# Planned Giving Essentials

## Webinar

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# I. WHY PLANNED GIVING?

## A. Why People Make Charitable Gifts

People give to an institution when:

(1) they have enough assets to afford to give some of them away;
(2) they understand and believe in the institution;
(3) the institution expresses their values;
(4) they and the community are benefited by the institution;
(5) they experience personal satisfaction and meaning through giving; and
(6) they are asked in the right way by the right person.

Tax savings generally do not motivate people to make gifts. However, tax savings can affect the amount people give, how they give, and when the give.

## B. How People Make Charitable Gifts

The simplest way to make a gift is to write a check. However, many people cannot or choose not to make major gifts in this manner because: (1) they have mostly non-cash assets; (2) they cannot afford to surrender income-producing capital; and (3) they want to maintain control of assets during their lifetime.

A major gift might be possible for them if they could give something other than cash, they don't reduce their cash flow, and they continue to feel personally secure.

## C. What's different about planned gifts?

- They are made from assets (accumulated assets), rather than from income.
- They usually occur in response to developments in the lives of donors – retirement, death of a spouse, birth of a child or grandchild, sale of a family business, desire to simplify their affairs, legacy planning.
- Donors make planned gifts when *they're* ready, not when *we're* ready
- They often require the involvement of persons besides the donors themselves, e.g., stockbrokers, lawyers, insurance agents, financial advisors, trust officers, and institutional gift planners.
- They result mostly from deep commitments of donors to the missions of particular organizations. Tax incentives and various financial benefits influence the nature, size, and timing of a gift but not the basic decision to give, which is ultimately a


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function of psychological factors and practical considerations. Donors must have philanthropic intent.

- In many cases, they are "ultimate gifts" due to their magnitude in relation to prior gifts or in relation to the net worth of the donors who make them. In the majority of cases, a bequest gift will exceed the donor's total lifetime giving.

# II. CHARACTERISTICS OF PLANNED GIVING DONORS

- Long time and/or consistent giving; often the giving is at modest levels
- May be "cash poor" but "asset rich"
- Often (but not always) nearing retirement
- Interested in exploring ways to maximize a major gift – blended gift
- Own highly appreciated property (stocks, mutual funds, real estate, etc.)
- May be single or widowed
- Have often already provided for heirs, or have no heirs
- Are generally philanthropically motivated
- Ways of giving: monthly donors, give from a donor-advised fund, IRA rollover

# III. BASIC TAX INFORMATION FOR PLANNED GIFTS

## A. Charitable Deduction

To encourage charitable giving, contributions to qualified charitable organizations are deductible for income tax purposes (as well as for gift and estate tax purposes, as noted later in these materials). Contributions must generally meet the conditions of Internal Revenue Code Section 170 to be deductible for income tax purposes. This Code section and the accompanying regulations address the types of charities eligible to receive deductible gifts, the kinds of property that can be donated, and the substantiation of charitable deductions.

To be strictly accurate and for the purpose of providing definitions, a *charitable contribution* is the amount that a donor gives to charity. The income tax *deduction* a taxpayer receives in connection with making a charitable gift is the benefit that may be claimed on his or her income tax return (IRS Form 1040), provided, among other things, that the total of all itemized deductions – including any other charitable deductions available for the year in question – is more than the applicable "standard deduction."

Deductions reduce, dollar-for-dollar, the amount of income subject to taxation. By contrast, an income tax *credit* reduces, dollar-for-dollar, the amount of tax owed. Unfortunately, no type of charitable gift produces an income tax credit. If the gift is


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made on other than an outright basis, the amount of the contribution equals the amount transferred minus the value of the income stream or other non-charitable aspect of the arrangement. For example, if a donor funds a charitable remainder unitrust with $100,000 and the present value of the payments to be made to the trust's income beneficiaries is $60,000, the donor's contribution will be $100,000 - $60,000 or $40,000, not the entire $100,000.

Amount of the Deduction a Donor May Claim Each Year

The amount of the charitable deduction that can actually be used in any one year depends on two variables: the type of property donated and the type of organization that benefits from the gift. If, based on the application of these two criteria, the entire deduction cannot be reported in the year the gift is made, the donor has as many as five carryover years in which to use it. Carryovers apply in connection with gifts to private non-operating foundations as well as to public charities and operating foundations.

