

Charitable Planning

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Overview

- Charitable contributions
 - To whom may a client make charitable contributions?
 - When can a client take an income tax charitable deduction?
 - When can a client take a gift and estate tax charitable deduction?
- Donor-Advised Funds
- Charitable Remainder Trusts
- Charitable Lead Trusts
- Other permissible split-interest gifts
- Charitable Gift Annuities
- Charitable planning with retirement assets

What constitutes a charitable contribution?

- Donation of cash or property
- To an organization described in section 170(c)
 - 170(c)(1) – U.S. or state government if for exclusively public purposes
 - Quasi-governmental organizations under IRC 115
 - 170(c)(2) – To a charitable organization
 - Created or organized in the United States or under US law
 - If by a corporation to a trust, deductible only if to be used exclusively in US
 - 501(c)(3) requirements met
 - Recognized by IRS (see 508(d)(2)(B); Rev. Proc. 2018-32)
 - Exceptions for churches, integrated auxiliaries
 - 4947(a)(1) trusts

What constitutes a charitable contribution?

- 170(c)(3) – A war veterans post or auxiliary if organized in the US and no private inurement
- 170(c)(4) – If by individual, to a domestic fraternal society under a lodge system if to be used exclusively for charitable purposes
- 170(c)(5) – Certain nonprofit cemetery companies if no private inurement
- Treaty exceptions (Canada, Mexico, Israel)
- Gifts to foreign charities by way of U.S. charities may not be eligible for income tax deduction if earmarked or if U.S. charity did not exercise independent discretion and control
 - See Rev. Rul. 63-252

Types of 501(c)(3) Organizations

- **Public Charity**
 - 509(a)(1) (grants and government support)
 - 509(a)(2) (program service revenue)
 - 509(a)(3) (supporting organizations)
 - Type I (parent-subsidiary)
 - Type II (brother-sister)
 - Type III (quasi-private foundation)
 - Functionally integrated
 - Non-functionally integrated
- **Private Foundation**
- 4947(a)(1) trust

Donor-Advised Funds

Pre-2006

- No specific treatment of DAFs in Internal Revenue Code
- Issues with retained control by donors
- Advisory rights vs. retained control

2006 Pension Protection Act

- IRC 4966 (definition of DAF, taxable distributions)
- IRC 4967 and expansion of IRC 4958 (excess benefit transactions)
- IRC 4943(e) (excess business holdings)
- IRC 170(f)(18) (required contemporaneous written acknowledgement that sponsor has exclusive legal control; Type III NFI SO's)
- IRC 508(f) (Notice by sponsoring organizations)

Donor-Advised Funds – Defined in IRC 4966

- A fund or account within a public charity
 - Which is owned and controlled by a sponsoring organization
 - Which is separately identified by reference to contributions of a donor or donors
 - With respect to which a donor (or designee) has, or reasonably expects to have, by virtue of his or her status as a donor, advisory privileges with respect to distributions or investments

Donor-Advised Funds – What is NOT a DAF?

- Fund established by private foundation (not necessary because of IRC 4941-4945)
- Fund established by government or political subdivision
- Fund which supports only a single identified organization
- Certain scholarship funds
 - Advisory privileges performed only as minority (with related persons) of committee appointed by sponsoring organization, following private foundation guidelines
- Certain employer-sponsored disaster relief assistance programs
 - Solely for relief from qualified disasters, large or indefinite charitable class, independent selection committee, objective determinations of need, no benefit to employer or insiders
 - Exempted per Notice 2006-109
- Advisory fund by Type III NFI SO is a DAF, but no income tax charitable deduction

Donor-Advised Funds – Taxable Distributions – IRC 4966

The following distributions are taxable (20% tax on sponsoring organization, potential 5% tax on fund manager):

- For any non-charitable purpose (including political, lobbying, etc.)
- To any natural person (*Note*: qualifying scholarship fund not a DAF)
- To any organization other than a public charity, private operating foundation, or private pass-through foundation, unless expenditure responsibility procedures followed (IRC 4945(h))
- Distributions to DAF sponsor itself or to other DAFs permitted

