

CHARITABLE GIFTING TECHNIQUES

I. CHARITABLE GIFT PLANNING

- A. Planned gifts are an alternative method to outright gifts of cash.
 - 1. Planned gifts are not just for the very wealthy. It allows people of relatively modest means to pay small premiums that will yield a tremendous benefit to the charity.
 - 2. With an aging baby boomer population, a large amount of wealth is being created which is being eaten into by various tax considerations.
 - 3. Planned gifting to higher education has increased by 645% in the last 20 years.

- B. Insurance and Charitable Gifting
 - 1. Charitable organizations of all sizes can include insurance in their planned giving program. For the charitably-inclined client, insurance may be the perfect tool for their philanthropic plans.
 - 2. It is important to present planned gifts as a means of making a gift to their favorite charity rather than as investments for tax shelters.
 - 3. Caution should be exercised as to whether to structure the planned gifting as a pooled income fund and whether under the Security and Exchange Commission the fund qualifies as needing to be registered with the S.E.C.

II. CHARITY NAMED AS BENEFICIARY OF A LIFE INSURANCE POLICY

- A. Advantages
 - 1. Flexibility. The owner of the policy can change his beneficiary at any time the circumstances change. He can name the charity as primary or beneficiary while still being allowed to borrow against the policy.
 - 2. This is also simple in that all the beneficiary needs to do is to change the forms provided by the insurance company. In so doing, the bequest will avoid delays and costs of probate as well.

- B. Disadvantages
 - 1. There is no income tax deduction under Internal Revenue Code Section 170 (f) (3) (A), since the donor retains ownership interests in the policy and is not giving his or her entire interest in the policy to the charity. Further, this is not considered a completed gift, so there are no gift tax consequences.

2. While the insured owner will have the policy proceeds included in his estate for estate tax purposes, the proceeds are then deducted for purposes of computing the estate tax.

III. GIFT OF POLICY TO CHARITABLE ORGANIZATION

A. In General

1. The charitable organization will preferably be established as a public charity rather than as a private foundation.
2. The primary advantages of donating a life insurance policy outright are the donor can leverage premium payments into a substantial gift, he can make the gift out of current income rather than his primary assets, there are numerous tax benefits to the gift, he receives recognition by the charity during his lifetime, and it is a relatively simple way to gift. Further, the gift avoids the cost delay and publicity of probate and insures that the size of the gift is certain.

B. Disadvantages of This Type of Planning

1. Typically, there is an ongoing obligation to pay premiums unless there is a vanishing premium. However, even with a vanishing premium, if it does not in fact “vanish” the donor may have to pay premiums well beyond what he expected.
2. Further, if a donor discontinues his annual gifts of the premiums, the charity must make a decision as to whether or not to continue the policy and pay for it itself, or discontinue the policy in which case all prior gifts of premium are of no advantage.
3. There are also administrative considerations for maintaining this program
4. The assignment should comply with State law (La.R.S. 22:1521 requirements do not apply to donations of life insurance), the correct legal name of the charity should be used including the taxpayer identification number, and written instructions on how policy proceeds are to be used should be provided (e.g. whether they are restricted, unrestricted, or an endowed fund).

C. Gifts of Policy on Which Premiums Still Must Be Paid

1. Usually the donor will continue to pay the premium although the charity may agree to pay the premiums. The charity may choose to convert the policy to a paid up policy at a reduced face amount. The charity may surrender the policy for its cash value or choose to extend the term option. If the charity borrows against the policy to pay premiums, be certain that this does not result in unrelated business taxable income.
2. With a public charity, the deduction is limited to 50% of the adjusted gross income of the donor except for any net operating loss carry backs, and the

deduction can be carried over for a five year period.

3. The donor can also receive an income tax deduction for premiums paid after the policy is donated to the charitable organization. If the charity is not legally obligated to keep the policy in force, the gift is considered “to” a charity as opposed to “for the use of” the charity which entitles the donor to a 50%, rather than a 30% deduction.
4. I.R.S. Form 8283 must be completed for non-cash charitable contributions over \$500.00. If the value of the policy exceeds \$5,000.00, an independent appraisal maybe required. The insurance company that issues the policy or the company’s agent is not considered to be a qualified independent appraiser.

D. Insurable Interest Requirements

1. Care must be taken to insure that the charity has an insurable interest under State law. Some state statutes do not allow a charity to have an insurable interest on the life of the donor who makes gifts of life insurance policies.
2. The Louisiana statute (La,R.S. Sect 22.614.1) provides that any “religious, educational...” institution or undertaking may be named beneficiary in or owner of any policy of life insurance upon the life of any individual. The beneficiaries or owners have an insurable interest for the full face value of the policy and are entitled to collect same.

