# OVERVIEW OF CHARITABLE GIVING OPPORTUNITIES

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# Benefits of Combining Charity and Family

- Develop Next Generation Moral and Social Values
- Educate Next Generation on Investments
- Tax Advantages Ways to Transfer Wealth to Next Generation

# Focus of Charitable Planning

- Coordinate <u>How</u> to Give
- Coordinate <u>When</u> to Give
- Coordinate <u>What</u> to Give

## Federal Estate and Gift Tax Exemption Equivalents

| Year | Estate Tax | Gift Tax | Top Bracket |
|---|---|---|---|
| 2009 | $3,500,000 | $1,000,000 | 45% |
| 2010 | REPEAL* | $1,000,000 | 35% |
| 2011-2017 | $5,000,000* | $5,000,000* | 40% |
| 2018-2025 | $10,000,000* | $10,000,000* | 40% |
| 2026 > | $5,000,000* | $5,000,000* | 40% |

- Annual gift tax exclusion of $17,000
- Exemption amount is indexed for inflation from 2011, so in 2023, the exemption amount is $12,920,000

# Outright Gifts

- Easiest to do
- Donor gives up complete control and charity receives full value and use of the asset
  - Donor receives income tax deduction for contribution during life
  - Estate receives estate tax deduction for contribution at death
- Contribution of appreciated securities during lifetime provides not just an income tax charitable deduction, but also avoids the unrealized capital gain

# Planning with an IRA (the Secure Act 2.0 and QCDs)

- Qualified Charitable Distributions (QCD)
  - Participant over 70 ½ can make distributions from an IRA directly to qualifying charities
    - Limited to $100,000 per year
    - Counts towards required minimum distributions

- Changes made by Secure 2.0
  - $100,000 limit indexed for inflation (rounded to the nearest thousand)
  - One time $50,000 contribution to a charitable gift annuity or charitable remainder trust

- Loss of ability to stretch IRA to most non-spouse beneficiaries
  - Introduced by Secure 1.0
  - Limited to payout over 10 years
  - Naming a CGA or CRT as beneficiary at death may extend deferral

# Charitable Gift Annuities – General Characteristics

- Annuity contract between charity and donor
- Transaction is both a purchase of the contract and a charitable contribution
- Charity pays donor a regular, fixed sum each year for the rest of donor's life
- Amount of annuity depends on donor's age, size of the gift, immediate or deferred income payments, and whether a second person is to receive payments
  - Immediate annuity begins upon contribution
  - Flexible deferred annuity begins at a date no later than a set date
  - Testamentary annuity paid to someone other than decedent
- Issue of CGA's by charities is subject to state regulation

# Charitable Gift Annuities – Tax Consequences

- Income Tax Treatment
  - Charitable contribution is equal to how much the value of the property contributed exceeds the FMV of the annuity
  - FMV of the annuity is measured using IRC § 7520 tables
  - Deduction is subject to donor’s AGI limitations
  - If appreciated property is transferred, treated as a bargain sale and any capital gain realized is recognized by the donor as annuity payments are made (no gain if cash contributed)
  - Annuity payments contain both taxable income and return of capital

# Charitable Gift Annuities – Tax Consequences (cont.)

- Gift Tax Treatment
  - Donor receives gift tax charitable deduction for amount going to charity which should be reported on gift tax return
  - If annuity is payable to a second person, portion of annuity is treated as gift (qualifies for $17,000 per year annual exclusion and marital deduction)
- Estate Tax Treatment
  - Single life annuity, no inclusion in donor's estate
  - Value of survivor's interest in two life annuity included in donor's estate
  - Estate tax charitable deduction allowed if established at death

# Charitable Gift Annuities – Examples

## One Life Immediate Annuity*

Mary
Age 72
Rate 6.2%

| | |
|---|---|
| Market value: | $50,000 |
| Cost Basis: | $20,000 |
| Charitable Deduction: | $18,604** |
| Annuity: | $ 3,200 |
| Tax Free Income: | $ 2,080 |
| Capital Gain Income: | $ 0 |
| Ordinary Income: | $ 1,020 |

Life expectancy: 14.6 years

* Same results if a testamentary annuity paid to another 72 year old
** Income tax deduction during life, estate tax deduction at death

