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Client Alert

Current Issues Relevant to Our Clients

September 2015

Charitable Giving Techniques — Part One

According to Giving USA, Americans gave an estimated $358.38 billion to charity in 2014, surpassing the peak last seen in 2007 prior to the Great Recession. The 2014 total jumped 7.1% from 2013. Gifts to charity can take many forms, including (i) direct gifts of cash or property to a charitable organization, (ii) gifts in trust for charity that also provide an annuity stream back to the donor, (iii) gifts in trust for charity that also provide benefits for the donor's family and (iv) current gifts to a fund or entity that will be distributed later to charity. This article, which addresses the first three forms, is the first of a two-part series that will discuss various alternatives for making gifts to charity.

Why make charitable gifts?

Typically, people give to charity for the simple joy of giving and helping others. However, the federal tax laws encourage charitable giving by providing deductions for charitable gifts. A limited income tax deduction is available for contributions to qualified charities. Income tax deduction limitations will depend on the character of the donated property and the status of the charitable donee. An unlimited gift and estate tax deduction also is available for gifts or bequests to qualified charities.

How to give?

Charitable gifts may be made in many forms depending upon your needs and objectives. Gifts may be made outright, in trust and as annuities.

Gifts to charity can be unrestricted or restricted. "Unrestricted" funds are donations that are available for the charity to use toward any charitable purpose. Typically, unrestricted funds are used toward the operating expenses of the charity. Alternatively, you can restrict the use of your donation to a particular project or purpose, such as a particular scholarship or endowment fund at a university.

Direct gifts to charity

The simplest form of gift to a charitable organization is an outright gift. Direct gifts to charity can be comprised of cash, securities, real estate, tangible personal property, life insurance or other property.

If you hold highly appreciated marketable securities in taxable investment accounts, you should consider donating those shares instead of cash. In addition to getting the deduction for the charitable gift, you will avoid paying the capital gains tax when you sell the shares. For example, let us assume you have $100,000 worth of stock that you bought many years ago for $20,000. If you sell the stock, you likely will owe $19,000 in capital gains tax on the $80,000 of capital gain, leaving you only $81,000 to give to charity. If you donate the shares of stock instead of cash, the charity will get the full $100,000.

In recent years, one of the best ways to give directly to charity is through your individual retirement account (IRA). If you are over the age of 70-1/2, you can transfer up to $100,000 from a traditional or Roth IRA directly to charity. The amount transferred is not required to be reported as taxable income on your income tax return; however, the amount still counts toward your required minimum distribution. Because the direct distribution to charity is not considered taxable income, you do not receive a charitable income tax deduction for the contribution. At this time, it is unclear whether a charitable distribution from an IRA will be available for 2015. Last year, Congress waited until mid-December to allow this form of charitable gift for 2014.

Charitable gifts that give back to the donor

Some charitable giving techniques can offer a stream of income to donors (or their family members).

1. Charitable remainder trusts

A charitable remainder trust can be established during your lifetime or upon your demise. When a charitable remainder trust is established, you transfer cash and/or property to an irrevocable trust but retain (either for yourself or for one or more non-charitable beneficiaries) an annuity from the trust. At the end of a specified term of years, or upon the death of the beneficiary, the balance of the assets in the trust passes to the charitable organization(s) that the you have specified. The annuity payout can be a set dollar amount or a percentage of trust assets, valued each year. You get an upfront charitable deduction for transferring assets to the trust, but the charitable deduction is calculated based on the value of the future distribution to charity under a formula provided by the Internal Revenue Code.

If you establish a charitable remainder trust during your lifetime, you can serve as trustee of the trust, and you also can retain the power to change the charitable organization(s) that ultimately receive the remaining trust assets at the end of the trust term. If appreciated assets are contributed to the trust, the assets can be sold, and the trust will not owe any capital gains tax since the trust is a tax-exempt entity for income tax purposes. However, annuity distributions to you or your beneficiaries may be taxable (depending on the taxable income generated by the charitable remainder trust).

2. Charitable gift annuities

If you would rather forgo the complexity and expense of establishing a trust, a charitable gift annuity also allows you to make a charitable gift but be paid an annuity. With this technique, you transfer cash and/or property to a charity, and the charity has a contractual obligation to pay you (or other beneficiaries) an annuity for life from the general funds of the charity. The size of the annuity payments depends partly on the age of the annuity recipients. Currently, a 65-year-old can get a rate of 4.7%, according to the American Council on Gift Annuities, which sets gift annuity rates followed by many charities.

If you are considering a charitable gift annuity, it is important to understand that the income stream depends on the charity's ability to make the payments. In adverse economic times, even charities can go bankrupt.

Gifts to charity (and your family)

In today's low interest rate environment, one charitable technique that works particularly well and has become more popular is a charitable lead trust. Charitable lead trusts are the mirror image of charitable remainder trusts and offer you the opportunity to benefit both charity and your family. A charitable lead trust is a trust that is designed to provide annuity payments to one or more charities for the term of the trust. At the end of the term, the remaining trust assets are paid outright to or in trust for your children or grandchildren. Like a charitable remainder trust, the annual payouts to charity can be a set dollar amount or a percentage of trust assets, valued each year. A charitable lead trust can be established during your lifetime or at your death.

For gift and estate tax purposes, a portion of the initial contribution to the charitable lead trust is deemed to be a taxable gift to the family. The value of the gift is calculated based on the value of the future distribution to charity under a formula provided by the Internal Revenue Code. The present value of the charitable annuity stream is determined based on the monthly interest rates published by the IRS. Given current historically low interest rates, the published monthly interest rate used by the IRS for valuing an annuity in September 2015 is only 2.2%. Lower interest rates increase the present value of the charitable annuity stream and decrease the value of the gift to your family. In fact, if the charitable annuity term is long enough and/or the annuity payment amounts are sufficiently large, it may be possible to structure the charitable lead trust so that little or no taxable gift is made at the inception of the trust. If the underlying investment performance over the term of the trust exceeds the interest rate assumptions at the time of the gift (currently 2.2%), the excess growth can pass to your family free of estate tax.

If you intend to provide for grandchildren following the charitable trust term, a charitable lead annuity trust with a fixed annual payout to charity must be utilized to preserve the ability to allocate GST exemption to the trust at the end of the charitable term.

Conclusion

Depending upon your individual goals and objectives, there are a variety of different techniques that can be utilized when making gifts to charity. This client alert discusses direct contributions to charity, charitable remainder trusts, charitable gift annuities and charitable lead trusts. The next client alert in our two-part series on charitable gifting will compare and contrast the use of private foundations and donor-advised funds when making charitable gifts.

Chapman and Cutler Trusts and Estates attorneys are familiar with the many available charitable gift planning opportunities. If you have any questions or would like more information regarding charitable giving strategies, please contact Molly Carney (312.845.3438), David Crossett (312.845.3011), David Lullo (312.845.3902) or Rebecca Wallenfelsz (312.845.3442), or visit us online at www.chapman.com.