The table below summarizes the rules relating to deductibility by type of organization and type of property donated:

| Type of Organization | Examples | Type of Property | Deductibility |
|---|---|---|---|
| Public charities and private operating foundations. Sometimes called "50% Charities." | Educational institutions, churches, tax-exempt hospitals, governmental units, publicly supported organizations such as the American Red Cross or a symphony orchestra, along with private operating foundations. | Cash and Ordinary Income Property | 50% of AGI |
| | | Long-term Capital Gain Property | 30% of AGI |
| Private non-operating foundations. Sometimes called "30% Charities." | Strictly "grant making" foundations. | Cash and Ordinary Income Property | 30% of AGI |
| | | Long-term Capital Gain Property | 20% of AGI |

## B. Impact of Charitable Giving on Taxation of Capital Gains

Capital gain is income derived from the sale of an investment asset. By way of example, a capital asset can be stocks, bonds, mutual fund shares, a home or farm, a business, or a work of art. The capital gain is the difference between what the asset is worth and its cost basis, which will typically be what was paid to acquire it, possibly adjusted upwards for certain amounts paid to preserve or enhance its value or downwards for any depreciation claimed by the donor.


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There is an income tax on capital gains, just as there is on the different sorts of "ordinary" taxable income, such as wages and interest. The tax rate is lower on "long-term" capital gains, which are gains on assets held for over one year before being sold, than on "short-term" capital gains associated with assets held for a year or less.

The top federal tax rate on long term capital gain income is 20% for high income taxpayers (those in the 39.6% income tax bracket). Taxpayers who are in the 25% - 35% income tax brackets pay 15% on capital gain income, while those in the 10% or 15% income tax brackets are not taxed on long term capital gains.

Capital gain attributable to assets donated outright to charity is completely forgiven. For many donors, this phenomenon makes a gift of cash less attractive than a gift of long-term capital gain assets having the same value, as in either case, the deduction will be the same. If, however, a donor is contemplating donating capital assets held at a loss, he or she is generally better off selling those assets and then contributing some or all of the resulting cash. This approach allows the donor to recognize a capital loss that can, at least to some extent, reduce the amount of his or her income subject to taxation.

Appreciated assets used to fund life income gifts are likewise entitled to favorable capital gains tax treatment. A gift annuity funded with appreciated property will always eliminate the capital gain associated with the gift portion of the transaction. If the donor is also the annuitant, the gain associated with the retained annuity interest can be reported over the annuitant's life expectancy. If the donor is not the annuitant, the capital gain associated with the retained income interest must be reported in the year of the gift.

The income paid from a charitable remainder trust is generally taxed on a "worst-in, first-out" basis. This means that, with a few exceptions, the most heavily tax-burdened assets are considered the first assets distributed to the income beneficiary. The tax character of the assets in the trust determines how the payments made to income beneficiaries will be taxed. Therefore, if the trust realizes long-term capital gain from the sale of its assets (regardless of whether the assets were transferred to the trust by the donor or acquired by the trust as investments), a portion of the income paid to the beneficiary will be taxed at capital gain rates after any ordinary income earned by the trust has been distributed.

### C. Possible Income Tax Attributable to Transfers Made upon Death

If a person was either the owner or beneficiary of something which, had he or she remained alive, would have been a source of payments that would have been taxed to him or her as ordinary income, then that asset features Income in Respect of a Decedent (IRD). If, upon death, others then become entitled to receive such previously untaxed amounts, those payments constitute IRD.

Most distributions from an IRA made after the IRA owner has died are common examples of IRD with respect to every dollar distributed. (The only exceptions are distributions from a Roth IRA or distributions attributable to contributions of after-tax


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dollars made by the decedent to some other type of IRA.) The same can hold true for most qualified retirement plans. In the case of certain commercial annuity contracts and savings bonds, some of what is distributed will be IRD, with the rest being nontaxable principal.

The good news for charities is that by virtue of their tax-exempt status, no income tax will be due on any IRD they receive. This means that if a donor's estate plan calls for benefiting both individuals and charities upon death, it is most efficient from a tax standpoint to draw upon IRD assets (to the extent they are available) in making charitable gifts and to earmark other assets for individuals. An additional characteristic that distributions of IRD to charity share with bequests is deductibility of the distributions for estate tax purposes.

## D. Federal Estate Tax

The federal government imposes a tax on the transfer of assets from an estate valued above a certain amount. The gross estate consists of assets owned by the decedent at death, as well as assets in revocable trusts, retirement accounts, and life insurance policies over which the decedent retained control. Qualified charitable contributions reduce the value of the estate. In addition, any property transferred to a spouse is deducted from the taxable estate. This is called the "Unlimited Marital Deduction."

According to the Joint Committee on Taxation, only 2 in every 1,000 estates (0.2%) owe federal estate tax. This is because the federal estate tax exemption is very high. In 2017, the exemption amount before federal estate taxes are due is $5.49 million. For spouses, the combined federal estate tax exemption in 2016 is $10.98 million. These exemption amounts are indexed for inflation and therefore tend to increase from year to year.

*Estate tax marital deduction* –The first spouse to die can leave an unlimited amount to the surviving spouse, who is a U.S. citizen, completely free of federal estate tax. The amount passing to the surviving spouse can qualify for this marital deduction if it is given outright or under certain approved trust arrangements. Property passing to a surviving spouse, who is not a U.S. citizen, is not eligible for the marital deduction, unless the property passes to the alien spouse through a qualified domestic trust (QDT).

