Charitable Planned Giving
How To Reduce Your Taxes While Helping Others

As a New Year begins, many of us reflect on our values and how we want to be remembered. Many of us value making a difference in the lives of others and that includes our family, friends and those in need. To help those in need many people consider making ***charitable planned giving*** part of their personal legacy. Whether you think of yourself as rich or poor, or somewhere in between, some form of charitable planned giving can make a big difference in the lives of those in need and can save significant income and estate tax along the way.

Charitable planned giving is the well-thought-out and thorough approach to helping those in need while reducing taxes. It involves **identifying** which assets to contribute, controlling the **timing** of the giving and choosing the best **vehicle** for directing it.

One of America's most influential judges, the Honorable Learned Hand, in one of his most famous tax cases, said "There is nothing sinister in so arranging one's affairs as to keep taxes as low as possible." That quote is credited for making tax planning to minimize income taxes an acceptable practice for American citizens. One of the few tax deductions that have not been eliminated over the years is the deduction for contributions to charity. The bequeathing of assets to charity at the time of one's passing is also a way of reducing estate taxes for larger estates.

The three main parts to planned giving are:

- **Identifying which assets to give**
- **Determining the timing of the giving**
- **Determining the vehicle through which the giving is to be directed**

Identifying which assets to give

Listed below are examples and brief descriptions of types of property typically involved in planned giving:

- **Cash**
- **Publicly traded securities**
- **Real estate**
- **An interest in a privately held business**
- **Retirement and pension accounts**
- **Life insurance and annuity contracts**
- **Personal property**

Cash: Funds held in bank, brokerage or money market accounts. This includes checking accounts, savings accounts, US Treasury Bills and other short term securities.

Publicly traded securities: This category includes stocks, mutual funds and bonds held in brokerage accounts or held directly by the donor. The capital gains tax is avoided on the donation of stocks, mutual funds or bonds to charity. The donor also receives an income tax deduction for the full value of the security donated. When given the choice between donating cash or low cost basis securities, donating the low cost basis securities is usually the best way to go because of the avoidance capital gains taxes.

Real estate: Virtually any type of real estate may be donated to charity. Partial interests in real estate can also be given. Real estate is often gifted to charity in trust or one of the other vehicles discussed below. It is also frequently structured to involve retaining an income stream from the property and having the property go to the charity at some point in the future. The income tax and estate tax savings can be very significant.

Privately held business interest: An interest in a closely held business can be donated to charity either currently or at a predetermined point in the future. Some donors choose to make gifts of privately held interests in companies that are about to go public to reduce estate taxes or just after they have gone public to reduce income taxes. Another example of when some or all of a privately held business is donated to charity is when there are no family members involved or interested in continuing the business after the passing of the founder. This can result in significant estate tax savings which could allow the business to continue without having to be sold.

Retirement and pension accounts: Retirement assets can be subject to multiple levels of taxation. Distributions can be subjected to both income tax and estate tax making the combined tax rate in excess of 75%. This potential onerous amount of tax makes them particularly attractive for charitable giving.

Life insurance and annuity contracts: Naming a favorite charity as the beneficiary of a life insurance policy or an annuity contract can save taxes and does not use any of the donor's current assets. Sometimes donors wish to make meaningful contributions to a charity but need to retain most of their assets while they are alive to support their lifestyle. Life insurance or certain annuity contracts can be used to provide for the charity following the passing of the donor.

Personal property: This can be any type of tangible property--artwork, baseball cards, rare books, jewelry - that a charity is willing to accept.

Determining the timing of the giving

A planned gift to charity can be done up front, over time or at some time in the future. The timing depends on the objectives, type of property available, overall financial resources and tax status of the donor.

A planned gift can be designed to provide income to the donor for life or specified term with the residual asset going to charity in the future. This can result in a current income tax deduction for the present value of the residual interest and the asset may not be taxed in the donor's estate.

Another technique is to provide an ongoing income stream to a charity and then directing the residual principal back to the donor or to another family member. This technique results in a current income tax deduction for the value of the income stream.

An **endowment** is the delayed use of property contributed to a charity. The donor can put restrictions on when the money can be spent and what it can be spent on. This is one of the simplest forms of planned giving. An example is an endowment structured such that the principal amount of the contribution is not allowed to be spent, but the earnings or a specified percentage of the principal can be used each year for the support of a particular program.

A **bequest** is a contribution stipulated in the donor's will or living trust. It may be a specific bequest that can be used by the charity upon receipt or it may go into one of the vehicles discussed below. The value of any bequest to charity is not included in a decedent's estate and therefore avoids estate tax. A common question is whether an estate can make a donation after the death of the decedent and exclude the assets from the estate. Unfortunately, the answer is no. The donation must be specified in the Will or Trust of the decedent. It is therefore important to make sure your will and trust are up to date to reflect your current philanthropic wishes.

