PG Calc
Invested in your mission

PLANNED GIVING FOR YOUNGER DONORS

Presented by:

Jeff Lydenberg, Vice President
PG Calc
617-497-4997
jeff@pgcalc.com

I. Introduction

Planned giving is largely a business that is preoccupied with designing gifts for the oldest donors in our prospect pool. For most estate gift plans there is no magic age at which one becomes eligible to charitable legacy planning. However, the economics of certain planned gifts, such as life income plans, begin to work well for the donor and for charity when the donor is over age 70. A charitable remainder unitrust could work well for younger donors seeking to avoid capital gain and generate income that could potentially hedge inflation. Gift annuities, on the other hand, are best suited for older individuals. From the perspective of charity, the long wait to receive estate gifts from young donors erodes the present value of such gifts enough to make them unattractive for charity.

Nonetheless, there are good reasons to begin the planned gift conversation sooner than popular wisdom might advise. There are creative ways to structure the familiar vehicles in innovative ways that make them attractive to donors in their 50s or 60s.

II. Defining the market

The process of planned giving encourages close engagement with your charity's mission. By engaging younger donors in planned giving, charities have more time to develop important relationships with supporters. This long history of support will translate into more gifts and larger gifts for charity.

Younger donors are motivated by the same factors that engage the traditional planned gift donor. 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 at the right time.

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

III. Tax and financial factors motivating younger donors

A. Capital gain taxes

Capital gain is income derived from the sale of an investment. A capital investment can be stocks, bonds, mutual funds, a home or farm, a business, or a work of art, for example. The capital gain is the difference between the money received from selling the asset and the price paid for it.

Therefore, there is an income tax on the total of all capital gains just as they there is on other sorts of income. The tax rate on capital gain is lower on "long-term capital gains", which are gains on assets that have been held for over one year before being sold.

The American Taxpayer Relief Act of 2012 increased the top federal tax rate on most long-term capital gain income from 15% to 20% for taxpayers with taxable income above the following thresholds, Married filing jointly and surviving spouses $450,000, Single taxpayers $400,000, Heads of households $425,000. These thresholds are indexed annually for inflation. Some donors must pay not only a 20% capital gains tax rate, but also to a new 3.8% surtax on net investment income, which includes realized capital gains. It is imposed on top of other income taxes and kicks in when a taxpayer's modified adjusted gross income (MAGI) is above $250,000 for joint returns and surviving spouses, less than that for other filers. The surtax applies to the lesser of (1) net investment income or (2) the amount by which a taxpayer's MAGI exceeds the applicable threshold. There is no charitable deduction against the surtax and the threshold MAGI above which it applies is not indexed for inflation.

Example: *George and Ann McNeil are married filing jointly with $450,000 in wage income and $200,000 of long-term gain on the sale of $250,000 in appreciated stock that they purchased for $50,000. They will be in the 20% capital gains tax bracket. Since their MAGI is over $250,000, they are subject to the 3.8% surtax as well. The surtax effectively raises their marginal capital gains tax rate from 20% to 23.8%. They will pay $47,600 of tax on the sale of their stock, leaving only $202,400 to reinvest.*

Example: *Bill and Susan Silver have wage income of $200,000 plus qualified dividends of $50,000 for a MAGI of $250,000. That puts them in the 28% bracket on wages and 15% on dividends. They also have an appreciated asset worth $1,000,000 with a cost basis of $100,000. If they were to sell that asset, the first $200,000 of gain would be taxed at 15%, the remaining $700,000 of gain would be taxed at 20%, and the entire $900,000 of gain would be subject to the 3.8% surtax. That's a total tax of $204,200, leaving them with $795,800 to reinvest.*

B. Qualified Retirement Plans

Qualified retirement plans, such as 401(k), 403(b), profit-sharing, money purchase, defined benefit, SEP and SIMPLE plans and IRAs, are set up to provide employees with opportunities to save for retirement on a tax advantaged basis.

Qualified plans are referred to as qualified because they qualify for favorable tax treatment under the Internal Revenue Code. Employees who participate in such plans are not immediately taxed on the contributions made on their behalf by their employer, they can often make contributions on a pre-tax basis, and earnings on their retirement plan funds get to accrue on a tax-deferred basis.

Limits on Contributions to Qualified Retirement Plans

Federal law limits the amount one can contribute to qualified retirement plans on a pre-tax basis. Recent changes in the law increased the amount that can be contributed to traditional, Roth and SIMPLE IRA's, as well as the maximum allowable contributions to 401(k) and 403(b) accounts. In addition, taxpayers 50 years of age and older will be allowed to make "catch-up" contributions.

To keep up with inflation, the Internal Revenue Service increases the annual limit on contributions to 401(k) and 403(b) plans. In 2015 the limits are $18,000 and for those over 50 years old, the additional "catch-up" amount allowed is $6,000, meaning the overall limit for such workers is $24,000 per person or $48,000.

Example: *Mr. Busken is 53 years old and earns $275,000 a year. He is eligible to participate in his companies 401(k) and contributed $18,000 of his pre-tax salary plus makes the $6,000 catch contribution. Mrs. Busken is 52 years old and is an executive at a non-profit agency. She earns*

$125,000 per year and participates in her agency's 403(b). She contributes the maximum permissible amount, $24,000 to her 403(b).

