations).

 © 2021 Russell James

How to take advantage of low interest rates BEFORE THEY DISAPPEAR! The Retained Life Estate

Another relatively underutilized strategy can also generate massive immediate charitable tax deductions is the Retained Life Estate Deed. Just as with the grantor Charitable Lead Trust, such a strategy can be particularly powerful this year both because §7520 rates are low and because the desire for immediate deduction may be higher to the extent that donors will also be engaging in Roth conversions and thus experiencing a temporary spike in income.

The Retained Life Estate Deeds is only for personal residences and farmland. The basic idea is that it transfers the inheritance rights in the property to a charity. However, unlike a will, a retained life estate deed is not revocable. Consequently, it generates an immediate income tax deduction. The execution of such an arrangement is relatively simple. It is not, and indeed cannot, be completed using a trust or contract. Instead, it must be completed by recording a deed. This can be a fairly standard deed but using some variation of language such as, e.g., "To John A. Donor for life, remainder to Texas Tech Foundation, Lubbock, TX 70409." Such donations can be for farmland or for personal residences including second homes, vacation homes, or even a boat with bathroom, cooking, and sleeping facilities, if used by the donor as a residence.

The deduction for such gifts vary massively with the §7520 rate at the time of gift. For example, suppose an age 55 donor gives the inheritance rights to one million dollars worth of farmland to a charity by recording a remainder interest deed. In May of 1989 when the §7520 rate was 11.6%, such a gift would generate a deduction of $122,350. That same gift made in November of 2020 when with the §7520 rate was 0.4% would generate a deduction of $903,710. At varying §7520 rates, the same gift would generate deductions of $779,640 at 1% §7520 rate, $616,350 at 2% §7520 rate, or $494,000 at 3% §7520 rate. Thus, completing such gifts in a low interest rate environment such as the one we are currently experiencing generates a much larger deduction.

Of course this same gift can be made by will instead of by a Retained Life Estate Deed. Giving this way is revocable, allowing the donor to change his or her mind. However, it generates no income tax deduction. Conversely giving by a Retained Life Estate Deed is irrevocable, but generates an immediate income tax deduction. This also can immediately increase the donor's available cash (and potentially the advisor's assets under management) by lowering taxes.

More phrasing concepts from behavioral economics

In fundraising experiments, a match works better than an identical rebate.[3] And we see this in fundraising practice. Everyone offers matches. No one offers rebates. Problem solved, right? Not exactly.

[3] Epperson, R., & Reif, C. (2019). Matching subsidies and voluntary contributions: A review. *Journal of Economic Surveys, 33*(5), 1578-1601.

 © 2021 Russell James

Unfortunately, the biggest money benefit that a donor gets is a rebate. A tax deduction is a rebate. The donor makes a gift and then gets a tax benefit. We can't change this. But rebates don't work as well. So, it makes sense to change the words we use to describe tax benefits. We want to use words that frame the tax benefit *as if* it were a match.

Match language – Yes

"You give and the government matches your gift with a tax benefit. Your dollars become more powerful because the government pays for part of the cost of the gift."

Rebate language – No

"You give and you get a tax benefit back in return. Giving this way means that the charity benefits and so do you."

The math is the same. But the language changes the giving response. Some other examples of phrasing comparisons include the following.

Match framing – Yes

- "Your giving becomes more powerful when you get the government to match your gift with tax benefits."
- "We want the government to chip in more, so that your giving has a greater impact."
- "It's smarter to get the government to share the cost of your gift because it makes your giving more powerful."

Rebate framing – No

- "The government gives you money back for your philanthropy."
- "This way you get the maximum cash in your pocket from your giving."

Types of tax benefits

Getting the government to "match" the donor's charitable gift makes the donor's giving more powerful. Sometimes, the government will pay part of the cost of the donor's gift with a tax deduction. This can sometimes be good, but it only helps if the donor is itemizing. An even more powerful technique is to use tax avoidance, rather than seeking tax deductions. This can benefit any donor, even those who are not itemizing.

Tax avoidance: The magic disappearing tax bill

Tax avoidance can make an upcoming tax bill disappear. The donor avoids tax because they have income that now they never have to report. For example, they earned regular income – but now they never have to report it as taxable income. Or, they made a profitable investment – but now they never have to report it as taxable income. Again, this happens without any itemization of deduction.

