Charitable planning strategies for advisors

The Top 10 Rules

Helping your clients and your business with charitable planning

Professor Russell James III, J.D., Ph.D., CFP®

Director of Graduate Studies in Charitable Financial Planning
& CH Foundation Chair in Personal Financial Planning
Texas Tech University

Before getting started, make sure to establish charitable intent. Are they already donating? Do the plan to do so?

You can leave it to
____% family
____% government
____% charity (causes that have been important in your life)

Of course, with every rule, there's always an exception.

Don't leave estate gifts to family that are illegal to sell. They'll still owe estate taxes on the appraised value.

"Canyon" by Robert Rauschenberg appraised by the IRS at $65M ($29.2M in Estate Taxes). It's a felony to sell the art because it includes a stuffed eagle. Other examples: Ivory, Indian Artifacts

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2. Use the charitable swap
3. Learn "bunching" and other new tricks
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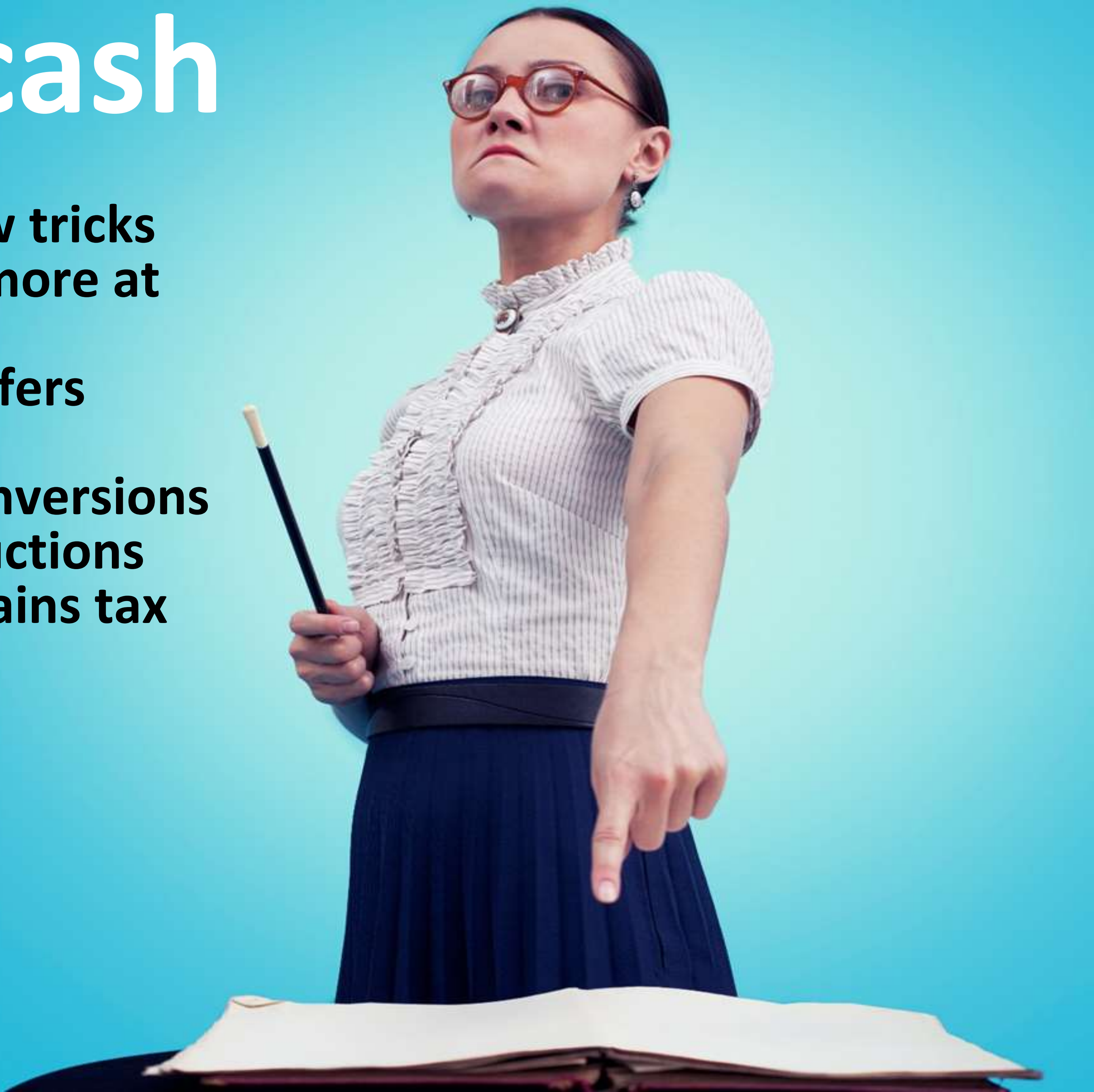
5. Take deductions today for transfers tomorrow
6. Match deductions with Roth conversions
7. Buy life insurance with tax deductions
8. Earn more by avoiding capital gains tax
9. Grow tax free
10. Maintain wealth over multiple generations



