Ten Great Charitable Planning Ideas for 2018

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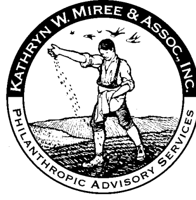

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TEN GREAT CHARITABLE PLANNING IDEAS FOR 2018

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TOP TEN CHARITABLE PLANNING IDEAS FOR 2016

I. The Current Environmental Challenges

The economic news has been uncertain or gloomy since 2000. Lower stock values, higher gas prices, fewer jobs, and the related economic turmoil have affected all donors. Even the wealthy – especially those holding concentrations in financial stocks, automotive stocks, mortgage backed bonds, or real estate – have felt the pinch. In this environment, planners must structure gifts in a way that maximize results using the many available gift planning options.

A. The Economic Impact of the Stock Market on Donors

The nature of financial markets is to move to reflect current economic conditions and fears, but markets have been particularly erratic since 2000. As a reminder, annual returns from 1999 through 2016 are shown in Table 1 and 2. The tables do not tell the full story. Mid-market fluctuations, the reduction or elimination of dividends, and tight credit markets have created even greater uncertainty for clients.

TABLE 1
MAJOR INDEX RETURNS 1999 – 2007

INDEX	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*
DJIA	25.22%	-6.18%	-7.1%	-16.76%	25.32%	3.15%	-0.61%	16.29%	6.4%
S&P 500	19.53%	-10.14%	-13.09%	-23.37%	26.38%	8.99%	3%	13.62%	3.5%
NASDAQ	85.5%	-39.29%	-21.05%	-31.53%	50.01%	8.59%	1.37%	9.52%	9.8%
DJ World	31.54%	-17.36%	-21.02%	-15.63%	38.58%	19.23%	14.4%	23.01%	11.8%
Barclays LT Treas.	-15.13%	20.11%	3.5%	14.62%	1.38%	5.06%	2.7%	1.85%	10.2%
ML Muni Master Bond Index	-6.34%	18.1%	4.5%	10.73%	2.54%	5.45%	3.9%	4.4%	4.18%
Barclays Corp. Bond Index	-1.89%	9.1%	10.7%	10.17%	8.31%	5.41%	2%	4.3%	4.56%

TABLE 2
MAJOR INDEX RETURNS 2008 - 2017

INDEX	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	*2014*	*2015*	*2016*	*2017*
DJIA	-33.8%	18.8%	11%	5.5%	7.3%	26.5%	7.5%	-2.2%	13.40%	28.1%
S&P 500	-38.5%	23.5%	12.8%	0%	13.4%	29.6%	11.4%	-0.7%	9.50%	21.8%
NASDAQ	-40.5%	43.9%	16.9%	-1.8%	15.9%	38.3%	13.4%	5.7%	7.50%	29.6%
MSCI World	-46%	37%	10.1%	-16.3%	13.6%	13.3%	-5.5%	-6.6%	1.80%	22.4%

INDEX	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
US 10-Yr Treasury	20.64%	13.17%	9.37%	34.01%	0.87%	-13.33%	23.19%	-0.68%	1.33%	2.5%
ML Muni Master Bond Index	0.54%	9.4%	2.52%	10.64%	5.56%	-2.19%	7.9%	3.01%	-0.015%	3.6%
ML US Corp Master	-6.54%	18.68%	9%	8.15%	9.82%	-1.57%	7.46%	-0.68%	6.11%	6.5%

B. Interest Rates and Donors

As interest rates have declined, the interest paid on bonds, certificates of deposit, checking accounts and other fixed income instruments that seniors and retired donors rely on for living expenses has also declined. For a look at how those rates have fluctuated over the last decade, see Table 3. Prime rose to 3.5% on December 17, 2015.

TABLE 3
PRIME RATES, QUARTERLY, 2003 – 2018

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Jan 1	5.25%	7.25%	8.25%	7.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.5%	3.75%	4.5%
Apr 1	5.75%	7.75%	8.25%	5.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.5%	4.0%	4.75%
July 1	6.25%	8.25%	8.25%	5%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.5%	4.25%	5.0%
Oct 1	6.75%	8.25%	7.75%	5%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.5%	4.25%	
Dec 1	7%	8.25%	7.5%	4%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.5%	4.25%	

C. Interest Rates and Split Interest Gifts

Low interest rates have also had an impact on split interest gifts.

1. Split Interest Gifts With Remainders to Charity

In this environment, charitable income tax deductions for split interest gifts that pay income streams to donors with the remainder to charity are substantially lower than in the 2006-2007 years in which prime rates were in the 7% to 8% range. This has dampened interest in some donors in creating charitable gift annuities and charitable remainder trusts. Table 4 demonstrates the variance in the deduction using a 1.4% CFMR and a 5.8% CFMR for a $1 million charitable remainder trust, one life age 65.

TABLE 4
COMPARISON OF RESULTS FOR CHARITABLE REMAINDER ANNUITY TRUST AND UNITRUST
5% PAYOUT, ONE LIFE AGE 65

Type of Trust - 5% Payout	*Charitable Income Tax Deduction 1.4% CFMR*	*Charitable Income Tax Deduction 5.8% CFMR*
Charitable Remainder Annuity Trust	$235,224	$495,747
Charitable Remainder Unitrust	$447,400	$468,210

2. Split Interest Gifts with Remainder to Individuals

Lower charitable federal midterm rates increase the charitable deduction for lead trusts. This is because the lower the rate reduces the calculated value of the remainder (and increases the value of the charitable deduction). Table 5 calculates the charitable deduction for a $1 million gift for a charitable lead trust using a 1.4% CFMR and a 5.8% CFMR.

TABLE 5
COMPARING THE IMPACT OF THE CHARITABLE FEDERAL MIDTERM RATE ON THE CHARITABLE DEDUCTION

20-Year Term, 5% Payout	*Gift Tax Deduction 1.4% CFMR*	*Gift Tax Deduction 5.8% CFMR*
Charitable Lead Annuity Trust	$866,950	$582,920
Charitable Lead Unitrust	$636,270	$620,250

D. Congressional Activity and Changing Rules[1]

Scandals in the nonprofit sector have made headlines in the Washington Post, the Wall Street Journal and many more beginning with the William Aramony/United Way in 1992, John Bennett and the New Era Foundation in 1995, and The Nature Conservancy insider dealing and non-cash gift valuation issues highlighted by the Washington Post in 2001. These ongoing issues prompted a series of Congressional hearings, legislative reforms, and dramatic proposed regulations and legislation affecting donors and the nonprofit sector.

1. Proposals in Staff Discussion Draft

The Senate Finance Committee Staff drafted proposals which set the tone for reform:

✓Five-year review of tax-exempt status

- Every fifth year on anniversary of tax determination letter
- Goal to determine whether determination letter should remain in effect

[1] Many of these reforms have already made their way into legislation enacted since 2004.

- Looking for changes to articles and by-laws, conflict of interest policies, policies and procedures reflecting industry best practices, accreditation
- Outcome? No upside – only downside, revocation of status

✓**Imposition of private foundation self-dealing rules to public charities**

- Taxes on self-dealing, such as sale, exchange, or lease; lending money/credit; furnishing goos or services; payments to government officials - unreasonable compensation excluded from the list

✓**Modification of intermediate sanction compensation rules to provide more accountability and ensure independent evaluation**

- Expand definition of disqualified person to include someone with substantial influence over the charity, to include corporations or partnerships where a disqualified person has substantial influence
- Increase taxes for prohibited transactions (self-dealing, jeopardizing investments, taxable expenditures) by an undetermined amount

✓**Creation of compensation rules**

- Limit compensation of private foundation trustees – either eliminate compensation to trustees of non-operating foundations, or limit that compensation to a statutory *de minimis* amount
- Limit compensation of disqualified persons
- Compensation of disqualified persons at non-operating private foundation (other than employees) must use comparable federal government rates for similar work and time
- Compensation of individuals over $200,000 ($75,000 for disqualified persons) requires the filing of additional attachments with the 990. All compensation exceeding these levels must be approved in advance each year by the board (excluding those with a conflict to the payment)

✓**Private foundation grantmaking reforms**

- Payment of expenses exceeding 10% of the foundation's expenses would require an additional filing, and the IRS would review it to see if it were "reasonable and necessary" and appropriate for consideration as a qualifying distribution
- Administrative costs above 35% of total expenses would be excluded as a qualifying distribution
- Eliminate excise tax on investment income in years when foundation pays out more than 12 percent of its investment assets
- Prohibit private foundation payments to donor advised funds
- Limit amounts paid for expenses. Expenses for travel, meals, lodging would be capped at the government rate or a separately published charitable rate (public charities would not be restricted to these amounts if the charity's board approves

expenses in excess of these amounts and reveals the expenditures on the 990)

✓**Increasing and leveraging enforcement**

- Give states the right to pursue federal tax law violations with the approval of the IRS
- Make changes to the 990 to make it more transparent, consistent, and easier to monitor
- Add Sarbanes-Oxley type penalties to include requiring a signature by the CEO attesting to the accuracy and completeness of the information
- Double or triple (for larger organizations) fines for the failure to complete and accurate 990
- Limit extensions by classifying extensions of greater than 4 months as a failure to file
- Require all charities to have an independent auditor review the Form 990 and/or annual report; the report would be attached to the Form 990 as a public document
- Exempt organizations with gross receipts over $250,000 would be required to have an independent audit of the organization's financial statements (and must address the organization UBTI). A new auditor must be used at leave every five years. For organizations with income over $100,000 but less than $250,00, the financial statements must be reviewed by a CPA
- Attach a chart showing affiliated exempt and nonexempt organizations with the 990. All charities must file a list of partnership interests.
- Charities with more than $250,000 in gross receipts must include the charity's performance goals (and how well they did in achieving them) for the current and upcoming year.
- Charities would have to report material changes in activities, operations, or structure.
- The charity's expenses would have to report expenses accurately on financial statements and Form 990.
- A charity would have to make its investment public upon request.
- Financial statements would have to be disclosed to the public.
- Charities with a web site would be required to post the information currently required to be disclosed – Form 1023, Determination letters, financial statements for the five most recent years.
- Audits of tax-exempt organizations and closing agreements would be disclosed without redaction.
- Form 990-Ts would become public, with editing allowed to cover trade secrets.
- Publicly-traded corporations would have to file an annual return showing all gifts over $10,000 (aggregated) for which a charitable deduction is claimed.
- Appropriate a portion of the private foundation investment income tax (or impose a 990/990 PF filing fee) to enforcement.

    - A portion would be allocated to state enforcement
    - Grant funds for charities that train other charities on best practices and inform the public about charities engaged in best

practices, with priority to those groups working with small charities
    - The five-year review discussed earlier
    - Accreditation

- Give U.S. Tax Court equity powers to rescind transactions, surcharge trustees, order accountings, substitute trustees, divest assets, stop activities, appoint receivers. The goals are to allow the U.S. Tax Court to remedy any detriment to a charity and ensure the charity's assets are used (and preserved) for philanthropic purposes. The new laws would create a working/review relationships between the state courts and U.S. Tax Court.
- The IRS or a board member may file an action with the U.S. Tax Court to remove an officer.
- A director or trustee may bring action against the charity in the U.S. Tax Court, and must detail actions taken to make corrections at the board/organization level.
- Individuals may file complaints directly with the IRS. There would be a $250 filing fee (or a $10,000 penalty for a frivolous filing).

✓**Requirements for non-profit Governance**

- Board members and trustees would be subject to a standard of care of an "ordinarily prudent person in a like position…under similar circumstances"; the director would have to act in the best interests of the mission, goals, and purposes of the charity; those with special skills or expertise would have a duty to use those enhanced skills. There would be federal liability for breach of these duties.
- When compensation consultants are hired to establish the reasonableness and appropriateness of compensation, that consultant must be hired by and report to the board (and must be independent.) Compensation for management positions must be approved annual and in advance (unless the only compensation change is an inflation adjustment). Compensation must be supported, explained, and publicly disclosed.
- The board must establish management policies and procedures and must review deviations.
- The board must establish, review, and approve program objectives and performance measures, and must approve "significant" transactions.
- The board must review and approve auditing and accounting principles and practices used to prepare the charity's financial statements; the board must also retain and replace the charity's independent auditor (must change every five years).
- The board must review and approve the budget and financial objectives, including significant investments, joint ventures, and business transactions.
- The board must exercise oversight of the charity's operations.
- The board must adopt a conflict of interest policy (which would be disclosed with the 990) – a summary of conflicts determinations would be provided on the 990.
- The board must create and oversee a risk management program – regulatory compliance and liability management.

