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Important Year-end Charitable Giving Strategies



Date: October 21, 2021
 Time: 1:00 – 2:30 Eastern
 Presenter: Russell James
 Professor
 Texas Tech University

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Important Year-end Charitable Giving Strategies

The strategies and the “words that work” in conversations

Professor Russell James, J.D., Ph.D., CFP®, Texas Tech University

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Our changing charitable world



Definite loss at the end of the year

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

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Our changing charitable world

Risk of loss

- The specter of immediate or retroactive tax legislation changing DAFs, stepped up basis at death, FMV gifts of appreciated assets, CRTs without upfront gain recognition, Roth conversions, estate tax avoidance, etc.
- Rising interest rates lowering tax benefits for grantor CLTs, non-grantor CLTs, retained life estates, and increased taxation of CGA payments.

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“No” is not the enemy.
“Later” is the enemy.

The most important impact of “proposed” legislation: Motivating your client or donor to act now!

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Behavioral economics: Financial loss motivates more than financial gain

Loss framing

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

**LOSS
AVERSION**

Gain framing

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

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Last chance “definitely” disappearing opportunities in 2021

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The “magic” 2021 charitable tax deduction for non-itemizers

- \$300 per person
- \$600 married couple (in 2020 was only \$300 for married couple)

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Offset 100% of your income with charitable deductions

- 2021 only
- Cash to an operating public charity
- Doesn't work with donor advised funds

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How can we leverage the expiring 100% limitation benefit?

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Roth conversions and charitable planning can work together to match

Income Deductions

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Accelerating a multi-year pledge by writing the check now can fit with a Roth conversion.

This year only, donors can eliminate 100% of income with gifts of cash to an operating public charity.

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New attraction to CGAs

If the donor can't use charitable deductions, lower interest rates mean a larger share of the annual payments will be considered tax-free return of the original investment.

If funded with cash, the deduction can eliminate 100% of income in 2021. (Connect with me on LinkedIn for the full paper on this.)

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Gift of Cash for a CGA (not CRT) should qualify for 100% income limitation for 2020 extended in 2021

A "qualified contribution" requires "(i) such contribution is paid in cash during calendar year 2020 to an organization described in section 170(b)(1)(A)"

A "qualified contribution" is a deductible "contribution,"

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

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With a CGA, the public charity gets cash immediately



A CGA is a "bargain sale" like paying \$1,000 for a dinner event worth \$95.

It's not a "split-interest gift" because the donor retains no rights in the gifted property.

2021

2022 2023 2024 2025 2026 ... Death

such contribution is paid in cash during calendar year 2020 [2021] to an organization described in section 170(b)(1)(A)

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With a Charitable Remainder Trust the 170(b)(1)(A) public charity gets no cash immediately

1. "paid in cash"
2. "during calendar year 2020"
3. "to an organization described in section 170(b)(1)(A)"

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

For a client capped out on income limitations (giving from assets with relatively little reportable income) and planning to continue donating:

Move an income-producing asset into a non-grantor CLT. (The asset goes to family at the end with all extra growth going gift/estate tax free.) Charitable giving can offset all income inside the CLT (100% deduction).

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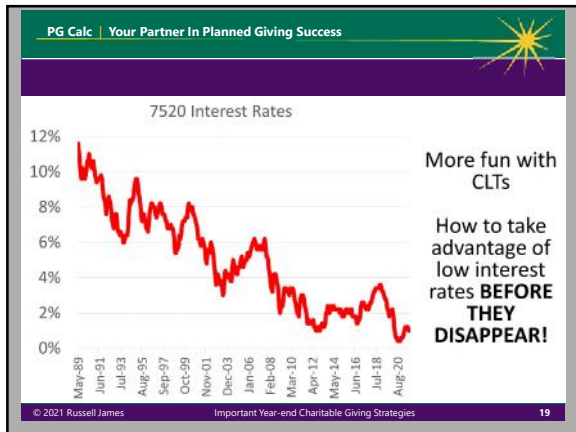
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Non-Grantor CLT pays income taxes but deducts charitable distributions usually without income limitations

