Charitable Planning
CLIENT GUIDE

CHARITABLE PLANNING

Giving to charity can provide many benefits and opportunities, both to the charity and to you. The charity, benefits from a donation that can help further its cause, and you may receive tax benefits along with pursuing your philanthropic goals. The ways in which donations can be made to charity vary and can be tailored to achieve specific planning objectives.

Benefits of making charitable gifts

Benefits to the charity:

- Receives a gift that can help further its cause.
- Generally receives the full value of the asset transferred because often charities are tax-exempt.

Benefits to you:

- May receive a charitable income tax deduction.
- May avoid capital gains tax on a highly appreciated asset.
- Potential gift tax savings and/or reduction in estate tax owed.
- Possibility to retain an income stream from the transferred asset for life or a period of years.
- Ability to diversify a concentrated stock position without incurring immediate taxes.
- May replace the asset given to charity with life insurance.

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Types of charities

Generally, there are two types of charities — public and private. The rules governing each type are very involved and are beyond the scope of this guide. Public charities and private foundations are typically tax-exempt, operate for charitable purposes, and provide the donor with a potential income tax deduction.

The principal purpose of a charity or foundation is to make grants to organizations, institutions, or to individuals for scientific, educational, cultural, religious, or other charitable purposes. The most common distinguishing characteristic of a private foundation is that most of its funds come from one source, such as an individual, a family, or a corporation. As a result, a private foundation generally does not engage in fundraising, but receives its funds through continuous contributions and investment income. There is potentially more control over the grant-making process by contributors of a private foundation. As a result, there is more room for abuse, and strict rules apply to gifts made to private foundations.

A public charity normally receives its support from multiple sources, which may include private foundations, individuals, government agencies, and fees for service. Moreover, a public charity must continue to seek money from diverse sources in order to retain its public status.[1]

Tax benefits of charitable gifts

If you make a gift to charity during your life, you may be able to receive an income tax deduction. Income tax benefits for charitable gifts are generally limited based on the type of asset transferred, the type of charity, and your adjusted gross income (AGI). Additionally, a charitable income tax deduction is only available if you itemize your deductions in the year the gift is made.[2]

Value of the charitable income tax deduction

Generally, the amount of your available deduction is based on the fair market value (FMV) of the property contributed to charity.[3] If you contribute property with a FMV less than your basis (i.e., what you paid for the property), your deduction is limited to the property's FMV. For appreciated property (i.e., FMV exceeds basis), there are some instances where your deduction may be limited to your basis. See a helpful summary of these rules below.

	CASH	LONG-TERM CAPITAL GAINS PROPERTY	ANNUITY[4]	SHORT-TERM CAPITAL GAINS PROPERTY	REAL ESTATE	NON-PUBLICLY TRADED STOCK	LIFE INSURANCE
Public Charity	Entire gift	Fair Market Value (FMV)	Lesser of FMV or cost basis	Lesser of FMV or cost basis	FMV*	FMV*	Lesser of FMV or cost basis
Private Charity/ Foundation	Entire gift	Lesser of FMV or cost basis[5]	Lesser of FMV or cost basis	Lesser of FMV or cost basis	Lesser of FMV or cost basis	Lesser of FMV or cost basis	Lesser of FMV or cost basis

*If the property is owned for less than one year, or of it is "inventory" in the hands of the donor, the charitable deduction will be based on the lesser of the FMV or cost basis.

AGI limitations on charitable income tax deduction

Generally, a taxpayer may only deduct the value of a charitable gift up to a certain percentage of the taxpayer's adjusted gross income (AGI) for the year. The chart below indicates the maximum amount that can be deducted based on AGI, the type of property transferred, and the type of charity.

TYPE OF GIFT	TYPE OF CHARITABLE RECIPIENT	
	PUBLIC CHARITY	PRIVATE CHARITY/FOUNDATION[6]
Cash	60%	30%
Ordinary income	50%	30%
Capital gains property	30%	20%
Gifts made by corporation or entity taxed as a C Corporation	10% regardless of type of property transferred	10% regardless of type of property transferred

If the entire value of the charitable gift cannot be deducted in the year when the gift is made due to the above AGI limitations, you may be able to carry over the remaining deduction for five additional years, subject to the same limitations.[7]

Required documentation for charitable gifts

Taxpayers making charitable contributions must keep records to prove the amount of contributions made during the year, especially if claiming an income tax deduction.