DAFs – Impermissible Benefits – IRC 4967 and 4958

IRC 4967 (Taxes on prohibited benefits)

- 125% tax on advisor/related party and potential 10% tax on fund manager
- Tax on “more than incidental benefit”
 - Not defined in IRC 4967
 - IRC 4941 (private foundation self-dealing) guidance may be relevant, but unclear
 - Credit / “reflected glory”
 - Direct or indirect economic benefits
 - Tickets to charity-sponsored event, membership benefits, etc. (Notice 2017-73)
 - Fulfilling pledges? See Notice 2017-73
 - Sports event ticket purchase rights?

Supplements IRC 4958 (Taxes on excess benefit transactions)

- Taxes excess benefit to “disqualified persons,” which (since 2006) includes donor-advisors and related persons
- Any grant, loan, compensation, etc. to donor / related party is automatically an excess benefit

DAFs – Notice 2017-73 – Donor/Advisor Benefits

More than incidental benefit

- Distributions to pay tax deductible portion of a ticket to charity-sponsored event or a membership fee (i.e., “split gifts”) – TAXABLE
- Distributions in fulfillment of donor pledges – NOT TAXABLE
 - Notice indicates this guidance regarding pledges may be relied upon immediately
 - Contrary to private foundation rules – see Treas. Reg. 53.4941(d)-2(f)(1) (distributions in satisfaction of legal obligation)
 - IRS notes that DAF sponsors have a hard time determining whether a pledge is legally enforceable under state law
 - Non-taxable only if:
 - (1) DAF sponsor makes no reference to existence of pledge when making DAF distribution
 - (2) Donor/advisor receives no other benefit that is more than incidental
 - (3) Donor/advisor does not attempt to claim income tax deduction for DAF distribution

DAFs – Notice 2017-73 – Public Support Test

- Generally, grants from individuals and private foundations are subject to a 2% (of total support) limitation in calculating the recipient's public support ratio. Grants from public charities are generally 100% public support.
- Treasury would treat DAF distributions as indirect contributions from donor (subject to 2% limitation).
- Anonymous contributions from a DAF would all be treated as having been made from one donor (subject to 2% limitation in the aggregate).
 - Strong incentive to identify DAF advisors at the time of distribution.
- Exception if DAF sponsor confirms distributions are not from DAFs or were made independently of donor advice.

Income Tax Deductions

- Itemized deductions - “Bunching” for non-itemizers
- Deduction limited to the extent of value received
 - Charity must inform donor of estimated value of goods/services received for gifts of \$75 or more
 - No more deduction for gifts to higher ed institutions in exchange for right to purchase tickets for seating at athletic events (170(I))
- Substantiation required for gifts of \$250 or more
 - Written acknowledgement from charity describing gift and value of goods/services received, if over certain de minimis amount
 - For gifts to DAFs, must include notice of no retained control
 - Over \$500, must attach Form 8283
 - Over \$5,000, must obtain a “qualified appraisal”
 - See 2018 final regulations under 1.170A-13 to 1.170A-18

“Bunching” of Charitable Gifts

	2018	2019	2020	2021	2022
<i>Standard Deduction</i>	\$24,000	\$24,000	\$24,000	\$24,000	\$24,000
Annual Contributions	\$20,000	\$20,000	\$20,000	\$20,000	\$20,000
Bunching	\$100,000	\$0	\$0	\$0	\$0
Total Deductions (no bunching)	\$24,000	\$24,000	\$24,000	\$24,000	\$24,000
Total Deductions (with bunching)	\$100,000	\$24,000	\$24,000	\$24,000	\$24,000

Income Tax Deductions

- Gifts of ordinary income or short-term capital gain property
 - Limited by amount of ordinary income realized if property were sold prior to gift
 - Various specific exceptions in 170(e)
- Gifts of long-term capital gain property
 - Capital gain avoidance
 - “Assignment of income” problem
 - *Ferguson v. Comm’r*, 174 F.3d 997 (9th Cir. 1999) (donor realizes income on sale of stock by charity where tender offer announced and acquiring company acquired majority of target company’s stock prior to charitable gift – no meaningful contingency)
 - Deduction limited to cost basis if to private foundation unless “qualified appreciated stock” not in excess of 10% of outstanding shares

