Tax Smart Charitable Giving—Creative Ways to Fund the Kingdom

CLE Presentation
2023 Christian Legal Society National Conference
Boston, Massachusetts
October 5-8, 2023

John Kea
EVP and General Counsel, Southern Baptist Foundation/LegacyWay

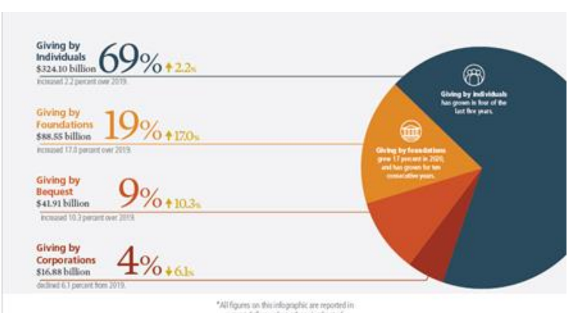
Introduction

"I planted the seed, Apollos watered it, but God has been making it grow."
1 Corinthians 3:6

"In their hearts humans plan their course, but the Lord establishes their steps."
Proverbs 16:9

We are living in the midst of the largest transfer of wealth in history. Cerulli and Associates projects that $84.4 trillion of wealth will be transferred between 2021 and 2045.[1] Almost $12 trillion of the assets will be donated to charity.[2] As attorneys who advise clients and others concerning financial and estate planning strategies, we must be ready to empower them with tools to be the faithful stewards in fulfilling the goals the Lord has placed in their hearts.

It's not just gifts through estates. Annual giving to charities continues to increase too. According to Giving USA's most recent report, $484.85 billion was donated to charity in 2021, marking the most generous giving year ever.[3] Combining annual giving, bequests, and foundations, individual philanthropy was meaningfully connected to 96% of the gifts in Giving USA's report.[4] In more good news, religion, education, human services, and health—key service areas for many Christian charities—were once again the top recipients of gifts.



[1] The Cerulli Report—U.S. High-Net-Worth and Ultra-High-Net-Worth Markets 2021: Evolving Wealth Demographics
[2] Id.
[3] *Giving USA 2022: The Annual Report on Philanthropy for the Year 2021*
[4] Id.

The truth is many attorneys, even ones who devote a significant portion of their practice to estate planning, are not well acquainted with tax-advantaged ways to make charitable gifts. If you have been one of those attorneys, you no longer will be after today's session.

Charitable Organizations

To qualify for the income, gift, and estate tax charitable deductions, a gift or bequest must be made to a qualifying charitable organization. The deductibility rules for the income tax charitable deduction distinguish between public charities and private foundations, though estate and gift tax deductions generally do not.

Charitable organizations are considered to be private foundations under the tax code unless they can satisfy the qualification requirements to be a public charity. This can be an important consideration since public charities offer more favorable deductibility rules for their donors.

There are four basic types of public charities:

1. Inherently public charities—these are considered charities as a matter of law and generally perform charitable activities rather than issuing grants. Examples include churches, universities, schools, nonprofit hospitals, and medical research institutions. These public charities are classified under Sections 170(b)(1)(A) (i) through (v) of the Internal Revenue Code.

2. Publicly supported organizations—these demonstrate that a minimum percentage of their financial support comes from a broad cross-section of the public, rather than from just one source. These charities fall under Section 170(b)(1)(A)(vi) of the Internal Revenue Code. The charity or foundation must satisfy one of two tests, both of which measure public support as a fraction of the total support the organization receives. This test is referred to as the public support test. Examples of charities that are publicly supported are community foundations, the American Red Cross, and the YMCA.

3. Exempt income function—these receive a substantial portion of their support from program service revenue. These organizations earn revenue from activities like selling tickets, or by charging admission or other fees for the charitable services they provide. These public charities fall under Section 509(a)(2) of the Internal Revenue Code. Charities in this category must ensure their investment income does not normally exceed one-third of their total support. An example of this kind of charity would be a museum or opera that charges for admission.

4. Supporting organizations—these are attached to or support one or more public charities. In effect, it acquires the public charity status of the organization it supports. Examples

include a foundation of a church denomination or the philanthropic arm of a university or hospital.

Charitable Deductions

Though people often speak of the "charitable deduction" as if there is a single deduction, there are actually three separate charitable deductions set forth in different chapters of the Internal Revenue Code (IRC). They are as follows:

- IRC Section 170—Income tax charitable deduction
- IRC Section 2055—Estate tax charitable deduction
- IRC Section 2522—Gift tax charitable deduction

The three deductions have many similarities, but there are differences, so it is important to become well acquainted with each of the deductions.

