HOOK LAW CENTER

SPECIAL REPORT

What You Should Know About Planned Giving

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CASE STUDY: PLANNED GIVING TECHNIQUES HELP DONOR ACHIEVE ESTATE-PLANNING GOALS

Joe Generous feels indebted to his *alma mater* because the education he received there changed his life in so many gratifying ways. Joe has always made modest annual gifts to the university. He would like to give more, but hesitates to do so for two reasons. First, Joe feels he can't afford to lose the cash flow provided by his assets; second, he is unwilling to sell appreciated assets because of the capital gains tax he'll owe from the sale. As a result, Joe has decided not to increase his annual gifts. Instead, he hopes to leave assets to the university at his death. But Joe is concerned that such a charitable bequest may need to be postponed or reduced if it will prevent him from achieving another important estate-planning goal: providing adequately for his children and, in particular, helping to fund his grandchildren's education.

Joe Generous is familiar with outright gifts and bequests. He would like to know more about other charitable giving techniques that might enable him to balance philanthropic objectives with the need to preserve his standard of living and his family's inheritance.

Joe has retained an attorney who specializes in estate planning. The attorney explains how Joe can achieve all of his estate-planning goals by utilizing planned giving techniques. Specifically, he recommends that Joe establish a Charitable Remainder Trust and purchase a life insurance policy. The trust will enable Joe to make annual gifts of appreciated securities to his alma mater. Since the gifts will be made with accumulated assets, rather than current income, they will not impact Joe's standard of living. The gifts will result in a current income-tax deduction for Joe each year, and the gifted securities will not be subject to capital gains tax when they are sold. Joe can further enhance his lifestyle with an annuity paid for by the trust. A life insurance policy naming Joe's children and grandchildren as beneficiaries can be purchased using a portion of the annuity and funds generated by the income-tax deduction. The proceeds of the policy will replace the assets gifted to the trust, enabling Joe to meet his goal of passing on a legacy to his family.

What Is Planned Giving?

Planned giving is a form of charitable giving in which gifts come from *accumulated resources*, such as real estate or marketable securities, rather than from *current income*. Planned giving techniques can help individuals who want to make generous gifts to worthy causes, but who must balance philanthropic intentions with the need for current income and the desire to pass on assets to loved ones.

Some planned giving techniques are quite simple, such as leaving assets to a charity through your will or naming a charity as the beneficiary of an IRA or other retirement plan. Other techniques are more complex, such as creating a Charitable Gift Annuity or establishing a Charitable Remainder Trust.

What Are the Benefits of Planned Giving?

Regardless of the technique(s) chosen, planned giving allows you (the donor) to align philanthropic objectives with other financial, tax and estate-planning goals. Planned giving can help you realize a wide range of benefits. These include:

- Preserved standard of living. Since gifts come from accumulated assets, not current income, they won't deplete the resources needed for living expenses.
- Enhanced standard of living. Several planned giving techniques, including Gift Annuities, Pooled Income Funds and Charitable Remainder Trusts, can provide you with additional cash flow from an annuity or earned income.
- Preserved legacy. Life insurance can be used to replace a charitable gift.
- Reduced capital gains tax exposure. When appreciated securities are gifted to a charitable trust, they are not subject to capital gains tax when sold.
- Gift- and estate-tax deductions. A charitable gift receives a current income-tax deduction even though the charity receives the gift in the future. Assets placed in trust are removed from your taxable estate and pass to charities estate-tax free.
- Other benefits. Planned giving can help you achieve diversification of investments, creditor protection and peace of mind.

What Is the Charitable Income-Tax Deduction?

The topic of charitable giving – or planned giving – sparks many questions about the income-tax ramifications of such generosity. While the tax benefits of planned giving vary, depending on the technique utilized, one commonality is that gifts result in charitable income-tax deductions. These deductions are not on a dollar-for-dollar basis, however, as such a tax benefit would have the result of making charitable giving too appealing, potentially depleting the nation's tax coffers.

Other tax considerations include:

- The Limitation of Percent Adjusted Gross Income. The law provides that a gift to charity will result in an income-tax deduction subject to certain limitations and based on the type of gift and type of charity. A gift of cash enjoys the greatest possible deduction but is limited to 50% of the donor's adjusted gross income (AGI) when made to a public charity. For example, if your AGI is $100,000, a $60,000 cash gift to a public charity could be deducted only up to $50,000. The excess amount could then be carried forward for up to five additional years, provided that your AGI was at least $20,000 in each of those years. In the above example, the excess $10,000 could be carried over to year two and receive a full deduction in that year.
- Biases regarding the type of charity. An important consideration regarding the deduction limitation is whether the donee is a public charity or a private foundation. Public charities are favored from a public policy perspective, and that bias is supported by tax laws. Consequently, while a cash gift to a public charity is subject to a 50% deduction limitation, the same cash gift made to a private foundation is subject to a 30% deduction limitation. The five-year carryover applies regardless of the type of charity.