Appreciated asset gifts are objectively cheaper

Tax deduction only

Tax deduction
+
Avoid capital gains tax

Asset gifts are cheaper for itemizers

Donor

Nonprofit

Income tax deduction ($10,000 x 37%)

$3,700

Costs $6,300

Donor

Nonprofit

$3,700

+

Avoid capital gains ($9,000 x 23.8%)

$2,142

Costs $4,158

Asset gifts are cheaper for non-itemizers

$10k Cash

Donor

Nonprofit

Income tax
deduction
($10,000 x 37%)
$3,700

Costs $10,000

$10k Stock

Donor

Nonprofit

$3,700
+
Avoid capital gains
($9,000 x 23.8%)
$2,142

Costs $7,858

Asset gifts became even cheaper for those in many states

Sunsets post-2025

Donor

Nonprofit

Net cost $52,000 in '18 vs. $53,756 in '17

Donor

Nonprofit

Net cost $20,680 in '18 vs. $26,356 in '17

2017	*2018*
Income tax deduct.	**Income tax deduct.**
($100,000 x 39.6%)	**($100,000 x 37%)**
$39,600 fed	**$37,000 fed**
($100,000 x 11%)	**($100,000 x 11%)** ~~–~~
–($100,000 x 4.36%)	~~($100,000 x 4.36%)~~
$6,644 state	**$11,000 state**
+	**+**
Avoid capital gains	**Avoid capital gains**
($90,000 x 23.8%)	**($90,000 x 23.8%)**
$21,420 fed	**$21,420 fed**
($90,000 x 11%)	**($90,000 x 11%)**
–($90,000 x 4.36%)	~~–($90,000 x 4.36%)~~
$5,980 state	**$9,900 state**