For a lifetime contribution to be eligible for an income tax charitable deduction, the donor must itemize deductions on the donor's tax return. A donor may not be able to take the full deduction in the year of the gift because charitable contributions are limited to a percentage of adjusted gross income for the tax year. The percentage limitations depend on two factors: (1) whether the gift is made to a public charity versus a private foundation; and (2) whether the gift is made in cash versus appreciated property held long-term.

The AGI limitations for donations to public charities are:

Cash donations: Gifts are deductible up to 60% of AGI if cash is contributed outright (and there are no non-cash contributions) to certain public charities and donor-advised funds.

Appreciated property donations: Gifts are deductible up to 30% of AGI for gifts of appreciated property held for more than one year.

The AGI limitations for donations to private foundations are:

Cash donations: Gifts are deductible up to 30% of AGI if cash is contributed outright to a private foundation.

Appreciated property donations: Gifts are deductible up to 20% of AGI for gifts of appreciated property held for more than one year.

A donor's AGI deduction limitations may be affected when different categories of gifts are donated or if gifts are made to both public charities and private foundations. Other assets, such as tangible personal property and ordinary income property, have special deduction rules that are beyond the scope of this session.

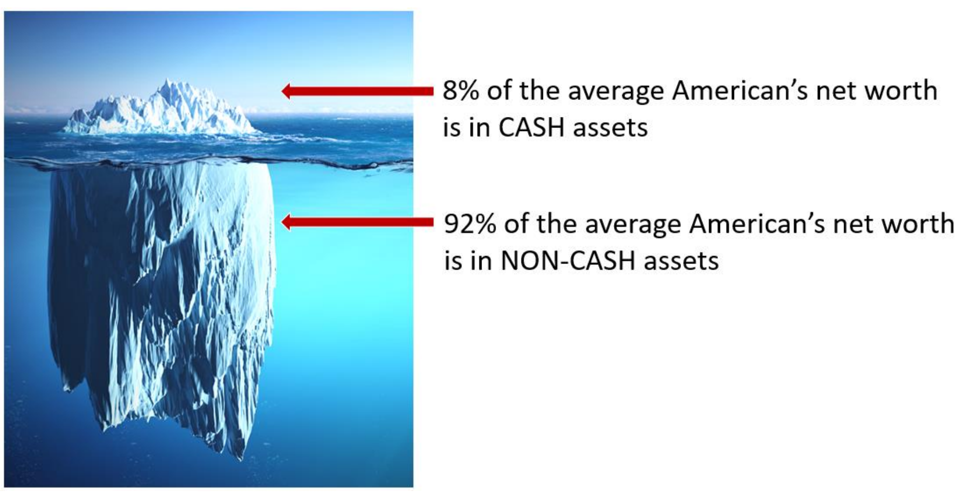
The 5-year carryover rule is a substantial benefit to many donors. If a donor cannot deduct the full amount of a gift to a public charity or private foundation in the year of the gift because of the AGI limitations, there is a 5-year carry forward for any unused deduction (subject to AGI percentage limitations).

A qualified appraisal is needed in most instances when an appreciated asset with a value of more than $5,000 is donated. See IRS Forms 8282 and 8283.

IRS Publication 526, Charitable Contributions, is a helpful resource with numerous explanatory illustrations.

Wealth Composition and Giving

It is estimated that only 8% of the average American's assets are held as cash or cash equivalents in financial institutions.[5]



However, "checkbook Philanthropy," gifts of cash and cash equivalents, accounts for approximately 80% of charitable gifts each year.[6] Cash and cash equivalents account for an even higher percentage of gifts to churches and other religious organizations.

---

[5] *The Wealth of Households: 2020*, Donald Hays and Briana Sullivan (Aug 2022), citing U.S. Census Bureau, 2021 Survey of Income and Program Participation, public use data.
[6] Giving USA 2022: The Annual Report on Philanthropy for the Year 2021

Rules for Cash Gifts to Charity

Under United States tax law, charitable gifts made in cash are generally deductible from the donor's federal income tax return. However, there are certain rules and limitations that apply to these deductions. Here are three key points to consider, along with citations to relevant tax law and revenue rulings:

1. Qualified charitable organizations: In order for a cash donation to be tax-deductible, it must be made to a qualified charitable organization. These include organizations that are recognized as tax-exempt under Section 501(c)(3) of IRC, as well as certain religious organizations, educational institutions, and other qualified organizations. IRC Section 170(c).

2. Donation amount: The amount of the cash donation that is tax-deductible generally depends on the amount of the donation and the donor's income level. For individual donors, cash donations to qualified charitable organizations are generally deductible up to 60% of their AGI, and up to 30% of AGI for gifts to private foundations, in a given tax year. IRC Section 170(b)(1)(A).

3. Substantiation requirements: In order to claim a tax deduction for a cash donation, the donor must maintain records of the donation, such as a bank record or written statement from the charity. For donations of $250 or more, the donor must also obtain a written acknowledgement from the charity that includes certain information about the donation, such as the amount, date, and a statement that no goods or services were provided in exchange for the donation. IRC Section 170(f)(8).