*Deductibility of bequests to charity* - A donor is allowed an unlimited charitable estate tax deduction. If the bequest is in the form of a charitable remainder trust with the surviving spouse as income beneficiary, the deduction is for the present value of the remainder interest. If a surviving spouse is the only income beneficiary, the combination of the marital deduction and charitable deduction will eliminate estate tax on the property.

*Basis step-up* - Appreciated assets passing to heirs are entitled to a step-up in basis upon the death of the decedent. This step-up increases the cost basis of assets inherited upon the owner's death to their value on the date of death. The step-up in basis erases the potential capital gain associated with an appreciated asset up to the decedent's date of


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death. If the heirs subsequently sell the property, the taxable gain is calculated based on the increase in fair market value since the time of death, not the increase in fair market value since the asset was purchased.

*State taxes* – As of 2017, 18 states impose their own estate or inheritance taxes. However, it should be noted that recent years have seen many changes in these laws, typically involving an increase in exemption amounts or an outright repeal. Sometimes state estate taxes are tied to the Federal estate tax, with the same level of exemption, but in some states the exemption is much lower and an estate that is not subject to tax at the Federal level is subject to estate tax at the state level. While estate taxes are assessed against the estate, inheritance taxes are tied to specific bequests and technically payable by the beneficiary, although frequently the will provides for the estate to cover the tax. Spouses are typically exempt from inheritance taxes, whereas children may not be. The donor should always be directed to consult with professional advisors to determine the possible impact of state taxes on her estate.

## E. Gift Tax

The gift tax is a federal transfer tax that is assessed on an individual who transfers assets to another individual during life. The tax is computed using the Gift and Estate Tax Schedule applicable in the year of transfer and with reference to the donor's annual gift tax exclusion and available gift tax credit. Retention of control may make gift incomplete, and therefore not subject to gift tax. The gift tax is cumulative.

*Annual Gift Tax Exclusion* - An individual may give another individual up to $14,000 in cash or property *each year* without having to report the gift or incurring a gift tax. There is no limit to the number of individuals to whom such gifts may be made. Husbands and wives may join together (gift-splitting) and give up to $28,000 to any individual without making a taxable gift. To qualify for the annual exclusion, the gifts must be present-interest gifts. That is, the donee must have a right to benefit from the property now.

The annual exclusion is adjusted for inflation in increments of $1,000. Because inflation has been relatively low in recent years, the exclusion amount has increased only every three to four years.

*Gift tax marital deduction* - With the exception of certain gifts of future interests, gifts between spouses are not subject to gift tax whatever the amount. If the donee spouse is not a U.S. citizen, there is an annual exclusion of $149,000 in 2017 – this amount is indexed for inflation each year– on the amount the donor spouse can give the donee spouse during life without beginning to incur possible gift tax liability.

*Deductibility of lifetime gifts to charity* - A donor is allowed an unlimited charitable gift tax deduction for lifetime gifts to qualified charities. However, the donor is required to complete a Gift Tax Return Form 709 if a donor makes a future interest gift of any amount or a present interest gift of more than $14,000 where less than the entire value of


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the donated property qualifies for a gift tax charitable deduction (this can be the case with certain contributions for gift annuities, for example).

*Qualified transfers* - Payments made directly to service providers for tuition or medical care are not considered taxable transfers for purposes of gift taxes. These payments must be made directly to an educational institution or medical provider to be considered qualified transfers.

# IV. METHODS OF GIVING

## A. Bequests and Beneficiary Designations

A charitable bequest refers to a provision in a will or living trust leaving a sum of money, specific property, or a percentage of the estate to a charity. This is among the easiest of types of planned gifts to arrange and the most popular. These gifts are almost always revocable.

Below are the basic ways a bequest can be structured, along with applicable specimen bequest provisions. Any sample language a charity actually furnishes a donor or a donor's attorney should first be approved by the charity's legal counsel.

*Pecuniary Bequest* – This is simply a certain sum of money.

> "I give the sum of ________ dollars ($_________) to ABC Charity, which has a federal tax identification number of _________ and a current address of ___________________, or its successor organization."

*Specific Bequest* – In this instance, the donor is leaving the charity a particular asset or assets, such as real estate, securities, jewelry, works of art, etc.

> "I give [100 shares of XYZ Corp. stock/my guitar collection/the real estate legally described as follows] to ABC Charity, which has a federal tax identification number of __________ and a current address of ___________________, or its successor organization."

*Residual Bequest* – This is a gift of all (or perhaps only a portion) of what remains of a donor's estate after any pecuniary or specific bequests have been made and debts, taxes, and other estate expenses have been paid. Note: It is not possible for a person to make a bequest of literally all (or a portion) of his or her entire estate, due to the fact that, at a minimum, some of the assets of the estate will need to be drawn upon to pay estate expenses or other things that need to "come off the top."


