Structuring Your Charitable Gift to Leave a Lasting Impact

~ Elizabeth P. Diaz

Lifetime giving by individuals makes up the vast majority of charitable contributions to nonprofit organizations. In fact, individual giving generally makes up between 70 percent and 80 percent of such charitable donations and has been on an upward trend since the end of our most recent recession. However, with the passing of the Tax Cuts and Jobs Act, as it is commonly called, many nonprofit organizations are now concerned about how the law may impact both lifetime individual giving and giving by bequests (gifts from a decedent through a will or trust). It is estimated that the law's doubling of the standard deduction and estate and gift tax exemptions, and its lowering of the marginal income tax rates will result in an almost 5 percent reduction in overall charitable giving. This is thought to be largely attributable to the decrease in the number of individuals who receive benefits from itemizing their income tax deductions. Currently, almost 30 percent of Americans itemize their income tax deductions, meaning that they can deduct (up to a certain limit) their charitable donations from their taxable income. However, it is estimated that that number could now drop to as low as 5 percent of American taxpayers. While tax incentives are certainly not the only reason to give to charity, many donors are now, in response to the new law, looking for more creative ways to structure their charitable gifts.

The structure of a charitable gift can be as simple as writing a one-time check or as complex as establishing a private foundation. Regardless of the complexity, spending some time determining how to structure your gift (and what asset is best to gift) will ensure that you maximize the benefits of your hard-earned money, both to you and to the charity of your choice.

Outright Gifts

Outright gifts can comprise simple assets, such as cash or marketable securities, or complex assets, such as commercial or residential real estate, artwork, or closely held business interests. Gifts of cash enable the charity to put your gift to immediate use and should entitle you to an immediate income tax deduction if you itemize. If your income tax deductions are not large enough to itemize every year due to the higher standard deduction, you may wish to consider bundling your charitable donations in alternating years, so that you can still take advantage of the income tax deduction.

Gifts of long-term, highly appreciated securities (those held more than one year) are often even better than cash, as charities are exempt from the capital gains tax when they sell the donated securities, and you should receive the benefit of the income tax deduction based on the full, appreciated fair market value of the donated securities. This can be especially useful if you have long-term, highly appreciated securities with an unknown (or difficult to determine) original value or tax cost basis. If you have highly appreciated securities that you still wish to maintain in your portfolio, you can donate the securities to charity and then immediately repurchase the same securities for your portfolio. Because the securities would have resulted in a gain, the *wash sale* rules are not applicable, and you have essentially given yourself a *step-up* in basis while maintaining the same assets in your portfolio, all without having to recognize the gain or pay capital gains tax. Alternatively, if you have securities in your portfolio with a high basis (and thus are looking to deduct the capital loss), you will likely be in a better position if you first sell the securities and then donate the proceeds to charity. This should allow you to deduct the capital loss and receive a charitable income tax deduction for the amount of the donated proceeds. Note that if you wish to repurchase the high-basis securities to maintain them in your portfolio, you will need to wait at least 30 days, or else the wash sale rules would prevent you from being able to deduct the loss.

When determining what assets to donate, one thing you should consider is that the more appreciated the asset, the greater the tax efficiency of your gift. Accordingly, while there are outright gifts of many types of complex assets, such as the donation of artwork to charity (see "Contributing Your Art to Charity," *Requisite I*), gifts of closely held business interests to charity are quickly becoming more commonplace, due to the entrepreneurial success of retiring baby boomers. For many of you, gifts of your closely held business interest may be the best asset to gift to charity, as it is likely the most appreciated asset in your portfolio. This is especially true for those of you who have founded companies, as your basis in the donated interests may be effectively zero. Similar to gifting long-term, highly appreciated securities, gifts of these business interests may achieve the best tax results, as charities would be exempt from the otherwise large capital gains tax that would have been due, and you should receive an income tax deduction based on the full fair market value of the gifted interest.

While the tax efficiency of gifting a business interest may be greater, gifts of these interests typically require more thought and planning. For example, gifting a business interest will generally require a qualified appraisal to determine its fair market value. Additionally, you will need to consult with your advisors to determine how to best transfer the interests (e.g., a bargain sale to the charity or sale of the interest to a third party, followed by a gift of the proceeds, may sometimes be a better option than an outright gift). You will also need to communicate with

the charity in advance to determine its gift acceptance policies, as many smaller charities do not have the resources to handle receiving gifts of complex assets, such as business interests.

Retirement Assets

As is true for many people, some of your biggest assets may be your retirement accounts, such as your individual retirement account (IRA) or 401(k). Making a charitable gift of these assets can be very tax-efficient because charities are not subject to income tax, as your family members or other beneficiaries would be.

If you are at least age 70 ½, you can make a charitable gift of up to $100,000 directly from your IRA to a charity of your choice each calendar year. The gift not only satisfies the required minimum distribution (RMD), but it also avoids the inclusion of such amount in your taxable income, lowering your adjusted gross income (AGI) for the year. Because the charity is not subject to income tax, it will get the full benefit of your gift and can put it to immediate use.