A Smarter Way to Give

Cash is perfectly fine for smaller gifts or when a higher AGI deduction limit is needed, though attorneys should help clients explore planned giving strategies for larger gifts. As a basic definition, “planned giving” refers to gifts made during life or at death that combine a donor’s overall financial or estate planning goals with tax-efficient strategies.

At a more technical level, planned giving refers to a variety of charitable giving strategies that allow donors to make larger or more complex gifts to nonprofit organizations, often over an extended period of time. These strategies typically involve some sort of financial or estate planning, and they can include gifts made through a will or trust, charitable gift annuities, charitable trusts, DAFs, endowments, and other vehicles.

Our goal as Christian attorneys should be to help believing clients live as Kingdom-minded Christians. Planned giving strategies empower clients to fulfill the dreams the Lord has given them, with a bonus of disinheriting the government.

Let’s explore some essential planned giving strategies.

Gifts of Appreciated Assets

Donating appreciated assets to charity is a key strategy and funding source for gifts while a donor is *living*. It can have several advantages and disadvantages, both in terms of tax benefits and other considerations.

Advantages of donating appreciated assets during life include:

1. Increased tax benefits: Donating appreciated assets such as stocks, bonds, or real estate can provide greater tax benefits than donating cash, since donors normally can avoid capital gains taxes on the appreciation of the assets. Also, donors can deduct the fair market value of the donated assets on their federal income tax returns, subject to certain limitations. IRC Section 170(b)(1)(C), Revenue Ruling 78-197.

2. Increased giving potential: Donating appreciated assets allows donors to make larger gifts to charity than they might be able to afford with cash donations alone. This can help donors make a bigger impact on the causes they care about.

3. Estate planning benefits: Donating appreciated assets as part of an estate plan can help reduce estate taxes and provide other estate planning benefits, such as reducing the size of the estate and potentially increasing the amount of assets that can be passed on to heirs. IRC Section 2055.

Disadvantages of donating appreciated assets during life include:

1. Potential liquidity concerns: Donating appreciated assets can be less flexible than donating cash, since it may be more difficult for the charity to sell the assets or convert them to cash.

2. Potential valuation issues: Donating appreciated assets can sometimes present valuation challenges, particularly for assets that are not publicly traded or have other unique characteristics. Donors should work with a qualified appraiser and consult IRS guidance to ensure that their donation is properly valued for tax purposes. IRC Section 170(f)(11).

3. Situation-specific limitations: There are certain rules and limitations that apply to donations of appreciated assets, such as restrictions on donations of certain types of property and limitations on the amount of the deduction that can be claimed in a given tax year.

There are several types of appreciated assets that can be donated to charity, each with their own unique tax and other considerations. Here are some examples:

1. Stocks and other securities: Donating appreciated stocks, bonds, mutual funds, and other securities can provide significant tax benefits, since donors can ordinarily avoid paying capital gains taxes on the appreciation of the assets. Donors can deduct the fair market value of the donated securities on their federal income tax returns, subject to certain limitations. IRC Section 170(b)(1)(C), Revenue Ruling 78-197.

2. Real estate: Donating appreciated real estate, such as a rental property or a vacation home, can also provide significant tax benefits, since donors can generally avoid paying capital gains taxes on the appreciation of the property. Donors can deduct the fair market value of the donated real estate on their federal income tax returns, subject to certain limitations. IRC Section 170(b)(1)(C), Revenue Ruling 78-197.

3. Art and collectibles: Donating appreciated art, antiques, and other collectibles can provide tax benefits, but donors should be aware of certain rules and limitations that apply. For example, donations of art and collectibles are deductible at the lesser of their fair market value or the donor's basis in the assets, and donations of certain types of property may be subject to additional appraisal and substantiation requirements. IRC Section 170(f)(11), Revenue Ruling 68-609.

4. Business interests: Donating appreciated business interests, such as stock in a closely held corporation or a partnership interest, can also provide tax benefits, but donors should be aware of certain complex rules and limitations that apply. For example, donations of closely held business interests may be subject to various restrictions and valuation challenges, and donors may need to consult with a qualified appraiser or other professional to ensure that their donation is properly valued. IRC Section 170(b)(1)(F), Revenue Ruling 80-7.

Tax-Deferred Retirement Assets

Donating tax-deferred retirement assets, such as traditional IRAs or 401(k)s, is a key funding source for charitable gifts made upon a donor’s *death*. A common means to implement this strategy involves naming a qualified charity as the beneficiary of a retirement account, which allows the charity to receive the assets tax-free after the account owner's death.

