HOOK LAW CENTER

SPECIAL REPORT

Charitable Gifts

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There are many different ways to make charitable donations. The variety of options makes it easier to find a means of giving that best fits your personal goals and financial situation, as well as retirement concerns. The purpose of this article is to inform you of the different giving possibilities that are available to a donor who wishes to give to a public charity as defined by the IRS. This article will address the three main categories of charitable giving: (1) ways that you can give during your lifetime by making outright gifts of cash, appreciated property, or real estate, (2) ways of giving after your lifetime, and (3) gifts that are made in partnership with the charitable organization. This article will hopefully provide you with enough information that you have a basic understanding of the issues involved with each giving method and allow you to more effectively seek assistance from a professional, which is necessary for many of these options, to fulfill your giving wishes. Charitable giving requires one to consider three potential variables, all three of which are important in general planning – timing, taxes, and liquidity.

It is important to note that aside from the personal satisfaction derived from altruistic giving to worthy causes, many of these options also present the donor with several tax benefits, some quite substantial. If taking advantage of the tax benefits of charitable giving is desirable to you, it is important that you have a plan in place before the donation is made, so that you can take full advantage of any available tax deductions. If the deduction plan is constructed after the donation is made, one runs the risk of time and action delays that can reduce the overall tax benefit of the gift. Thus, it is recommended that, prior to making any sizeable donation, you speak to a professional advisor and the organization and have a plan in place before you actually make the donation. Since the IRS often requires thorough documentation of any gift in order to get a deduction, it is critical that the recipient organization is on board with your plan. This will help to ensure that both you and your chosen charitable organization will derive the full benefit of your generosity.

Gifts You Can Make Now

The easiest and most common form of charitable gift that can be made during your lifetime is an outright gift of cash. This simply involves either writing a check or making a donation in cash to the organization. Charitable organizations can then easily use the money for a purpose it designates. Cash gifts can also be given for a use that you designate, but, as a general rule, that applies not only to cash gifts but to any charitable gifts, if you want your donation to be used only for a particular purpose, you must get a prior commitment from the organization that this is acceptable. For example, if you wish to make a donation to St. Paul's Church to be used for the restoration of the church, check to make sure that this is acceptable with the entity. Cash gifts also provide donors with two tax benefits to reduce the overall net cost of giving. First, they can provide an estate tax deduction (if your estate is subject to estate tax) by removing assets from your estate, thereby lowering the value of your estate through the charitable deduction. Secondly, cash gifts also provide donors with a charitable gift income tax deduction. Donors who itemize their deductions can receive a deduction of up to 50% of their Adjusted Gross Income (AGI) for a cash donation every year. In the event that your donation exceeds 50% of your AGI in a given year, the deduction can be rolled over and used on a subsequent tax filing for up to five years. It is important to remember to get a receipt from the organization for any gift by check exceeding $250 or any gift of cash as proof of your donation. From a financial planning perspective, it is beneficial to estimate the amount of tax you will have to pay each spring prior to tax time. Then, before the prior year concludes, you have the best information possible as to the amount you can give and the offsetting tax benefit. For those who are already itemizing, writing a check to a local charity may be more enjoyable than writing a check to the IRS.

Another option of charitable giving that can be made now is an outright gift of appreciated property. This typically includes gifts of appreciated securities (stocks, mutual funds, etc) that have been owned for more than one year, real estate (which will be discussed in more detail below), or appreciated personal property such as art, antiques, or collectibles. The key advantage to gifts of appreciated property is that it enables you to enjoy not only an income tax benefit of up to 30% of your AGI, but it also allows you to avoid paying capital gains tax on the amount that the property or securities have appreciated since you have owned it. Generally, capital gains are calculated by taking the value of the property now and subtracting the value of the property when you purchased it. Simply put, as the value of the property such as stocks increases, so do the federal capital gains taxes, which are normally assessed at 15% of the appreciated value. Although the rest of this section deals with securities, remember that securities are not the only property that can be donated. Some appreciated personal property can also make a useful gift, and can generate tax deductions based on the property's appraised fair market value. When dealing with other forms of personal property, it is especially important to coordinate with the organization first to make sure that both you and the charity benefit from the donation. Although a home can be given, a personal residence is not subject to income tax up to the first 250,000 of growth, and also receives a step-up in basis at death. Thus, personal homes are rarely taxed as aggressively as other forms of wealth.