# Charitable Gift Annuities – Examples (cont.)

## One Life Deferred Flexible Annuity

Mary
Age 72
Rate 8.0%*
Payments deferred until at least 2028

| | |
|---|---|
| Market value: | $50,000 |
| Cost Basis: | $20,000 |
| Charitable Deduction: | $26,930 |
| Annuity: | $ 4,000 |
| Tax Free Income: | $ 2,024 |
| Capital Gain Income: | $ 0 |
| Ordinary Income: | $ 1,976 |

Life expectancy: 11.9 years

* Annuity rate gets higher the longer the beginning date of the annuity is deferred

# What is a Split Interest Trust?

- A tax-exempt trust designed to pay you or your beneficiaries a stream of income for life or for a term of years (Charitable Remainder Trust)

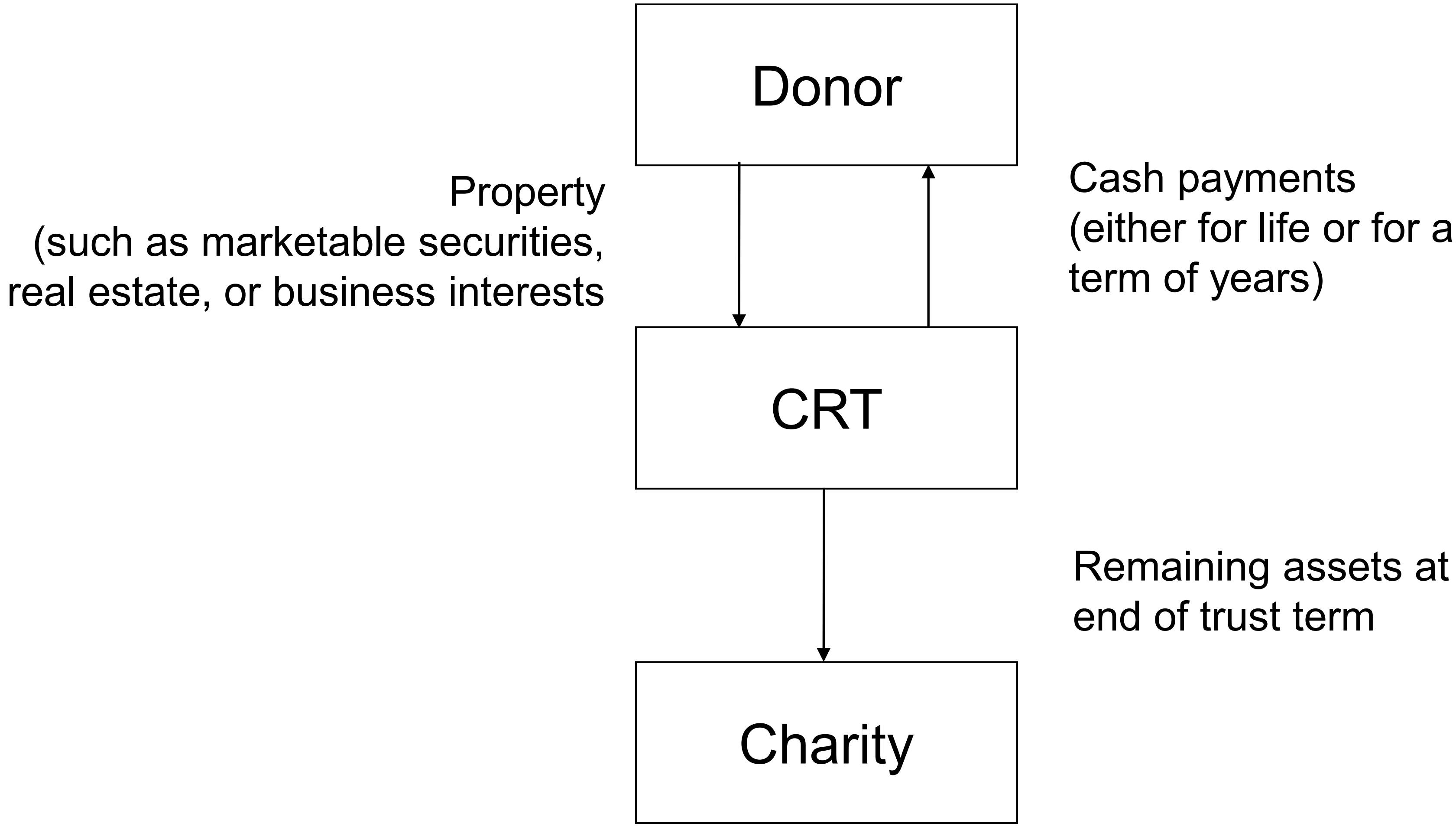
- A taxable trust designed to pay a charity a stream of income for a life or for a term of years (Charitable Lead Trust)

