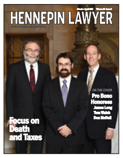

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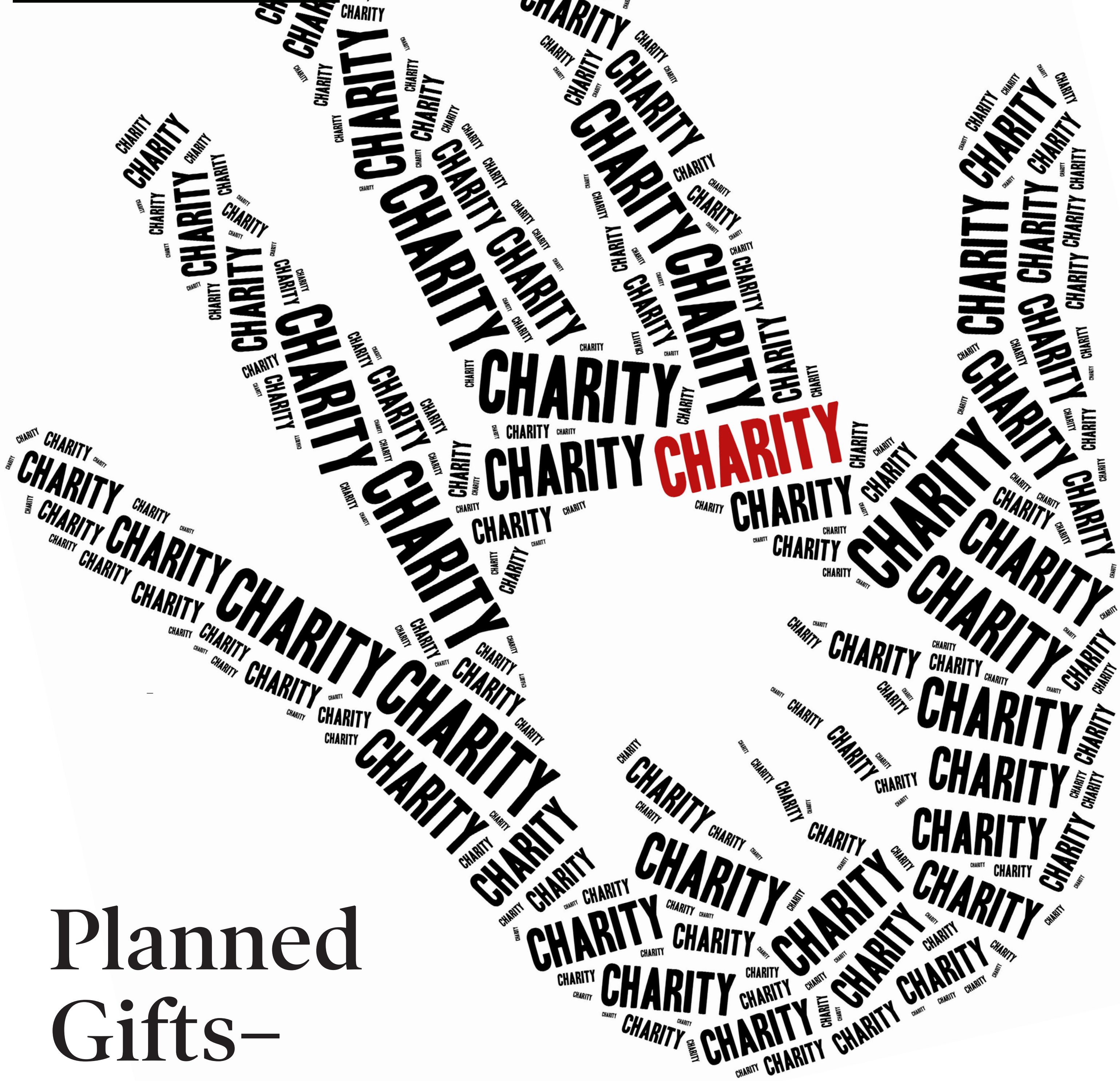