Additionally, if you make a donation of goods or services of $75 or more to a charitable organization and you receive a benefit in return from the charity, the charity must provide you with a written statement indicating the deductible amount (i.e., the value of goods/services donated less the value of goods/services received). Keep this statement for your records as it may satisfy all or part of your recording and substantiation requirements.

In addition to any receipts given by the charity, you may be responsible for providing additional information to the IRS in order to claim a deduction. For example, for gifts of property with a value exceeding $5,000, you must provide additional information about how you obtained the property, your basis in the property, and obtain a qualified written appraisal of the donated property from a qualified appraiser. Failure to properly document and report the gift to the IRS may lead to a denial of an income tax deduction for estate taxes, and possibly a charitable gift tax deduction.

See IRS Publication 526 for helpful guidance about deducting charitable gifts and the requirements for reporting.

Making charitable gifts

Gifts to charity can be made during your life or upon your passing as part of your Will. Gifts can be made directly to a charity, or indirectly by way of a "split interest" that can benefit both you and the charity.

Direct gifts

GIFTS OF CASH, SECURITIES, OR REAL ESTATE

When an asset is given away to charity, typically the charity will sell the asset without any tax consequences, because it is a tax-exempt entity. The charity will then use the proceeds from the sale for its charitable purposes.

If you would like to make a gift to charity, but are concerned about retaining enough income, you can also consider a "charitable gift annuity." With a charitable gift annuity, you make a gift to charity of cash, securities or other assets in return for a fixed stream of income from the charity for the rest of your life. As an additional benefit, you can receive a partial income tax deduction based on the value of the asset transferred to charity reduced by the value of the annuity being paid to you.

GIFTS OF LIFE INSURANCE POLICIES

A gift of a life insurance policy can benefit a charity significantly, and can be accomplished in a variety of ways:

Transfer existing policy	If you currently own a life insurance policy that you no longer need, you may consider transferring that policy to your favorite charity or foundation. Before transferring a policy, it is important that you first reach out to the charity as some charities may require the donor to commit to making annual cash gifts to cover any ongoing premium payments prior to accepting ownership. A gift of an existing life insurance policy may allow you to take an income tax deduction for gift of the policy and any subsequent cash gifts to pay premium. The value of the policy for the purposes of taking a deduction will generally be the **lower of the cost basis of the policy or its fair market value**. An income tax deduction may be unavailable if there is an existing loan on the policy at the time of transfer.[8]
Name charity as policy beneficiary	A charity can be named as beneficiary of an existing life insurance policy but no income tax deduction is allowed because you still have full ownership rights, including the right to change the beneficiary. In this case, the life insurance proceeds will be included in your taxable estate, but the estate should receive an estate tax charitable deduction at death for the full value of the death proceeds transferred to charity.
Charity-owned life insurance	You can make cash gifts equivalent to the premium amount on a new or existing life insurance policy owned by a charity. Like any cash gift, an income tax deduction is available for the amount of the cash given directly to charity.[9] Please be aware that there may be additional financial underwriting considerations, including a strong connection to the charity if a new policy is being purchased by the charity.

This chart illustrates the income tax deduction that a donor may receive by donating an existing life insurance policy to a public charity:

EXISTING POLICY DEATH BENEFIT	COST BASIS	FAIR MARKET VALUE	INCOME TAX DEDUCTION (LESSER OF FMV OR COST BASIS)	AGI LIMITATION YEAR 1* (50% OF $120,000 AGI)	INCOME TAX SAVINGS YEAR 1 (24% TAX RATE)	CARRY-OVER DEDUCTION (YEAR 2)
$1,000,000	$75,000	$78,000	$75,000	$60,000	$14,000	$15,000

* This example assumes an AGI of $120,000 and that the life insurance is transferred to a public charity.

Indirect gifts

CHARITABLE TRUSTS

A charitable trust allows you to set assets aside for one or more of your favorite charities while also retaining a benefit for you and/or your family. Often referred to as a "split interest trust," a charitable trust splits the interest in the assets contributed to the trust between a charitable and a noncharitable beneficiary.

There are two types of charitable trusts — charitable remainder trusts and charitable lead trusts. Which one is most appropriate for you will depend on a number of factors including, when you want the charity to receive your gift, the type of assets you wish to donate, and your goals for estate planning and wealth preservation.