When dealing with securities that have increased in value, if you were to sell your securities yourself, you would be subject to the capital gains tax. However, if you were to donate securities that you have owned for more than one year to a charitable organization such as a church (which is tax-exempt), you would receive an income tax deduction of the full fair market value of the securities and the church would be able to enjoy the entire value of the securities, including any future growth and dividends. The fair market value of the securities is calculated as the average between the high and low trade price of the stock on the day the gift is made multiplied by the number of shares donated. Though appreciated property only qualifies for a 30% of your AGI deduction, like the cash gift deduction, any unused excess deduction can be used for up to five subsequent years. Given today's market conditions, however, many people hold stock that has depreciated in value since the time that it was purchased. This presents a different giving possibility that is also beneficial to both you as the donor and the organization you wish to donate to. When dealing with stock that has lost value since the time it was purchased, you can sell the stock yourself, thereby allowing you to take a capital loss tax deduction, and then donate the proceeds of the sale to the charity to generate an additional income tax deduction. This procedure helps to further reduce the net cost of your donation.

The last possible donation option that can be gifted now is an outright gift of real estate. As discussed above, real estate is appreciated property that is subject to capital gains tax when it is sold, although some growth is exempt from tax. Although federal tax law allows a sizeable exclusion of the property's appreciated value if the property has been used as your primary residence for two of the last five years, other property such as a vacation home or additional land that you might own will be subject to the full capital gains tax. If you choose to donate that land to a charitable organization, however, you obtain an income tax deduction of the fair market value of the property and avoid capital gains tax on the property's appreciation. Your deduction for a gift of appreciated real estate that has been owned for more than one year is generally limited to 30% of your AGI in any one year, with a five-year carryover of the unused deduction. For real estate you have held for less than a year, your charitable deduction is limited to the property's cost basis, but there is no tax on the appreciation. The deduction may then be claimed up to 50% of your AGI, again with a five-year carryover for any excess value. As mentioned above, if you are considering this option, you will want to consult with a financial professional and the organization prior to making the gift both to ensure that the organization can accept the gift and to coordinate the donation to the current tax year to make sure that the full tax benefit can be realized.

Gifts You Can Make After Your Lifetime

There are many different options available when making gifts after your lifetime. These options include bequests in either a will or revocable trust, gifts of the proceeds from a retirement plan, and gifts derived from a life insurance plan you may own. These options are all revocable decisions, which mean that you can change your mind or adjust amounts and beneficiaries up to the point that you pass away. This flexibility enables you to enjoy full use of the assets during your lifetime and to distribute assets after your death in a way that is advantageous to both the charitable organization and to your heirs who will be able to enjoy the tax benefits provided by these options.

The first option is the traditional bequest in either a will or a revocable living trust. A bequest is achieved by naming a specific party, which can be a charitable organization in your will along with an amount or item to be given to that party. Bequests can be of any asset that you own, and can be made for a specific item, amount, percentage of your estate, or can be of the "rest, residue and remainder" of your estate. This is the value of your estate that is left after all of your other wishes are carried out. One can also make a contingent bequest, which will take effect only if a stated condition is met. Bequests to charitable organizations can be either restricted or unrestricted, meaning that they can be designated to be used for a stated purpose or can just be given to the organization to use in a way that they see best. Some of the advantages of a bequest are that it enables you to continue using the assets by deferring the giving until after your lifetime, it allows you to make sure that an organization whose cause you care about continues to receive money after you are gone, and the fact that charitable donations are exempt from estate tax. This is an important decision and you should think carefully about what you want given to whom. After considering the issue, it is important that you talk to an attorney who can draw up or amend your will so that your precise wishes will be carried out.

The second charitable giving option available after your lifetime is to designate a charity as the beneficiary of a retirement plan such as an IRA or a 401(k). An important consideration to keep in mind when deciding who should receive the balance of your retirement account is how retirement plans are taxed. Qualified retirement plans are those that receive favorable income tax treatment during an employee's lifetime. No income tax is due on the funds as contributed, and no income tax is due on the earnings and appreciation while in the plan – you only pay taxes on the funds as you receive them. Usually, the undistributed balance of qualified retirement plans is included in your estate for estate tax purposes; however, since the funds in retirement accounts usually represent deferred compensation that has not been subject to income tax, giving the accounts to individual heirs also exposes the balance to income taxes. Therefore, leaving these funds to an individual could result in double taxation at rates that can be up to 65% of the amount left in the plan. Naming a charitable organization as a beneficiary of a retirement plan, however, allows all of the funds to pass to the organization free of estate and income tax; and also generates an estate tax charitable deduction that can be applied by your heirs to the remainder of your estate, allowing them to receive more of the other assets available in the estate. There are many other considerations that should be taken into account in order to maximize the tax benefit to your heirs and estate, so it is very important that you consult with a professional before pursuing this option.