- The board must establish a whistleblower policy (to address complaints and prevent retaliation).
- Boards would have no less than 3 or more than 15 board members. No more than one of these members may be directly or indirectly compensated by the charity (and that compensated person may not be board chair or treasurer.)
- At least 1 (or 1/5th) of a public charity's board members must be independent.
- Charity boards may not include:

    1. Individuals not permitted to serve on a publicly-traded company board under federal or state law
    2. Individuals criminally convicted of fraud or similar offense for five years after the conviction.
    3. Individuals convicted of a crime under the Federal Trade Commission, USPS, or State Attorney General for actions related to service as an officer or director of a charity for 5 years.

- The IRS would have the authority to remove a member, officer, or employee of a charity who violates the self-dealing, conflict of interest, excess benefit, private inurement, or charitable solicitation laws.
- Create an accreditation process to encourage "best practices" that would drive tax-exempt status, enable participation in CFC campaigns, and provide preference for government grants. This accreditation may occur through the IRS or through separately designated agencies.
- Adopt a federal prudent investor rule that mirrors current state rules.

2. June 2004: "Charity Oversight and Reform: Keeping Bad Things from Happening to Good Charities"

On June 22, 2004, the Senate Finance Committee met to hear testimony about the abuses in the nonprofit sector recently reported in the press. It was not a good day for charities. Witnesses behind curtains and with electronically altered voices discussed abuses in gifts of non-marketable property such as automobiles, housing abuses, excessive compensation, credit counseling, and self-dealing.

3. Panel on the Nonprofit Sector

The Panel on the Nonprofit Sector was convened at the encouragement of the U.S. Senate Finance Committee in October 2004. Its goal was to make recommendations on reform, both legislative and non-legislative. The team included more than 175 experts and leaders serving in a variety of nonprofit roles. The committee issued its Interim Report in March 2005. The final report was issued on June 24, 2005 and is available at www.nonprofitpanel.org and encompasses many of the recommendations in the staff draft report and in the Panel's interim report.

4. Senate Finance Committee April 2005: "Charities and Charitable Giving: Proposals for Reform"

The Senate Finance Committee reconvened to receive the report and hear testimony. The Panel on the Nonprofit Sector recommended reforms. The tone at that meeting was decidedly punitive and regulatory.

5. House Ways and Means Hearings: "Hearing on an Overview of the Tax-Exempt Sector"

The House Ways and Means Committee held hearings on April 20, 2005, to provide a better understanding of the issues before the Senate Finance Committee. The hearings focused on the history and growth of the tax-exempt sector, and current enforcement in place to address compliance.

6. Senate Finance Committee June 2005: "The Tax Code and Land Conservation: Report on Investigations and Proposals for Reform"

The Senate Finance Committee, on June 8, 2005, published its investigative report on The Nature Conservancy and conservation easement abuses and made recommendations for change. The Committee took testimony from regulators and parties with an interest in preserving deductions for conservations easements. The full report is available at the Senate Finance Committee website, http://finance.senate.gov.

7. And It Continues

Congress has continued to investigate the nonprofit sector. It focused on nonprofit hospitals in 2006/2007 and then engaged in intense scrutiny of large college and university endowments in 2008/2009. The focus will likely continue, especially for large "profitable" nonprofits with large pools of assets, just as consideration of reduction of tax benefits for wealthier taxpayers making charitable gifts remains an open question.

8. American Jobs Creation Act of 2004[2]

a. New Intellectual Property/Patent Laws

The IRS has identified intellectual property gifts as an area open to abuse. In early 2004, the 2004, the IRS published an information release and notice warning of increased scrutiny of such gifts.[3] The law governing the deductibility of patents and intellectual property was then changed under The American Jobs Creation Act of 2004.[4] Under current law, the charitable deduction for a gift of intellectual property ("any patent, copyright (other than a copyright described in section 1221(a)(3) or 1231(b)(1)(C)), trademark, trade name, trade secret, know-how, software (other than software described in section 197(e)

[2] Pub. L. 108-357, 118 Stat. 1418.

[3] IR-2003-131, Notice 2004-7, 2004-3 I.R>B. 310

[4] Pub. L. No. 108-357 , 118 Stat. 1418 (2004).

(3)(A)(i)), or similar property, or applications or registrations of such property"[5]) is limited to the lesser of the patent's market value or the donor's basis.[6] However, if the donor notifies the donee of the intent to treat the charitable contribution as a qualified intellectual property contribution, the donor may deduct "qualified donee income" received on the patent or intellectual property in the years of receipt for the legal life of the interest, or through the 10th anniversary of gift.[7] These deductions are only allowed to the extent the aggregate of statutory percentages of income (the statute provides a table) exceeds the donor's original contribution.[8] In May, 2005, the IRS issued guidance and temporary regulations for intellectual property contributions.[9]

b. New Vehicle Donation Laws

Many national and local charities actively solicit gifts of used vehicles, many of which are handled through third-party firms serving as the charity's agent in the transaction and paid a percentage of the sale amount.[10] As an increasingly number of charities began to solicit used vehicles, observers inside Congress and the IRS became concerned about potential abuse. These concerns were heightened by a December 2003 General Accounting Office report that found taxpayers were taking overstated deductions for vehicle donations.[11] The GAO examined 54 transactions to compare the donor's charitable deduction to the net proceeds received by charity. In two thirds of the transactions, the charity received 5 percent or less of the amount claimed by the taxpayer. In December, the IRS issued a taxpayer alert explaining how taxpayers can avoid problems when gifting automobiles to charity.[12]

Within a year of this report, legislation was in place to address vehicle donation valuation. Effective January 1, 2005, Section 884 of the American Jobs Creation Act sets out new rules for valuation of donated vehicles exceeding $500.[13] When a donor contributes a vehicle to charity exceeding $500, special substantiation and valuation rules apply.[14]

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[5] IRC §170(e)(1)(iii).

[6] *Id.*

[7] IRC §§170(m)(2), (8).

[8] *Id.*

[9] Notice 2005-41, T.D. 9206, 70 FR 29450, May 23, 2005

[10] In Letter Ruling 200230007, the IRS confirms that a gift to a for-profit firm that receives and sells the property as the agent of the charity is a gift "to": a charity and qualifies for an income tax deduction under IRC Section 170(a) provided the gift is properly substantiated and otherwise complies with the regulations. See also Rev. Rul. 2002-67, 2002-47 I.R.B. 873.

[11] Vehicle Donations: Benefits to Charities and Donors, but Limited Program Oversight, Report to the Committee on Finance, U.S. Senate, GAO-04-73 (Nov. 2003).

[12] IR-2003-139.

[13] Pub. L. No. 108-357, 118 Stat. 1418, IRC §170(f)(12).

[14] The sales rule and first two exceptions are set out in IRC §170(f)(12); the third exception is created and all rules amplified in Notice 2005-44, 2005-25 IRB 1.

- *The sales rule*. If the charity sells the vehicle (outside of the three exceptions listed below), the donor's deduction is limited to the gross sales proceeds. The substantiation from the charity – provided within 30 days of the sale – must contain:[15]

    - The taxpayers name and tax identification number;
    - The vehicle identification number
    - A certification the vehicle was sold in an arm's length transaction between unrelated parties.
    - The gross sales proceeds
    - A statement that the donor may not deduct more than the gross sales proceeds.

- *The significant intervening use exception*.[16] A donor may deduct the vehicle's market value on date of gift if the charity plans to use the vehicle in a significant manner, such as in a "Meals on Wheels" program. In this case, the charity must provide an acknowledgement certifying the intended intervening use of the vehicle, the expected duration of that use, and a statement the vehicle will not be sold before the end of its intended use. The statement must be provided within 30 days of contribution.

- *The material improvement exception*.[17] A donor may deduct the vehicle's market value on date of gift if the charity plans to make major repairs or improvements to the vehicle that significantly increases its value. (A material improvement is not considered application of paint, removal of dents and scratches, cleaning or repairing upholstery, or installation of theft devices, and the improvement cannot be funded through a payment from the donor.) To support the deduction, the charity must provide an acknowledgement within 30 days of the date of contribution certifying the intended material improvement and statement the vehicle will not be sold before that material improvement is made.

- *The transfer or below-market-sale to a needy person exception*. The new legislation contained a provision allowing the Secretary to issue guidance or regulations allowing exceptions for the use of vehicles in direct furtherance of the charity's charitable purposes.[18] In Notice 2005-25, the IRS made an exception where the vehicle is either transferred or sold at below market price to a "needy individual." For example, the charity might give or sell the vehicle to an individual participating in a Welfare to Work Program, so that the needy individual can use the car to get to a job. (Selling the vehicle and using the sales proceeds for charitable purposes will not suffice.) The substantiation – which should be provided no more than 30 days after date of contribution – must contain certification that the charity will give the vehicle to a needy individual or that it will be sold to a needy individual at a price significantly below fair market value, and that the transfer will be in direct furtherance of the charity's mission.

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[15] IRC §170(f)(12)(B).

[16] IRC §170(f)(12)(A)(ii).

[17] *Id.*

[18] IRC §170(f)(12)(F).

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When vehicles with a value of $500 or less are donated to charity, the general rules governing substantiation and valuation are applicable. A used-car pricing guide that provides pricing for like cars (same make, model, year) sold in the same area may suffice.[19] The valuation must take into consideration the car's condition at the time of gift.[20]

9. Pension Protection Act of 2006, H. R. 4[21]

On August 17, 2006, President Bush signed the Pension Protection Act of 2006 (H. R. 4) which included a charitable IRA rollover provision, as well as other charitable incentives and reforms. The charitable incentive of greatest interest to donors and advisors allows individuals to make annual transfers not exceeding $100,000 from traditional and Roth IRAs directly to most public charities (donor advised funds, §509(a)(3) supporting organizations, and private foundations are excluded) without including the amount in gross income. The provision, for donors age 70 ½ or older and for amounts that would otherwise be included in gross income, was applicable through 2007.[22] Donors who may received the greatest benefit from the new law include those who prefer to use tax burdened assets for lifetime gifts, those who have exceeded the 50% giving limitations, and those who do not itemize.

Other charitable incentives in the bill included an increase in the charitable deduction for businesses that contribute food inventory, a basis adjustment to the stock of S Corporations that contribute property to charity, an extension of the enhanced deduction for qualified book inventory to public schools (for C Corporations), and an increase in the charitable deduction limit for certain qualified conservation gifts. Each of these provisions is available through 2007.

There were more charitable reforms than charitable incentives in the bill. The reforms included an increase in excise taxes applicable to certain charities, recapture of the deduction value represented by the difference between cost basis and market value of a related use tangible personal property gift when the gift is not ultimately used for the charity's exempt purpose, an excess benefits transaction tax on amounts paid from a donor-advised fund or a type III supporting organization to certain related parties, application of the excise tax on excess business holdings to donor advised funds, increased substantiation requirements for gifts to donor advised funds, and new rules (including a directive to Treasury to create new payout requirement regulations) for type III supporting organizations which are not "functionally integrated type III supporting organizations".

Update #1: On October 3, 2008, the Congress passed and President Bush signed the Emergency Economic Stabilization Act of 2008, H.R. 1424 which extended the Lifetime IRA Transfer to Charity, the basis adjustment to the stock of an S corporation making a charitable contribution of appreciated property, and the enhanced deduction for contributions of food inventory, book inventory, and certain computer equipment and software through December 31, 2009.

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[19] One of the most well-recognized used-car pricing guides is the Kelly Blue Book, <www.kbb.com>.

[20] Rev. Rul. 2002-67, 2002-47 I.R.B. 873.

[21] http://thomas.loc.gov;

[22] This provision was renewed periodically in two-year increments and became permanent at the end of December, 2015 with the enactment of the Protecting Americans from Tax Hikes (PATH) Act.

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Update #2: On September 24, 2009 the Treasury issued proposed regulations for Type III supporting organizations that implemented the changes in the Pension Protection Act of 2009.[23] Specifically, the following were addressed:

- How to qualify as a Type III Supporting Organization
- Requirement to notify the Type III's supported organizations
- The responsiveness test
- The integral part test (for functionally integrated Type IIIs)
- The integral part test (for non-functionally integrated Type III's)
- Distribution requirements for non-functionally integrated Type III's
- Transitional relief

Following passage of the Act, the IRS issued a notice with interim guidance, and an advance notice of rule making on supporting organizations summarized below.