- The income stream can be a fixed dollar amount or a fixed percentage of the trust's value determined annually

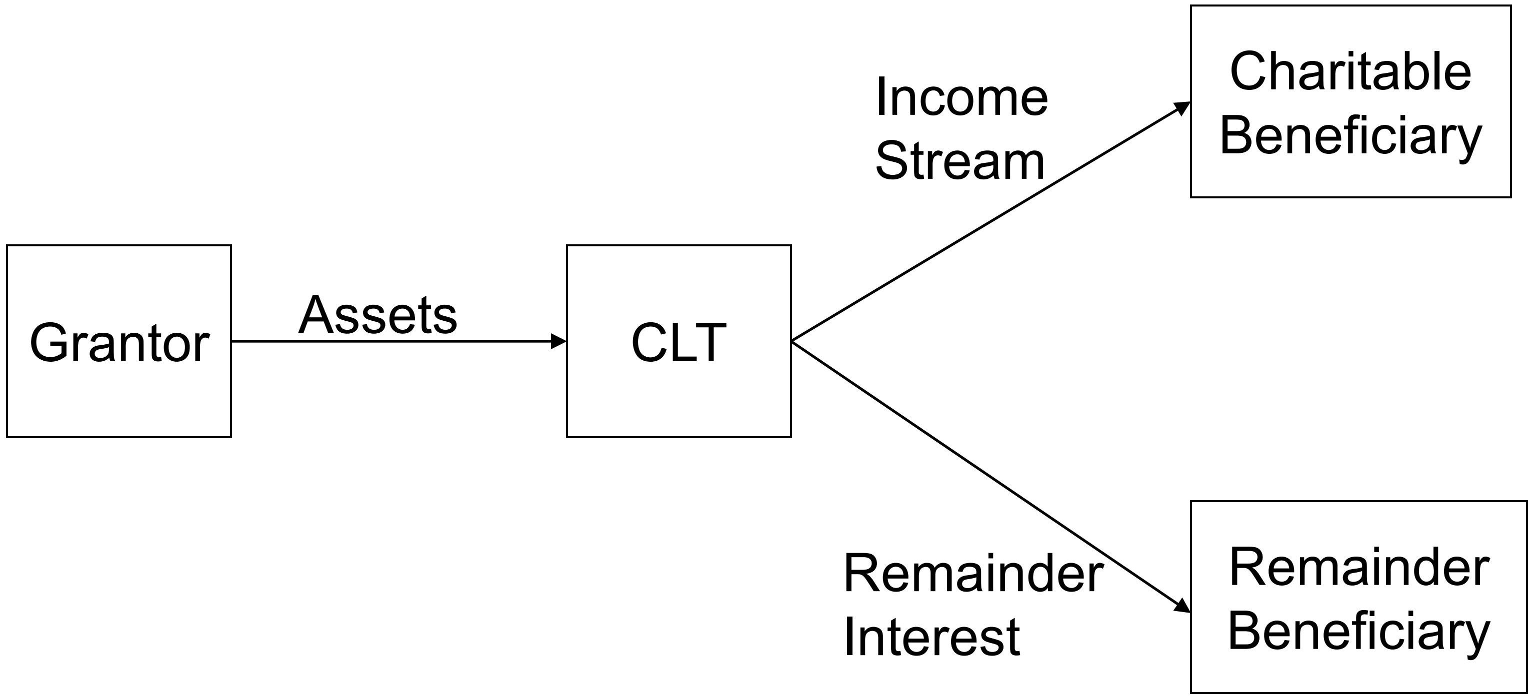
# What is a Split Interest Trust, Cont.

