10 Practical Planned Giving Ideas for the Current Environment

PG Calc Webinar

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I. THE CURRENT CHALLENGES IN THE CHARITABLE AND ESTATE PLANNING ENVIRONMENT

The economic news has been uncertain or gloomy since 2000. Fluctuating stock values, low interest rates, high income tax rates, rising healthcare costs, fewer jobs, and the related economic turmoil have affected all donors. Even the wealthy have felt the pinch. In this environment, gift planning is more powerful than ever. These ten gift planning ideas are designed to maximize results for donors and expand options for charities against the current economic and tax backdrop.

A. The Economic Impact of the Stock Market on Donors

First it is important to understand why donors are so nervous about the financial markets. The nature of financial markets is to move to reflect current economic conditions and fears, but markets have been particularly erratic since 2000. As a reminder, annual returns from 1999 through 2010 are shown in Table1 and 2.

TABLE 1
MAJOR INDEX RETURNS 1999 – 2005

INDEX	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*
DJIA	25.22%	-6.18%	-7.1%	-16.76%	25.32%	3.15%	-0.61%
S&P 500	19.53%	-10.14%	-13.09%	-23.37%	26.38%	8.99%	3%
NASDAQ	85.5%	-39.29%	-21.05%	-31.53%	50.01%	8.59%	1.37%
DJ World	31.54%	-17.36%	-21.02%	-15.63%	38.58%	19.23%	14.4%
Barclays LT Treas.	-15.13%	20.11%	3.5%	14.62%	1.38%	5.06%	2.7%
ML Muni Master Bond Index	-6.34%	18.1%	4.5%	10.73%	2.54%	5.45%	3.9%
Barclays Corp. Bond Index	-1.89%	9.1%	10.7%	10.17%	8.31%	5.41%	2%

TABLE 2
MAJOR INDEX RETURNS 2005 - 2014

INDEX	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	*2014*
DJIA	16.29%	6.4%	-33.8%	18.8%	11%	5.5%	7.3%	26.5%	7.5%
S&P 500	13.62%	3.5%	-38.5%	23.5%	12.8%	0%	13.4%	29.6%	11.4%
NASDAQ	9.52%	9.8%	-40.5%	43.9%	16.9%	-1.8%	15.9%	38.3%	13.4%
DJ World	23.01%	11.8%	-46%	37%	10.1%	-16.3%	13.6%	13.3%	-5.5%

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INDEX	2006	2007	2008	2009	2010	2011	2012	2013	2014
Barclays LT Treas.	1.85%	10.2%	20.64%	-13.17%	9.37%	34.01%	0.87%	-13.33%	23.19%
ML Muni Master Bond Index	4.4%	4.18%	0.54%	9.4%	2.52%	10.64%	5.56%	-2.19%	7.9%
Barclays Corp. Bond Index	4.3%	4.56%	-6.54%	18.68%	9%	8.15%	9.82%	-1.57%	7.46%

B. Interest Rates and Donors

As interest rates have declined, the interest paid on bonds, certificates of deposit, checking accounts and other fixed income instruments that seniors and retired donors rely on for living expenses has also declined. For a look at how those rates have fluctuated over the last decade, see Table 3.

TABLE 3
PRIME RATES, QUARTERLY, 2000 – 2014

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Jan 1	4.75%	4.25%	4%	5.25%	7.25%	8.25%	7.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%
Apr 1	4.75%	4.25%	4%	5.75%	7.75%	8.25%	5.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%
July 1	4.75%	4%	4.25%	6.25%	8.25%	8.25%	5%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%
Oct 1	4.75%	4%	4.75%	6.75%	8.25%	7.75%	5%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	
Dec 1	4.25%	4%	5%	7%	8.25%	7.5%	4%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	

C. Interest Rates and Split Interest Gifts

Low interest rates have also had an impact on split interest gifts.

1. Split Interest Gifts With Remainders to Charity

In this environment, charitable income tax deductions for split interest gifts that pay income streams to donors with the remainder to charity are substantially lower than in 2006 and 2007 in which prime rates were in the 7% to 8% range. This has dampened interest in some donors in creating charitable gift annuities and charitable remainder trusts. Table 4 demonstrates the variance in the deduction using a low end rate of 1.4% CFMR and a higher end rate of 5.8% CFMR for a $1 million charitable remainder trust, one life age 65.

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TABLE 4
COMPARISON OF RESULTS FOR CHARITABLE REMAINDER ANNUITY TRUST AND UNITRUST
5% PAYOUT, ONE LIFE AGE 65

Type of Trust - 5% Payout	*Charitable Income Tax Deduction 1.4% CFMR*	*Charitable Income Tax Deduction 5.8% CFMR*
Charitable Remainder Annuity Trust	$235,224	$495,747
Charitable Remainder Unitrust	$447,400	$468,210

2. Split Interest Gifts with Remainder to Individuals

Lower charitable federal midterm rates increase the charitable deduction for lead trusts. This is because the lower the rate reduces the calculated value of the remainder (and increases the value of the charitable deduction). Table 5 calculates the charitable deduction for a $1 million gift for a charitable lead trust, again using a 1.4% CFMR and a 5.8% CFMR.

TABLE 5
COMPARING THE IMPACT OF THE CHARITABLE FEDERAL MIDTERM RATE ON THE CHARITABLE DEDUCTION

20-Year Term, 5% Payout	*Gift Tax Deduction 1.4% CFMR*	*Gift Tax Deduction 5.8% CFMR*
Charitable Lead Annuity Trust	$866,950	$582,920
Charitable Lead Unitrust	$636,270	$620,250

3. Congress is Changing the Rules

As every planner knows, the tax rules are constantly changing. Those changes have not only changed the rules on charitable deductions, but also changed the rules for some types of nonprofit entities.

a. Pension Protection Act of 2006, H. R. 4[1]

On August 17, 2006, President Bush signed the Pension Protection Act of 2006 (H. R. 4) which included a charitable IRA rollover provision, as well as other charitable incentives and reforms. The charitable incentive of greatest interest to donors and advisors allows individuals to make annual transfers not exceeding $100,000 from traditional and Roth IRAs directly to most public charities (donor advised funds, §509(a)(3) supporting organizations, and private foundations are excluded) without including the amount in gross income. The provision, for donors age 70 ½ or older and for amounts that would otherwise be included in gross income, is applicable through 2007. Donors who may receive the greatest benefit from the new law include those who prefer to use tax burdened assets for lifetime gifts, those who have exceeded the 50% giving limitations, and those who do not itemize.

[1] http://thomas.loc.gov;

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Other charitable incentives in the bill included an increase in the charitable deduction for businesses that contribute food inventory, a basis adjustment to the stock of S Corporations that contribute property to charity, an extension of the enhanced deduction for qualified book inventory to public schools (for C Corporations), and an increase in the charitable deduction limit for certain qualified conservation gifts. Each of these provisions is available through 2007.

There were more charitable reforms than charitable incentives in the bill. The reforms included an increase in excise taxes applicable to certain charities, recapture of the deduction value represented by the difference between cost basis and market value of a related use tangible personal property gift when the gift is not ultimately used for the charity's exempt purpose, an excess benefits transaction tax on amounts paid from a donor-advised fund or a type III supporting organization to certain related parties, application of the excise tax on excess business holdings to donor advised funds, increased substantiation requirements for gifts to donor advised funds, and new rules (including a directive to Treasury to create new payout requirement regulations) for type III supporting organizations which are not "functionally integrated type III supporting organizations".

Update #1: On October 3, 2008, the Congress passed and President Bush signed the Emergency Economic Stabilization Act of 2008, H.R. 1424 which extended the Lifetime IRA Transfer to Charity, the basis adjustment to the stock of an S corporation making a charitable contribution of appreciated property, and the enhanced deduction for contributions of food inventory, book inventory, and certain computer equipment and software through December 31, 2009.

Update #2: On September 24, 2009 the Treasury issued proposed regulations for Type III supporting organizations that implemented the changes in the Pension Protection Act of 2009.[2] Specifically, the following were addressed:

- How to qualify as a Type III Supporting Organization
- Requirement to notify the Type III's supported organizations
- The responsiveness test
- The integral part test (for functionally integrated Type IIIs)
- The integral part test (for non-functionally integrated Type III's)
- Distribution requirements for non-functionally integrated Type III's
- Transitional relief

Following passage of the Act, the IRS issued a notice with interim guidance, and an advance notice of rule making on supporting organizations summarized below.

- IRS Notice 2006-109, Interim Guidance Regarding Supporting Organizations and Donor Advised Funds was published shortly thereafter focusing on four areas:
    - Criteria for private foundations that make distributions to supporting organizations that allow the foundation to determine if the supporting organization is a Type I, Type II, or Type III (and further distinguishing between a functionally-integrated Type III or non-functionally integrated Type III);

[2] REG-155929-06; 74 F.R. 48672-48687.

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- Clarification of the effective date for the new IRC §4958(c)(3) excise tax on excess benefit transactions with supporting organizations;
- Exclusion of certain employer-sponsored disaster relief funds from definition of a donor-advised fund; and
- Clarification of how the IRS will apply the new IRC §4966(a) excise taxes (relating to payments made pursuant to educational grants awarded prior to August 17, 2006)

- IRS Announcement 2007-87, Payout Requirements for Type III Supporting Organizations That Are Not Functionally Integrated, Advance Notice of Rulemaking. This proposal included four terms that included a proposed functionally integrated test for Type III Supporting Organizations, a payout requirement for non-functionally integrated Type III supporting organizations that would follow the minimum distribution rules for private, non-operating foundations, [3] the type of information a Type III supporting organization must provided to its supported organizations to demonstrate responsiveness, and modified requirements for Type III supporting organizations organized as trusts (the responsiveness test),

b. Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010

In 2010, the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 changed the rules again.[4] Instead of returning to pre-2001 Act rates, Congress set the exclusion amount at $5,000,000 through December 31, 2012 (indexed for inflation as of 1/1/2012) and the top rate at 35%. (For 2010, taxpayers could use the $5,000,000 exclusion with a step up in basis, or elect the zero tax option with carryover basis.)

c. The American Taxpayer Relief Act of 2012

In early 2013, The American Taxpayer Relief Act of 2012[5] (ATRA) was enacted and made changes to the income, gift, estate, and generation skipping tax rates and calculations. The overriding concern of many observers was that Congress would modify or cap itemized deductions for all giving levels, essentially eliminating the value of the deduction for donors making larger gifts. This did not happen, although most believe the conversation is not yet over and may become a part of the budget and debt ceiling discussions still to come in 2013. President Obama's Budget, for example, would uncouple estate and gift tax rates, reduce the lifetime gift tax transfer exclusion amount to $1 million, reduce the estate tax exclusion amount to $3.5 million, eliminate the inflation adjustment, and increase the marginal rate to 45%. The ATRA of 2012 tax law changes impacting giving are summarized as follows:

a) *Charitable IRA Rollover.* The "Charitable IRA Rollover" was revived for another two years through the end of 2013. The charitable IRA rollover allows taxpayers age 70 1/2 or older to make distributions from their IRA directly to qualified public charities in an amount up to $100,000 in 2012 and 2013. The charitable IRA rollover was first introduced in the Pension

[3] IRC §4942 qualifying distribution requirements; valuation of assets for the purpose of computing the distribution requirement would also follow the private foundation rules.