While most taxable assets like stocks in a brokerage account or a personal residence get a step-up in basis at death, enabling heirs to sell them with little or no tax liability, distributions from tax-deferred retirement accounts are subject to the beneficiaries’ personal income tax rate. If an IRA is left to children, they must pay taxes on the full value of the account as it is liquidated. If a charity is the beneficiary, due to its tax-exempt status, no tax will be owed on the withdrawals and the donor’s taxable estate and potential federal estate taxes may be reduced.

Advantages of donating tax-deferred retirement assets at death include:

1. Tax benefits: Charitable bequests can provide tax benefits to both the donor and the charity. The donor's estate can receive a tax deduction for the charitable donation, which can help reduce estate taxes. Additionally, because charities are tax-exempt, they can receive the assets tax-free.

2. Flexibility: Charitable bequests provide flexibility for donors, as they can change the beneficiary designation or amount of a gift at any time during their lifetime. In addition, the donors have full access to their financial resources in case they have unanticipated expenses during their lifetime.

3. Legacy: Charitable bequests allow donors to leave a lasting legacy by supporting causes that are important to them.

Disadvantages of donating tax-deferred retirement assets at death include:

1. Limitations on Beneficiaries: Retirement accounts are subject to beneficiary designation rules of financial institutions, which may limit the donor's ability to distribute assets to other beneficiaries.

2. Required Minimum Distributions: Beneficiaries of retirement accounts are required to take minimum distributions each year, which may reduce the amount of assets that can be donated to charity at death.

3. Complexities in Estate Planning: Charitable bequests require careful estate planning to ensure that the donor's wishes are fulfilled and to maximize tax benefits.

Revenue Ruling 78-197 provides guidance on how to properly designate a charity as a beneficiary of a retirement account. Private Letter Ruling 201919002 provides an example of how a charitable bequest can be used to reduce estate taxes.

Bunching

The strategy of "bunching" several years of charitable gifts into one year involves combining multiple years' worth of charitable contributions in a single year to maximize the tax benefit of the charitable deduction. To preserve the income tax benefits of giving to charity, even in light of larger standard deductions, donors can bunch or aggregate their donations. Bunching means taking what would ordinarily comprise multiple years’ worth of donations and giving them all to charity in a single tax year, resulting in donations large enough for a donor to itemize on their tax return. Some donors bunch direct donations to charity, while others may prefer to bunch their giving through a DAF and distribute grants in future years.

Advantages of bunching donations include:

1. Exceed the standard deduction: This strategy can help donors exceed the standard deduction threshold, which was increased under the Tax Cuts and Jobs Act of 2017. By bunching several years of charitable gifts into one year, donors can itemize their deductions in that year to potentially lower their taxable income, while taking the standard deduction during the next few years.

2. Bigger potential impact: Instead of making smaller annual gifts, donors can make a larger gift in one year and potentially make a greater impact on the charitable organization they support.

Disadvantages of bunching donations include:

1. Advanced planning: Bunching requires careful planning and coordination with the charitable organization. Donors must ensure that the charitable organization is able to receive and process the larger gift amount in the desired tax year, and that the organization's mission and values will continue to align with the donor's charitable goals.

2. Lower contributions in other years: Donors may be less likely to make charitable contributions in the years following the bunching year, which could impact the organization's ability to receive consistent support.

Qualified Charitable Distribution (IRA Charitable Rollover)

A qualified charitable distribution (QCD) is a charitable giving strategy that allows an individual who is at least 70½ years old to donate up to $100,000 each year directly from their individual retirement account (IRA) to a qualified charity. This distribution is excluded from the individual's taxable income, and it counts towards the individual's required minimum distribution (RMD). From a tax perspective, a QCD is tantamount to giving a donor a full charitable deduction, with no AGI limitation, for the QCD amount, while still preserving the possibility of also taking the standard deduction since the QCD is not an itemized deduction.

Advantages of QCDs include:

1. Tax benefits: QCDs can provide substantial tax benefits to individuals who want to make charitable donations. By making a QCD, an individual can avoid paying taxes on the distribution, and they can also reduce their taxable income.

2. Fulfillment of RMD: QCDs help individuals fulfill their RMD requirements. When individuals reach 70½ years of age, they are required to withdraw a certain amount of money from their IRA each year, which is known as the RMD. By making a QCD, an individual can fulfill their RMD requirement while also making a charitable contribution.

3. Impact: Charitable organizations have benefitted greatly from QCDs since the law was enacted. QCDs created an entirely new funding source to support their programs and initiatives.

Disadvantages of QCDs include:

1. Eligibility Requirements: In order to make a QCD, an individual must be at least 70½ years old and have an IRA. These requirements may exclude some individuals from participating in this charitable giving strategy.

2. Contribution Limits: The maximum amount that an individual can donate through a QCD is $100,000 per year (which will soon be indexed for inflation). This limit may not be sufficient for individuals who wish to make larger donations.