Income Tax Deductions

- Gifts of tangible personal property
 - Limited to cost basis unless used by recipient for exempt purposes (limited to cost basis regardless if to private foundation)
 - If sold by charity in same year, limited to cost basis
 - If within three years, must recapture portion of deduction relating to capital gain
 - In either case, no reduction/limitation if charity certifies related use
 - Special rules for gifts of partial interests
- Other special rules for gifts of IP, food or pharmaceutical inventory, scientific research property, taxidermy property, books to public schools, etc. (IRC 170(e) through (p))

Deduction Limitations for Charitable Gifts

	Public Charity		Private Foundation	
	Maximum Annual Deduction	Value That Can Be Deducted	Maximum Annual Deduction	Value That Can Be Deducted
Gift of cash	60% of AGI ¹	100%	30% of AGI	100%
Gift of publicly traded stock	30% of AGI	Fair market value at date of gift ²	20% of AGI	Fair market value at date of gift ¹
Gift of property other than cash or publicly traded stock	30% of AGI	Fair market value at date of gift ^{2, 3}	20% of AGI	Basis

1. 60% limit only if all cash to public charities. If mix of cash and other property, or mix of gifts to public charities and private foundations, effectively limited to 50%.
2. The charitable deduction for gifts of property with a holding period under 12 months (short-term capital gain property) is limited to cost basis.
3. The charitable deduction for gifts of tangible personal property, such as artwork, is limited to cost basis if the charity does not intend to use the property for its exempt purpose.

New 60% AGI Limitation

	PC/PF	Cash	STCG (cost basis only)	LTCG (no cost basis election)
Sub. G	PC	60%	N/A	N/A
Sub. A	PC	50% minus Sub. G gifts	50% minus Sub. G gifts	50% minus Sub. G gifts subject to Sub. C max
Sub. C	PC	N/A	N/A	Limited to 30% max (see Sub A)
Sub. B	PF	Lesser of (i) 30% and (ii) 50% minus Sub. G gifts minus Sub. A gifts	Lesser of (i) 30% and (ii) 50% minus Sub. G gifts minus Sub. A gifts	Lesser of (i) 30% and (ii) 50% minus Sub. G gifts minus Sub. A gifts subject to Sub. D max
Sub. D	PF	N/A	N/A	Limited to max of lesser of (i) 20% and (ii) 30% minus Sub. C gifts
Sub. E	50% (100% if qualified rancher/farmer) minus all other gifts under IRC 170 (to “qualified organization”)			
Disaster	Cash gifts up to 100% (stacks) to PCs for qualified disaster relief (special legislation)			

Income Tax Deductions

- Gifts Subject to Conditions
 - A condition may reduce the value of the gift
 - Ex., restrictions on sale
 - A condition may make the gift incomplete
 - Ex., retained control
 - A condition may eliminate any charitable deduction
 - Unless the likelihood of the condition resulting in loss of the gift is “so remote as to be negligible”
 - Ex., gift to town as long as always used for public park

Income Tax Deductions

- Gifts of Partial Interests

- Must give entire interest in property or fraction of “each and every substantial interest or right”
- No “unbundling” of rights, with some retained or transferred (other than for FMV) to noncharitable recipients.
 - No temporal unbundling (e.g., gift for seasons or periods of time)
 - No gifts of partial use (e.g., right to harvest timber on land if donor retains other rights) unless insubstantial (ex., certain easement rights)
 - No gifts of economic rights in stock while retaining voting rights
 - Rev. Rul. 81-282; but see PLR 201129033 (Class A and B shares are separate property interests) and PLR 200108012 (voting rights transferred many years previously for independent business purposes not split interest under 170)
- Special rules for fractional interest gifts of tangible personal property (IRC 170(o))