- IRS Notice 2006-109, Interim Guidance Regarding Supporting Organizations and Donor Advised Funds was published shortly thereafter focusing on four areas:
  - Criteria for private foundations that make distributions to supporting organizations that allow the foundation to determine if the supporting organization is a Type I, Type II, or Type III (and further distinguishing between a functionally-integrated Type III or non-functionally integrated Type III);
  - Clarification of the effective date for the new IRC §4958(c)(3) excise tax on excess benefit transactions with supporting organizations;
  - Exclusion of certain employer-sponsored disaster relief funds from definition of a donor-advised fund; and
  - Clarification of how the IRS will apply the new IRC §4966(a) excise taxes (relating to payments made pursuant to educational grants awarded prior to August 17, 2006)

- IRS Announcement 2007-87, Payout Requirements for Type III Supporting Organizations That Are Not Functionally Integrated, Advance Notice of Rulemaking. This proposal included four terms that included a proposed functionally integrated test for Type III Supporting Organizations, a payout requirement for non-functionally integrated Type III supporting organizations that would follow the minimum distribution rules for private, non-operating foundations, [24] the type of information a Type III supporting organization must provided to its supported organizations to demonstrate responsiveness, and modified requirements for Type III supporting organizations organized as trusts (the responsiveness test),

[23] REG-155929-06; 74 F.R. 48672-48687.

[24] IRC §4942 qualifying distribution requirements; valuation of assets for the purpose of computing the distribution requirement would also follow the private foundation rules.

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10. Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010

In 2010, the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 changed the rules again.[25] Instead of returning to pre-2001 Act rates, Congress set the exclusion amount at $5,000,000 through December 31, 2012 (indexed for inflation as of 1/1/2012) and the top rate at 35%. (For 2010, taxpayers could use the $5,000,000 exclusion with a step up in basis, or elect the zero tax option with carryover basis.)

11. The American Taxpayer Relief Act of 2012

In early 2013, The American Taxpayer Relief Act of 2012[26] (ATRA) was enacted and made changes to the income, gift, estate, and generation skipping tax rates and calculations. The overriding concern of many observers was that Congress would modify or cap itemized deductions for all giving levels, essentially eliminating the value of the deduction for donors making larger gifts. This did not happen, although most believe the conversation is not yet over and may become a part of the budget and debt ceiling discussions still to come in 2013. President Obama's Budget, for example, would uncouple estate and gift tax rates, reduce the lifetime gift tax transfer exclusion amount to $1 million, reduce the estate tax exclusion amount to $3.5 million, eliminate the inflation adjustment, and increase the marginal rate to 45%. The ATRA of 2012 tax law changes impacting giving are summarized as follows:

a) *Income Tax Rates*. Income tax rates on higher-income taxpayers ($400,000 for single taxpayers, $425,000 for head of household, and $450,000 for married taxpayers filing jointly) were raised as expected. The new rate for taxpayers beyond threshold amounts is 39.6%.

b) *Capital Gains Rates.* Capital gains rates were raised at the same threshhold amounts, from 15% to 20%.

c) *Medicare contribution tax.* While not part of the Taxpayer Relief Act of 2012, provisions in the 2010 healthcare act calls for a Medicare contribution tax of 3.8% will be imposed on capital gains, dividends, interest, and other unearned income in 2013 for taxpayers over $200,000 (for single taxpayers and heads of households) or $250,000 (for married filing jointly).

d) *The Pease Limitations (the 3% Rule).* As explained in more detail later, the Pease limitations on itemized deductions are reduced by the lessor of: a) 3% of amounts over $250,000 (single taxpayers), $275,000 (heads of household) and $300,000 (married, filing jointly) or b) 80% of the taxpayer's itemized deductions. The Pease limitations were phased out and eliminated in 2010, but reinstated in this legislation.

e) *Estate and Gift Tax Rates.* Estate and gift tax rates were maintained at the 2011 and 2012 $5 million exclusion amount, indexed for inflation. The indexed amount for 2013 was $5.25 million.[27] The tax rate was raised from 35% to 40%. Since estate and gift tax rates were

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[25] Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, P.L. 111-312 (December 17, 2010).

[26] American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313.

[27] Rev. Proc. 2013-15, January 11, 2013.

slated to return to a $1 million exclusion amount and 55% top rate, this was a welcome result for affluent taxpayers with large estates.

E. Misfeasance, Malfeasance, and Lawsuits

Judging by the increasing number of lawsuits over the last ten years, charities are having a harder and harder time honoring donor commitments. The following five cases provide some perspective.

1. *William Robertson, et. al. v. Princeton University, et. al.*[28]

Charles S. and Marie H. Robertson[29] contributed $35 million in A & P stock to Princeton University in 1961 to create a supporting organization to fund the Woodrow Wilson School of Public and International Affairs "where men and women dedicated to public service may prepare themselves for careers in government service, with particular emphasis on the education of such persons for careers in those areas of the Federal Government that are concerned with international relations and affairs."[30] The Foundation, with assets of roughly $900 million in recent years, provided funds for the Woodrow Wilson School and also funded other budgets, including a $13million principal distribution to build Wallace Hall, a building designed to house the expansion of the Woodrow Wilson School as well as the Sociology Department and other programs.

During his lifetime, Mr. Robertson grew unhappy with the Foundation's spending patterns and the low numbers of students engaged in pursuit of diplomatic service, expressing his concerns in writing. The school dismissed his concerns explaining the world of diplomacy was no longer the same. Marie Robertson died in 1972 and Charles Robertson died in 1981. Their son William S. Robertson, his sisters Katherine Ernst and Anne Meier, and cousin Robert Halligan – also unhappy about the application of Foundation funds – filed a lawsuit in July 2002 to redirect funds to other universities that could fulfill the donors' goals. The suit alleged the school intentionally violated the donors' intent and further claimed Princeton was engaged in self-dealing with regard to the Foundation's investments and distribution of funds. The lawsuit involved numerous depositions and other discovery, costing Princeton over $40 million in expenses through December 2008 when the suit was settled.[31] The settlement required Princeton to transfer $90 million plus interest to the Foundation.[32]

2. *Howard v. Administrators of the Tulane Educational Fund*

From 1886 to 1901, Josephine Louise Newcomb contributed over $3.6 million to create the Sophie Newcomb College in Tulane University to advance "the cause of female education in Louisiana." The gift, worth approximately $75 million in today's dollars, established the first separate college for

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[28] Docket No. C-99-02, Superior Court of New Jersey, Chancery Division: Mercer County

[29] Mrs. Robertson was the daughter of the founder of the A & P grocery chain.

[30] The language setting out the Foundation's purpose is taken from its Certificate of Incorporation. To provide context, in 1961 the U.S. and Russia were engaged in a cold war, the United States was involved in Vietnam, and President Kennedy was asking American to: "Ask not what your country can do for you – ask what you can do for your country."

[31] Hathirimani, Raj, "Robertson Lawsuit Most Expensive in University History," *The Daily Princetonian*, www.dailyprincetonian.com (November 19, 2004); the lawsuit was settled on December 10, 2008 and approved by the court on December 12, 2008.

[32] "Robertson Lawsuit Settled," http://paw.princeton.edu/issues/2009/01/28/pages/7658/index.xml.

women in a university in the United States. In 2006, the Trustees voted to merge Newcomb College into Tulane and to absorb its endowment.

Two heirs of Josephine Newcomb – Parma Howard and Jane Smith – filed suit to enforce Ms. Newcomb's intent in maintaining a separate college. The district court judge dismissed the Newcomb heirs' lawsuit holding they had no standing to enforce the gift;[33] this ruling was affirmed by Louisiana Fourth Circuit Court.[34] The heirs appealed, and on July 1, 2008, the Louisiana Supreme Court vacated the dismissal and remanded the case to the trial court to allow the descendants of Ms. Newcomb to proceed with the lawsuit to enforce the gift's terms. In August 2008, a second lawsuit was filed in the district court of the Parish of Orleans by another Newcomb descendant, Susan Henderson Montgomery, also seeking to enforce the terms of the gift.[35] Ms. Montgomery filed a Motion for Summary Judgment with the Civil District Court in New Orleans which was denied in August 2009. Ms. Montgomery appealed, and in October 2010 the Fourth Circuit Court of Appeals in a 3-2 decision denied the appeal finding "Ms. Newcomb's will created an unconditional bequest to the Administrators of the Tulane Educational Fund."[36] The case history and court filings can be found at www.newcomblives.com.

3. *The Barnes Foundation's Petition to the Orphan's Court to Change Settlor's Intent*

Dr. Albert C. Barnes established the Barnes Foundation in 1922 to house his extensive Impressionist, Post-Impressionist and early Modern art collection (including many masterpieces with a collective current value of $6 billion) and to educate the working class about art. The collection – which was assembled and mounted by Dr. Barnes – was located in a modest structure in Merion, Pennsylvania, a Philadelphia suburb. Dr. Barnes arranged the paintings and designed the art education curriculum himself. He did not intend to have the entity operate as a traditional museum.[37]

Dr. Barnes died in 1951. In 1991, the trustees went to court to amend the Foundation's governing documents which prevented the trustees from selling or loaning the art in the collection.[38] While the lawsuit – which cost the Foundation about $10 million in expenses – did not result in a change in the Foundation's by-laws, the Judge did allow the Foundation to take the art on tour raising about $16 million for renovations.[39]

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[33] *Howard v. Administrators of the Tulane Educational Fund*, unreported, Civil District Court, Orleans Parish, No. 2006-4200, Div. B-15.

[34] *Howard v. Administrators of the Tulane Educational Fund*, 970 So. 2nd 21 (Ct. App. 4th Cir. October 22, 2007).

[35] *Montgomery v. Administrators of the Tulane Educational Fund*, unreported, Civil District Court, Orleans Parish, No. 08-8619, Div. B-I.

[36] This lawsuit is still unfolding and further developments may have occurred after this article was written. Please check for recent developments at www.newcomblives.com.

[37] According to the Foundation's press release the Foundation has a 3-year horticulture program, and a 2-year art and esthetics program with a 1-year seminar extension.

[38] Solis-Cohen, Lita, Maine Antiques Digest, March 2004 <http://www.maineantiquedigest.com/articles/mar04/barnes0304.htm>.

[39] *Id.*

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In September 2002, the financially-strapped trustees filed another lawsuit seeking permission to move the art collection from the Merion building to a new building (to be constructed) in downtown Philadelphia; in addition, it asked the Court to allow it to expand the number of trustees from 5 – as designated by Dr. Barnes in the governing documents – to 15.[40] In early 2004, the Court approved the increase in the number of Trustees, deferring the decision on the move until other options to raise funds were explored. Then, on December 13, 2004, the Court of Common Pleas of Montgomery County, Pennsylvania, Orphans' Court Division granted the Trustees' request to move the Foundation's art gallery from Lower Merion Township, Pennsylvania to a new location in downtown Philadelphia. The court's 41-page published opinion[41] acknowledged the changes ran counter to the terms of the Foundation's 1922 charter and governing documents but noted there was "no viable alternative" for the financially-compromised charity.[42] An appeal to the ruling filed by an art student at the Foundation was dismissed by the Pennsylvania Supreme Court for lack of standing.[43]

4. *Tennessee Division of the United Daughters of the Confederacy v. Vanderbilt University*

In 1913, the Tennessee Division of the United Daughters of the Confederacy entered into the first of a series of gift agreements with George Peabody College for Teachers ("Peabody College") to raise $50,000 for the construction of a dormitory, a portion of which would provide rent-free housing for students of Confederate ancestry. The agreements spelled out key restrictions on the gift, including the requirement the dormitory bear the name of "Confederate Memorial Hall." The dormitory was completed in 1935, and for many years Peabody College, and Vanderbilt University following its merger with Peabody, abided by the terms of the gift. In 2002, however, Vanderbilt's President decided to rename the building (feeling "Confederate" created a marketing problem for the University).