[4] Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, P.L. 111-312 (December 17, 2010).

[5] American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313.

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Protection Act of 2006 for a two year period. It has subsequently been renewed for a two-year period every two years, although some years (such as this one) the renewal occurs so late that many miss the opportunity. Since the American Taxpayer Relief Act of 2012 was not signed into law until 2013, Congress allowed taxpayers who took a withdrawal from their IRA in December 2012 to make a cash contribution to charity of all or part of that amount before January 31, 2013 and treat it as a distribution from their IRA for 2012. They may also make a distribution from their IRA to a qualified public charity by January 31, 2012 and deem it to be a 2012 transfer.

b) *Income Tax Rates*. Income tax rates on higher-income taxpayers ($400,000 for single taxpayers, $425,000 for head of household, and $450,000 for married taxpayers filing jointly) were raised as expected. The new rate for taxpayers beyond threshold amounts is 39.6%.

c) *Capital Gains Rates.* Capital gains rates were raised at the same threshhold amounts, from 15% to 20%.

d) *Medicare contribution tax.* While not part of the Taxpayer Relief Act of 2012, provisions in the 2010 healthcare act calls for a Medicare contribution tax of 3.8% will be imposed on capital gains, dividends, interest, and other unearned income in 2013 for taxpayers over $200,000 (for single taxpayers and heads of households) or $250,000 (for married filing jointly).

e) *The Pease Limitations (the 3% Rule).* As explained in more detail later, the Pease limitations on itemized deductions are reduced by the lessor of: a) 3% of amounts over $250,000 (single taxpayers), $275,000 (heads of household) and $300,000 (married, filing jointly) or b) 80% of the taxpayer's itemized deductions. The Pease limitations were phased out and eliminated in 2010, but reinstated in this legislation.

f) *Estate and Gift Tax Rates.* Estate and gift tax rates were maintained at the 2011 and 2012 $5 million exclusion amount, indexed for inflation. The indexed amount for 2013 was $5.25 million.[6] The tax rate was raised from 35% to 40%. Since estate and gift tax rates were slated to return to a $1 million exclusion amount and 55% top rate, this was a welcome result for affluent taxpayers with large estates.

E. Misfeasance, Malfeasance, and Lawsuits

Judging by the increasing number of lawsuits over the last ten years, charities are having a harder and harder time honoring donor commitments resulting in lawsuits filed by donors and families of donors to enforce gift restrictions or sometimes initiated by charities to escape restrictions. These lawsuits have created concern among some donors, making them wary about creating long-term gifts. The following four cases provide some perspective.

[6] Rev. Proc. 2013-15, January 11, 2013.

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1. *William Robertson, et. al. v. Princeton University, et. al.*[7]

Charles S. and Marie H. Robertson[8] contributed $35 million in A & P stock to Princeton University in 1961 to create a supporting organization to fund the Woodrow Wilson School of Public and International Affairs "where men and women dedicated to public service may prepare themselves for careers in government service, with particular emphasis on the education of such persons for careers in those areas of the Federal Government that are concerned with international relations and affairs."[9] The Foundation, with assets of roughly $900 million in recent years, provided funds for the Woodrow Wilson School and also funded other budgets, including a $13million principal distribution to build Wallace Hall, a building designed to house the expansion of the Woodrow Wilson School as well as the Sociology Department and other programs.

During his lifetime, Mr. Robertson grew unhappy with the Foundation's spending patterns and the low numbers of students engaged in pursuit of diplomatic service, expressing his concerns in writing. The school dismissed his concerns explaining the world of diplomacy was no longer the same. Marie Robertson died in 1972 and Charles Robertson died in 1981. Their son William S. Robertson, his sisters Katherine Ernst and Anne Meier, and cousin Robert Halligan – also unhappy about the application of Foundation funds – filed a lawsuit in July 2002 to redirect funds to other universities that could fulfill the donors' goals. The suit alleged the school intentionally violated the donors' intent and further claimed Princeton was engaged in self-dealing with regard to the Foundation's investments and distribution of funds. The lawsuit involved numerous depositions and other discovery, costing Princeton over $40 million in expenses through December 2008 when the suit was settled.[10] The settlement required Princeton to transfer $90 million plus interest to the Foundation.[11]

2. *Howard v. Administrators of the Tulane Educational Fund*

From 1886 to 1901, Josephine Louise Newcomb contributed over $3.6 million to create the Sophie Newcomb College in Tulane University to advance "the cause of female education in Louisiana." The gift, worth approximately $75 million in today's dollars, established the first separate college for women in a university in the United States. In 2006, the Trustees voted to merge Newcomb College into Tulane and to absorb its endowment.

Two heirs of Josephine Newcomb – Parma Howard and Jane Smith – filed suit to enforce Ms. Newcomb's intent in maintaining a separate college. The district court judge dismissed the Newcomb heirs'

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[7] Docket No. C-99-02, Superior Court of New Jersey, Chancery Division: Mercer County

[8] Mrs. Robertson was the daughter of the founder of the A & P grocery chain.

[9] The language setting out the Foundation's purpose is taken from its Certificate of Incorporation. To provide context, in 1961 the U.S. and Russia were engaged in a cold war, the United States was involved in Vietnam, and President Kennedy was asking American to: "Ask not what your country can do for you – ask what you can do for your country."

[10] Hathirimani, Raj, "Robertson Lawsuit Most Expensive in University History," *The Daily Princetonian*, www.dailyprincetonian.com (November 19, 2004); the lawsuit was settled on December 10, 2008 and approved by the court on December 12, 2008.

[11] "Robertson Lawsuit Settled," http://paw.princeton.edu/issues/2009/01/28/pages/7658/index.xml.

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lawsuit holding they had no standing to enforce the gift; [12] this ruling was affirmed by Louisiana Fourth Circuit Court. [13] The heirs appealed, and on July 1, 2008, the Louisiana Supreme Court vacated the dismissal and remanded the case to the trial court to allow the descendants of Ms. Newcomb to proceed with the lawsuit to enforce the gift's terms. In August 2008, a second lawsuit was filed in the district court of the Parish of Orleans by another Newcomb descendant, Susan Henderson Montgomery, also seeking to enforce the terms of the gift.[14] Ms. Montgomery filed a Motion for Summary Judgment with the Civil District Court in New Orleans which was denied in August 2009. Ms. Montgomery appealed, and in October 2010 the Fourth Circuit Court of Appeals in a 3-2 decision denied the appeal finding "Ms. Newcomb's will created an unconditional bequest to the Administrators of the Tulane Educational Fund."[15] The case history and court filings can be found at www.newcomblives.com.

3. The Barnes Foundation's Petition to the Orphan's Court to Change Settlor's Intent

Dr. Albert C. Barnes established the Barnes Foundation in 1922 to house his extensive Impressionist, Post-Impressionist and early Modern art collection (including many masterpieces with a collective current value of $6 billion) and to educate the working class about art. The collection – which was assembled and mounted by Dr. Barnes – was located in a modest structure in Merion, Pennsylvania, a Philadelphia suburb. Dr. Barnes arranged the paintings and designed the art education curriculum himself. He did not intend to have the entity operate as a traditional museum.[16]

Dr. Barnes died in 1951. In 1991, the trustees went to court to amend the Foundation's governing documents which prevented the trustees from selling or loaning the art in the collection.[17] While the lawsuit – which cost the Foundation about $10 million in expenses – did not result in a change in the Foundation's by-laws, the Judge did allow the Foundation to take the art on tour raising about $16 million for renovations.[18]

In September 2002, the financially-strapped trustees filed another lawsuit seeking permission to move the art collection from the Merion building to a new building (to be constructed) in downtown Philadelphia; in addition, it asked the Court to allow it to expand the number of trustees from 5 – as designated by Dr. Barnes in the governing documents – to 15.[19] In early 2004, the Court approved the

[12] *Howard v. Administrators of the Tulane Educational Fund*, unreported, Civil District Court, Orleans Parish, No. 2006-4200, Div. B-15.

[13] *Howard v. Administrators of the Tulane Educational Fund*, 970 So. 2nd 21 (Ct. App. 4th Cir. October 22, 2007).

[14] *Montgomery v. Administrators of the Tulane Educational Fund*, unreported, Civil District Court, Orleans Parish, No. 08-8619, Div. B-I.

[15] This lawsuit is still unfolding and further developments may have occurred after this article was written. Please check for recent developments at www.newcomblives.com.

[16] According to the Foundation's press release the Foundation has a 3-year horticulture program, and a 2-year art and esthetics program with a 1-year seminar extension.

[17] Solis-Cohen, Lita, Maine Antiques Digest, March 2004 <http://www.maineantiquedigest.com/articles/mar04/barnes0304.htm>.

[18] *Id.*

[19] *Id.*

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increase in the number of Trustees, deferring the decision on the move until other options to raise funds were explored. Then, on December 13, 2004, the Court of Common Pleas of Montgomery County, Pennsylvania, Orphans' Court Division granted the Trustees' request to move the Foundation's art gallery from Lower Merion Township, Pennsylvania to a new location in downtown Philadelphia. The court's 41-page published opinion[20] acknowledged the changes ran counter to the terms of the Foundation's 1922 charter and governing documents but noted there was "no viable alternative" for the financially-compromised charity.[21] An appeal to the ruling filed by an art student at the Foundation was dismissed by the Pennsylvania Supreme Court for lack of standing.[22]

4. *Fisk University v. Georgia O'Keeffe Foundation*

In 1949, Georgia O'Keeffe, the widow of Alfred Stieglitz (and executrix of his estate), transferred the Alfred Stieglitz collection of 97 photographs and paintings to Fisk University in Nashville, Tennessee subject to a restriction that Fisk University would not at any time sell or exchange the pieces of the collection. Ms. O'Keeffe then contributed four additional pieces that were part of her personal collection for a total of 101 pieces. In 2005 Fisk University filed a petition in the Chancery Court of Davidson County asking the court to invoke the legal doctrine of *cy pres* to permit the sale of two of the paintings in the college citing the cost of maintaining the collection and other financial needs. The Georgia O'Keeffe Foundation originally filed to block the action; in 2006, the Georgia O'Keeffe Museum filed a petition, granted by the Court, to substitute the Museum for the Foundation, alleging the Museum was Georgia O'Keeffe's successor in interest and seeking through counterclaim to have the collection transferred to the Museum through right of reverter. In 2007, the Tennessee Attorney General was permitted to join the proceedings to protect the interests of the people of Tennessee.

