CHARITABLE TAX PLANNING OPPORTUNITIES AND TECHNIQUES

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I. <u>**Overview of Estate Planning**</u>.

A. <u>**Asset Disposition**</u>.

1. To whom should assets be given.

2. Methods for disposing of assets: outright, trust, distribution ages, etc.

B. <u>**Asset Preservation**</u>.

1. Protection from creditors.

2. Protection from predators.

3. Protection from taxes.

C. <u>**Charitable Planning May Involve Both Asset Disposition and Asset Preservation**</u>.

1. Whether to include a charity in one's estate plan and how to do so.

2. Using a charitable transfer to help preserve assets, particularly through estate tax reduction.

II. <u>**Overview of Pertinent Tax Rates**</u>

A. <u>**Estate and Gift Taxes**</u>.

ESTATE AND GIFT TRANSFER TAX EXCLUSION, CREDITS, AND EXEMPTION AMOUNTS - 1998-2016 TRANSFERS

Year	Estate Tax Applicable Exclusion Amounts*	Applicable Credit Amounts**	Gift Tax Lifetime Exemption	Starting Tax Rate on Estate (or Gift) above Exclusion Amount
1998	625,000	202,050	675,000*	37%
1999	650,000	211,300	675,000*	37%
2000	675,000	220,550	675,000+	37%
2001	675,000	220,550	675,000+	37%
2002	1,000,000	345,888	1,000,000	41%
2003	1,000,000	345,800	1,000,000	41%
2004	1,500,000	555,800	1,000,000	45%
2005	1,500,000	555,800	1,000,000	45%
2006	2,000,000	780,800	1,000,000	46%
2007	2,000,000	780,800	1,000,000	45%
2008	2,000,000	780,800	1,000,000	45%
2009	3,500,000	1,455,800	1,000,000	45%
2010	5,000,000	1,730,800	5,000,000	35%
2011*** ****	5,000,000	1,730,800	5,000,000	35%
2012	5,120,000	1,772,800	5,120,000	35%
2013	5,250,000	2,045,800	5,250,000	40%
2014	5,340,000	2,081,800	5,340,000	40%
2015	5,430,000	2,117,800	5,430,000	40%
2016	5,450,000	2,125,800	5,450,000	40%

* The unified credit is reduced by 20% of the prior law's lifetime $30,000 specific gift tax exemption used in the calculation of taxable gifts made after September 8, 1976 and before 1977 [IRC 2010(b)]. The applicable exclusion amount is indexed for inflation for years after 2011.

** The "applicable exclusion amount" is the taxable amount that would produce each year's credit amount shown above if that taxable amount were subject to tax computed on the unified transfer tax rate table [see IRC 2010(c)].

*** The applicable exclusion amount for the surviving spouse of a deceased spouse dying after 12/31/2010 includes the "deceased spousal unused exclusion amount" ("DSUEA").

**** Beginning in 2011, the applicable exclusion amount is increased by DSUEA.

\+ Combined with estate tax.

B. **Portability.**

1. The exemption of each spouse is permanently portable for gift and estate tax purposes, but not generation skipping transfer tax ("GST") purposes. Consequently, the unused exemption of the first spouse to die (the DSUEA) is ported to or available for use by the surviving spouse. Ensuring that assets transferred by the first spouse to die to the surviving spouse qualify for the marital deduction remains important.

2. Although portability may conceptually have simplified estate planning for spouses, the implementation of portability is not so simple. Portability must be elected on a timely filed estate tax return. Recently issued Treasury Regulations provide, however, special rules for reporting the value of property on an estate tax return that is filed solely to elect portability but would not otherwise be required, which would be the case if the decedent's estate were under the exemption. See Treas. Reg. §20.2010-2T et seq. This Regulation generally requires only an estimate of the fair market value of the gross estate, so long as the executor "exercises due diligence" in making such an estimate.

C. **Federal Income Tax.**

1. **Table.**

Col. 1	Single Individuals		Joint Returns & Surviving Spouses		Heads of Households		Married Filing Separately	
$ 0	$ 0	10%	$ 0	10%	$ 0	10%	$ 0	10%
9,275	927.50	15%					927.50	15%
13,250					1,325.00	15%		
18,550			1,855	15%				
37,650	5,183.75	25%					5,183.75	25%
50,400					6,897.50	25%		
75,300			10,367.50	25%				
75,950							14,758.75	28%
91,150	18,558.75	28%						
115,725							25,895.75	33%
130,150					26,835.00	28%		
151,900			29,517.50	28%				
190,150	46,278.75	33%						
206,675							55,909.25	35%
210,800					49,417.00	33%		
231,450			51,791.50	33%				
233,475							65,289.25	39.6%
413,350	119,934.75	35%	111,818.50	35%	116,258.50	35%		
415,050	120,529.75	39.6%						
441,000					125,936.00	39.6%		
466,950			130,578.50	39.6%				

2. **Federal Income Tax on Capital Gains.** Net long-term capital gains on assets held more than 12 months are taxed generally at a maximum rate of 20% for filers in the 39.6% tax bracket, 15% for taxpayers in the 25%, 28%, and 33% brackets and 0% for 10% and 15% bracket taxpayers

except for children under age 19, or 24 if full-time college students, whose net unearned income exceeds $2,100. Taxpayers with AGI in excess of $200,000 (unmarried filers and heads of households) or $250,000 (joint filers) are subject to an additional 3.8% tax on net investment income. A 28% top rate applies to long-term gain on collectibles. A 25% top rate applies to long-term gain on real estate attributed to depreciation claimed in past years (unrecaptured §1250 gain). Short-term gains are taxed at the taxpayer's highest ordinary income tax rates. Net short-term and long-term losses are deductible dollar-for-dollar against ordinary income up to $3,000, with unlimited carryover for excess loss deductions.

3. **Federal Income Tax on Dividends**. The maximum tax rate on qualified dividends paid by corporations, mutual funds and real estate investment trusts to individuals is 20% for filers in the 39.6% tax bracket, 15% for taxpayers in the 25%, 28%, 33% and 35% brackets, and zero for taxpayers in the 10% and 15% ordinary income brackets, subject to application of the "kiddie tax." Taxpayers with AGI in excess of $200,000 (unmarried filers and heads of households) or $250,000 (joint filers) are subject to an additional 3.8% tax on investment income.

III. Motivations for Charitable Giving.

A. Desire to benefit worthwhile causes; ideological commitments; religious commitments; help to change or improve society; and to connect with something larger than oneself.

B. Personal rewards - recognition or the perks of giving - "quid pro quo philanthropy."

C. Establish a pattern of giving to institutionalize or perpetuate family traditions of philanthropy (multi-generational philanthropy).

D. Enhance beauty - music, art, the environment, etc.

E. Provide help for those who cannot reasonably help themselves.

F. Tax benefits.

1. One's decisions to make a substantial charitable gift should consider the tax benefits, but should not solely be driven by those benefits.

2. If one's goal is only to move maximum family wealth to the next generation, a charitable gift in most instances would be inconsistent with that goal.

No gift	$2,000,000.00 taxable estate
	$ 435,000.00 federal estate tax
	$1,565,000.00 to family
Gift	$2,000,000.00 taxable estate
	$1,000,000.00 charitable gift
	$1,000,000.00 taxable estate
	$ 0.00 federal estate tax
	$1,000,000.00 to family

3. Sophisticated planning techniques may narrow the spread, but in almost no instance can a charitable gift create more value for one's family than if no gift had been made and after tax assets were left to the family.

IV. Factors to Consider in Making Charitable Gifts.

A. What effect will a gift have on
- you as a donor,
- your family,
- the charity,
- your family's tax liabilities.

B. Giving is investing, and should be considered with similar care.

C. Donors should expect accountability from the recipient.

D. What property should be the subject of the gift?

E. What contribution strategy or technique will be most consistent with your motivation in making the gift?

F. Will the charity be a qualified charity?
- organized in the United States
- operated solely for charitable purposes
- not for profit
- not politically active or a lobbying organization

V. Lifetime Gifts - Rules and Techniques.

A. Many Charitable Giving Techniques Are Applicable Both to Gifts During One's Lifetime and Gifts after Death.

1. Lifetime gifts - income tax deduction, subject to the following:

   - The gift must be to a qualified charitable organization.

   - Must meet certain substantiation requirements.

   - The contribution will be limited to 50%, 30%, or 20% of the donor's adjusted gross income, depending on the type of property contributed and the type of donee. Publicly supported charities, including Cottonwood, are treated as "50% charities."