The United Daughters of the Confederacy, who were not consulted about or informed of the change, filed a lawsuit to compel Vanderbilt to honor the terms of the gift agreement. At trial, the court granted Vanderbilt's motion for summary judgment finding the obligation to comply with the gift agreements was "impractical and unduly burdensome." The Court of Appeals of Tennessee, however, reversed the trial court and upheld the gift agreement.[44] It gave Vanderbilt two choices: 1) either abide by the terms of the agreements between the United Daughters of the Confederacy and Peabody College; or 2) return the present value of the original gift to the United Daughters of the Confederacy. Vanderbilt decided not to appeal the decision and to honor the gift terms.

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[40] *Id.*

[41] *The Barnes Foundation,* No. 58,788 (12/13/04).

[42] Blum Debra E., "Court Ruling Could Influence Restrictions Donors Place on Bequests," *The Chronicle of Philanthropy* (January 6, 2005; "Court Allows Barnes Foundation To Move Collection to Philadelphia," *Nonprofit Issues,* December 16, 2004 – January 15, 2005 <www.nonprofitissues.com/public/features/leadfree/2004dec2-IS....>

[43] Blum Debra E., "Pennsylvania's Highest Court Allows Multibillion-Dollar Art Collection to Move," *The Chronicle of Philanthropy* (April 28, 2005).

[44] *Tennessee Division of the United Daughters of the Confederacy v. Vanderbilt University*, 174 S. W. 3rd 98, 203 Ed. Law Rep. 396 Ct.App., 2005.

The epilogue of this case occurred in 2016, when Vanderbilt paid the United Daughters of the Confederacy over $1 million for the privilege of renaming the building. The University cited favorable interest rates as the motivation for settling.

5. *Fisk University v. Georgia O'Keeffe Foundation*

In 1949, Georgia O'Keeffe, the widow of Alfred Stieglitz (and executrix of his estate), transferred the Alfred Stieglitz collection of 97 photographs and paintings to Fisk University in Nashville, Tennessee subject to a restriction that Fisk University would not at any time sell or exchange the pieces of the collection. Ms. O'Keeffe then contributed four additional pieces that were part of her personal collection for a total of 101 pieces. In 2005 Fisk University filed a petition in the Chancery Court of Davidson County asking the court to invoke the legal doctrine of *cy pres* to permit the sale of two of the paintings in the college citing the cost of maintaining the collection and other financial needs. The Georgia O'Keeffe Foundation originally filed to block the action; in 2006, the Georgia O'Keeffe Museum filed a petition, granted by the Court, to substitute the Museum for the Foundation, alleging the Museum was Georgia O'Keeffe's successor in interest and seeking through counterclaim to have the collection transferred to the Museum through right of reverter. In 2007, the Tennessee Attorney General was permitted to join the proceedings to protect the interests of the people of Tennessee.

A settlement with the Georgia O'Keeffe Museum involving a sale of several of the paintings was rejected, as was an outside offer from Crystal Bridges – Museum of American Art, Inc. involving the purchase of an undivided 50% interest that would allow the Crystal Bridges Museum and Fisk to share the college. In a pre-trial motion, the Court ruled the *cy pres* doctrine was not applicable because O'Keeffe had specific rather than general charitable intent when she transferred the collection to Fisk and that the Court had the power to order reversion if the Georgia O'Keeffe Museum could demonstrate Fisk breached the gift conditions. Following trial, the Court ruled that none of Fisk's actions had yet violated the gift terms and imposed an injunction that Fisk comply with the gift terms. Fisk appealed,[45] and in July, 2009 the Court of Appeals reversed the Trial Court's determination the Georgia O'Keeffe Museum had standing to sue finding the Museum had no right of reversion in either the 97 pieces transferred to Fisk from Mr. Stieglitz's Estate by Ms. O'Keeffe using her power of appointment, or the four pieces from Ms. O'Keeffe's personal collection gifted to Fisk.[46] The Court also found the Trial Court erred in dismissing the University's petition for *cy pres* relief after determining *cy pres* was not applicable because Ms. O'Keeffe's charitable intent was specific rather than general. The Trial Court did not determine *cy pres* relief was appropriate, but remanded the petition to the Trial Court for that determination.[47]

II. Ideas 1 and 2: Simple But Smart

A. Accelerating Charitable Gifts

Sometimes the simplest planning concepts generate the most profound results. As the gift and estate tax rates shift under the schedules legislated in the 2001 Tax Act (EGTERRA) and slated income tax reductions are accelerated in the 2003 Tax Act (JGTRRA), planners must review assumptions made

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[45] A copy of the appeal can be found on the Tennessean website at http://www.tennessean.com/assets/pdf/DN115593814.PDF.

[46] Slip Copy, 2009 WL. 2047376, Tenn. Ct. App., July 14, 2009 (No. M200800723 COAR3CV).

[47] *Supra.*

about tax benefits of planned gifts in current estate plans and consider changing the timing – and the form – of those gifts to maximize taxpayer benefits.

According to a recent IRS report in the Statistics of Income Bulletin, *Recent Changes in the Estate Tax Exemption Level and Filing Population*, there has been a dramatic drop in the number of estate tax returns filed since the 2001 Act. Estate tax filings dropped from 108,071 in 2001 to 45,070 in 2005, a drop of more than 58%.[48]

- *Accelerate gifts destined for charity that generate no income.* The easiest gifts to accelerate are those designated for charity under a will or will substitute that produce no current income. Classic examples include life insurance policies owned by the donor designating charity as the beneficiary, or valuable art collections headed for a museum (especially if the donor is downsizing and is concerned about the ongoing cost of insuring and safeguarding the assets).

- *Accelerate a testamentary gift of a home or farm by making a retained life interest gift*. A similar, but often overlooked asset is a home designated for charity under a will. The donor may want to transfer the home to charity today, retaining the lifetime right to remain in the home, and take a charitable deduction for the remainder interest.

  When a donor makes a gift of a remainder interest gift in a home or farm, it is impossible to know whether he may need to sell the real estate and move to an assisted care or long-term skilled nursing facility prior to death. The real property used for the gift may be his asset of greatest value, or simply the asset needed, to ensure housing needs are met. There are at least five ways to handle this problem.

  1. *A bargain sale of the residence*. If the donor knows he will need to sell the residence at the time the gift is in the planning process, a bargain sale may meet his goals. This means that the donor can sell the remainder interest to charity for a price that is less than the fair market value of the remainder interest. The donor can use the cash received from the sale portion to fund his housing needs. The sale triggers recognition of capital gain on the sale portion of the transaction under the bargain sale rules.

  2. *A bargain sale of the remainder interest*. If the donor knows he will need some cash from the transaction, he can consider a bargain sale of the remainder interest, instead. This transaction triggers capital gains on the non-charitable portion of the transaction under the bargain sale rules.[49]

  3. *A bargain sale of the residence or the remainder interest in the residence in exchange for a charitable gift annuity.* If the donor needs income, he may make a bargain sale of the residence or the remainder interest in the residence in exchange for a charitable gift

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[48] Raub, Brian G. Recent Changes in the Estate Tax Exemption Level and Filing Population, Fall 2007 Statistics of Income Bulletin, Figure C, p. 115.

[49] *Id.* See Ltr. Rul. 8134106.

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annuity. This transaction triggers capital gains for the non-charitable portion of the transaction under the bargain sale rules.[50]

4. *A sale during the donor's life term*. If the need is not identified until well into the life interest, the donor and charity may decide to sell the home and split the proceeds of the sale. The donor will receive the proceeds attributable to his life interest remaining in the property, and the charity will receive the balance. Since many charities plan to sell the property upon receipt, this will allow the charity to receive the cash earlier than expected, and will provided the donor with needed cash. This transaction triggers capital gain on sale of the asset.

- *IRA Charitable Rollover.* In 2015, Congress made the Charitable IRA Rollover - which was first introduced in the Pension Protection Act of 2016 for a two-year period, and thereafter periodically renewed for two-years periods - permanent. Under this law, taxpayers age 70 1/2 or older may transfer up to $100,000 each year from their IRA to qualified public charities. (Qualified public charities include all public charities with the exception of supporting organizations and gifts to donor advised funds.) These amounts must be transferred directly from the IRA to the recipient charity, and the donor may not receive benefits (quid pro quo) as a result of the transfer. These transfers may not be used to create charitable gift annuities or charitable remainder trusts. These amounts transferred to charity are not included in the taxpayer's income for that year, nor do they generate a charitable deduction. The result is similar to having the full amount included in gross income, and getting a dollar for dollar charitable deduction for the gift, with one big advantage: income is not grossed up. The amounts transferred qualify for the taxpayer's Required Minimum Distribution.

There is no single rule applicable to every client. Every taxpayer's personal and tax situation is different. The planner must consider the client's age and family obligations, the potential need to call on the assets, the need for flexibility, and his or her charitable objectives as well as the value of the tax deduction to the donor. Successful planning is predicated on careful consideration of the options, and selecting the gift plan that maximizes the charitable and tax benefits to the donor.

B. Using IRD Assets for Testamentary Gifts

Income in respect of a decedent (IRD) creates unique opportunities for charitable planning. IRD assets – including IRAs, savings bonds, untaxed compensation, or any asset on which income tax is due at death – are often avoided by gift planners because of unpleasant tax consequences if transferred during life. In an estate, however, these assets can work magic when used to make charitable gifts.

1. The Basic Principles of IRD Planning

IRD is the term defining income that has accrued but not taxed at a decedent's death. These assets reach beneficiaries with a tax burden; the decedent's estate, the named beneficiary, or person or entity to which the asset is properly distributed is responsible for payment.[51] The untaxed income has the

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[50] *Id.* See Ltr Ruls. 8120089, 8305075 and 8806042.

[51] IRC § 691(a)(1).

same character in the hands of the recipient it had in the hands of the owner.[52] Since the highest estate tax rate in 2013 is 40%, and the highest federal income tax rate is 39.6%, the two taxes can take a significant bite out of the asset's value at death.[53]

The goal of using IRD assets in testamentary charitable planning is simple: give the most highly taxed assets to charity, leaving the non-taxed assets for heirs. If the transfer is structured properly:

- The estate receives a charitable estate tax deduction for the gift to charity;
- The income in the property is allocated to the charity, an entity that pays no tax; and
- The non-charitable beneficiaries receive estate assets with a stepped-up basis and no inherent tax burden.

Many commonly-held assets have IRD, including the following:

✓ *Retirement plans*, such as qualified employee benefit plans, Keoughs, IRAs, and other retirement benefits funded with pre-tax income. This would not include defined benefit plans (where there is the right to certain benefits but no ownership or right of disposition of the assets funding those benefits), Roth IRAs, or portions of retirement plans funded with after-tax dollars.

✓ *Savings bonds* with accrued, untaxed income. The most common form of bond with untaxed income is the EE (Patriot) Savings Bond, which is purchased at a discount of face value, and accrues interest for up to 30 years. Until August 31, 2004, it was possible to convert EE Bonds to HH Bonds without triggering tax on the accrued income; the Treasury no longer allows such a conversion. It was also possible until August 31, 2004 to defer interest on HH Bonds; this option, too, has been eliminated.

✓ *Deferred compensation*.

✓ *Compensation earned – but not received* – before death. This includes any payment for remaining vacation or sick time accruing to the decedent.

✓ *Accounts receivable*, earned but not received before death.

✓ *Unrecognized income from annuities*, such as deferred annuities.

✓ *Remaining installment sale payments*.

✓ *Accrued interest* on stocks and bonds due at date of death.

Sometimes the inclusion of these assets in an estate is predictable. Retirement plans and savings bonds, for example, may comprise a large percentage of a decedent's assets. In other cases, the inclusion of the asset is not anticipated. An installment sale, for example, may have been executed

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[52] IRC § 691(a)(3).

[53] Most states also impose a state estate tax and income tax. The state estate tax can be claimed in part or in whole as a credit against the federal estate tax; the state income tax adds an additional overall tax burden to the IRD.

after the estate plan was prepared. Only a few of these IRD assets will be explored in detail. However, the principles of IRD planning are equally applicable to all assets with this form of income.