Planned Gifts–Legacy Makers

by Susan Link and Ann Wilczynski

Black's Law Dictionary defines a "planned gift" as "any charitable donation that is given by the donor, after creating a proper plan for it. Usually, planned giving is mentioned in the will of the departed." The common understanding of "planned giving" is using an estate plan[s] to remember and support favorite charities by making gifts to named charities, of a certain dollar amount or as a percentage of the assets of the estate, in a will or trust document. For some donors, these gifts are a continuation of their habit of lifetime gifting, while others are making their first significant gift at the time of their death. Whatever the size of an estate, including charitable organizations as a beneficiary in estate planning documents not only continues (or creates) a legacy, but it also may provide income and estate tax benefits to an estate (and therefore, the heirs of the estate).

While the focus of this article is on the benefits of gifts of retirement assets or insurance proceeds, as well as the types of trusts used to fund gifts to charities, charitable organizations increasingly are capable of accepting other assets (for example, real estate or operating businesses). Estate planners should not limit their planning discussions, therefore, to their clients' liquid assets; both the clients and the charities they hold dear could well appreciate it.

As the baby boomer population ages, it has been estimated that more than 30 trillion dollars will pass from the baby boomer generation in the next 10 years.[1] Most charitable organizations are well aware of this statistic, and if baby boomers are included in the demographic of their supporters, in addition to receiving lifetime donations, these charities would also like to be remembered in these donors' estate plans. Some charitable organizations have become quite creative in reaching out to, and educating, prospective donors about the benefits of including charitable beneficiaries in their estate planning documents. At one time or another, we have all received one of those well-thought-out mailings reminding us about all of the ways we could benefit a certain charitable organization. When the planned giving committee of a well-known northern Indiana university was brainstorming about how to reach all of the aging football fans that would be coming back to campus for the upcoming home football games, a suggestion was made that the committee should hire one of those small planes that have a message flying behind it that would read: "You kick off—We receive." Though very original, the university did not bless the idea.

The most common type of planned gift is one that is made through a specific gift to a charity in a decedent's will or trust agreement. This is accomplished through the inclusion of a specific bequest of an asset, such as: "I give all of my 3M stock to Greater Twin Cities United Way," or through a designation of a certain dollar amount, such as: "I give $10,000 to the University of Minnesota."

It is possible, however, to make planned gifts via beneficiary designations. Most people realize that when a distribution is taken from a retirement asset, income tax will be due on such distribution. However, many people do not realize that distributions made directly to a tax-qualified charity from retirement assets are not subject to income tax. A common way people utilize this benefit is by making planned gifts to named charities directly from retirement savings. This is accomplished by naming the charity as a beneficiary of a retirement asset. Note that this is greatly preferred to naming your "estate" as the beneficiary and then using retirement assets to fund a charitable bequest in your will or trust. If an "estate" is named as the beneficiary of a pre-tax asset (like a retirement account), the "estate" will have to pay the income tax on that asset, possibly reducing the amount that the charity, or the other beneficiaries, will ultimately receive.

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More and more frequently estate planners are recommending that clients include charitable gifts in the beneficiary designations on their retirement accounts and life insurance policies, "Transfer on Death" beneficiary designations on brokerage accounts, and "Pay on Death" beneficiary designations on bank accounts. As explained in the preceding paragraph, including a specific gift to a charitable organization or organizations as a named beneficiary of a retirement asset, such as an IRA or 401(k), is a great strategy to maximize the tax efficiency of a client's giving. Client can simply list a charity or charities on the beneficiary designation form provided by their employer or IRA administrator, and specify the dollar amount or percentage of the assets they would like the charity to receive. (The same holds true for making gifts of life insurance proceeds.) If the retirement asset has not previously been subject to income tax (such as 401(k) contributions), upon death, the assets will pass to the designated charity without income tax ever being paid. The client's estate may also be able to take a charitable estate tax deduction for this gift, reducing the amount of estate tax paid by the estate. This is also a very flexible way to designate charities, as the procedure to accomplish changes only involves contacting the retirement plan administrator, financial advisor, or life insurance representative, in order to obtain Change of Beneficiary forms. Clients do not need to contact attorneys to draft codicils to their wills or amendments to their trust agreements in order to make the gift, or to facilitate a change in the charities that they wish to benefit in their estate plans.