Income Tax Deductions

- Gifts of Partial Interests

- Ok if giving all (or equal %) interests in all rights that taxpayer has
 - If donor received a partial interest from someone else, she can give that to charity, as long as she's giving everything she has
 - However, cannot split interest for purpose of creating separate property
 - Reg. 1.170A-7(a)(2) (“If, however, the property in which such partial interest exists was divided in order to create such interest and thus avoid section 170(f)(3)(A), the deduction will not be allowed.”)
 - See also Reg. 25.2522(c)-3(c)(1)(i) (disallowing gift tax deduction where “an interest in the same property is retained by the donor, or is transferred or has been transferred for private purposes” for less than FMV)

Income Tax Deductions

- Gifts of Partial Interests – Key Exceptions (see IRC 170(f))
 - Charitable Remainder Trusts
 - Charitable Lead Trusts
 - Pooled Income Funds
 - Remainder in Personal Residence or Farm
 - Qualified Conservation Easements

Gift and Estate Tax Deductions

- Gift and estate tax apply to charitable gifts unless deduction applies under IRC 2522(a) or IRC 2055(a).
- Broader class of permitted recipients for US donors/decedents
 - US/state government, for exclusively public purposes
 - Foreign or domestic charitable 501(c)(3) corporation or trust
 - Foreign or domestic fraternal society which will use for exclusively charitable purposes
 - For estate tax deduction, society must be described in 501(c)(3)
 - Domestic war veterans' post (for estate tax, must be a veterans' organization incorporated by an Act of Congress)
 - Certain bequests to ESOPs (estate tax ONLY)
 - 501(c)(4), (5), and (6) organizations (gift tax ONLY) (not deduction – simply doesn't apply per IRC 2501(6)).

Gift and Estate Tax Deductions

- Unlimited deduction (100% of gift/bequest)
- No distinction between public charity and private foundation
- Fair market value deduction (no ordinary income limitations)
- Split interest rules apply
 - Similar to (but not identical to) income tax split interest rules
 - If in trust, must be qualifying CRT or CLT
- Special rules for real property easements
- Special rules for gifts of tangible personal property

Gift and Estate Tax Deductions – Non-Resident Aliens

- Applies only for U.S. situs property
 - *Gift tax*: Real or tangible personal property located in the US.
 - *Estate tax*: Broader category of property (IRC 2104)
- Recipients:
 - Gift tax (IRC 2522(b)) or Estate tax (IRC 2106(a)(2)):
 - US/state government, for exclusively public purposes
 - Domestic (NOT foreign) charitable 501(c)(3) corporation
 - Domestic or foreign trust satisfying 501(c)(3) tests which will use assets for exclusively charitable purposes within the U.S.
 - Domestic or foreign fraternal society satisfying 501(c)(3) tests which will use assets for exclusively charitable purposes within the U.S.
 - Domestic war veterans' post (gift tax ONLY)
- Must be gift/bequest of U.S. situs property to qualified recipient
 - PLR 9040003 (No deduction for bequest of non-U.S. art collection to U.S. art galleries against estate tax generated by separate U.S. situs property)

Gift and Estate Tax Deductions – Non-Resident Aliens

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 - PLR 9040003 (No deduction for bequest of non-U.S. art collection to U.S. art galleries against estate tax generated by separate U.S. situs property)
- Must be no fiduciary discretion
 - PLR 9135003 (charitable deduction denied for gift of U.S. situs assets to U.S. charity where executor could have distributed the property to foreign charities)
 - TAM 199925043 (charitable deduction allowed where local court construed trust as requiring distribution of U.S. situs assets to U.S. affiliate of foreign charity)
- Some treaty exceptions
 - Ex., *Estate of Avrom Silver*, 120 T.C. 14 (2003) (deduction allowed under Art. XXXIX B, par. 1 of 1995 Protocol to the U.S. Canadian Income Tax Treaty for bequest by Canadian NRA to Canadian charity, but only with respect to property subject to U.S. estate tax)

