
Charitable Planning

ACTEC Florida Fellows Institute
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Overview

Part I	Income Tax Charitable Deduction
Part II	Gift and Estate Tax Charitable Deductions
Part III	Permitted Partial Interest Gifts
Part IV	Benefiting Charity with Retirement Assets
Part V	Charitable Vehicles

Part I – Income Tax Charitable Deduction

- What constitutes a charitable contribution?
- Types of 501(c)(3) organizations
- Quid Pro Quo and Substantiation
- Gifts of Ordinary Income and Capital Gain Property
- Gifts of Tangible Personal Property
- AGI Limitations
- Gifts Subject to Conditions
- Partial Interest Gifts

What constitutes a charitable contribution?

Donation of cash or property



To an organization described
in section 170(c)

What constitutes a charitable contribution?

170(c)(1)	U.S. or state government if for exclusively public purposes <ul style="list-style-type: none">• Quasi-governmental organizations under IRC 115
170(c)(2)	To a charitable organization <ul style="list-style-type: none">• Created or organized in the United States or under US law<ul style="list-style-type: none">• 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 IRC 508(d)(2)(B); Rev. Proc. 2018-32)<ul style="list-style-type: none">• Exceptions for churches, integrated auxiliaries• 4947(a)(1) trusts
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

What constitutes a charitable contribution?

- **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 Charities**
 - 509(a)(1) (**PC**)
 - Churches - 170(b)(1)(A)(i)
 - Schools - 170(b)(1)(A)(ii)
 - Hospitals - 170(b)(1)(A)(iii)
 - Publicly supported organizations - 170(b)(1)(A)(vi)
 - 509(a)(2) (**PC**)
 - 509(a)(3) (Supporting Organizations)
 - Types I, II, and III Functionally Integrated (**SO** or **SOUNK**)
 - Type III Non-Functionally Integrated (**SONFI** or **SOUNK**)
- **Private Foundations (PF)**
- **Private Operating Foundations (POF)**
- **4947(a)(1) Trust**

Income Tax Deductions – Quid Pro Quo and Substantiation

Itemized deductions (mostly)

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(l))

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

Gifts of Ordinary Income and Capital Gain Property

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

Giving Appreciated Assets

Property: \$100,000 of stock,
\$50,000 cost basis (held for more than one year)

Option 1: Sale and gift of \$100,000 cash

- \$100,000 income tax deduction
- **\$10,000 capital gain tax due (at 20% rate)**

Option 2: Gift of \$100,000 stock, charity sells

- \$100,000 income tax deduction
- **No tax due on sale by charity**

Gifts of Tangible Personal Property

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 intellectual property, food or pharmaceutical inventory, scientific research property, taxidermy property, books to public schools, etc. (IRC 170(e) through (p))

Deduction Limitations for Charitable Gifts – Itemizers (2021)

	Public Charity / POF		Private Foundation	
	Maximum Annual Deduction	Value That Can Be Deducted	Maximum Annual Deduction	Value That Can Be Deducted
Gift of cash	100% 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. 100% limit for cash gifts to public charities in 2020 and 2021 (CARES Act; Consolidated Appropriations Act). Can be “stacked” on top of other gifts (including non-cash gifts or gifts to private foundations up to applicable limits).
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.

Charitable Giving - Itemizers

100% AGI Deduction

- Definition of “qualified contribution” (Section 2105, CARES Act)
 - Charitable contribution defined in IRC 170
 - Paid in cash
 - During calendar year 2020 or 2021
 - To a 170(b)(1)(A) organization (not a DAF or SO)
 - Public charities, private operating foundations, governmental units for exclusively public purposes
 - For which the taxpayer makes an election

Charitable Giving - Itemizers

Use of 100% deduction in 2021 – “Stacking” example

- Assume AGI of \$300,000
- Give \$90,000 of appreciated stock to public charity (30% of AGI)
- Give \$60,000 of cash to a DAF (up to 50% of AGI)
- Give \$150,000 of cash to public charity (up to 100% of AGI)

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)			

Charitable Giving – Non-itemizers

- **\$300/\$600 deduction (2021 only)**
— Cash gifts to public charities (not DAFs or SOs)
- **“Bunching”**

	2021	2022	2023	2024	2025
<i>Standard Deduction</i>	\$25,100	\$25,400*	\$25,800*	\$26,200*	\$26,700*
Annual Contributions	\$20,000	\$20,000	\$20,000	\$20,000	\$20,000
Bunching	\$100,000	\$0	\$0	\$0	\$0
Total Deductions (no bunching)	\$25,100	\$25,400	\$25,800	\$26,200	\$26,700
Total Deductions (with bunching)	\$100,000	\$25,400	\$25,800	\$26,200	\$26,700

* Estimated

Income Tax Deductions

Gifts Subject to Conditions

	Gifts	EXAMPLES
1.	A condition may reduce the value of the gift	Restrictions on sale
2.	A condition may make the gift incomplete	Retained control
3.	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”	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)

Gifts of Partial Interests – Key Exceptions (see IRC 170(f))