- At the end of the term of the CRT, the assets that remain are paid to the charities of your choice
- At the end of the term of the CLT, the assets that remain are paid to non-charitable remainder persons (can include grantor and/or grantor’s family members)
- CRTs work better when §7520 rates are higher
- CLTs work better when §7520 rates are lower
- CRTs/CLTs can be created during life or at death

# Charitable Remainder Trust “CRT”



# Charitable Lead Trust (“CLT”)



# What Objectives can a CRT Accomplish?

- Increase income during Donor's lifetime (i.e. supplemental retirement plan)
- Achieve asset diversification
- Obtain income tax deduction against high income
- Immediately reduce value of estate without regard to living out a term
- Leave charitable legacy

# What Objectives can a CLT Accomplish?

- Reduce gift and estate tax impact on passing property to family descendants (children and/or grandchildren)

- Leverage generation skipping exemption

- Grantor and family forgo immediate use of property in exchange for prospect of long-term capital appreciation that would then be available for children and grandchildren at end of term

- Immediately removes value of estate without regard to living out a term

# Types of Split Interest Trusts

- Charitable Remainder Annuity Trust (CRAT) and Charitable Lead Annuity Trust (CLAT)
  - Income stream is a fixed dollar amount
  - Income does not fluctuate
  - Steady predictable payout
  - No additional contributions allowed

# Types of Split Interest Trusts, cont.

- Charitable Remainder Unitrust (CRUT) and Charitable Lead Unitrust (CLUT)
  - Income stream is a fixed percentage of the value of the trust assets
    - With a CRUT, full payment of set income stream can be delayed until a certain event, like the sale of property contributed to the trust, called a "Flip" trust
    - Trust agreement provides that any income required to be paid prior to the flip date, but wasn't because the income was insufficient, must be caught up after the flip date (net income with make up provision CRUT or NIMCRUT)
  - Trust re-valued each year (require "qualified appraisal" if Donor or related or subordinate party serve as Trustee); WELS Foundation is usually serving as Trustee and is an independent trustee, which mitigates the appraisal need
  - Income fluctuates with asset value
  - Additional contributions allowed

# Who Can be a Donor?

- An Individual, Corporation, Partnership or Trust
- Donor characteristics that make donations to charitable trusts beneficial:
  - High Income Tax Bracket
  - Own Appreciated Asset (CRT)
  - Own Assets that are expected to greatly appreciate that donor can part with for some time (CLT)
  - Desire to Avoid Capital Gains and Estate Taxes
  - Desire to Contribute to Charity

# Who can receive trust income?

- CRT: Donor, Spouse, Children for lifetime(s) or term of years (maximum term of 20 years)
- CLT: Charities for a lifetime (restrictions on who can be used as a measuring life – no “ghoul trusts”) or term of years

# Who can be a remainder beneficiary of a split interest trust?

- CRT: Private Foundations (including those established by the Settlor), Public Charities, including:
  - WELS Foundation
  - Hospitals
  - Churches
  - Schools/Universities
- CLT: Non-charitable beneficiaries, including
  - Children
  - Grandchildren

# Who can be a trustee?

- Individual
  - The donor could be the trustee of their own CRT and CLT; however, if not administered correctly, tax advantages could be lost
- Corporate Trustee
  - WELS Foundation
  - Bank or trust company
- Charity

# What are the benefits for the donor?

- Current income tax charitable deduction (CRT)
- Defer or avoid capital gains tax on the trust’s sale of the low-basis property
- Convert asset to income (i.e. cash flow)
- Retain income stream for life or a term of years (CRT)
- Reduce estate tax
- Benefit one or more charities of choice

# Income tax deductibility for donations to charity

- Type of property donated, identity of donee, and AGI of donee impact the amount deductible

- Public charities

  - Capital gain property deductible at fair market value; ordinary income property deductible at cost

  - 50% AGI limitation for ordinary income property; 30% AGI limitation (usually) for capital gain property

