Giving Today to Guarantee Tomorrow: A Charitable Trust Review

A careful review of the various ways to structure charitable gifts can help make your gifts more meaningful, both to you and to the charities you choose to support.

Prepared for:

Brought to you by:

MRW FINANCIAL BROKERAGE

Life Insurance, Annuities and Long-Term Care

Table of Contents **Page**

Why Consider a Charitable Gift?

People give to charities for a variety of reasons. They give:

1. Because they have compassion for the less fortunate.
2. From a belief that they owe something back to society.
3. To support a favored institution or cause.
4. For the recognition attained by making substantial charitable donations.
5. To benefit from the financial incentives our tax system provides for charitable gifts.

According to the Giving USA Foundation, individual giving accounted for 69% of all contributions to charitable organizations in 2019.

Source: Giving USA Foundation™ - Giving USA 2020

Regardless of your reasons for giving, a careful review of the various ways to structure charitable gifts can help make your gifts more meaningful, both to you and to the charities you choose to support.

How Can Charitable Gifts Be Structured?

Outright Gifts Today

Some people prefer to make outright gifts of cash or other assets to their charities of choice. In many situations, an immediate charitable contribution makes sense…the charity receives the cash or property at once, the donor receives immediate tax benefits and the transaction is complete.

Retirement Plan Gifts

A charity can be named as beneficiary of the funds in an IRA or employer-sponsored retirement plan, which provides a double tax benefit…the charitable gift will be deductible for estate tax purposes and the charity will owe no income tax on the funds it receives.

Outright Gifts at Death

Other people wish to make sizeable charitable contributions, but are hesitant to do so during their lifetime. They may depend on the income produced by their assets, want a family member to receive some benefit from the property, or simply be concerned about what the future will bring in terms of their financial needs. As a result, they decide to wait and make charitable gifts at their death, through a will or trust.

There is, however, another alternative…

Split-Interest Gifts

If you want to make a charitable gift, especially a substantial one, there are charitable giving techniques available that allow you to make the gift today, while retaining an interest in the property and receiving both immediate and longer-term tax benefits.

Tax Benefits of Charitable Giving

While generally not the primary motivation behind charitable giving, it is important to understand how the tax savings generated by charitable gifts can fit into your overall financial and estate planning.

Federal Income Tax Deduction

Gifts to **qualified charitable organizations** are deductible up to a maximum of 60% of the donor's adjusted gross income (AGI), depending on the charitable organization and type of asset given. If the value of the property given exceeds the donor's AGI limit, the excess can be carried over and deducted for up to five years. The donor must itemize in order to receive a federal income tax deduction for charitable gifts.

Type of Asset	Deduction Based on:	AGI Limit	
		Public Charity	Private Charity
1. Cash	Amount Given	60%	30%
2. Ordinary Income and Short-Term Capital Gains Property	Donor's Cost Basis	50%	30%
3. Long-Term Capital Gains Property (general treatment)	Fair Market Value	30%	20%
4. Tangible Personal Property:			
Use related to charity's function	Fair Market Value	30%	20%
Use unrelated to charity's function	Donor's Cost Basis	30%	20%

Federal Gift Tax

Irrevocable gifts to charity are **not** subject to federal gift taxation.

Federal Estate Tax Deduction

A federal estate tax deduction is allowed for charitable gifts made at death, whether through a will, a trust or from a life insurance policy. There is no limit on the federal estate tax charitable deduction.

Split-Interest Charitable Giving Techniques

With a split-interest charitable gift, the asset is split into two parts:

1. **Income Interest:** The stream of income produced by the asset;

   and

2. **Remainder Interest:** The principal remaining after the income interest is paid.

Through the use of a **charitable trust**, the donor transfers the asset(s) to the trust and names a beneficiary for either the income interest or the remainder interest, with the charity receiving the other interest.

Assuming the charitable trust is properly designed, a person making a split-interest gift may also realize some or all of these tax benefits:

- A current federal income tax deduction;
- Avoidance or delay of capital gains taxation; and/or
- A reduction of the federal estate tax bill.

Depending on your personal and charitable giving objectives, there are several different types of charitable trusts from which to select.

