

Kingdom Advisors Charitable Giving Tool Kit

I. Outright charitable gift arrangements

- Gifts of appreciated publicly-traded stock or real estate: For most donors, gifts of appreciated assets are more beneficial than gifts of cash. By giving appreciated stock or real estate, the donor can deduct the fair market value (not the cost basis) of the asset, and further avoid all capital gains taxes on the donated asset. Clients should select long-term appreciated assets (stocks or real estate owned for longer than one year) to achieve these benefits.
- Gifts of stock in closely-held business: Owners of closely-held businesses may find that their lack of liquidity prevents them from making lifetime charitable gifts of cash. However, these owners may donate stock from the business and deduct the fair market value (as determined by a qualified appraisal) of the stock. This technique is especially useful if the owner is anticipating selling the company in the near future, as the donor not only avoids capital gains tax on the donated stock, but the charitable deduction can offset income generated by the sale of the business.

The stock can be given directly to a charity, or transfer the stock to a Donor Advised Fund account (see below). Charity will be subject to Unrelated Business Taxable Income (UBIT) during time that it holds the stock, and must evaluate the impact of that taxable income to the organization.

II. Deferred charitable gift arrangements

Many charitably-inclined individuals desire to make a significant gift to charity, but lack the liquidity or capacity to make those gifts during their lifetime. As a result, they opt to defer their gift in a manner that meets their need for financial flexibility.

- Bequests: The most common deferred gift arrangement, the donor includes a provision in their Will/Living Trust, giving a specified dollar amount or percentage of their estate to certain named charities. This bequest is revocable, meaning that the donor can change or revoke the gift completely any time prior to their death. Since the gift is not complete until the donor's death, there is an estate tax deduction but no income tax deduction for the gift.
- Gift of IRA assets at death: Similar to a bequest, the donor chooses to make this gift from their IRA account instead of their other estate assets. IRA's are potentially subject to both estate tax and income tax if passed to heirs, a dual tax rate that can exceed 60%. Since charities pay no taxes, the IRA owner can name the charity as beneficiary (specific dollar amount or percentage), typically after the owner and

spouse have both died. This must be specified on the Beneficiary Designation form for the account, as this designation (and not the Will/Living Trust) controls the disposition of IRA assets. This gift is also revocable until the donor's death, and provides an estate tax deduction (no current income tax deduction).

- Charitable Life Estate Agreement (Gift of Residence or Farm): As stated above, a bequest provides no current income tax benefits to a donor, since the gift occurs after the donor's death.

However, by utilizing a Life Estate Agreement, a donor can give the family residence or farm to charity, retain the right to live on the property for their lifetime, and receive a current tax deduction reflecting the present value of the gift of the property to charity. Charity becomes the legal owner immediately upon the client's death, with no probate or estate taxes involved.

The client remains responsible for all taxes and maintenance of the property during the client's lifetime, and the Agreement can be drafted so as to provide for the client moving into a retirement home/assisted living facility prior to their death.

Some creative Charity's have combined this Agreement with a Charitable Gift Annuity (see below). In that case, the charity (which must have an endowment for some other form of available cash) provides the client with annual fixed income to assist with the taxes and maintenance of the property until Charity takes ownership at the client's death.

III. Deferred charitable gift arrangements that provide life income (irrevocable)

- Charitable Gift Annuity: Offered by charities and community foundations. Donor receives fixed income for life in exchange for cash/publicly-traded securities. Donor also receives current income tax deduction, based on amount calculated to be left for charity after annuitant's death. Portion of annuity payments are tax-free return of principal.

(1) Immediate payment gift annuity: Annuity payments begin in quarter after agreement established. Annuity rate based upon age of annuitant, with older donors receiving higher rates.

(2) Deferred payment gift annuity: Annuity payments are deferred to a future date (usually anticipated date of retirement). Deferral of payments increases annuity rate (favored by working donors in their 50's.)

- Charitable Remainder Trust: Donor establishes special tax-exempt trust (CRT) and typically funds trust with highly appreciated assets (e.g. stock or real estate). Donor avoids capital gains taxes and receives lifetime income from trust. When last trust beneficiary dies (usually second spouse to die) charity(s) receive remainder. Donor

qualifies for current income tax deduction based on value of remainder interest. Donor selects payout rate for trust, usually 5%-7%. Trust assets grow tax-free within trust.