Charitable Remainder Trust (CRT)

A CRT is an irrevocable tax-exempt trust that pays a stream of income to you, as the donor, or to someone you designate, and then pays whatever is left at the end of the trust term (known as the "remainder") to your designated charity or charities. This income stream payable from the trust to you (or your designated family member) can last for life or for a specific number of years (not to exceed 20 years).

The income stream payable is determined in one of two ways:

- A Charitable Remainder Unitrust (CRUT) will pay a fixed percentage based on the annual value of the trust assets. For example, if the value of trust assets in year 1 is $1,000,000 and the trust is required to pay you a 5% unitrust interest, you would receive $50,000. If the value of trust assets decreases in year 2 to $750,000, you would receive $37,500.
- A Charitable Remainder Annuity Trust (CRAT) will pay a fixed dollar amount each year based on the value of the trust assets when the trust was first created. For example, if you contributed $500,000 to a CRAT and retained a 5% annuity interest, you will receive $25,000/year, regardless of whether the trust assets increase or decrease in value over the subsequent years.

One of the primary advantages for a donor in creating this type of trust is the ability to claim an income tax deduction, which is generally equal to the value that is expected to pass on to charity (i.e. the remainder value) at the end of the trust term.[10]

In order to qualify as a charitable remainder trust (and receive the tax benefits discussed), the trust will have to meet certain testing requirements, which are meant to protect the charity's interest in the trust assets. These requirements include:

CRT Testing Requirements

TEST	DEFINITION
10% Remainder Test	Present value of the calculated charitable remainder interest must be at least 10% of the net fair market value of the gift at the time the gift is made.
5% Payout Test*	A minimum income payment of 5% must be paid out every year to a non-charitable beneficiary
50% Maximum Payout Test	The maximum amount of income that can be paid is 50% of the trust asset.

*In a CRAT, a minimum of 5% of the initial gift must be paid out. In a CRUT, a minimum of 5% of the adjusted annual value of the trust must be paid.

Charitable Lead Trust (CLT)

Similar to a CRT, a CLT is set up for your lifetime or for a period of years. However, it is the charity that receives an income stream from the CLT for the trust term (known as the "lead" interest). At the end of the term, you, or the person you designate will receive the balance of the trust assets (the "remainder").

The amount of income payable to the charity during the trust term is based upon whether the charity has a "unitrust" interest or an "annuity" interest:

- With a charitable lead *unitrust* (CLUT), the charity will a fixed percentage of income each year based on the annual value of the trust assets — like a CRUT.
- With a charitable lead *annuity* trust (CLAT), the charity receives a fixed dollar amount each year based on the value of the trust assets when the trust was first created — like a CRAT.

Many of the rules that govern the operation and taxation of CLTs differ significantly from those of CRTs. For example, CLTs are not tax exempt trusts; instead, CLT income is either taxed at the trust level (known as a "Non-Grantor CLT") or taxed to you, the grantor of the trust (known as a "Grantor CLT"). In order to receive an income-tax deduction, the CLT must be designed as a Grantor CLT.[11]

Non-transferrable assets

Certain types of assets should not be transferred to a charitable trust to ensure the viability of the tax benefits.

TYPE OF PROPERTY	ISSUE
Debt-financed property	With a CRT, debt may be considered Unrelated Business Taxable Income (UBTI), and the charitable trust will pay 100% excise tax on all UBTI.[12]
A partial interest in property is transferred	With a CRT, the trustee and donor may face substantial excise taxes due to the prohibition of self-dealing and donor may lose out on income tax deductions.
S Corporation Stock	A CRT is not an eligible S Corporation shareholder. Consequently, if S Corporation stock is transferred to a CRT, the Subchapter S election will be terminated. A CLT may be a permissible S Corporation shareholder in certain cases (consult your advisor).
Stock Options	Most stock options have statutory restrictions on transferability.
Qualified Plan Assets (e.g., 401(k), IRA, etc.)	Qualified plan assets transferred to a charitable trust will first be deemed to have been distributed to the taxpayer/donor, for which tax will have to be recognized.