Types of Charitable Trusts

There are two types of charitable trusts, each of which treats the income interest and remainder interest differently:

Charitable Remainder Trusts	A beneficiary named by the donor receives the income interest for life or for a stated number of years, after which the remainder interest is donated to the charity.
Charitable Lead (or Income) Trusts	The opposite…the charity receives the income interest for a stated period of time, with the remainder interest then going to a beneficiary named by the donor.

While each type of charitable trust satisfies different objectives, they share certain common features:

During Life	In order to realize maximum tax benefits, most people create charitable trusts during their lifetime, especially during their highest income-producing years.
Irrevocable	Once a charitable trust is created and becomes operational, it is irrevocable…you cannot regain ownership of property given to the trust.
Tax-Exempt Charities	The gift must be made to a tax-exempt charity approved by the IRS in order to provide the desired tax benefits.
Income Tax Deduction	A split-interest gift to a charitable trust results in a current income tax deduction, assuming the taxpayer itemizes.

The Charitable Remainder Trust

A charitable remainder trust may be the solution for someone who wants to donate property to a charity during lifetime and receive an immediate income tax deduction, while reserving an income from the property for themselves, their spouses or even for other family members.

Using a charitable remainder trust, the donor receives an immediate charitable income tax deduction based on the present value of the charity's remainder interest. The income beneficiary (donor, spouse, other family member) receives an income from the trust for life or a stated number of years, and the trust principal (the remainder) is distributed to the charity at the end of the income period.

A charitable remainder trust is especially advantageous for donors with highly-appreciated assets, such as growth stocks and mutual funds or raw land, that need to be sold and converted to income-producing assets.

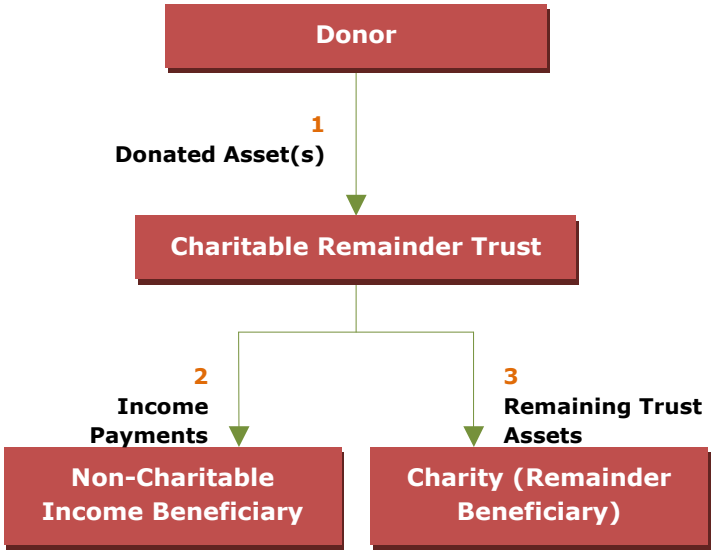
Advantages

- The donor can give highly-appreciated property to the trust and eliminate capital gains tax on the appreciation when the gifted asset is sold by the charity.
- Non-income-producing property can become income producing, since the charity can sell the asset and use the proceeds to purchase income-producing assets.
- The income beneficiary (donor, spouse, other family member) may realize an increase in current income.
- A current income tax deduction is available to taxpayers who itemize.
- The size of the donor's estate is reduced for federal estate tax purposes.

Disadvantages

- Donation of property to the trust is irrevocable.
- Income paid to someone other than the donor or donor's spouse may incur gift tax and/or generation skipping transfer tax.

How Does a Charitable Remainder Trust Work?



1. The **donor** transfers the donated asset(s) to an irrevocable **charitable remainder trust** and receives a current income tax deduction based on the value of the charity's remainder interest.

2. The **non-charitable income beneficiary** (e.g., donor, spouse, other family member) receives a stream of income for life or a term not to exceed 20 years.

3. At the end of the income period, the **charity** receives the remaining trust assets.

Charitable Remainder Trust Variations:

Gifts of remainder interests are deductible for federal income tax purposes only if made to one of the following:

- charitable remainder annuity trust (CRAT);
- charitable remainder unitrust (CRUT); or
- pooled income fund.