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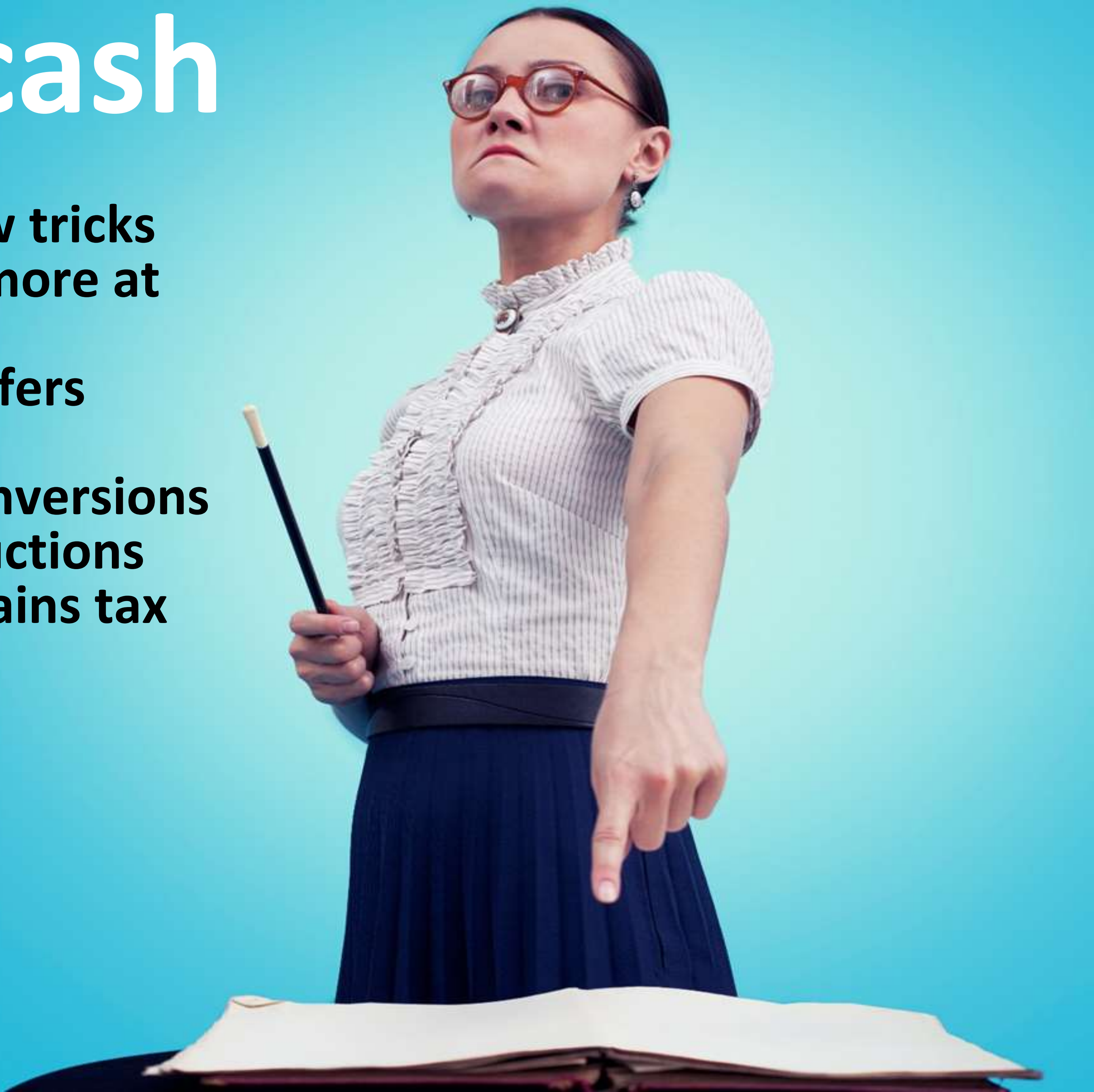