Mr. and Mrs. Busken's combined income is $400,000 but they can only save $48,000 or a little more than 10% of their pre-tax income on a tax advantaged basis.

III. Planned Gifts Appropriate for the Younger Donor

The perception of younger donors is that they are still accumulating assets to be used in retirement. They can't "afford" to surrender current income or dispose of their assets now. Planned giving options that allow younger donors to meet financial commitments can increase the pool of potential planned givers.

Life income as a supplemental retirement vehicle. Life income vehicles can be an ideal addition to supplement retirement income. This is particularly true for highly compensated individuals who are contributing the maximum permissible amounts to their qualified retirement accounts.

There are a variety of life income arrangements that can be used to accumulate savings during the donor's working years and later be drawn upon as a source of income for the donor.

Charitable gift annuities are fixed income vehicles that do not keep pace with inflation. Therefore, few younger donors will be interested in immediate payment gift annuities. Likewise, the long interval between the contribution and payment of the residuum to charity make the present value of an immediate payment gift annuity unattractive to charity as well.

There are familiar planned gift vehicles that are attractive to the younger individual. For example, a deferred payment gift annuity is appropriate for someone who wants fixed guaranteed income that is not subject to market risk.

If the donor objects to the lack of inflation protection, the familiar deferred payment gift annuity can be structured in a unique way. The donor can create a series of laddered deferred payment gift annuities with progressive start dates to create an increasing stream of income that marries some inflation protection with the safe, guaranteed income stream of the gift annuity.

A deferred payment gift annuity requires the donor to pick a date of first payment when the annuity will begin to make payments. Traditionally the date of first payment is fixed in the annuity contract and cannot be changed if the annuitant's circumstances change. A flexible deferred payment gift annuity can solve the problem of not knowing exactly when the donor might need income. This annuity allows the donor to choose a range of potential dates upon which the first payment may be made, and those dates are set forth in the annuity contract. The longer the deferral the higher the annuity payments once the date of first payment is elected.

While a fixed term gift annuity is not permissible, a commuted payment gift annuity gives the annuitant the option to commute the lifetime of payments to a fixed number of payments of equivalent value. Once the annuitant has received all the payments, the remaining principal is available for the issuing charity's use.

The traditional use of the commuted annuity is the college annuity. The donor initially contributes assets for a deferred annuity naming a child as annuitant with life payments to begin at age 18. Prior to the annuity starting date the annuity is commuted to a series of installments to be received over the course of four or more years. Thus, instead of receiving very modest payments for life beginning at age 18, the annuitant receives large installments during the college years. The installments would have the same present value as the life payments.

A commuted payment gift annuity can be an ideal bridge between early retirement and when full eligibility government and qualified retirement plan benefits kick in A donor may want to take early retirement before they can make withdrawals from a qualified retirement plan which is age 59 ½. A person born in 1960 or later is not eligible for 100% of their Social Security benefits until they reach age 67.

Donors who are more financially savvy and willing to take investment risk will not be satisfied with the modest returns of the deferred gift annuity arrangements described so far. These donors are looking for a more sophisticated and flexible planned gift. A charitable remainder unitrust with a flip provision can provide inflation protection for those who are willing to expose their income to market risk and don't need income until retirement.

IV. Life Income Overview

We will review some case studies illustrating each of the life income arrangements described above. In preparation for that, this section provides an overview of each of the planned gift vehicles. The specific application of these vehicles to benefit the younger donor will be set forth in the case studies. A variety of planned gifts generate income for the donor or the donor's designated beneficiaries. There are three broad categories of life income arrangements: charitable gift annuities, charitable remainder trusts, and pooled income funds.

Charitable Gift Annuity Basics

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 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 gift annuity rates offered by most charities are set by a voluntary body of charities known as the American Council on Gift Annuities (www.acga-web.org). The ACGA promulgates suggested maximum annuity rates that are attractive to donors yet will leave a generous residuum to the charity. The ACGA's most recent rate table as of the date of this paper became effective January 1, 2012. Examples in this presentation use those rates.

The 2012 ACGA rates are significantly lower than the ones they replaced. Importantly, these rates for immediate payment annuities ensure a contribution value of at least 10% of the funding amount at all ages down to an IRS discount rate of 1.4% (as compared to 3.0% under the July 1, 2011 rates). This change reduced the need for gift planners to offer donors an annuity rate that is less than the ACGA's standard maximum rate to make the contribution value greater than 10%.

Assumptions Underlying the 2012 ACGA Annuity Rates
The ACGA has made the assumptions listed below in determining the schedule of suggested maximum annuity rates that will go into effect on 1/1/2012. Only items 5, 6, and 7 differ from the assumptions used to determine the rates that went into effect on 7/1/2011.