   - If the gift is of appreciated property such as appreciated stock, to a 50% charity it will be limited to 30% of the donor's contribution base unless election is made to reduce the amount of the contribution through the tax basis of the gifted asset, in which case the 50% ceiling applies.

   - If a taxpayer's charitable gifts exceed the percentage ceiling, the excess generally may be carried forward and be deducted for up to 5 years.

   - Itemized deductions, including charitable contributions, may be phased out for certain high-income taxpayers. The phase-out generally is not total, but the total of itemized deductions may be reduced by 3% of the amount by which the taxpayer's adjusted gross income exceeds certain threshold amounts, with a reduction not to exceed 80% of the otherwise allowable itemized deductions. Not all deductions are subject to the phase-out, but charitable contributions are.

2. Gifts at death - estate tax deduction.

B. Lifetime Charitable Gift Techniques.

1. **Outright Charitable Gifts.**

a. **Gifts of Money**. Deductible up to 50% of donor's adjusted gross income. Carryover allowed for up to 5 years for any excess deductions.

b. **Gifts of Securities and Other Assets Which If Sold Would Produce Long-term Capital Gain.** These gifts are deductible up to 30% of adjusted gross income, with a 5-year carryover for any excess deductions. If donor elects, the amount deductible can be increased to 50% of adjusted gross income by (i) reducing the amount of the deduction for all long-term property gifts during the year by 100% of appreciation and (ii) similarly reducing the deduction for long-term property gifts being carried over from earlier years. Fifty per cent ceiling is only available for gifts to public charities, and is not available for gifts to private foundations, except for gifts of publicly traded securities.

c. **Gifts of Securities and Other Assets Which If Sold Would Produce Short-term Capital Gain.** The donor's deduction is limited to cost basis only, and is deductible up to 50% of adjusted gross income for gifts to public charities. Five-year carry over allowed. The same rule is applicable to gifts of securities and assets held short term; that is, that would produce short-term capital gain if sold. Ordinary income property would include inventory, crops, works of art created by the donor, and similar items.

d. **Gifts of Tangible Personal Property, Such as Art Work.** The fair market value of the gift is deductible if a charity uses a gift in an activity related to the charity's exempt function. The gift is deductible up to 30% of adjusted gross income, or up to 50% of adjusted gross income if the donor elects to reduce the amount of the deduction by 100% of the appreciation on the gifted property. Five-year carry over is available. If the gift is unrelated to the charity's exempt function, the deduction must be reduced by 100% of the amount of gain that would have been long-term capital gain if the property would have been sold at its fair market value. The deduction is up to 50% of adjusted gross income with a 5-year carry over available.

e. **Gifts of Partial Interest in Tangible Personal Property.** To qualify, the charity must receive a fractional or percentage of the

interest owned by the donor in the property. In effect, the charity becomes a co-owner of the property with the donor. Example: art collector gives a university art museum an undivided 50% interest in a painting valued at $100,000.00. The donor would receive a $50,000.00 charitable deduction, and the university museum would be entitled to the unrestricted use and possession of the painting for 50% (six months) of each year. *Note, however, that under IRC §170(f)(3) such gifts must meet rigid tests to be deductible.*

f. **Be Cautious of Gifts of Mortgaged Property.**

2. **Planning Strategies for Outright Gifts.**

a. A gift of appreciated assets is generally better than a gift of cash.

b. Give appreciated securities instead of cash, with cash used to buy the same securities in the open market. Example: donor wishes to make a gift of $100,000.00 to charity. The donor has publicly traded stock with a basis of $10,000.00 that has appreciated to $100,000.00. If instead of making a $100,000.00 cash gift, the donor contributes the stock, the donor receives a $100,000.00 income tax charitable tax deduction (just as if a gift of $100,000.00 cash were made) and avoids tax on the $90,000.00 of appreciation. With the $100,000.00 cash (which this example presumes the donor has) the donor buys the same stock on the open market. Result: donor owns the same stock with a $100,000.00 basis which, if subsequently sold for $150,000.00 would generate a $50,000.00 capital gain, rather than a $140,000.00 capital gain if the original stock had been held and sold. *Note, however, the possible limitations described in Paragraph V.A., above.*

c. Lifetime charitable gifts generally are more advantageous than gifts made at the time of death. Lifetime gifts have two significant advantages:

- Although a gift to a charitable organization at death is deductible for federal estate tax purposes (which is now of limited value because of the high exemptions), there is no income tax or other benefit.

- If a gift of the same amount were made immediately prior to death, the amount of the gift is removed from the estate for estate tax purposes, but in addition the gift made immediately before death generates an income tax charitable deduction which can reduce the donor's income tax liability.

Persons who have made charitable gifts in their will or trust might therefore consider the following techniques that accelerate charitable gifts into one's lifetime:

- The person might include in his or her durable power of attorney the authority for the attorney in fact to prepay charitable gifts during lifetime.

- Lifetime, rather than testamentary gifts, should be thoughtfully considered.

- If the person's primary estate planning document is a revocable trust, the trust can be amended to give the trustee authority to prepay charitable distributions which would otherwise be made at death.

- Several planning techniques that are discussed subsequently in this outline, such as charitable remainder unit trusts or annuity trusts, or charitable gift annuities, may permit the donor to maintain an income stream during lifetime and lifetime income tax deduction even though the remainder will not pass to the charity until the time of death.

d. Method for passing the charitable income tax deduction on to a surviving spouse: Instead of making a gift at death, the property that would otherwise have been gifted by will is left to a cooperative surviving spouse, who then makes the gift to charity on his or her own, thus generating an income tax deduction for the surviving spouse. This arrangement will cause no extra estate tax in the estate of the deceased spouse because of the estate tax marital deduction, which would eliminate tax on the gifted property in the same manner in which the charitable deduction would have eliminated that tax. This arrangement prevents wasting the charitable deduction if there is a surviving spouse. If

the surviving spouse fails to cooperate, however, the decedent spouse's plans may be frustrated.

C. **Lifetime Gifts with Strings Attached**.

1. **Gift of Remainder Interest in Personal Residence or Farm/Ranch.** The interest transferred to the charity must be a remainder interest following either a life estate or specific term of years. Although the computation for the charitable income tax deduction is complex, the donor would generally be entitled to charitable deduction equal to the value of the remainder given to charity. This value is the value of the property less the actuarial present value of the life estate or term of years retained. Residence may be a vacation home and need not be a donor's primary residence. The current low interest rate environment significantly improves the income tax benefits of a gift of remainder interest in a personal residence or a farm/ranch. The donor who intends to leave his or her home or farm to charity should consider a lifetime gift of remainder interest in the home or farm to the charity because of the increased charitable income tax deduction that would be available under the low interest rate regime.

2. **Bargain Sales to Charity.** This technique may be used when the donor has the dual objective of making a charitable gift and receiving some payment for the transferred property. The sale price is therefore established at an amount less than the fair market value of the property. The transaction is considered a part sale and part gift. The excess of the value of the property over the payment received by the donor is deductible as a charitable contribution, subject to the usual qualifications and limitations. The donor must, however, allocate the donor's cost basis in computing the gain between the sale and gifted portions of the transaction. Example: A charity wishes to acquire a piece of real estate owned by a potential donor. The fair market value of the real estate is $500,000.00. The donor's cost basis in the real estate is $100,000.00. The donor agrees to sell the real estate to the charity for $250,000.00. The donor has made a $250,000.00 gift, but one-half of the donor's basis, or $50,000.00 must be allocated to the gift portion, thus leaving only a basis of $50,000.00 to reduce gain on the $250,000.00 sale portion.

3. **Gift of Conservation Easement.** Such a gift involves a transfer to a qualified organization (e.g., The Nature Conservancy or the Kansas Land Trust) which has an enforceable easement to restrict the use of the property

to anything other than its qualified purpose, such as preserving open space. The amount of the owner's deduction for conservation easement is usually established by a before and after approach, in which the value of the property is determined before the easement is imposed and after the easement is imposed. The difference represents the charitable deduction.

4. **Charitable Gift Annuities.** A charitable gift annuity involves the donor entering into a contract with the charity, pursuant to which the donor transfers cash or property to the charity in exchange for the charity's promise to pay to the donor (or another named annuitant) an annuity for life. The value of the annuity payments is usually less than the value of the cash or property transferred to the charity, and the excess is available as a charitable deduction. The transfer is in part a charitable gift and in part the purchase of an annuity. The annuity payments may begin immediately, or may be deferred for one or more years from the date the cash or property is transferred to the charity. The donor is thus able to make a gift immediately, and obtain a current income tax deduction, perhaps when he or she is in a high income tax bracket, and defer receiving payments until later years when the donor may be in a lower income tax bracket. The current low interest rate regime makes charitable gift annuities less attractive because the value of the annuity interest that benefits the donor will be increased and the value of the assumed remainder interest that benefits the charity will be decreased, resulting in a smaller charitable income tax deduction.