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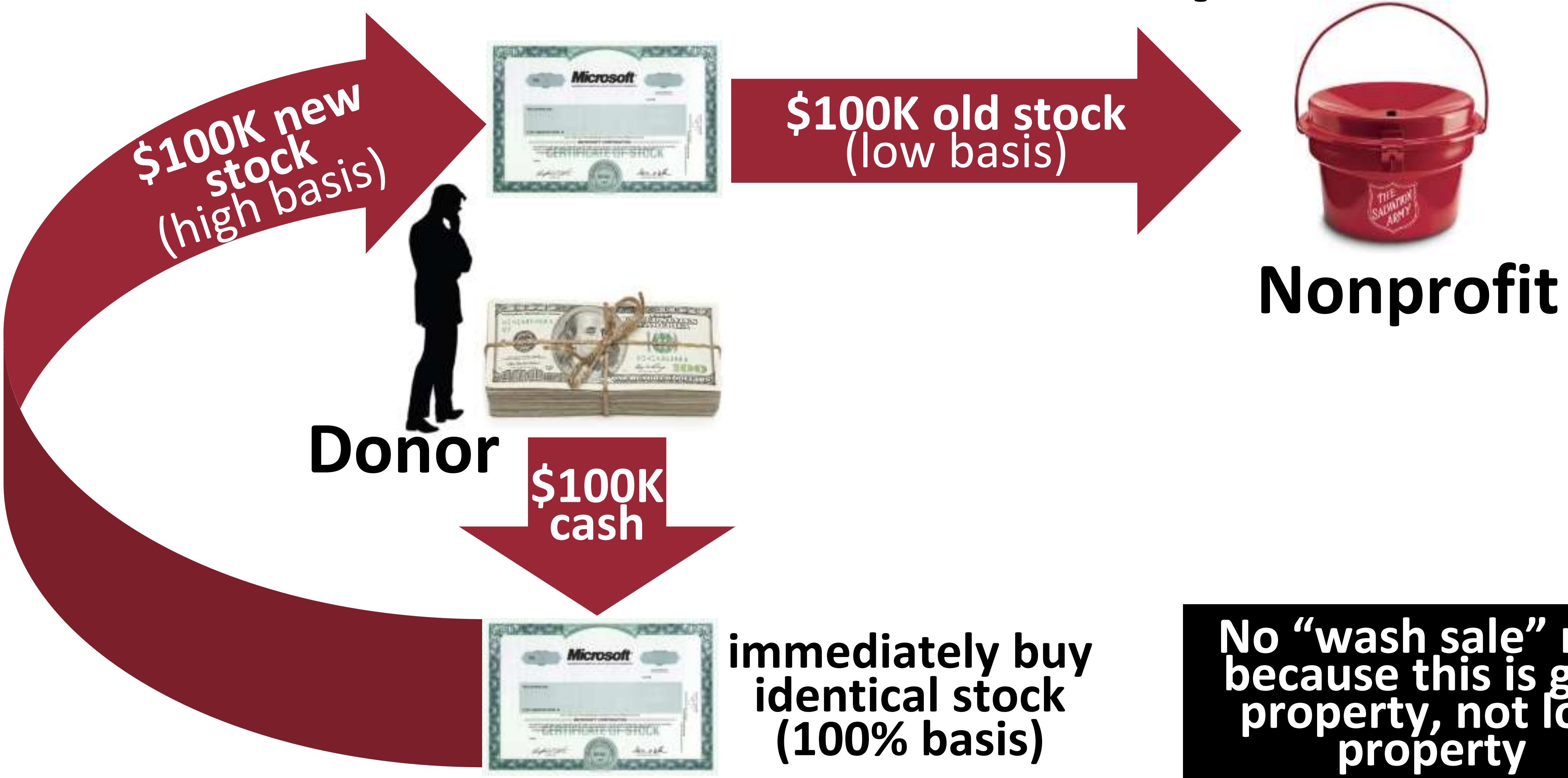