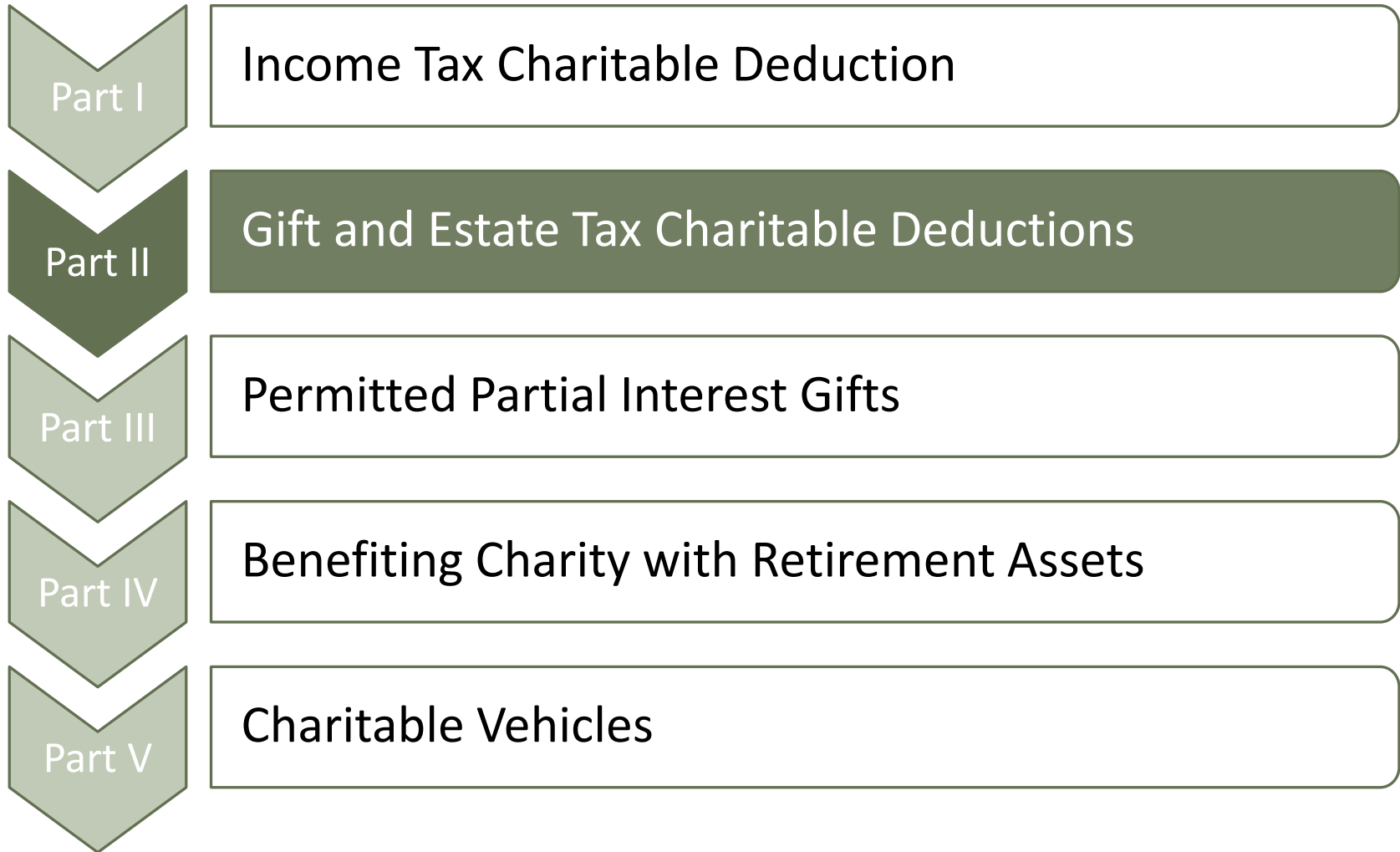
- Charitable Remainder Trusts
- Charitable Lead Trusts
- Pooled Income Funds
- Remainder in Personal Residence or Farm
- Qualified Conservation Easements

Part I – Income Tax Charitable Deduction

Key Points

- Deduction not available for gifts to non-US entities
- Consider quid pro quo benefits
- Substantiation requirements are strictly construed
- Gifts of ordinary income property reduce deduction
- Beware assignment of income concerns for gifts of LTCG
- Non-cash gifts to private foundation limited to cost basis (other than qualified appreciated stock)
- Gifts of TPP generally limited to cost basis (unless related use)
- Consider AGI limitations (temporary 100% AGI limit; back to 60% in 2022)
- Consider effect of restrictions or conditions on use of gifted property
- Split-interest gifts can result in gift/estate tax, not just loss of income tax deduction

Overview



Part II - Gift and Estate Tax Charitable 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

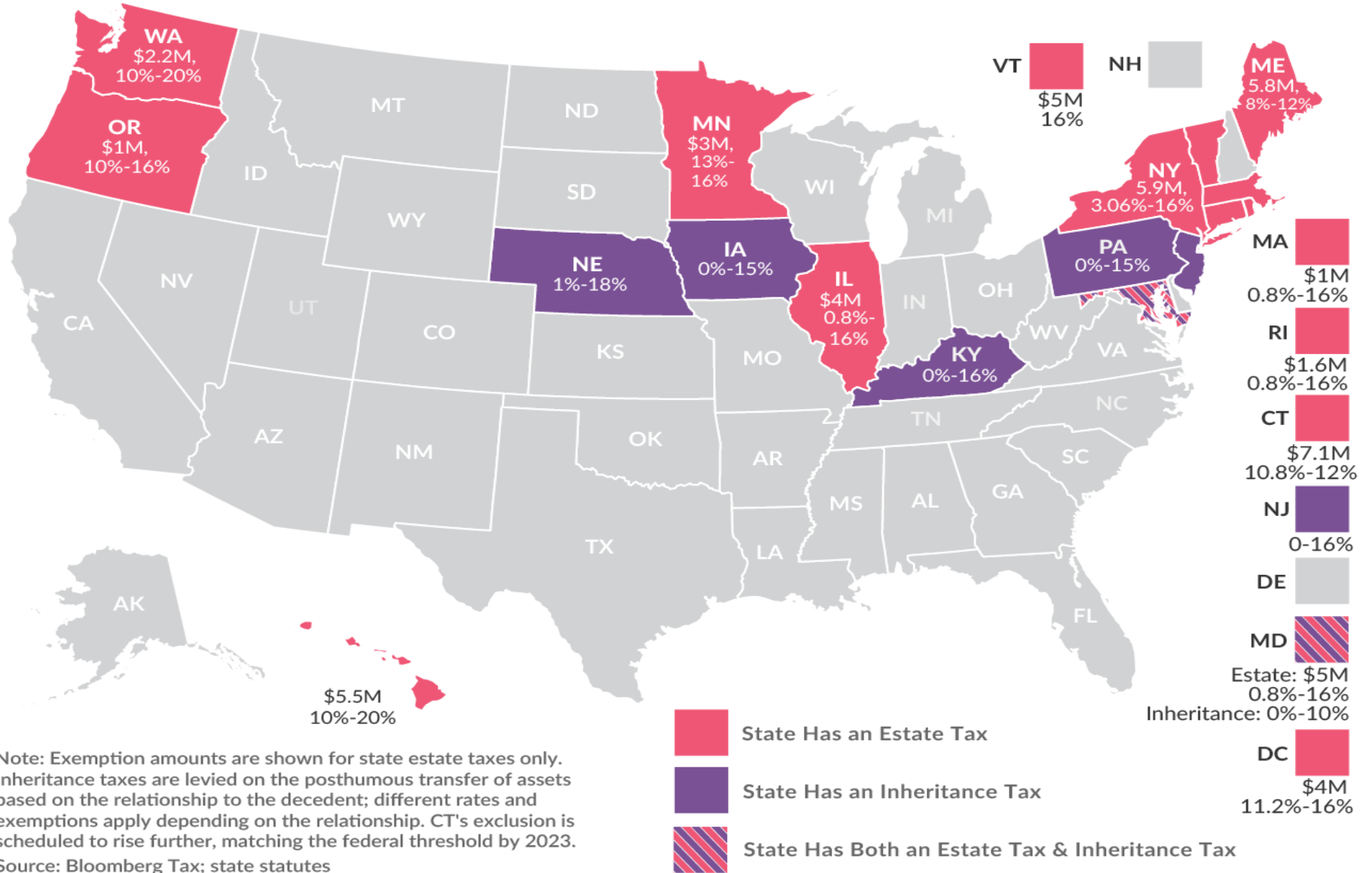
- Similar to (but not identical to) income tax split interest rules
- If in trust, must be qualifying CRT or CLT

