



THE COLUMBUS FOUNDATION

Charitable Gift Planning Strategies

AFP/OSU Education Summit

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TABLE OF CONTENTS

| | | |
|------|--|----|
| I. | Summary of Charitable Deduction Rules..... | 1 |
| II. | Outright Gifts During Lifetime | 2 |
| | A. Gifts of Cash | 2 |
| | B. Gifts of Appreciated Securities | 2 |
| | C. Gifts of Mutual Funds | 4 |
| | D. Gifts of Closely-Held Stock..... | 5 |
| | E. Gifts of Real Estate..... | 6 |
| | F. Gifts of Tangible Personal Property | 8 |
| III. | Gifts Providing Income to Charity With Remainder Passing to Donor or Donor's Heirs--The Charitable Lead Trust | 9 |
| IV. | Gifts Providing Lifetime Interest to Noncharitable Beneficiary | 12 |
| | A. Charitable Remainder Unitrust | 13 |
| | B. Charitable Remainder Annuity Trust | 16 |
| | C. Charitable Gift Annuity..... | 22 |
| | D. Deferred Charitable Gift Annuity | 25 |
| | E. Pooled Income Fund..... | 27 |
| | F. Gift of Remainder Interest in Personal Residence or Farm with Retained Life Estate..... | 30 |
| V. | Gift of Qualified Retirement Plan and IRA Assets | 33 |
| VI. | Gifts of Life Insurance..... | 37 |
| VII. | Gifts by Bequest | 39 |

I. Summary of Charitable Deduction Rules

Contributions of cash to a public charity such as The Columbus Foundation, (i.e., a section 501(c)(3) organization that is not a private foundation) are deductible up to 50% of the donor's adjusted gross income with five year carry-forward period for any excess amount.

Gifts of long-term appreciated property to a public charity are deductible at fair market value up to 30% of the donor's adjusted gross income with a five year carry-forward period for any excess amount. A donor has held property long-term if he or she has held it for more than one year.

If a donor gives appreciated property that he or she has owned short-term (for one year or less), the charitable deduction is for the property's cost basis. Gifts of short-term property are deductible up to 50% of the donor's adjusted gross income.

There are many exceptions to these basic rules, including those involving the following:

- Gifts to private foundations.
- Contributions of inventory and other property by a corporation.
- Contributions of tangible personal property to a charity whose use of the donated property is not related to its charitable function.

II. Outright Gifts During Lifetime

A. Gifts of Cash

Cash, usually in the form of a check, is the most common form for charitable gifts. Cash gifts enable the donor to claim a current income tax deduction of up to 50% of the donor's adjusted gross income in the year of the gift with a five year carry-forward if needed. Actual savings from gifts of cash depend on the donor's tax bracket. The higher the tax bracket, the less the cost of the gift.

B. Gifts of Appreciated Securities

Donors who contribute long-term appreciated securities to The Columbus Foundation get a double Federal income tax benefit.

1. Gifts of appreciated securities are deductible at their full market value if held long term. Fair market value is the mean between the high and low trades on the date of the gift.
2. The capital gains tax on the stock's appreciation (the difference between the property's cost basis and its present fair market value) is completely avoided.

The fair market value of the donated securities can be deducted up to 30% of the donor's adjusted gross income, and any excess can be carried forward for up to five additional years.

Comparison of a Stock Gift with a Fair Market Value of \$5,000 and
a Cost Basis of \$1,000 and a Gift of \$5,000 Cash

| Asset | \$5,000 Cash | \$5,000 Stock |
|--|--------------|---------------|
| Gift/Deduction Value | \$5,000 | \$5,000 |
| Ordinary Income Tax Savings (using 28% rate) | \$1,400 | \$1,400 |
| Capital Gains Tax Savings (using 15% rate) | 0 | \$600 |
| After Tax Cost | \$3,600 | \$3,000 |

The donor's decision to contribute \$5,000 in appreciated securities results in the lowest cost of giving.