Charitable Remainder Trusts

- Exception to partial interest rules (IRC 170(f)(3), 2522(c)(2) and 2055(e)(2)) if meets the requirements of IRC 664 (exempting CRTs from income tax)
- Requirements must be satisfied from inception
 - CRT may be reformed *nunc pro tunc* by way of qualified reformation per IRC 2055(e)(3) or 2522(c)(4)
- Must operate exclusively as a CRT throughout the trust's lifetime
 - See, e.g., *Estate of Atkinson v. Comm'r*, 115 TC 26 (2000), aff'd 309 F.3d 1290 (11th Cir. 2002); PLR 201714002
- Exempt from tax under IRC 664, but any UBTI is taxed at a 100% rate
- Must report on calendar year
- Cannot be a grantor trust

Charitable Remainder Trusts

- Non-remainder interest must be a qualified annuity (IRC 664(d)(1)) or unitrust (IRC 664(d)(2)) interest paid at least annually.
 - *Annuity*: Must be a “sum certain” not less than 5% nor more than 50% of initial FMV
 - *Unitrust*: Must be a fixed percentage not less than 5% nor more than 50% of FMV valued annually
- CRUT may permit future contributions – CRAT may not (trust may provide that additional contributions create a new CRAT)
- For testamentary CRT, obligation to pay must commence as of date of death, but initial payments may be deferred until the end of the year in which CRT funding occurs (with interest)
- May be funded by any “person” (need not be an individual)

Charitable Remainder Trusts

- **Potential annuity/unitrust beneficiaries:**
 - One or more “persons” (IRC 7701) at least one of which is not a 170(c) organization
 - Joint or survivor interests (individuals living at time of CRT creation), term of years (no more than 20), or lesser of the two
 - A charity can receive some of the annuity/unitrust interest, as long as the interest of non-charitable recipients is substantial (ex., “cap” spillover distributions to charity)
 - However, this non-remainder charitable interest will not affect the income tax deduction, which is only for the remainder interest
 - An independent trustee may have the power to “sprinkle” an annuity or unitrust amount among permissible beneficiaries where the CRT is for joint individual beneficiaries or term of years (PLR 9052038).

Charitable Remainder Trusts

- **Charitable Remainder Recipients:**

- One or more 170(c) organizations (or qualifying ESOP)
 - If only public charities may receive remainder, funding treated as gift “to”, not “for the benefit of” public charities
 - If private foundation included as potential beneficiary, or if property held in continuing trust, less favorable AGI limitations and rules for gifts to private foundations apply
 - Donor may retain power to substitute one charitable beneficiary for another
- Value of remainder interest must be at least 10% of initial FMV
 - Problem for CRATs in low-interest rate environment
- 5% probability of exhaustion test (Rev. Rul. 77-374) – CRAT will fail if more than 5% probability that trust assets will be exhausted before annuity interest terminates
 - But see Rev. Proc. 2016-42 (Ok if keep revaluing, terminate if payment of annuity would reduce corpus below 10% of initial value)

Charitable Remainder Trusts

- Possibility of Estate Tax Burden, Elective Share, Etc.
 - Possibility that CRT may incur estate tax liability or be invaded per elective share laws in theory threatens qualification
 - Rev. Proc. 2005-24 – IRS attempted to impose spousal waiver requirements (suspending by IRS Notice 2006-15)
 - CRT forms commonly provide that donor will make alternative provisions for payment of estate taxes, that CRT will have a claim against the estate of a donor if estate taxes come due, and that a successor income beneficiary must pay any estate taxes that nonetheless become due or forfeit his or her interest (see Rev. Rul. 82-128)
- Sample IRS CRT Forms
 - Rev. Procs. 2003-53 to 2003-60 (CRATs); 2005-52 to 2005-59 (CRUTs)

Charitable Remainder Trusts – Variations – IRC 664(d)(3)

- SCRUTs: Standard CRUTs
- NICRUTs: Net income CRUTs
 - Lesser of trust income and annuity/unitrust amount
 - May not take UPIA “unitrust” approach to determining income and principal, as that could effectively allow a percentage interest of less than 5%
 - Realized capital gain can be treated as income only to the extent that the property sold has appreciated in value between the time of funding and the time of sale
- NIMCRUTs: Net income with make-up CRUTs
 - Trust income in excess of annuity/unitrust amount may be paid out to make-up deficit in annuity/unitrust payments in prior years