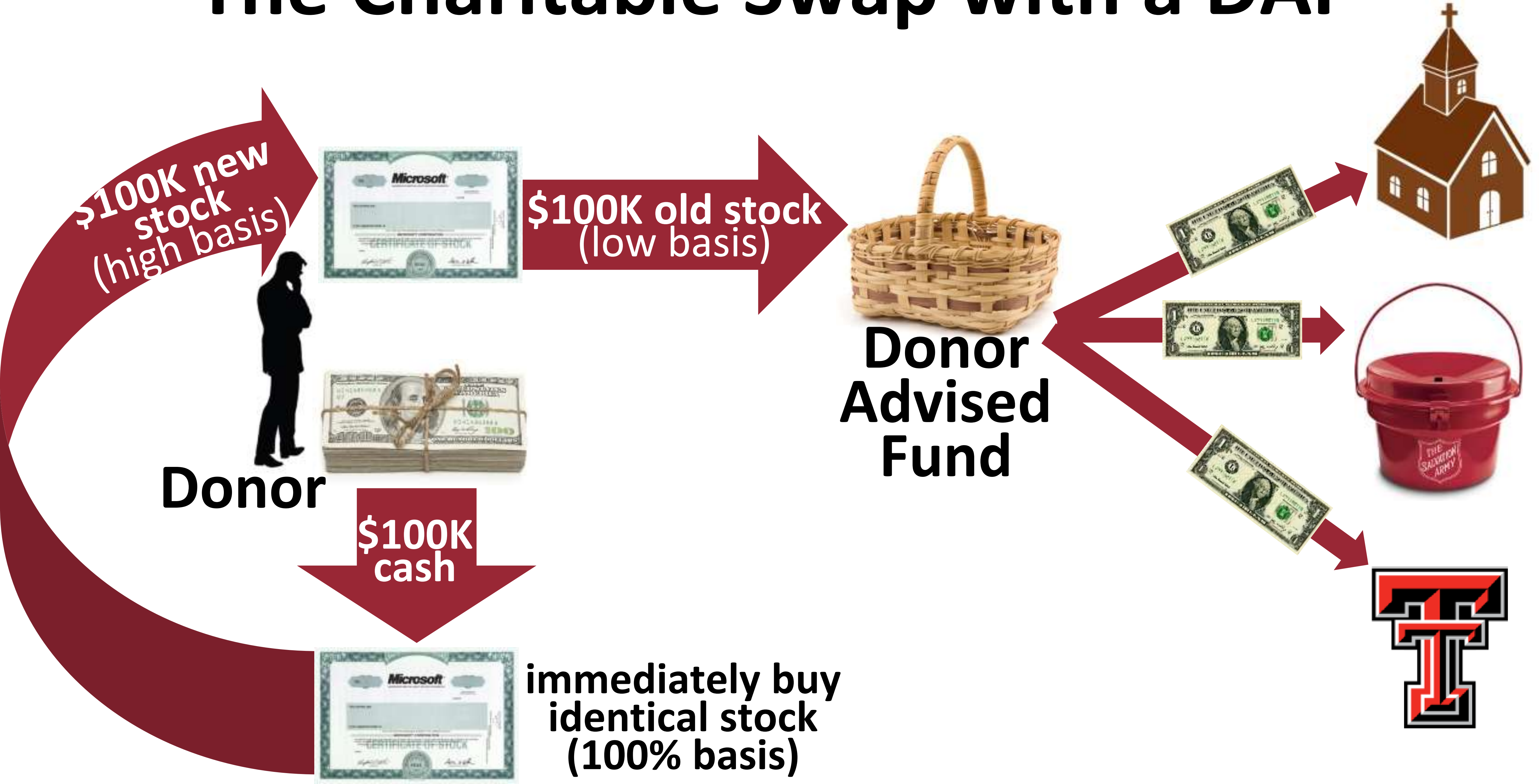
No need to change your portfolio!