5. **Gift to Charitable Pooled Income Fund.**

   a. How it works. Donor transfers money or property to a public charity, as only public charities can have pooled income funds. The donor's gift is added to the charity's pooled income fund, in which all similar gifts are invested together. Annually the donor receives his or her pro rata share of pooled income fund earnings on which the donor pays ordinary income tax. At the time of donor's death, the charitable organization removes the donor's pro rata share of assets from the fund and makes such shares available for the charity's general purposes.

   b. Not all charities have pooled income funds, as only public charities may have pooled income funds, and even then, the administrative and compliance requirements to maintain such funds are burdensome.

6. **Charitable Remainder Trusts.** Charitable Remainder Trusts are important techniques for both gifts during life and gifts at death.

   a. **Charitable Remainder Annuity Trust** - CRAT. A CRAT is a trust established by a donor to which assets, often highly appreciated, are transferred. A fixed dollar amount, which must be at least 5% of the initial fair market value of the transferred property, is to be paid annually to the donor or another named income beneficiary for life. On the death of the beneficiary (or a surviving beneficiary if more than one is named) the charity receives the remainder. Please note, however, that as with charitable gift annuities, the current low interest rate regime reduces the income tax benefits of a CRAT because the value of the remainder interest passing to charity is decreased and the value of the annuity interest retained by the donor is increased. See more detailed discussion at Section VII. A., below.

   b. **A Charitable Remainder Unitrust** - CRUT involves the same general arrangement as a CRAT, except that the income beneficiary receives annual payments established by multiplying a fixed percentage (which must be at least 5%) by the net fair market value of the trust's assets, as determined each year. A CRUT, as a unitrust, generally is not affected one way or the other by low interest rates. See more detailed discussion at Section VII. B., below.

7. **Charitable Lead Trust.** A Charitable Lead Trust is the opposite of a Charitable Remainder Trust, in that the charity receives an income flow for a term of years and following the end of that term, the remainder passes to designated individuals, often the donor's family. See more detailed discussion at Section VII. D., below.

VI. Gifts of Life Insurance to Charities

A. Gift of Presently Owned Policy.

1. The ownership of the policy is transferred to the charity.

2. The donor pays future premiums which are fully deductible for income tax purposes. To avoid gifts that are treated as for the use of charity, rather

than to a charity, the premium amount should be paid directly to the charity and the charity should pay the premiums.

3. Current income tax deduction for the gift of the policy (rather than the future premiums) is equal to the lesser of the donor's income tax basis in the policy (usually the total premiums paid) or the fair market value of the policy. A policy's fair market value is usually its replacement cost. No deduction is allowed, however, if the donor retains any incidents of ownership in the policy.

4. At the time of the owners death, the policy proceeds are not included in the donor's estate for federal estate tax purposes.

B. **Naming Charity as Beneficiary of a Life Insurance Policy**.

This technique does not involve a present gift of the policy, but simply naming a charity as the beneficiary. The consequences of such a potential gift are as follows:

1. Donor can change his or her mind and change the beneficiary, thus depriving the charity of the policy proceeds.

2. Cash value of the policy is still available to the donor.

3. There is no current income tax deduction.

4. The value of the policy proceeds will be included in the donor's gross estate for federal estate tax purposes, but there will be an offsetting charitable estate tax deduction.

C. **Charity Obtaining a New Policy on the Life of a Donor**.

1. This arrangement has been used by several charities through a mass marketing program with the following features:

   a. Donor makes an annual contribution to the charity, e.g. $1,000.00, and the charity uses the contribution to make premium payments on a life insurance policy on the donor's life owned by the charity. The charity is named as the policy's beneficiary. This arrangement is generally easy for the charity to manage, and can often be done by its own staff.

b. Small gifts are leveraged into much larger gifts.

c. The charity knows when the policy will be paid up and knows that the gift is certain, subject only to the mortality of the donor. An issue remains in some states as to whether the charity has an insurable interest in the life of the donor.

D. **Wealth Replacement Insurance**. This term describes an insurance plan used in connection with other charitable gifts to make up for the reduction in property otherwise passing to the donor's family following the donor's death. Most often, a donor who creates a charitable remainder trust will use distributions from the trust or the income tax savings from the charitable deductions to pay premiums on a life insurance policy held in an irrevocable life insurance trust. Thus, at the time of the donor insured's death, the policy proceeds will be made available to the donor's family without estate tax and with a goal of replacing the family wealth lost by the value of the gift passing to charity.

VII. CRATS, CRUTS, CLATS, and CLUTS.

A. Charitable Remainder Annuity Trusts (CRATS).

See general description at Section V. C.6.a, and diagram at Appendix 4.

1. How are payments taxed to the donor or recipient? Each payment is considered to involve one or more of four possible tiers:

a. First, as ordinary income to the extent of the charitable trust's ordinary income for the current year and undistributed ordinary income for prior years.

b. Second, as capital gain to the extent of the charitable trust's capital gains for the year and undistributed gains for prior years. The effect of this tier is to cause capital gains, ordinarily subject to favorable tax treatment, to be treated as ordinary income.

c. Third, as other income, such as tax-exempt income, to the extent of the trust's other income for the year and undistributed other income for prior years.

d. Fourth, as a tax free distribution of principal, i.e. return of part of the original value transferred to the trust,

2. Donor - recipient receives no benefit from the growth of trust principal.

3. The actuarial amount considered to pass to the charity at the end of the trust term must equal 10% of the value of the property initially transferred to the trust. Failure to comply means a loss of otherwise allowable income or estate tax deductions. Example: Donor wishes to create a testamentary charitable remainder trust with annuity paid to the donor's four children during their joint lifetimes. Depending on the ages of the children, the present value of the charity's right to receive the principal at the time of the last child's death may be less than 10% of the value of the property transferred to the trust. Consequently, there would be no charitable estate tax deduction in the donor's estate.

4. No additional contributions can be made to a CRAT following the time it is established.

5. CRATS are often used for the purpose of transferring substantially appreciated property to the trust, which in turn sells the property. Because the trust is tax exempt, it recognizes no gain. The full value of the sale proceeds, undiminished by the tax that would have been imposed upon the donor, is thus available to fund the annuity.

6. The maximum annual CRAT payment cannot exceed 50% of the initial fair market value of the property placed in the trust.

B. **<u>Charitable Remainder Unitrusts (CRUTS)</u>**.
See general description at Section V. C.6.b. and Appendix 5.

1. A CRUT involves a hedge against inflation, in that the annual payment to the donor or recipient will increase as the value of the charitable trust's assets increase.

2. A CRUT may involve valuation problems, particularly if the donor wishes to be the trustee.

3. Acronyms abound - STAN-CRUTS, NIM-CRUTS, and NI-CRUTS.
   a. STAN-CRUT - Standard Charitable Remainder Unitrust

   b. NIM-CRUT - Net Income Makeup Charitable Remainder Unitrust.

c. NI-CRUT - The variation seldom is used, in that there is no income makeup in later years.

d. FLIP-CRUT - A FLIP-CRUT involves transferring an asset that is initially unmarketable to a NIM-CRUT. When the asset becomes marketable by the trustee and is sold, the trust switches to a STAN-CRUT. Complex and precise regulations have been issued by the Internal Revenue Service for a CRUT to be a FLIP-CRUT.

4. The maximum annual CRUT payment cannot exceed 50% of the net fair market value of the trust's assets, valued annually.

C. **Benefits of Charitable Remainder Trusts**.
The following benefits are applicable generally to both CRATS and CRUTS.

1. A potential double benefit results - the donor receives an income tax charitable deduction if it is a lifetime gift, and in effect, an estate tax charitable deduction because neither the gifted property nor any appreciation in the value of the gifted property is included in the donor's gross estate.

