EMERGING PHILANTHROPY CONFERENCE

How To Tap Into Donors' Planned Giving Motivations

Jack Owen, Esq., LLM (Tax)

Tax Cuts and Jobs Act (TCJA) Impact

- Standard Deduction – Nearly Doubles!

  Indexed for Inflation
- Personal Exemption Eliminated
- Charitable deduction limit for individuals increased from 50% to 60% of gross income

TCJA Impact (continued)

- Pease limitation Repealed
- College Athletic Events – Priority seating deduction repealed
- Estate and Gift Tax Exemption - Doubled

TCJA Impact (continued)

- IRA Charitable Rollovers – remain the same
- Donor Advised Funds – remain the same
- Private Foundations – remain the same

TCJA – Ultimate Impact

- Mixed
- “Bunching” more popular
- Certain tools can help with bunching (DAFs, private foundations and planned gifts)

Positive Impact on Charitable Giving

- Due to standard deduction and cap on state tax deductions, effective combined federal and state capital gains rates have risen
- Pease cuts eliminated
- Income limits increased from 50% to 60% of gross income
- Due to corporate tax rate cut, corporate stock more valuable

Example – Capital gains tax increase

- Capital gains taxes are already high and effectively increase due to $10,000 state tax deduction limit in TCJA
- 2017 LTCG (PA) 23.8% + 1.85 (3.07 – 1.22) = 25.65%
- 2018 LTCG (PA) 23.8% + 3.07% = 26.87%
- Response: Give to charity. Even more reason in high tax rate states like CA

What is “Bunching”?

- TP picks a year to itemize and makes several years’ worth of charitable contributions in chosen year
- Without a planned giving vehicle
- With donor advised fund, private foundation or other planned giving vehicle
- Beauty of DAF or PF = large up front deduction and can pick charitable recipients in future years

What is a Donor Advised Fund?

A charitable fund into which donors can make deductible charitable contributions usually controlled by a community foundation. Donors can recommend distributions to individual charities, but DAF has ultimate control.

What is a Private Foundation?

- IRS-approved charitable organization usually maintained by a family or business corporation. Subject to complicated tax rules and Form 990-PF reporting.
- A valuable vehicle for bunching.

Other Current Gifts to Charity

- Cash (Checks)
- Tangible Items (Artwork, Coins, Business Furnishings)
- IRA Charitable Rollover (Now a Permanent Opportunity)
- Stock (Publicly Traded or Closely Held)
- Life Insurance
- Real Estate

IRA Charitable Rollover

- Way, Truth and Life for Donors age 70 ½
- Made Permanent
- Confusion among financial advisors, CPAs & 1040 preparers
- Financial Advisors – don't recommend as an option
- CPAs & Tax Preparers – <u>not</u> a deduction but is an exclusion

IRA Charitable Rollover

- 70 ½ or older
- Up to $100,000
- Must come from an IRA (not qualified retirement plan)
- Direct transfer to qualified charity

IRA Charitable Rollover – General Rules

- Qualified charities – public charities but not DAFs, supporting organizations, private foundations nor planned gifts
- Better than a Deduction
- Excluded from Income!

IRA Charitable Rollover – TCJA

- No change to rules
- Even more valuable since an income exclusion
- Charitable tax deduction changes in TCJA have no effect

Required Minimum Distributions (RMDs)

- Apply to qualified retirement plans, IRAs and most governmental plans
- Distributions must start by required beginning date (RBD)
- RBD is generally April 1 of the year after taxpayer turns age 70 ½

Required Minimum Distributions

- Donors 70 ½ and older are usually subject to RMDs
- IRA Charitable Rollover eases the pain
- Charity PGOs should understand
- Charities should <u>NOT</u> give standard tax substantiation notice to donor

IRA Charitable Rollover

Thank you for the direct gift of $________ from your individual retirement account (or annuity) directly to ____________ (name charity). No goods or services were received by us in exchange for your gift. As an IRA Charitable Rollover, your gift is excluded from income provided you have met the requirements of federal tax law. Please contact your tax advisor for additional information on the tax effect of your gift, and thanks again for your generosity.

Planned Giving to Charity

- ***Planned Giving** is any technique where a charitable donor makes a tax-wise gift during life or at death, as part of a financial or estate plan.*
- Planned Giving **Vehicles** can be used to help you reach your goals.
- Categories of Planned Gifts include:
  - Gifts payable to a beneficiary upon the death of the donor;
  - Outright gifts that use appreciated assets as substitutes for cash; and
  - Gifts that return financial benefits to the donor of the gift (e.g., income that can be used for retirement, etc.).