Special rules for real
property easements

Special rules for gifts of
tangible personal
property

Does Your State Have an Estate or Inheritance Tax?

State Estate & Inheritance Tax Rates & Exemptions in 2021



Note: Exemption amounts are shown for state estate taxes only. Inheritance taxes are levied on the posthumous transfer of assets based on the relationship to the decedent; different rates and exemptions apply depending on the relationship. CT's exclusion is scheduled to rise further, matching the federal threshold by 2023. Source: Bloomberg Tax; state statutes

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)

Gift and Estate Tax Deductions – Non-Resident Aliens

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)

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

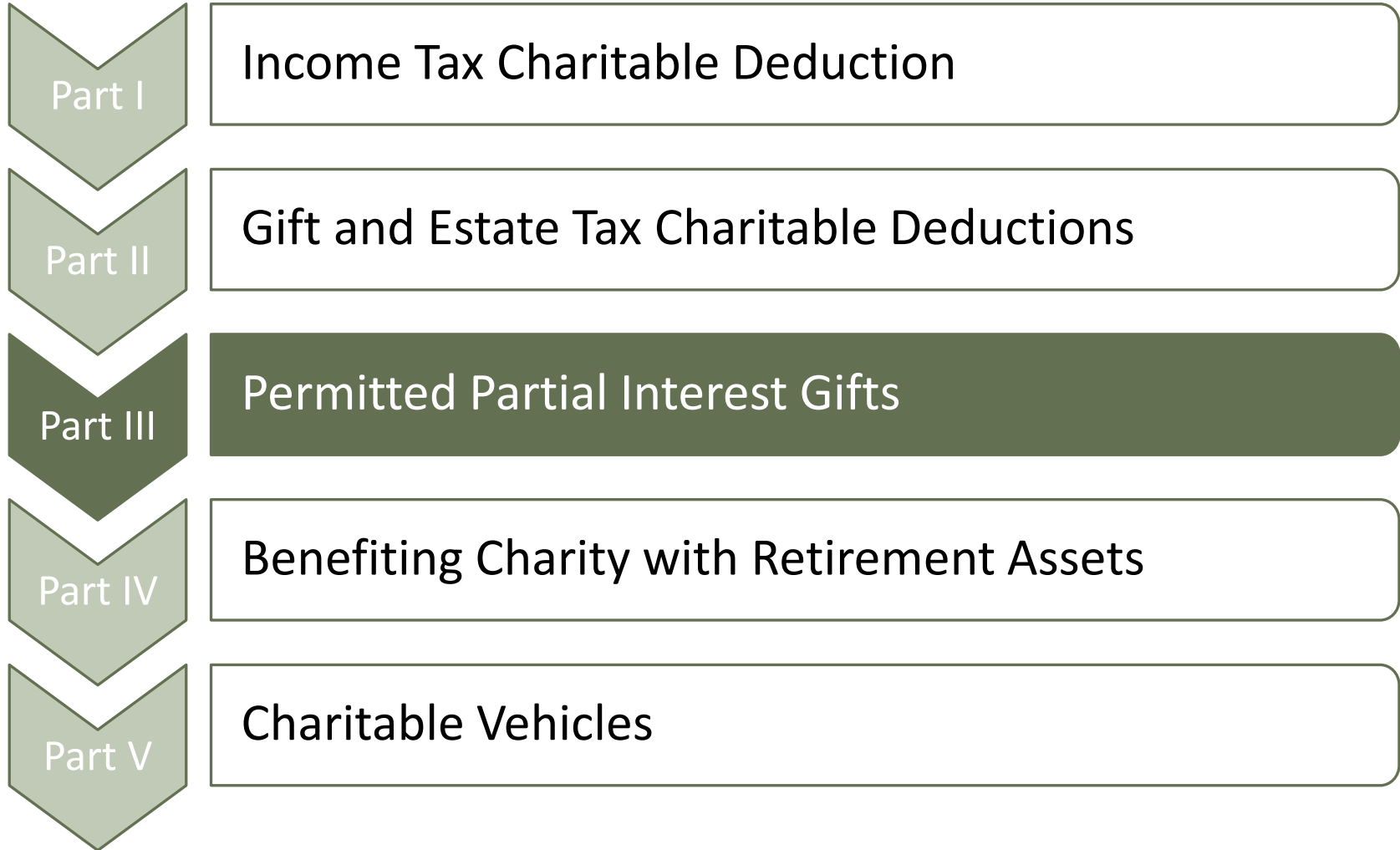
- Ex., *Estate of Avrom Silver*, 120 T.C. 14 (2003) (deduction allowed under Art. XXXIX B, par. 1 of 1995 Protocol to the U.S. Canadian Income Tax Treaty for bequest by Canadian NRA to Canadian charity, but only with respect to property subject to U.S. estate tax)

Part II – Gift and Estate Tax Deduction – Key Points

Key Points

- Be as afraid of blowing the gift/estate tax charitable deduction as we are trained to be afraid of blowing the marital deduction
- Partial interest rules
- Flexibility for US citizens/residents to benefit foreign charities
- NRAs who want a charitable estate tax deduction generally must leave US situs property to a qualified US entity (generally US corporation, or qualified trust for use exclusively for charitable purposes within the US)

