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Fundamentals of Planned Giving Part 4: Advanced Planned Giving Methods



Date: August 6, 2014
Time: 1:00 – 2:30 Eastern Time
Presenter: Craig C. Wruck
Vice President, Advancement
Humboldt State University



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Agenda

- Life income gifts
 - Charitable gift annuity
 - Charitable remainder trust
- Charitable lead trust
- Retained life estate

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Life Income Gifts

- Donor makes contribution now and receives income in return
 - Fixed or variable amount of income
 - For one or more lifetimes, a term of years, or a combination of the two
 - Income beneficiary can be donor or others
 - Capital gains tax delayed or avoided
 - Made during lifetime or in Will
- Life income gifts are **irrevocable**

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Life Income Gifts

- Charitable gift annuity
 - Contract in exchange for a contribution that promises fixed payments for life
- Charitable remainder trust
 - Separate legal entity holds and manages assets, makes payments to beneficiaries, distributes remainder to charity
 - Annuity trust pays fixed dollar amount
 - Unitrust pays fixed percentage of trust value
- Pooled income fund

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Charitable Deduction

- Split interest
 - Right to receive payments
 - Right to hold remainder
- Donor retains right to payments, contributes right to receive remainder in the future
- Charitable deduction for calculated present value of the right to hold the remainder
- Older (or fewer) beneficiaries or lower payout yields larger deduction

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Charitable Gift Annuity


- Donor makes a current contribution to charity
- Charity issues contract promising to pay fixed amount annually for life
- Amount of payment is determined at time of gift and cannot change
- Taxation of payments:
 - Ordinary income
 - Tax-free income
 - Capital gain income

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Charitable Gift Annuity funded with:	Cash	Appreciated Securities
Assumptions		
Annuitant Age	72	72
Principal Donated	\$10,000	\$10,000
Cost Basis	\$10,000	\$2,000
Annuity Rate	5.4%	5.4%
Charitable Deduction (CMFR = 2.4%)	\$4,240	\$4,240
Annuity	\$540	\$540
Tax-free Income	\$397	\$79
Capital Gain Income *	\$0	\$318
Ordinary Income	\$143	\$143
* Capital gain of \$4,608 must be reported over 14.5 years, after which the entire annuity becomes ordinary income.		

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Charitable Gift Annuity

Notes:

- Contribution of appreciated property:
 - If donor is annuitant, portion of each payment taxed as long-term capital gain over life expectancy
 - If donor is not annuitant, portion of gain is taxable to donor in year of gift
- Deferred payment gift annuity
 - First annuity payment some years in future
 - Payout and deduction will be larger

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Deferred Payment Gift Annuity

Assumptions	
Annuitant Age at Date of Gift	50
Age at Date of First Payment	65
Cash Contributed	\$10,000
Annuity Rate	7.6%
Charitable Deduction (CMFR = 2.4%)	\$3,520
Annuity	\$760
Tax-free Income	\$325
Ordinary Income	\$435
After 19.9 years the entire annuity becomes ordinary income.	