Types of Planned Gifts to Charity

- Bequests
- Beneficiary Designations, including Life Insurance
- Life Insurance
- Pooled Income Funds
- Charitable Gift Annuities
- Charitable Lead Trusts & Charitable Remainder Trusts

Bequests

A Bequest is a gift that you make by will.

- Easy to do.
- You can change your mind, and change your will accordingly.
- A bequest to a charity is not subject to PA inheritance tax.
- Your bequest (gift) is given to your ***beneficiary*** (the person or charity that you intend to be the recipient of your gift) after your death.
- The language in your will is <u>important</u>: “I give and bequeath _____(description of the gift) to ________(name and address of individual or charity, and if to charity, the EIN of the charity), or, “all [or a percent of the value of] the rest, residue and remainder of my estate”, or, “if my daughter Jane Doe predeceases me, I give such property to XYZ charity” (contingent bequest).

Beneficiary Designations

- You can use beneficiary designations for an asset to pass outside of your will, avoiding probate and lowering inheritance taxes to your beneficiaries.
- Pensions, IRAs, Bequests in combination with Trusts.
- Existing Life Insurance Policies where the individual no longer needs the coverage.
- New Life Insurance Policies where your favorite Charity is the beneficiary of the policy, or where you make gifts to the Charity and the Charity pays the premiums.

- You may need some professional assistance since pension and tax rules can be difficult.

Beneficiary Designation Example

- ***Busy Woman*** is a dentist, with a high income. She is also a single mom with two children in college, both looking at medical school;
- She is paying a sizable mortgage and has put a lot of money into her dental practice. Once her children are established in practices of their own, she would like to retire. She has a substantial pension, and eventually she must take a forced distribution from that pension. She knows that she can realize a charitable deduction if she makes a current gift to charity, but has virtually *no cash* to do so;
- ***Busy Woman*** has a goal of saving for her children's education and another goal of saving for a comfortable retirement.

*How can **Busy Woman** use charitable giving to help meet her goals?*

Beneficiary Designation Outcome

- ***Busy Woman*** designates a portion of her life insurance to her favorite charity as a beneficiary.

- She is giving her gift “later”, not “now”, so ***Busy Woman*** will have more current cash to pay for her children’s educational needs.

Planned Gifts:

Following types can help with Bunching

Pooled Income Fund

- A pooled income fund is a trust maintained and invested by a Charity, into which various people (donors) contribute and which pays an income to those donors.
- A pooled income fund can be built around the shared interest of several donors.
- Donors retain an “interest income”. They can designate “non-charitable beneficiaries” (a child, spouse, or even the donor), who get a prorated share of the income earned by the trust for life.
- Donor gets a current income tax deduction for the gift, based on the age(s) of the beneficiary(s) and the fund’s rate of return.
  - At the death of the last non-charitable beneficiary linked to any particular Donor, that prorated share of the investment pool is withdrawn and given to the Charity.

Charitable Gift Annuities

- A contractual agreement in which the donor makes a gift and the Charity promises to pay one or two annuitants for life.
- A CGA can be set up with relatively small amounts, ($5,000 - $50,000), depending on the Charity's policy.
- Annual payment depends on ages and rates of return (charities should use rates set by the American Council on Gift Annuities).
- The rates of return are generally better than the rate of return on a savings account or CD.

Advantages/Characteristics of Charitable Gift Annuities

- Donor gets an immediate charitable deduction.
- Donor can defer capital gains.
- Donor can experience a partial tax-free recovery and income for life.
- CGA can be deferred with possibly better tax results.
- CGA can be a retirement substitute for high earners.
- The gift to a charity passes outside of Donor’s estate.
- The gift is irrevocable.

Charitable Gift Annuity Example

Ms. Teacher taught at an elementary school for her entire career. She is an 84 year old widow with no close relatives. Ms. Teacher is living comfortably on a moderate income. ***Ms. Teacher*** maintains an interest in education and wishes to leave a legacy to her favorite charity, the ***Don't be a Fool, Stay in School Foundation***.

In 2018, Ms. Teacher sold her life story and made $100,000. The extra income, which should come in handy in her remaining retirement years, is part of her 2018 income, pushing her into a higher income tax bracket and ensuring that she will pay more in income taxes in 2018.