When clients are making charitable gifts through their estate plans, it is very important to make sure that they are naming the correct charity. A good example of this is a local charity that is often incorrectly named — "the Basilica." There are, in fact, two separate entities that are commonly called "the Basilica." Many clients assume that if they just name "The Basilica," their donated funds will end up in one place and be used where needed most. However, the Basilica of St. Mary (i.e., the parish) and the Basilica Landmark (an entity separate from the parish, with its own mission) are two very separate and distinct legal entities, and if clients want to benefit the Landmark, as opposed to the parish, they need to make sure that the correct entity is designated. The best way to ensure that a client's gift gets to the right place is to check the charity's website or speak with someone in the charity's development office to obtain the correct wording.

Sometimes clients are concerned that if they are not creating some type of permanent endowment, it is not worth the trouble of making "smaller" planned gifts. As noted above, if a gift is made through a beneficiary designation on a retirement account or a life insurance policy, there is no "cost" to make the gift (meaning that you do not need to hire someone to help you draft the will or trust that will accomplish the gift. You also do not have to hire someone to help you change it later). The gift can simply be made on the beneficiary designation form. And, there are not normally any restrictions on how many organizations you can designate. There are so many smaller, 501(c)(3) charities that greatly benefit from a gift as small as $250. For instance, to a wholly volunteer organization such as the Minnesota Wills for Heroes Program, that $250 donation could purchase eight ink cartridges and a case of printer paper. You would be amazed to see what relatively small amounts of money, when leveraged, can do in our community. So, if your clients appear charitably inclined, encourage them to include charitable gifts in their estate plans, no matter the amount.

Besides the relatively simple ways to accomplish charitable gifts in a client's estate plan, there are several more involved, ways of accomplishing a client's charitable goals through estate planning documents. Some goals are achieved through lifetime gifts to irrevocable charitable trusts and contributions to gift annuity programs. Others are accomplished at death through the creation of testamentary charitable trusts. And though they are more involved and usually require the assistance of an attorney to draft the documentation and an accountant to file the tax return, if a client's attorney is not comfortable creating the necessary documents, most charities have attorneys that are willing to assist with the drafting. Two of the more common trusts used to accomplish a client's charitable gifts are a charitable remainder trust and a charitable lead trust.

Charitable Remainder Trust

This is a type of irrevocable trust that pays either a fixed annuity or a percentage of the trust assets to an individual beneficiary, or joint beneficiaries, for a term of years or for the individuals' lifetimes, with the remaining assets passing to charity at expiration of the specified time period or the beneficiary's death. Upon the expiration of the trust term, the remainder interest must be either held by the trust for charitable purposes or paid to or for the use of a charitable organization.

A charitable remainder trust can take two basic forms: (1) a charitable remainder *annuity* trust (CRAT) and (2) a charitable remainder *unitrust* (CRUT). With a charitable remainder annuity trust, the donor transfers property to the trustee and in return receives regular payments from the trust in a fixed sum, which must be at least 5% and not more than 50% of the fair market value of the assets at the time that the assets are contributed to the trust. The annuity payment remains fixed for the life of the trust. No additional contributions to the trust are permitted after the initial contribution. With a charitable remainder unitrust, the payments are a fixed percentage of the trust assets, which must be at least 5% and not more than 50% of the fair market value of the assets, as valued annually by the trustee. Additional contributions can be made to a unitrust.

The primary differences between a CRAT and a CRUT are (1) the payment of a fixed sum (with the CRAT), as opposed to an amount which may change annually (with a CRUT); and (2) the inability to make additional contributions to a CRAT versus the ability to make additional contributions to a CRUT.