As an infomercial would say: But wait, there's more! With a charitable deduction, the donor's reported income (AGI) stays high, but taxes are lower. With charitable tax avoidance, BOTH reported income (AGI) AND taxes are lower. This lower AGI can

© 2021 Russell James

help with a variety of other programs. For example, it can reduce payments for Medicare Part B & D. It can also help with eligibility for

- Deducting IRA contributions
- Making Roth IRA contributions
- Adoption credit
- Earned income tax credit
- Child tax credit
- Qualified business income deduction
- Education tax benefits
    - American Opportunity Credit
    - Lifetime Learning Credit
    - Deductibility of student loan interest

In charitable giving, common examples of tax avoidance inclued

- Gifts of appreciated assets
- The charitable swap
- IRA gifts instead of required minimum distributions
- IRA gifts without or above required minimum distributions
- IRA beneficiary gifts

Tax avoidance: Gifts of appreciated assets

Suppose a donor makes a gift of $10,000 in cash. They can get a tax deduction of $10,000. Maybe they can use it. Maybe they can't. It depends on their other deductions and whether or not they are itemizing. In the ideal scenario, they can use the entire deduction at the top federal tax rate ($10,000 x 37%) creating a benefit of $3,700. Thus, the net cost of the gift is $6,300.

Suppose instead a donor makes a gift of $10,000 in appreciated stocks. They can get a tax deduction of the same size. However, they also avoid paying the capital gains taxes associated with that gift. And that benefit they can use regardless of whether or not they are itemizing their deductions. Suppose they donated 100 shares of stock worth $100 per share that they bought for $10 per share. In an ideal scenario, the donation results in a deduction worth $3,700 and avoidance of $2,142 ($9,000 x 23.8%) of capital gains tax. This last benefit is available even if the donor is not itemizing.

Tax avoidance: The charitable swap

When a donor gives publicly-traded securities, this last benefit can arise even without changing the donor's portfolio. Suppose a donor was preparing to write a check for $10,000 to the charity. Instead, they donate $10,000 worth of appreciated stock. (Let's say they donate 100 shares of stock worth $100 per share that they bought for $10 per share.) But now they take the $10,000 of cash they were going to have given to the charity and they use it to buy new shares in the same company. (They purchase 100 shares of stock for $100 per share.) Their portfolio hasn't changed. (They owned 100 shares in the company before the transaction and now they own 100 shares in the same company after the transaction.) However, the capital gain inside the portfolio has been

© 2021 Russell James

removed. (Those 100 shares have a basis of $10,000, as compared with the old shares that had a basis of $1,000.)

This “charitable swap” can be done in the same day or at the same moment. There is no waiting period as with the wash sale rule. The wash sale rule doesn’t apply here as this is gain property (appreciated assets) not loss property. Of course, a donor should never give depreciated or loss property. They should sell the loss property, tax the valuable tax loss, and then donate the proceeds if desired. Understanding this leads to a second way to benefit from the charitable swap. By removing the gain from the portfolio, the charitable swap not only avoids taxation on that gain, but it can also lead to a tax benefit from a future loss.

Consider this example: Suppose a donor buys stock for $10 per share. The stock rises to $110 per share. Later the stock falls back to $10 per share and the donor sells the stock. There is no benefit, no profit. But the charitable swap gives the donor a chance to lock in part of their gains *without changing their portfolio.* Now suppose that at $110 per share the donor gives the appreciated stock, replacing an otherwise planned gift of cash. To complete the charitable swap, the donor then uses the cash to purchase identical replacement shares at $110 per share. The portfolio hasn’t changed, but the donor’s basis is now $110 per share. As before, the stock falls to $10 per share and the donor sells the stock. Now for every share sold, the donor harvests a valuable $100 tax loss (instead of a $0 tax loss as in the prior scenario). This could be worth up to $23.80 in federal capital gains taxes and $13.30 in state capital gains taxes.

Understanding this benefit leads to new ways of thinking about investing and giving. The charitable swap gives donors a way to lock in part of their gains without changing their portfolio. Instead of just, “Buy Low, Sell High,” donors can “Buy Low, Give High, and Lock in the Tax Benefits!” Additionally, the donor can often do this without having to guess exactly when the top of the market is for the shares of the stock. Whenever the donor has been holding stock for at least 12 months that has gone up in value, they can repeat this process. Thus, like the gears on a ratchet, a donor can keep removing the gain from the portfolio as various shares appreciate over time by replacing all of their cash giving with appreciated asset giving.