# What are the income tax implications of a CRT?

- The donor is allowed a current income tax charitable deduction upon the transfer of assets to the CRT
- The amount of the tax deduction is based upon several factors, including the donors’ age and the present value of the future interest.
- No capital gains tax is recognized when the CRT sells the assets since the CRT is a tax-exempt entity
- Income (annuity or unitrust payment) is taxable to the donor when received

# Income Taxation of CRT and Income Recipient

- Income Recipient: 4 Tier System
  - Ordinary income
  - Capital gain
  - Other income (for example, tax-exempt income)
  - Corpus/Return of principal

# Income Taxation of CLT

- Grantor CLT
  - Current deduction is allowed upon funding, but all income, deductions and credits of the CLT are taxed to the donor during the term of the CLT
  - Advantageous if donor has high bracket in year of donation and anticipated lower brackets during term
  - Also advantageous if CLT is funded with assets that do not produce income (tax exempt bonds or no dividend yield stock)
- Non-Grantor CLT (separate taxpayer from donor)
  - No deduction allowed upon funding, but donor is <u>not</u> taxed on assets inside trust
  - CLT treated as a complex trust for income tax purposes

# Gift Tax Implications

- CRTs
  - No gift tax on value of charitable remainder or when Donor retains income interest
  - Gift is made when income interest paid to someone other than Donor
  - Retain testamentary right to revoke survivors income interest to avoid gift
- CLTs
  - Present value of remainder interest is gift, and GST exemption may be allocated to the transfer

# Estate Tax Implications

- CRT
  - No estate tax payable on remainder
  - When settlor retains income interest, trust assets includible in gross estate, but deduct value of charitable remainder
  - When trust provides for second beneficiary, if second beneficiary survives, value of survivor's interest is taxable
- CLT
  - No estate payable on remainder unless it reverts to Settlor at end of term

# CRT Qualification Rules

- CRTs: The income stream retained by the donor cannot be less than 5% nor more than 50% of the fair market value of the trust assets
- CRTs: The charitable remainder interest must have a present value equal to or greater than 10% of the total amount initially transferred to the trust (and additional contributions in the case of a CRUT)
- CRATs, deduction will be denied if probability exceeds 5% that annuitant will survive beyond exhaustion of trust assets

# What assets work best?

- Publicly Traded Marketable Securities
- Investment Real Estate
- Closely-Hold Business Stock
  - (<u>NOT</u> S Corporation Stock)

# MARKETABLE SECURITIES EXAMPLE

# Assumptions

- Charitable Remainder Unitrust (“CRUT”)
- Entered into in March, 2023
- Highest/Best §7520 Rate is January/February, 2023: 4.6%

# Assumptions:

| | |
|---|---|
| Term: | 20 Years |
| Securities - FMV: | $1,000,000 |
| Securities - Basis: | $200,000 |
| Expected Growth: | 3% |
| Expected Income: | 5% |
| CRT Income Stream: | 6% of prior year end value, so fluctuates |
| Capital Gains Tax: | 18% (combined federal & state) |
| Ordinary Income Tax: | 40% (combined federal & state) |
| Estate Tax: | 40% |

# INCOME TAX RESULTS:

| | W/O CRUT | W/CRUT |
|---|---|---|
| Fair Market Value | $1,000,000 | $1,000,000 |
| Capital Gains Tax | - 144,000 | - 0 |
| Balance to Reinvest | $ 856,000 | $1,000,000 |
| | | |
| 6% Annual Income | $ 51,360 | $ 60,000* |
| Income over term | $1,027,200 | $1,399,863 |
| | | |
| Income tax deduction | $ 0 | $ 290,106 |
| Income tax benefit | $ 0 | $ 116,042 |

## ESTATE TAX RESULTS:

| | W/O CRUT | W/CRUT |
|---|---|---|
| Gross Value of Estate | $ 856,000 | $ 0 |
| Estate Tax | -342,400 | 0 |
| Net Estate for Heirs | $ 513,600 | $ 0 |

## BENEFIT SUMMARY:

| | | |
|---|---|---|
| Family Benefit<br>(lifetime income + income tax benefit + net estate) | $1,540,800 | $1,515,905 |
| Amount to Charity | $ 0 | $1,371,099 |
| Total Benefit | $ 1,540,800 | $2,887,004 |