2. A Charitable Remainder Trust provides an opportunity for persons to make lifetime charitable gifts and receive an income tax deduction even though he or she might not otherwise be able to afford to give property away.

a. Retained life income interest eases the pain of making the gift.

b. The actual income received from the gifted property may be increased after the charitable remainder trust is established, in that the assets can be sold by the charity without capital gain, thus enlarging the income producing asset base.

c. Asset diversification can occur without immediate taxation. The four-tier rule may allow income to be taxed to the beneficiary more favorably than presently taxed on income earned by the assets.

d. When income savings are added to the estate tax savings and the elimination of estate tax on appreciation, and when avoiding a tax on diversification is considered, substantial charitable gifts can often be made at a much lower cost than one might expect.

e. Donor receives the benefit of professional money management.

f. Charitable Remainder Trusts do not subject the donor's estate to probate.

g. Donor receives the pleasure of making an important immediate charitable gift, if the gift is made during lifetime (little empirical evidence is available regarding the emotional satisfaction of gifts made at death).

h. If a Charitable Remainder Trust cannot be created during lifetime, one created at death can provide the following:

   i. Life income and money management for a survivor, perhaps a surviving spouse. Investments in the trust can grow, and be sold, reinvested, and be sold again, without capital gains tax.

   ii. Estate taxes can be significantly reduced.

D. **Charitable Lead Trusts**.
See general description at Section V. C.7., and diagram at Appendix 6.

1. CLT's may reduce and perhaps eliminate estate tax on property passing to family members several years after the gift is made or after the donor dies. Although the generation skipping transfer tax rules apply to CLT's, properly planned, substantial wealth can be transferred to family members after a period of years, during which the CLT income passes to charity.

2. CLT's are particularly effective during periods of low interest rates. A CLT is in many ways the opposite of a CRAT in that if a CLT is established during lifetime, the donor is making a taxable gift of the remainder, with an annual annuity payment made to a charity for either the donor's lifetime or a specific term of years. The lower the applicable interest rate, the less the gift for gift tax purposes. If over the term of the trust the investment performance exceeds the IRC §7520 rate in effect when the trust is created (currently 1.8%) the value of the gift for gift tax purposes will be less than the value of the assets actually passing to the donor's family, and the excess will be a pre-transfer to family members for transfer tax purposes.

3. CLT created during lifetime. An income tax charitable deduction is available only if the charity's lead interest is a guaranteed annuity interest or unitrust interest and the grantor is considered to be the owner of the lead trust interest. Thus, the grantor may receive an income tax charitable deduction in the year the trust is created, but the grantor will be taxed annually on the trust's income even though the income is being paid to charity. Grantor trust status usually arises because the donor has retained a reversionary interest. Similarly, the trust assets are includable in grantor's gross estate at death, subject to an offsetting charitable deduction.

    a. Deduction ceiling is 30% of adjusted gross income for lead trusts benefitting public charities, and also 30% for private foundations, but with a ceiling of 20% of adjusted gross income when the trust is funded with capital gain property.

    b. If the grantor of a CLT who has taken an income tax charitable deduction dies before the termination of the charitable lead interest to be treated as the owner of the trust (as for example, when the donor dies before termination of the charitable trust interest) the grantor is treated as if recapturing the charitable deduction and is subject to income tax on the deduction originally taken when the CLT was created.

    c. Because the income tax deduction is available only if the grantor is taxable on payments made to the charity, and may be subject to recapture, CLT's are generally not used during lifetime. The tradeoff may be advantageous in limited situations, such as when the grantor is in a much higher income tax bracket in the year the trust is created than the grantor will be for the balance of the trust term.

4. CLT's created at death. CLT's may answer a family's needs when the parents believe that their children or grandchildren may need some or all of the family wealth several years after the senior family member's death, but do not need that wealth during the intervening years. During those intervening years, grantor's charitable objectives can be fulfilled by CLT payments to one or more charities.

5. If Estate Tax repeal actually occurs, a CLT created at death will seldom be used. If no federal estate tax exists, the complexity of a CLT which is intended to reduce estate tax and still provide ultimate benefits to family

will lose the benefit of reducing the estate tax because there will be no estate tax. Prior to repeal, however, substantial tax-planning leverage may occur during the first few exemption phase-in years by using CLT's. If a CLT can beat the IRC §7520 rate, future appreciation may be shifted to the next generation. If one believes repeal will actually occur, the lead period must necessarily be fairly short. A short lead period will require careful computations to be certain that unnecessary gift tax is not incurred, particularly as gift tax rates are lowered. If repeal in fact occurs, a long lead period would probably not be effective, particularly if the CLT is a testamentary trust.

VIII. Charitable Gifts of Individual Retirement Accounts ("IRA's") and Qualified Retirement Plans ("QRP's").

A. IRA and QRP distributions generally are subject to income tax. Consequently, naming a charity as a beneficiary of such plans has substantial tax appeal in that a charity pays no income tax and thus can receive plan distributions free from the burden of income taxes. Naming a charity as a beneficiary of an IRA or a QRP may, therefore, be the most tax-effective way to fund a gift to a charity.

B. Until recently, lifetime charitable gifts of IRA's and QRP's were generally ill-advised, in that the amount of the gift was treated as a distribution to the donor and subject to income tax in the year of the gift. Even though there may be an offsetting charitable income tax deduction, the gift has provided no charitable income tax benefit to the donor.

C. In December, 2015, Congress made permanent the so-called "charitable rollover" that was to expire on December 31, 2015. The charitable rollover, often called a "qualified charitable distribution" or a "QCD" is available with respect to IRA's, but not 401K's or similar retirement plans. The QCD permits a taxpayer over age 70-1/2 to exclude from income up to $100,000 per person, per year, for IRA distributions given directly to public charities. The QCD counts toward one's Required Minimum Distribution (RMD), and a donor can contribute more than his or her annual RMD to charity so long as the total QCD does not exceed $100,000 in a calendar year. The contribution cannot go to a donor advised fund or a private foundation. Benefits of using the QCD arrangement include the following:

- Although there is no charitable deduction for the QCD, the payment to charity is not included in the donor's adjusted gross income (AGI).

- The advantage of not having the QCD included in AGI is that the AGI is a trigger for several tax provisions, such as the 3.8% surtax on investment income. Similarly, AGI is used to determine payments for certain Medicare premiums and taxes on Social Security payments. Lowering AGI through a QCD consequently may reduce extra Medicare premiums, tax on Social Security payments, and phase-out of itemized deductions for high income taxpayers.

- A charitable contribution for a taxpayer who does not itemize deductions generally is wasted. Consequently, for such a taxpayer, the QCD gives an obvious tax benefit.

- The following example was recently featured in the Wall Street Journal: A single IRA owner has AGI of $210,000, including $160,000 of investment income. That person has a $50,000 required minimum distribution, has to write checks of $15,000 to charities in the tax year. Under current law, $10,000 of the investment income would be subject to the 3.8% surtax because the owner's AGI is above $200,000. If, however, the IRA owner makes the $15,000 of charitable gifts from her IRA, the situation changes. She receives no write-off, but the taxable portion of her IRA payment can drop to $35,000 and her AGI to $195,000, so there is no 3.8% surtax. Similarly, Medicare premiums and taxes on Social Security may be lowered.

- The QCD can be split among as many charities as the donor wishes. The reporting requirements are, however, rigid, and the IRA custodian must send a separate check to each charity. In other words, the distribution must be a direct transfer from the IRA trustee to the charity, not a reimbursement to the IRA owner for gifts previously made on their own.

- Before making a QCD, however, one should consider whether making a gift of appreciated securities provides a greater tax benefit. Often, a gift of appreciated stock will be more tax-advantageous than a QCD.

D. Because distributions from IRA's and QRP's generally are subject to income tax, whether distributions are made to the participant before death or to beneficiaries after death (this is not usually true for Roth IRA's, which are excluded from this discussion), good planning generally involves attempting to stretch out the time over which distributions are made. Delaying distributions as long as possible, and then stretching them out once they begin, allows investment growth within the IRA or QRP to continue to be tax free as long as possible, and similarly defers the

imposition of income tax as long as possible. Unfortunately, however, the tax law requires distributions to be made from IRA's and QRP's to begin on what is referred to as the "required beginning date," and be taken out over a certain period in amounts called "required minimum distributions." Many issues pertaining to the required beginning date and required minimum distributions are beyond the scope of this outline. For a discussion of these, and the many other rules relating to planning for retirement benefits, the author recommends a book by Natalie B. Choate, entitled *Life and Death Planning for Retirement Benefits*.

E. Disastrous combination of estate tax and income tax at the time of participant's death.

1. IRA and QRP's are fully subject to estate tax at the time of the participant's death. Because distributions from IRA's and QRP's are also subject to income tax, if a lump-sum distribution is made from an IRA or QRP following death to the participant's beneficiaries, the combined estate tax and income tax may amount to as much as 78% of the total value of the IRA or QRP, thus leaving 22¢ of each dollar for the beneficiaries. This consequence will not occur if the primary beneficiary is the surviving spouse, in that he or she is entitled to an estate tax marital deduction. The income tax consequences are, however, the same except that the surviving spouse is entitled to roll the IRA or QRP proceeds over into his or her individual IRA and thus extend the payout period.