Charitable Remainder Trust Variations

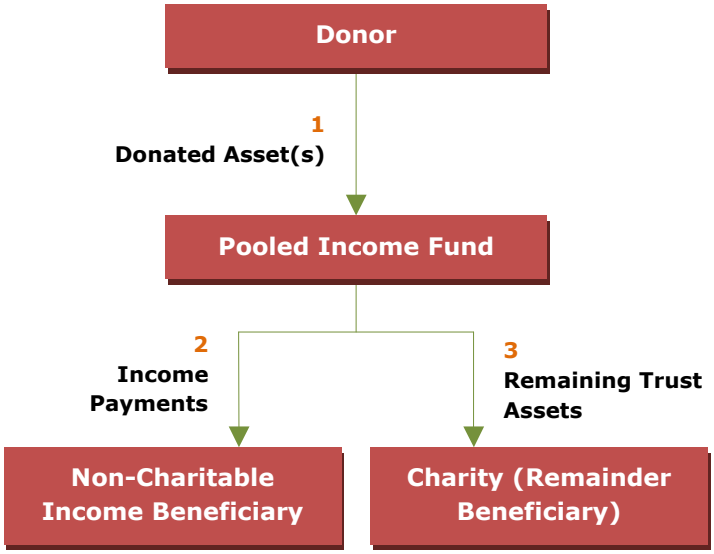
How Are a Charitable Remainder Annuity Trust (CRAT) and a Charitable Remainder Unitrust (CRUT) Different?

There are two primary differences between these variations of the charitable remainder trust:

	CRAT	CRUT
Income Payments	The yearly income stream is a **fixed amount** determined at inception of the trust and expressed as either a fixed percentage of the initial value of trust assets or as a fixed dollar amount; must be equal to at least 5% and not more than 50% of the initial value of trust assets and must remain constant.	The yearly income stream is based on a **percentage of the current value** of trust assets; expressed as a fixed percentage of trust assets (not less than 5% or more than 50%) at inception of the trust. Since trust assets must be revalued each year, **income payments may increase or decrease** if trust assets increase or decrease in value.
Additional Contributions	Not allowed.	Trust document may provide for additional contributions.

What Is a Pooled Income Fund?

A pooled income fund is a trust maintained by a public charity. Donors contribute assets to this trust maintained by the charity and those assets are commingled and managed together with assets donated by other individuals, all of whom have retained an income interest.



1. The **donor** transfers the donated asset(s) to a charity's **pooled income fund**, where the donation is commingled with other donated assets and managed by the charity in a trust. The donor receives a current income tax deduction based on the age(s) of the beneficiary(ies) and the fund's rate of return.

2. The **non-charitable income beneficiary** (e.g., donor, spouse, other family member) receives a pro rata share of the income earned by the trust for life.

3. When the income beneficiaries are all deceased, the remaining property reverts to the **charity** for its use.

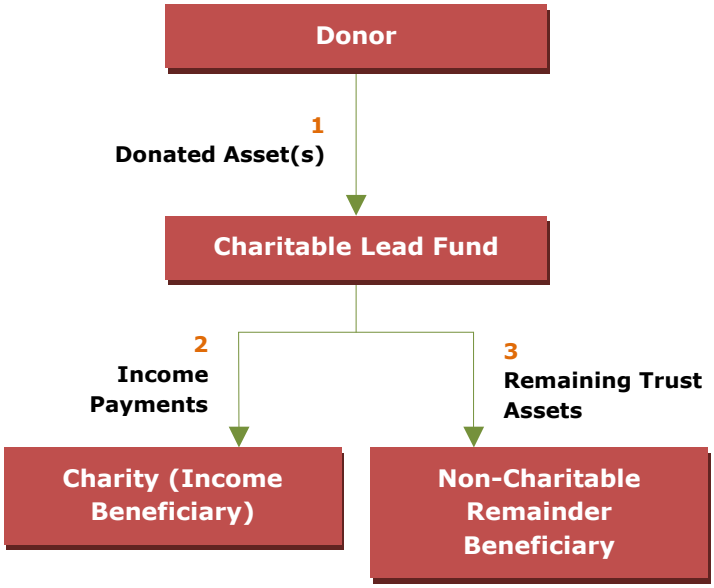
The Charitable Gift Annuity… Another Alternative

A charitable gift annuity allows a donor to irrevocably transfer property to a charity in return for a lifetime income and an immediate income tax deduction.