Charitable Remainder Trusts – Variations – IRC 664(d)(3)

- FLIPCRUTs:
 - NICRUT or NIMCRUT may “flip” to a SCRUT on certain triggering dates or events
 - Date or event must be outside the control of the trustees or any other person
 - Marriage, divorce, death, birth of child, reaching certain age, and sale of **unmarketable** assets are treated as outside the control of the trustees or other person
 - Sale of **marketable** assets and request of beneficiary NOT permissible triggering events
 - Commonly used for gifts of illiquid, non-income producing property
 - Flip must be effective at beginning of taxable year immediately following taxable year in which triggering event occurred.
 - Any “make-up” amount (if NIMCRUT) forfeited upon the flip

Charitable Remainder Trusts – Termination

- Qualified contingencies (IRC 664(f)):
 - Allowed if annuity/unitrust payments will terminate earlier or at the same time (but not later)
 - Example, termination on surviving spouse's remarriage
 - In terrorem provisions
- Gift of remaining annuity/unitrust interests
 - Must be permitted under local law and CRT instrument
 - Confirm doctrine of merger applies to terminate (otherwise, charity as sole annuitant would disqualify CRT)
- Actuarial division (see, e.g., PLR 200127023, 200314021)
 - Treated as sale of income interest to charitable remaindermen at zero cost basis
 - Confirm no self-dealing concern if PF or DAF involved
 - Valued as of month of termination
 - Valuation of NICRUTs/NIMCRUTs – see PLR 200725044 (requiring valuation of unitrust interest as lower of % distribution rate and 7520 rate)

Charitable Remainder Trusts – Gift and Estate Tax

- If 664 satisfied, present value of charitable remainder interest will qualify for gift tax charitable deduction
- Annuity/unitrust interest will qualify for gift tax marital deduction if spouse is the only other (noncharitable) beneficiary and is a U.S. citizen (IRC 2523(g))
- Because deduction relies on special exception, not normal QTIP, general POA or “estate trust” qualification, CRTs can be established with terminable interests if within “qualified contingencies” of IRC 664(f), as long as only remainder charities will benefit from such a termination

Charitable Remainder Trusts – Gift and Estate Tax

- Gifts of annuity/unitrust interests to non-charitable and non-U.S. citizen spouse beneficiaries will be subject to gift tax unless the donor retains a testamentary right to revoke that interest
- If right retained, gift is incomplete until donor dies or distributions actually made
 - Normally, a gift of a CRT interest is not a gift of a “present interest”, and therefore is not eligible for the gift tax annual exclusion. However, if right of revocation is retained, the gift is complete as each distribution is made, and so the gift tax annual exclusion is available.
- Property in CRT subject to retained right of revocation is includable in the donor’s estate under IRC 2036, but an estate tax charitable deduction should be available to the extent of the then qualifying charitable remainder interests.

Charitable Remainder Trusts – Taxation of Distributions

- Ordering Rules of IRC 664(B)
 - Ordinary income
 - Capital gain
 - Tax-exempt income
 - Return of principal
- In each case, accrued income from previous years passes out before the next class applies
- If different tax rates within a class, subclass taxed at higher rate deemed to pass out before subclass taxed at lower rate
- Note complicated loss-netting rules

Charitable Remainder Trusts – Taxation of Distributions

- Applicability of Chapter 42 Private Foundation Rules (IRC 4947(a)(2))
 - IRC 4941 (self-dealing) applies (other than regarding annuity/unitrust payment)
 - IRC 4943 (excess business holdings) applies
 - IRC 4944 (jeopardizing investments) applies
 - IRC 4945 (taxable expenditures) applies (other than regarding annuity/unitrust payment)