2. Because of the potential of leaving only 22¢ on each dollar of an IRA or QRP for the participant's beneficiaries, such assets should be considered as candidates for charitable transfers at death.

3. Even in the absence of estate tax, IRA's and QRP's should be considered as candidates for charitable gifts rather than gifts to individuals. For example, Mom has an estate of $600,000.00, consisting of a $200,000.00 IRA, stock with a value of $200,000.00 and a basis of $50,000.00, and $200,000.00 of cash. Mom decides, for purposes of simplicity, to leave $200,000.00 in cash to her favorite charity; the IRA to her son, and the stock to her daughter. Following Mom's death, the daughter sells the stock, and because of the current step up in basis, the $150,000.00 gain is not recognized and the daughter has $200,000.00 net cash. The son, needing money, cashes in the IRA. Because the full $200,000.00 IRA will be subject to income tax, the son is pushed into a combined federal and state tax bracket of 45%, leaving him with $110,000.00 in cash after tax. The charity has $200,000.00, but could have had the same $200,000.00 if

the IRA had been left to charity. If the appropriate choice had been made, son, daughter, and charity, each would have had $200,000.00.

F. Do's and don'ts in naming a charity as beneficiary of an IRA or QRP.

1. Unless a charity is to be the only beneficiary of an IRA or QRP, professional assistance should be obtained prior to completing the beneficiary designation. Professional advisors can provide assistance in how to structure beneficiary designations in which part of the IRA or QRP is left to charity, and the balance is left to one or more individual beneficiaries who can stretch out the receipt of taxable distributions from the IRA or QRP as long as possible. Prior to January, 2001, such a stretch out would have been difficult to achieve. Following new proposed regulations issued by the Internal Revenue Service in January, 2001, with proper planning, whether pre-death or post-death, one can usually accomplish the stretch-out goal allowing a life expectancy payout distribution to an individual beneficiary from an IRA or QRP, even though a charity receives the remaining part of the IRA or QRP proceeds. In the absence of proper pre-death or post-death planning, however, naming both an individual and a charity as beneficiaries of an IRA or QRP may require the individual's portion to be paid out in five years from the date of death, rather than over the individual's life expectancy.

2. Do not create a trust funded with IRA or QRP proceeds and name both an individual as the lifetime trust beneficiary with the remainder to be paid to a charity after the beneficiary's death. For example, creating a trust to be funded with IRA or QRP proceeds that provides that all of the income from the trust is to be payable to one's child for the child's lifetime and upon the child's death to a charity may require all of the IRA or QRP proceeds to be subject to income tax within five years, rather than over the beneficiary's lifetime. This problem may be avoided by the use of a Charitable Remainder Trust in which the child is the lifetime beneficiary and at the child's death the balance passes to charity. Because a Charitable Remainder Trust is a tax-exempt trust, payment of IRA or QRP proceeds to the trust will not generate income tax and thus the five-year rule would be inapplicable.

IX. **Private Foundations and Donor Advised Funds**.

A. **Private Foundations.** Private family foundations are tax-exempt charitable trusts or corporations created to hold assets for charitable purposes. Usually, private

foundations distribute income, or both income and principal, to publicly supported charities. Contributions by an individual to a private foundation qualify for charitable income and estate tax deductions, subject to substantial technical restrictions regarding the deductibility for income tax purposes. Restrictions on the deductibility for contributions of appreciated property to private foundations are extremely rigid. Ordinarily, the charitable contribution deduction for gifts of long-term capital gain property of any kind to private foundations (other than private operating foundations) must be reduced by the amount of gain that would have been long-term capital gains if the property had been sold at its fair market value. Consequently, such gifts are deductible at the lower of cost basis or fair market value, unless the gift is to a private operating foundation, which distributes all of its receipts to public charities. Gifts of cash and ordinary income property are limited to 30% of adjusted gross income.

1. Private foundations must meet the detailed organizational and operational requirements of the Internal Revenue Code.

2. Substantial penalties are imposed if a foundation manager or substantial contributor is involved in "self dealing".

3. Notwithstanding the complexities and rigid operating requirements, private foundations can provide a valuable vehicle for a donor's family who can cooperate in continuing a tradition of charitable giving while retaining control over the assets and ultimate recipients of the property.

B. **Donor Advised Funds.**

1. A Donor Advised Fund, although not defined in the Internal Revenue Code or the Treasury Regulations, is a fund in which the donor or the donor's designee's may make non-binding recommendations to the governing body of the fund suggesting which charitable organization should receive grants from the donor's account. The donor's recommendations are advisory only.

2. The donor's gift is unconditional and with "no strings attached". The donor receives, however, the privilege of making non-binding recommendations to the fund's governing body as to how, where, and when the contributions should be made from the donor's account. The governing body cannot, however, be required to follow the donor's suggestions.

3. Advantages from the donor's point of view:

   a. Low cost.

   b. Efficiency.

   c. Involvement in how charitable distributions are made from the fund.

4. Disadvantages from the donor's point of view:

   a. Loss of control.

   b. The risk of changing policies of the fund's governing body regarding acceptable recipients from the fund.

   c. Because a donor advised fund is not a creature of statute, such funds lack clear rules governing their operation.

5. Donor advised funds have become widely publicized primarily because of the success of the Fidelity Charitable Gift Fund. The Fidelity Charitable Gift Fund, ranks high among all charities in contributions.

C. **Community Foundations.** Although called a community foundation, it is a public charity and not a private foundation for federal income tax purposes. A community foundation may permit donor advised fund accounts. A community foundation usually separates the investment management function from the grant disbursement function. In other words, investments funds are managed by a trustee who makes investments and the fund, through its staff and committees, acts as the grant maker. The Douglas County Community Foundation is an established and successful community foundation.

X. Substantiating Charitable Deductions for Tax Purposes.

A. **Gifts of Property** - the appraisal rules.

1. The appraisal rules apply to gifts of property (other than money and publicly traded securities).

2. Qualified appraisal is required. A qualified appraisal can be completed any time from 60 days before the contribution up until the due date

(including extensions) for the donor's tax return on which the donor reports or claims the gift. The Treasury Regulations require specific information to be provided in the appraisal, including the qualifications of the appraiser. A qualified appraiser must be a person holding himself or herself out to the public as an appraiser who, because of qualifications as described in the appraisal, is qualified to make appraisals of the type of property being valued. The appraisal summary must be signed by the qualified appraiser, and must also be signed and dated by the charity. In the absence of a qualified appraisal, the gift will be disallowed for tax purposes.

B. **Charitable Gifts of $250.00 or More.** Contributions of $250.00 or more are not deductible if they are not substantiated by a "contemporaneous written acknowledgment" from the charity. A contemporaneous acknowledgment is one received before the donor files his or her income tax return for the year in which the deduction is claimed. The acknowledgment must include the following: (a) the amount of the cash and a description of other property contributed; (b) whether the charity provided any goods or services in exchange for the contributions; (c) a description and good faith estimate of the value of any goods or services received by the donor. Any contribution deduction must be reduced by the value of any goods or services received. Certain token benefits are disregarded for this purpose. The substantiation rule applies to pooled fund gifts and perhaps to gifts of personal residences and farms with a life estate retained by the donor.

C. **Quid Pro Quo Gifts over $75.00.** A quid pro quo contribution is a transfer or other payment to a charity that is made in part as a gift and in part in consideration for goods or services provided by the charity. For such gifts, the charity, either as a part of the solicitation for the gift or acknowledgment of the gift, must provide a written statement sending out the following: (a) informing the donor that the deduction is limited to the excess of any money (and the value of any property other than money) contributed over the value of the goods or services provided by the charity; and (b) providing the donor with a good faith estimate of the value of the goods or services. In other words, the charity must tell you what you have bought and its value.

D. **Penalties for Negligence and Failing to Comply with Tax Rules and Procedures, and for Substantially Understating or Overstating Valuation.**

1. The penalties are all integrated into a single 20% "accuracy-related penalty". Additional penalties may apply for failure to file required tax

returns. A charity may also be penalized if it sells, exchanges, consumes, or otherwise disposes of property within two years after the gift and does not file an information return providing complete information with regard to the donor and the amount the charity received when it disposed of the gift. The so-called "tattle tale" rule is intended to disclose any significant difference between the donor's claimed charitable deduction and the actual amount received by the charity when it disposed of the gifted property.