When assets are transferred to a charitable remainder trust during a donor's lifetime, the donor is entitled to a charitable income and gift tax deduction for the fair market value of the remainder interest that passes to charity. However, the charitable income deduction is generally limited to 50% of the individual's adjusted gross income. When any appreciated assets that were contributed to the charitable remainder trust are sold by the trustee, neither the donor or the trust will recognize any capital gains tax on the sale of the appreciated assets. The income beneficiary of the charitable remainder trust is taxed on the annuity or unitrust payments from the trust.[2]

When assets are transferred to a charitable remainder trust that has been created upon a donor's death (a testamentary charitable trust), the assets passing to the charitable trust are fully includable in the donor's estate, and therefore receive a basis equal to their fair market value at date of death or at the alternate valuation date, and the donor's estate will be entitled to an estate tax deduction equal to the present value of the charitable remainder interest.

Charitable Lead Trust

Sometimes considered to be the inverse of a charitable remainder trust, a charitable lead trust is another type of irrevocable trust. This type of irrevocable trust pays an annuity to a chosen charitable beneficiary, or beneficiaries, for a term of years (typically 10, 15, or 20 years) or the lives of one or more individuals, with the assets remaining in the trust at the end of that term passing to one or more non-charitable beneficiaries—tax-free. As long as the assets in the charitable lead trust appreciate faster than the amount needed to service the annuity to charity, the excess appreciation will pass to the donor's beneficiaries tax-free. Similar to the charitable remainder trust, a charitable lead trust can require the payment of an annuity amount or a unitrust amount. However, unlike charitable remainder annuity trusts, the annuity amount may be changed during the term of the trust, and there are no minimum or maximum annuity or unitrust payout rates applicable to charitable lead trusts.

Practitioners can deepen their client relationships by using estate planning techniques to create charitable gifts. In doing so, it is important to remember all the guidelines your clients must adhere to in order to reap each of the possible benefits of their giving. Estate planners, financial advisors, and CPAs can be a great resource for planned giving advice. It is often optimal for all of a client's professional advisors to participate in the planning work, as then all those resources can be brought to bear. But do not underestimate the wealth of knowledge, ideas, and tools to accomplish charitable goals that can be found on the website of almost any charity that your clients may wish to benefit. Frequently, your clients will have become familiar with these. Practitioners can also find practical tools through Minnesota Continuing Legal Education (*www.minncle.org*), and on the webpages of Minnesota Philanthropy Partners (*www.mnpartners.org*) and the Minnesota Council on Foundations (*www.mcf.org*).

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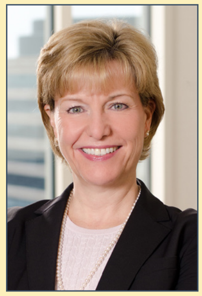
[1] Cam Marston, *Great wealth transfer will be $30 trillion – yes, that's trillion with a T*, CNBC July 22, 2014 *available at* http://www.cnbc.com/2014/07/22/great-wealth-transfer-will-be-30-trillionyes-thats-trillion-with-a-t.html.

[2] The income is taxed in accordance with a four-tier system under Internal Revenue Code§ 664(b) as follows: (1) First, any distribution is ordinary income to the extent of the trust's ordinary income for the taxable year of the distribution, and any ordinary income from prior years not deemed to have been previously distributed. Internal Revenue Code § 664(b)(1); Treas. Reg. § 1.664-1(d)(1)(i)(a). (2) Second, a distribution is next deemed to consist of capital gain income to the extent of the trust's capital gain income for the current year and undistributed capital gains from prior years. Internal Revenue Code § 664(b)(2); Treas. Reg. § 1.664-1(d)(1)(i)(b). (3) After the ordinary income and capital gain tiers are exhausted, distributions are deemed to come from other income, such as tax-exempt bond income. Internal Revenue Code § 664(b)(3); Treas. Reg. § 1.664-1(d)(1)(i)(c). (4) When the current and accumulated income from the above three categories is exhausted, remaining distributions are considered to be corpus, and therefore to have been made as a tax-free return of basis. Internal Revenue Code § 664(b)(4); Treas. Reg. § 1.664-1(d)(i)(1)(d).



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