CHARITABLE LIFE ESTATES

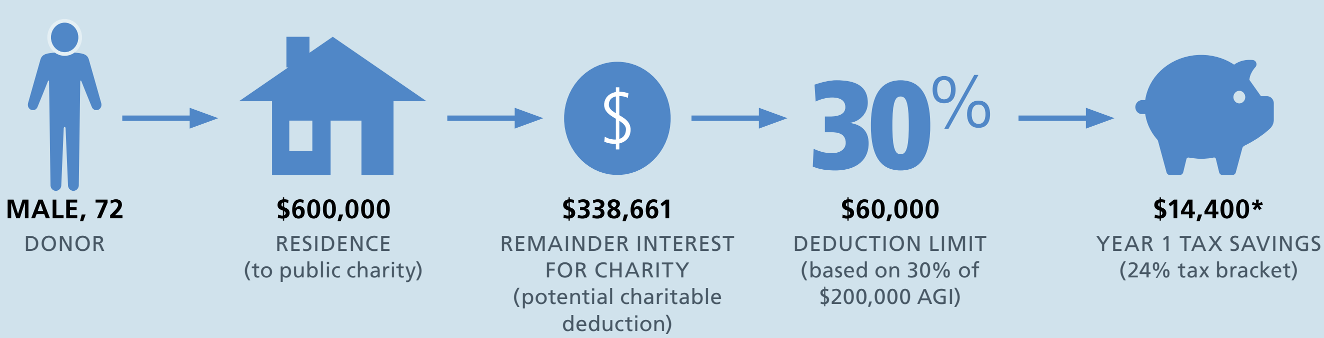
You may prefer to make charitable gifts without giving up assets today. This can be accomplished using the following approaches:

Charitable Life Estate

A Charitable Life Estate allows you to transfer your home to a charity today while retaining the right to live in your home for the rest of your life. Upon your death, the charity immediately takes over ownership of your house and can sell it without tax consequences. The benefit to you for creating a charitable life estate is an immediate income tax deduction, which is based on the present value of the charity's remainder interest. Additionally, your home's value at your death is not included in your taxable estate for estate tax purposes.

Note that if there is debt on the property, transferring your home to a charity may lead to an immediate recognition of gain equal to the debt. You will also be responsible for all taxes and costs of maintaining the property during your life.

MECHANICS OF A CHARITABLE LIFE ESTATE



* Carry-over deduction for an additional five years. This example assumes an AGI of $200,000.

Charitable Gift Annuity for a Life Estate

A retained life estate plus a gift annuity combines two gifting arrangements — a charitable life estate and a charitable gift annuity. First, you transfer your home to a charity in return for the right to live in the house for the rest of your life. Additionally, the charity agrees to pay you (or someone you name) a fixed sum each year for life. The income tax deduction associated with this arrangement is generally valued based on the difference between the present value of the annuity payments and the remainder value of the life estate.

Benefits of using life insurance in charitable planning

By combining charitable giving with life insurance planning, you may be able to preserve your personal wealth and address the following planning concerns:

Maximizing charitable gifts

To make current charitable gifts go farther, it may be possible to have a favorite charity own a life insurance policy on your life. Note, certain underwriting requirements must be met, including a strong connection to the charity. You can then make gifts to the charity in the amount of annual premiums. The annual cash gifts are tax deductible and can provide you with current tax savings.[13]

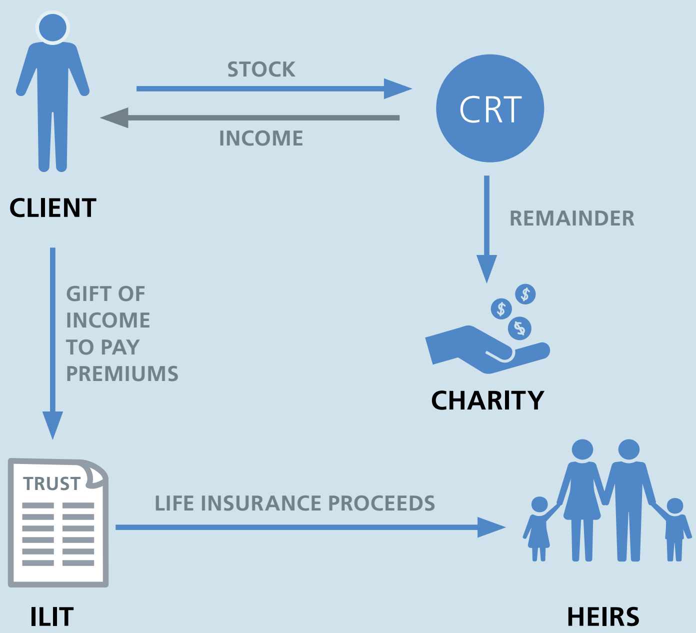
Wealth replacement

When you make a substantial gift to charity, the asset and all of its growth are removed from your estate, thus reducing the amount that will be received by your heirs upon your passing. Life insurance purchased on your life can help replace the value that otherwise would be lost to heirs and may provide a more tax efficient legacy due to the income-tax free death benefit.