2. A valuation overstatement for property for which a charitable deduction is claimed may trigger a penalty if the valuation overstatement is substantial. A valuation overstatement is considered substantial if the value of any property (including charitable gifts) claimed on a return is 200% or more of the correct value. The accuracy related penalty rises to 40% of any underpayment resulting from a "gross" valuation overstatement. A gross valuation overstatement occurs when the property's value claimed on a return is 400% or more of the correct value. These accuracy rated penalties do not apply, however, if the claimed value of the property was based on a "qualified appraisal" by a "qualified appraiser".

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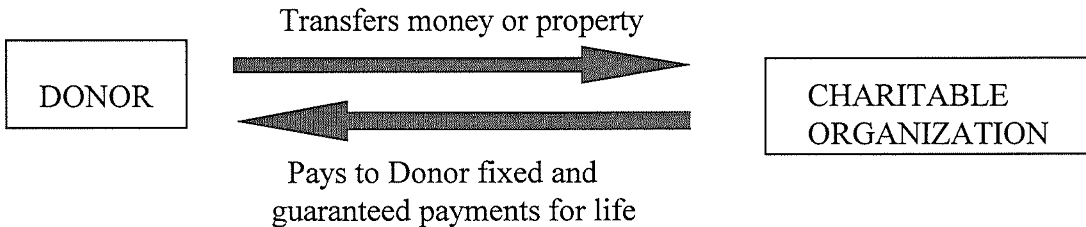
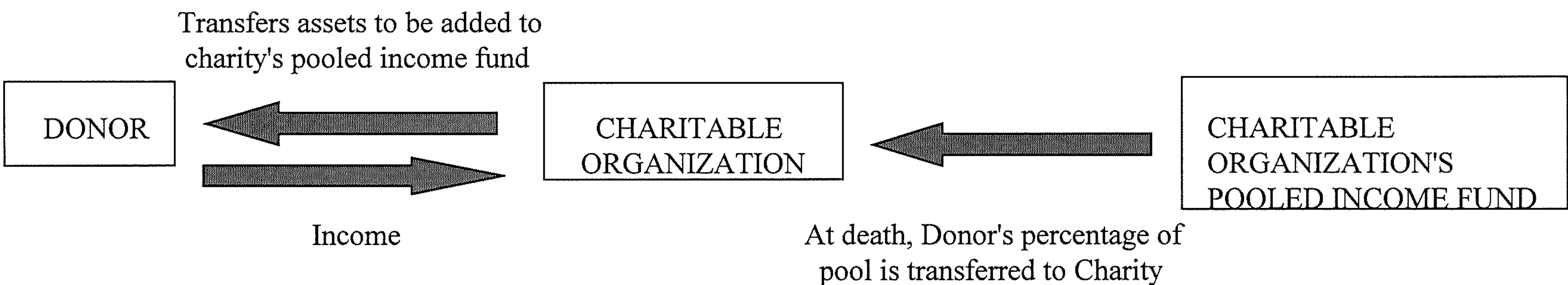
Appendix 1
CHARITABLE GIFT ANNUITY



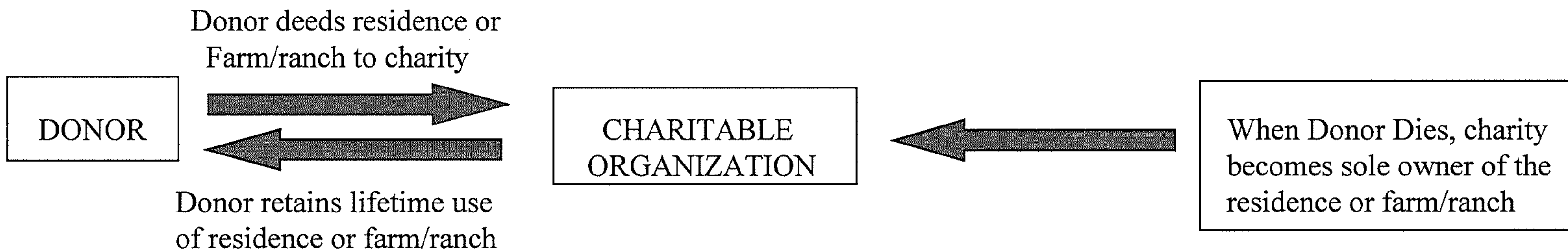
How it Works	Advantages	Disadvantages
* Part gift and part purchase of an annuity * Charitable contribution is the difference between the value of the money or property transferred and the present value of the annuity to be paid to donor * Annual payments are partially taxable income and partially return of principal	* Guaranteed and predictable income * Simple and inexpensive to create * Annuity is backed by all the assets of the charity * Benefits charity and still assures donor of guaranteed income	* Irrevocable * Bargain sale rules apply if appreciated property is transferred for the annuity * If charity ceases to exist or becomes insolvent, annuity will end

Appendix 2
POOLED INCOME FUND



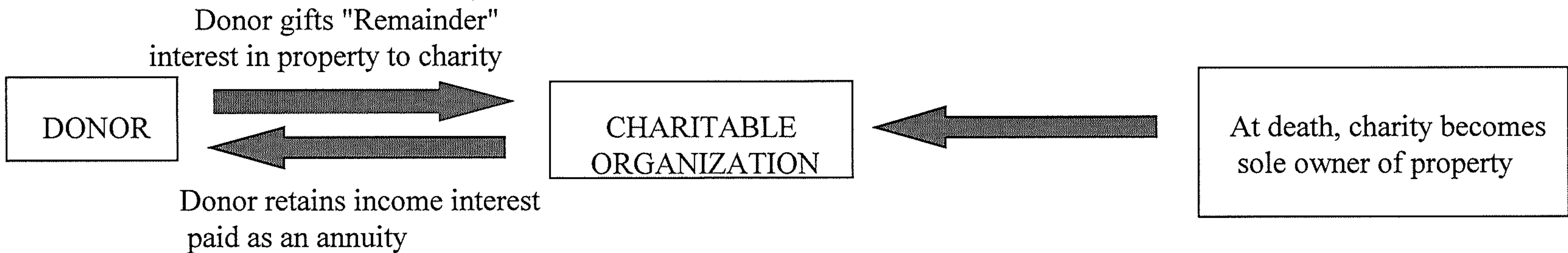
How it Works	Advantages	Disadvantages
* Donation is split gift - Donor retains income interest - Donor gifts principal * Contributions of a number of donors pooled into one large trust fund * Trust managed by Charity * Donor receives tax deduction * Charity receives fund's pro-rata principal value at Donor's death	* Donor is paid pro-rata annual amount from fund's earnings for life or for a fixed term of years * Charitable income tax deduction based on highest rate of return for prior 3 year period, date of gift and Donor's age * No capital gain tax on gift of appreciated nonmortgaged assets * Easy to maintain once set up	* Gifted property is not available for transfer to heirs * Donor cannot be trustee * Donor has no management power over assets in trust fund * Trust cannot invest in tax exempt securities * Charity must be a "public charity", but can be a community foundation

Appendix 3
TRANSFER OF RESIDENCE OR FARM/RANCH TO CHARITY WITH LIFE ESTATE RESERVED TO DONOR



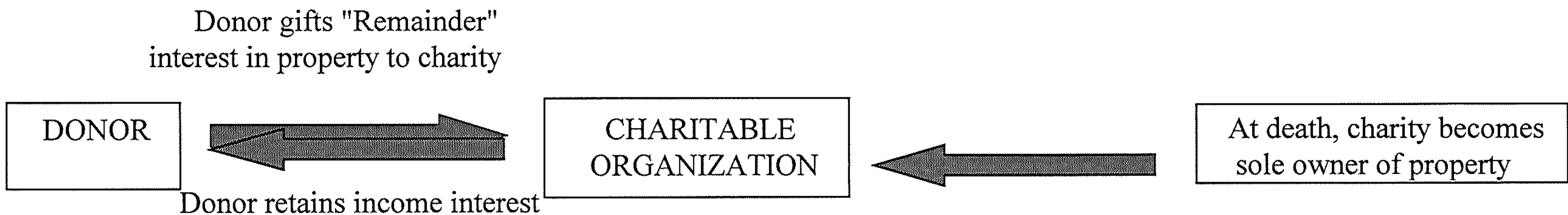
How it Works	Advantages	Disadvantages
* Donation is split gift - Donor retains use of the property for his or her lifetime or for a term of years - Donor deeds "remainder" interest in property to charity	* Donor retains enjoyment of property for life	* Gifted property is not available for transfer to heirs
* Property must be "qualified" - Home or residence - Farm or ranch	* Donor receives current income tax deduction	* Complexity in determining amount of charitable deduction
* Tax deduction based on age of Donor	* Future estate tax exclusion of value of the residence or the farm/ranch	* Gain may be taxable if property is subject to indebtedness
* Charity becomes the owner of transferred property following life estate retained by Donor		