C. Gifts of Mutual Funds

Mutual funds also can be contributed outright to a charity. The deduction is determined by valuing a mutual fund at its public redemption price. Completing the gift transaction often is a time-consuming process; it generally takes two to six weeks. (In some cases, electronic transfers via DTC wire to a broker is possible.) The following steps should be followed:

- Ask the donor for a copy of the most recent mutual fund statement.
- Call the mutual fund company, bank or brokerage firm representative and inform him/her of the donor's intent to transfer (not sell, exchange or redeem) the mutual fund shares to the charity. Establish who the contact person will be and where written communications should be sent. If a separate transfer agent is involved, obtain the agent's phone number and address. Verify what documentation and forms are required from both the donor and the charity to make the transfer happen.
- Prepare whatever documentation is necessary on the charity's behalf and assist the donor in getting the appropriate letter of instructions signed and signature-guaranteed as necessary. It would be ideal to send the entire package of the donor's and charity's documentation to the mutual fund company or transfer agent.
- Monitor the transaction closely. Make sure the materials were received and call periodically to ensure that the transfer is completed.

D. Gifts of Closely-Held Stock

Closely-held stocks are shares in a privately-owned business. The shares are usually owned by family members, top management, and the corporation itself.¹

The stock can be contributed outright to a public charity and the donor is entitled to a deduction for the appraised fair market value. Often the stock pays no dividends, so the charity realizes no economic benefit until the stock is sold. Possible buyers include the corporation, other shareholders, or an external buyer interested in acquiring the company. The charity can sell to any of these potential buyers, and the charity should not be legally bound or compelled to sell the donated shares to the corporation or any other person or entity (through an explicit or implicit agreement entered into before the gift is made).

The donor is entitled to a deduction for the full value of the stock up to 30% of the donor's adjusted gross income. A "qualified appraisal" is required if the claimed value exceeds \$10,000. Such appraisals may be costly; thus, such a gift is often considered in conjunction with plans for the sale of the company or other event that would necessitate appraisal expenses. Some privately-held companies have regular net asset valuations done by external firms such as banks and accounting firms. Such businesses are good candidates for gifts of closely-held stock.

Example of a Gift of Closely-Held Stock

\$10,000 Gift of Closely-Held Stock With a Zero Cost Basis

| | |
|---|----------|
| Gift/Deduction Value | \$10,000 |
| Ordinary Income Tax Savings (using 28% rate) | \$ 2,800 |
| Capital Gains Tax Savings (using 15% rate) | \$ 1,500 |
| After Tax Cost of Gift | \$ 5,700 |

The charity receives a \$10,000 gift, which in turn is redeemed by the corporation for \$10,000 in cash. The cash to redeem the stock comes from the corporation, so that the stockholder is able to make a significant gift and receive a personal income tax deduction, and the corporation pays for the stock.

¹ Traditionally, a charity could hold only shares in a "subchapter C" corporation. Beginning January 1, 1998, shares in a "subchapter S" corporation may be gifted to a charity. However, gifts of these shares still involve complex issues and should be discussed in advance with the donor's and the charity's professional advisors.

E. Gifts of Real Estate

Gifts of real estate include a gift of a house or other personal residence, farm, vacation home, commercial buildings, and income producing or non-income producing land. Gifts of real estate, if held long-term, are deductible at fair market value up to 30% of the donor's adjusted gross income in the year of the gift with a five year carry-forward period if required. For real estate held short-term, the charitable deduction is limited to the property's cost basis.

Gifts of real estate require certain procedural steps, which may include the following:

- a site visit to the property;
- an environmental assessment;
- a qualified appraisal;
- obtaining a copy of the latest tax assessment;
- a determination as to whether or not the property has a mortgage and/or whether there are any leases or other contracts affecting the property; and
- if there are items that will require a cash outlay between the time the property is contributed and eventually sold, an indemnity agreement for such expenses.

Gifts of real estate may be contributed to The Columbus Foundation as outright gifts, and, as explained later, as a gift of a remainder interest with retained life estate, to a charitable remainder trust, or through a donor's will or other estate planning document.

CASE: Gift of Appreciated Real Estate

Mary and Gene own a commercial building. They paid \$25,000 for it many years ago and it now has an appraised fair market value of \$150,000. After consulting with their attorney, they decide to contribute this building to The Columbus Foundation to establish a fund to support their favorite charities.

| | |
|---|-----------|
| Appraised Value of Property | \$150,000 |
| Cost Basis of Property | \$25,000 |
| Capital Gain (if sold) | \$125,000 |
| Gift/Deduction Value | \$150,000 |
| Ordinary Income Tax Savings (using 28% rate) | \$42,000 |
| Capital Gains Tax Savings (using 15% rate) | \$18,750 |
| After-Tax Cost of Gift | \$89,250 |

F. Gifts of Tangible Personal Property

Tangible personal property includes (but is not limited to) artwork, collectibles, jewelry, antiques, books, automobiles and boats.