E. Mass Marketing of Open Enrollment Plans

1. In this situation, the charitable organization applies to enroll in a program. The organization prints pledge cards in which a donor pledges to make contributions, authorizes the charity to purchase the policy on the life of donor, and agrees that the charity will be the owner and beneficiary. The charity markets the program through direct mail solicitation or personal contact with prospective donors and the prospective donors are not contacted by an insurance agent.
2. Typically, no physical is required. The donor signs a pledge card and the contribution can be a one time payment or payable over a fixed term. The charity deposits contributions in an interest bearing account and pays premiums as they are billed.
3. This allows the charity to reach large donor bases. The selection and marketing of the program may imply endorsement by the charity and there are administrative costs and effort associated with this type of plan.

IV. WEALTH REPLACEMENT PLANS

A. Conceptual issues

1. A donor that makes a charitable gift will realize tax savings and perhaps

increase his income as a result, and will use the tax savings and/or income to buy an insurance policy to replace the wealth given away.

2. This concept is often implemented in conjunction with a charitable remainder trust.
3. A wealth replacement plan can allow the donor to make a charitable gift while still providing for family members. It also provides an immediate income tax deduction to the donor while increasing donor's income stream. Further, this situation avoids the imposition of capital gains if the gift is of appreciated assets held more than a year prior to the donation. Finally, assets are removed from the donor's estate for estate tax purposes.

B. Example

1. John Raider and his wife, Rachel, own appreciated stock valued at \$200,000.00 in which they have a \$50,000.00 basis. The stock yields 2%. Their objectives are to support Archbishop Rummel High School through a substantial gift, increase their income by moving from growth stocks to higher yielding investments, and provide for their children without increasing their taxable estate. John and Rachel donate the stock to a charitable remainder unitrust paying them 6% of the value of the trust for life in quarterly installments.
2. John and Rachel receive an income tax deduction for the present value of the charity's remainder interest. The deduction is affected by the age of the beneficiaries, the payout to the income beneficiary, and the frequency of payments. John and Rachel can deduct up to 50% of their adjusted gross income as a charitable income tax deduction for the gift. A five year carry over of the deduction is allowed.
3. Capital gain will not be realized when the gift is made to the trust. If John and Rachel had instead sold that asset, the amount available for reinvestment would be reduced by the tax on capital gains. Since the unitrust is a tax exempt entity, the trustee can sell the assets donated to the trust free of capital gains tax. Thus, the trustee can sell John and Rachel's stock and invest the proceeds in higher yielding, more diversified assets without reduction by capital gains tax. Further, John and Rachel's income increased from 2% to 6% of the amount invested.
4. John and Rachel also achieve a gift tax deduction as the gift will not be considered for gift tax purposes.
5. Estate tax deduction. The property that passes to the charity will constitute a deduction and thereby save on any estate taxes that may be due in John and Rachel's estates.
6. The tax savings or income from the unitrust can be used to purchase insurance on the life of donor to insure that donor's family members do not lose the

wealth attributable to the trust, if the insurance policy is held in an insurance trust, the proceeds from the policy will be excludable from the estate. Thus, assets that would have been includable in the donor's estate are replaced by an asset that is not includable.

C. Other types of charitable life income plans

1. Charitable remainder annuity trusts. This type of trust pays a fixed income of at least 5% per year, but is not revalued every year as is the case with a unitrust. The annuity amount is set when the trust is first established. However, there is no protection here against inflation. Further, additional contributions cannot be made to an annuity trust.
2. Charitable gift annuity. This annuity can only be used by a charity and is a contractual promise by the charity to pay an annuity to one or two annuitants for life in exchange for a gift from a donor. Part of the transaction is a gift to the charity while the remaining part is a purchase of annuity. The major advantage is that a gift annuity is simple and does not involve a trust.
3. Pooled income fund gift. Here, gifts of several donors are pooled and invested together. Income is paid on a pro-rata basis to the donor or one of his beneficiaries. When the beneficiary's income interests end, the donor's share of the fund is removed from the fund and transferred to the charity. This arrangement requires that the charity constitute a public charity as opposed to a private foundation.

V. NAMING CHARITABLE REMAINDER TRUST AS BENEFICIARY OF A POLICY

- A. Proceeds will be includable in gross estate, but charitable deduction is allowed for the present value of the remainder interest in the proceeds.
- B. An inter vivos unitrust can be named as the beneficiary of a policy if the unitrust permits additions to the trust.
- C. Cannot name an inter vivos annuity trust as the beneficiary of a policy because additional contributions are not permitted.