Appendix 4
CHARITABLE REMAINDER ANNUITY TRUST



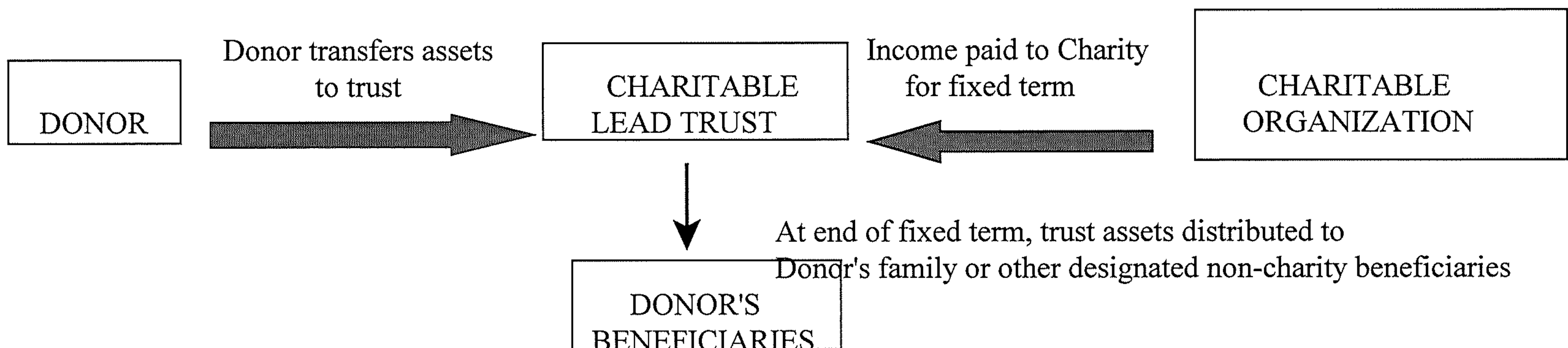
How it Works	Advantages	Disadvantages
* Donation is split gift - Donor retains income interest - Donor transfers "remainder" interest in property to charity	* Donor and other income beneficiaries retain income stream from property	* Gifted property is not available for transfer to heirs
* Trust pays fixed $ amount or fixed % of initial value of trust back to Donor each year--must be at least 5%	* Current tax deduction based on remainder interest value of appreciated property	* Additional contributions prohibited
* Donor receives income tax deduction if transfer is during lifetime or estate tax deduction if at death	* No capital gain tax on gifts of appreciated property	* Annuity payment is the same each year regardless of inflation or need
* Charity receives principal at end of period	* No need for annual valuation	* Complex, four-tier system to determine tax character of income paid to Donor
	* Predictable income flow	* Charity's remainder interest must initially equal 10% of the value of assets transferred to trust
	* Trust is exempt from income tax	

Appendix 5
CHARITABLE REMAINDER UNITRUST



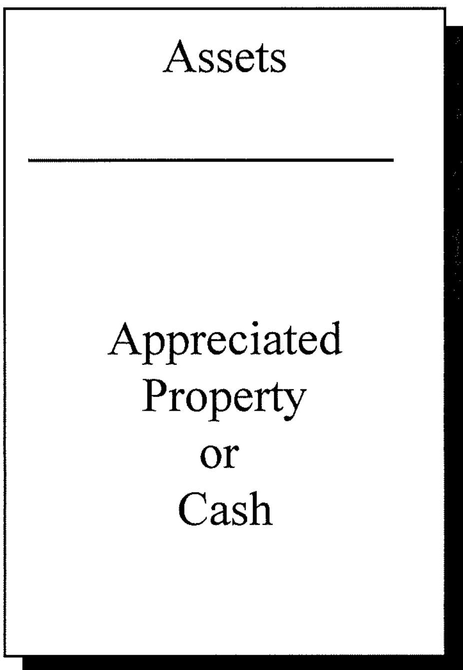
How it Works	Advantages	Disadvantages
* Donation is split gift - Donor retains income interest - Donor transfers "remainder" interest in property to charity of the value of the trust's assets (determined annually)	* Donor can function as trustee but may be annual valuation problem	* Gifted property is not available for transfer to heirs
* Trust pays % of annual value to the Donor, but must be at least 5%	* Ability of Donor to control income stream by use of NIMCRUT	* Annual valuation required
* Donor receives income tax deduction, if transfer is during lifetime or estate tax deduction if at death	* Current tax deduction based on remainder interest value of donated asset	* If donor is the trustee, independent valuation of trust's assets required annually
* Charity receives principal at end of period	* No capital gain tax on gifts of appreciated property	* Complex, four-tier system to determine tax character of income paid to Donor
	* Hedge against inflation	* Charity's remainder interest must initially equal 10% of the value of assets transferred to trust
	* Additional gifts permitted	
	* Trust is exempt from income tax	