For donors interested in simplifying this process – or those desiring to give to charities unfamiliar with the processes for accepting stock gifts – the donor advised fund is an ideal instrument. The donor simply gives the shares to the donor advised fund. The fund then sells those shares and can later send checks to the various charities.

Legislative uncertainty means, “Do it now, or risk losing out!”

As of the time of this writing, the results of what will arise with the new tax law discussions are unknown. However, the range of proposals has been sweeping. Thus, an advisor might previously have seen little need to eliminate gain from a portfolio when the client planned to hold the shares until death. At death, the heirs would receive a stepped up basis at death, eliminating the accumulated gain. Of course, this cavalier approach ignores two important realities. First, the possibility of harvesting tax losses should some

© 2021 Russell James

parts of the portfolio fall in value. Second, the possibility that the client's personal circumstances might change and he or she might end up needing to sell during life. But now, we live in a world in which the existence of stepped-up basis at death might not last another three months, much less for the rest of the donor's life! Further, the ability to receive fair market valuation for charitable deductions from gifts of appreciated property might disappear as well. All of this uncertainty leads to an increased motivation to make such gifts of appreciated assets sooner rather than later.

Tax avoidance with IRA gifts

Traditional IRA's, 401Ks, 403Bs, and the like represent an ideal circumstance for tax avoidance. This is earned income, and subsequent appreciation, that has never been taxed. Whenever a donor can give by making a direct transfer from the account to the charity – and thus avoid recognizing this earned income – it can constitutes an ideal giving scenario. This can be done at death, through a charitable beneficiary designation, and at age 70 ½ or older through a qualified charitable distribution (QCD). Although such QCDs will offset required minimum distributions (RMD) which begin at age 72, they are still possible without or above any RMD. Thus, QCDs are always available up to $100,000 starting at age 70 ½ regardless of the RMD amount.

Non-IRA accounts, such as 401Ks, must first be converted to an IRA rollover in order to use a QCD. Critically, this conversion should be done when the client hits age 70 ½ or before. Why? Because if the donor waits until the year in which they will turn age 72, then they will be forced to take the RMD in the year of conversion. A QCD cannot offset this non-IRA RMD in the year of conversion.

QCD gifts can be made using an IRA checkbook. However, IRA checkbook gifts must be written early, because there is a trap for the unwary here. Unlike other types of gifts, the IRA checkbook gift must clear the bank before the end of the year to qualify under the QCD rules. The QCD rules require that money is removed from the IRA by the end of the year. But the IRA account check is not actually from the IRA; it is from an empty account that is authorized to then request funds from the IRA.

Finally, for a donor who has interest in leaving anything to charity in their estate plan, the very first assets they should leave are the qualified plan assets, such as an IRA, 401k, etc. Any of those assets inherited by the family are subject to income tax. Now, with the new Secure Act rules all such funds must be withdrawn by non-spouse heirs within 10 years, requiring an even faster payment of taxes than before.

Naming the charity as beneficiary of an IRA can sometimes lead to a misunderstanding of a "problem" that's not really a problem. Charities are not "designated beneficiaries," and so the concern is that they might accelerate RMDs for other beneficiaries. But there are so many solutions to this potential problem, that it hardly constitutes much of a concern. For example, simply paying out the charity's share before September 30 of year following the year of the participant's death eliminates this issue. Treas. Reg. sec. 1.401(a)(9)-4 Q&A 4(a). Similarly, the beneficiaries can separate the accounts into charitable and non-charitable by the end of year following the participant's death. Treas.

© 2021 Russell James

Reg. sec. 1.401(a)(9)-8 Q&A 2(a). If the spouse is the beneficiary, then simply roll that share into spouse's IRA also avoids this issue. Of course, advanced planning also works as the donor could separate IRAs into a 100% charitable and 100% non-charitable account before death thus leaving the opportunity to take RMDs from either account to match desired estate transfer plans.

Conclusion

Those are a few ideas for giving, especially before the end of the tax year. Which strategies will still be available in the new year is anyone's guess, so encourage your donors to take advantage now – before it's too late!

© 2021 Russell James