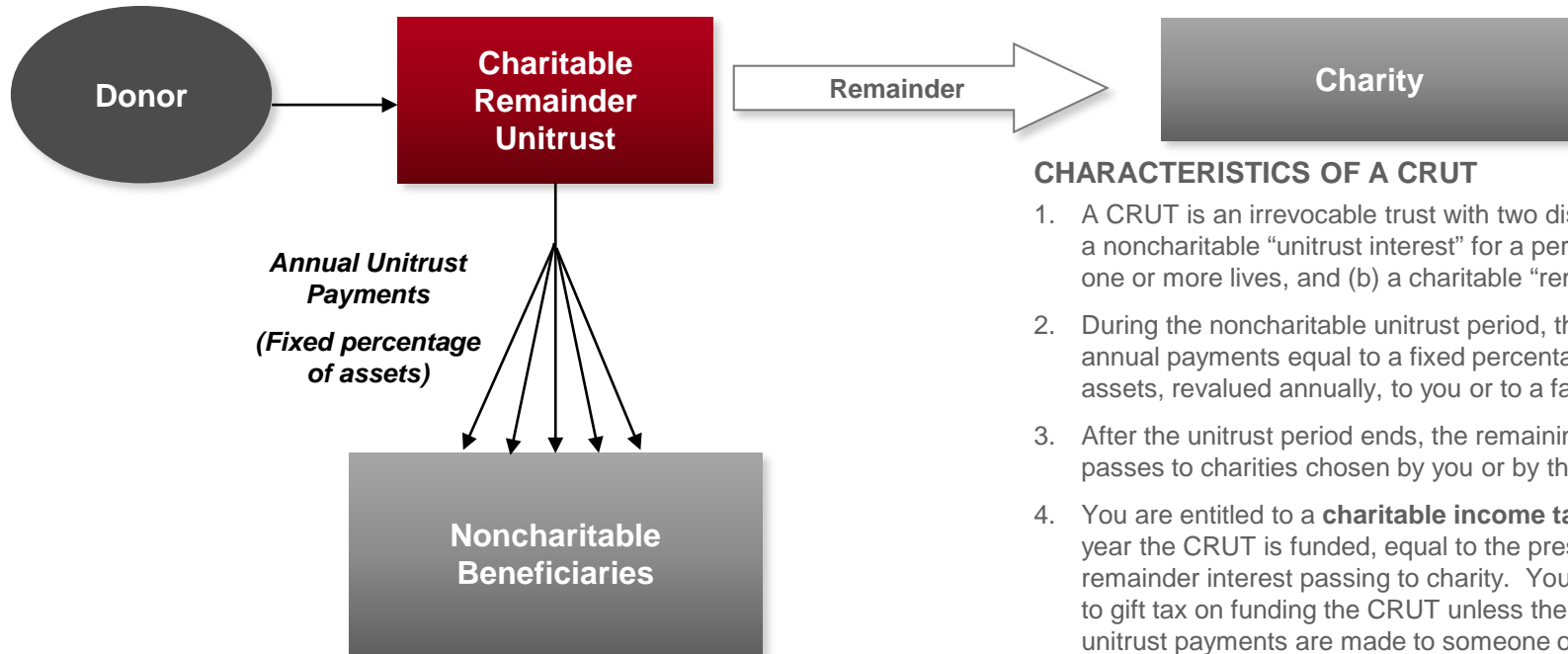
Overview



Part III – Permitted Partial Interest Gifts

- Charitable Remainder Trusts
- Charitable Lead Trusts
- Pooled Income Funds
- Remainder in Personal Residence or Farm
- Qualified Conservation Easements
- Charitable Gift Annuities (Quid Pro Quo Gift)

Charitable Remainder Trusts



CHARACTERISTICS OF A CRUT

1. A CRUT is an irrevocable trust with two distinct interests – (a) a noncharitable “unitrust interest” for a period of years or for one or more lives, and (b) a charitable “remainder interest.”
2. During the noncharitable unitrust period, the CRUT makes annual payments equal to a fixed percentage of the trust’s assets, revalued annually, to you or to a family member.
3. After the unitrust period ends, the remaining CRUT property passes to charities chosen by you or by the trustees.
4. You are entitled to a **charitable income tax deduction** in the year the CRUT is funded, equal to the present value of the remainder interest passing to charity. You will not be subject to gift tax on funding the CRUT unless the noncharitable unitrust payments are made to someone other than you or a U.S. citizen spouse.
5. The CRUT is not subject to income taxes (including capital gains taxes). As such, you may contribute highly appreciated securities to the CRUT, and the CRUT may sell those securities without incurring any present gains taxes. **This makes a CRUT a useful vehicle for diversification.** The noncharitable unitrust beneficiary will pay the capital gains taxes over time, as unitrust distributions are made.

ADVANTAGES

- *Charitable income tax deduction* – You receive an immediate income tax deduction equal to the present value of the charitable remainder interest.
- *Capital Gains Tax Deferral* – You may use a CRUT to sell appreciated securities, deferring the capital gains tax liability over many years.
- *Estate tax savings* – As long as the noncharitable unitrust interest ends at your death, or passes to your surviving U.S. citizen spouse, the CRUT assets will not be taxed in your estate.

LIMITATIONS

- *Continuing income tax liability* – Some portion of the annual unitrust distributions will be taxable income to the noncharitable beneficiary.

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

10% Test

- Value of remainder interest must be at least 10% of initial FMV.
- Problem for CRATs in low-interest rate environment.