A settlement with the Georgia O'Keeffe Museum involving a sale of several of the paintings was rejected, as was an outside offer from Crystal Bridges – Museum of American Art, Inc. involving the purchase of an undivided 50% interest that would allow the Crystal Bridges Museum and Fisk to share the college. In a pre-trial motion, the Court ruled the *cy pres* doctrine was not applicable because O'Keeffe had specific rather than general charitable intent when she transferred the collection to Fisk and that the Court had the power to order reversion if the Georgia O'Keeffe Museum could demonstrate Fisk breached the gift conditions. Following trial, the Court ruled that none of Fisk's actions had yet violated the gift terms and imposed an injunction that Fisk comply with the gift terms. Fisk appealed,[23] and in July, 2009 the Court of Appeals reversed the Trial Court's determination the Georgia O'Keeffe Museum had standing to sue finding the Museum had no right of reversion in either the 97 pieces transferred to Fisk from Mr. Stieglitz's Estate by Ms. O'Keeffe using her power of appointment, or the four pieces from Ms. O'Keeffe's personal collection gifted to Fisk.[24] The Court also found the Trial Court erred in dismissing the University's petition for *cy pres* relief after determining *cy pres* was not applicable because Ms. O'Keeffe's charitable intent was

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[20] *The Barnes Foundation,* No. 58,788 (12/13/04).

[21] Blum Debra E., "Court Ruling Could Influence Restrictions Donors Place on Bequests," *The Chronicle of Philanthropy* (January 6, 2005; "Court Allows Barnes Foundation To Move Collection to Philadelphia," *Nonprofit Issues,* December 16, 2004 – January 15, 2005 <www.nonprofitissues.com/public/features/leadfree/2004dec2-IS....>

[22] Blum Debra E., "Pennsylvania's Highest Court Allows Multibillion-Dollar Art Collection to Move," *The Chronicle of Philanthropy* (April 28, 2005).

[23] A copy of the appeal can be found on the Tennessean website at http://www.tennessean.com/assets/pdf/DN115593814.PDF.

[24] Slip Copy, 2009 WL. 2047376, Tenn. Ct. App., July 14, 2009 (No. M200800723 COAR3CV).

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specific rather than general. The Trial Court did not determine *cy pres* relief was appropriate, but remanded the petition to the Trial Court for that determination.[25]

F. Yet, Donors Keep Giving

1. *Giving USA 2015*[26]

On June 16, 2015, Giving USA Foundation released *Giving USA 2015* reporting charitable gifts of $358.38 in 2014 an increase of 7.1% over 2013. 2014 giving represented 2.!% of GDP. As in years past, individuals accounted for most (80%) of the gifts. Table 6 shows the sources of 2014 charitable gifts, while Table 7 shows the charitable sectors that were the largest recipients of funds.

TABLE 6
SOURCES OF CHARITABLE GIVING, *GIVING USA 2015*

Source	*Amount in Billions*	*Percentage of Total*
Individuals	$258.51	72%
Foundations	$53.97	15%
Bequests	$28.13	8%
Corporations	$17.77	5%
Total	$358.38	100%

TABLE 7
RECIPIENTS OF CHARITABLE GIFTS, *GIVING USA 2015*

Sector	*Amount in Billions*	*Percentage of Total*
Religion	$114.90	32%
Education	$54.62	15%
Human Services	$42.10	12%
Foundations	$41.62	12%
Health	$30.37	8%
Public Society/Benefit	$26.29	7%
Arts, Culture, and Humanities	$17.23	5%
International Affairs	$15.10	4%
Environment/Animals	$10.50	3%

[25] *Supra.*

[26] “Giving USA 2015: An Estimated $358.38 Billion to Charity in 2014, (June 16, 2015), http://www.philanthropy.iupui.edu/news/article/giving-usa-2015

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2. Statistics of Income Bulletin

The IRS publishes an annual *Statistics of Income Bulletin* that includes a state-by-state extraction of data on charitable giving drawn from income tax returns of taxpayers who itemize. The most current report, published in Spring 2014, provides data from the 2012 tax year. Americans who claimed itemized charitable deductions (31.58 percent of those who filed returns) gave $198.55 billion to charity in 2012. Table 8 provides figures for all states.

TABLE 8
ITEMIZED DEDUCTIONS FOR THE TAX YEAR 2012[27]

State	*Number of Returns*	*Number of Taxpayers Taking Itemized Deductions*	*Number of Itemizers with Charitable Deductions*	*Value of Charitable Deductions (in thousands)*
Alabama	2,050,890	581,579	502,270	$3,064,129
Alaska	363,090	88,090	63,240	$327,812
Arizona	2,761,490	852,670	713,230	$3,003,303
Arkansas	1,219,480	295,320	235,710	$1,540,729
California	16,909,110	5,926,570	4,883,120	$25,605,870
Colorado	2,450,150	868,250	710,290	$3,376,603
Connecticut	1,741,480	744,740	621,010	$3,415,839
Delaware	434,150	148,110	122,160	$476,211
DC	327,730	131,320	108,180	$894,565
Florida	9,226,420	2,279,830	1,833,000	$11.183 billion
Georgia	4,335,320	1,490,980	1,267,540	$7,280,155
Hawaii	665,320	203,620	165,280	$625,856
Idaho	679,220	206,670	166,600	$932,206
Illinois	6,077,090	2,081,570	1,709,910	$8,104,268
Indiana	3,029,600	769,040	612,960	$2,981,325
Iowa	1,426,710	442,110	358,340	$1,538,857
Kansas	1,323,740	394,920	322,210	$1,987,637
Kentucky	1,879,100	527,260	428,360	$1,963,576
Louisiana	2,011,770	482,860	375,510	$2,141,117

[27] IRS Statistics of Income, Tax Stats. As of July 22, 2015, the 2013 statistics had not been posted.

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State	*Number of Returns*	*Number of Taxpayers Taking Itemized Deductions*	*Number of Itemizers with Charitable Deductions*	*Value of Charitable Deductions (in thousands)*
Maine	631,380	188,670	141,920	$424,979
Maryland	2,860,930	1,339,000	1,126,250	$5,271,380
Massachusetts	3,264,490	1,253,430	1,034,660	$4,869,437
Michigan	4,631,040	1,341,490	1,127,060	$4,982,502
Minnesota	2,619,920	988,000	835,210	$3,394,429
Mississippi	1,250,140	301,480	251,260	$1,574,132
Missouri	2,728,430	783,690	625,990	$3,212,195
Montana	485,250	144,960	112,040	$574,011
Nebraska	871,940	258,160	215,060	$1,213,344
Nevada	1,289,360	346,820	280,280	$1,529,393
New Hampshire	679,910	230,220	175,070	$548,246
New Jersey	4,307,560	1,826,250	1,546,490	$5,648,492
New Mexico	905,340	222,490	170,230	$797,904
New York	9,363,750	3,328,930	2,811,220	$16,464,825
North Carolina	4,287,590	1,413,250	1,195,580	$5,915,060
North Dakota	353,830	70,490	51,750	$313,676
Ohio	5,507,560	1,613,880	1,263,460	$5,194,268
Oklahoma	1,618,460	414,250	329,670	$2,489,316
Oregon	1,768,810	668,060	534,490	$6,816,561
Pennsylvania	6,134,120	1,865,610	1,517,640	$6,513,138
Rhode Island	512,930	178,630	148,770	$469,371
South Carolina	2,077,310	604,020	515,610	$2,717,067
South Dakota	414,950	77,370	60,230	$521,281
Tennessee	2,882,040	652,560	534,660	$3,761,285
Texas	11,573,440	2,808,710	2,197,550	$16,075,775
Utah	1,174,090	438,950	380,900	$3,304,338
Vermont	321,250	92,660	67,520	$269,093

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State	*Number of Returns*	*Number of Taxpayers Taking Itemized Deductions*	*Number of Itemizers with Charitable Deductions*	*Value of Charitable Deductions (in thousands)*
Virginia	3,811,070	1,482,160	1,216,580	$5,720,706
Washington	3,244,400	1,074,930	853,750	$4,512,735
West Virginia	788,490	144,190	102,690	$484,818
Wisconsin	2,778,100	960,610	770,910	$2,741,076
Wyoming	301,660	67,240	45,780	$3,764,824
United States	145,025,450	45,792,280 31.58% of all who filed	37,490,960 81.87% of all who itemized	$198,552,435

II. IDEAS #1 AND #2: SIMPLE BUT SMART

A. Accelerating Charitable Gifts

Sometimes the simplest planning concepts generate the most profound results. Under the higher estate tax exclusion amounts instituted by the 2012 Act ($5.43 million for 2015), most individuals are not subject to estate tax. When individuals who make charitable gifts through their estates will not receive an estate tax benefit (since they will pay not estate tax), planners may want to consider accelerating those gifts to generate a charitable income tax benefit where appropriate. Consider these simple ideas:

- *Accelerate gifts destined for charity that generate no income.* The easiest gifts to accelerate are those designated for charity under a will or will substitute that produce no current income. Classic examples include life insurance policies owned by the donor designating charity as the beneficiary, or valuable art collections headed for a museum (especially if the donor is downsizing and is concerned about the ongoing cost of insuring and safeguarding the assets).

- *Accelerate a testamentary gift of a home or farm by making a retained life interest gift*. A similar, but often overlooked asset is a home designated for charity under a will. The donor may want to transfer the home to charity today, retaining the lifetime right to remain in the home, and take a charitable deduction for the remainder interest.

  When a donor makes a gift of a remainder interest gift in a home or farm, it is impossible to know whether he may need to sell the real estate and move to an assisted care or long-term skilled nursing facility prior to death. The real property used for the gift may be his asset of greatest value, or simply the asset needed, to ensure housing needs are met. There are at least five ways to handle this problem.

  1. *A bargain sale of the residence*. If the donor knows he will need to sell the residence at the time the gift is in the planning process, a bargain sale may meet his goals. This means that the donor can sell the remainder interest to charity for a price that is less than the fair market value of the remainder interest. The donor can use the cash received from the sale

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portion to fund his housing needs. The sale triggers recognition of capital gain on the sale portion of the transaction under the bargain sale rules.

2. *A bargain sale of the remainder interest*. If the donor knows he will need some cash from the transaction, he can consider a bargain sale of the remainder interest, instead. This transaction triggers capital gains on the non-charitable portion of the transaction under the bargain sale rules.[28]

3. *A bargain sale of the residence or the remainder interest in the residence in exchange for a charitable gift annuity.* If the donor needs income, he may make a bargain sale of the residence or the remainder interest in the residence in exchange for a charitable gift annuity. This transaction triggers capital gains for the non-charitable portion of the transaction under the bargain sale rules.[29]

4. *A sale during the donor's life term*. If the need is not identified until well into the life interest, the donor and charity may decide to sell the home and split the proceeds of the sale. The donor will receive the proceeds attributable to his life interest remaining in the property, and the charity will receive the balance. Since many charities plan to sell the property upon receipt, this will allow the charity to receive the cash earlier than expected, and will provided the donor with needed cash. This transaction triggers capital gain on sale of the asset.

- *Accelerate a bequest to create a charitable gift annuity.* For individuals in retirement who need additional income who plan to leave a bequest to charity (but do not have a taxable estate), a charitable gift annuity will generate a charitable income tax deduction in the year of gift, a lifetime annuity stream during life to supplement retirement income, and make an impact on the selected charity.