Effect of Interest Rates on CRATs vs. CRUTs

- **Higher Interest Rates**

- *CRATs*: Better income tax deduction for donor
 - Gift = IV (Initial Value) – PVA (Present Value of Annuity)
 - Higher interest rate = lower PVA (less needs to be invested at assumed interest rate to get same amount at end of period)
 - Lower PVA = higher gift portion
 - Higher charitable deduction, or more annuity for same charitable deduction
- Easier to meet 5% chance of exhaustion test (note Rev. Proc. 2016-42, alternative 10% of initial principal termination option)
- Less likely to have UBTI (gift portion must be at least 10% of value of property)
- *CRUTs* – Largely unaffected

Charitable Lead Trusts

- Annuity/unitrust interest to charity, remainder to family members
- Unlike CRT, CLT is NOT exempt from income tax. Instead, CLTs rely on 642(c) deduction to minimize or eliminate tax
- Income tax deduction depends on whether CLAT is a grantor trust
- Gift/estate tax deductions available for value of qualifying charitable interests
- Primary objective: Appreciation of assets in excess of section 7520 rate
- “Zeroed-out CLATs”: Can establish CLAT with taxable remainder of zero (common as part of testamentary planning)

Charitable Lead Trusts

- **Grantor CLAT:**
 - Charitable deduction up-front
 - BUT, no 642(c) deduction thereafter (all future CLT income included on grantor's income tax return)
 - May be some recapture of the income tax deduction
- **Non-Grantor CLAT:**
 - No income tax charitable deduction up-front
 - But, 642(c) deductions available each year
 - Income tax due if 642(c) deduction not available (i.e., if UBTI, or if income not fully offset by deduction)
 - Note income ordering provisions of CLT may be disregarded if no economic effect independent of income tax consequences. See Reg. 1.642(c)-3 and -5.
- See 2007 and 2008 IRS sample forms

Charitable Lead Trusts

- Annuity/unitrust payments:

- For life/lives (donor, spouse, ancestor of all remainder beneficiaries, or spouse of ancestor, living when CLT established), period of years (unlimited), or combination
- May vary from year to year (unclear by how much)
 - Amount must be “determinable,” in that the exact amount to be paid can “ascertained” at the beginning (Treas. Reg. 25.2522(c)-3(c)(2)(vi))
 - See Rev. Proc. 2007-45 and 2007-46 (annuities may increase)
 - GRAT restrictions on more than 20% increases do not expressly apply to CLTs
 - See PLR 201216045 (blessing CLT that varies its annuity payments by 20% per year)
- “Shark-fin” CLATs

- Remainder Interest:

- Can pass to any person, but special GST rules apply (IRC 2642(e))
 - GST inclusion ratio adjusted to capture appreciation over section 7520 rate
 - “Applicable fraction” = “adjusted GST exemption” / CLT value at termination
 - Adjusted GST exemption = original GST exemption applied plus interest at 7520 rate for actual period of CLT

Charitable Lead Trusts

- Applicability of Chapter 42 Private Foundation Rules (IRC 4947(a)(2))
 - IRC 4941 (self-dealing) applies
 - IRC 4943 (excess business holdings) and IRC 4944 (jeopardizing investments) apply ONLY if amounts for which tax deductions allowed = no more than 60% of FMV of trust
 - IRC 4945 (taxable expenditures) applies

Other Split-Interest Gifts

- **Remainder Interest in Personal Residence or Farm**
 - Allow homeowners/farmers to keep using property for lifetime and enjoy income tax deduction for remainder interest
 - When computing present value of remainder, depreciable portion of gift (value of house alone less salvage value following estimated useful life) must be subject to a special factor that will decrease the value of the gift
- **Pooled Income Funds**
 - Charitable organizations can sponsor fund to which donors contribute and receive pro rata share of income for life of donor and/or named beneficiaries
 - Deduction is present value of remainder interest, using IRS tables and a discount rate equal to fund's highest yearly rate of return during three years preceding gift
 - Distributions are ordinary income
- **Conservation Easements**