1. The residuum realized by the charity upon termination of an annuity is 50 percent of the gift amount.
2. The present value of the residuum must be at least 20% of the gift amount.
3. All annuitants are assumed to be female and one year younger than their actual ages. The suggested rates use the Annuity 2000 Mortality Tables. The rates also incorporate projections for increasing life expectancies (improvements in mortality) using a scale supplied by the ACGA's actuary.
4. Annual expenses for investment and administration are 1.0% of the fair market value of gift annuity reserves.
5. The total annual return on gift annuity reserves is 4.25% percent (down from 5.00%).
6. The rates for younger single-life ages (5 – 49) are somewhat lower than the rates that would follow from the first five assumptions to ensure that all immediate payment gift annuities have a contribution value that is at least 10% of the funding amount for an IRS discount rate of 1.4% (down from 3.0%).
7. The rates for the oldest ages (81 and above) are somewhat lower than the rates that would follow from the first five assumptions. One-life rates are capped at 9.0% at age 90 (down from 9.8%) and the rates from 81 to 89 are graduated downward from that cap.

Charitable Remainder Trust Basics
Charitable remainder trusts are distinct from gift annuities in that a remainder trust is a legal entity separate and independent from the donor and the charity. The trust holds and invests the contributed assets, makes the specified payments and only on the conclusion of the trust term may the remaining trust assets be applied for charitable purposes.

All charitable remainder trusts share certain characteristics:
- The trust donor is entitled to a charitable income tax deduction for the present value of the charitable remainder.
- The trust must be irrevocable and create a valid trust under local law.
- The trust must make payments at least annually to at least one non-charitable beneficiary.
- The trust may make payments for the life of the designated beneficiaries or a term not to exceed 20 years (or a combination of the two).
- The trust annual payment may be no less than 5% and no more than 50%.
- The trust's income tax charitable deduction must be equal to or greater than 10% of the trust funding amount.
- The payout to the trust beneficiary may be in the form of an annuity or unitrust amount.

Charitable Remainder Annuity Trusts

A charitable remainder annuity trust must make a fixed payment of a specified dollar amount to the designated income beneficiary. The fixed payment must be no less than 5% and no more than 50% of the initial value of the assets transferred to the trust. The annuity trust's annual payment is based on the initial funding amount of the trust and remains constant throughout its term. Subsequent additions to the annuity trust are prohibited. It is not possible to defer payments from an annuity trust.

Charitable remainder annuity trusts are subject to the 5% probability test is a test described in Revenue Ruling 77-374 that requires all remainder annuity trusts that will make payments for one or more lifetimes to have less than a 5% chance of corpus exhaustion. If a CRAT fails the 5% test, no deduction is allowed. It is also questionable if a CRAT fails the 5% test whether the trust will qualify as a charitable remainder trust. With the IRS discount rate only 2.0% in December 2015, a CRAT income beneficiary must be at least 72 years old for the trust to pass the 5% test.

Charitable Remainder Unitrusts

A charitable remainder unitrust must make payments of a fixed percentage of the trust value as revalued annually to the designated income beneficiary. The payment each year is based on the then current value of the assets held by the trust. The unitrust's annual payment fluctuates from year to year based on the value of the trust each year. Subsequent additions to a unitrust trust are permitted.

If the unitrust's value goes up from one year to the next, its payout increases proportionately. Likewise, if the unitrust's value goes down, the amount it distributes also goes down. For this reason, it may be advantageous to choose a relatively low payout percentage so that the unitrust assets can grow, which in turn will allow the unitrust's yearly payments to grow.

Regular

A regular unitrust is the standard type of charitable remainder unitrust: it pays out a fixed percentage of its fair market value, as re-valued annually. If necessary, principal must be invaded to fulfill the trust's payment obligation.

Net Income/ Net Income with Makeup (also known as an income exception unitrust)

The net income unitrust makes income payments each year equal to the lesser of the unitrust percentage of the trust's fair market value and the trust's total income for the year. If the trust earns less income than is necessary to meet its percentage obligation, it is required to distribute only its earned income. The trust never invades principal to make a distribution.

The net income with makeup unitrust is like a net income remainder unitrust with one crucial difference. If the unitrust ever generates insufficient income to pay its unitrust percentage for the year, the shortfall is added to any previous shortfalls as payments to be made up. If, in a later year, the unitrust earns more than necessary to meet its percentage obligation, it will pay out the accumulated "makeup" to the extent that the trust has earned excess income or until the makeup accumulation has been exhausted.

Flip/ Flip with makeup
The flip unitrust starts out as a net income unitrust, then changes into a regular unitrust in the year after a designated triggering event occurs. Once the unitrust makes the flip, it cannot flip back to a net income unitrust. The trust “flips” or converts to a straight payout unitrust in the year following the year of the flip triggering event. Allowable triggering events are 1) a specific date, 2) the sale of a specific asset, or 3) the occurrence of an event outside the control of the trustee and anyone else, including the birth, death, marriage, or divorce of a specific person.

A flip unitrust with makeup starts out as a net income unitrust with makeup provision, then changes into a regular unitrust in the year after a designated triggering event occurs. Any makeup balance remaining at the end of the year in which the flip occurs cannot be distributed later.

Pooled Income Fund
A pooled income fund is a trust arrangement maintained by the sponsoring charity. The donor contributes property to the trust and receives a proportionate share of the trust’s future earnings for life. The pooled fund donor is entitled to a charitable income tax deduction for the present value of the charitable remainder. Fund participants are assigned units proportionate to their contribution and the total value of the fund. Income is distributed determined by the income earned by the trust and allocated per unit held by each participant.