There is no single rule applicable to every client. Every taxpayer's personal and tax situation is different. The planner must consider the client's age and family obligations, the potential need to call on the assets, the need for flexibility, and his or her charitable objectives as well as the value of the tax deduction to the donor. Successful planning is predicated on careful consideration of the options, and selecting the gift plan that maximizes the charitable and tax benefits to the donor.

B. Using IRD Assets for Testamentary Gifts

Where the donor is focused on a testamentary gift, the single most applicable testamentary planning rule is to use Income in Respect of a Decedent (IRD) property to make charitable gifts. Income in respect of a decedent (IRD) creates unique opportunities for charitable planning. IRD assets – including IRAs, savings bonds, untaxed compensation, or any asset on which income tax is due at death – are often avoided by gift planners because of unpleasant tax consequences if transferred during life. In an estate, however, these assets can work magic when used to make charitable gifts.

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[28] *Id.* See Ltr. Rul. 8134106.

[29] *Id.* See Ltr Ruls. 8120089, 8305075 and 8806042.

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1. The Basic Principles of IRD Planning

IRD is the term defining income that has accrued but not taxed at a decedent's death. These assets reach beneficiaries with a tax burden; the decedent's estate, the named beneficiary, or person or entity to which the asset is properly distributed is responsible for payment.[30] The untaxed income has the same character in the hands of the recipient it had in the hands of the owner.[31] Since the highest estate tax rate in 2015 is 40%, and the highest federal income tax rate is 39.6%, the two taxes can take a significant bite out of the asset's value at death.[32]

The goal of using IRD assets in testamentary charitable planning is simple: give the most highly taxed assets to charity, leaving the non-taxed assets for heirs. If the transfer is structured properly:

- The estate receives a charitable estate tax deduction for the gift to charity;
- The income in the property is allocated to the charity, an entity that pays no tax; and
- The non-charitable beneficiaries receive estate assets with a stepped-up basis and no inherent tax burden.

Many commonly-held assets have IRD, including the following:

✓ *Retirement plans*, such as qualified employee benefit plans, Keoughs, IRAs, and other retirement benefits funded with pre-tax income. This would not include defined benefit plans (where there is the right to certain benefits but no ownership or right of disposition of the assets funding those benefits), Roth IRAs, or portions of retirement plans funded with after-tax dollars.

✓ *Savings bonds* with accrued, untaxed income. The most common form of bond with untaxed income is the EE (Patriot) Savings Bond, which is purchased at a discount of face value, and accrues interest for up to 30 years. Until August 31, 2004, it was possible to convert EE Bonds to HH Bonds without triggering tax on the accrued income; the Treasury no longer allows such a conversion. It was also possible until August 31, 2004 to defer interest on HH Bonds; this option, too, has been eliminated.

✓ *Deferred compensation*.

✓ *Compensation earned – but not received* – before death. This includes any payment for remaining vacation or sick time accruing to the decedent.

✓ *Accounts receivable*, earned but not received before death.

✓ *Unrecognized income from annuities*, such as deferred annuities.

✓ *Remaining installment sale payments*.

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[30] IRC § 691(a)(1).

[31] IRC § 691(a)(3).

[32] Most states also impose a state estate tax and income tax. The state estate tax can be claimed in part or in whole as a credit against the federal estate tax; the state income tax adds an additional overall tax burden to the IRD.

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- ✓ *Accrued interest* on stocks and bonds due at date of death.

Sometimes the inclusion of these assets in an estate is predictable. Retirement plans and savings bonds, for example, may comprise a large percentage of a decedent's assets. In other cases, the inclusion of the asset is not anticipated. An installment sale, for example, may have been executed after the estate plan was prepared. The principles of IRD planning are equally applicable to all assets with this form of income.

2. Retirement Plan Gifts

Retirement plans represent a major asset in many estates. Companies that formerly offered defined benefit plans now find it less expensive to provide defined contribution plans. Defined benefit plans – often referred to as pension plans – require a company to maintain an actuarially calculated reserve to pay retirees a specific annual benefit for life. The retired employee does not own the assets generating the benefit, and the cash flow normally ceases at the death of the retiree. Define contribution plans allow a company to make a retirement contribution that vests (or becomes owned by) the employee after a specific period of service. The employee is then responsible for investing the assets to generate a sufficient return in retirement. Many of these plans allow employees to defer income to further build retirement assets.

a. Retirement Plans with Income in Respect of a Decedent (IRD)

Profit Sharing Plans: A profit sharing plan is funded on a defined contribution basis, meaning that the company decides each year how much it will contribute. Employees become vested with ownership depending upon years of employment and the terms for vesting set out in the plan. Once an employee is vested, the funds are the property of the employee and can be distributed, if funds remain at death, through a beneficiary designation.

IRC Section 401(k) Plans: A 401(k) plan allows an employee to contribute pre-tax earned income to the plan. Many times profit sharing plans include a 401(k) feature so that employees may grow retirement savings through profit sharing contributions and 401(k) contributions. 401(k) assets are owned by the employee and any funds remaining in these plans can be distributed through a beneficiary distribution. The plan document may limit the manner of distribution so it is important that the plan owner and advisor be familiar with plan limitations.

IRAs: IRAs may be the most common form of retirement plan. Contributions to IRAs accumulate and grow tax-free. Distributions from the fund are taxed as ordinary income. Assets remaining at death are the property of the taxpayer and may be distributed in accordance with beneficiary designations.

Keoghs: Keogh plans are structured much like IRAs, but are tax-deferred retirement savings plans for the self-employed. Participants in Keoughs are subject to the same restrictions on distribution (between ages 59 1/2 and 70 1/2) as are participants in IRA's.

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b. Plans Not Characterized as Income in Respect of a Decedent

Pension Plans: Pension plans are company-funded retirement packages for employees. The traditional pension plan is a defined benefit plan, meaning that the employee, once vested, receives defined benefits from the plan at retirement. These benefits may continue for the life of the employee, or the life of the employee and his or her spouse. But the employee does not own the plan assets and cannot generally distribute those assets. The benefits cease at the employee's death, or at the second to die of the employee and his or her spouse.

Roth IRAs: Roth IRAs are not included in the group of retirement plans with IRD. Roth IRAs are funded with after-tax dollars. The assets in the plan then accumulate, and are distributed, tax-free. Taxpayers were allowed to covert standard IRAs to Roth IRAs by paying the tax due and making an election to move the funds. While these assets can still be used to make charitable gifts, the gift does not carry the double tax benefit – avoiding ordinary income tax and estate tax – that gifts of IRD retirement plans generate.

3. Lifetime Retirement Plan Gift Options

Retirement plans that offer opportunities for charitable planning include, but are not limited to, the following lifetime options.

✓ *Lifetime Outright Gift to Nonprofit Organization*

As of this writing, the IRA Charitable Rollover has not been extended and is not available. The only way to make a gift to charity under current law is to take a distribution from the plan, pay income tax on that distribution, make the gift to charity, and take a charitable deduction for the gift. Several obstacles prevent the taxpayer from receiving a $1 for $1 charitable gift credit for the gift. First, the charitable deduction is available only if the taxpayer itemizes. Second, many taxpayers receive limited benefit from itemized deductions because of the application of the three percent rule (reduced by legislation to 1% in 2008 and 2009, and eliminated in 2010 but revived in AFTRA 2012).[33] And finally, there may be other tax items on the taxpayer's return (such as prior year credits or carry forwards) that prevent the use of the deduction. If the donor withdraws funds during life to make a contribution to charity, consider using long-term appreciated property to make the gift to charity (rather than the cash withdrawn) to get the additional benefit of avoiding the tax on the gains in the appreciated property.

✓ *Lump Sum Distribution from Profit Sharing Plan Used to Fund Charitable Remainder Trust*

In the facts of Letter Ruling 200202078, the donor retired and received his retirement plan assets in the form of an in-kind distribution of company stock and other assets. He rolled a portion of the in-kind distribution into an IRA and received the balance of the shares outright. He transferred a portion the non-rollover shares to a charitable remainder trust. The taxpayer recognized ordinary income on the non-rollover shares to the extent of the retirement plan's basis in the stock. The net unrealized appreciation (the value of the shares in excess of the basis) was characterized as long-term capital gain. The IRS ruled that the contribution of the shares to charitable remainder trust did not trigger ordinary income or capital gain to the donor, and would not trigger tax to the donor or the trust upon subsequent sale (absent any unrelated

[33] IRC § 68.

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business taxable income or a prearranged sale). This ruling was consistent with two earlier rulings involving retirement plan transfers to charitable remainder trusts.[34]

4. Testamentary Options for Retirement Plans

Donors have a number of ways to use retirement plans to make testamentary gifts at death. Consider these options.

✓ *Outright Gift to Community Foundation at Death*

Retirement plan assets may also be used to make an outright gift to a community foundation. Community foundations offer donors a variety of options.[35] The transfer agreement can reserve the right to advise on distributions from the funds to the decedent's spouse and/or children, thereby providing family members with a means to make charitable distributions that they choose.

✓ *Outright Gift to Private Foundation at Death*

When a donor has substantial funds to contribute to charity, the taxpayer may want to consider creating and funding a private foundation.[36] A private foundation is used by many families to teach family members about philanthropy and to control the distribution of charitable dollars. The consequence of a distribution to a private foundation is that some tax may be due. Private foundations are generally considered to be one of the lowest forms of charitable life simply because they are subject to regulations and excise taxes that public charities are not required to bear. One of those taxes is an excise tax due on the foundation income, defined as interest, dividends, rents, and royalties. The distribution of retirement plan assets to the private foundation may create taxable income if the proceeds are subject to the 2 percent excise tax on investment income.[37]

✓ *Testamentary Outright Gift to Nonprofit Organization*

One of the simplest ways to maximize distributions from retirement plans is to name a charitable organization as beneficiary of all or part of the remainder. A distribution to charity of retirement assets at death (through beneficiary designation) avoids payment of both income and estate tax.

Generally speaking, when a client is making both charitable and non-charitable distributions from an estate, the charitable distributions should be made from IRD assets such as a retirement plan. The simple act of making a bequest from a retirement plan rather than the estate generally increases the net assets available for family. The distribution, especially when it represents only a portion of the assets,

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[34] See also LR 199919039, LR 200038050, and LR20035017.

[35] Get information about community foundations, and locate a community foundation in your community, by contacting The Foundation Center, <http://fdncenter.org>, or the Council on Foundations, <www.cof.org>.

[36] "Large" is a relative term. Private foundations are not cost-effective for assets of less than $1,000,000 and are really most appropriate at $3,000,000 to $5,000,000. See McCoy, Jerry J. and Kathryn W. Miree, *The Family Foundation Handbook (2008 Edition)* (CCH: 2007) for a full discussion of funding and managing family foundations.