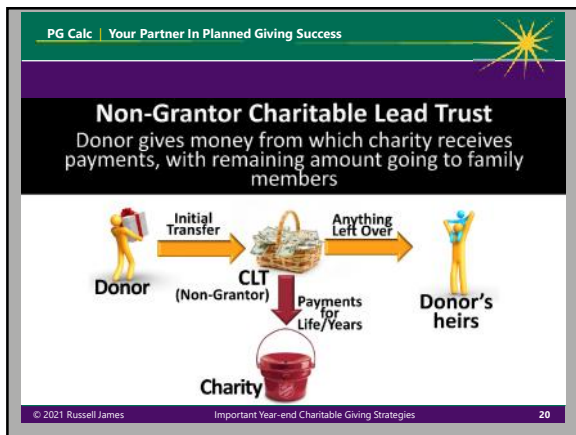
(Non-Grantor) CLT taxed on income

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Gift taxes are paid on the present value of the **PROJECTED** remainder going to the heirs

Gift taxes are not paid on the **ACTUAL** remainder that eventually goes to the heirs

Projected Value of Remainder → Donor → Initial Transfer → Charity → Payments for Life/Years → Anything Left Over → Donor's heirs

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If the **ACTUAL** amount is higher than the **PROJECTED** amount, this part goes to heirs tax free

Projected Value of Remainder → Donor → Initial Transfer → Charity → Payments for Life/Years → Anything Left Over → Donor's heirs

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The **PROJECTED** remainder assumes investment will grow at the **INITIAL** \$7520 rate

If actual growth is greater than the \$7520 rate, the **ACTUAL** remainder will be greater than projected

Projected Value of Remainder → Donor → Initial Transfer → Charity → Payments for Life/Years → Anything Left Over → Donor's heirs

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The **PROJECTED** remainder of \$10MM at 0.4% \$7520 with \$521,266/year charitable payments for 20 years is \$0, resulting in \$0 gift taxation

If actual growth is 8%, the **ACTUAL** remainder will be \$22,755,415

At 1% rate use \$554,153 payments leaving \$21,250,442

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If the charitable gift (or bequest) was already planned, the zeroed-out CLAT (or zeroed-out testamentary CLAT) provides a no cost chance at tax-free transfers to family

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Grantor CLT

Donor immediately deducts present value of all future projected payments to charity

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Funding \$10,000/year gifts through a 20-year grantor CLAT (returning remainder to donor) creates an immediate deduction of

- **\$191,840 at 0.4%** §7520 rate
- **\$98,181 at 8%** §7520 rate

See iclat.net

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Roth conversions and charitable planning can work together to match

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Roth conversion creates need for immediate tax deductions.

Pulling forward deductions from future giving includes grantor CLTs and Retained Life Estates.

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Retained Life Estate Deeds for Homes and Farmland

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A retained life estate deed can give the inheritance rights to a charity

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Unlike a will, a retained life estate deed is not revocable

Remainder Interest

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Transferred by recording a deed
(not by trust or contract)

e.g., "To John A. Donor for life, remainder to Texas Tech Foundation, Lubbock, TX 70409"

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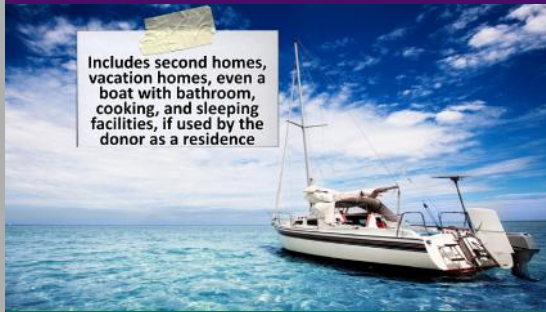
Remainder Interest

Donating inheritance rights to personal residences or farmland with a retained life estate deed creates a charitable tax deduction

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Includes second homes, vacation homes, even a boat with bathroom, cooking, and sleeping facilities, if used by the donor as a residence

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Charitable deduction for remainder interest deed with retained life estate in \$1,000,000 of farmland by age 55 donor

You can use the tax savings to buy life insurance for heirs who weren't going to farm anyway

11.6% (May 89) **\$122,350**

0.4% (Nov 20) **\$903,710**

1% = \$779,640
2% = \$616,350
3% = \$494,000

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7520 Interest Rates

Lock in the biggest deduction by donating the inheritance rights when interest rates are low