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Charitable Gift Annuity

Donor gives money or property to charity

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    graph TD
      Donor[Donor] -- "Donor gives money or property to charity" --> Charity[Charity]
      Charity -- "Charity promises to make annual payments to annuitant" --> Donor
  
```

Charity promises to make annual payments to annuitant

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Charitable Remainder Trust

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    graph LR
      A[Grantor / Donor] --> B[Trustee]
      B --> C[Income Beneficiary]
      C --> D[Remainder Beneficiary]
  
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Charitable Remainder Trust

- Requirements to qualify as CRT
 - Remainder irrevocably directed charity
 - Not perpetual: lifetimes, term of years, or combination of the two
 - Income beneficiaries must be living at time trust is created
 - Must make payments to beneficiaries at least annually
 - Must be either “annuity trust” or “unitrust”

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Unitrust Types

- Standard (SCRUT, Type I) – principal can be distributed if needed to make payment
- Net income (NICRUT, Type II) – beneficiary receives unitrust % or net income (dividends & interest), whichever is less
- Make-up (NIMCRUT, Type III) – Type II, but can make up past deficiencies with excesses in future years
- Flip Trust – begins as Type II or III, but can become Type I in the future

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Taxation of Beneficiary Income

Four tier payout rule:

1. Ordinary income: net income including dividends and interest collected by the trust
2. Capital gain income: gains realized from sales by the trust
3. Tax-exempt: municipal bonds and other tax-exempt income collected by the trust
4. Return of principal

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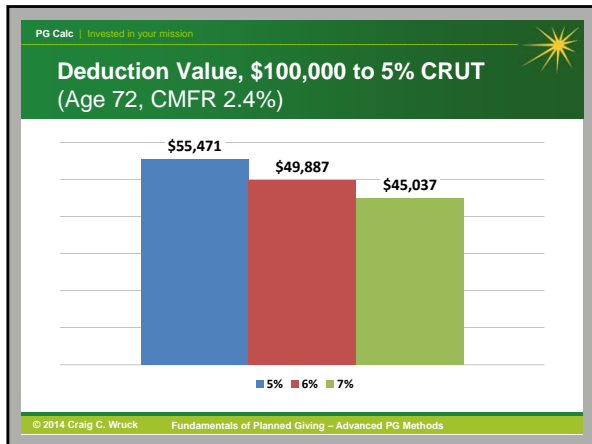
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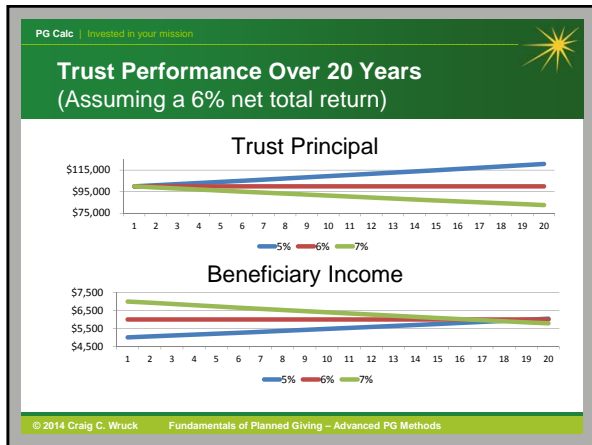
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Negotiating the Payout Rate

- Fixed at the time trust is created
- 5% minimum
- At least 10% deduction value
- Lower payout can afford growth
- Payout higher than expected investment return is folly

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Charitable Remainder Unitrust

Charitable Remainder Unitrust funded with appreciated property

Assumptions	
Beneficiary Age	72
Value of Property Donated	\$100,000
Cost Basis of Property	\$20,000
Payout Rate	5%
Charitable Deduction (CMFR = 2.4%)	\$56,243
Estimated Income in First Full Year	\$5,000
(Future income will vary each year with trust value.)	

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Life Income Projection

Assumptions	
Projection runs for 14 years (life expectancy at age 72)	
Original Principal is \$100,000 with \$20,000 cost basis	
Income tax bracket 35%, 15% for capital gains	
Total investment return (income + appreciation) 6% per year	
Charitable Deduction	\$56,243
Income Tax Savings at 35%	\$19,685
After-tax Cost of Gift	\$80,315
Total Before-tax Income to Beneficiary	\$74,737
Projected Remainder for Charity	\$114,947

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CRUT vs. Sell & Reinvest

Assumptions		
Projection runs for 14 years (life expectancy at age 72)		
Original Principal is \$100,000 with \$20,000 cost basis		
Income tax bracket 35%, 15% for capital gains		
Total investment return (income + appreciation) 6% per year		
	5% CRUT	Sell
Gross Principal	\$100,000	\$100,000
Net Principal to Invest	\$100,000	\$88,000
Capital Gains Tax Paid	\$0	\$12,000
Tax Savings from Charitable Deduction	\$19,685	\$0
Total Before-tax Income to Beneficiary	\$74,737	\$65,769
Remainder to Charity or Heirs	\$114,947	\$101,903

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Charitable Lead Trust

- Pays income to charity for a term of years, then distributes remainder to individuals
- May be either annuity trust or unitrust
- “Non-grantor” type generates gift tax deduction that can reduce gift tax on transfer of remainder to others

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Charitable Lead Annuity Trust

- \$10 million asset contributed to 20-year CLAT
- CLAT pays \$625,000 to charity each year
- After 20 years, trust assets transfer to heirs
- Results:
 - \$12.5 million given to charity over 20 years
 - Transfer to heirs 20 years hence is tax-free due to gift tax deduction



Retained Life Estate

- Donor irrevocably contributes home or farm now but retains right to live in and use it
- Income tax deduction now for calculated value of charity's right to property
- Donor continues to pay expenses for taxes, maintenance, et cetera



Retained Life Estate

Assumptions	
Life Tenant is Age 72	72
Value of Property is \$600,000	\$600,000
Value of Buildings is \$400,000	\$400,000
Useful Life of Buildings is 45 years	45 years
Salvage Value of Building is \$100,000	\$100,000
Charitable Deduction (CMFR = 2.4%)	\$389,379



Still Have a Question?

Contact: Craig Wruck

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