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> "I give all [***alternative***: ________ *percent (___%)*] of the residue of my estate to ABC Charity, which has a federal tax identification number of __________ and a current address of ___________________, or its successor organization."

<u>*Contingent Bequest*</u> – This is a pecuniary, specific, or residual bequest that takes effect only under certain circumstances.

> "If my spouse does not survive me, then I give _______________ to ABC Charity, which has a federal tax identification number of _________ and a current address of ___________________, or its successor organization."

In addition to the bequest language given above, ideally the donor will indicate the intended use of their bequest. If the donor is silent on this point, from a legal standpoint the gift is unrestricted and can be used however the organization sees fit. Nevertheless, from a donor relations standpoint, the answer may not be so clear, given indications in the donor's file (sometimes conflicting), oral representations made by the donor over time, or the donor's giving pattern while living. It is better to nip any issues in the bud and have the donor specify their intention in the will itself. *Regardless of how a bequest is structured,* a donor is free either to allow the charity to use the gift in its complete discretion or to require the charity to use it in some particular way.

- <u>Unrestricted Use</u>
  …. "to be used for such charitable purposes as the governing board of ABC Charity may determine."

- <u>Restricted use</u>
  …. "to support medical research in the field of cardiology," "for student financial aid," "for producing television programs on matters of local interest."

Donors find making a gift in their will or trust an appealing way to give for many reasons.

- **Satisfaction of giving without parting with the asset** – The donor does not need to part with the asset when the gift is put in place, yet the donor can have the satisfaction of having provided for the future of the charity.
- **Revocable** – The donor can change her mind for whatever reason or need.
- **Retain control of the assets** – If the donor needs the assets in retirement, they are available.
- **Flexible**. The donor can structure the estate gift to meet other family needs and priorities. For example, the gift can be contingent on another family member predeceasing the donor.
- **Reduce estate taxes** – If the donor's estate will be subject to federal estate tax, the estate **will** be entitled to a dollar-for-dollar federal estate tax charitable deduction for the amount going to a qualified charity.


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### Beneficiary designation: retirement plans

A charity can be named as beneficiary of a portion of an IRA or other qualified retirement plan, e.g., 401(k), 403(b) plans. It could be 10%, 25%, 50%, or even the entire amount if there are no heirs. Following death, that portion of left-over funds will be paid to the charity in a lump sum.

This is a very tax-wise way to give as retirement assets may be subject to both estate tax and income tax (IRD) if given to heirs. It is better to use retirement assets for charitable gifts and leave other types of assets (cash, securities, real estate) to heirs.

In addition to the same flexibility and control as bequest provisions, beneficiary designations are even easier to arrange (often they can be done on-line) and do not require an attorney's assistance.

### Beneficiary designation: donor-advised fund

A donor-advised fund is established at a sponsoring charity (i.e. religious organization, university, or investment brokerage that has established a charity). The donor gets an immediate income tax charitable deduction and suggests gifts to qualified charities from the fund over time. Most donors who establish donor-advised funds will suggest charitable beneficiaries to receive the remaining assets in the fund when the donor dies and the fund terminates. See who is making annual gifts to Charity from donor-advised funds.

### Beneficiary designation: life insurance policy

The owner of a life insurance policy might name a charity as the primary beneficiary, a co-beneficiary or a contingent beneficiary:

> Primary beneficiary: The best prospects for this arrangement are individuals who either have no heirs or have otherwise provided for their heirs, but who want to retain access to the cash value if they should need it, and to retain the right to name a different beneficiary should family circumstances change. They could name the charity as beneficiary of any type of policy. Where group life insurance is provided by an employer, and it is not an essential part of the employee's estate plan, the employee may be willing to make a charity the beneficiary if this option is brought to his or her attention.
>
> Co-beneficiary: Individuals who name the charity as a co-beneficiary, rather than sole beneficiary, may have other charitable commitments or family responsibilities for which a portion of the death benefits is needed.
>
> Contingent beneficiary: Some individuals, at their present stage of life, feel that all of their assets, including life insurance policies, are required to provide financial security for family members. However, they are willing for the charity to


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be the default beneficiary in the unlikely event that all family members predecease them or the entire family is "wiped out" in a disaster. Even though the charity would prefer to be a primary beneficiary, it should gratefully acknowledge a contingent beneficiary designation. A donor who feels appreciated for such a designation may take steps to assure a charitable gift as family responsibilities diminish and the estate grows.

Life insurance proceeds payable upon death are included in the policy owner's gross estate, but an estate tax charitable deduction is allowed for the amount paid to a charity. If an individual were named as beneficiary, the proceeds would be subject to estate tax at the applicable rate. In certain states, proceeds paid to an individual would also be subject to state estate tax.