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Leaving land to charity **by will**

- Revocable
- \$0 income tax deduction


Leaving land to charity **by retained life estate deed**

- Irrevocable
- Immediate income tax deduction
- Immediately increases donor's available cash by lowering taxes

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More phrasing concepts from behavioral economics

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Behavioral economics: Matches create more giving than financially identical rebates

Match framing

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

Rebate framing

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

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Getting the government to match your charitable gift makes your giving more powerful

The government pays part of the cost of your gift with

1. Tax deduction (Good, if you are itemizing)
2. Tax avoidance (Even more powerful!)



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Tax avoidance: The magic disappearing tax bill

It makes an upcoming tax bill disappear

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Tax avoidance: Income you never have to report

TAXES

- You earned the income – but now you never have to pay taxes on it.
- You made a profitable investment – but now you never have to pay taxes on it.
- No itemizing required!

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Tax avoidance: But wait, there's more!

Deduction: Reported income (AGI) stays high, but taxes are lower


Avoidance: BOTH reported income (AGI) AND taxes are lower. This can help with

- Medicare Part B & D payments
- Eligibility for
- Deducting IRA contributions
- Making Roth IRA contributions
- Adoption credit
- Earned income tax credit
- Child tax credit
- Qualified business income deduction
- Education tax benefits (American Opportunity Credit, Lifetime Learning Credit, deductibility of student loan interest)

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Tax avoidance with charitable giving

1. Gifts of appreciated assets
2. The charitable swap
3. IRA gifts instead of required minimum distributions
4. IRA gifts without or above required minimum distributions
5. IRA beneficiary gifts

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Appreciated asset gifts are objectively cheaper



Tax deduction + Avoid capital gains tax

Tax deduction only

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Asset gifts are cheaper for itemizers







| | | | | |
|---|---|---|--|----------------------|
|  Donor |  \$10k Cash |  Nonprofit | Income tax deduction (\$10,000 x 37%) \$3,700 | Costs \$6,300 |
|  Donor |  \$10k Stock |  Nonprofit | \$3,700 + Avoid capital gains (\$9,000 x 23.8%) \$2,142 | Costs \$4,158 |

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Asset gifts are cheaper for non-itemizers

| | | | | |
|---|---|---|--|-----------------------|
|  Donor |  \$10k Cash |  Nonprofit | Income tax deduction (\$10,000 x 37%) \$3,700 | Costs \$10,000 |
|  Donor |  \$10k Stock |  Nonprofit | \$3,700 + Avoid capital gains (\$9,000 x 23.8%) \$2,142 | Costs \$7,858 |

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Asset gifts are cheaper for non-itemizers (especially with state capital gains taxes)

| | | | | |
|---|---|---|--|-----------------------|
|  Donor |  \$10k Cash |  Nonprofit | Income tax deduction (\$10,000 x 37%) \$3,700 | Costs \$10,000 |
|  Donor |  \$10k Stock |  Nonprofit | \$3,700 + Avoid capital gains (\$9,000 x 23.8%) + (\$9,000 x 6%) \$2,682 | Costs \$7,318 |

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Tax avoidance with charitable giving


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No need to change your portfolio! The Charitable Swap



Donor

\$10K new stock (high basis)

\$10K old stock (low basis)

Nonprofit

\$10K cash

immediately buy identical stock (100% basis)


No "wash sale" rule wait time because this is gain property, not loss property

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The Charitable Swap with a DAF



Donor

\$10K new stock (high basis)

\$10K old stock (low basis)

Donor Advised Fund

\$10K cash

immediately buy identical stock (100% basis)

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Buy low, give high, lock in the tax benefits!

The Charitable Swap with a DAF

“Lock in part of your gains without changing your portfolio.”

1. @\$10/share – buy
2. @\$110/share – give as a charitable swap replacing gifts of cash
3. @\$10/share – sell

Harvest a \$100 tax loss (instead of \$0)! Worth up to \$23.80 federal plus up to \$13.30 state.

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Do it now or risk losing out!