A pooled income fund is like a charitable remainder unitrust in that the amount of income distributed varies with the trust performance. Unlike a unitrust there is no maximum amount that can be distributed each year. The pooled funds annual payments are not fixed and depend exclusively on the pooled fund’s investment performance.

On the death of the income beneficiary an amount equal to the then current fund value attributable to the beneficiary’s income interest is severed from the fund and contributed to the charity maintaining the pooled fund.

V. Case Studies

Build-Up Deferred Gift Annuity
A deferred gift annuity begins making payments to the annuitant at a future time designated at the time of the gift, which must be more than one year after the date of the contribution. The longer the deferral, the higher the payment once the annuity begins making payments.

Add to the deferred gift annuity the idea of making annual periodic contributions to build up an account for retirement. A donor could enter in to an annuity contract each year in preparation for retirement. All these annuities could be timed to begin making payments at the same time. Alternatively, the start dates of each contract could be staggered so that each year a new contract begins making payments resulting in an increasing payment stream. Let’s look at an example.

Example: *Mr. and Mrs. Denton, who are 60 and 57 years old respectively, want to provide a supplemental retirement income once they retire but they are concerned about keeping pace with inflation. Each year they have been contributing the maximum permissible amount to their workplace retirement savings plans. They decide to fund a series of 5 deferred gift annuities with $20,000 each for a total of $100,000 in cash.*

Mr. and Mrs. Denton receive a charitable income tax deduction for the five deferred annuities in the year they make the contribution for the annuity. The chart below shows the total annuity to which Mrs. and Mrs. Denton would be entitled each year as each annuity contract begins making payments. Notice that the total annuity increases every year until the all the deferred annuity contracts have begun making payments.

Age	Annuity Payment	Total Annuity payments	Annuity Rate
65/62	$960	$960	4.8%
66/63	$1,020	$1,920	5.1%
67/64	$1,060	$3,040	5.3%
68/65	$1,100	$4,140	5.5%
69/66	$1,160	$5,300	5.8%
For life		$5,300	

The Flexible Deferred Annuity

In 1997, the IRS approved a deferred annuity in which the donor does not have to choose in advance the date of first payment. See PLR 9743054. That decision can be made later, depending on circumstances. The older the beneficiary when payments begin, the larger the payments. A national charitable organization has obtained its own private letter ruling approving the flexible deferred annuity. See PLR 200449033.

Example: *Mr. Jasper, who is 56 years old, wants to provide a supplemental retirement income when he retires, but he does not know at this time when he will be ready to retire. He contributes stock having a fair market value of $160,000 and a cost basis of $60,000 for a gift annuity and reserves the option to start quarterly payments on March 31 of any year from age 65 to age 75. That allows him to take payments as early as age 65 or as late as age 75.*

The income tax charitable deduction (the lowest deduction resulting from any of the possible payment start dates) is $69,698, assuming a 3% discount rate. Mr. Jasper has the right to elect the date of first payment from among the possible start years specified in the annuity contract. Based on his circumstances at that point in the future he can decide if he wants payments to begin or continue to defer the payments. As shown in the chart below, the longer he defers taking payments, the higher his annuity amount.

Age at Start Date	Annuity Rate	Total Annuity
65	6.2%	$6,200.00
66	6.6%	$6,600.00
67	6.8%	$6,800.00
68	7.1%	$7,100.00
69	7.5%	$7,500.00
70	7.9%	$7,900.00
71	8.5%	$8,500.00
72	9.0%	$9,000.00
73	9.4%	$9,400.00
74	10.1%	$10,100.00
75	10.6%	$10,600.00

Commuted Payment Gift Annuity

The commuted payment gift annuity is really a modified deferred gift annuity. In exchange for an irrevocable gift of assets, the charity agrees to pay one or two annuitants a fixed sum each year for life, with payments starting at least one year after the gift. The contract includes language, however, that gives the annuitant (or the donor) the option to commute the lifetime of payments to a fixed number of payments of equivalent value. The annuitant may commute the payments immediately or at any time prior to the date of first payment.

Although a gift annuity cannot be for a term of years or guarantee a minimum number of payments, the IRS has approved gift annuity agreements that permit an exchange of life payments for a lump sum or for installments to be received during a limited period. This lump sum or series of payments are actuarially equivalent to the lifetime payment stream.

Such a commutation provision is typically included in the agreement for a college annuity, but it could be used anytime a donor wants to give an annuitant (including even the donor himself or herself) the option of receiving term rather than life payments.

How might the commuted payment gift annuity benefit a person approaching retirement?
Let’s say a donor wants to start getting retirement income at age 60 (over 59½ so no 10% early withdrawal payment from the commuted payment gift annuity) so that he doesn’t have to start drawing from his qualified retirement plan money until forced to start taking the required minimum distribution at age 70½. Maybe he wants to leave as much as he can in his IRA to go to charity at his death (avoids the significant tax burden possible on IRA assets passing to family). The remainder in his taxable accounts at death goes to family and would get a step up in basis.

Let’s look at an example.