3. Restrictions on Charities: The charity receiving the QCD must be a qualified charity. This restriction may limit the individual's ability to donate to certain charities, including donor-advised funds, that do not meet the qualified charity criteria.

The Internal Revenue Code (IRC) provides the framework for QCDs. According to IRC Section 408(d)(8), a QCD must meet the following requirements:

1. The distribution must be made from an IRA.

2. The distribution must be made directly to a qualified charity.

3. The individual making the donation must be at least 70½ years old at the time of the distribution.

Revenue rulings and private letter rulings have provided additional guidance on QCDs. For example, Revenue Ruling 2007-71 clarifies that a QCD must be made directly from the IRA custodian to the qualified charity, and that the distribution cannot be made to the individual first and then donated to the charity. Private Letter Ruling 201833012 provides an example of how a QCD can be used to satisfy a pledge to a qualified charity.

The Consolidated Appropriations Act, which includes the SECURE Act 2.0, was signed into law on December 29, 2022. This new legislation includes enhancements to QCDs:

1. QCD Maximum Indexed for Inflation: Individuals age 70½ or older are permitted to make QCDs from their IRA directly to charity and avoid recognition of income. The QCD is limited to a maximum of $100,000 each year. Under SECURE 2.0, the maximum amount will be indexed for inflation beginning in 2024, which should become a meaningful addition when compounded over several years.

2. QCD to Split Interest Entity: In a completely new charitable provision that begins this year, donors have a one-time opportunity to make a QCD of up to $50,000 to fund a charitable remainder annuity trust (CRAT), a charitable remainder unitrust (CRUT), or an immediate charitable gift annuity (CGA). The principal amount can be doubled to $100,000 if funded by the IRAs of both spouses. In addition to supporting a favorite ministry, this type of QCD has the added benefit of allowing individuals to diversify, and potentially fix, a portion of their income during times of volatile IRA investment returns.

   Key requirements are:

   1. The beneficiary must be the QCD maker and/or spouse.
   2. The minimum annual payout must be at least 5%.
   3. Annual distributions will be treated as ordinary income.
   4. Distributions are not assignable to another individual or charity.
   5. The trust or annuity must be funded exclusively by a QCD.

From a practical standpoint, the cost of setting up a CRAT or CRUT may be prohibitive for a $50,000 QCD, and their suitability may still be questionable for a $100,000 trust funded by QCDs from both spouses. As a result, a CGA will be the preferred giving design in many instances. An additional advantage of funding a CGA is the American Council on Gift Annuities has raised the maximum recommended annuity rates twice in the last eight months, which will be attractive to donors who are seeking increased streams of income.

Charitable Gift Annuity

A CGA is a contractual arrangement between a donor and a charity, whereby the donor transfers cash or property to the charity in exchange for the charity's promise to make fixed payments to the donor for the remainder of the donor's lifetime. IRC Section 501(m)(5). The payment amounts are based on the donor's age at the time of the gift and are determined by actuarial calculations. Treasury Regulations Section 1.170A-6(c). CGAs can be funded with cash, publicly traded securities, or other types of property. Revenue Ruling 55-66. Typically, a donor will receive an income tax deduction equal to the gift given to charity, less the present value of the lifetime annuity payouts. Treasury Regulations Section 1.170A1(d)(1). If the gift to the CGA is made in cash, each annuity payment to the annuitant usually will be partially income-tax-free. If the gift is a long-term capital gain asset, such as publicly traded stock, the annuity payouts the annuitant receives may be partially income-tax-free, partially taxed as ordinary income, and partially taxed as long-term capital gain. CGAs also have a much lower funding threshold than charitable trusts. Many CGA programs permit donations as low as $10,000.

Advantages of CGAs include:

1. Fixed income stream: The donor, or potentially donors if married, receives a fixed income stream for life, regardless of market conditions or changes in interest rates. IRC Section 501(m)(5).

2. Tax benefits: Donors receive an income tax deduction for the present value of the charity's remainder interest in the CGA. IRC Section 170(f)(2)(A).

3. Capital gains tax savings: If the CGA is funded with appreciated property, donors can avoid paying capital gains tax on the transfer, and spread out applicable capital gains taxes through the annuity payments over their life expectancy. IRC Section 170(e)(1).

Disadvantages of CGAs include:

1. Limited liquidity: Once the gift is made, the donor cannot access the principal amount of the gift, which can limit liquidity if a donor encounters a substantial financial need. Revenue Ruling 55-66.

2. Irrevocable: CGAs are irrevocable, meaning the donor cannot change the payment terms or reclaim the donated property. Treasury Regulations Section 1.170A-6(d).