- Fair market value deductions might disappear!
- Stepped-up basis might disappear!
- Stock value might drop (losing the chance to harvest tax losses)!

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Life stages of a retirement account

- Early distribution (before 59 ½)
- Regular distribution (59 ½ to 72)
- Required minimum distribution (72+)

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Giving after 72

After age 72 participants must take required minimum distributions (account balance / remaining life expectancy) or pay 50% penalty

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Giving after 72

If the income is not needed, a charitable gift deduction **might** offset the income
 (if itemizing *and* no income giving limitations exceeded *and* no negative effects from increased AGI *and* not in the wrong state)

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Giving after ~~70½~~

A Qualified Charitable Distribution (QCD) eliminates both the income and deduction

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How much can a donor age 70½+ transfer via QCD?

1. If their RMD is \$25,000? Answer: \$100,000.
2. If their RMD is \$0? Answer: \$100,000.
3. If their RMD is \$200,000? Answer: \$100,000.
4. If their RMD is \$2 Million? Answer: \$100,000.

(Hint: The answer is always \$100,000.)

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Convert to IRA rollover before December 31 at age 71

- To make charitable distributions from an 401(k), 403(b), 457(b), or other pre-tax qualified plan, requires first converting to an IRA rollover.
- Any RMDs must be paid in the year of conversion. Waiting until the year you turn age 72 is too late!

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Tax avoidance with charitable giving

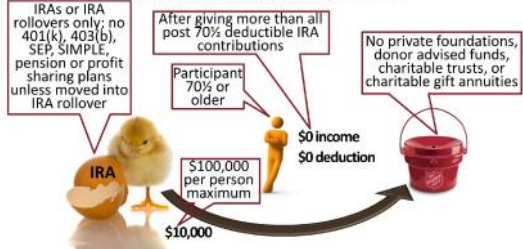
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You can give more than your required minimum distribution



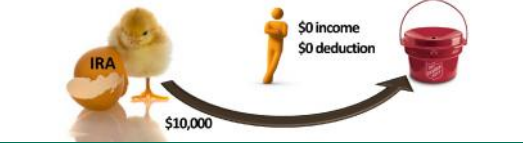
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Giving beyond or without a required minimum distribution

- Income taxes must be paid on this money sometime unless it is transferred to charity.
- Tax avoidance (QCD) is more efficient than a tax deduction.
- It is much more efficient that an unused tax deduction (not itemizing).



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How much can a donor age 70½+ transfer via QCD?

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3. If their RMD is \$200,000? Answer: \$100,000.
4. If their RMD is \$2 Million? Answer: \$100,000.

(Hint: The answer is always \$100,000.)

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You can give more than your required minimum distribution

IRAs or IRA rollovers only: no 401(k), 403(b), SEP, SIMPLE, pension or profit sharing plans unless moved into IRA rollover

After giving more than all post 70½ deductible IRA contributions

Participant 70½ or older

No private foundations, donor advised funds, charitable trusts, or charitable gift annuities

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The SECURE Act's "above-the-line" charitable deduction

A donor couple has earned income, but doesn't want to add to combined IRA balance

\$7,000 of wife's earned income → Checking Account → \$7,000 Gift → Charity

RESULT: An unusable itemized deduction

\$7,000 of wife's earned income → Wife's IRA → Husband's IRA → \$7,000 QCD Gift → Charity

RESULT: An above-the-line \$7,000 deduction for Wife's IRA contribution regardless of her age. No change in combined IRA balance: \$7,000 shift from Husband's IRA to Wife's IRA. A \$7,000 reduction in Husband's Required Minimum Distribution with no income recognition.


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End of Year Warning:
IRA checkbook gifts must be written early!

Unlike other gifts, the check must clear the bank before the end of the year. (QCD rules require money is removed from the IRA by the end of the year, but the check is not actually from the IRA; it is from an empty account that is authorized to then request funds from the IRA.)




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Tax avoidance with charitable giving



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Retirement plan assets inherited by non-charitable beneficiaries are reduced by income tax

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A client with a \$1MM IRA and a \$1MM house wants to leave one to her child and one to charity

Does it matter which goes where?