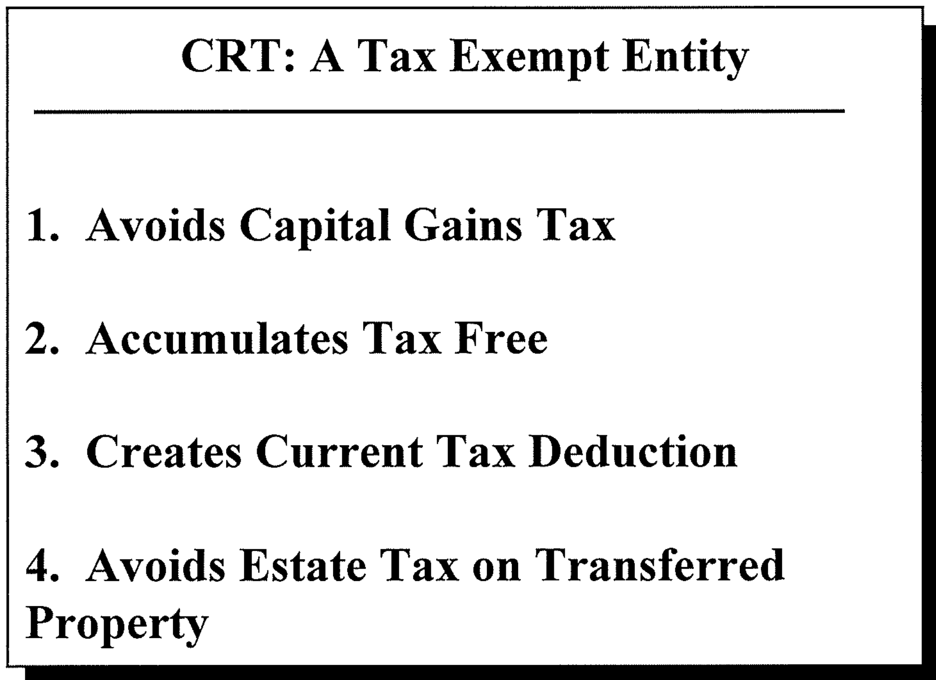
Appendix 6
CHARITABLE LEAD TRUST



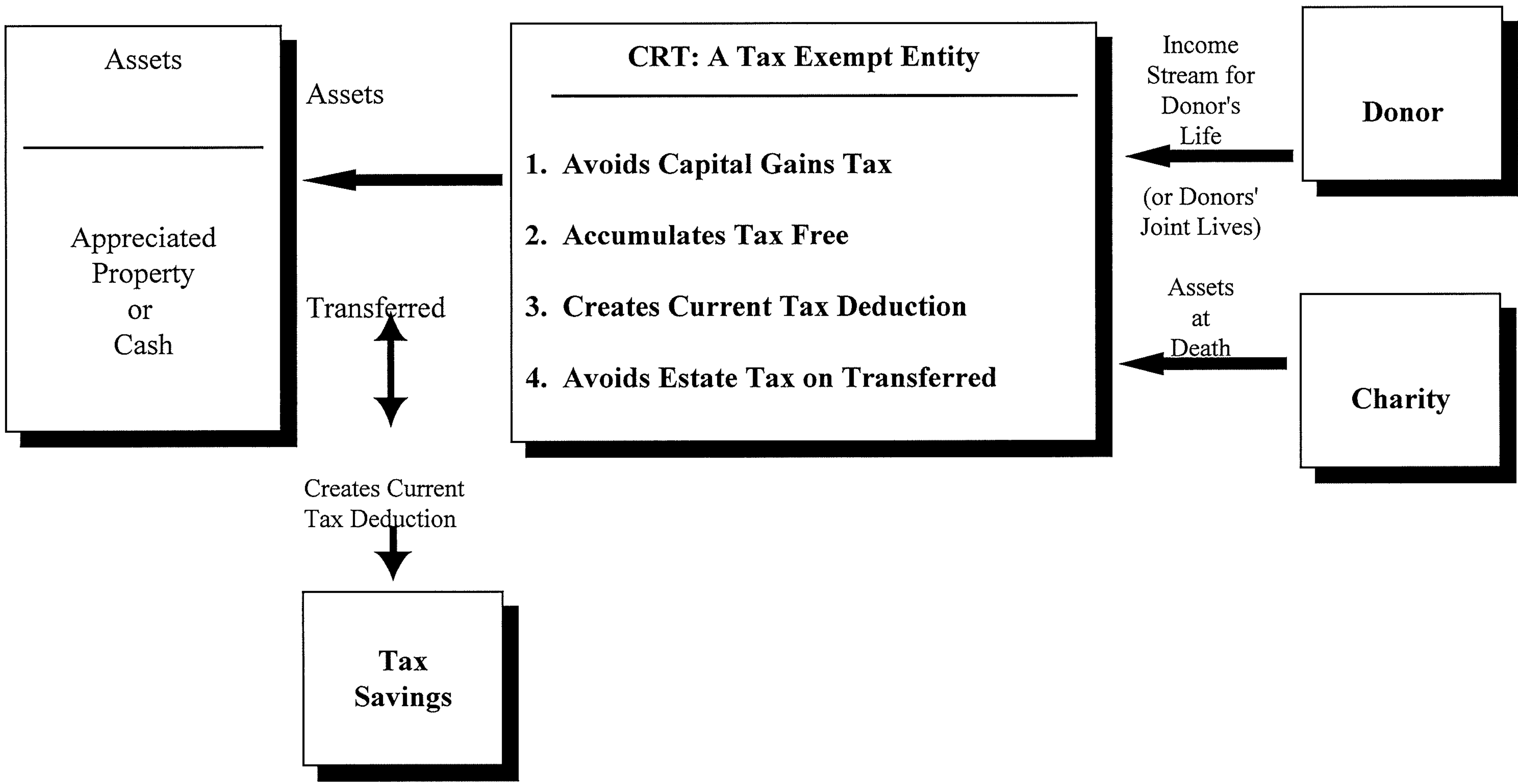
How it Works	Advantages	Disadvantages
* Donor transfers income producing property to a trust * Trust provides Charity with a guaranteed annuity or annual payments equal to a fixed % of the fair market value of the trust * At termination of trust, ownership of the property and the income it produces passes to family members or other non-charity beneficiaries	* Provides immediate cash flow to Charity for a definite term of years * Allows transfer of property to family members at a discount for transfer tax purposes * Probably most advantageous if created in will or living trust	* No income tax charitable deduction unless grantor is owner of the income interest and taxable each year on the trust income * Income tax charitable deduction recaptured if Donor ceases to be taxed on income before the charitable term ends (e.g., where Donor dies before the termination of lead trust term)

Appendix 7
HOW A CHARITABLE REMAINDER TRUST WORKS
LIFETIME CRT
Step 1

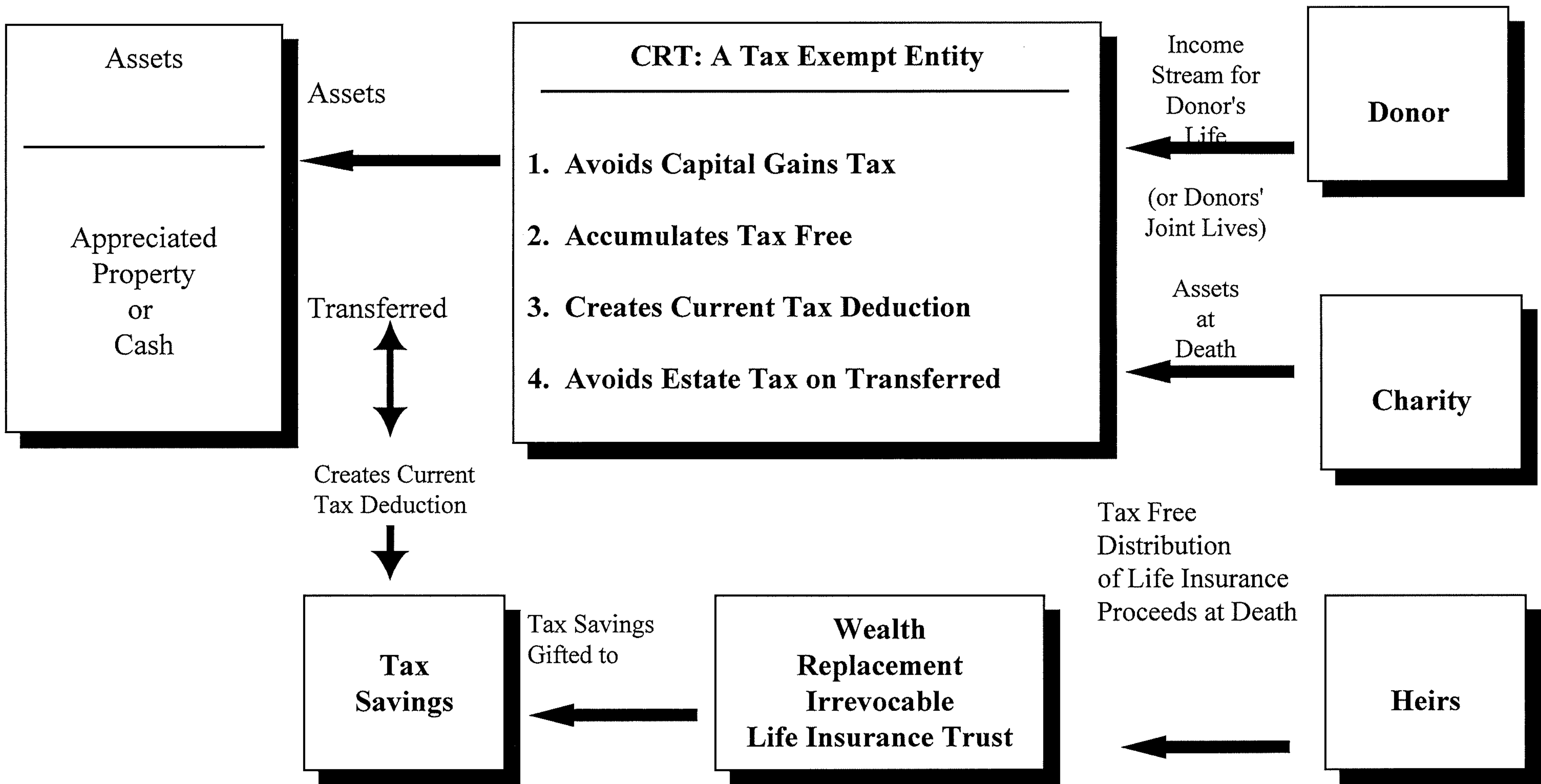




HOW A CHARITABLE REMAINDER TRUST WORKS
LIFETIME CRT
Step 2



HOW A CHARITABLE REMAINDER TRUST WORKS
LIFETIME CRT
Step 3
Use of a "Wealth Replacement Trust"



Appendix 8

OUTRIGHT GIFTS OF CASH

How it works:

Mr. Smith has an adjusted gross income of $70,000. He can take a charitable deduction of 50 percent, or $35,000, this year. Mr. Smith contributes $50,000 to a charity. Because of the five-year carry-over provision, the $15,000 ($50,000 - $35,000) not deductible in the year of gift can be deducted the following year (assuming adjusted gross income is at least $30,000 next year). So, his $50,000 gift is fully deductible.

Benefits:

The simplest method of giving is an outright cash gift, deductible from one's income tax for amounts up to 50 percent of adjusted gross income. Contributions of amounts over that ceiling, can be carried over for up to five years, which means that nearly every outright charitable gift can be completely deducted.

OUTRIGHT GIFTS OF SECURITIES

How it works:

Ms. Smith contributes long-term capital gain securities to a charity which cost her $25,000 and are now worth $30,000. She is entitled to a $30,000 charitable deduction and avoids paying tax on the $5,000 appreciation.

Benefits:

Instead of paying taxes on gains from long-term capital gain securities, one can give those gains away. Also, the full fair-market value is generally deductible; the limitation for all such gifts of appreciation long-term capital gain property is 30 percent of adjusted gross income, and one may utilize the same five-year carry-over option as for outright gifts of cash.