If the use of the tangible personal property is related to a charity's exempt function, the donor may receive a deduction for the property's fair market value, up to 30% of the donor's adjusted gross income, with a five-year carryforward if required. (Example: A donor gives a painting to an art museum.)

If the use of the tangible personal property is unrelated to the charity's exempt function, the donor's deduction is limited to the donor's cost basis in the property. (Example: A donor gives a herd of cattle to an art museum.) The percentage limitation is 50% of the donor's adjusted gross income, with a five-year carryforward if required.

III. Gifts Providing Income to Charity With Remainder Passing to Donor or Donor's Heirs--The Charitable Lead Trust

The Charitable Lead Trust (CLT) is a very powerful charitable estate planning vehicle. Under a CLT arrangement, an annuity or unitrust amount is paid to a charity for a term of years or the life of an individual. On termination of the lead trust, trust assets are distributed to others (usually to heirs).

There are several types of lead trusts. The type of lead trust used to earn a gift and estate tax deduction (but not an income tax deduction) is called a *non-grantor lead trust*.

- Charitable lead trusts must make payments to charity in the form of a guaranteed annuity (Charitable Lead Annuity Trust), which is a fixed dollar amount to charity distributed no less often than annually, or in the form of a unitrust interest (Charitable Lead Unitrust), which is a fixed percentage of the fair market value of the principal distributed no less often than annually, with the value of the principal redetermined annually.
- CLTs are used to transfer substantial amounts of wealth from generation to generation free (or largely free) of estate and gift taxes.
- The CLT is frequently used by people who want to combine a charitable gift with a gift of assets to children or other heirs.
- Assets are placed into the trust by donors who may choose the trustee of the trust, which is usually a professional trustee such as a bank or trust company.
- When the trust is established, the donor is entitled to a gift tax deduction which represents the present value of the annuity or unitrust payout to charity. (No income tax deduction is allowed in the case of a non-grantor lead trust.)
- The trustee manages the assets to produce the required payment to charity each year and to increase the value of the assets over the term of the trust. Any asset growth that occurs within the trust will be distributed to beneficiaries at the termination of the trust free of gift and estate tax (except for the appreciation that is passed out to charity in the form of increased unitrust payments).
- At the end of the trust term, the trust principal is distributed to the named beneficiary or beneficiaries.

CASE: Charitable Lead Trust (*non-grantor*)

Joe and Jane have a substantial estate totaling \$25 million and are in the top federal estate tax bracket of 45%. They have been active charitable givers for years. They know that, absent charitable planning, their estate will be subject to a large estate tax, substantially reducing the amount they can leave to their children and grandchildren. Joe and Jane would like to be able to reduce their estate tax liability and to involve their children and grandchildren in family philanthropy. They spoke to their attorney and to a Donor Services and Development Officer at The Columbus Foundation and learned that through the use of a Charitable Lead Trust, they can make a very large charitable gift and transfer substantial amounts of wealth to their children largely free of gift and estate taxes.

Illustration

Joe and Jane decided to establish a Charitable Lead Annuity Trust with a 7% payout for a period of 22 years. The trust is funded with appreciated property worth \$10 million. Each year for 22 years, The Columbus Foundation will receive \$700,000. Initially, Joe and Jane will use the income from the trust to establish and augment a donor advised fund at The Columbus Foundation from which they can make recommendations on grants to charities of their choice. In approximately seven years, they will establish a supporting foundation at The Columbus Foundation that is funded out of their donor advised fund and then the trust. Joe and Jane can involve their children, and subsequently their grandchildren, with their supporting foundation by having them serve as trustees of the supporting foundation.

Assuming a 5% income and 5% capital appreciation investment return for the trust, and a federal discount rate of 5%,* Joe's and Jane's children will receive \$29,048,198 in 22 years at an estate and gift tax cost of zero. Joe and Jane will receive a charitable gift tax deduction of \$9,214,100 in the year of the gift based on the present value of the Foundation's charitable interest in the annuity payments; gift tax on the remainder that eventually will pass to children is avoided through use of the \$1 million exemption from gift tax. In 22 years, their supporting foundation at The Columbus Foundation will have received \$15,400,000 from the trust. This gift will have created a family foundation at The Columbus Foundation through which Joe and Jane's family can carry forth their philanthropy for generations.

* The federal discount rate is used to determine the charitable deduction for many types of planned gifts, such as charitable remainder and lead trusts and gift annuities. The rate is the annual rate of return that the IRS assumes the gift assets will earn during the gift term. The IRS discount rate is published monthly.