(1) Charitable Remainder Unitrust (CRUT or SCRUT): Beneficiaries receive variable annual income from trust, based upon percentage rate of trust applied to value of trust assets for given year. Example: \$1 million 5% CRUT pays out \$50,000 in Year 1. Trust earns 10%. In Year 2, value of trust is \$1,050,000 and trust pays out \$52,500. Designed for younger donors (below age 70) who want annual income from trust to keep pace with inflation.

(2) Charitable Remainder Annuity Trust (CRAT): Beneficiaries receive fixed annual income from trust, based upon percentage rate of trust and trust value at time trust is established. Example: \$1 million 5% CRAT pays \$50,000 in Year 1. Trust earns 10%. In Year 2, trust once again pays out \$50,000. Trust must be funded with assets that are sufficiently liquid for trust to make required annuity payments. Designed for older donors (age 70 and older) who are less subject to affects of inflation.

(3) Charitable Remainder Unitrust with Net Income Makeup (NIMCRUT): Variation of CRUT which provides that beneficiary receives lesser of payout rate of trust (e.g. 5%) or net income earned by trust. If beneficiary receives lesser (net income) amount, any deficiency is credited to a "make up account" and paid out in a future year when trust earns income which exceeds payout rate. Example: \$1 million 5% NIMCRUT earns 2% in Year 1. Trust pays out \$20,000 (net income is less than 5% payout) and credits \$30,000 to makeup account. In Year 5, Trust earns 8% and pays out \$50,000 plus \$30,000 in makeup account. Favored by donors who want to defer trust income to future years.

(4) Charitable Remainder Flip Trust: Variation of CRUT in which trust initially operates as NIMCRUT, providing lesser of trust payout or net income (any deficiencies are made up in later years). Then, upon a specified triggering event (e.g. retirement, sale of non-liquid asset), the trust "flips" and operates as a standard unitrust. Example: \$1 million 5% flip trust is funded with shares of a growth stock paying very low (e.g. 1%) dividends. The trust pays out 1% each year (the lesser of 5% or the income earned by the trust) with 4% credited to the makeup account each year. Upon the date specified in the trust agreement, the donor retires and the trust "flips" to a standard unitrust and pays 5% of the fair market value of the trust assets as revalued annually. This arrangement is favored by donors with non-liquid assets or who wish to defer income to future years.

- Pooled Income Fund (PIF): Usually offered by larger charities (universities and hospitals), a pooled income fund accepts gifts of cash or publicly-traded securities and commingles (pools) all donor gifts for investment purposes. Each year, the donors receive their proportionate share of the net income earned by the pool. Upon the death of a PIF donor, the portion remaining is used by the charity for its mission.

Favored by younger donors during high interest rate environments, PIF's have fallen into relative disuse in recent years.

IV. Charitable gifts that provide gift/estate tax benefits (irrevocable)

- Charitable Lead Trust (CLT): A charitable lead trust allows a donor to establish annual payments to charity for a specified number of years and then pass the trust assets to heirs at significantly reduced (or even zero) tax rates. This is accomplished (primarily during extremely low interest rate environments) by reducing the taxable value of the future gift to the heirs by the combination of (a) charitable deductions earned annually by the trust and (b) the passage of time before the trust ends and the heirs receive the trust assets. Unlike a charitable remainder trust, a CLT is not a tax-exempt trust, and must be funded and administered with a high degree of skill. There is no current income tax deduction, as the trust is designed for gift/estate tax benefits.

(1) Charitable Lead Annuity Trust (CLAT): Lead trust that pays a set dollar amount to charity annually for a specified term of years, after which the trust assets pass directly to heirs. Example: Donor owns a \$1 million apartment building which has been depreciated to near zero. She would like to pass this asset on to her heirs while providing annual support for her favorite charity. She establishes a charitable lead annuity trust during a time in which federal discount rates are low (3.4%). In order to zero out the trust for gift tax purposes, she sets the annuity rate at 7.5% and selects a 20-year term of years for the trust. The trust pays her charity \$75,000 each year for 20 years, after which her heirs receive the apartment building (plus any appreciation) tax-free.

(2) Charitable Lead Unitrust (CLUT): Lead trust that pays variable income annually to charity (based upon a fixed percentage of the trust assets as valued annually) for a specified term of years, after which the trust assets pass directly to heirs. Most lead trusts are set up as annuity trusts, since the certainty of the fixed payments to charity allows the trust to be "zeroed out" for gift/estate tax purposes.