Diversifying a concentrated stock position

If you are interested in diversifying a concentrated stock position, but are reluctant to trigger immediate income taxes, a CRT may be able to help. First, the contribution of stock to the CRT does not cause you to recognize any income taxes upfront, and you may receive an income tax deduction associated with this transfer. When the CRT sells the stock to diversify, no tax is recognized because the trust is a tax-exempt entity. Only as you receive income payments from the CRT (i.e., a unitrust payment or annuity payment) will you recognize any income taxes.

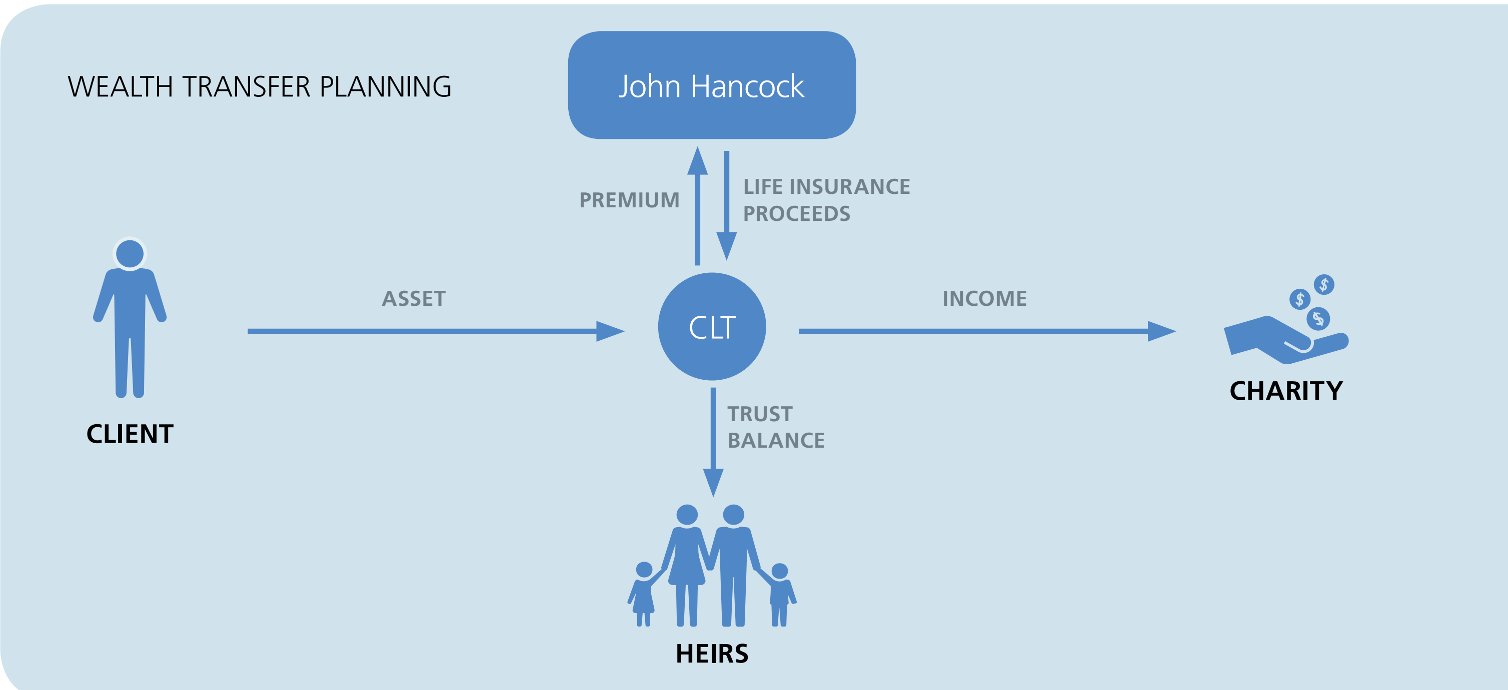
CONCENTRATED STOCK POSITION



While this technique allows you to diversify a stock position and reduce your income tax exposure, a portion of the stock's value is lost to your heirs because of the remainder value paid to charity from the CRT. Consequently, many CRT donors will use some or all of the income received from their CRT to purchase a life insurance policy to help make up the loss in value to the family. If you have an estate that may have exposure to estate taxes (either at the state or federal level), you should consider purchasing the life insurance inside an Irrevocable Life Insurance Trust (ILIT), which keeps the death benefit outside of your estate.