[37] See IRC § 4940; See Ltr. Rul. 9341008 (July 14, 1993) and Ltr. Rul. 9838028; also see a different result for IRD from savings bonds under Rev. Rul. 80-118, 1980-1 CB 254.

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should be structured to preserve elections of the individual beneficiaries receiving the remainder of the retirement assets. Consider these three options.

- *Create a separate IRA* to hold the gift to charity, and designate the charity as the sole beneficiary of that IRA. While this is no longer necessary to maximize recalculation options, it may make the client's wishes clearer and to ensure the distribution is made prior to the required distribution date.

- *Designate a share of the IRA* to the charitable beneficiary(ies).

- *Make the assets payable to the estate and draft the will to specifically allocate the IRA to the charitable share.*[38] Consider this sample language:

  ✓ *An in-kind distribution* – "I direct that my IRA held at Merrill Lynch be distributed to XYZ Charity." Note: this alternative is also appropriate for other IRD assets such as savings bonds, accounts receivable, etc. This will have the effect of having the charity or CRT recognize the income from the IRD asset.[39] If the charitable recipient is a public charity or charitable remainder trust, no income tax will be due.

  ✓ *A non-pro-rata distribution* – A non-pro-rata distribution means that the will specifically directs that the IRD asset be allocated to a particular beneficiary's share rather than have it split on a pro-rata basis among all estate beneficiaries. Sometimes state law and/or the will may allow an executor the discretion to make non-pro-rata distributions. If this is the case, and the executor elects to distribute the IRD assets to charity, it may be possible to avoid taxable income on distribution.[40] However, if either the state law or the will gives the executor this power, a distribution of the IRD assets to a specific beneficiary may trigger the tax as a taxable exchange among the beneficiaries.[41] The safest way to do this is to address the issue directly.

  ✓ *Language directing that the bequest be made with IRD assets to the extent possible* – This language provides the greatest protection. The will might say: "I instruct that all of my charitable gifts, bequests and devises shall be made, to the extent possible, from property that constitutes 'income in respect of a decedent' as that term is defined in the Internal Revenue Code."[42] This allows the executor to claim a deduction for the IRD in the portion of the IRD assets passing to

[38] PLR 200452004 ruled an estate's assignment of IRAs to a charity as part of the residuary share of an estate would not cause the estate (or any estate beneficiary) to have taxable income.

[39] IRC § 691(a); Reg. § 1.691(a)-4(b)(2); Rev. Rul. 64-104, 1964-1 C.B. 223.

[40] Ltr. Ruling 9537011 (June 16, 1995).

[41] Rev. Rul. 69-486, 1969-2 C.B. 159.

[42] This language was recommended by Professor Christopher Hoyt, professor of law at the University of Missouri (Kansas City) School of Law in a presentation made at the National Conference on Planned Giving in October, 1999.

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charity. Without the language, the estate is limited to an estate tax deduction for the property and will not be able to claim an income tax deduction.[43]

Retirement plan proceeds should not be used to satisfy a debt or pledge, such as a capital campaign obligation. If plan proceeds are pledged on an enforceable debt or loan, the estate will be required to pay tax on the distribution.[44] Also remember that spousal consent is required for distributions from corporate retirement plans that are not paid to the spouse. Spousal consent is not required for distributions from IRAs.

✓ *Testamentary Gift in Exchange for Charitable Gift Annuity*

In an important 2002 ruling,[45] the IRS allowed a taxpayer to name a charity as the designated beneficiary of an IRA in exchange for a testamentary charitable gift annuity payable to a named individual beneficiary. Previous to this ruling, the IRS had approved designating a charitable remainder trust as the beneficiary of an IRA, but had not ruled on a similar arrangement with a charitable gift annuity. In this ruling, the court made four determinations: the IRA would not generate unrelated business income for the charity, the IRA would be included in the owner's gross estate for estate tax purposes, the estate could claim a deduction for the charitable portion of the charitable gift annuity, and the IRA proceeds would be income in respect of a decedent (IRD) to the charity, not the owner's estate. Unfortunately, the IRS did not discuss the potential IRD impact on the annuitant. This ruling adds a simpler option for IRA owners who want to create a life income arrangement for an heir at death.

✓ *Testamentary Gift to Charitable Remainder Trust*

Another way to structure retirement plan distributions is create a testamentary charitable remainder trust for the benefit of family members. Since a charitable remainder trust does not pay tax, the retirement assets are not subject to income tax.[46] Then, the estate will receive a charitable deduction for the charitable portion of the charitable remainder trust. Table 9 compares the result of an outright gift of a $250,000 retirement plan to the estate for family (for a $4,000,000 estate) and the gift of that retirement plan to a 5%, 20-year charitable remainder trust for family.

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[43] *Crestar Bank v. IRS*, KTC 1999-279 (E.D. Va. 1999); *Van Buren v. Commissioner*, 89 T.C. 1101 (1987); *Riggs National Bank v. U.S.*, 352 F.2d 812 (Ct. Cl. 1965).

[44] *John T. Harrington Estate*, 2 TCM 540, Dec. 13, 1943, 405 (M)

[45] Ltr. Rul. 2002230018.

[46] Although it is important to note that the retirement plan distributions are considered to be Tier I income and may impact the taxation of payments to beneficiaries of the charitable remainder trust.

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TABLE 9
COMPARISON OF $250,000 RETIREMENT PLAN TRANSFERRED TO FAMILY AND TO 20-YEAR 5% CRUT (ASSUMING $4,000,000 ESTATE, 35% TAX BRACKET, 15% CAPITAL GAINS BRACKET)

	$250,000 Bequest of Retirement Plan to Family	*$250,000 Bequest of Retirement Plan to 5%, 20-Year CRAT*
Total Estate	$4,000,000	$4,000,000
Total Taxes on $250,000 Retirement Plan	$99,000	$0
Effective Tax Rate on Retirement Plan (federal taxes only)	39.6%	$0
Net Bequest	$151,000	$250,000
Net Savings vs. Bequest		$99,000

5. Options for Savings Bonds

U. S. Savings Bonds, first introduced in 1935, are a widely held asset. More than 55 million Americans own savings bonds with a value in excess of $186 billion.[47] Since many of these bonds have accrued, untaxed interest, these assets are popular for testamentary charitable planning.

There are three types of savings bonds issued by the United States Government: Series EE/E Bonds, Series I Bonds, and Series HH/H Bonds.[48]

- ✓ *Series EE Bonds.* Series EE Bonds (formerly Series E Bonds) are savings bonds issued at a discount by the U.S. Government.[49] For example, a purchaser pays $50 to purchase an EE Bond with a $100 face value. The bond matures at face value and then continues to accrue interest for up to 30 years.[50] Purchasers can elect to report the accrued interest on the bonds annually or to defer recognizing income until redemption; most chose to defer. When holders of Series EE/E Bonds with deferred income contribute the bonds to a charity during life, the gift is valued at the full fair market value of the bond (rather than the discounted value paid for the bond), but the donor must report the accrued interest (as ordinary income) in the year of the gift.[51] Conceptually, this is the opposite tax result from a gift of appreciated stock for which the donor receives a charitable deduction equal to market value and avoids the capital gains tax on the appreciation.[52] A donor would generally be better off to simply make a gift of cash.

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[47] <www.aarp.org/financial-investsave/Articles/a2002-10-08-ussavingsbonds.html>.

[48] For detailed information on United States Savings Bonds, go to <www.publicdebt.treas.gov/sav/sav.htm>.

[49] For savings bonds redemption values, six month earnings as an annual yield, and yield from issue date for Series EE/E bonds can be found at www.publicdebt.treas.gov/sav/savreport.htm>>.

[50] Bonds purchased before November 1965 accrue interest for up to 40 years.

[51] Reg. § 1.170A-4(a)(3).

[52] Actually, the result is generally much worse, since the gain avoided on gifts of appreciated securities is long-term capital gain, while the income recognized on disposition of E or EE Bonds is taxed as ordinary income.

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Series EE Bonds could be converted to HH Bonds (see below) through August 31, 2004, without triggering tax on the accrued interest in the bond.[53] However, the bond could not be transferred to another (charitable or non-charitable) beneficiary at this point without triggering the tax.[54] Likewise, Series EE/E Bonds cannot be reregistered in the charity's name during life without triggering the tax. The only way to avoid recognition of ordinary income on these bonds is to transfer them to charity through a specific bequest under the will (or, if the bonds are held in a revocable trust, through a testamentary disposition to charity in that trust).[55] A specific bequest of the bonds will shift the accrued income to charity and avoid taxation as income in respect of a decedent in the donor's estate.[56] This is not possible when bonds are owned jointly with right of survivorship, since these bonds will pass to the survivor and will not be subject to the terms of the will. The survivor of the two interests may leave the bonds to charity under will.

- ✓ *Series HH Bonds.* Series HH/H Bonds are savings bonds issued at face value that pay annual interest. When donors contribute Series HH/H bonds to charity during life, the gift is valued at the full fair market value of the bond. If, however, the HH/H bonds have been converted from EE/E bonds (and the interest was deferred, rather than paid, on conversion), the gift to charity will trigger the deferred ordinary income accrued during the period the donor owned the EE/E bonds.[57] Until August 31, 2004, the owner had an option to reinvest interest on these bonds; that is no longer possible.[58]

- ✓ *Series I Bonds.* Series I Bonds are the most recent addition to the savings bond options. These bonds, first offered in September, 1998, are sold at face value and pay interest that is adjusted twice a year to reflect increases in the Consumer Price Index for all Urban Consumers (CPI-U). Interest is compounded semi-annually. The bonds have a thirty year maximum, but may be redeemed for cash after a six-month holding period. The interest on the bonds is deferred for federal tax purposes during the life of the bond. The Bonds are exempt from state and local income taxes. The gain in these bonds is taxed as ordinary income in the year of maturity, redemption, or disposition. Therefore, these assets make poor gifts for charity during life, but make excellent gifts to charity under will.

Savings bonds may be owned in one of three ways: sole ownership, joint ownership, or sole with remainder beneficiary.[59]

- ✓ *Sole ownership* implies the bond is in a single individual's name; that bond will become a part of the owner's estate on death.

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[53] <www.publicdebt.treas.gov/sav/savinvst.htm>.

[54] See Letter Ruling 8010082 for a discussion of this result.

[55] See Ltr. Rul. 8010082 (December 13, 1979) for further information on EE/H bonds. Also see Ltr. Rul. 9507008, where IRS ruled that savings bonds in a revocable trust with testamentary provisions used to discharge pecuniary bequest to charity triggered recognition of income in respect of decedent in the trust.

[56] IRC § 691(a)(1).

[57] Ltr. Rul. 8010082.

[58] <www.publicdebt.treas.gov/sav/savinvst.htm>.

[59] See the Treasury web site cited earlier.

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- ✓ *Joint ownership* gives full rights of ownership to both individuals. Either named owner can redeem the bond or exercise elections. Registering a bond jointly transfers ownership outside of the probate process at the first death; at the death of the survivor, the asset becomes a part of that individual's estate assets.