2. Retirement Plan Gifts

Retirement plans represent a major asset in many estates due to two factors. First, companies that formerly offered defined benefit plans now find it less expensive to provide defined contribution plans. Defined benefit plans – often referred to as pension plans – require a company to maintain an actuarially calculated reserve to pay retirees a specific annual benefit for life. The retired employee does not own the assets generating the benefit, and the cash flow normally ceases at the death of the retiree. Define contribution plans allow a company to make a retirement contribution that vests (or becomes owned by) the employee after a specific period of service. The employee is then responsible for investing the assets to generate a sufficient return in retirement. Many of these plans allow employees to defer income to further build retirement assets. Second, the bull market of the 1990s increased the presence of retirement plans in estates. Individuals who had not yet retired found their plans grew dramatically, with or without additional contributions; those who had retired found the plans grew faster than required withdrawals were made.

a. Retirement Plans with Income in Respect of a Decedent (IRD)

Profit Sharing Plans: A profit sharing plan is funded on a defined contribution basis, meaning that the company decides each year how much it will contribute. Employees become vested with ownership depending upon years of employment and the terms for vesting set out in the plan. Once an employee is vested, the funds are the property of the employee and can be distributed, if funds remain at death, through a beneficiary designation.

IRC Section 401(k) Plans: A 401(k) plan allows an employee to contribute pre-tax earned income to the plan. Many times profit sharing plans include a 401(k) feature so that employees may grow retirement savings through profit sharing contributions and 401(k) contributions. 401(k) assets are owned by the employee and any funds remaining in these plans can be distributed through a beneficiary distribution. The plan document may limit the manner of distribution so it is important that the plan owner and advisor be familiar with plan limitations.

IRAs: IRAs may be the most common form of retirement plan. Contributions to IRAs accumulate and grow tax-free. Distributions from the fund are taxed as ordinary income. Assets remaining at death are the property of the taxpayer and may be distributed in accordance with beneficiary designations.

Keoghs: Keogh plans are structured much like IRAs, but are tax-deferred retirement savings plans for the self-employed. Participants in Keoughs are subject to the same restrictions on distribution (between ages 59 1/2 and 70 1/2) as are participants in IRA's.

b. Plans Not Characterized as Income in Respect of a Decedent

Pension Plans: Pension plans are company-funded retirement packages for employees. The traditional pension plan is a defined benefit plan, meaning that the employee, once vested, receives defined benefits from the plan at retirement. These benefits may continue for the life of the employee, or the life of the employee and his or her spouse. But the employee does not own the plan assets and

cannot generally distribute those assets. The benefits cease at the employee's death, or at the second to die of the employee and his or her spouse.

Roth IRA: Roth IRAs are not included in the group of retirement plans with IRD. Roth IRAs are funded with after-tax dollars. The assets in the plan then accumulate, and are distributed, tax-free. Taxpayers were allowed to covert standard IRAs to Roth IRAs by paying the tax due and making an election to move the funds. While these assets can still be used to make charitable gifts, the gift does not carry the double tax benefit – avoiding ordinary income tax and estate tax – that gifts of IRD retirement plans generate.

3. Retirement Plan Gift Options

Retirement plans that offer opportunities for charitable planning include, but are not limited to, the following options.

✓ *Lifetime Outright Gift to Nonprofit Organization*

There are two ways to make a gift to charity using an IRA. The first, for taxpayers age 70 1/2 or older, is the IRA Charitable Rollover described above. The second option is to take a distribution from the plan, pay income tax on that distribution, make the gift to charity, and take a charitable deduction for the gift. Several obstacles prevent the taxpayer from receiving a $1 for $1 charitable gift credit for the gift. First, the charitable deduction is available only if the taxpayer itemizes (a group that in 2014 included 30.41 percent of all taxpayers). Next, many taxpayers receive limited benefit from itemized deductions because of the application of the three percent rule (reduced by legislation to 1% in 2008 and 2009, and eliminated in 2010 but revived in AFTRA 2012).[54] And finally, there may be other tax items on the taxpayer's return (such as prior year credits or carry forwards) that prevent the use of the deduction.

If the taxpayer has an excessive amount of funds in the IRA, he or she may choose to withdraw funds, pay the tax and make the gift to charity. If so, consider these ways to maximize that decision.

1. The withdrawn funds can be contributed to charity in exchange for an IRA. This generates a charitable deduction to cover part of the tax, removes the funds from the estate and generates an income in retirement.

2. The withdrawn funds can be contributed to a charitable remainder trust. If the taxpayer funds a charitable remainder trust, it is best to use appreciated funds and use the cash from the retirement fund distribution to replace the stock at a higher basis.

3. The taxpayer can make an outright distribution to charity. Again, the taxpayer should use appreciated stock, using the cash from the retirement plan distribution to replace the stock at a higher cost basis.

✓ *Lump Sum Distribution from Profit Sharing Plan Used to Fund Charitable Remainder Trust*

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[54] IRC § 68.

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In the facts of Letter Ruling 200202078, the donor retired and received his retirement plan assets in the form of an in-kind distribution of company stock and other assets. He rolled a portion of the in-kind distribution into an IRA and received the balance of the shares outright. He transferred a portion the non-rollover shares to a charitable remainder trust. The taxpayer recognized ordinary income on the non-rollover shares to the extent of the retirement plan's basis in the stock. The net unrealized appreciation (the value of the shares in excess of the basis) was characterized as long-term capital gain. The IRS ruled that the contribution of the shares to charitable remainder trust did not trigger ordinary income or capital gain to the donor, and would not trigger tax to the donor or the trust upon subsequent sale (absent any unrelated business taxable income or a prearranged sale). This ruling was consistent with two earlier rulings involving retirement plan transfers to charitable remainder trusts.[55]

- ✓ *Outright Gift to Community Foundation at Death*

Retirement plan assets may also be used to make an outright gift to a community foundation. Community foundations offer donors a variety of options.[56] The transfer agreement can reserve the right to advise on distributions from the funds to the decedent's spouse and/or children, thereby providing family members with a means to make charitable distributions that they choose. (Advised Fund) The transfer can be made to a field of interest fund to benefit a particular area of the taxpayer's interest such as healthcare, education, welfare reform, etc. (Field of Interest Fund). The transfer can be made to a designated fund, designed to distribute funds annually to specific organizations. (Designated Fund) Or the transfer may be made to an unrestricted fund labeled with the donor's name.

- ✓ *Outright Gift to Private Foundation at Death*

When a donor has substantial funds to contribute to charity, the taxpayer may want to consider creating and funding a private foundation.[57] A private foundation is used by many families to teach family members about philanthropy and to control the distribution of charitable dollars. The consequence of a distribution to a private foundation is that some tax may be due. Private foundations are generally considered to be one of the lowest forms of charitable life simply because they are subject to regulations and excise taxes that public charities are not required to bear. One of those taxes is an excise tax due on the foundation income, defined as interest, dividends, rents, and royalties. The distribution of retirement plan assets to the private foundation may create taxable income if the proceeds are subject to the 2 percent excise tax on investment income.[58]

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[55] See also LR 199919039, LR 200038050, and LR20035017.

[56] Get information about community foundations, and locate a community foundation in your community, by contacting The Foundation Center, <http://fdncenter.org>, or the Council on Foundations, <www.cof.org>.

[57] "Large" is a relative term. Private foundations are not cost-effective for assets of less than $1,000,000 and are really most appropriate at $3,000,000 to $5,000,000. See McCoy, Jerry J. and Kathryn W. Miree, *The Family Foundation Handbook (2008 Edition)* (CCH: 2007) for a full discussion of funding and managing family foundations.

[58] See IRC § 4940; See Ltr. Rul. 9341008 (July 14, 1993) and Ltr. Rul. 9838028; also see a different result for IRD from savings bonds under Rev. Rul. 80-118, 1980-1 CB 254.

✓ *Testamentary Outright Gift to Nonprofit Organization*

One of the simplest ways to maximize distributions from retirement plans is to name a charitable organization as beneficiary of all or part of the remainder. A distribution to charity of retirement assets at death (through beneficiary designation) avoids payment of both income and estate tax.

Generally speaking, when a client is making both charitable and non-charitable distributions from an estate, the charitable distributions should be made from IRD assets such as a retirement plan. The simple act of making a bequest from a retirement plan rather than the estate generally increases the net assets available for family. The distribution, especially when it represents only a portion of the assets, should be structured to preserve elections of the individual beneficiaries receiving the remainder of the retirement assets. Consider these three options.

- *Create a separate IRA* to hold the gift to charity, and designate the charity as the sole beneficiary of that IRA. While this is no longer necessary to maximize recalculation options, it may make the client's wishes clearer and to ensure the distribution is made prior to the required distribution date.

- *Designate a share of the IRA* to the charitable beneficiary(ies).

- *Make the assets payable to the estate and draft the will to specifically allocate the IRA to the charitable share.*[59] Consider this sample language:

  ✓ *An in-kind distribution* – "I direct that my IRA held at Merrill Lynch be distributed to XYZ Charity." Note: this alternative is also appropriate for other IRD assets such as savings bonds, accounts receivable, etc. This will have the effect of having the charity or CRT recognize the income from the IRD asset.[60] If the charitable recipient is a public charity or charitable remainder trust, no income tax will be due.

  ✓ *A non-pro-rata distribution* – A non-pro-rata distribution means that the will specifically directs that the IRD asset be allocated to a particular beneficiary's share rather than have it split on a pro-rata basis among all estate beneficiaries. Sometimes state law and/or the will may allow an executor the discretion to make non-pro-rata distributions. If this is the case, and the executor elects to distribute the IRD assets to charity, it may be possible to avoid taxable income on distribution.[61] However, if either the state law or the will gives the executor this power, a distribution of the IRD assets to a specific beneficiary may trigger the tax as a taxable exchange among the beneficiaries.[62] The safest way to do this is to address the issue directly.

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[59] PLR 200452004 ruled an estate's assignment of IRAs to a charity as part of the residuary share of an estate would not cause the estate (or any estate beneficiary) to have taxable income.

[60] IRC § 691(a); Reg. § 1.691(a)-4(b)(2); Rev. Rul. 64-104, 1964-1 C.B. 223.

[61] Ltr. Ruling 9537011 (June 16, 1995).

[62] Rev. Rul. 69-486, 1969-2 C.B. 159.

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- ✓ *Language directing that the bequest be made with IRD assets to the extent possible* – This language provides the greatest protection. The will might say: "I instruct that all of my charitable gifts, bequests and devises shall be made, to the extent possible, from property that constitutes 'income in respect of a decedent' as that term is defined in the Internal Revenue Code."[63] This allows the executor to claim a deduction for the IRD in the portion of the IRD assets passing to charity. Without the language, the estate is limited to an estate tax deduction for the property and will not be able to claim an income tax deduction.[64]

Retirement plan proceeds should not be used to satisfy a debt or pledge, such as a capital campaign obligation. If plan proceeds are pledged on an enforceable debt or loan, the estate will be required to pay tax on the distribution.[65] Also remember that spousal consent is required for distributions from corporate retirement plans that are not paid to the spouse. Spousal consent is not required for distributions from IRAs.

✓ *Testamentary Gift in Exchange for Charitable Gift Annuity*

In an important 2002 ruling,[66] the IRS allowed a taxpayer to name a charity as the designated beneficiary of an IRA in exchange for a testamentary charitable gift annuity payable to a named individual beneficiary. Previous to this ruling, the IRS had approved designating a charitable remainder trust as the beneficiary of an IRA, but had not ruled on a similar arrangement with a charitable gift annuity. In this ruling, the court made four determinations: the IRA would not generate unrelated business income for the charity, the IRA would be included in the owner's gross estate for estate tax purposes, the estate could claim a deduction for the charitable portion of the charitable gift annuity, and the IRA proceeds would be income in respect of a decedent (IRD) to the charity, not the owner's estate. Unfortunately, the IRS did not discuss the potential IRD impact on the annuitant. This ruling adds a simpler option for IRA owners who want to create a life income arrangement for an heir at death.

✓ *Testamentary Gift to Charitable Remainder Trust*

Another way to structure retirement plan distributions is create a testamentary charitable remainder trust for the benefit of family members. Since a charitable remainder trust does not pay tax, the retirement assets are not subject to income tax.[67] Then, the estate will receive a charitable deduction for the charitable portion of the charitable remainder trust. Table 12 compares the result of an outright gift of a $250,000 retirement plan to family (for a $4,000,000 estate) and the gift of that retirement plan to a

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[63] This language was recommended by Professor Christopher Hoyt, professor of law at the University of Missouri (Kansas City) School of Law in a presentation made at the National Conference on Planned Giving in October, 1999.