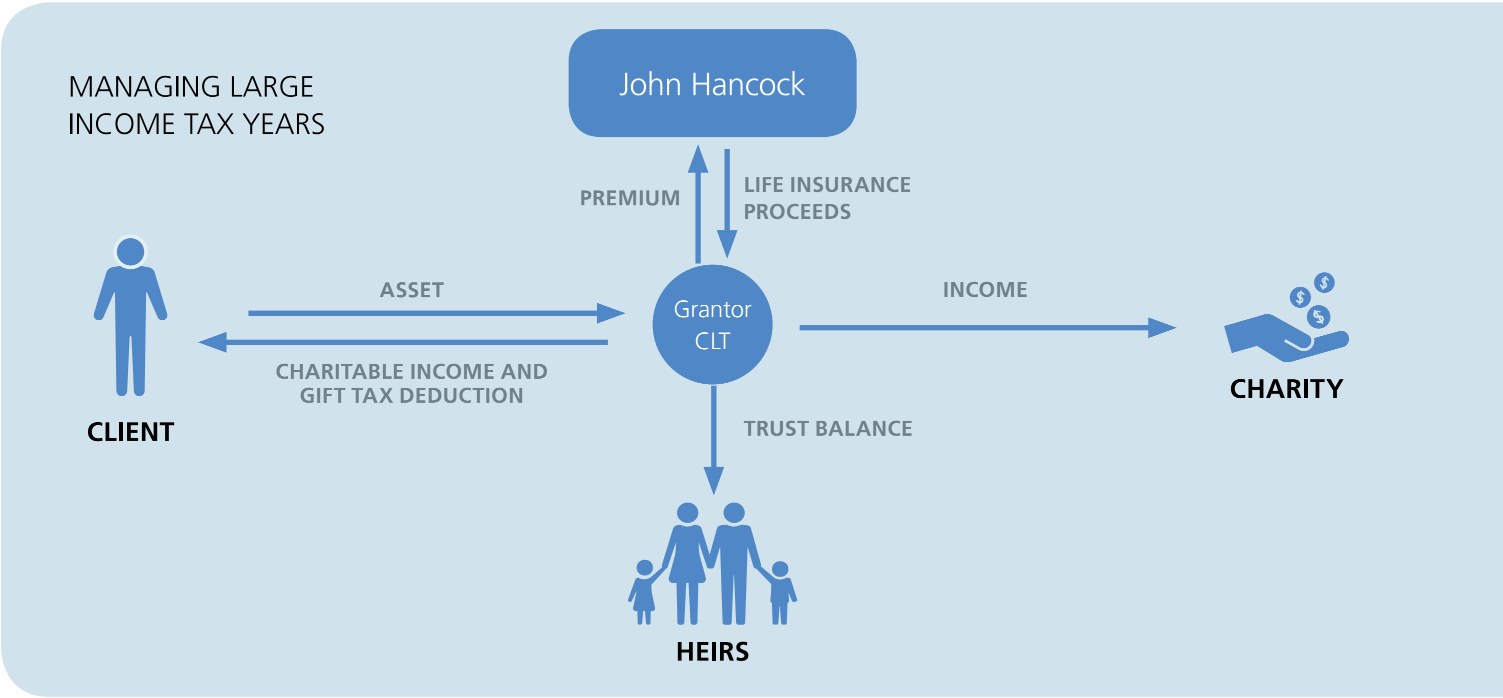
Wealth transfer planning

If protecting and preserving wealth for future generations is a concern, the use of a non-grantor CLT may provide substantial gift tax savings and a reduced taxable estate, while leveraging wealth for your family. A non-grantor CLT has readily available funds growing outside the taxable estate that may be leveraged with life insurance to significantly increase the amount you ultimately transfer to your heirs.[14]



Managing large income tax years

If you have substantial income in a single year due to the sale of a business, receipt of a large bonus, or perhaps taxation of stock options, a grantor CLT may provide an immediate income tax deduction to help minimize your tax exposure. In addition, a grantor CLT may consider using a portion of the trust principal to purchase life insurance and potentially increase the amount that will be left to heirs after the charitable term ends.[15]



Having a plan is key to ensuring your philanthropic goals are met. Many of these charitable planning techniques offer tax benefits, and combined with life insurance, can further benefit both your heirs and your favorite charities. For more information speak to your financial advisor.