Like bequests and other beneficiary designations, naming a charity beneficiary of a life insurance policy is a revocable gift. While beyond the scope of this paper, there are also ways to make irrevocable gifts involving life insurance:

- Gift of a paid-up policy
- Gift of existing policy on which premiums are owing
- Gift of new policy on which premiums are owing

### B. Charitable IRA Rollover

The charitable IRA rollover enables qualifying donors to transfer funds from their traditional IRA or Roth IRA directly to a public charity without recognizing any income from the withdrawal or receiving a deduction. Because the donor doesn't declare the withdrawal as income on his or her tax return, a charitable IRA rollover never results in additional income tax for the donor. This giving technique has been a popular method for making charitable gifts.

A "qualified charitable distribution" counts towards an individual's required minimum distribution from an IRA, and is not included in the taxable income of the donor. Other requirements:

- The donor must be age 70½ or older.
- The gift must be made to a public charity and not to a private foundation or supporting organization.
- The gift cannot be made to a donor advised fund maintained by a charity.
- The donor cannot receive any benefit in exchange for the gift. (This rules out gifts for life income arrangements.)
- The gift, combined with other qualifying IRA charitable rollover gifts made during the year, cannot exceed $100,000.

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- The donor must receive documentation from the charity that the distribution was received and that he or she received no benefits.
- The rollover can be made only from an IRA. Rollovers from 401(k) and 403(b) plans would be treated as taxable distributions. A donor could roll assets from these plans into an IRA and subsequently authorize a distribution to charity from the IRA.
- Funds transferred per the charitable IRA rollover can fulfill a pledge to the charity.

## C. Charitable Gift Annuities

A gift annuity is a contract under which a charity, in return for a transfer of cash or other property, agrees to pay a fixed sum of money for a period measured by one or two lives. A person who receives payments is called an "annuitant" or "beneficiary." The contributed property becomes part of the charity's assets, and the payments are a general obligation of the charity. The annuity is backed by all of the charity's assets, not just by the property contributed.

The charity may spend a portion of the contribution immediately, provided it retains sufficient reserves to satisfy the requirements of applicable states in which gift annuities are regulated. Most charities, however, keep the entire contribution (increased by earnings and decreased by annuity payments and expenses) in reserve until the sole or surviving annuitant dies. The remaining portion of the contribution is called the "residuum."

The donor is entitled to an income tax, gift tax, and/or estate tax charitable deduction for the difference between the present value of the annuity stream and the amount contributed. Payments to the annuitant(s) will include a tax-free portion, a part taxed as ordinary income and/or a part taxed as capital gain, depending on the nature of the asset contributed and whether the annuitant was also the donor. The portion that is tax-free or taxed as capital gain will last for the life expectancy of the annuitant, as calculated at the time the contribution was made; should the annuitant live beyond that life expectancy the payment would continue but would be taxed entirely as ordinary income.

### Types of Gift Annuities

*Immediate Gift Annuity*

With an immediate gift annuity the annuitant starts receiving payments at the end (or beginning) of the payment period immediately following the contribution. Payments can be made monthly, quarterly, semi-annually, or annually. The most common arrangement is quarterly payments at the end of the quarter. The first payment is customarily prorated from the date of the contribution to the end of the first period, and thus is smaller than

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subsequent payments, but it is possible to stipulate that the first payment be for the full amount. All of these factors have some effect on the charitable deduction.

The annual annuity is determined by multiplying the amount contributed by the annuity rate. For example, if a person, age 65, contributes $10,000 and the charity follows the current American Council on Gift Annuities (ACGA) suggested rate of 4.7 percent, the annual annuity would be $10,000 × 4.7% = $470. If quarterly payments have been selected, the annuitant would receive $117.50 for each full quarter.

*Deferred Gift Annuity*

With a deferred gift annuity the annuitant starts receiving payments at a future time, which must be more than one year after the date of the contribution. Annuity rates for deferred annuities are higher than for immediate annuities, the result of annual compounding of an interest rate (currently 3.25%) for the deferral period; thus, the longer the deferral, the more the annuity rate is increased. While typically the annuity rate is known at the time the contribution is made, as most deferred annuities have a fixed starting date and thus a fixed deferral period, there is a variation called a Flexible Deferred Annuity, in which there is a range of starting dates that can be elected by the annuitant; the applicable annuity rate will be based on the starting date chosen. As with immediate gift annuities, payments can be made monthly, quarterly, semi-annually, or annually.