The Charitable Swap



No “wash sale” rule because this is gain property, not loss property

The Charitable Swap with a DAF



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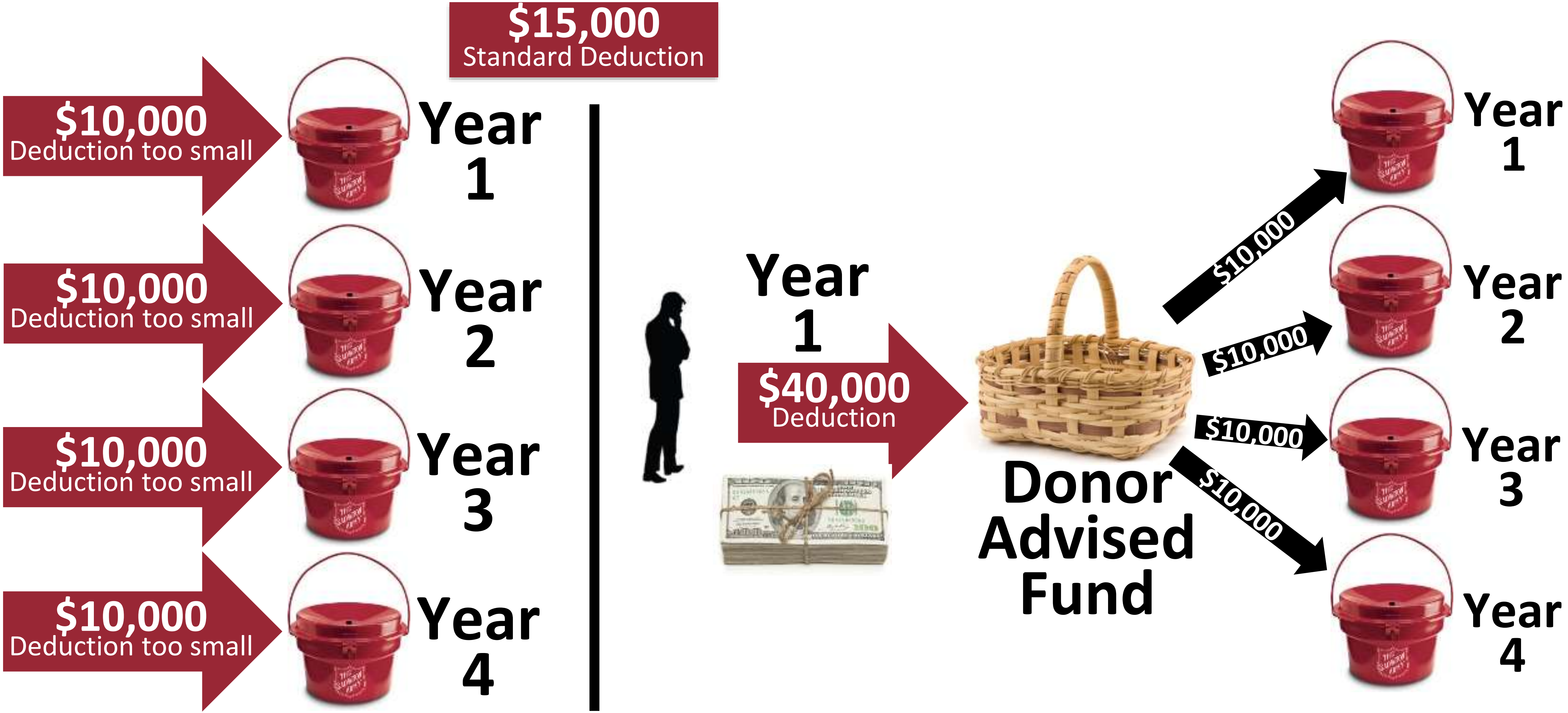
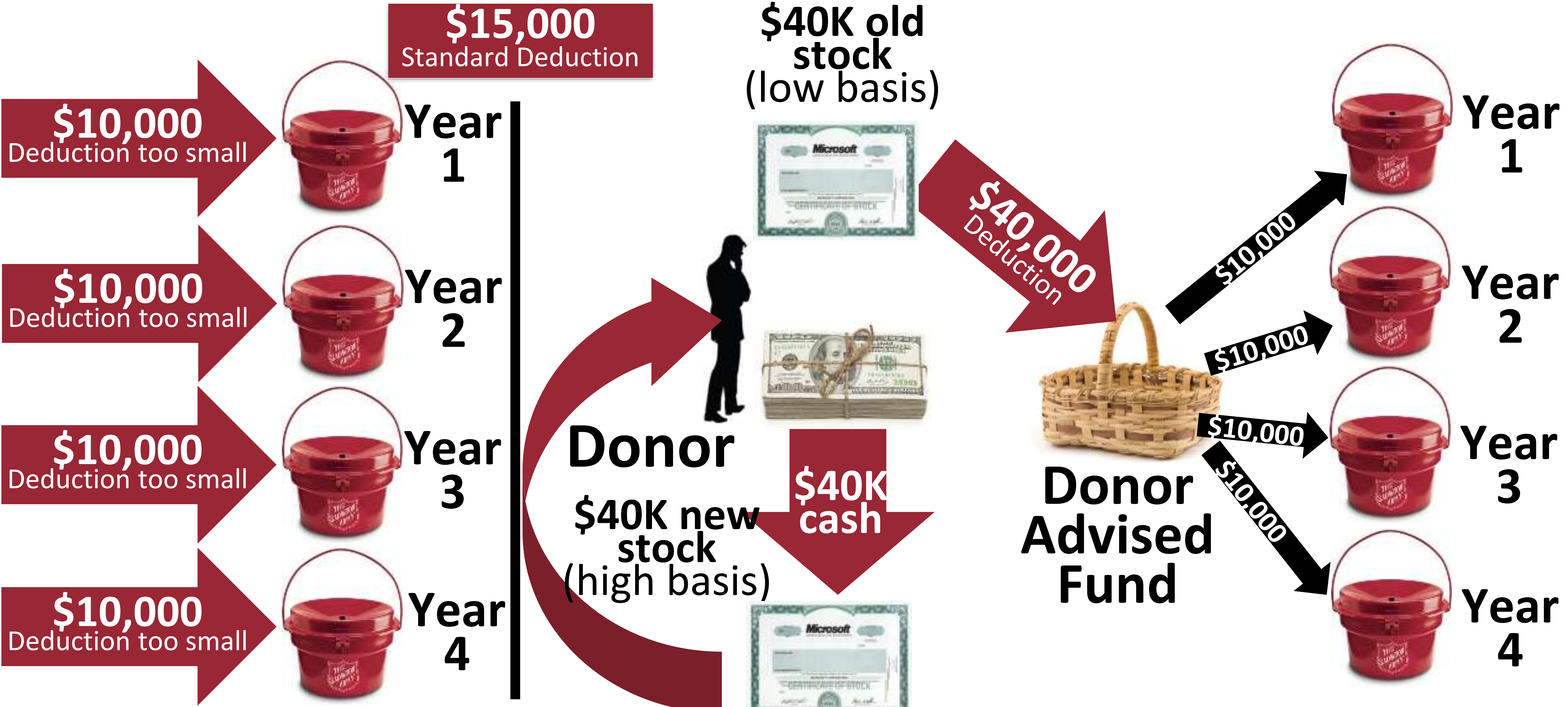
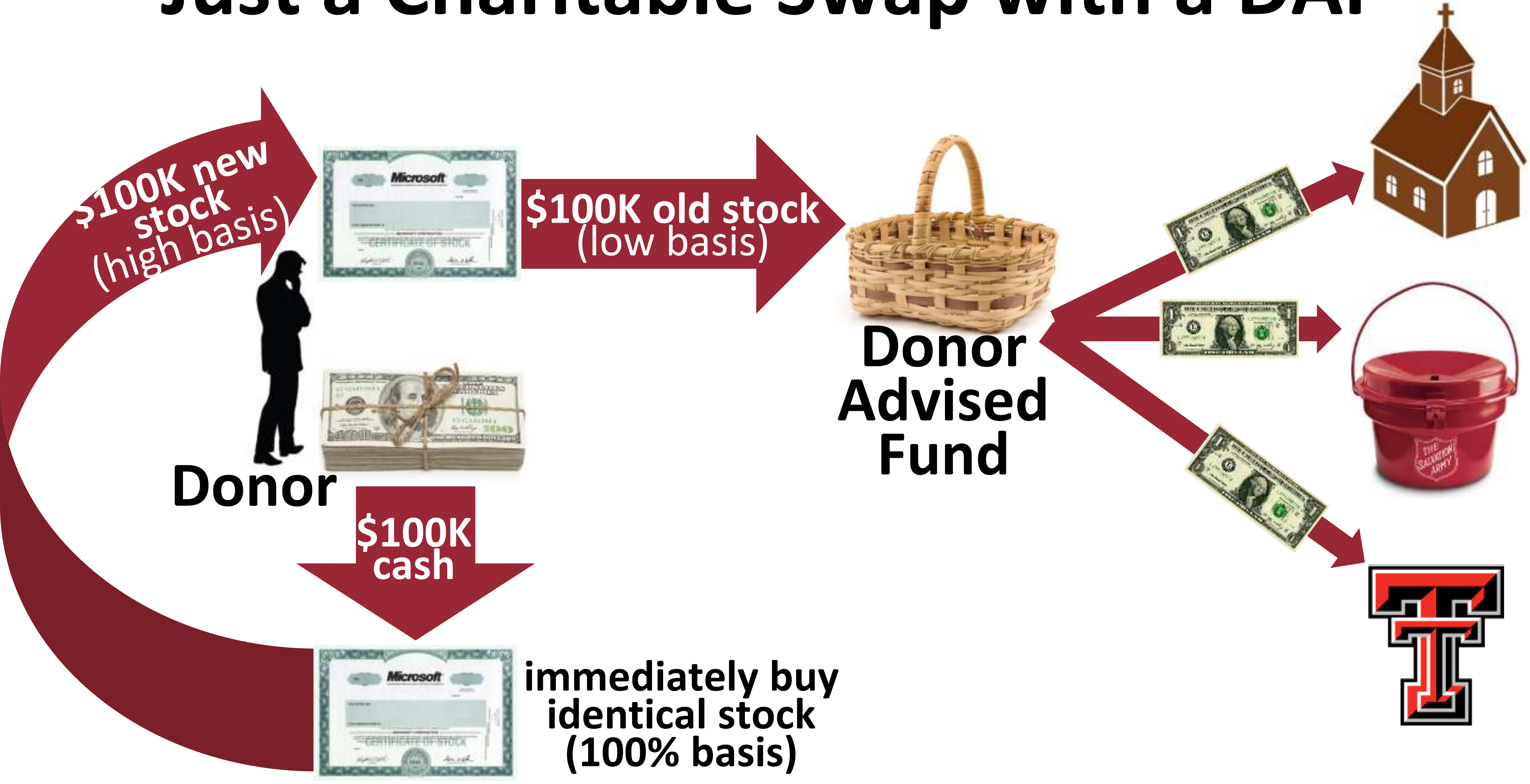
For non-itemizers, consider bunching donations into BIG giving years