Another example of the bias toward public charities involves a gift of what is characterized as Long-Term Capital Gain Property, i.e., any investment, other than cash, owned for more than one year. Donated property that fits this characterization enjoys a 30% deduction limitation when the gift is made to a public charity, but a 20% deduction limitation when the donee is a private foundation.

A further discouragement to giving Long-Term Capital Gain property to a private foundation is that the deductible amount is limited to the cost basis of the property rather than to the property's fair market value. For example, if you purchased a building for $100,000 (cost basis = $100,000) and the building is now worth $300,000 (fair market value = $300,000), you could only deduct $100,000. Gifting the same building to a public charity, however, would allow you to deduct the fair market value of $300,000. There is one exception to this rule: When the Long-Term Capital Gain property consists of marketable securities (i.e., stock traded on an exchange), a gift of such property to a private foundation results in a deduction equal to the fair market value of the securities. The gift is still subject to a 20% deduction limitation under the Limitation of Percent Adjusted Gross Income rule.

WHAT PLANNED GIVING TECHNIQUES ARE AVAILABLE?

There are several planned giving techniques available that can help you balance philanthropic objectives with financial, tax and estate-planning goals.

- Gift Annuities. A Gift Annuity is a gift of cash or other property to a qualified charity that, in turn, promises to pay the donor a fixed annuity for the remainder of his or her life. The value of the gift, for income-tax deduction purposes, is equal to the gift of cash or property less the annuity. The charity can set the annuity rate as it wishes, but generally, rates conform to those followed by other charities. Rather than compete with other charities on rates, most charities have opted instead to compete on the merits of their organizations.

A Gift Annuity allows you to make a gift to charity today and receive a current income-tax deduction, while obtaining a desirable lifetime cash flow to support yourself (and possibly your spouse). Note that a Gift Annuity is unsecured in that you are simply relying on the ability of the charity to make your annuity payments. Therefore, this technique may be more appropriate with a large public charity, such as the Alzheimer's Association, than with a small organization like your local church or synagogue.

- Gifts of life insurance. You can gift an existing life insurance policy to a charity. The income-tax deduction depends on a number of factors, including the face value of the policy, its cash surrender value and whether it is paid in full. This type of gift is appropriate if the insurance proceeds won't be needed to meet living expenses and the original purpose of the policy (e.g., supporting and educating children, paying off the mortgage) no longer exists.

- Remainder interests in a personal residence. With a remainder interest in a personal residence, you can transfer your personal residence (e.g., a permanent residence, vacation home, coop share or farm) to a charity while retaining a life estate or the right to use and occupy the property for a term of years. The gift to the charity is known as the "remainder interest." The technique allows you to make a sizable gift today and receive a current income-tax deduction, while retaining a lifetime right to use the residence.

- Pooled Income Funds. With a Pooled Income Fund, you pool your gift to a charity with those of other donors. The gifts are deposited into a fund managed by the charity. Donors reserve a lifetime right to a pro-rata share of the pooled income fund's earnings. At the death of a donor (or his or her spouse), the donor's portion of the fund becomes the property of the charity.

- Charitable Remainder Trusts. With a Charitable Remainder Trust, you make annual gifts to a charity and enjoy a current income-tax deduction each year. Gifts are made to an irrevocable trust and often consist of appreciated assets that can be sold without incurring capital gains tax since charitable trusts do not pay taxes. The trust pays you (and/or other family members) an annuity, either for life or a term of years. Since you create the trust, you create the rate of the annuity, which must be at least 5%, but usually is much higher. Like a pooled trust, the principal is secured in that the charity does not have use of the money until after the trust terminates. Upon the trust's termination, the charity receives any remaining trust assets (the remainder) estate-tax free. Charitable Remainder Trusts are appropriate for those who want to meet a number of estate-planning objectives, including enhancing their standard of living and reducing income tax, capital gains tax and estate tax. As an additional planning technique to ensure an inheritance for your family, you can use funds generated by the current income-tax deduction and a portion of the annuity payments to purchase a life insurance policy that will replace the charitable gift.

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