[64] *Crestar Bank v. IRS*, KTC 1999-279 (E.D. Va. 1999); *Van Buren v. Commissioner*, 89 T.C. 1101 (1987); *Riggs National Bank v. U.S.*, 352 F.2d 812 (Ct. Cl. 1965).

[65] *John T. Harrington Estate*, 2 TCM 540, Dec. 13, 1943, 405 (M)

[66] Ltr. Rul. 2002230018.

[67] Although it is important to note that the retirement plan distributions are considered to be Tier I income and may impact the taxation of payments to beneficiaries of the charitable remainder trust.

5%, 20-year charitable remainder trust for family. The calculation assumes the gift was made in April 2012 (1.4% CFMR).

If the spouse is named as the sole beneficiary of the charitable remainder trust, his or her interest will qualify for the marital deduction[68] so that estate tax is avoided altogether at the taxpayer's death. The assets can then distribute income annually to the decedent's wife, or children. If the sole beneficiary is the decedent's spouse, a marital deduction is available so that all taxes are avoided.[69]

TABLE 9
COMPARISON OF $250,000 RETIREMENT PLAN TRANSFERRED TO FAMILY AND TO 20-YEAR 5% CRUT (ASSUMING $4,000,000 ESTATE, 35% TAX BRACKET, 15% CAPITAL GAINS BRACKET)

	$250,000 Bequest of Retirement Plan to Family	*$250,000 Bequest of Retirement Plan to 5%, 20-Year CRUT*
Total Estate	$4,000,000	$4,000,000
Total Taxes on $250,000 Retirement Plan	$87,500	$0
Effective Income Tax Rate on Retirement Plan (federal taxes only)	35%	$0
Net Bequest	$162,500	$250,000
Net Savings vs. Bequest		$87,500

4. Options for Savings Bonds

U. S. Savings Bonds, first introduced in 1935, are a widely held asset. More than 55 million Americans own savings bonds with a value in excess of $186 billion.[70] Since many of these bonds have accrued, untaxed interest, these assets are popular for testamentary charitable planning.

There are three types of savings bonds issued by the United States Government: Series EE/E Bonds, Series I Bonds, and Series HH/H Bonds.[71]

- ✓ *Series EE Bonds.* Series EE Bonds (formerly Series E Bonds) are savings bonds issued at a discount by the U.S. Government.[72] For example, a purchaser pays $50 to purchase an EE Bond with a $100 face value. The bond matures at face value and then continues to accrue interest for

[68] IRC § 2056(b)(8).

[69] Ltr. Rul. 9253038.

[70] <www.aarp.org/financial-investsave/Articles/a2002-10-08-ussavingsbonds.html>.

[71] For detailed information on United States Savings Bonds, go to <www.publicdebt.treas.gov/sav/sav.htm>.

[72] For savings bonds redemption values, six month earnings as an annual yield, and yield from issue date for Series EE/E bonds can be found at www.publicdebt.treas.gov/sav/savreport.htm>>.

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up to 30 years.[73] Purchasers can elect to report the accrued interest on the bonds annually or to defer recognizing income until redemption; most chose to defer. When holders of Series EE/E Bonds with deferred income contribute the bonds to a charity during life, the gift is valued at the full fair market value of the bond (rather than the discounted value paid for the bond), but the donor must report the accrued interest (as ordinary income) in the year of the gift.[74] Conceptually, this is the opposite tax result from a gift of appreciated stock for which the donor receives a charitable deduction equal to market value and avoids the capital gains tax on the appreciation.[75] A donor would generally be better off to simply make a gift of cash.

Series EE Bonds could be converted to HH Bonds (see below) through August 31, 2004, without triggering tax on the accrued interest in the bond.[76] However, the bond could not be transferred to another (charitable or non-charitable) beneficiary at this point without triggering the tax.[77] Likewise, Series EE/E Bonds cannot be reregistered in the charity's name during life without triggering the tax. The only way to avoid recognition of ordinary income on these bonds is to transfer them to charity through a specific bequest under the will (or, if the bonds are held in a revocable trust, through a testamentary disposition to charity in that trust).[78] A specific bequest of the bonds will shift the accrued income to charity and avoid taxation as income in respect of a decedent in the donor's estate.[79] This is not possible when bonds are owned jointly with right of survivorship, since these bonds will pass to the survivor and will not be subject to the terms of the will. The survivor of the two interests may leave the bonds to charity under will.

✓ *Series HH Bonds.* Series HH/H Bonds are savings bonds issued at face value that pay annual interest. When donors contribute Series HH/H bonds to charity during life, the gift is valued at the full fair market value of the bond. If, however, the HH/H bonds have been converted from EE/E bonds (and the interest was deferred, rather than paid, on conversion), the gift to charity will trigger the deferred ordinary income accrued during the period the donor owned the EE/E bonds.[80] Until August 31, 2004, the owner had an option to reinvest interest on these bonds; that is no longer possible.[81]

✓ *Series I Bonds.* Series I Bonds are the most recent addition to the savings bond options. These bonds, first offered in September, 1998, are sold at face value and pay interest that is adjusted twice

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[73] Bonds purchased before November 1965 accrue interest for up to 40 years.

[74] Reg. § 1.170A-4(a)(3).

[75] Actually, the result is generally much worse, since the gain avoided on gifts of appreciated securities is long-term capital gain, while the income recognized on disposition of E or EE Bonds is taxed as ordinary income.

[76] <www.publicdebt.treas.gov/sav/savinvst.htm>.

[77] See Letter Ruling 8010082 for a discussion of this result.

[78] See Ltr. Rul. 8010082 (December 13, 1979) for further information on EE/H bonds. Also see Ltr. Rul. 9507008, where IRS ruled that savings bonds in a revocable trust with testamentary provisions used to discharge pecuniary bequest to charity triggered recognition of income in respect of decedent in the trust.

[79] IRC § 691(a)(1).

[80] Ltr. Rul. 8010082.

[81] <www.publicdebt.treas.gov/sav/savinvst.htm>.

a year to reflect increases in the Consumer Price Index for all Urban Consumers (CPI-U). Interest is compounded semi-annually. The bonds have a thirty year maximum, but may be redeemed for cash after a six-month holding period. The interest on the bonds is deferred for federal tax purposes during the life of the bond. The Bonds are exempt from state and local income taxes. The gain in these bonds is taxed as ordinary income in the year of maturity, redemption, or disposition. Therefore, these assets make poor gifts for charity during life, but make excellent gifts to charity under will.

Savings bonds may be owned in one of three ways: sole ownership, joint ownership, or sole with remainder beneficiary.[82]

- ✓ *Sole ownership* implies the bond is in a single individual's name; that bond will become a part of the owner's estate on death.

- ✓ *Joint ownership* gives full rights of ownership to both individuals. Either named owner can redeem the bond or exercise elections. Registering a bond jointly transfers ownership outside of the probate process at the first death; at the death of the survivor, the asset becomes a part of that individual's estate assets.

- ✓ *Sole ownership with a designated surviving beneficiary* leaves ownership rights with the registered owner, but names a beneficiary at death, again allowing the bond to bypass probate. This also allows a deferral of the tax on accrued income since the income will not be taxed until the bond is redeemed.

The accrued income in the bonds is classified as IRD. It is recognized when the bonds are disposed of, redeemed, or reach maturity, which occurs first.[83] The tax is generally paid by the named recipient. There is one exception to the rule. The executor may make an (irrevocable) election to report the interest on the decedent's final income tax return.[84] This option may create a better net result for the beneficiaries if the decedent's income tax rate is lower than the estate's. It is not recommended when a public charity (or private foundation) is designated to receive the bonds since it will result in payment of taxes when otherwise none would be due.

Savings bonds can be used in the same manner as retirement benefits in testamentary charitable plans. This includes the following options:

- ✓ Make a specific devise of the bonds to a public charity (no income or estate tax should be due), a private foundation (a 2 percent/1 percent tax is paid by private foundations on all income), a community foundation advised fund, or other direct charitable beneficiary. This is best accomplished by including specific language to this effect in the will.

- ✓ Make a specific devise of the bonds to a testamentary charitable remainder trust. The charitable estate tax deduction for the charitable portion of the gift (the non-income portion) will reduce the

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[82] See the Treasury web site cited earlier.

[83] Reg. § 1.691(a)-2(b); Rev. Rul. 4-104, 1964-1 C.B. 223.

[84] Rev. Rul. 68-145, 1968-1 C.B. 203.

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estate tax, and the charitable remainder trust's tax exempt status (a charitable remainder trust pays no tax unless the trust has unrelated business taxable income) allows it to avoid tax on the accrued bond income. To ensure this result, the savings bonds should be transferred to the charitable remainder trust and redeemed inside the trust. (If the bonds are redeemed by the estate, the income will likely be included on the estate's income tax return. It is unclear whether the estate can claim a deduction when the proceeds are then transferred to the charitable remainder trust.)

III. Ideas 3 and 4: The Family Business and Charitable Donors

A. The Family Business Market

The family business is the single most important asset held by many individuals – for financial and emotional reasons. The business may represent the family's most significant source of income and also contribute to its stature in the community. In addition, a first generation owner may feel the business represents his life's work, uniquely reflecting his or her business principles.

Family businesses – C Corporations, S Corporations, LLCs, LLPs, partnerships, and other less formal arrangements – are often the largest single asset of wealthy clients. Consider these statistics:

- Family businesses represent 80 to 90 percent of all business entities.[85]
- Family businesses contributed 64% of GDP and employed 62% of the U.S. work force.[86]
- The generational transfer attrition rate is high. 70 percent do not survive to the second generation; 88 percent do not make it to the third generation; and 97 percent do not make it to the fourth generation or beyond.[87]
- A surprising 19 percent of family business participants have not created an estate plan other than writing a will; only 37% have strategic plans; and 85% of those that have identified successors pointed to family members.[88]
- Leadership of 39 percent of family enterprises will change hands over the next five years.[89]

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[85] J. H. Astrachan and M. C. Shanker, "Family Businesses' Contribution to the U.S. Economy: A Closer Look," Family Business Review (September 2003); Isabella McPeak, Family Business Statistics in the US, www.peakfamilybusiness.com/2011/10/25/family-business-statistics-in-the-us.

[86] *Id.*

[87] Joseph Astrachan, Ph.D., editor, *Family Business Review*, www.ffi.org.

[88] University of Southern California Marshall School of Business, Facts On Family Businesses, <www.marshall.usc.edu>.

[89] Raymond Institute/MassMutual American Family Business Survey (2003).

- Wealth holders in family owned firms are interested in passing their wealth to the next generation, as well as their values. They want their descendants to earn their income and engage in philanthropy through giving and volunteering.[90]

B. Creating a Charitable Gift in Conjunction with the Sale of a Family Business

Many of today's business owners have built their own companies and own all or the majority of the stock in their non-publicly traded corporation. As the business owner reaches retirement age he often sells the business. As a part of this planning process, the small business owner should consider combining personal charitable goals with the disposition of the business by gifting some of the closely held stock to a charitable remainder trust. The capital gain on the shares gifted to the charitable remainder trust will not be taxed, and the charitable deduction can help shelter gain on shares sold outside the trust. The trust's shares can later be purchased by the purchaser of the business at a fair market value.[91] In the example shown in Table 10, the donor is age 68, and spouse is age 65, the gift occurs in August 2017 2.4% CFMR), the business has a total value of $5,000,000 and a basis of $1,000,000, and the gift to the 5% charitable remainder unitrust for their joint lives is $500,000.

TABLE 10
C CORPORATION STOCK TO CHARITABLE REMAINDER TRUST
$5,000,000 Market Value of Closely Held Business; $1,000,000 Tax Basis of Shares;
68 Year Old Donor with 65 Year Old Spouse; $500,000 5% Charitable Remainder Unitrust[92]

STEP ONE *$500,000, 5% CRUT*	*STEP TWO* *Sale of Remaining Shares to Purchaser*	*STEP THREE*
$500,000 Gift	$4,500,000 Sale	Purchaser buys $500,000 of stock from CRUT
$100,000 Tax Basis	($900,000) Tax Basis	
$179,970 CD	$3,600,000 Gain	
$25,000 First Year's Income	$720,000 Tax at 20%	

C. Creating a Charitable Gift When the Family Business Will Pass to the Next Generation

In another scenario, the closely held corporation may have many accumulated earnings that will be taxed to the recipient if distributed. In this case the charitably inclined business owner may want to contribute shares of the closely held stock to a charitable remainder trust. The closely held corporation can then use its accumulated earnings to buy back the stock and retire it as treasury stock. Key points include the following:

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[90] Bankers Trust Private Banking/Deutsche Bank, Wealth with Responsibility Study (2000).