VI. PLANNING WITH CHARITABLE TRUSTS

A. In General

1. Numerous charitable gifting solutions are available, both during lifetime and at death, that provide significant tax benefits for the charitably inclined client.
2. Qualifying testamentary charitable transfers are deductible in full for estate tax purposes to the extent that the property transferred is includable in the client's gross estate.
3. If instead, the transfer is made during the client's lifetime, it can qualify for a full gift tax charitable deduction as well as an income tax charitable deduction subject

to the charitable deduction limitations of the Internal Revenue Code. The lifetime gift provides an income tax deduction that is not available for a testamentary gift, and can therefore be more advantageous to the client. However, the disadvantage to a lifetime charitable gift is that it must be irrevocable in order to save income taxes.

4. Charitable gifting options include outright gifts, gifts in the form of a charitable remainder trust, gifts to a Charitable Lead Trust, and charitable gifts to a pooled income fund. Typically, it is best to choose property that has appreciated in value since the appreciation in value of the property is not taxable to the estate owner even though the full fair market value of the property may be deductible for income taxes. However, extreme care must be exercised in selecting appreciated property since various rules limit the amount that is deductible by the donor. For example, appreciated ordinary income property that is gifted to charity will yield a deduction equal to the owner's basis rather than the fair market value of the property.
5. If the client is concerned about the lost value of the gift in their estate, the income tax savings generated by a lifetime gift can be used to purchase life insurance so that there is no diminution in the value of the estate. Ownership of the policy should be carefully arranged so that the estate owner has no incidents of ownership in the policy at their death and has made no transfers of the policy within three years of their death.

B. The Use of Charitable Remainder Trusts

1. Properly drafted Charitable Remainder Trusts (herein "CRT") provide numerous benefits to a client including a charitable income tax deduction, charitable estate tax deduction and avoidance of capital gains on the sale of the assets placed into the trust.
2. Clients have the opportunity to increase their return on investment since low-yielding appreciated assets can be sold without any tax on the appreciation and the proceeds can then be used to purchase higher-yielding assets or assets that produce tax-exempt income to further reduce the income tax consequences to the client.
3. A CRT can also be an alternative to a qualified retirement plan through the use of a Net Income Makeup Trust. NIMCRUTS's are generally simpler than retirement plans in the sense that there are no rules regarding highly compensated employees, the amount that can be contributed to the CRT, and various other requirements under ERISA.
4. If a CRT plan is implemented, the client must decide whether to use a Charitable Remainder Unitrust (herein "CRUT") or a Charitable Remainder Annuity Trust (herein "CRAT"). Numerous differences exist between a CRUT and a CRAT, which are detailed below.
5. Generally, a CRUT must provide for an annual payout to the estate owner, or another person named by the estate owner of an amount equal to a fixed

percentage of the trust assets valued annually. This percentage must be at least 5% and no more than 50% of the value of the trust assets. It is important to note that this payment must be made annually to the client and is based upon the principal of the trust on the valuation date, and not the investment performance of the assets. Consequently, this can act as an inflation hedge if the assets produce more than the required payout as set forth by the trust. The trust may provide that income payouts be limited to the amount of actual trust income in any given year with the difference between the actual income and the required unitrust amount being made up in future years. In this manner, a CRUT can be used as a retirement plan by investing the trust assets in a way that does not yield income. This is commonly referred to as a net income makeup CRUT.

6. Beyond the requirements that the income payment must be at least 5% and no greater than 50%, Internal Revenue Code Sees. 664 (d)(2)(D) requires with respect to each transfer to the trust that at least 10% of the net fair market value of the property transferred to trust will eventually be paid to the charity.
7. Finally, only a CRUT can be used if the client wishes to transfer additional assets to the trust at a future date. This is in distinction to a CRAT which, once it is created, cannot be funded in later years.
8. A CRAT is similar to a CRUT except that the annual payout is a specified sum which may be expressed as a stated dollar amount or a fraction of percentage of the initial net fair market value of the assets placed in trust. Later additions may not be made to a CRAT and it offers the estate owner no protection against inflation since the annual payout is a specified sum fixed at the inception of the trust. The advantage of the CRAT is that annual valuations of the assets are not required which may provide more flexibility in funding with assets that are not easily valued.

C. Pooled Income Funds

1. A pooled income fund is a special form of trust in which each donor is entitled to their proportionate share of the fund income for life with the remainder interest passing to charity at the life beneficiary's death. Similar to the use of a CRT, the client will receive an immediate income tax charitable deduction, the elimination of the estate tax on the donated property and the avoidance of taxes on the sale of the assets while retaining income for their life.
2. The primary differences between a CRT and Pool Income Fund are that the income payment in a Pool Income Fund is geared to the actual income earned by the fund and not a percentage of the trust assets.
3. The Pooled Income Fund may pay out income to the donor only for the life of the income beneficiary. Whereas the CRT can allow for income payouts for a term of years with successor income beneficiaries named.
4. A Pooled Income Fund may not receive or invest in tax exempt securities.