5% Test

- 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 - 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 whichever is longer or shorter (but cannot tack 20 years onto one or more lives)
- 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 (or may give that power to unitrust beneficiary)

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
- **If children take after spouses, no marital deduction**
 - However, if jointly funded, no gift tax between spouses except to the extent that **actuarial interests** differ in value – Rev. Rul. 76-157

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

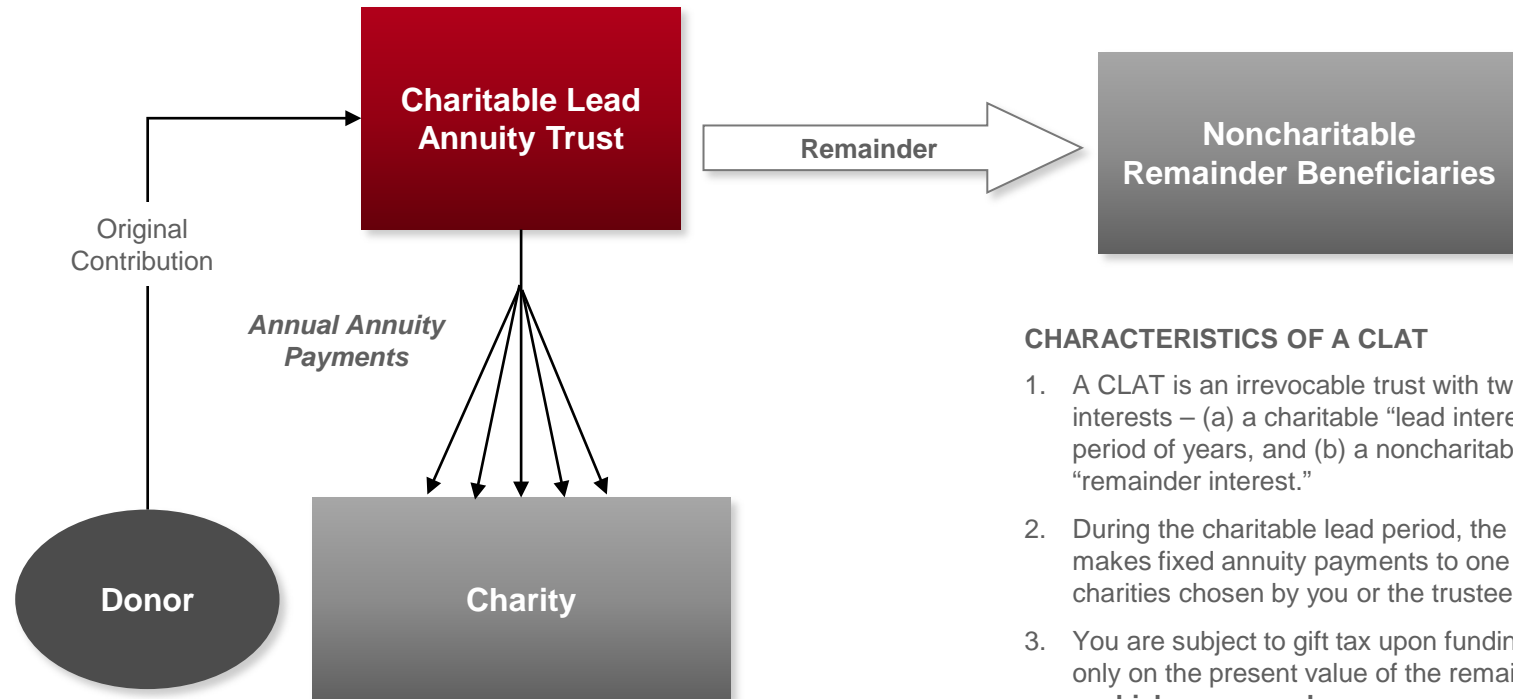
- Largely unaffected

Charitable Remainder Trusts

Key Points

- Follow IRC 664 carefully – once it's blown, it's blown forever
- No UBTI property (100% tax)
- All CRUTs these days, not CRATs (low interest rates)
- Any “person” (IRC 7701) can fund a CRT
- Usually 5-7% payouts; 10% and 5% tests
- One or more lives, or term of years not to exceed 20 (can do longer or shorter, but can't tack 20 years onto one or more lives)
- Can do “sprinkle” trusts if independent trustee and limited to 20 years or joint individual beneficiaries
- Can retain testamentary power to revoke interests
- Can retain power to change remainder beneficiary (or give it to unitrust beneficiary)
- Limit remainder beneficiary to public charities to get higher AGI limit
- SCRUTs, NICRUTs, NIMCRUTs and FLIPCRUTs
- Beware marital deduction if non-spouse successor beneficiaries (IRC 2523(g))
- Income tax ordering rules – worst first
- Beware private foundation rules (especially self-dealing)

Charitable Lead Annuity Trust



ADVANTAGES

- *Gift tax cost* – Allows you to “leverage” your gift tax exemption and transfer significant assets to children and others at a reduced, or even zero, gift tax cost.
- *Estate tax savings* – The CLAT assets are out of your estate.
- *Limited risk* – If the CLAT assets do not perform well, you have not wasted any gift tax exemption.

LIMITATION

- Not advisable to allocate GST exemption to a CLAT.

CHARACTERISTICS OF A CLAT

1. A CLAT is an irrevocable trust with two distinct interests – (a) a charitable “lead interest” for a period of years, and (b) a noncharitable “remainder interest.”
2. During the charitable lead period, the CLAT makes fixed annuity payments to one or more charities chosen by you or the trustees.
3. You are subject to gift tax upon funding the CLAT only on the present value of the remainder interest – **which can go as low as zero.**
4. At the expiration of the charitable lead period, the CLAT pays the remaining trust property to one or more noncharitable beneficiaries named by you, free of gift tax.

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 be “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 unless 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).