- ✓ *Sole ownership with a designated surviving beneficiary* leaves ownership rights with the registered owner, but names a beneficiary at death, again allowing the bond to bypass probate. This also allows a deferral of the tax on accrued income since the income will not be taxed until the bond is redeemed.

The accrued income in the bonds is classified as IRD. It is recognized when the bonds are disposed of, redeemed, or reach maturity, which occurs first.[60] The tax is generally paid by the named recipient. There is one exception to the rule. The executor may make an (irrevocable) election to report the interest on the decedent's final income tax return.[61] This option may create a better net result for the beneficiaries if the decedent's income tax rate is lower than the estate's. It is not recommended when a public charity (or private foundation) is designated to receive the bonds since it will result in payment of taxes when otherwise none would be due.

Savings bonds can be used in the same manner as retirement benefits in testamentary charitable plans. This includes the following options:

- ✓ Make a specific devise of the bonds to a public charity (no income or estate tax should be due), a private foundation (a 2 percent/1 percent tax is paid by private foundations on all income), a community foundation advised fund, or other direct charitable beneficiary. This is best accomplished by including specific language to this effect in the will.

- ✓ Make a specific devise of the bonds to a testamentary charitable remainder trust. The charitable estate tax deduction for the charitable portion of the gift (the non-income portion) will reduce the estate tax, and the charitable remainder trust's tax exempt status (a charitable remainder trust pays no tax unless the trust has unrelated business taxable income) allows it to avoid tax on the accrued bond income. To ensure this result, the savings bonds should be transferred to the charitable remainder trust and redeemed inside the trust. (If the bonds are redeemed by the estate, the income will likely be included on the estate's income tax return. It is unclear whether the estate can claim a deduction when the proceeds are then transferred to the charitable remainder trust.)

[60] Reg. § 1.691(a)-2(b); Rev. Rul. 4-104, 1964-1 C.B. 223.

[61] Rev. Rul. 68-145, 1968-1 C.B. 203.

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III. IDEAS #3 AND #4: USING THE FAMILY BUSINESS TO MAKE A CHARITABLE GIFT

A. The Family Business Market

The family business is the single most important asset held by many individuals – for financial and emotional reasons. The business may represent the family's most significant source of income and also contribute to its stature in the community. In addition, a first generation owner may feel the business represents his life's work, uniquely reflecting his or her business principles.

Family businesses – C Corporations, S Corporations, LLCs, LLPs, partnerships, and other less formal arrangements – are often the largest single asset of wealthy clients. Consider these statistics:

- Family businesses represent 80 to 90 percent of all business entities.[62]
- Family businesses contributed 64% of GDP and employed 62% of the U.S. work force.[63]
- The generational transfer attrition rate is high: 70 percent do not survive to the second generation; 88 percent do not make it to the third generation; and 97 percent do not make it to the fourth generation or beyond.[64]
- A surprising 19 percent of family business participants have not created an estate plan other than writing a will; only 37% have strategic plans; and 85% of those that have identified successors pointed to family members.[65]
- Leadership of 39 percent of family enterprises will change hands over the next five years.[66]
- Wealth holders in family owned firms are interested in passing their wealth to the next generation, as well as their values. They want their descendants to earn their income and engage in philanthropy through giving and volunteering.[67]

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[62] J. H. Astrachan and M. C. Shanker, "Family Businesses' Contribution to the U.S. Economy: A Closer Look," Family Business Review (September 2003); Isabella McPeak, Family Business Statistics in the US, www.peakfamilybusiness.com/2011/10/25/family-business-statistics-in-the-us.

[63] *Id.*

[64] Joseph Astrachan, Ph.D., editor, *Family Business Review*, www.ffi.org.

[65] University of Southern California Marshall School of Business, Facts On Family Businesses, <www.marshall.usc.edu>.

[66] Raymond Institute/MassMutual American Family Business Survey (2003).

[67] Bankers Trust Private Banking/Deutsche Bank, Wealth with Responsibility Study (2000).

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B. Creating a Charitable Gift in Conjunction with the Sale of a Family Business

Many of today's business owners have built their own companies and own all or the majority of the stock in their non-publicly traded corporation. As the business owner reaches retirement age he often sells the business. As a part of this planning process, the small business owner should consider combining personal charitable goals with the disposition of the business by gifting some of the closely held stock to a charitable remainder trust. The capital gain on the shares gifted to the charitable remainder trust will not be taxed, and the charitable deduction can help shelter gain on shares sold outside the trust. The trust's shares can later be purchased by the purchaser of the business at a fair market value.[68] In the example shown in Table 10, the donor is age 68, and spouse is age 65, the gift uses a CFMR of 2.2%, the business has a market value of $5,000,000 and a basis of $1,000,000, the market value of the gift is $500,000, and the gift is make to a two-life net income with makeup charitable remainder unitrust with a FLIP provision.

TABLE 10
C CORPORATION STOCK TO CHARITABLE REMAINDER UNITRUST (NIMCRUT WITH FLIP PROVISION)
$5,000,000 Market Value of Closely Held Business; $1,000,000 Tax Basis of Shares;
68 Year Old Donor with 65 Year Old Spouse; $500,000 5% Charitable Remainder Unitrust[69]

STEP ONE $500,000, 5% NIMCRUT with FLIP Provision	*STEP TWO Sale of Remaining Shares to Purchaser*	*STEP THREE*
$500,000 Gift	$4,500,000 Sale	Purchaser buys $500,000 of stock from CRUT
$100,000 Tax Basis	($900,000) Tax Basis	
$178,725 CD	$3,600,000 Gain	
$25,000 First Year's Income	$540,000 Tax at 15%	

C. Creating a Charitable Gift When the Family Business Will Pass to the Next Generation

In another scenario, the closely held corporation may have many accumulated earnings that will be taxed to the recipient if distributed. In this case the charitably inclined business owner may want to contribute shares of the closely held stock to a charitable remainder trust. The closely held corporation can then use its accumulated earnings to buy back the stock and retire it as treasury stock. Key points include the following:

1. *If structured properly, there is no constructive dividend to the contributing shareholder and no adverse consequences to the corporation.*

2. The majority corporate owner/donor may still be the majority owner after the gift with planning.

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[68] Note: You must avoid a prearranged/step transaction. There can be no repurchase agreement at the time of the contribution of the shares to the charitable remainder trust.

[69] Calculations are based on a 2.2% CFMR.

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3. *If the interest is less than a majority interest in the corporation, the IRS may require a minority discount be applied to the appraised value of the shares.*

4. *The redemption offer must be made to all stockholders. Even though all shareholders are offered the opportunity, the trust may be the only shareholder to redeem.*

5. There cannot be a prearranged sale agreement with this transaction.[70]

IV. IDEAS #5 AND #6: GIFTS THAT TAKE CARE OF FAMILY

A. Combining a Charitable Gift with Care of a Special Needs Family Member

Sometimes a parent or grandparent is faced with the responsibility of taking care of a disabled child. While federal or state medical assistance is available for those with no assets, families like to provide for special needs when possible without eliminating the possibility of outside coverage. In this case, the planner may want to couple a charitable remainder trust with a special needs trust.

A special needs trust involves a transfer of assets to a trust to make specific types of payments to the trust beneficiary without disqualifying that beneficiary for public assistance benefits such as SSI and Medicaid. There are three ways that this trust may be structured.

- It can be created by a family member, with the family member's funds, for the benefit of the disabled individual.
- It can be created through a court proceeding using the disabled individual's funds.
- It can be part of a pooled fund managed by charity.

✓ *A Special Needs Trust Created By a Family Member.* One of the most common approaches to creating a special needs trust is to create a trust for the benefit of a disabled individual using a family member's (not the disabled beneficiary's) funds. The trust must be created by a family member other than the trust beneficiary. In other words, Charles cannot take the assets left to him by his parents and create this type of trust. However, his parents could have created such a trust during life, or at death under their wills. The trust must also have a trustee, which can be anyone qualified to serve under state law other than the beneficiary. Once established, the trustee makes distributions to the beneficiary to meet the needs listed in the trust.

The government specifically recognizes special needs trusts, so long as they meet these requirements:

- It must be established by a family member (other than the beneficiary).
- It must be managed by a trustee (who is not the beneficiary).

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[70] For the latest ruling on the assignment of income issue, see *Gerald A. Rauenhorst, et ux. v. Commissioner, 119 T.C. 9 (7 Oct 2002)*. In these facts, the taxpayers owned stock in a closely-held company and warrants allowing the purchase of additional shares. The taxpayers were approached by a purchaser interested in acquiring taxpayers' stock and warrants. Following the purchase offer, the taxpayers assigned the warrants to four charities and sold their remaining stock to the purchaser. The four charities, in unrelated transactions, also sold their warrants to the purchaser. On audit, the IRS assessed the taxpayers with the capital gain on the warrants as an anticipatory assignment of income. The court dismissed the IRS claim, relying on the test in Revenue Ruling 78-197 that attributes income to the donor only if the donee, after receipt of the gift, is legally bound or can be compelled to sell. Since the charities had the option to sell, but were not obligated to do so, the capital gains were properly attributed to the charities.

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- It must give the trustee absolute discretion to make distributions.
- It should not give the beneficiary more income or resources than permitted to qualify for benefits.
- It can only be used to provide supplementary needs.
- It must provide instructions for final arrangements (funeral expenses).
- It directs what will happen to assets left in the trust at death.
- It must protect assets from credits or agencies seeking funds to pay debts of the beneficiary or beneficiary's family.

✓ *Special Needs Trust Created by the Court*. Sometimes an individual who is disabled enough to qualify for social security owns assets and needs protection. In these cases, a special needs trust can be established by the disabled person's parent, grandparent, legal guardian or the court. This type of trust is permitted only if the individual is under age 65 at the time of creation of the trust. The trust is structured to make the same forms of discretionary payments but has one major distinction. At the death of the beneficiary, the funds remaining in the trust must first be used to repay any benefits that have been paid on the beneficiary's behalf.

✓ *Pooled Trusts*. Non-profit organizations in some states offer pooled special needs trusts. These non-profit serves as trustee, manages the money, and makes the distributions to the beneficiary. At the beneficiary's death, any remaining assets are held for the benefit of other disabled individuals. This type of trust can be funded by the beneficiary or the beneficiary's parents. However, all assets are transferred to the trust and are owned by the nonprofit.

The trust may make payments that contribute to the quality of life, rather than the essentials of life – such as vacations, eye glasses, a motorized wheelchair, or entertainment – but should not make payments for basic needs (housing, food, clothing) or fixed monthly payments that exceed set income limits. If it does, government benefits may be reduced or eliminated.

There have been several letter rulings from the IRS that allow a donor to pay the income stream of a charitable remainder trust to a special needs trust (or to make the distributions from the trust to meet special needs).[71] Normally, the charitable remainder trust distribution must be paid directly to the individual. Under the rulings, the distribution was allowed to be paid to a special needs trust, which then distributed the funds in a discretionary fashion to the disabled beneficiary. This allows a donor to create a charitable remainder trust to benefit both the disabled child as well as the charity.