Typical Charitable Gift Annuity Donor Profile

**Immediate Gift Annuity**

- Aged 65 to 90
- Concerned about outliving their resources
- Wanting security of fixed payments
- Have investments yielding low returns
- In higher tax brackets wanting partially tax-free payments

**Deferred Gift Annuity**

- Aged 55 to 70
- Individuals who want to establish a supplemental retirement plan


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- Retired individuals who want a deduction now but do not need payments until later

**Flexible Deferred Gift Annuity**

- Aged 55 to 70
- Individuals who want to establish a supplemental retirement plan but are unsure when they will retire

## D. Charitable Remainder Trusts

A charitable remainder trust is an irrevocable trust, established by the trustor(s) either during life or at death, which pays to one or more beneficiaries, at least one of whom or one of which is not a charity, for the lifetime(s) of one or more individual beneficiaries, or for a term not exceeding 20 years, a specified amount until the termination of the trust, at which point the trust remainder is paid to, or for the use of, one or more charitable organizations. The specified amount paid to beneficiaries must be either (1) an annuity amount, i.e., a fixed dollar amount, which is not less than 5 percent or more than 50 percent of the initial fair market value of the property transferred to the trust or (2) a unitrust amount, i.e., a fixed percentage, which is not less than 5 percent or more than 50 percent of the net fair market value of trust assets re-valued annually.

A CRT established by a donor during his lifetime is entitled an income tax charitable deduction for the present value of the remainder interest. A qualified CRT is exempt from federal income tax on all income, ordinary as well as capital gain. Thus when appreciated property is transferred to the trust the gain is taxed neither when the property is transferred to the trust nor subsequently when sold by the trust, resulting in the entire sales proceeds being available to reinvest to generate income.

Income to beneficiaries is taxed under a “four-tier” system, one which reflects a “WIFO” (worst-in, first-out) approach within each tier (within each tier, the income subject to the highest tax rate is distributed first):

> First: Ordinary income to the extent payments consist of interest, dividends, and rents earned by the trust. Furthermore, ordinary dividends are deemed to be distributed before qualified dividends.
>
> Second: Capital gain to the extent payments consist of capital gain realized by the trust. Furthermore, short-term capital gain is deemed to be distributed before long-term capital gain.
>
> Third: Tax-exempt income to the extent that the trust invests in tax-exempt securities and distributes interest from them.


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Fourth: Tax-free return of principal.

Types of CRTs

*Charitable Remainder Annuity Trust (CRAT)* – Pays to beneficiaries a sum certain, which must not be less than 5 percent or more than 50 percent of the initial fair market value of the assets transferred to the trust, even if principal must be invaded. IRC Sec. 664(d)(1). (Appeals to older individuals who want the security of predictable income.) Subsequent transfers of assets into the trust are not permitted.

*Charitable Remainder Unitrust (CRUT)* – Pays to beneficiaries a fixed percentage (not less than 5 percent or more than 50 percent) of trust assets as re-valued annually. IRC Sec. 664(d)(2). (Appeals to individuals who would like for income to keep pace with inflation if possible, although there is also a risk that income will decrease from one year to the next.) Subsequent transfers of assets into the trust are permitted.

These variations of a CRUT are permissible:

- Standard Charitable Remainder Unitrust (SCRUT) – Pays the fixed percentage even if principal must be invaded.

- Net-income Charitable Remainder Unitrust (NICRUT) – Pays the lesser of the fixed percentage or actual net income. IRC Sec. 664(d)(3)(A). Principal may not be invaded.

- Net-Income with Make-up Charitable Remainder Unitrust (NIMCRUT) – Pays the lesser of the fixed percentage or actual net income, but can pay make-up distributions to beneficiaries to the extent of accrued past deficiencies in payments. IRC Sec. 664(d)(3)(B). Again, principal may not be invaded.

- “Flip” Trust – Treasury regulations permit a NICRUT or NIMCRUT to flip to a SCRUT upon the occurrence of a triggering event. The change is effective at the beginning of the taxable year immediately following the taxable year in which the triggering event occurs. Reg. Sec. 1.664-3(c). If the trust starts out as a NIMCRUT, any make-up amount not paid out by the end of the year in which the triggering event occurs is forgone. A trust may flip only once. This type of CRT is often used when the funding asset is real estate or another asset that may take time to sell.

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Typical CRT Donor Profile

**Charitable Remainder Annuity Trust**

- Individuals 60 and up.
- Individuals with appreciated securities.
- Individuals with tax-exempt securities.
- Older individuals who want the security of fixed, predictable income.
- Those interested in providing a college education to a child or grandchild, or helping support an aged parent.

**Charitable Remainder Unitrust**

- Individuals 50 and up.
- Individuals with appreciated securities or real estate.
- Individuals interested in potential income growth to offset inflation.
- Mid-life professionals who want to accumulate for retirement.
- Owners of closely-held companies.

## F. Blended Gifts

Blended gifts is a term that refers to a gift plan that combines more than one type of gift vehicle. The assets used to fund the gift may also vary, such as a gift funded with some cash, some appreciated securities, real estate, etc. A blended gift is a way to maximize a donor's giving, often enabling the donor to accomplish a philanthropic goal by giving more than they thought they could. A blended gift may include some outright giving, a life income gift, and a bequest intention.