The amount of life insurance coverage that you may qualify for would be subject to medical and financial underwriting requirements and may be more (or less) than applied for. Please note that trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including generation-skipping transfer tax). Failure to do so could result in adverse tax consequences.

1. See IRC §501 (c)(3) and IRC §170 to understand the differences between private and public charities and how a determination is made as to what type a charity is considered to be.
2. Consult your tax advisor to determine the deductibility of a specific asset for charitable planning purposes.
3. Please see IRC §170 for specific rules regarding charitable deductions. If you donate property that has a current fair market value that is less than your cost basis, your deduction amount is limited to the lower fair market value. A charitable gift of $250 or more must be substantiated by a written acknowledgment from the charity, which includes the amount contributed, a declaration of whether the charity provided any goods or services to the donor, and a description of the goods or services provided, if any. There may be additional filing and appraisal requirements for large non-cash gifts to charity. Consult your tax advisors regarding the IRS requirements for charitable gifts.
4. You are taxed on the gain at ordinary income tax rates when you transfer an annuity to charity. For annuities purchased prior to April 23, 1987, the deduction is limited to cost basis, and you are taxed on the gain when the charity surrenders the annuity, not at transfer.
5. The deduction for qualified appreciated stock whose value is readily available on an established securities market can be deducted at its fair market value.
6. An operating private foundation is equivalent to a public charity with regard to deductibility. Most private foundations, however, are non-operating and therefore will be subject to the deductions based on a gift made to a private charity.
7. The IRS has ruled previously that the five-year deduction carry forward is not available for a CLT benefiting a private foundation. See PLR 8824039.
8. A donor's deduction for both the gift of a policy subject to a loan and any subsequent premiums contributed to a charity may be denied under the charitable split dollar rules of IRC Sec. 170(f)(10).
9. Generally, the direct payment of the premium to the insurance carrier will result in a lower AGI limitation of the charitable deduction.
10. If death occurs prior to the end of the trust term, the charitable income tax deduction may be recaptured. Gifts made to a Charitable Trust in which there are both public and private charities named or the charity is unspecified, the income tax deduction limitation is based on gifts made to a private charity.
11. The income tax deduction for a CLT taxed as a grantor trust is limited to 30% of AGI when the lead interest is held by a public charity and 20% when the lead interest is held by a private charity.
12. The Tax Relief and Health Care Act of 2006, which was signed into law by President Bush on December 20, 2006, includes a major change to the taxation of charitable remainder trusts (CRTs) which have unrelated business income (UBTI), as defined in IRC §512. The Act, which took effect for tax years beginning after December 31, 2006, changed the penalty for CRTs that have unrelated business income. Instead of losing its tax-exempt status, a CRT that has unrelated business income is now subject to a 100% excise tax on the unrelated business income. As a result of this legislation, IRC §664 has been amended.
13. Caution should be taken by charities to avoid arrangements where the charity shares its insurable interest in a donor with investors (commonly referred to as "ChOLI" arrangements). A charity engaging in a ChOLI arrangement, may be subject to excise taxes or could lose its exempt status. See "Report to Congress on Charity-Owned Life Insurance," Department of Treasury, April 2010.
14. Income generated from a CLT should not be used to purchase the life insurance or the CLT may be characterized as a grantor trust, in which case the trust income will be taxable to you. See IRC §671-679.
15. Where the arrangement employs life insurance owned by a grantor CLT, and the CLT has been structured to yield no taxable transfer to the non-charitable remainderman of the CLT, many advisors are concerned that the life insurance contract could constitute a "personal benefit contract" for purposes of IRC §170(f)(10) with potentially negative tax consequences. Taxpayers should consult competent tax counsel when considering any such arrangement.

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