<u>Example:</u> *Mr. Thomas whose date of birth is 58 years old has accumulated sufficient assets in his taxable accounts to last his retirement years. He is single and wants to leave a legacy for your charity. He is planning on taking early retirement next year. However, he cannot access his qualified retirement plan until he turns 59½ without triggering a 10% penalty tax. Beginning when he turns 59½ he estimates he will need $70,000 a year until he reaches age 70 ½ and must begin taking his mandatory distributions from his IRA.*

Mr. Thomas funds a commuted payment gift annuity with $872,717.30 in assets from his taxable accounts. (The target funding amount of $872,717.30 is computed by dividing the target annuity of $70,000 a year by the commuted payout rate.) Beginning at age 60½ he would receive an annuity of $70,000 a year for ten years. At age 70½, the remaining assets distribute to charity and Mr. Thomas begins drawing assets from his qualified retirement plans for retirement. If the charity earned 5% on the annuity during its 10-year term, the charity would have a residuum of $442,712 left from the original gift.

Retirement Flip Unitrust

One of the advantages of the deferred gift annuity is that it can offer “perfect” income deferral. That means during the deferral years the annuity pays absolutely no income. The disadvantage of the deferred annuity is that its fixed payments offer no inflation protection.

The alternative to the deferred annuity is the charitable remainder unitrust with a flip provision. The trust functions as a net income unitrust paying the lesser of the unitrust amount or the net income earned by the trust. Once the flip event occurs the trust converts to a regular payout unitrust paying the stated unitrust amount without regard to the income earned inside the trust.

The flip unitrust allows the principal to grow during the years leading up to the flip event. After the flip, the trust pays the unitrust amount based on the annual revaluation of the principal offering the opportunity for the income to keep up with inflation.

A challenge for the trustee is to minimize trust income in the years prior to the flip triggering event. Even an investment portfolio that emphasizes growth will produce some income, albeit very little. Therefore, the flip unitrust will likely generate a small amount of income prior to the flip event.

<u>Life Income for Others</u>

Gift Annuity or CRT for Parent

Many younger donors are providing income for elderly parents. These children must earn the income, pay income taxes on it and then give it to their parents. A gift annuity or unitrust might be a more efficient way to provide this stream of income. The donor would be entitled to the charitable income tax deduction for establishing such a gift.

There are capital gains tax issues if a gift annuity is established for the benefit of someone other than the donor. A portion of the gain on a gift annuity funded with appreciated property is completely forgiven. This is still true even if the donor funds the annuity for someone else. However, the reportable capital gain on an annuity funded with appreciated property that makes payments to the donor can be reported over the donor's life expectancy. Not so with an annuity that makes payments to someone other than the donor. In that case, the reportable capital gain must be reported in the year of the gift. However, it is only a portion of the gain that would otherwise be due if the donor sold the donated appreciated asset. A CRT is not subject to this capital gain tax treatment. Capital gain is handled the same whether the CRT is for the benefit of the donor or someone else.

A life income gift for another also raises gift tax issues. The donor of a life income gift for another is making a taxable gift equal to the present value of the income stream to the income beneficiary. If the value of this gift is less than the available annual gift tax exclusion, no gift tax return need be filed and no gift tax is due. If the value of the life income interest exceeds the available annual gift tax exclusion, the donor can retain the right to revoke the beneficiary's income interest and the gift is incomplete and not subject to gift tax at that time.

<u>Example:</u> *Mr. Gomez, age 55, a single man, has been helping to support his 80-year-old mother with after-tax dollars. Since he is in a 35% federal tax bracket, it takes quite a lot of pre-tax earnings to pay her the $500 per month he has been providing. He wonders whether there is a way that he could simultaneously make a gift to Charity and provide for his mother more tax-efficiently. He also thinks he should reduce his holdings in a stock. The market value of his shares is $300,000, and his cost basis is $70,000. The stock is paying a dividend of 2%.*

Mr. Gomez has multiple objectives and multiple problems. He wants to support your charity and his mother. Because of his 35% income tax rate he must earn $746 a month to provide his mother with $500 on an after-tax basis. Selling and reinvesting the proceeds from his stock position will generate a capital gain tax of $34,500. However, he receives only $6,000 income from the stock, barely $5,000 after tax.

Mr. Gomez could fund a charitable gift annuity with his stock for the benefit of his mother that would pay her an annuity of 6.8% or $20,400 a year! He would be making a taxable gift to his mother but could offset the gift tax with his gift tax exemption or retain the right to revoke his mother's annuity payments. Since the annuity is paid to someone other than the donor, a portion of the capital gain tax is due in the year of the gift. Mr. Gomez is still in the 15% capital gains tax bracket since his income is under $400,000 but he is liable for the Medicare surtax of 3.8% if his AGI is over $250,000. He would realize capital gain income of $115,803 in the year of the gift. The capital gain tax would be offset by the charitable income tax deduction of $148,953.

Reducing Gift and Estate Taxes

The gift planner's toolbox most frequently includes life income gifts that increase the donor's available income. That increased income is important to individuals who are in retirement and may worry about outliving their income.

Younger donors are typically mid-career professionals with extremely high incomes. More income for these donors only means more income. These donors typically want to reduce their current income. Therefore, a life income gift would not be attractive to them. Below are some gift options that allow the donor to reduce current income, reduce their taxes and make a gift to charity.