The third charitable giving option available after your lifetime is to make a gift of a life insurance policy that might no longer be needed to fulfill the purpose for which it was originally purchased. This is an easy way to make a very generous gift with little cost to you, and can be done for insurance policies that are either paid up or for ones on which you are still paying premiums. For example, if the life insurance was originally purchased to make sure your children had money for college, but your children have already graduated, this can make a very generous gift for a charity. Two different options for gifting life insurance are to name the organization owner of the plan or to name the organization a beneficiary of the plan. If you chose to name the organization owner of the plan, then you are relieved of paying any remaining premiums on the plan and allow the organization to surrender the policy to receive the cash value now. Assigning ownership provides you with an income tax deduction now for the fair market value of the plan and removes the proceeds from your estate thereby reducing estate tax. Since you would no longer own the policy, it would be fully outside of your taxable estate. You could instead choose to name the organization as a beneficiary of your insurance plan. Doing this creates an estate tax deduction for the insurance proceeds. You can also name the organization as a contingent beneficiary of the plan to make sure that your heirs' needs are provided for first.

Life insurance is actually a very versatile tool, however, and can be used in a variety of other ways. One of the greatest increases in use for life insurance is to replace the value of assets being given, in some way or other, to a charitable organization. For example, it might be more effective to donate appreciated securities to a charity and then use the proceeds from the resulting tax deductions to purchase a similar quantity of life insurance to benefit your heirs. This is an incredibly efficient tax-structured move that leverages the benefits of life insurance with the tax benefits associated with appreciated stock. It often makes sense if the stock is unlikely to appreciate any more or if the company of the stock is going through a transition. Keep in mind that life insurance plans are flexible assets and a financial professional will be able to best help you structure a use that works best for you and your heirs.

GIFTS MADE IN PARTNERSHIP WITH THE CHARITABLE ORGANIZATION

Charitable giving in partnership with a charitable organization involves entering into an agreement with a charitable organization now that provides tangible benefits (besides the tax deductions from such gifts) to you during your lifetime and to the organization after your lifetime. There are several planned giving partnership options available including a Charitable Remainder Trust, Charitable Lead Trust, Charitable Gift Annuity, and Retained Life Estate. These options are considerably more involved and technical than the options discussed previously and require you to consult with both the organization you wish to donate to and a legal or financial professional in order to establish and maintain these generous charitable gifts.

The first planned giving partnership option is the Charitable Remainder Trust. This can be thought of as a combination gift and future investment plan. This option involves placing assets into a trust from which you or a designated beneficiary receives income for the remainder of his/her life. This income can either be a fixed, stable amount that is distributed annually regardless of the current value of the assets in the trust (a Charitable Remainder Annuity Trust) or the income can be a yearly distribution of income based on a predetermined percentage of a yearly revaluation of the assets in the trust based on your age at the time the trust is established (a Charitable Remainder Unitrust). There are certainly benefits to being confident in having a fixed amount of income each year; however, one problem with the Annuity is that the longer you live, the less valuable the payments will become due to inflation. On the other hand, with the Unitrust, you have a hedge against inflation, in that the percentage of income stays the same every year; however, because the percentage is dependent on the value of the assets in the trust, if those assets depreciate, the amount of income you receive will also decrease.

The “gift” part of this trust is that after your or any named beneficiary’s lifetime, the remaining value of the assets in the trust then pass to the charitable organization. Thus, you and potentially another beneficiary receive a steady stream of income for the remainder of your life while also making a valuable contribution to a charitable organization. Some of the advantages of a Remainder Trust are income, estate, and capital gains tax benefits (if you place appreciated property into the trust) and the opportunity to receive a higher rate of return on the assets put into the trust. For example, one could place $50,000 of stock that currently yields 2% interest per year into a remainder trust that yields 7% interest per year. There are limitations on how much value must still be in the trust at the time that it turns over to the charity, but in this way it is still possible to have a higher rate of return on the same assets and make a valuable contribution to a chosen charity.