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| IRA(child); House(charity) | IRA(charity); House(child) |
|---|--|
| \$1,000,000 House \$1,000,000 to charity | \$1,000,000 IRA \$1,000,000 to charity |
| \$1,000,000 IRA -\$370,000 (37% federal income tax) -\$133,000 (13.3% California state income tax) \$497,000 to child | \$1,000,000 House -\$0 (no income tax) \$1,000,000 to child |

SECURE Act now requires faster withdraw (10 years)



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Easy answers to a misunderstood issue

Problem? Charities are not “designated beneficiaries,” so might accelerate RMDs for other beneficiaries.

No problem! Many solutions:

- Payout charity share before September 30 of year following participant death.¹
- Beneficiaries can separate accounts by end of year following participant death.²
- If spouse is beneficiary, simply roll that share into spouse’s IRA.
- Separate IRAs into a 100% charitable and 100% non-charitable account before death (+ RMDs can be taken from either to match desired plans).




1. Treas. Reg. sec. 1.401(a)(9)-1 Q&A 4(a) 2. Treas. Reg. sec. 1.401(a)(9)-5 Q&A 2(a)

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Getting the government to match your charitable gift makes your giving more powerful


The government pays part of the cost of your gift with

1. Tax deduction (Good, if you are itemizing)
2. Tax avoidance (Even more powerful!)

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Behavioral economics and bad information

Should you mention tax benefits?

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Social Desirability Bias

People report socially-approved motivations

Other motivations must be tested, not self-reported

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Donating isn't only about motivation. It's also about cost.

- A gift results from the intersection of motivation and cost
- Smart planning and tax benefits can help with cost

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Mentioning tax deductions increases charitable interest

Random assignment

Avoid capital gains tax by making a gift of stocks or bonds to a charity.

Make a gift of stocks or bonds to charity.

| | Interested Now | Will Never Be Interested |
|---|----------------|--------------------------|
| Avoid capital gains tax by making a gift of stocks or bonds to a charity. | 20% | 17% |
| Make a gift of stocks or bonds to charity. | 14% | 23% |

1,006 Respondents Groups A/B

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Janos, R. N. 81 (2019). *Mentioning tax deductions increases charitable interest*. Department of National Finance (Income and Tax Services, Program Management and Logistics, Advance Online Publication, DCI, 11/03/2019 31:52.

Random rotating assignment

| Interested Now | | Will Never Be Interested |
|----------------|--|--------------------------|
| 50% | Receive a tax deduction and make a gift that pays you income for life. | 8% |
| 33% | Make a gift that pays you income for life and receive a tax deduction. | 14% |
| 31% | Make a gift that pays you income for life. | 20% |

1,858 Respondents
Groups 02/F

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Janos, R. N. 81 (2019). *Mentioning tax deductions increases charitable interest*. Department of National Finance (Income and Tax Services, Program Management and Logistics, Advance Online Publication, DCI, 11/03/2019 31:52.

Random rotating assignment

| Interested Now | | Will Never Be Interested |
|----------------|---|--------------------------|
| 26% | Immediately receive a tax deduction for 70% of the value of a house or land by making a charitable gift of the property, but keeping the RIGHT TO USE it for the rest of your life. | 23% |
| 12% | Make a charitable gift of either a house or land, but keep the RIGHT TO USE for the rest of your life and immediately receive a tax deduction for 70% of the value of the property. | 33% |
| 11% | Make a charitable gift of either a house or land, but keep the RIGHT TO USE it for the rest of your life. | 42% |

1,828 Respondents
Groups 11/B

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Janos, R. N. 81 (2019). *Mentioning tax deductions increases charitable interest*. Department of National Finance (Income and Tax Services, Program Management and Logistics, Advance Online Publication, DCI, 11/03/2019 31:52.

Random rotating assignment

| Interested Now | | Will Never Be Interested |
|----------------|---|--------------------------|
| 28% | Get an immediate tax deduction by making a gift where you still control the investment of the assets, and receive income from the investments for the rest of your life with anything left over going to charity at your death. | 17% |
| 27% | Make a gift where you get an immediate tax deduction, still control the investment of the assets and receive income from the investments for the rest of your life with anything left over going to charity at your death. | 20% |
| 21% | Make a gift where you still control the investment of the assets, and receive income from the investments for the rest of your life with anything left over going to charity at your death. | 25% |

1,787 Respondents
Groups 04/C

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Best phrasing to describe tax benefits

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I might be/am definitely interested _____%

Please rate your level of interest in clicking on the button to read the corresponding information.