Charitable Gift Annuities

- Bargain sale treatment
- Annuity as general obligation of the charity
- UBTI to charity unless (per IRC 514(c)(5)) annuity:
 - Is the sole consideration in exchange for property and value of annuity is less than 90 percent of the value of the property received in exchange
 - Is payable over the life of one or two (consecutively or concurrently) individuals in being when annuity is issued
 - Is payable under a contract which does not guarantee a minimum amount of payments or specify a maximum amount of payments, and does not provide for adjustment of amount by reference to income received from transferred property (or other property)

Charitable Gift Annuities - Types

- Single Life
- Dual Life – Consecutive or Joint and Survivor
- Deferred Gift Annuities
 - Obligation to begin paying annuity set at future time (at least one year later), reducing value of annuity interest
 - Time to begin payments can be set from the beginning, or can be left open, with amount of payment to vary based on starting date to ensure the same actuarial result with reference to the contract date (a “Flexible Gift Annuity”).
 - See, e.g., PLR 200449033, PLR 9743054
 - “College Fund” Gift Annuities
 - Gift annuities cannot be for a term of years or guarantee a minimum number of payments
 - However, the IRS has approved agreements that allow exchange of life payments for lump sum or installments (see PLR 200233023, 9042043), valued based on factors in effect at time of commutation

Charitable Gift Annuities - Taxation

- **Income Tax**

- “Gift portion” (amount in excess of FMV of annuity) treated as outright gift to charity
 - If funded with LTCG property, subject to lower 30 percent AGI limitation
 - Basis must be allocated between “sale” portion and “gift” portion
- Annual annuity payments are treated as mix of (1) ordinary income, (2) capital gain, and (3) return of capital
 - *Capital Gain*: Normally, bargain sale would trigger capital gain on “sale” portion immediately.
 - However, under a special rule, capital gain may be spread out over the donor’s lifetime if the donor is one of the annuitants (with part of each annuity payment “carrying out” capital gain to the donor)

Charitable Gift Annuities - Taxation

- **Estate and Gift Tax**

- Generally, any annuity interest other than donor's retained interest is a taxable gift at the time of the transaction
- Donor may retain testamentary right to revoke another annuitant's interest, making the gift incomplete
 - Any annuity payments to the donee while that right is outstanding are gifts at the time of such payments (qualifying for the gift tax annual exclusion)
 - The interest over which the right extended will be included in the donor's taxable estate
- A **gift tax marital deduction** is available for a spouse's interest ONLY if (1) the spouse is the sole annuitant (Treas. Reg. 25.2523(b)-1(c)) or (2) the donor and spouse hold a joint and survivor annuity (IRC 2523(f)(6)) (the spouse must also be a U.S. citizen).
 - A CGA to the donor for life and then the spouse may not qualify for the gift tax marital deduction (terminable interest, as the spouse may not survive the donor). However, the donor can retain the right to revoke the spouse's interest, making the gift incomplete until the donor dies (leaving the spouse as the sole annuitant at the time of the gift).

Effect of Interest Rates on CGAs and Other Vehicles

- **Higher Interest Rates**

- *CGAs*

- Higher charitable deductions
- Lower tax-free return of principal
- Relationship of Section 7520 rates to ACGA rates

- *Life estates*: Lower charitable deduction (higher rate = lower present value of remainder)

- *CLATs*: High interest rates worse for donors (lower present value of charitable annuity interest = lower gift/estate tax deduction = higher charitable interest required to zero out)

- *Gift/disclaimer of annuity/unitrust interest*: High interest rates worse for donors (reduced value of disclaimed interest)

Charitable Giving with Retirement Assets

- Lifetime gifts:
 - IRA charitable rollover (up to \$100k/year) if age 70 1/2 or older (IRC 408(d)(8))
 - Counts towards RMD
 - Does not work for gifts to supporting organizations or DAFs
 - Benefit lost if goods or services received in exchange
 - See IRC 408(d)(8)(C) (“treated as a qualified charitable distribution only if a deduction for the **entire** distribution would be allowable under section 170...”)
- Gifts at death:
 - If direct, estate tax deduction and avoidance of income tax realization
 - Beware making bequests of retirement assets by way of a will or revocable trust

Contact Information



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