There is one caveat. This plan requires creation of two trusts: a special needs trust and a charitable remainder trust.[72] Further, taxpayers cannot rely on a letter ruling and must obtain their own ruling to be safe. Therefore, this arrangement is a bit more expensive than the normal trust creation.

B. Caring for Parents Using Charitable Gifts

An increasing use of charitable remainder trusts and gift annuities is to fund needs of elderly parents. Increasing nursing home costs and health care costs often result in an unanticipated depletion of

[71] See, for example, Revenue Ruling 76-270, 1976-2 C.B. 194.

[72] For a ruling involving discretionary payments from the charitable remainder trust (without creating a separate special needs trust, see Revenue Ruling 77-73, 1977-1 C.B. 175.

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assets requiring that children fund the cost of lodging and care. Create a charitable remainder trust with an income stream to the parents. This allows a child to receive a charitable deduction for the gift and to provide a stream of income to a parent. Gift tax must be paid (or unified credit used) on the value of the income stream created for the parent. In this example, the children created a $100,000 5.7% charitable gift annuity for the joint lives of parents, ages 78 and 82. This gift calculations uses a 2.2% CFMR. The results are shown in Table 11.

TABLE 11
$100,000 6.5% CHARITABLE GIFT ANNUITY FOR AGES 78 AND 82

Principal Amount	$100,000.00
Charitable Deduction	$ 42,715.57[73]
Annual Income to Parents (5.7%)	$ 5,700.00
Tax-free Portion	$ 4,440.65
Ordinary Income Portion	$ 1,259.35

V. IDEA #7: GIFTS TO FUND RETIREMENT

It is easy to understand the popularity of charitable gift annuities as a planned giving option.

- Charitable *gift annuities are easy for charities to explain and donors to understand.*
- The *gift provides the donor with a guaranteed, specific income stream*. Often this income stream is higher than the donor can receive from a certificate of deposit, a U.S. Treasury bond, or other investment.
- The *transaction is part gift*, meaning that in creating a charitable gift annuity the donor also makes a gift to a favorite charity.
- The *gift generates a charitable income tax deduction for the donor* in the year in which the gift is made[74]
- The *transaction creates beneficial capital gain treatment* for the donor who contributes appreciated property.
- *Creating the gift is simple*, requiring a one or two-page governing instrument supplied by the charity.

A. Current Charitable Gift Annuity for Those in Retirement

Many retired individuals – or those planning for retirement – create charitable gift annuities to generate more income. In this example, Doug and Anita Jones, ages 70 and 71, used a maturing certificate of deposit to create a charitable gift annuity. The certificate of deposit had a renewal rate of

[73] The gift portion is $57,284.43.

[74] Gift annuities involve an outright gift to charity deductible under IRC § 170(c). The contract element of the life interest is addressed in IRC §§ 501(m)(3)(E), -(5),514(c)(5).

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.75% ($187.50); the charitable gift annuity provided a yield of 4.6% ($1,150). In addition, $306.33 of the charitable gift annuity payment is ordinary income, while the remaining $843.67 is tax-free return of income.

TABLE 12
CHARITABLE GIFT ANNUITY FOR COUPLE AGES 70, 71[75]

Contributed amount:	$25,000.00
Charitable deduction:	$ 8,042.33
Annuity amount (4.6%)	$ 1,150.00
Tax-free payments:	$ 843.67
Ordinary income:	$ 306.33

B. Deferred Charitable Gift Annuities for Those in 40's or 50's

Deferred charitable gift annuities offer a donor a way to make a series of contributions to a charity during high-income-earning-years in exchange for a series of charitable deferred gift annuities whose payments begin during retirement. Those payments can be structured so that they all begin on the same date.

TABLE 13
45 YEAR-OLD DONOR MAKING ANNUAL $25,000 PAYMENTS
AGE 45 THROUGH 54[76]

Age at Date of Gift	*Amount of Contribution*	*CGA Rate * Notes the rate had to be reduced from published rates to meet the 10% test*	*Charitable Deduction*	*Annual Payment Single Gift*
45	$25,000	9%	$7,254.48	$2,225
46	$25,000	8.7%	$7,415.56	$2,175
47	$25,000	8.4%	$7,591.42	$2,100
48	$25,000	8.1%	$7,782.84	$2,025
49	$25,000	7.9%	$7,772.87	$1,975
50	$25,000	7.6%	$7,992.91	$1,900
51	$25,000	7.4%	$8,001.46	$1,850
52	$25,000	7.2%	$8,017.00	$1,800
53	$25,000	6.9%	$8,281.82	$1,725
54	$25,000	6.7%	$8,317.33	$1,675
Total	$250,000		$78,427.69	$19,450

[75] Calculations based on a 2.2% CFMR..

[76] Deductions based on 2.2% CFMR. Calculations increase age by 1 year for each calculation, assuming payments begin at age 65.

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As an alternative, the donor can structure the payments so that the cumulative payments increase over retirement years by setting staggering start dates for the payments. This increase in payments will help the recipient overcome the effects of inflation during the retirement years.

C. Flexible Deferred Charitable Gift Annuity for the Ultimate Flexibility

A variation on the deferred gift annuity theme is the flexible deferred charitable gift annuity. Letter ruling 9743054 allows greater flexibility in the structure of deferred charitable gift annuities. This ruling allows a donor to contribute funds in exchange for a deferred charitable gift annuity and to retain the right to select the date on which the payments begin. The later the payment begins, the larger the annual payment will be. This allows the client control of the date payments start, and the amount of those payments. The following example shows the deferred payment options at various dates for a 60 year-old donor who creates a $25,000 flexible deferred charitable gift annuity.

TABLE 14
$25,000 DEFERRED FLEXIBLE GIFT ANNUITY; 45 YEAR-OLD DONOR; CALCULATIONS ASSUME DONOR IS AGE 60, FIRST PAYMENT MAY BE MADE AS EARLY AS AGE 65 AND AS LATE AS AGE 74; CHARITABLE DEDUCTION $8,164.50

Effective Start Date	*Age at Start Date*	*Annuity Payment Rate*	*Annuity Amount*
9/30/2018	65	5.5%	$1,375
9/30/2019	66	5.8%	$1,450
9/30/2020	67	6%	$1,500
9/30/2021	68	6.3%	$1,575
9/30/2022	69	6.6%	$1,650
9/30/2023	70	7%	$1,750
9/30/2024	71	7.5%	$1,875
9/30/2025	72	7.9%	$1,975
9/30/2026	73	8.3%	$2,075
9/30/2027	74	8.9%	$2,225

VI. IDEA #8: SELECTING THE RIGHT ASSET

There may be times your client wants to make a charitable gift but does not have sufficient cash to do so. Sometimes the best asset to contribute – even if cash is available – is non-cash property such as real estate, securities or even a life insurance policy.

Selecting the right asset is an important element of gift planning. To pick the right asset, consider the donor's dependence on the asset or its income, the form of the gift, the tax benefits and the cost of making the gift. The following assets are most commonly used to make gifts in lieu of cash.

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Marketable securities – Marketable securities (stocks and bonds) are appropriate for almost every type of gift. Publicly-traded stocks are the single most popular non-cash gift. Stocks often contain long-term appreciation, generate little income (on average, about 1.3%) and can easily be sold on receipt. The gift generates a charitable income tax deduction for the market value of the stock and allows the donor to avoid capital gains tax on the appreciation. Bonds are used to make gifts less frequently. Bonds generally have a higher income stream than stocks or cash and contain little or no appreciation. While bonds may be used to make gifts if cash is not available, they may not create as great a tax benefit for the donor as appreciated stock.

Privately held securities – Privately-held securities may be the single largest asset held by some clients. These securities make good assets for outright gifts, testamentary gifts and even charitable remainder unitrust gifts as long as there is some market or mechanism for sale after contribution. Always check with the charity before contributing privately-held stock since some will not accept this asset for pooled income funds or charitable gift annuities because of uncertainty of the timing and proceeds of sale. For the same reason, privately held securities may not be appropriate for a charitable remainder annuity trust unless the trust has other assets with which to make the annuity payment. The donor is required to obtain a qualified appraisal establishing the value of privately-held securities when the gift exceeds $10,000.

Real estate – Real estate (including commercial, residential, undeveloped land, timber, and oil and gas interests) makes an excellent outright gift, testamentary gift or contribution to a charitable remainder unitrust (with net income, net income with makeup or flip provisions), or even a deferred charitable gift annuity. Real estate is not generally appropriate for gifts to create a standard charitable gift annuity, charitable remainder annuity trust or pooled income fund because of the uncertainty of the asset's sale timing and proceeds. The donor is required to obtain a qualified appraisal when the gift exceeds $5,000 and is generally required to supply an environmental assessment. The donor should also be prepared to supply details on the costs associated the property including taxes, maintenance and other costs.

Life insurance – Life insurance is an excellent gift for donors who have old policies that are no longer needed for protection of family or those who want to purchase a new policy to ensure a specific gift to charity at death. When the donor contributes an existing policy to charity, he receives a deduction equivalent to the policy's replacement value. Since the policy has no publicly established value, he must obtain a qualified appraisal when that value exceeds $5,000. If he contributes cash to the charity to purchase a new policy, he may deduct the cash contribution and any additional contributions made to make premium payments.

Tangible personal property – Collectibles, art or other tangible property may also make good assets for outright gifts, although they are poor choices for life income arrangements. The uncertainty of the timing and proceeds of sale make charities unwilling to accept these assets for charitable gift annuities or pooled income funds. In addition, the related use rule limits the deduction to the donor's basis unless the gift is used by the nonprofit in fulfilling its mission, and personal property gifts contributed to charitable remainder trusts are generally not deductible until sold. Donors are required to obtain qualified appraisals for gifts in excess of $5,000.

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VII. IDEAS #9 AND #10: GIFTS WHERE GIFT AND ESTATE TAXES ARE NOT AN ISSUE

The Tax Reform Act of 1969[77] created massive changes in the structure, form, and treatment of charitable entities, creating strict forms, tax structures, and operating rules for private foundations and charitable remainder trusts. These laws have created stress for planners over the years because it took expertise to get the forms and documents within the guidelines, and was even more limiting in the assets appropriate for entities and the effective long-term operation. Individuals who wanted to add a personal trust to their foundation or trust structure quickly found these creatures of the tax code allowed little variation or personalization.

Traditionally, few taxpayers have been affected by the estate tax. In the Summer 2005 *Statistics of Income Bulletin*, the IRS reported 1.17% of the 2.4 million decedents who died in that year had taxable estate returns. In that year, estate tax return filing was required with a gross estate of $1 million or greater. See Table 15 for an historical perspective on the number of decedents required to file estate tax returns, and the percentage of taxable returns.