[91] Note: You must avoid a prearranged/step transaction. There can be no repurchase agreement at the time of the contribution of the shares to the charitable remainder trust.

[92] Calculations made in October 2018 3.4% CFMR.

1. *If structured properly, there is no constructive dividend to the contributing shareholder and no adverse consequences to the corporation.*

2. The majority corporate owner/donor may still be the majority owner after the gift with planning.

3. *If the interest is less than a majority interest in the corporation, the IRS may require a minority discount be applied to the appraised value of the shares.*

4. *The redemption offer must be made to all stockholders. Even though all shareholders are offered the opportunity, the trust may be the only shareholder to redeem.*

5. There cannot be a prearranged sale agreement with this transaction.[93]

IV. Ideas 5 and 6: Gifts That Take Care of Family

A. Combining a Charitable Gift with Care of a Special Needs Family Member

Sometimes a parent or grandparent is faced with the responsibility of taking care of a disabled child. While federal or state medical assistance is available for those with no assets, families like to provide for special needs when possible without eliminating the possibility of outside coverage. In this case, the planner may want to couple a charitable remainder trust with a special needs trust.

A special needs trust involves a transfer of assets to a trust to make specific types of payments to the trust beneficiary without disqualifying that beneficiary for public assistance benefits such as SSI and Medicaid. There are three ways that this trust may be structured.

- It can be created by a family member, with the family member's funds, for the benefit of the disabled individual.
- It can be created through a court proceeding using the disabled individual's funds.
- It can be part of a pooled fund managed by charity.

✓ *A Special Needs Trust Created By a Family Member.* One of the most common approaches to creating a special needs trust is to create a trust for the benefit of a disabled individual using a family member's (not the disabled beneficiary's) funds. The trust must be created by a family member other than the trust beneficiary. In other words, Charles cannot take the assets left to him by his parents and create this type of trust. However, his parents could have created such a trust during life, or at death under their wills. The trust must also have a trustee, which can be

[93] For the latest ruling on the assignment of income issue, see *Gerald A. Rauenhorst, et ux. v. Commissioner, 119 T.C. 9 (7 Oct 2002)*. In these facts, the taxpayers owned stock in a closely-held company and warrants allowing the purchase of additional shares. The taxpayers were approached by a purchaser interested in acquiring taxpayers' stock and warrants. Following the purchase offer, the taxpayers assigned the warrants to four charities and sold their remaining stock to the purchaser. The four charities, in unrelated transactions, also sold their warrants to the purchaser. On audit, the IRS assessed the taxpayers with the capital gain on the warrants as an anticipatory assignment of income. The court dismissed the IRS claim, relying on the test in Revenue Ruling 78-197 that attributes income to the donor only if the donee, after receipt of the gift, is legally bound or can be compelled to sell. Since the charities had the option to sell, but were not obligated to do so, the capital gains were properly attributed to the charities.

anyone qualified to serve under state law other than the beneficiary. Once established, the trustee makes distributions to the beneficiary to meet the needs listed in the trust.

The government specifically recognizes special needs trusts, so long as they meet these requirements:

- It must be established by a family member (other than the beneficiary).
- It must be managed by a trustee (who is not the beneficiary).
- It must give the trustee absolute discretion to make distributions.
- It should not give the beneficiary more income or resources than permitted to qualify for benefits.
- It can only be used to provide supplementary needs.
- It must provide instructions for final arrangements (funeral expenses).
- It directs what will happen to assets left in the trust at death.
- It must protect assets from credits or agencies seeking funds to pay debts of the beneficiary or beneficiary's family.

✓ *Special Needs Trust Created by the Court*. Sometimes an individual who is disabled enough to qualify for social security owns assets and needs protection. In these cases, a special needs trust can be established by the disabled person's parent, grandparent, legal guardian or the court. This type of trust is permitted only if the individual is under age 65 at the time of creation of the trust. The trust is structured to make the same forms of discretionary payments but has one major distinction. At the death of the beneficiary, the funds remaining in the trust must first be used to repay any benefits that have been paid on the beneficiary's behalf.

✓ *Pooled Trusts*. Non-profit organizations in some states offer pooled special needs trusts. These non-profit serves as trustee, manages the money, and makes the distributions to the beneficiary. At the beneficiary's death, any remaining assets are held for the benefit of other disabled individuals. This type of trust can be funded by the beneficiary or the beneficiary's parents. However, all assets are transferred to the trust and are owned by the nonprofit.

The trust may make payments that contribute to the quality of life, rather than the essentials of life – such as vacations, eye glasses, a motorized wheelchair, or entertainment – but should not make payments for basic needs (housing, food, clothing) or fixed monthly payments that exceed set income limits. If it does, government benefits may be reduced or eliminated.

There have been several letter rulings from the IRS that allow a donor to pay the income stream of a charitable remainder trust to a special needs trust (or to make the distributions from the trust to meet special needs).[94] Normally, the charitable remainder trust distribution must be paid directly to the individual. Under the rulings, the distribution was allowed to be paid to a special needs trust, which then distributed the funds in a discretionary fashion to the disabled beneficiary. This allows a donor to create a charitable remainder trust to benefit both the disabled child as well as the charity.

[94] See, for example, Revenue Ruling 76-270, 1976-2 C.B. 194.

There is one caveat. This plan requires creation of two trusts: a special needs trust and a charitable remainder trust.[95] Further, taxpayers cannot rely on a letter ruling and must obtain their own ruling to be safe. Therefore, this arrangement is a bit more expensive than the normal trust creation.

B. Caring for Parents Using Charitable Gifts

An increasing use of charitable remainder trusts and gift annuities is to fund needs of elderly parents. Increasing nursing home costs and health care costs often result in an unanticipated depletion of assets requiring that children fund the cost of lodging and care. Create a charitable remainder trust with an income stream to the parents. This allows a child to receive a charitable deduction for the gift and to provide a stream of income to a parent. Gift tax must be paid (or unified credit used) on the value of the income stream created for the parent. In this example, the children created a $100,000 6.2% charitable gift annuity for the joint lives of parents, ages 78 and 82. This gift occurred in October 2018 3.4% CFMR. The results are shown in Table 11.

TABLE 11
$100,000 6.5% CHARITABLE GIFT ANNUITY FOR AGES 78 AND 82

Principal Amount	$100,000.00
Charitable Deduction	$ 442,241.00[96]
Annual Income to parents (6.2%)	$ 6,200.00
Tax-free portion	$ 4,476.40
Ordinary income portion	$ 1,723.60

V. Idea 7: A Gift to Fund Retirement in Retirement

It is easy to understand the popularity of charitable gift annuities as a planned giving option.

- Charitable *gift annuities are easy for charities to explain and donors to understand.*
- The *gift provides the donor with a guaranteed, specific income stream*. Often this income stream is higher than the donor can receive from a certificate of deposit, a U.S. Treasury bond, or other investment.
- The *transaction is part gift*, meaning that in creating a charitable gift annuity the donor also makes a gift to a favorite charity.
- The *gift generates a charitable income tax deduction for the donor* in the year in which the gift is made[97]
- The *transaction creates beneficial capital gain treatment* for the donor who contributes appreciated property.

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[95] For a ruling involving discretionary payments from the charitable remainder trust (without creating a separate special needs trust, see Revenue Ruling 77-73, 1977-1 C.B. 175.

[96] The gift portion is $56,552.

[97] Gift annuities involve an outright gift to charity deductible under IRC § 170(c). The contract element of the life interest is addressed in IRC §§ 501(m)(3)(E), -(5),514(c)(5).

- *Creating the gift is simple*, requiring a one or two-page governing instrument supplied by the charity.

Many retired individuals – or those planning for retirement – create charitable gift annuities to generate more income. In this example, Doug and Anita Jones, ages 70 and 71, used a maturing certificate of deposit to create a charitable gift annuity. The certificate of deposit had a renewal rate of .75% ($187.50); the charitable gift annuity provided an annuity of $1,250 (5%). In addition, $426.25 of the charitable gift annuity payment is ordinary income, while the remaining $823.75 is tax-free return of income.

TABLE 12
CHARITABLE GIFT ANNUITY FOR COUPLE AGES 70, 71[98]

Contributed amount:	$25,000.00
Charitable deduction:	$ 8,445.00
Annuity amount (5.0%)	$ 1,250.00
Tax-free payments:	$ 823.75
Ordinary income:	$ 426.25

VI. Idea 8: Selecting the Right Asset

There may be times your client wants to make a charitable gift but does not have sufficient cash to do so. Sometimes the best asset to contribute – even if cash is available – is non-cash property such as real estate, securities or even a life insurance policy.

Selecting the right asset is an important element of gift planning. To pick the right asset, consider the donor's dependence on the asset or its income, the form of the gift, the tax benefits and the cost of making the gift. The following assets are most commonly used to make gifts in lieu of cash.

Marketable securities – Marketable securities (stocks and bonds) are appropriate for almost every type of gift. Publicly-traded stocks are the single most popular non-cash gift. Stocks often contain long-term appreciation, generate little income (on average, about 1.3%) and can easily be sold on receipt. The gift generates a charitable income tax deduction for the market value of the stock and allows the donor to avoid capital gains tax on the appreciation. Bonds are used to make gifts less frequently. Bonds generally have a higher income stream than stocks or cash and contain little or no appreciation. While bonds may be used to make gifts if cash is not available, they may not create as great a tax benefit for the donor as appreciated stock.

Privately held securities – Privately-held securities may be the single largest asset held by some clients. These securities make good assets for outright gifts, testamentary gifts and even charitable remainder unitrust gifts as long as there is some market or mechanism for sale after contribution. Always check with the charity before contributing privately-held stock since some will not accept this asset for pooled income funds or charitable gift annuities because of uncertainty of the timing and proceeds of sale. For the same reason, privately held securities may not be appropriate for a charitable remainder annuity trust unless the trust has other assets with which to make the annuity

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[98] Calculations made in August 2017, 2.4% CFMR..

payment. The donor is required to obtain a qualified appraisal establishing the value of privately-held securities when the gift exceeds $10,000.

Real estate – Real estate (including commercial, residential, undeveloped land, timber, and oil and gas interests) makes an excellent outright gift, testamentary gift or contribution to a charitable remainder unitrust (with net income, net income with makeup or flip provisions), or even a deferred charitable gift annuity. Real estate is not generally appropriate for gifts to create a standard charitable gift annuity, charitable remainder annuity trust or pooled income fund because of the uncertainty of the asset's sale timing and proceeds. The donor is required to obtain a qualified appraisal when the gift exceeds $5,000 and is generally required to supply an environmental assessment. The donor should also be prepared to supply details on the costs associated the property including taxes, maintenance and other costs.

Life insurance – Life insurance is an excellent gift for donors who have old policies that are no longer needed for protection of family or those who want to purchase a new policy to ensure a specific gift to charity at death. When the donor contributes an existing policy to charity, he receives a deduction equivalent to the policy's replacement value. Since the policy has no publicly established value, he must obtain a qualified appraisal when that value exceeds $5,000. If he contributes cash to the charity to purchase a new policy, he may deduct the cash contribution and any additional contributions made to make premium payments.

Tangible personal property – Collectibles, art or other tangible property may also make good assets for outright gifts, although they are poor choices for life income arrangements. The uncertainty of the timing and proceeds of sale make charities unwilling to accept these assets for charitable gift annuities or pooled income funds. In addition, the related use rule limits the deduction to the donor's basis unless the gift is used by the nonprofit in fulfilling its mission, and personal property gifts contributed to charitable remainder trusts are generally not deductible until sold. Donors are required to obtain qualified appraisals for gifts in excess of $5,000.

VII. Ideas 9 and 10: Gifts Where Gift and Estate Taxes Are Not an Issue

The Tax Reform Act of 1969[99] created massive changes in the structure, form, and treatment of charitable entities, creating strict forms, tax structures, and operating rules for private foundations and charitable remainder trusts. These laws have created stress for planners over the years because it took expertise to get the forms and documents within the guidelines, and was even more limiting in the assets appropriate for entities and the effective long-term operation. Individuals who wanted to add a personal trust to their foundation or trust structure quickly found these creatures of the tax code allowed little variation or personalization.