There is no trust involved. Instead, through a contractual agreement, the charity pays a fixed amount to one or two annuitants (e.g., the donor alone or the donor and spouse) for life. In addition, the annuity payments from the charity may begin immediately or be deferred until a future point in time.

The Charitable Lead (or Income) Trust

The charitable lead trust works in reverse fashion from the charitable remainder trust…the named charity receives a fixed amount of income from the trust for a specified number of years or for the lifetimes of specified individuals, such as the donor or the donor and spouse. At the end of that time, the donor, donor's estate or individuals named by the donor receive the remaining trust assets.



1. The **donor** transfers the donated asset(s) to an irrevocable **charitable lead trust** and receives a current income tax deduction for the present value of the charity's income interest.

2. The **charity** receives a **fixed annual income** from the trust for a specified number of years or for the lifetimes of specified individuals (e.g., the donor or the donor and spouse).

3. At the end of the income period, the remaining trust assets go to the **final beneficiary(ies)** named by the donor. The final beneficiaries can be the donor, if the term of the trust is for a set number of years, or, for example, the donor's surviving spouse, children or grandchildren.

A Comparison of Charitable Trusts

	Charitable Remainder Annuity Trust (CRAT)	Charitable Remainder Unitrust (CRUT)	Pooled Income Fund	Charitable Lead Trust
Primary objectives	Income and estate tax savings; fixed income stream	Income and estate tax savings; income hedged against inflation	Income and estate tax savings; income reflecting pooled investment results	Income and estate tax savings; preservation of trust assets for final beneficiaries
Trust property	Money or tangible assets	Money or tangible assets	Money or equities	Money or tangible assets
Trust valuation	At inception only	Annually	Not applicable	At inception only
Additional contributions	Not allowed	Yes, if permitted by trust document	Yes	Yes, if permitted by trust document
Current income tax deduction	Yes (generally larger than with unitrust)	Yes (generally smaller than with annuity trust)	Yes	Yes
Income beneficiary	Donor or anyone else named by donor	Donor or anyone else named by donor	Donor or anyone else named by donor	Named charity
Income paid to income beneficiary	Fixed dollar amount each year	Fixed percentage of trust assets each year	Donor's pro rata share of income earned by the trust	Fixed dollar amount or percentage of trust assets
Final beneficiary	Named charity	Named charity	Named charity	Donor or other beneficiaries named by donor
Trustee	Selected by donor (can include donor or the charity)	Selected by donor (can include donor or the charity)	The charity	Selected by donor (can include donor or the charity)

The Wealth Replacement Trust

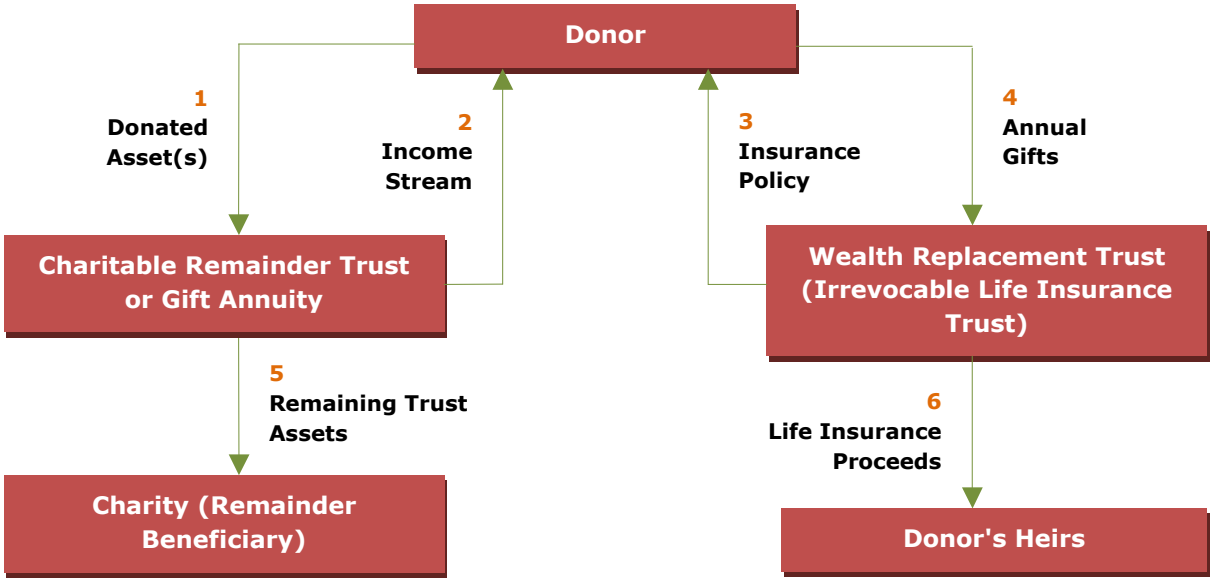
The Problem:

Through a charitable remainder trust (or charitable gift annuity), a charitably-minded person can realize certain income and estate tax objectives, while ultimately providing assets to a favorite charity. In doing so, however, the donor's family will be deprived of those assets that they might otherwise have received.

A Potential Life Insurance Solution:

In order to replace the value of the assets transferred to a charitable remainder trust (or charitable gift annuity), the donor establishes a second trust - an irrevocable life insurance trust - and the trustee acquires life insurance on the donor's life in an amount equal to the value transferred to the charitable remainder trust or charitable gift annuity. Using the charitable deduction income tax savings and the annual cash flow from the remainder trust or gift annuity, the donor makes gifts to the irrevocable life insurance trust that are then used to pay the life insurance policy premiums. At the donor's death, the life insurance proceeds generally pass to the donor's heirs free of income tax and estate tax, replacing the assets that then belong to the charity.

The Wealth Replacement Trust in Action



1. The **donor** transfers the donated asset(s) to an irrevocable **charitable remainder trust or gift annuity** and receives a current income tax deduction based on the value of the charity's remainder interest.
2. The **donor** receives an income stream for life or a term not to exceed 20 years.
3. The donor establishes an **irrevocable life insurance trust**, which purchases insurance on the donor's life.
4. The donor uses the income stream, together with the charitable deduction income tax savings, to make **annual gifts** to the irrevocable life insurance trust, which then pays the life insurance premiums.
5. At the donor's death, the remaining trust assets revert to the **charity** for its use.
6. The **donor's heirs** receive the life insurance proceeds, free of estate tax.

Charitable Trust Action Checklist

In consultation with your professional advisor:

Analysis…

- ☐ Do you have assets (particularly highly-appreciated assets) you want to remove from your estate to avoid federal estate tax?
- ☐ Do you have highly-appreciated and/or non-income-producing assets you want to turn into income-producing assets without paying capital gains tax?
- ☐ Would you benefit from a significant current income tax deduction?

If a charitable trust is right for you, decide which type of trust to use:

- ☐ Do you need current income or do you want to defer income for the future?
- ☐ Do you want a fixed income or an income that varies each year depending on the value of the assets in the trust?
- ☐ Do you want to maximize the benefit to yourself or to the charity?
- ☐ Will you want to make additional contributions to the trust in the future?

Implementation…

- ☐ Use a qualified attorney to draft the trust document, which names both the charitable and non-charitable trust beneficiaries and defines the amount of yearly income to be paid and for how long.
- ☐ Decide whether you will serve as trustee or appoint the charity as trustee.
- ☐ Donate the appreciated asset(s) to the trust. The trustee then arranges for the sale of the asset(s) and decides how the money will be reinvested in order to generate the required income.
- ☐ Determine if life insurance should be purchased on your life to replace trust assets that your family might otherwise have received.

Important Information

The information, general principles and conclusions presented in this report are subject to local, state and federal laws and regulations, court cases and any revisions of same. While every care has been taken in the preparation of this report, VSA, L.P. is not engaged in providing legal, accounting, financial or other professional services. This report should not be used as a substitute for the professional advice of an attorney, accountant, or other qualified professional.

Life insurance contracts contain exclusions, limitations, reductions of benefits and terms for keeping them in force. All contract guarantees are based on the claims-paying ability of the issuing insurance company. Consult with your licensed financial representative on how specific life insurance contracts may work for you in your particular situation. Your licensed financial representative will also provide you with costs and complete details about specific life insurance contracts recommended to meet your specific needs and financial objectives.

NOTE ABOUT THE FEDERAL ESTATE TAX: Whether your estate is actually subject to the federal estate tax will depend on the size of your estate, the year you die and whether future Congressional action modifies the estate tax rules.

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