Low Interest Rate Charitable Giving

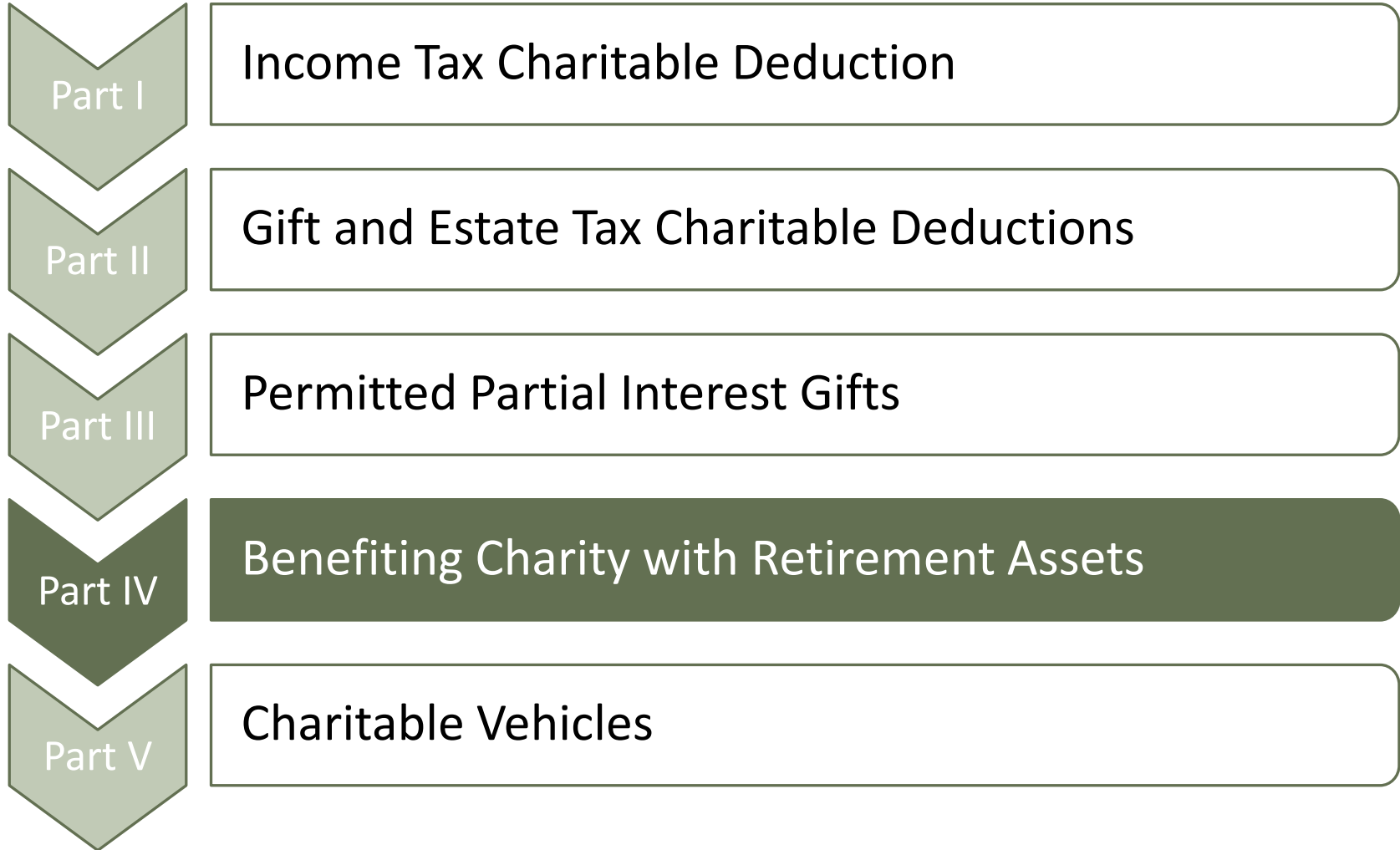
Better for Donors

- Gifts of remainder interests in real estate
- CLATs
- Gifts of annuity or unitrust interests
- CGAs (Higher tax-free return of principal)

Worse for Donors

- CRATs (CRUTs largely unaffected by interest rates)
- CGAs (Lower charitable deductions)

Overview



Part IV – Benefiting Charity with Retirement Assets

- Qualified Charitable Distributions during lifetime
- Bequests of Retirement Assets to Charity

Part IV - Qualified Charitable Distributions from IRAs

Requirements

- Direct payment to charity required
- Must be a public charity (but not a donor-advised fund or supporting organization)
- Up to \$100k/year
- Beneficiary must be age 70 ½ or older (even for inherited IRA)
- Must receive no benefits from charity in return

Effect

- Treated as direct payment to charity – no income inclusion
- Satisfies Required Minimum Distribution
- Not subject to the AGI deduction limits

Gifts at Death

- Receive estate tax deduction and avoid income tax

Bequests of Retirement Assets to Charity

- Leave assets outright via beneficiary designation forms
 - Be careful running through estate or revocable trust
- Spousal waiver if 401(k)
- No stretch post SECURE ACT - Replicate stretch with IRA bequest to CRT?

Stretching with Charitable Remainder Trusts?

Mechanics

- IRA left to charitable remainder trust
- Beneficiaries receive percentage interest (CRUT) or annuity (CRAT) for life (or term of up to 20 years)
 - Percentage interest typically 5%
 - Must ensure that charitable remainder worth at least 10% of funding amount
- No income tax on funding of CRT on death
 - Annual distributions carry out taxable income
- Partial estate tax charitable deduction

Effect

- Converts lump sum or 10 year IRA interests to lifetime payments
- Spreads out income tax consequences over beneficiary's lifetime
- Creates partial estate tax charitable deduction

Stretching with CRTs – Example

Assumptions: \$1M IRA, 40 year old beneficiary, 1.2% Section 7520 rate, 35% income tax rate, est. 7% tax-free growth in IRA or CRT, 5% growth net of taxes outside of IRA or CRT, child lives to age 70

To Child Outright

- Estimated tax of \$350,000, net bequest of \$650,000
- *After 30 years: \$2.8 million*

To Child After 10 Years

- 10 years in IRA -> \$2 million less \$700,000 tax = \$1.3 million
- *After 30 years: \$3.45 million*

To CRUT

- \$1M CRUT initial value, 5% annual payout
- Aggregate cash paid out over 30 years (not weighted, before tax): \$2 million
- *Total after 30 years (35% tax on distribution of first \$1M; blended 25% tax on remainder)*
 - Value with distributions invested: **\$3.03 million**
 - Remainder to Charity: **\$1.8 million**