What to do????

- *Put the money into a savings account where she will earn 1%, at best?*
- *Buy a CD, which will tie up the money for a long time and earn a low interest rate?*
- *Or, earn a better rate of return with a steady stream of income for life, while at the same time, contributing to a charity that she loves?*

Charitable Gift Annuity Outcome

Ms. Teacher has a passion for Education and for the ***Don't Be A Fool, Stay in School Foundation***. She would like to address her current income tax problem while making a tax-wise gift to the ***"Foundation"***.

- Gift Annuity Data

  First Person: Ms. Teacher Age: 84

  Gift Value: $100,000 Life Exp.: 8.1 yrs.

- Summary of Annuity

  Charitable Deduction: $57,332

  Annuity Payout: $ 7,600

  Exclusion Ratio: 81.4%

  Tax Free Payments: **$6,186**

  Annual Rate of Return: **7.6%**

Goals realized: Ms. Teacher gets income and a break on taxes. The *Foundation* gets a sizeable gift.

Charitable Reminder Trusts (CRT)

- The donor gives the “tree” but not the “fruit”.
- The donor gets an immediate tax deduction and annuity for life (or period of years).
- The donor does not pay capital gains taxes on the contribution.
- The Charitable Remainder Trust can be ***“intervivos”*** (transferring assets during a donor’s life), or “testamentary” (established by will or trust provision to take place at the death of the donor).
- The low interest rate climate is not the best for a Charitable Remainder Trust, but is still a good vehicle for a donor who wishes to remove appreciated assets (like securities or property not earning a good return), from an estate.

Large CRAT (or CGA) – Bunching

- $1M contribution to a CRT with donor age 70
- 5% Annuity results in $50,000 annual payment to donor
- Up front charitable deduction exceeds $450,000
- Old law – May prefer to spread out deductions (5 year carryover)
- New law favors bunching in one year

Charitable Lead Trust

- The donor gives the “fruit” to charity but not the “tree”.
- Example: The charity gets the income interest (the “fruit”) of an asset belonging to the donor (like income from a stock portfolio) but the actual property is kept in trust for a period of time.
- The donor’s designated “remaindermen”(her children) take the remainder of the asset, with appreciation, upon her death.
- Some charitable lead trusts result in an immediate charitable income tax deduction. The current atmosphere of low interest rates results in higher gift tax deductions.

A donor can use a Charitable Lead Trust to obtain a charitable estate tax deduction, and still use the trust asset to provide for her family after her death.

Life Estates

- With a life estate, the donor gives title to an asset, like a house or farm, to a charity, but maintains the right to live in or use the asset for life.
- The donor receives an immediate charitable deduction, but usually maintains the asset and pays any taxes owed.
- Special care is required for valuation on the property. An appraisal is required.
- This is a good option for those who own an asset outright, want a large income tax savings now, and who want to use the asset for life. Tax benefits include a charitable deduction and the avoidance of capital gains tax.

Life Estate Example

Ms. Fan, is a St. Vincent College Alum and an ardent Steelers fan. She wants to move to Florida, but her children still reside in western Pennsylvania. Her entire estate is worth $1.5 Million, plus her house near St. Vincent College, which has been valued at $250,000.

Ms. Fan is of a charitable mindset and loves St. Vincent College. But, she also loves her adult children and wants to provide for them. Even if she moves to Florida, she plans to return to Latrobe each year for Steelers training camp, which she and her children always attend together. Ms. Fan wants her children to be the sole beneficiaries of her $1.5 Million estate.

Here is what Ms. Fan did to realize her goals:

- She donated her Latrobe house to St. Vincent College, retaining the right, as a Life Estate, to use the house for her life. She got a tax deduction, and bought a condo in Florida, where there is no state income tax.
- Ms. Fan and her family continue to use the Latrobe house, meeting there several times per year, especially during Steelers training camp.
- St. Vincent's College gets the remainder of the house at the donor's death, using it for visiting professors. Ms. Fan's children inherit the remainder of her $1.5 Million estate.

Questions:

For more information on your specific issue, feel free to contact:

Jack R. Owen, Esq.

Owen & Conley, LLC

310 Grant Street, Suite 1005

Pittsburgh, PA 15219

412-765-1020

jowen@owenconley.com

THANK YOU!