3. Risk of insolvency: If the charity becomes insolvent, the donor's payments may be at risk. IRC Section 501(m)(5)(D).

Types of CGAs include:

A. Single-life CGA

A single-life CGA pays a fixed income stream to one person (the annuitant) for the remainder of their lifetime. Revenue Ruling 55-66.

Advantages: Single-life CGAs may provide a higher payout rate than other types of CGAs, as the payments are based on the life expectancy of one person. Treasury Regulations Section 1.170A-6(c)(2)(iii).

Disadvantages: Once the annuitant dies, payments stop and the remaining principal goes to the charity, which may not be suitable for donors who want to provide for a surviving spouse or other loved ones.

B. Joint and survivor CGA

A joint and survivor CGA pays a fixed income stream to two people (the annuitants) for the remainder of their lifetimes. When one annuitant dies, payments continue to the surviving annuitant at the same rate. Revenue Ruling 55-66.

Advantages: Joint and survivor CGAs provide an income stream for the lifetimes of two people, which may be beneficial for donors who want to provide for a surviving spouse.

Disadvantages: The payout rate for joint and survivor CGAs is typically lower than for single-life CGAs because the payments are based on the joint life expectancy of the annuitants. Treasury Regulations Section 1.170A-6(c)(2)(iii).

C. Deferred CGA

A deferred CGA delays the start of payments until a specified future date. IRC Section 501(m)(5)(C). A subgroup of deferred CGAs is a "flexible" CGA that allows a donor to commence payments within a specified window of time in the future.

Advantages of Deferred CGAs include:

1. Higher income stream: Because the income stream does not start immediately, donors can receive a higher income stream than with an immediate CGA.

2. Tax benefits: Deferred CGAs provide donors with a charitable deduction for the present value of the charitable gift, which can help reduce their income taxes.

3. Flexibility: Deferred CGAs provide donors with more flexibility than immediate CGAs, as they can choose when the income stream starts.

Disadvantages of Deferred CGAs include:

1. Delayed income: Deferred CGAs do not provide immediate income, which may not be suitable for donors who need income right away.

2. Longer Deferral Period: A donor has an increased likelihood of dying before receiving substantial, or any, distributions from the CGA.

Charitable Remainder Trusts

A charitable remainder trust (CRT) is a planned giving vehicle that enables donors to donate appreciated assets to a charitable organization while retaining an income stream for themselves or other beneficiaries. The income stream of a CRT can be designed to be paid for the lifetimes of the individual beneficiaries or for a period up to 20 years. The annual distribution from the CRT must be at least 5% and cannot exceed 50% of the corpus of the trust. At the end of the trust term, the remainder passes to charity. To qualify as a CRT, the actuarial value of the charitable remainder interest must be at least 10%. The CRT is a popular option for donors who wish to provide a significant charitable gift, generate income for themselves or others, and reduce their tax liability. CRTs are known as “split interest” trusts because the trust provides a benefit to both charities and individual beneficiaries (typically the grantor, spouse, or other loved ones). Distributions from CRTs are taxed as distributable net income, which involves four-tier accounting rules.

There are two general categories of CRTs: charitable remainder annuity trusts (CRATs) and charitable remainder unitrusts (CRUTs).

A. Charitable Remainder Annuity Trusts (CRATs)

A CRAT is a trust that provides a fixed annual income to the donor or other designated beneficiaries for the duration of the trust term.

Advantages of CRATs include:

1. Diversification: The tax-free transfer of assets into a CRAT and subsequent sale by the CRAT offers an opportunity to diversify highly concentrated assets or low-income producing assets that would otherwise be subject to significant taxation because the donated assets are highly appreciated.

2. Predictable income stream: CRATs provide a fixed income stream to the donor or other beneficiaries, regardless of market fluctuations.

3. Tax savings: Donors receive an income tax deduction for the present value of the charity's remainder interest in the trust.

Disadvantages of CRATs include:

1. Lack of flexibility: Once the CRAT is established, the payout rate cannot be changed, even if the donor's needs change.

2. No growth potential: Because the distribution amount is fixed, there is no opportunity for the trust distributions to increase.

3. Additional Test: A CRAT must pass the “5% probability test” of Rev. Rul. 77-374. For CRATs created after August 8, 2017, an alternative to the test in Rev. Rul. 77-374 is to include an early termination qualified contingency provision. Rev. Proc. 2016-42, though some commentators caution against this alternative option.

B. Charitable Remainder Unitrusts (CRUTs)

A CRUT is a trust that provides a variable annual income to the donor or other designated beneficiaries for the duration of the trust term.

Advantages of CRUTs include:

1. Diversification: The tax-free transfer of assets into a CRUT and subsequent sale by the CRUT offers an opportunity to diversify highly concentrated assets or low-income producing assets that would otherwise be subject to significant taxation because the donated assets are highly appreciated.

2. Flexibility: The distribution from the trust can be designed to adjust annually, depending on the value of the trust assets or the income of the trust.