Stretching with CRTs

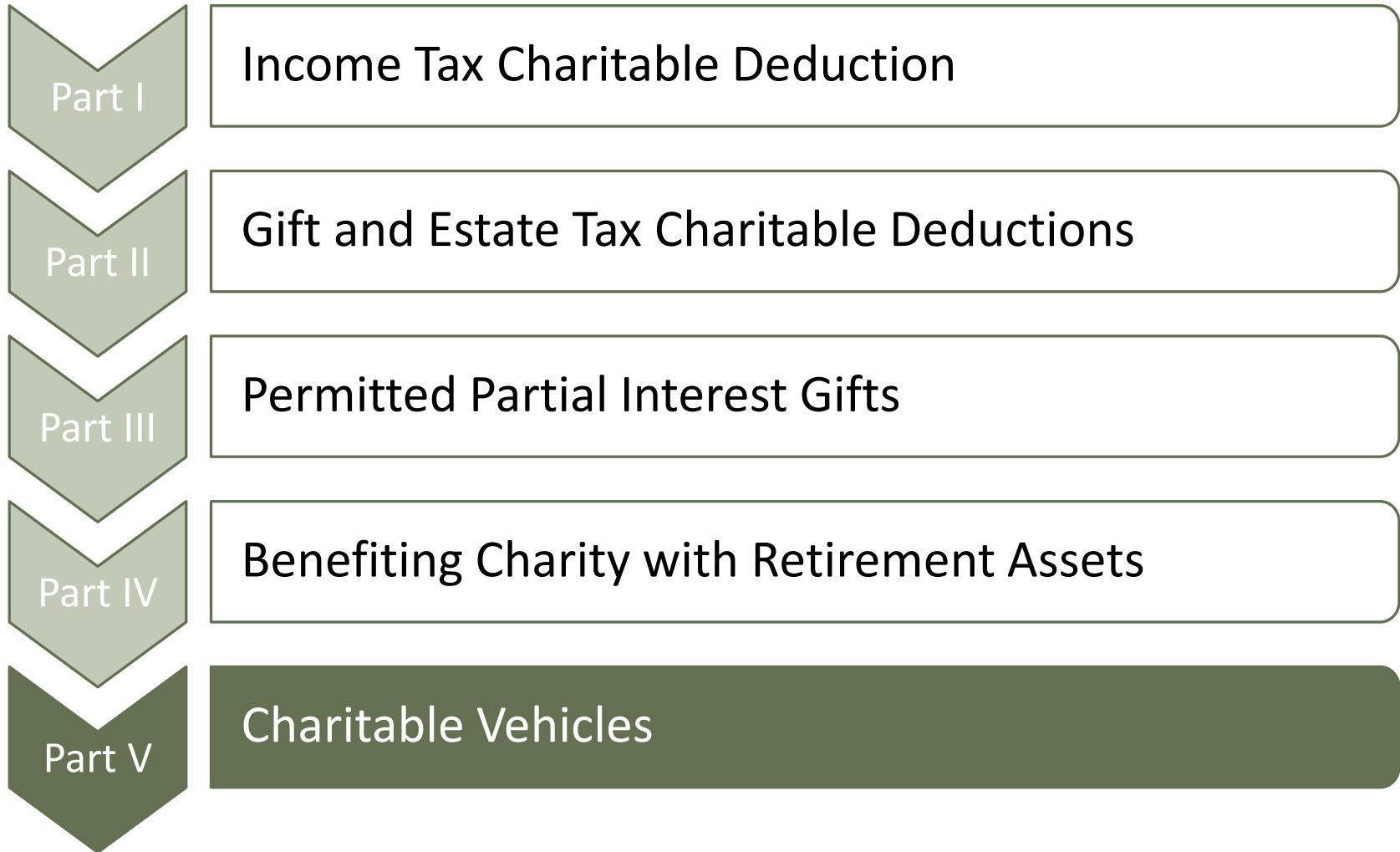
Benefits

- Spreading out payments (income stream; potentially lower tax brackets)
- Spreading out income tax consequences
- Partial estate tax deduction
- Trust protections (creditors, spendthrift, etc.)

Additional Considerations

- Less benefit for family if CRT beneficiary dies early
- Must establish and maintain trust

Overview



Part V – Charitable Vehicles

- Public Charities
 - Supporting Organizations
- Private Foundations
- Donor-Advised Funds
- 501(c)(4) Social Welfare Organizations
- “Zuckerberg” LLCs

Public Support Test – 509(a)(1) – 33 1/3% Test

$$\text{Public Support Ratio} = \text{Public Support} \div \text{Total Support}$$

- Calculated over trailing 5 year period
- If qualify, 509(a)(1) for qualifying year and following year
- New organization: Years 1-5 or 2-6

Public Support	Total, Not Public Support	Excluded Entirely
Government grants	Grants above 2% limitation	Unusual grants
Grants from publicly supported organizations*	Unrelated business income	Capital gain income
Part of other grants (up to 2% limitation)	Investment income (other than capital gains)	Program service income**

* Includes 509(a)(1) public charities that satisfy the public support test under 170(b)(1)(A)(vi) and others (such as churches) that are able to satisfy that test (Treas. Reg. 1.170A-9(f)(6)(i))

** Program service income cannot be substantially all of organization's income for 509(a)(1) (ok for 509(a)(2))

Public Support Test – 509(a)(1) – 33 1/3% Test

What is the 2% limitation?

- **Add up all contributions for past five years, take 2% of that**
- **Example:**
 - \$350,000 per year
 - \$250,000 per year from single PF
 - \$100,000 per year from diverse sources (all below 2% limit)
 - \$1.75 million over five years
 - 2% of \$1.75 million = \$35,000
- **PF has given \$1.25 million over five years**
- **Public Support portion = \$35,000**
- **Non-Public Support Portion = \$1,215,000 (counts in denominator, not numerator)**
- **Public Support Ratio:**
 - \$1,750,000 (grants) - \$1,215,000 (excess over 2%) = \$535,000
 - \$535,000 (public support) ÷ \$1,750,000 (total support) = **30.57%**

If PF donation drops to \$200,000 per year, public support = **35.33%**

Public Support Test – 509(a)(1) – Facts and Circumstances

Public Support Ratio between 10% and 33 1/3%

Factors

- Percentage of public support
- Fundraising efforts
- Public visibility
- Broadly representative board

Public Support Test – 509(a)(2)

509(a)(2) Organizations

- 33 1/3% Public Support (focus on service revenue, less on grants)
- No more than 33 1/3% from investment income and UBTI (can't rely on endowment)

Public Support Test – 509(a)(2)

Key differences

- Program service revenue can help ratio (excluded from 509(a)(1) test)
- “Bright line” limit on investment income and UBTI
- No “facts and circumstances” safety net
- *Note:* “Unusual grants” excluded from *both* 509(a)(1) and 509(a)(2) calculations

Key limitations

- **“Disqualified Person” grants/receipts** excluded *entirely* from numerator
- **Per person limit** - receipts count only up to **greater of \$5,000 or 1%** of total support for the year (excluding disqualified person receipts)
 - Grants are not subject to this \$5k/1% limitation, and therefore count in full as public support
 - However, some large grants may be treated as non-public support as grants from disqualified persons

Public Support Test – 509(a)(2)

Disqualified person

- Substantial contributors (at least \$5k and exceeds 2% of contributions in current or past year)
- Directors and officers
- Close family members
- Related organizations

Private Foundations

- Negative	Extra Rules <ul style="list-style-type: none">• IRC 4940 – Excise Tax on Net Investment Income (1.39%)• IRC 4941 – Self-Dealing• IRC 4942 – Minimum Distribution Requirements<ul style="list-style-type: none">• Public Operating Foundations• IRC 4943 – Excess Business Holdings Limitations• IRC 4944 – Jeopardizing Investments• IRC 4945 – Taxable Expenditures
- Negative	More limited tax benefits (AGI limitations, less deduction for gifts of complex assets)
+ Positive	No need for broad, independent board of directors
+ Positive	No need to worry about “public support test”

Donor-Advised Funds

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 – Why Does It Matter?