- _____ % Avoid taxes by giving stocks
- _____ % How to avoid taxes by giving stocks
- _____ % Save taxes by giving stocks
- _____ % Tax tips when giving stocks
- _____ % Avoiding capital gains taxes by giving stocks
- _____ % Giving stocks

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I might be/am definitely interested _____%

Please rate your level of interest in clicking on the button to read the corresponding information.

- 28%** Avoid taxes by giving stocks
- 27%** How to avoid taxes by giving stocks
- 25%** Save taxes by giving stocks
- 24%** Tax tips when giving stocks
- 24%** Avoiding capital gains taxes by giving stocks
- 16%** Giving stocks

James, R. N., III (2019). Describing complex charitable giving strategies: Governmental issues of technical assistance. Center for Retirement Research, Management and Leadership, Advance Center for Support, 102. 10.1007/978-1-133-1332-1

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Mentioning tax benefits works, but it isn't "the reason"

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Cost is still important

- Cost is not about motivations
- It's about the barrier to acting on those motivations

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The problem with tax deductions

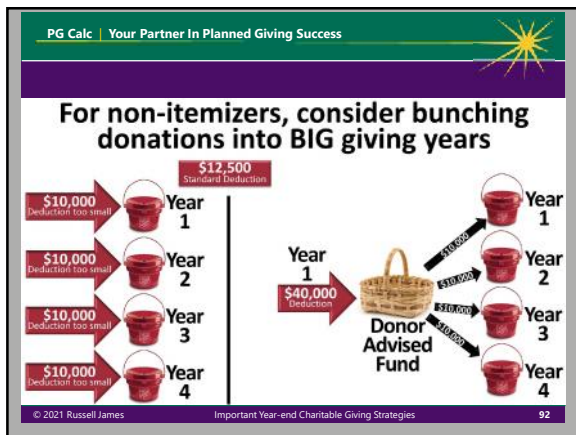
- With higher standard deductions, fewer people itemize
- If you aren't itemizing, you can't use charitable tax deductions, right?
- Not so fast ...

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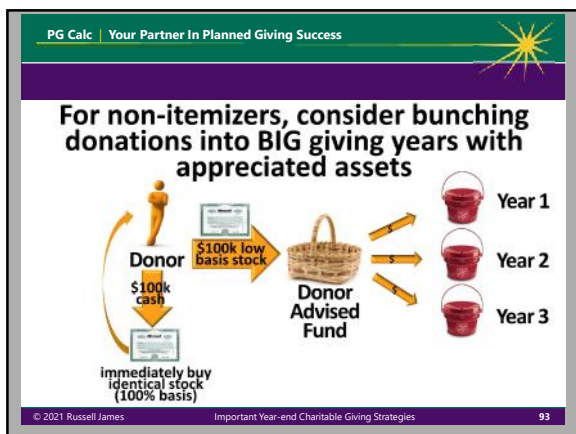
90



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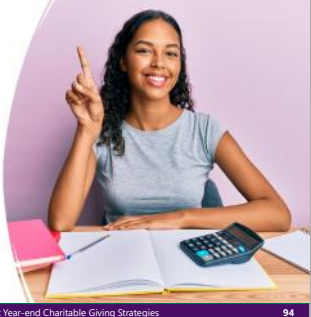


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One last wonky end-of-year tax tip

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1. The 20% deduction for qualified business income can phase out at higher **taxable income** levels
2. But charitable deductions reduce **taxable income**, and can “bring back” this business deduction from the dead
3. Double benefit: Charitable deduction + bringing back the phased-out qualified business income deduction

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Important Year-end Charitable Giving Strategies
The strategies and the “words that work” in conversations


Professor Russell James, J.D., Ph.D., CFP®, Texas Tech University


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Questions?

- To ask a question:
 - ✓ Click  to the left of the slide.



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Still Have a Question?

Contact: Russell James
Email: russell.james@ttu.edu
or Connect with me on LinkedIn

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