V. Charitable Foundations (Private and Public)

- Private Family Foundations: A private family foundation is a separate legal entity (either a corporation or a trust) funded and controlled by a family or individual for the purpose of making charitable gifts. They are distinguished from public charities and public foundations, which must either receive a broad base of public support for their funding (public charity) or relinquish some element of control in their operations to a public charity (public foundation).

Private family foundations are frequently used to engage in "venture philanthropy", to make gifts to non-U.S. charitable organizations and to facilitate multi-generational giving. Donations to a private foundation provide current income tax benefits

(deductible up to 30% of adjusted gross income for gifts of cash and 20% of AGI for gifts of appreciated assets), though these benefits are inferior to those for donations to public charities or public foundations. Private family foundations come in three types:

(1) Operating Foundation: The donor establishes an operating foundation in order to create their own private charity, as opposed to providing grants to other such charities. A private operating foundation is established in order to operate its own programs or services, such as a museum, historical site or library. Offers the private funding and control elements of a private foundation, along with the direct charitable involvement offered by a public charity.

(2) Non-operating (endowed) foundation: The most common type of private foundation, the private non-operating foundation is funded with assets and uses by an individual or family and uses the investment income from those assets to make grants to selected public charities. The foundation exercises complete control over grants and operations. The principal is invested as an endowment and typically not spent. Non-operating foundations are required to give a minimum of 5% of the value of the trust assets annually to charity.

(3) Pass-through foundation: A private pass-through foundation is a foundation that distributes all of its contributions in a given year to charity, instead of the 5% minimum for non-operating foundations. A foundation may elect the pass through option on an annual basis.

- **Public family foundations**: A public family foundation is a charitable entity established with some formal connection to a public charity (or structure that has been granted the tax status of a public charity, such as a Donor Advised Fund). While usually funded by an individual or family, a public family foundation relinquishes some aspect of control to the public charity to which they are connected. By relinquishing this control, the public family foundation may deduct donations as if the donations were made directly to a public charity (up to 50% of adjusted gross income for gifts of cash and up to 30% of AGI for gifts of appreciated assets). Public family foundations fall into two basic categories, Supporting Organizations (three types) and Donor Advised Funds:

(1) **Supporting Organizations**: A supporting organization can be established by an individual or family, and is created for the express purpose of supporting one or more existing public charity (or community foundation). This support relationship allows the supporting organization to enjoy the tax status of a public charity, even though it lacks the “broad base of public support” requirement of public charities. To qualify as a supporting organization, the entity must be operated or controlled either by, with or in connection with a public charity. The individual or family may only have a minority vote in the governance of the organization. Supporting organizations come in three types:

(a) Type I: This supporting organization is operated or controlled “by” one or more public charities, similar to a parent-subsidiary relationship.

(b) Type II: The supporting organization is operated or controlled “with” a public charity, with common supervision between the two organizations. Similar to a brother-sister relationship.

(c) Type III: This supporting organization is operated or controlled “in connection with” a public charity. This structure has come under intense IRS scrutiny, as the supporting organization must prove that it is both “responsive to and significantly involved” in the operations of the public charity.

(2) Donor Advised Funds: rapidly gaining in popularity, DAF’s are offered by brokerage firms to their clients (Fidelity’s Gift Fund is one of the largest foundations in the world), community foundations and some individual charities. A DAF is analogous to a “charitable checking account”, in that the donor (the “Advisor”) opens an account with the organizations (the “Sponsor”) and deposits cash or other assets. The Advisor then submits grant requests to the Sponsor for gifts to IRS-approved public charities, with the Sponsor retaining final control over the distribution.

By relinquishing this control element to the Sponsor, the donations of the donor/Advisor qualify for tax treatment of public charities (deductible up to 50% of adjusted gross income for cash, 30% of AGI for appreciated assets). Even better, the deduction occurs at the time funds are deposited into the account, not at the time they are ultimately distributed to charity. And because it is not subject to the rules of private non-operating foundations, there is no requirement that a minimum of 5% of the assets in the account be distributed on a yearly basis.

The Advisor can name children or grandchildren as successor advisors, and thus can involve them in multi-generational philanthropy.