3. Growth potential: If the trust assets appreciate, there is an opportunity for the income stream to increase over time.

4. Tax savings: Donors receive an income tax deduction for the present value of the charity's remainder interest in the trust.

Disadvantages of CRUTs include:

1. Less predictable income stream: The income stream generated by a CRUT can vary from year to year, depending on the value of the trust assets.

2. Market risk: Because the trust assets are invested, there is a risk that the assets may not appreciate and may even depreciate.

Comparison of CRATs and CRUTs

1. Income stream: CRATs provide a fixed income stream, while CRUTs provide a variable income stream.

2. Flexibility: CRATs are inflexible, while CRUTs offer substantial flexibility in design options.

3. Growth potential of distributions: CRATs offer no growth potential since the distribution amount is fixed, while CRUTs offer growth potential.

4. Tax Savings: Both CRATs and CRUTs provide income tax deductions for the present value of the charity's remainder interest in the trust. In general, the charitable deduction is higher for a CRUT than a CRAT.

Both CRATs and CRUTs are powerful planned giving tools that enable donors to make significant charitable gifts while still providing income for themselves or other beneficiaries. The key feature of CRATs is a fixed income stream, while CRUTs offer a variable income stream and growth potential.

There are three main types of charitable remainder unitrusts (CRUTs), with several more sub-variations, that donors can choose from, each with its relative advantages and disadvantages. These include standard CRUTs, Net Income CRUTs, and Flip CRUTs.

I. Standard CRUTs

A standard CRUT is a trust that pays a fixed percentage of the trust's value, which is recalculated each year, to the donor or other designated beneficiaries for the duration of the trust term. IRC Section 664(d)(2).

Advantages of Standard CRUTs include:

1. Flexibility: The income distribution adjusts annually, depending on the value of the trust assets. IRC Section 664(d)(2)(A).

2. Growth potential: Because the trust assets can appreciate, there is an opportunity for the income stream to increase over time. Treasury Regulations Section 1.664-3(a)(1).

3. Tax savings: Donors receive an income tax deduction for the present value of the charity's remainder interest in the trust. IRC Section 170(f)(2)(A).

Disadvantages of Standard CRUTs include:

1. Less predictable income stream: The income stream generated by a standard CRUT can vary from year to year, depending on the value of the trust assets. IRC Section 664(d)(2)(B).

2. Market risk: Because the trust assets are invested, there is a risk that the assets may not appreciate and could even depreciate. Treasury Regulations Section 1.664-3(a)(1).

II. Net Income CRUTs

A Net Income CRUT is a trust that pays the lesser of the trust's income or a fixed percentage of the trust's value to the donor or other designated beneficiaries for the duration of the trust term. IRC Section 664(d)(3). A make-up provision can be incorporated to gain greater control over the timing of the distribution of the income. This version is a NIMCRUT.

Advantages of Net Income CRUTs include:

1. Control over income stream: The income stream generated by a Net Income CRUT is more controllable than that of a standard CRUT because the trust's income can be significantly influenced by the investments of the trust. IRC Section 664(d)(3)(B).

2. Tax savings: Donors receive an income tax deduction for the present value of the charity's remainder interest in the trust. IRC Section 170(f)(2)(A).

Disadvantages of Net Income CRUTs include:

1. Limited growth potential: Because the distribution is restricted to the trust's income, there is limited growth potential for the income stream. IRC Section 664(d)(3)(B).

2. Lack of flexibility: The distribution percentage of a Net Income CRUT cannot be adjusted to include the capital appreciation of the trust's assets. IRC Section 664(d)(3)(A).

III. Flip CRUTs

A Flip CRUT is a trust that starts as a Net Income CRUT but then "flips" to a standard CRUT when certain triggering events occur, such as the sale of an asset or a specified period of time passing. Revenue Ruling 2003-121.

Advantages of Flip CRUTs include:

1. Funding flexibility: Flip CRUTs are ideal designs for contributions of real estate or other assets that may not generate income or may take time to sell. If the sale of the asset is the triggering event, the CRUT is obligated to distribute only the income of the trust until after the flip.

2. Growth potential: When the Flip CRUT "flips" to a standard CRUT, there is an opportunity for the income stream to significantly increase. Revenue Ruling 2003-121.

3. Tax savings: Donors receive an income tax deduction for the present value of the charity's remainder interest in the trust.

Disadvantages of Flip CRUTs include:

1. Complexity: Flip CRUTs can be more complicated to set up and administer than other types of CRUTs.

2. Limited control: Donors may have limited control over when the trust "flips" to a standard CRUT.

Comparison of CRUT Types

1. Income stream: Standard CRUTs and Flip CRUTs offer a higher, though variable, income stream, while Net Income CRUTs offer a more predictable income stream.