Lead Trust

The American Taxpayer Relief Act (ATRA) set the transfer tax exemption amount at $5.25 million per individual, $10.5 million for married couples subject to inflation adjustment. The Tax Cuts and Jobs Act effective January 1, 2018 increased the exemption amounts for each of these taxes to $11.2 million per individual, and to $22.4 million for married couples. Impact on planned givers: With higher exemptions (that will continue to be adjusted for inflation) there are precious few people with "estate tax problems," although these are often the donors major and principal gift officers spend time cultivating. The higher top rate for taxable transfers and the possibility of transfer tax repeal no longer on the horizon make lead trust gifts look even better for the ultra-wealthy.

A charitable lead trust is the reverse of a charitable remainder trust. Instead of paying income to one or more individuals and then distributing the remainder to one or more charities, it pays income to one or more charities, and then distributes the remainder to one or more individuals. By its very nature, it is a gift of an income interest. It derives its name from the fact that the charity's interest leads off, i.e., is paid first. Lead trusts usually last for a term of years, but they can last for the lifetime of one or more individuals. They can be established during the lifetime of the donor or at the donor's death.

The Non-Grantor Lead Trust

Historically, the most common form of the lead trust has been the non-grantor charitable lead trust in which the grantor (or donor) is not treated as owner. At the termination of the trust, the remaining corpus is distributed to others. None of it is returned to the donor. Since the donor retains no personal financial interest in the trust, he/she receives no income tax charitable deduction at the outset and is not taxed on the income. The purpose of the non-grantor lead trust is to support one or more charities and pass property to heirs at reduced gift and estate taxes. The trust can be established either during lifetime (inter vivos) or under a will (testamentary), and it can last either for a term of years or the lifetime of the donor or other individuals.

Gift and Estate Tax Consequences
The present value of the charitable income interest qualifies for a gift or estate tax deduction. Only the present value of the remainder interest (the amount remaining for heirs when the trust terminates) is subject to gift or estate tax. The method of computing these values is the same as for a charitable remainder annuity trust and charitable remainder unitrust, except that the deductible portions are reversed. With a charitable remainder trust, the remainder interest is deductible. With a charitable lead trust, the deductible portion is the income interest paid to charity.

The size of the deduction depends on the duration of the trust, the amount paid to charity, and the discount in effect when the trust is established. By increasing the payout to charity and lengthening the trust term, the amount of the taxable gift can be reduced—sometimes even to zero. A lower discount rate also increases the size of the deduction, particularly for charitable lead annuity trusts. A charitable lead unitrust deduction is not significantly affected by the discount rate.

When the discount rate falls, charitable lead annuity trusts become more appealing. They are generally preferred over charitable lead unitrusts for transferring wealth because all growth more than the required charitable payments can be accumulated for heirs. Now, even more can be accumulated because the desired deduction is obtainable with lower charitable payments.

Example of Inter Vivos, Non-Grantor Charitable Lead Trust: *Mr. and Mrs. Thomas, both age 55, contributed $4,000,000 of jointly-owned property to a non-grantor charitable lead annuity trust with a term of 20 years to benefit Charity. At the end of the term, the trust corpus will be distributed to their children, now ages 29 and 27. The trust will pay 6% or $240,000 at the end of each taxable year to Charity. The trust was funded using a 2.6% discount rate.*

Gift Tax Charitable Deduction	$4,000,000
Taxable Gift (Reduces estate/gift tax exemption to $22.1M)	$293,240
Total gifts to Charity	$4,800,000
Principal distributed to children at age 49 and 47	$5,522,332*

* This assumes an annual return of 7% and annual trust distributions of $240,000 were sufficient to offset all income and capital gain taxes on the lead trust principal.

Mr. and Mrs. Thomas will have passed over $5M to their children while reducing their $22.4M exemption amount by only $293,720. They will also have made gifts to charity totaling $4,800,000.

The Grantor Lead Trust

A CLT is a "grantor" trust if the grantor (or "donor") is treated as owner of the trust under the grantor trust rules of IRC Sections 671 through 677.

In particular, the grantor will be treated as owner if he or she retains a reversionary interest in the trust having an actuarial value exceeding five percent of the value of the trust corpus at the time the trust was established.

In almost all cases where the trust principal will be returned to the grantor, the grantor will be treated as owner. Only in cases where the payout to charity is relatively high and the trust term relatively long would the actuarial value of the reversionary interest be five percent or less. For example, using a discount rate of 3 percent, a grantor CLAT with a 7-percent payout rate making payments at the end of each year for 18 years would produce a reversionary interest of 3.7 percent.

Certain other powers, such as the right of a non-adverse person to exercise a non-fiduciary right to substitute property of equal value, may also cause the grantor to be treated as owner. The right to designate charitable remainder beneficiaries will not, by itself, make the grantor the owner of the trust for income tax purposes, although it might well do so for gift tax purposes.

B. Income, Gift and Estate Tax Consequences

The grantor of a grantor lead trust is entitled to income tax and gift tax charitable deductions for the present value of the income interest.