5. Finally, with Pooled Income Fund, the charity receiving the remainder interest must be a “50%” charity, whereas with a CRT any charity can be the recipient of the remainder interest.

D. Charitable Lead Trusts

1. In this form of planning, the charity receives an income interest in the trust for a certain term and, after the term expires, the property reverts to the donor or their family.
2. The gift and estate transfer taxes on the principal of the trust passing to the donor’s family is reduced due to the fact that the charity will receive an income interest for a certain length of time, which reduces the value of the property that will eventually pass to the family members. Further, estate taxes on any appreciation in the value of the property after the trust is established are eliminated. Furthermore, to the extent that the client pays gift taxes on the transfer of the assets that will eventually benefit their family, the amount of dollars used to pay that tax will escape eventual estate tax if the client lives for more than 3 years after the transfer into trust.
3. To obtain a gift tax charitable deduction as well as an income tax or estate tax deduction, the income interest payable to the charity must be in the form of a guaranteed annuity interest or a unitrust interest.
4. One primary draw back of a typical CLT is that it generates no income tax deduction for the grantor. However, an income tax deduction can be obtained in the year that the trust is created with an income tax “defective” CLT if the grantor is willing to report all income earned by the trust without any offsetting deduction for the income that is paid to the charity. If the assets are invested in tax-exempt securities, the grantor can receive the income tax charitable deduction without later incurring the income tax liability of any earnings of the trust. Practically, the difficulty is obtaining a sufficient yield on tax-exempt securities to make the guaranteed payments to charity without unduly depleting the trust principal.

E. Testamentary Charitable Bequests

1. An alternative to lifetime transfer to a charity is the use of a testamentary charitable trust. While no income tax savings will be realized, the client will be able to use the assets until their passing.
2. It is imperative that the particular charity be described with specificity to insure that it is correctly named and that proof of its tax exempt status is received by the client’s advisors. For example, there are many charities that work toward the prevention of heart disease, and it is important that you name the proper charity and, if appropriate, its local affiliate.
3. Under recent changes to Louisiana law, a testator can allow their executor to choose the specific charities that will receive a bequest. If this is done, it is important that the language in the will be structured so that the selection of the charity is limited to those charities that shall yield a charitable estate tax deduction.

4. The primary type of testamentary charitable bequests are outright bequests, and bequests in trust. Either way, the bequest can consist of a specified sum of money, a particular asset or a percentage of the estate. It is imperative to coordinate your client's intentions with the fact that a will can only govern probate property, and not non-probate property such as life insurance, retirement plans, IRAs and annuities.
5. Bequests to charity can be made either with or without restriction as to the use of the bequest. If no restrictions are given, the bequest can be used by the charitable beneficiary for its general charitable purposes. If the client wishes to restrict the purpose for which the bequest can be used, the charity should be contacted to make sure it will except the bequest limitations stipulated by your client.
6. If you client wishes to leave assets to a charity but also wishes to provide for lifetime support of one or more individuals, a CRT will accomplish their purposes. For example, if your client does not have any children or other close relatives who might receive their assets, the client could leave property to a CRT while providing for their spouse's lifetime income needs through the use of a CRT. If a spouse is the beneficiary for life, and certain other requirements are met, the client may receive both a marital deduction for the income interest paid to the spouse and a charitable deduction for the remainder interest passing to charity.
7. Another way to reduce the imposition of estate tax is to create a Charitable Lead Trust (herein "CLT") in which the charity is given the income interest with the remainder going to non-charitable beneficiaries. If the income interest is structured properly, the client's estate receives an estate tax charitable deduction for the value of the income interest payable to charity. This plan is very useful for very wealthy families since it permits beneficiaries who are already in a high income tax bracket to avoid the income produced by the assets placed in the CLT.
8. In order to obtain the estate tax charitable deduction, the property must be bequeathed to a qualifying Charitable Remainder Trust. The CRT can be structured as either a CRUT or a CRAT. The duration of the trust, whether a CRUT or a CRAT, must be either a term of years not exceeding 20 years, or the life or lives of the non-charitable beneficiaries. The non-charitable beneficiary must be living at the time the CRT is created. The trustee cannot have the power to invade the principal of a CRT for a non-charitable beneficiary except to the extent that the trust's income is insufficient to produce the annuity or unitrust amount.
9. In sum, the use of both Inter Vivos and Testamentary Charitable planning can be a very effective tool for clients wishing to reduce the overall impact of taxes with regard to their assets. Care should be taken that the documents are reviewed carefully to ensure that the proper charities are named, and that the various IRS rules and regulations are met. With careful planning, these vehicles can be very effective.