There are many variations and combinations of these techniques that can be structured to fit the donor's economic and philanthropic circumstances.

Determining the vehicle through which the giving is to be directed

Following is a brief discussion of the most common vehicles used to control the timing of donations as well as to provide economic benefits to the donor or members of the donor's family.

Charitable Remainder Trust: These trusts are structured to receive a low cost basis asset, sell the asset, diversify the investments, distribute an income stream to the donor for life or a specified period of time and ultimately contribute the remainder to a charity. The donor receives a modest tax deduction for the present value of the remainder interest going to charity and, more importantly, avoids capital gain and or income tax from the sale of the asset. Distributions from the trust are taxable to the recipient. This has the effect of spreading the tax consequences from the sale of the asset over many years and can increase the cash flow from the asset by selling the asset and investing in higher income producing investments. It can also reduce the investment risk by diversifying the investments. The asset is also removed from the estate of the donor thereby saving estate taxes.

Charitable Lead Trust: This trust is similar to a charitable remainder trust, except that the roles of the beneficiaries are reversed. In this type of trust, the charity receives the income stream and the donor or a family member receives the remainder. This trust is designed for donors who have a surplus asset they do not currently need and want to increase and donate the income from it to charity. There is a current tax deduction for the value of the income stream being donated to the charity. The remainder will be included in the donor's estate for estate tax purposes unless the remainder is also a charity.

Pooled Income Trust: This is trust set up by a charity into which multiple donors contribute assets. The assets are sold and diversified into a portfolio pool managed by the charity from which an income stream is paid to the donor. Following the passing of the donor, the charity receives the principal of the portfolio for use in their charitable purpose or for a purpose specified by the donor. The tax benefits are similar to the Charitable Remainder Trust.

Charitable Gift Annuity: This vehicle is where the donor enters into a contract with a charitable organization to pay a specified income stream for a specified period of time to the donor. The property that is contributed is usually sold immediately and the proceeds put into a diversified reserve and invested by the charity. The donor can claim a deduction for the present value of the remainder interest going to charity. These types of annuities also have the advantage, compared to commercial annuities, of not being subject to as high of costs so they tend to pay a higher amount of income.

Donor Advised Fund: This is a fund set up with a local community foundation, such as the Jewish Community Federation of the Greater East Bay, that manages the money and invests the money on the donor's behalf and for which it maintains a separate account. From time to time, the donor can instruct the fund to send donations to qualified charities. The donor could even be a family that is entitled to direct these donations during their lifetimes until the funds are depleted. New funds can be added to the fund at any time. Donations must be made to 501(c)(3) organizations (charities approved as such by the IRS), and fund donations can be made in the name of the fund, in someone else's name or anonymously. The donor is entitled to a tax deduction for the amount contributed to the fund even though the donations have not been made to the end charities. This allows the donor to control the timing and amount of the deduction without having to commit to a specific charity.

Supporting Organization: Another type of organization similar to the donor-advised fund is the supporting organization, sometimes referred to as an SO. This organization is set up as a separate charitable organization with its own board of directors, some of whom must be from a sponsoring charitable foundation, and the rest of the board can be made up of the donor and his family or designees. The benefit of a supporting organization is that there is more control by the donor over how the money is managed. Otherwise, the money is managed in accordance with the direction of the board of directors of the supporting organization, and donations are made also at the direction of the board of directors which, again, includes the donor. The tax advantages are the same as the Donor Advised Fund.

Private Foundation: The private foundation is an organization established by the donor over which the donor exercises a great deal of control. The donor selects the managers and board of directors and determines which charities it will contribute to and when. The private foundation has a disadvantage of being required to make donations equal to 5% of the value of the funds in the foundation each year. It is also subject to income tax of 1% to 2% of its income per year. Because of its higher degree of complexity, it is more expensive to administer. It is also required to be audited by outside auditors if its assets exceed $2 million. The cost of this audit can be in excess of $10,000 per year. The private foundation has value for donors who want to involve younger family members in its management as a way of educating them about philanthropy and business management. Some donor's even use their private foundations to help jump start the careers of their children or grandchildren by employing them in the private foundation for some period of time.

In closing, it is highly recommended that you consult with your attorney, CPA or financial advisor for guidance when considering charitable planned giving. It is our hope that when considering using any of the planned giving vehicles, you will include RCJL in your thinking and planning.

This article was authored by RCJL Board Members January 2007

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