Traditionally, few taxpayers have been affected by the estate tax. In the Summer 2005 *Statistics of Income Bulletin*, the IRS reported 1.17% of the 2.4 million decedents who died in that year had taxable estate returns. In that year, estate tax return filing was required with a gross estate of $1 million or greater. See Table 15 for an historical perspective on the number of decedents required to file estate tax returns, and the percentage of taxable returns.

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[99] Pub. L. 91-172, title IV, § 901(c), Oct. 22, 1986, 83 Stat. 618.

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TABLE 15
POPULATION AFFECTED BY ESTATE TAX
SELECTED YEARS BETWEEN 1934 AND 2001[100]

Year	*Number of Deaths*	*Estate Tax Returns Filed*	*Number of Taxable Returns*	*% of Deaths Requiring Estate Tax Returns/Taxable*
1934	983,970	N/A	8,655	NA/.88%
1935	1,172,245	N/A	9,137	N/A/1.08%
1940	1,237,186	N/A	13,336	N/A/1.12%
1944	1,238,917	N/A	13,869	N/A/1.12%
1950	1,304,343	N/A	18,941	N/A/1.45%
1954	1,332,412	N/A	25,143	N/A/1.89%
1960	1,426,146	N/A	45,439	N/A/3.19%
1965	1,578,813	N/A	67,404	N/A/4.27%
1969	1,796,055	N/A	93,424	N/A/5.2%
1976	1,819,107	N/A	139,115	N/A/7.65%
1982	1,897,820	N/A	34,426	N/A/1.81%
1985	2,015,070	N/A	22,326	N/A/1.11%
1990	2,079,034	50,367	23,104	2.42%/1.11%
1995	2,252,471	69,755	31,563	3.1%/1.4%
1996	2,314,690	79,321	37,711	3.42%/1.63%
1997	2,314,245	90,006	42,901	3.89%/1.85%
1998	2,337,256	97,856	47,475	4.19%/2.03%
1999	2,391,398	103,979	49,863	4.35%/2.09%
2000	2,403,351	108,322	52,000	4.5%/2.16%
2001	2,363,100	Unknown	49,911	Unknown/2.11%
2002	2,363,100	Unknown	49,911	Unknown/1.17%

Going forward, even fewer decedents will be affected by estate tax. The Center on Budget and Policy Priorities estimated that only .25% of all decedents who died in 2009 with a $3.5 million exclusion

[100] All figures from 1934 through 1985 from Internal Revenue Service, fall 2002 Statistics of Income Bulletin, Table 17, Estate Tax Returns as a Percentage of Adult Deaths, Selected Years of Death, 1934-1999; number of deaths data 1996-1999 from National Vital Statistics Report, Vol. 49, No. 8, September 21,2001, p. 16; 2000 death figures from National Vital Statistics Reports, Vol. 51, No. 5, March 14, 2003, p. 3; data on estate tax returns filed 1990 through 2000 from Spring 2004 Statistics of Income Bulletin, “Federal Estate Tax Returns 1998-2001”.

were subject to estate tax.[101] In the new era of $11,800,000 exclusion amount (for 2018 - the figure is indexed for inflation) amounts for each individual for gift and estate purposes, it is possible for a couple to transfer $23.6 million without incurring estate, gift, or generation skipping tax. Since this limit will cover the transfers for the vast majority of all American taxpayers, those taxpayers are not free to pursue charitable gifts and create charitable structure without using traditional charitable gift forms.

A. Partial Interest Gifts - a World of Flexibility Without the Need for the Charitable Deduction

Under current law, a charitable deduction is not generally allowed for a gift of less than an entire interest in property.[102] For example, a donor who allows a charity to use a building rent-free has not made a charitable gift, since the leasehold is a partial interest in the property.[103] A donor who gives his paintings to a museum, retaining the right to hold those paintings for life, has not made a charitable gift because he has transferred less than a full interest in the paintings. There are some partial interest gifts that do qualify for a charitable deduction:

- Charitable gift annuities (technically a bargain sale);
  - Must have a charitable value of at least 10% at funding
  - Annuitants are limited to two lives
  - Contract must be fixed income for life (income may not vary)
- Charitable remainder annuity trust or charitable remainder unitrust[104]
  - Must have a charitable value of at least 10% at funding
  - Cannot be funded with mortgaged property
  - If funded with a personal resident, the donors/owners cannot continue to live in the property even if they pay a far rent because of of self- dealing rules (private foundation prohibited transaction rules)
  - Charitable remainder trusts are also subject to other prohibited transaction rules including jeopardizing investments and taxable expenditures
  - Flip unitrusts “flips” cannot be within the discretion of the trustee
- Pooled income fund;
  - May only be offered by publicly support IRC §501(c)(3) entities;
  - Variable income - whatever is produced by the units
- Charitable lead annuity trust or charitable lead unitrust (grantor and non-grantor forms);[105]
  - Prohibitions against self-dealing, excess business holdings, joepardizing investments, taxable expenditures
  - Generally do not use donor or spouse as Trustee if the goal is to remove assets from estate (non-grantor)

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[101] Center on Budget and Policy Priorities, www.cbpp.org.

[102] IRC §170(f)(3)(A).

[103] Reg. §1.170A-7(a).

[104] IRC §170(f)(2)(A). *See* Chapter 11 for more detail on charitable remainder trusts and pooled income funds.

[105] IRC §170(f)(2)(B). *See* Chapter 11 for more detail on charitable lead trusts.

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- A remainder interest in a home or farm;[106]
    - Not allowed for commercial, undeveloped, or similar investment property
    - Charitable deduction may not include personal property
- An undivided portion of the donor's entire interest;[107] or
    - Must be an undivided portion of all interests - cannot separate income from underlying property interest
    - Cannot direct that income be separated for a term of years or a life
- A qualified conservation easement.[108]

Partial interest gifts that do not qualify include the following:

- *Gifts of future interests.* A gift of a future interest in a property is not deductible until all intervening interests in the assets or rights to possession or enjoyment of the property have expired or are no longer held by the donor or related party.[109216] However, a gift subject to a condition or event so remote as to be negligible will not be disqualified.[110]

- *Gifts divided for the purpose of transfer.* The donor does not receive a charitable deduction for a gift that has been divided for the specific purpose of making a gift of a partial interest to charity.[111]

- *Work of art separated from copyright.* An artist may not receive a deduction for a work of art that is separated from its copyright for income tax purposes, although such a gift is deductible for estate and gift tax purposes.[112] A donor may own both the copyright and the original work - or just one of those. A creator/author or widow/widower, child or grandchild who inherited just the copyright or the original work and the copyright - by federal law retains the right to revoke a gift/grant of a copyright - so a lifetime gift of the copyright or the copyright and the original work is not a gift of the donor's entire interest, so no income or gift tax deduction is allowed. A copyright owned by a third party ho did not inherit the copyright may give all or an undivided portion of the copyright to a charity, and if the donor owns both the copyright and the original work, the the donor must give both the copyright and the original work to charity for the gift to be deductible.[113]

- *Patents.* A gift of less than the entire interest occurs when the owner retains the right to license the patent to others, manufacture or use any product covered byt he patent or places conditions

[106] IRC §170(f)(3)(B)(i).

[107] IRC §170(f)(3)(B)(ii).

[108] IRC §170(f)(3)(B)(iii).

[109] Reg. §1.170A-5(a)(1); "related" is defined in IRC §§267(b), 170(a)(3).

[110] Reg. §1.170A-14(g)(3).

[111] Laura Hansen Dean, presentation to the Houston Planned Giving Council, November 2012.

[112] IRC §2522(c)(3) (gifts) and IRC §2055(e)(4) (estates). Indeed, artists are not allowed an income tax charitable deduction for their works of art because those gifts are tangible personal property and limited to basis.

[113] A creator

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on the gift that would result in the patent being returned to the donor (unless the likelihood of that return is so remote as to be negligible).[114]

- *The right to use property at less than fair market rental.* Current there is not an income tax deduction or gift tax deduction because this is a non-qualified partial interest gift.

Examples of options for donors:

- An individual can make a gift of the income from stocks to a family member for life, and then the transfer of the assets and income to charity.
- An individual can transfer the income from an investment portfolio to charity for a term of years, with remainder to family.
- A donor can devise surface rights to a charity, with mineral rights to heirs.
- A donor can devise a percentage interest in a business' profit without transferring ownership (and absolving the charity from a share of the costs or obligations).
- Can give a museum a share of the interest in a collectible, or the right to display it for a portion of the year.

While most of these non-qualified gifts will not qualify for income tax deductions or estate tax deductions, the estate tax deduction is no longer important for the vast majority of the decedent population and creates opportunities through estates to transfer interests in non-qualified ways to meet personal planning goals.

B. Irrevocable Trusts with Charitable and Non-Charitable Beneficiaries

Combining personal and charitable goals becomes much easier when creating irrevocable testamentary trusts when the decedent has no concerns about estate and gift tax. Charitable remainder trusts and charitable lead trusts are rigid vehicles, and somewhat limiting in terms of contributed assets, required ranges of distributions, and the prohibited transaction rules applicable to these entities. If the donor is working in a testamentary environment and is not worried about estate tax, why not simply create an irrevocable split interest trust that fits the donor's goals? The trust can provide for payments or income and/or principal to the decedent's family members, heirs, or other beneficiaries and distribute the remainder to charity. Or, it can make payments to charities and/or individuals for a period of time (as determined by the decedent's spouse or other trustee) and then terminate to the donor's designated beneficiaries. In these situations, the focus should be on designing a set of distribution powers and terms that can be effectively administered, and managing the income tax consequences inside the trust. (If these are irrevocable trusts they will likely be taxed as complex trusts.)

Be careful with lifetime charitable split-interest gifts, however. If the gift does not qualify for the charitable deduction, the donor will have created a taxable gift. For example, the donor will lose the benefits non-taxable trust benefits of charitable remainder trusts, and the income tax benefits associated with charitable gift annuities.

C. Revocable Trusts

Revocable trusts are already used by many individuals to serve as their family giving platform. In this arrangement, the donor creates a revocable trust, transfers assets to the trust, assigns it a name

[114] *Id.*

representing the family, and then gathers the family each year to make decisions about gifts to charities. While the donor receives no deduction when the trust is created, they maintain control over annual distributions. Annual distributions to charitable entities (under IRC §170(c)) qualify the donor (the grantor) for a charitable deduction. When additional funds are needed or the trust runs low, the donor simply transfers more money. These trusts often have a testamentary provision that either transfers the funds to family or to a donor advised fund for family, or even another entity. Or, the decedent/donor can transfer ownership to descendants leaving the trust in a revocable form, or direct that the entity become irrevocable at death.

The advantage of this approach is the creation of a formal platform that can be used to teach family members how to be effective philanthropists, and the flexibility it allows a family in both the timing and amount of its annual distributions. Using a donor advised fund platform offers similar flexibility, but a private foundation platform requires minimum annual distributions and has other restrictions. The disadvantage is that the assets belong to the donor and are not shielded from creditors, and individuals do not have as wide a variety of giving options as private foundations afford.[115]

VIII. Final Thoughts

Effective planning is about meet client goals. Charitable planning allows the planner to combine goals to create the most effective result. Charitable planning after AFTRA 2012 offers many opportunities to meet donor needs, and provide a tax-reduction incentive. Incorporate questions about charitable goals in your intake questionnaire, and call any of today's sponsoring charities for more information or help in gift planning.

[115] For example, private foundations may make grants to individuals and non-501(c)(3) foreign entities so long as the foundation exercises expenditure responsibility.

APPENDIX A
INDIVIDUAL GOAL SETTING WORKSHEET

Setting goals for care of family and distribution of funds is important. Use this chart to list your goals, and indicate the dollar figure required to fund those goals.

Priority	*Goal*	*$$ Required*
	Provide for personal lifestyle.	$
	Provide for family care and lifestyle.	$
	Provide for assets for children. Note: determine if that gift should be outright or in trust.	$
	Provide for assets for grandchildren.	$
	Provide for elderly parents or family.	$
	Provide for family members with disabilities or other special medical needs.	$
	Provide for charities supported during life.	$
	Provide for the U. S. Government's programs and activities through a gift to the Internal revenue Service.	$
	Other	$
		$
		$
		$
	TOTAL:	