A second giving option is the Charitable Lead Trust, which is a trust created to reduce gift and estate taxes on assets you pass to your heirs. This is a very complex giving option. Simply put, this involves establishing a trust either now (an *inter vivos* trust) or after your lifetime (a testamentary trust) that makes either a fixed or percentage payment to the charity for a set amount of time. After the time period is up, the principal in the trust then passes to the heir, usually a child or grandchild. Utilizing this option reduces estate and gift taxes on the inheritance, because the IRS only taxes the present value of the inheritance to the heir at the time the trust is created. It is likely that the assets in the trust will increase in value over time, so the heir will likely receive a larger sum of money when the trust ends because no additional taxes on the increased principal are due. Although this seems like a very nice way to provide both a yearly sum to charity and more for your heirs, this giving option is rarely utilized, however, for several reasons. First, it is unnecessary to try and avoid estate taxes, if your estate is valued at less than $3.5 million at the time of your death, because this is the allowable amount to be distributed free from the 45% estate tax. Second, Charitable Lead Trusts usually require a sizeable amount of assets be placed in the trust, which means that potential heirs must be financially secure so that they will not need the inheritance for some time. Since it is often hard to know the future needs of a family members, this plan if often leveraged alongside inter-vivos gifting. Lastly, there are still gift taxes assessed on the trust when it is established, which can be quite substantial. However, if you have the necessary means such that these disadvantages do not present an obstacle for you, the Charitable Lead Trust can be a very effective means of transferring assets to heirs, while at the same time providing a generous gift for charity.

The third partnership giving option is the Charitable Gift Annuity. The Charitable Gift Annuity is not a trust like those discussed above, but involves an irrevocable contract between you and the organization. Under this contract, you are ordinarily obligated to pay the charity a lump sum amount or donate securities which are assessed at their fair market value, and the charity is obligated to pay you (and possibly one other annuitant) a fixed percentage of that initial donation for the remainder of your lifetime. This percentage is set from an actuarial table which lays out percentages of the gift to be paid by the organization based on how old you are when you establish the Charitable Gift Annuity. The older you are when you establish the annuity, the higher the percentage of yearly payments will be made. It is important to note that, unlike the trusts discussed above in which the yearly payments are made from the assets in the trust, the charity's obligation to make payments to you is independent of the initial donation. Instead, this obligation is supported by all of the organization's assets and wealth. Thus, if you continue to live beyond what is projected based on your age at the time of the gift, the organization is still obligated to continue the gift payments to you even if they have already spent your donation. Like the Charitable Remainder Trust, this option provides the advantages of income, estate, and capital gains tax deductions (depending on the assets given to the organization to establish the Gift Annuity), a stable income for the remainder of your life regardless of the market conditions, and also the opportunity to earn a higher percentage than the assets themselves might yield. It is, however, important to speak to the organization to see if they are capable of this option, although it also might be possible for a professional advisor to work with another organization such as the Norfolk Foundation to make this giving option a possibility.

The last partnership giving option is a Retained Life Estate. The first section of this article discussed gifts of real estate that you could make to a charitable organization. Not only is it possible to make an outright gift of real estate, but it is also possible to make a gift of real estate ― such as your primary residence ― now and to continue to live there for the remainder of your or someone else's lifetime. This enables you to make a very generous gift to a charitable organization, and to continue to have full use of the property for the remainder of your lifetime. After those granted a life estate in the residence have passed away, the charity then takes possession of the real estate to sell and then keeps the proceeds. This option provides substantial income, estate, and capital gains tax benefits; however, keep in mind that these benefits are available because this is an irrevocable gift. This can be a good option if none of your heirs would like to live in your residence after your lifetime. Creating a Retained Life Estate creates significant tax benefits that could enable your heirs to keep more of other assets, while at the same time providing a very generous gift to a charity about which you care deeply.

CONCLUSION

This article is meant to enlighten you as to some of the options that are available to help fulfill your desire to support charitable organizations. There are many different ways to support these organizations, rather than thorough money only. Some of these options are quite complex and will require the services of an attorney or other qualified professional. Always remember to discuss any plans for giving with an attorney and the charitable organization first, so that both parties will receive the greatest possible benefit from the charitable gift.

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