IRC 4966 –

20% tax on DAF sponsor

5% tax on fund manager

Taxable Expenditure Rules

Cannot distribute:

- 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

Donor-Advised Funds – Why Does It Matter?

IRC 4967 –

125% tax on advisor/related party
potential 10% tax on fund manager

Prohibited Benefit Rules

Tax on “more than incidental benefit”

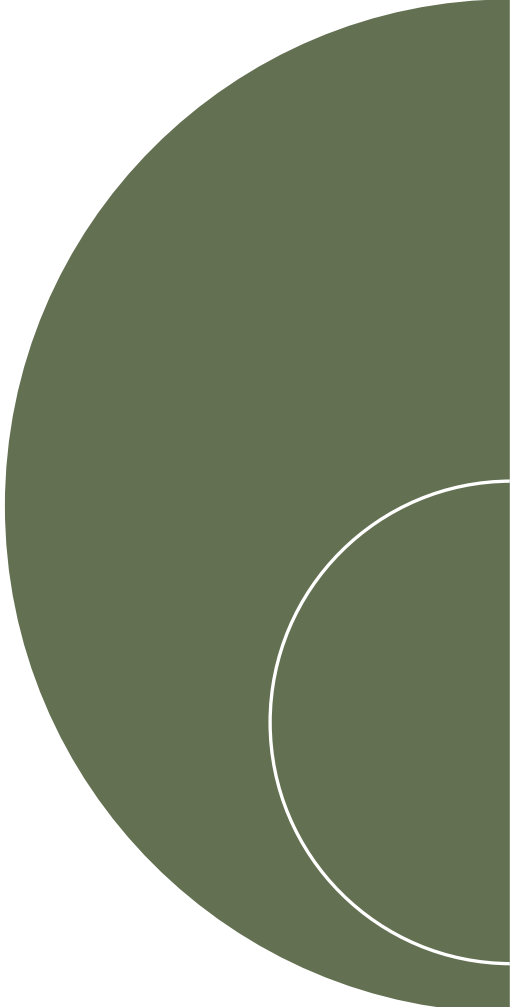
- Not defined in IRC 4967
- IRC 4941 (private foundation self-dealing) guidance may be relevant, but unclear
- Credit / “reflected glory”
- Direct or indirect economic benefits
 - Tickets to charity-sponsored event, membership benefits, etc.
 - Fulfilling pledges?
 - Sports event ticket purchase rights?

DAFs – Impermissible Benefits – IRC 4967 and 4958

IRC 4967 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

DAF Distributions for Tickets



<p>Distributions to pay tax deductible portion of a ticket to charity-sponsored event or a membership fee (i.e., “split gifts”) – TAXABLE (per Notice 2017-73)</p>	<p>Example: \$1,000 tickets for event, \$100 FMV, \$900 tax deductible, seats not available at lower price</p> <ul style="list-style-type: none">• Individual gift• Private foundation gift• DAF gift
<p>True severance of DAF and individual portions - NOT TAXABLE (probably)</p>	<p>Example: \$1,000 tickets for event, \$100 FMV, can buy seats at \$400 (remaining \$600 buys recognition only)</p> <ul style="list-style-type: none">• Pay \$400 individually• Pay \$600 from DAF (no benefit other than “reflected glory”) <p>No official IRS guidance to this effect, but should be correct</p>

DAFs – Notice 2017-73 – Donor Pledges

Distributions in fulfillment of donor pledges – NOT TAXABLE

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:

- DAF sponsor makes no reference to existence of pledge when making DAF distribution
- Donor/advisor receives no other benefit that is more than incidental
- Donor/advisor does not attempt to claim income tax deduction for DAF distribution

Notice indicates this guidance regarding pledges may be relied upon immediately

DAFs – Preferential Athletics Ticket Rights

- Not addressed expressly by IRS
- Based on IRS analysis regarding DAF distributions for tickets - TAXABLE (probably)
 - Value of benefit for purposes of DAF tax not just FMV of tickets, but also **ability to access**, which has value
 - Value of impermissible benefit may be full value of 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.

501(c)(4)s

Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare

- Exclusively public benefit; no private inurement or more than incidental private benefit
- No public support test
- No private foundation rules
- Lobbying and some political activity okay

Gift tax does not apply, but estate tax does

- IRC 2501(a)(6) – Partial interest rules, etc. don't apply
- Beware IRC 2036

“Zuckerberg” LLCs

- It's just an LLC

Comparing Charitable Vehicles

	Pros	Cons
Public Charity	<ul style="list-style-type: none"> - Best tax results for gifts - No private foundation rules 	<ul style="list-style-type: none"> - Loss of control - Public support test
Donor-Advised Fund	<ul style="list-style-type: none"> - Mostly best tax results for gifts - Fewer administration hassles/risks 	<ul style="list-style-type: none"> - No 100% AGI; no QCDs - Can't give to individuals - Can't freely give to non public charities
Private Foundation	<ul style="list-style-type: none"> - Control and flexibility 	<ul style="list-style-type: none"> - Restrictive rules - Less favorable tax benefits
4947(a)(1) Trust	<ul style="list-style-type: none"> - No need for Form 1023 	<ul style="list-style-type: none"> - Private foundation rules apply - Must file 1041s, pay tax if not all distributed out
501(c)(4)	<ul style="list-style-type: none"> - No Form 1023/1024 required - No public support test - No private foundation rules - No gift tax 	<ul style="list-style-type: none"> - No income tax deduction - Estate tax concerns
LLC	<ul style="list-style-type: none"> - Contracting vehicle for personal / family philanthropy 	<ul style="list-style-type: none"> - It's just an LLC – you haven't done anything tax-wise

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