A gift in the form of a grantor lead trust is "for the use of" a charity. Consequently, the contribution is subject to a 30-percent deduction limitation, so long as each charitable beneficiary of the trust (whether named in the trust instrument or selected by the trustee pursuant to the trust instrument) is required to be a public charity. Interestingly, the 30-percent limitation applies to the deduction associated with a contribution of long-term appreciated property, as well as the deduction associated with a contribution of cash or ordinary income property. If, however, a charitable beneficiary is or may be an entity other than a public charity, a 20-percent limitation will apply in the case of long-term capital gain property contributed to the trust. In any event, a five-year carryforward is allowed.

The donor is taxed on all a grantor trust's income, even on the income paid to the charity. Likewise, the donor is taxed on realized capital gains, even if they are accumulated within the trust. If appreciated property is distributed in-kind to the charity in satisfaction of the annuity trust or unitrust amount, the property will be considered to have been sold and the cash distributed, thereby causing the grantor to recognize the gain. In light of these considerations, a donor will sometimes use cash to fund a grantor CLT, at least in part, with the trustee then drawing upon the cash to purchase tax-free municipal bonds in order to decrease the amount of income that is generated by the trust yet taxable to the donor (or the trust will simply be funded with such bonds if the donor owns enough of them).

No deduction is allowed each year for payments to charity unless the donor did not receive a deduction at the outset because the trust was not a qualified grantor CLT. In that rather unlikely event, the donor would be taxed on trust income but would get a deduction for amounts paid to charity.

A portion of the donor's income tax deduction will be recaptured if he or she ceases to be owner of the trust before the expiration of the trust term. For example, if a donor establishes a 15-year grantor CLT, receives an income tax charitable deduction, and dies after 10 years, part of the deduction will be recaptured. The amount recaptured is the amount of the deduction less the discounted value of amounts actually paid to charity. In computing the discounted value, each amount paid to charity is treated as a contribution of a remainder interest after a term of years. (See Table B in IRS Publication 1457.)

Campaign Pledge Paid from a Grantor Lead Trust

You have solicited Mrs. Watson, Chairman of your Board, for a $500,000 capital campaign gift to support a building campaign at your charity. Mrs. Watson is prepared to make a gift at this level if she can pay it off in installments over the 5-year period of the campaign.

A possible solution would be for Mr. Watson to create a 10% grantor CLAT with a 5-year term and an annual payment amount of $100,000. A lead trust is a fully taxable trust. In the case of a grantor lead trust, the grantor must pay income and capital gain tax generated by the lead trust. The illustration below assumes the lead trust principal earns 3% annually in interest income. That would generate $62,136 in income taxes to the grantor spread over the 5-year term of the trust. Since the income earned is insufficient to meet the payment to charity, the trust also would have to sell some principal. Even though this trust was funded with cash, it is invested for growth and the donor will pay some capital gain tax on the sale of principal to meet the charitable payout.

	10% Grantor Lead Annuity Trust
Gross Principal	$1,000,000
Annuity to Charity	$100,000
Income Tax Deduction	**$468,620**
Income Tax Savings (assumes 40.8% rate)	**$173,389**
Total Ordinary Income and capital Gain Tax Paid by Donor	$48,066
Principal returned to Donor	**$899,840** *
Total Distributed to Donor	**$500,000**

* Assumes total return of 6% for five-year term

Total cost to make $500,000 gift is only $100,160!

Bargain Sale

Younger donors may own appreciated assets that would generate significant capital gains taxes on sale. A bargain sale of appreciated property can be structured to minimize or even eliminate taxes. With this gift the donor sells appreciated property to a charity for less than the appraised fair market value, intending to make a gift of the difference between what the property is worth and what it sells for.

The donor receives a charitable deduction for the difference between the property's appraised value and the bargain sale price. The charity can then sell the property and retain the difference between the price it paid and the price for which it sold (or perhaps the charity retains the property and uses it for its tax-exempt purposes).

The bargain sale can appeal to the younger donor who cannot afford to contribute all of an asset, especially if the asset is not easily divisible. Examples of this kind of property would include appreciated real estate and tangible personal property. The bargain sale can also be attractive to a donor who is willing to make a gift if he can recover his cost.

Example: *Ms. Sawyer is 52 and her filing status is married filing jointly. She purchased a home that she rents to transient executives of local companies. She paid $350,000 for the home ten years ago and the home is now worth $575,000. There is no mortgage on the property. She would like to make a major gift to your charity. She can't afford to donate the entire property, but she is willing to make a gift to your organization.*

If Ms. Sawyer sells the home, she would trigger $225,000 of capital gain on the property. Ms. Sawyer's income is under $450,000 so her capital gain tax bracket is 15%. Her net investment income is such that she owes the 3.8% Medicare surtax for a total capital gain rate of 18.8%. She would owe $42,300 in capital gain taxes if she sold the property. Her net proceeds would be $532,700.

Assume instead that Ms. Sawyer sells the home to your organization for $477,191 and receives an income tax charitable deduction of $97,809. Assuming she is in the 35% income tax bracket, her tax savings from the gift would total $34,953. She receives a payment of $475,133.44 and must report capital gain on the transaction of $185,921.78. The 18.8% tax on this gain will be $34,953, which will be exactly offset by the income tax savings from Ms. Sawyer's deduction. That means this is a zero-net-tax solution.