2. Flexibility: Flip CRUTs offer more design flexibility than Standard and Net Income CRUTs.

3. Growth potential: Standard CRUTs and Flip CRUTs offer more growth potential for the income stream than Net Income CRUTs.

Donor-Advised Funds

A donor-advised fund (DAF) is a convenient solution for donors seeking to simplify the administration of their charitable contributions over time and maximize their tax benefits. As philanthropic vehicles sponsored by public charities, DAFs allow donors to make charitable contributions, receive immediate tax deductions, and recommend grants from the fund over time. From a more technical perspective, a DAF is a separately identified fund or account that is sponsored by a public charity, to which donors can make irrevocable contributions of cash, securities, or other property. IRC Section 4966(d)(2). The donor retains advisory privileges over the distribution of funds from the account. Revenue Procedure 2019-4. The charity must have ultimate control over the use of the donated funds, but the donor is able to recommend how the funds are used. IRC Section 4966(d)(2). In addition, a DAF may appeal to clients who want to involve their family in giving decisions. Donors, their families, or other designated individuals can advise the fund on asset investment, organizations to receive grants, and how much to give.

Advantages of DAFs include:

1. Tax benefits: Donors receive an immediate income tax deduction for the full fair market value of the donated assets, subject to certain limitations. IRC Section 170(a)(1).

2. Flexibility: Donors can make contributions to the DAF and recommend distributions to qualified charities over time, providing flexibility in timing of gifts to charitable organizations. Revenue Procedure 2019-4.

3. Expertise: DAF sponsors often have expertise in charitable giving and can assist donors in identifying and evaluating charitable organizations. Revenue Procedure 2019-4. They also provide professional investment management services.

Disadvantages of DAFs include:

1. Control: While donors retain advisory privileges over the distribution of funds from the DAF, the charity has ultimate control over the use of the funds, which may not be desirable for some donors. Revenue Ruling 68-489.

2. Perpetuity: DAFs can exist in perpetuity and are not required to make distributions each year, which may not align with a donor's charitable goals. IRC Section 4966(d)(2).

3. Fees: DAFs typically charge administrative fees, which can reduce the amount of charitable funds available for distribution. However, DAF fees are usually considerably lower than the expense of maintaining a private foundation.

DAF are subject to several restrictions:

1. Prohibition on private benefit: DAFs are prohibited from providing more than an incidental benefit to the donor or any other disqualified person. IRC Section 4967.

2. Prohibition on self-dealing: DAFs are prohibited from engaging in any act of self-dealing, such as selling property to a disqualified person. IRC Section 4941(d)(1).

3. Prohibition on excess business holdings: DAFs are subject to restrictions on owning more than a certain percentage of the voting stock in any business enterprise. IRC Section 4943.

Bequests

Charitable bequests are gifts that are made as part of a donor’s estate plan. It involves a provision in a will or trust that directs the distribution of assets to a charitable organization after the donor's death. IRC Section 2055(a). The bequest can be a specific dollar amount, a percentage of the estate, or a residuary bequest. IRC Section 2055(a). Charitable bequests can be made to public charities or private foundations. Revenue Ruling 74-464.

Advantages of Bequests include:

1. Estate tax deduction: Charitable bequests are deductible for estate tax purposes, which can reduce the size of the estate subject to estate tax. IRC Section 2055(a).

2. Control: Charitable bequests allow donors to retain control over their assets during their lifetime, while still providing for a charitable organization after their death.

3. Legacy: Charitable bequests can help donors leave a lasting legacy and support causes they care about. Private Letter Ruling 201343016.

Disadvantages of Bequests include:

1. Delayed impact: Charitable bequests do not provide immediate support for charitable organizations since the gift occurs after the donor's death.

2. Administration: Charitable bequests can be subject to legal and administrative expenses that can reduce the amount of assets available for distribution to the charitable organization.

Common Types of Charitable Bequests:

1. Specific bequest: A bequest that directs a specific asset to a charitable organization. IRC Section 2055(a). For example, “I give my personal residence at 100 Main Street, Nashville, TN to XYZ Charity.”

2. General bequest: A bequest that directs a specific dollar amount or percentage of the general assets of the estate to a charitable organization. IRC Section 2055(a). For example, “$300,000 from my estate” or “20% of the value of my total estate.”

3. Residuary bequest: A bequest that directs the remaining assets of the estate to a charitable organization after debts and expenses are paid and all other bequests have been fulfilled. IRC Section 2055(a). For example, “30% of the remaining assets of my estate.”

Conclusion

This is a 40,000-foot overview of several charitable strategies that can empower the generosity of your clients and equip them with wiser alternatives than making cash donations. I hope it has stimulated your planning thoughts and stirred your curiosity for further research.

“*We make a living out of what we get, we make a life out of what we give*.”

--Winston Churchill