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# V. Discussing Planned Gifts with Donors

## A. Life Events

Planned gifts are frequently influenced by events in a donor's life. Events that disrupt the donor's routine or force focusing on unexpected or upsetting life changes can trigger the planned gift discussion. These disruptions need not be negative things. The birth of a child or grandchild, the sale of a business, a promotion, or retirement can trigger reexamination of estate plans and how charity fits in.

Negative events like the death of a spouse, a diagnosis of cancer or a heart condition, divorce or losing a job can also force the donor to contemplate her mortality and consider her charitable priorities.

Watch for life events that can signal an opportunity to discuss including charity in a donor's plans. Keep in mind that some of these disruptive episodes in a donor's life can cut both ways. The birth of a child or grandchild might reduce the likelihood of a donor making a charitable bequest. Cash events such as a promotion, receiving a large bequest, or selling a business may increase the likelihood of a donor making a charitable bequest.

The challenge of using life events as a field mark of a planned giver is that life events are not easily known by the fundraiser. Not all of a charity's supporters will have a life changing diagnosis at the same time. It's not possible to predict who in the database will experience a cash infusion. Therefore the importance of life events on donor decision making is managed on the retail level (one on one between donor and fundraiser) rather than on the wholesale level (mass communication through direct mail or social media.)

## B. Knowing a planned giver from what he or she owns

Knowing what kind of assets a donor holds can help determine what planned gift vehicles are appropriate for her. Virtually all assets can be used to fund planned gifts. However, some assets lend themselves better than others to planned giving purposes.

Remember that your priority is to get the donor excited about philanthropic opportunities, not to be their financial planner or attorney. Gain their trust; don't feel like you need to know all the answers.

<u>Character of Assets:</u>

*Illiquid assets*: these are assets that are not readily convertible to cash. Examples include real estate, collectibles, and closely held business assets. The vehicle of choice for illiquid assets is the flip unitrust. The net income provision of the flip unitrust allows the trustee time to sell the asset. After the sale, the trust can flip to a regular unitrust and begin making payments. Gift annuities also can be funded with illiquid assets, but the need to make fixed payments can present challenges for the charitable organization.


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*Appreciated assets:* assets that have appreciated in value since the donor purchased them will generate capital gain income on sale. All planned and outright gifts of appreciated assets to charity offer opportunities to avoid, defer, or reduce capital gain income. The best way to avoid capital gain is to make an outright gift to charity.

*Non-income producing assets:* assets that may have experienced significant increase in value may not produce corresponding income. Growth stocks may have appreciated greatly but may pay little or no dividend. Non-commercial real estate may be extremely valuable, but since it is not rented produces no income. Life income gifts funded with non-income producing assets are the best way to convert a stagnant asset into a source of income.

*"Income in respect of a decedent" ("IRD") assets:* IRAs, savings bonds, and commercial annuities are assets upon which the donor has never paid income tax. At death, these assets are included in the donor's estate for estate tax purposes and also in the donor's income on the final income tax return. The tax burden on these assets can run as high as 70%, leaving little for the donor's heirs. IRD assets are ideal to leave to charity at the donor's death. The tax burden is relieved through the estate tax deduction and the avoidance of income tax.

## C. Talking to prospects and motivating them to action

Starting the conversation

Planned givers share certain field marks, characteristics they have in common, but once identified, a prospect must be matched with the planned gift vehicle appropriate for the prospect. In order to do this you need to build trust with the donor, encourage them to share their philanthropic and financial goals, and learn how planned giving can help them.

It is the tendency of planned giving professionals, particularly those with legal or financial backgrounds, to immediately engage the planned giving prospect in a discussion to determine the vehicle most appropriate for the prospect. The technical aspects of the gift discussion should be the last part of the conversation. These gifts are driven by emotions that engage the donor's passion.

The place to start is uncovering the source of the passion that will drive the gift decision. An effective way to reveal a donor's motivation is to let them tell their story. Certainly no later than the qualification phase of engaging a prospect, ask them why they support or otherwise engage in your organization's mission. Ask open ended questions, sit back, and let them tell their story.

Consider opening with questions like:

- What inspired you to make your first gift to our charity?
- How did you become involved with us?


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- Of all the things our organization does, which ones do you consider most important? Why?
- There are other organizations with missions similar to ours. Why did you choose to become involved with us?

It is likely someone who has already provided financial support for your organization will feel particularly engaged with an aspect of your mission. Food bank donors may be passionate about child nourishment, but less concerned with job skills training the charity may offer. An academic medical center may conduct research in many areas of concern, but the donor is passionate about early detection of breast cancer.