Ms. Sawyer would net $475,133 from the bargain sale after accounting for the payment to her, the capital gain tax paid and the income tax savings. In addition, she would have made a gift of almost $100,000 to charity.

Bequests and Other Estate Gifts

Younger donors may feel there are too many uncertainties to make significant outright gifts to charity. There are a variety of gifts that become effective on the donor's death that can allow the donor to do something now to benefit your organization.

Research indicates that most individuals make their first will between their late 40s and late 50's. There is another group of individuals who will perhaps make their first will or change their will post retirement, between age 65 and 75. Very few individuals with charitable provisions ever change them. You can fill your bequest pipeline by actively marketing bequests to your younger supporters.

A bequest enables individuals both of great wealth and of modest means to make a significant and lasting gift. There may be surprises. Many charities know in advance about only approximately one-quarter of the estate gifts they receive.

The best younger prospects for bequests or other gifts effective at death are those who want to retain control of all their assets during their lifetime. The younger donor may have children to support and perhaps elderly parents to care for.

Forms of Bequests

There are several forms a bequest can take, and sample bequest language is helpful to have to offer people who indicate that they are considering a bequest commitment. The language can be a discussion point to explain to the donor the benefits of and the differences between, for example, a gift of a specific dollar amount and a gift of the residue of the estate (or a percentage thereof).

There are several basic ways a bequest can be structured. A <u>pecuniary bequest</u> is simply a certain sum of money. For example, "I give the sum of $X." Another example is a <u>specific</u> <u>bequest</u> in which the donor is leaving the charity a particular asset or assets, such as real estate, securities, jewelry, works of art, etc. For example, "I give 100 shares of XYZ Corp. stock."

There are other types of bequests, such as a <u>residual bequest</u>, where the donor makes 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. For example, "I give [all or __ percent] of the residue of my estate."

Finally, there is the <u>contingent bequest</u>, which is a pecuniary, specific, or residual bequest that takes effect only under certain circumstances. For example, "If my spouse does not survive me, I give…"

Arrangements Similar to Bequests

<u>Pay/Transfer on Death Accounts</u>

A "pay on death" account involves the donor instructing a bank to pay to a charity all or a portion of what remains in an account when the donor dies. A "transfer on death" account entails the donor giving essentially the same instruction to a brokerage firm regarding investments held in the account at the time of the donor's death. The details of each arrangement will depend on the bank or brokerage firm in question.

<u>Insurance Product Beneficiary Designations</u>

The types of products include life insurance policies of various kinds of commercial annuity contracts. The donor simply completes and returns to the insurance company a form designating that a charity receives all or a portion of the death benefit associated with a life insurance policy or the remaining contract value, if any, associated with a commercial annuity.

<u>U.S. Savings Bond Designations</u>

Either though a bank or directly with the U.S. Treasury Department, the donor designates that the proceeds of a new or existing savings bond be paid to a charity upon death. There are different types of savings bonds. In some cases, the proceeds will consist solely of the donor's principal, whereas other bonds will result in a distribution of both principal and accrued interest.

IRA and Qualified Retirement Plan Designations
A donor can designate that a charity receives all or a portion of what remains in an IRA (regardless of the type of IRA) or in most qualified retirement plans, such as 401(k) and 403(b) plans. The custodian of the account simply furnishes the donor with a form that can be completed and returned to the custodian.

Life Insurance

While younger donors may not have significant cash flow there are gift opportunities with life insurance. The cost of policies is lower for younger insured's and it can be a great way to leverage their support for your charity.

A life insurance gift is particularly appropriate for much younger individuals, primarily individuals in their 30s, 40s, 50s, or 60s. However, a life insurance gift may come from those of any age with existing policies they no longer need.

The flexibility of the beneficiary designation allows the younger donor to retain the death benefit if their loved ones are still alive. The donor could indicate that charity receives the death proceeds only if none of the individual beneficiaries is living.

A life insurance gift might also appeal to those who want to assure a significant future endowment with a modest current investment. However, some charities would prefer the younger donor to make current annual gifts because typically the charity's endowment performance is superior to the investment returns of an insurance company.

A donor could make a gift of life insurance to a charity in any of the following ways:

Gift of Paid-Up Policy
A donor who gives a paid-up policy to the charity receives a deduction for the replacement value (or net premiums paid, if less than replacement value).

Gift of Policy on Which Premiums Are Owing
A gift of an existing policy on which premiums are still owing results in a deduction for the interpolated terminal reserve value (cash value plus any pre-paid premiums), or net premiums paid, if less.

Gift of New Policy
A donor who gives a charity a new policy receives a deduction for each premium paid.

Charity Named as Beneficiary, But Not Owner
No income tax deduction, but estate tax deduction if charity receives proceeds.

VI. Conclusion

A comprehensive planned gift program will seek to maximize gift opportunities. This presentation demonstrates the potential for planned giving within a non-traditional demographic.

Younger donors who have established a planned gift will be much more likely to consider additional support of your organization once they reach the traditional planned giving age. Increased planned giving support from younger donors can help to fill the traditional planned giving pipeline in the future.