TABLE 15
POPULATION AFFECTED BY ESTATE TAX
SELECTED YEARS BETWEEN 1934 AND 2001[78]

Year	*Number of Deaths*	*Estate Tax Returns Filed*	*Number of Taxable Returns*	*% of Deaths Requiring Estate Tax Returns/Taxable*
1934	983,970	N/A	8,655	NA/.88%
1935	1,172,245	N/A	9,137	N/A/1.08%
1940	1,237,186	N/A	13,336	N/A/1.12%
1944	1,238,917	N/A	13,869	N/A/1.12%
1950	1,304,343	N/A	18,941	N/A/1.45%
1954	1,332,412	N/A	25,143	N/A/1.89%
1960	1,426,146	N/A	45,439	N/A/3.19%
1965	1,578,813	N/A	67,404	N/A/4.27%
1969	1,796,055	N/A	93,424	N/A/5.2%
1976	1,819,107	N/A	139,115	N/A/7.65%
1982	1,897,820	N/A	34,426	N/A/1.81%
1985	2,015,070	N/A	22,326	N/A/1.11%

[77] Pub. L. 91-172, title IV, § 901(c), Oct. 22, 1986, 83 Stat. 618.

[78] All figures from 1934 through 1985 from Internal Revenue Service, fall 2002 Statistics of Income Bulletin, Table 17, Estate Tax Returns as a Percentage of Adult Deaths, Selected Years of Death, 1934-1999; number of deaths data 1996-1999 from National Vital Statistics Report, Vol. 49, No. 8, September 21,2001, p. 16; 2000 death figures from National Vital Statistics Reports, Vol. 51, No. 5, March 14, 2003, p. 3; data on estate tax returns filed 1990 through 2000 from Spring 2004 Statistics of Income Bulletin, “Federal Estate Tax Returns 1998-2001”.

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Year	*Number of Deaths*	*Estate Tax Returns Filed*	*Number of Taxable Returns*	*% of Deaths Requiring Estate Tax Returns/Taxable*
1990	2,079,034	50,367	23,104	2.42%/1.11%
1995	2,252,471	69,755	31,563	3.1%/1.4%
1996	2,314,690	79,321	37,711	3.42%/1.63%
1997	2,314,245	90,006	42,901	3.89%/1.85%
1998	2,337,256	97,856	47,475	4.19%/2.03%
1999	2,391,398	103,979	49,863	4.35%/2.09%
2000	2,403,351	108,322	52,000	4.5%/2.16%
2001	2,363,100	Unknown	49,911	Unknown/2.11%
2002	2,363,100	Unknown	49,911	Unknown/1.17%

Going forward, even fewer decedents will be affected by estate tax. The Joint Committee on Taxation projects that in 2015, with a $5.43 million individual exclusion, only 2 in every 1,000 decedents (.2 percent) will will subject to estate tax.[79] Since this limit will cover the transfers for the vast majority of all American taxpayers, those taxpayers are now free to pursue charitable gifts and create charitable structure without using traditional charitable gift forms.

A. Partial Interest Gifts - a World of Flexibility Without the Need for the Charitable Deduction

Under current law, a charitable deduction is not generally allowed for a gift of less than an entire interest in property.[80] For example, a donor who allows a charity to use a building rent-free has not made a charitable gift, since the leasehold is a partial interest in the property.[81] A donor who gives his paintings to a museum, retaining the right to hold those paintings for life, has not made a charitable gift because he has transferred less than a full interest in the paintings. There are some partial interest gifts that do qualify for a charitable deduction:

- Charitable gift annuities (technically a bargain sale);
    - Must have a charitable value of at least 10% at funding
    - Annuitants are limited to two lives
    - Contract must be fixed income for life (income may not vary)
- Charitable remainder annuity trust or charitable remainder unitrust[82]

[79] Joint Committee on Taxation, "History, Present Law, and Analysis of the Federal Wealth Transfer Tax System," March 16, 2015, https://www.jct.gov/publications.html?func=startdown&id=4744.

[80] IRC §170(f)(3)(A).

[81] Reg. §1.170A-7(a).

[82] IRC §170(f)(2)(A). *See* Chapter 11 for more detail on charitable remainder trusts and pooled income funds.

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  - Must have a charitable value of at least 10% at funding
  - Cannot be funded with mortgaged property
  - If funded with a personal resident, the donors/owners cannot continue to live in the property even if they pay a far rent because of of self- dealing rules (private foundation prohibited transaction rules)
  - Charitable remainder trusts are also subject to other prohibited transaction rules including jeopardizing investments and taxable expenditures
  - Flip unitrusts "flips" cannot be within the discretion of the trustee
- Pooled income fund;
  - May only be offered by publicly support IRC §501(c)(3) entities;
  - Variable income - whatever is produced by the units
- Charitable lead annuity trust or charitable lead unitrust (grantor and non-grantor forms);[83]
  - Prohibitions against self-dealing, excess business holdings, joepardizing investments, taxable expenditures
  - Generally do not use donor or spouse as Trustee if the goal is to remove assets from estate (non-grantor)
- A remainder interest in a home or farm;[84]
  - Not allowed for commercial, undeveloped, or similar investment property
  - Charitable deduction may not include personal property
- An undivided portion of the donor's entire interest;[85] or
  - Must be an undivided portion of all interests - cannot separate income from underlying property interest
  - Cannot direct that income be separated for a term of years or a life
- A qualified conservation easement.[86]

Partial interest gifts that do not qualify include the following:

- *Gifts of future interests.* A gift of a future interest in a property is not deductible until all intervening interests in the assets or rights to possession or enjoyment of the property have expired or are no longer held by the donor or related party.[87216] However, a gift subject to a condition or event so remote as to be negligible will not be disqualified.[88]

- *Gifts divided for the purpose of transfer.* The donor does not receive a charitable deduction for a gift that has been divided for the specific purpose of making a gift of a partial interest to charity.[89]

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[83] IRC §170(f)(2)(B). *See* Chapter 11 for more detail on charitable lead trusts.

[84] IRC §170(f)(3)(B)(i).

[85] IRC §170(f)(3)(B)(ii).

[86] IRC §170(f)(3)(B)(iii).

[87] Reg. §1.170A-5(a)(1); "related" is defined in IRC §§267(b), 170(a)(3).

[88] Reg. §1.170A-14(g)(3).

[89] Laura Hansen Dean, presentation to the Houston Planned Giving Council, November 2012.

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- *Work of art separated from copyright.* An artist may not receive a deduction for a work of art that is separated from its copyright for income tax purposes, although such a gift is deductible for estate and gift tax purposes.[90] A donor may own both the copyright and the original work - or just one of those. A creator/author or widow/widower, child or grandchild who inherited just the copyright or the original work and the copyright - by federal law retains the right to revoke a gift/grant of a copyright - so a lifetime gift of the copyright or the copyright and the original work is not a gift of the donor's entire interest, so no income or gift tax deduction is allowed. A copyright owned by a third party ho did not inherit the copyright may give all or an undivided portion of the copyright to a charity, and if the donor owns both the copyright and the original work, the the donor must give both the copyright and the original work to charity for the gift to be deductible.[91]

- *Patents.* A gift of less than the entire interest occurs when the owner retains the right to license the patent to others, manufacture or use any product covered byt he patent or places conditions on the gift that would result in the patent being returned to the donor (unless the likelihood of that return is so remote as to be negligible).[92]

- *The right to use property at less than fair market rental.* Current there is not an income tax deduction or gift tax deduction because this is a non-qualified partial interest gift.

Examples of testamentary options for donors:

- An individual can make a gift of the income from stocks to a family member for life, and then the transfer of the assets and income to charity.
- An individual can transfer the income from an investment portfolio to charity for a term of years, with remainder to family.
- A donor can devise surface rights to a charity, with mineral rights to heirs.
- A donor can devise a percentage interest in a business' profit without transferring ownership (and absolving the charity from a share of the costs or obligations).
- Can give a museum a share of the interest in a collectible, or the right to display it for a portion of the year.

While most of these non-qualified gifts will not qualify for income tax deductions or estate tax deductions, the estate tax deduction is no longer important for the vast majority of the decedent population and creates opportunities through estates to transfer interests in non-qualified ways to meet personal planning goals.

B. Irrevocable Trusts with Charitable and Non-Charitable Beneficiaries

Combining personal and charitable goals becomes much easier when creating irrevocable testamentary trusts when the decedent has no concerns about estate and gift tax. Charitable remainder trusts and charitable lead trusts are rigid vehicles, and somewhat limiting in terms of contributed assets, required ranges of distributions, and the prohibited transaction rules applicable to these entities. If the donor is working in a testamentary environment and is not worried about estate tax, why not simply create an

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[90] IRC §2522(c)(3) (gifts) and IRC §2055(e)(4) (estates). Indeed, artists are not allowed an income tax charitable deduction for their works of art because those gifts are tangible personal property and limited to basis.

[91] A creator

[92] *Id.*

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irrevocable split interest trust that fits the donor's goals? The trust can provide for payments or income and/or principal to the decedent's family members, heirs, or other beneficiaries and distribute the remainder to charity. Or, it can make payments to charities and/or individuals for a period of time (as determined by the decedent's spouse or other trustee) and then terminate to the donor's designated beneficiaries. In these situations, the focus should be on designing a set of distribution powers and terms that can be effectively administered, and managing the income tax consequences inside the trust. (If these are irrevocable trusts they will likely be taxed as complex trusts.)

Be careful with lifetime charitable split-interest gifts, however. If the gift does not qualify for the charitable deduction, the donor will have created a taxable gift. For example, the donor will lose the benefits non-taxable trust benefits of charitable remainder trusts, and the income tax benefits associated with charitable gift annuities.

C. Revocable Trusts

Revocable trusts are already used by many individuals to serve as their family giving platform. In this arrangement, the donor creates a revocable trust, transfers assets to the trust, assigns it a name representing the family, and then gathers the family each year to make decisions about gifts to charities. While the donor receives no deduction when the trust is created, they maintain control over annual distributions. Annual distributions to charitable entities (under IRC §170(c)) qualify the donor (the grantor) for a charitable deduction. When additional funds are needed or the trust runs low, the donor simply transfers more money. These trusts often have a testamentary provision that either transfers the funds to family or to a donor advised fund for family, or even another entity. Or, the decedent/donor can transfer ownership to descendants leaving the trust in a revocable form, or direct that the entity become irrevocable at death.

The advantage of this approach is the creation of a formal platform that can be used to teach family members how to be effective philanthropists, and the flexibility it allows a family in both the timing and amount of its annual distributions. Using a donor advised fund platform offers similar flexibility, but a private foundation platform requires minimum annual distributions and has other restrictions. The disadvantage is that the assets belong to the donor and are not shielded from creditors, and individuals do not have as wide a variety of giving options as private foundations afford.[93]

VIII. FINAL THOUGHTS

Effective planning is about meeting client goals. Charitable planning allows the planner to combine goals to create the most effective result. Charitable planning after AFTRA 2012 offers many opportunities to meet donor needs, and provide a tax-reduction incentive. Incorporate questions about charitable goals in your intake questionnaire, and call any of today's sponsoring charities for more information or help in gift planning.

[93] For example, private foundations may make grants to individuals and non-501(c)(3) foreign entities so long as the foundation exercises expenditure responsibility.

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