The stronger the engagement with the donor's passion, the more likely the donor is to consider a planned gift. The challenge for all fundraisers, not just planned giving specialists, is the pressure to raise unrestricted dollars. The problem of encouraging unrestricted giving is particularly acute in the case of planned gifts. If including charity in long term plans raises that charity to the status of family, a broad request for general support is hardly likely to tap into the emotions that drive planned gifts. The donor must feel that support for a charity will fulfill an important need in their life. Only then will the donor be motivated to take action to include charity in her plans.

### D. What to Listen For

- Illiquid assets such as real estate (Ex. "We no longer use our house at the shore and the kids are living elsewhere.")
- Multiple financial goals (Ex. "Our son is just not great at managing money.")
- Ties to a family or closely-held business (Ex. "We're thinking of selling our family business.")
- Concerns about providing for heirs (Ex. "We want to provide additional income to our children.")
- Assets producing no income (Ex. "Our CD's are paying almost nothing" or "We have stock that has appreciated but it pays no dividends." )
- Retirement planning (Ex. "We plan to retire in a few years and who knows how much we'll need" or "I plan to retire and I don't have a pension.")
- Desire to make a major gift using assets other than cash (Ex. "I've had this rental property for years and I just don't want the hassle of management and tenants anymore.")
- Desire to make a major gift under a will or other estate plan (Ex. " I love what you do but I need to keep my assets as I age.")
- Desire to simplify financial matters (Ex. "The stock market keeps me up at night. I wish I had a check coming in that I could count on.")


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- Concerns about time/energy devoted to managing assets (Ex. "I don't understand what my financial advisor is doing and I don't want to be bothered.")

## E. How to Talk About Planned Giving

<u>The donor's personality</u>

Bear in mind that donors differ greatly especially when it comes to matters of property and inheritance and that, to have a comfortable conversation about planned giving and estate plans, it helps to know your donor well.

- Some donors will be sophisticated whereas others will know next to nothing about estate planning
- Some donors will willingly share with you details of family circumstances; others are very reticent
- Some will enjoy discussing technical details, others will not want to spend any time at all on such matters

<u>What you can say</u>

Gift officers sometimes find it difficult to bring up the subject of bequests but the subject should be easily incorporated into conversations you are already having.

- If you have established an element of rapport with the donor, you can ask the question in this respectful way: "Many of our donors who want to ensure the future of our mission have included ABC Charity for a gift from their will or trust. May I ask if you have included ABC Charity in your estate plan or have you considered that?"

- If you are already talking about gifts to your organization, and your donor says "I just am not in a position to make an outright gift now," you could reply "well you know… something you might want to think about…is putting a provision in your will…"

- If you are thanking your donor for longtime support, you can ask. "Have you considered endowing your support through a gift in your will or trust? Some of our donors have made provisions for an endowment gift in their estate plan that is approximately 20 times their annual gift. This ensures that the support they currently give now will continue in perpetuity."

- You can gently ask if people have had a chance to get their estate plan in order.

- You can ask if they are aware of your charity's legacy society and use that opportunity to explain the reason it exists. It is also a way of letting them know that others have made gifts similar to what you are asking for.


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- You can't go wrong with offering information that you believe to be helpful. Even donors who are the "let's keep it simple" types are invariably grateful for efforts to share useful information and provide them with encouragement and resources. You need to be tuned in to what is appropriate – and to know when to hold back.

- A useful tack – in almost all circumstances – if the conversation seems to be getting awkward is to ask if they have a found a good advisor upon whom they can depend – a financial advisor, an accountant, and/or an attorney from whom they can get help. If they haven't already found someone, you can offer to give them some names.

- Don't underestimate your donor's need for reassurance: There are usually many different reasons why a donor has not implemented an estate plan. Even if they have, they may not feel comfortable talking about it. Emotions that are often involved include indecision, apathy, guilt or fear.

- If the conversation seems to be getting awkward or if the donor states that they choose not to share that information, thank them for their candor and move the conversation away from the topic. There can be many different reasons why a donor has not implemented an estate plan. Even if they have, they may not feel comfortable talking about it. Emotions that are often involved include indecision, apathy, guilt, or fear. If they fear too much fuss, tell them that their gift is important, however small, and reassure them they will be able to choose their level of involvement. If they worry they are disinheriting children or other relatives, encourage them to get their family involved. Assure them that you know they will want to take care of family and loved ones first and that you are simply asking them to consider a place for your charity alongside them.

# VI. Conclusion

The most important thing to know before having planned gift conversations with donors is that you do not need to be a technician, with knowledge of all the intricacies of the gift structure and tax consequences. The key skill is to focus on what the donor is saying and listen for the clues they are giving you. From there you can seek out the more technical information from a colleague or an outside resource such as legal counsel, a consultant, or software provider (users of *Planned Giving Manager* will find great assistance from PG Calc's Client Services team). In fact, not knowing all the answers provides a perfect reason to continue the conversation later, or send follow-up information to the donor – developing the donor relationship even further.


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