Alternatively, you may designate the charity to receive your IRA or 401(k) upon your death. Making such a charitable gift is relatively easy, as you simply need to complete the designated beneficiary form available from the plan administrator. Once you complete the form, the charity will receive the assets (free of accrued federal income tax) immediately upon your death, without having the amount of that bequest go through a probate administration. If your gross estate is in excess of the new exemption equivalents, you may also benefit from a charitable federal estate tax deduction for your gift.

Charitable Trusts

What if you want to provide for both charitable and noncharitable beneficiaries? Charitable trusts allow you to set aside assets for charity, while still retaining some rights. There are two types of charitable trusts: a charitable remainder trust and a charitable lead trust.

Charitable remainder trusts (CRTs) allow you or a designee to receive either a fixed annual annuity payment or a payment that is based upon the value of the trust assets, either for life or for a term of years. Upon the expiration of the trust term, the remaining assets are distributed to the charity you designate. Like making a charitable gift of long-term, highly appreciated assets outright to charity, you can use such assets to fund the CRT and sell them within the CRT, generally without paying capital gains tax. This allows the CRT to get the full benefit of the gifted assets, which means more for both the noncharitable designee and the charity, and you should get the immediate income tax deduction. (Of course with any transaction, there are nuances in the tax law that may restrict this benefit. For example, you should not donate property to a CRT or charity after you have entered into a binding agreement to sell the property.)

A charitable lead trust (CLT), on the other hand, first provides the annual payments to the charity of your choice for a term of years, with the balance of the trust assets going to your designee upon the expiration of the term. A CLT may be an appropriate vehicle for those who would like to gift assets to loved ones but who want to defer the date that beneficiaries, such as minors or beneficiaries who are not yet fiscally responsible to handle the assets, receive and control the property. You can create both CRTs and CLTs during life or at death, as part of your overall estate plan.

Charitable Gift Annuity

A similar but alternative technique to a charitable trust is a charitable gift annuity, if the charitable organization you choose offers such a technique. Rather than utilize a trust to hold the funds, a charitable gift annuity involves making a gift directly to the charity. The charity then makes payments back to you or your designee for a designated term, with the remainder staying with the charity upon the charitable gift annuity's expiration. This can be useful if you would like to increase your cash flow from fixed-income investments that have declined in value or if you want to sell some of your highly appreciated stock to reinvest in assets that will produce more income, but you don't want to pay tax on capital gains. Please note that charitable gift annuities can carry a component of risk that other charitable giving vehicles do not. For example, if the charitable organization files for bankruptcy, you could lose your asset and your income stream. Accordingly, you should always exercise due diligence and review the financial stability of the charitable organization before entering into a charitable gift annuity.

Private Foundation

You or your family can establish a private foundation by funding a new, freestanding nonprofit organization. As with many other giving vehicles, you receive a current income tax deduction for your contributions to the foundation. However, unlike the other giving vehicles, you get to retain complete legal and financial control over the entity and the contributed assets, including how they are invested and spent over the lifetime of the foundation. You are also in control of appointing the board of directors and deciding whether to hire or compensate staff (including family members). Private foundations can be structured either as a trust or a not-for-profit corporation (see "Philanthropy as a Family Affair," *Requisite VII*). To maintain its tax-exempt status, a private foundation must make qualifying distributions during the year or incur an excise tax. In general, the qualifying distributions must equal 5 percent of the average fair market value of the foundation's assets and must be made to individuals or organizations for charitable purposes.

Donor-Advised Fund

A donor-advised Fund (DAF) is an account that you establish with a sponsoring public charity, such as your local community foundation, to

support a charitable cause or causes. Similar to a private foundation, a DAF allows you to remain involved by retaining advisory privileges, such as the ability to recommend how and where the funds are distributed or invested. (Of course, the sponsoring public charity has the ultimate authority to either accept or reject your recommendation.) You are entitled to an immediate tax deduction (subject to the higher limitations, since the community foundation is a public charity) each time you contribute assets to the DAF and pay no tax on its future earnings. Unlike funds in a private foundation, the funds in a DAF are allowed to sit and grow tax-free in the fund until you are ready to make distributions. There are also no required filings for which you are responsible.

One difference you should consider when determining whether to create a private foundation or a DAF at a sponsoring public charity is the limitations that are imposed on charitable deductions. Contributions of cash to a private foundation are generally limited to 30 percent of your adjusted gross income (as opposed to 60 percent of your adjusted gross income under the new law for contributions to a public charity). Additionally, contributions of appreciated illiquid assets (such as a closely held business interest) to a private foundation are generally only deductible to the extent of your tax basis in the property, regardless of the fair market value of those assets. Finally, another thing to note is that the creation of a private foundation and the creation of a DAF are not mutually exclusive. In fact, many times, creating a private foundation and a DAF together can produce the best result when you are trying to maintain control and achieve the largest philanthropic impact of your gift. You should explore the mechanics and the benefits of creating both with your advisors.

Structured properly, your gift has the potential to not only provide you with tremendous benefits, but also to provide your charity with an opportunity to make an important and meaningful difference in the lives of others.

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