Smarter bunching with asset gifts



Just a Charitable Swap with a DAF



For some, the benefits from giving even cash went up

1. 2017 charitable tax deductions reduced by 3% of income over $261,500 [Pease limitation].
2. Higher state tax benefits with SALT caps
3. Income limits raised to 60%
4. Above the line small gift deductions in 2020, 2021, dropped in 2022

For some, the benefits from giving even cash went up

1. 2017 charitable tax deduction… …uced by 3% of i… …e over $20… …00 [Pease limitation].
   Ends after 2025
2. Higher s… …tax bene… with SA…T caps
   Ends after 2025
3. Income li… …aised to 60%
   Ends after 2025
4. Above the li… …mall gift ded… …ns in 2020, 2021, d…opped in 2022
   Already ended

1. The 20% deduction for business income phases out at higher ***taxable income*** levels
2. But charitable deductions reduce ***taxable income***, and can thereby “bring back” the business income deduction from the dead
3. Double benefit: Charitable deduction + bringing back the phased out business income deduction

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Life stages of a retirement account

Early distribution (before 59 ½)

Regular distribution (59 ½ to 73)

Required minimum distribution (73+)

Giving after 73

After age 73 participants must take required minimum distributions (account balance / remaining life expectancy) or pay 25% penalty

Giving after 73

If the income is not needed, a charitable gift deduction ***might*** offset the income

(if itemizing *and* no income giving limitations exceeded *and* no negative effects from increased AGI *and* not in the wrong state)

IRA

$10,000

$10,000 income

$10,000

$10,000 deduction

Giving after 70½

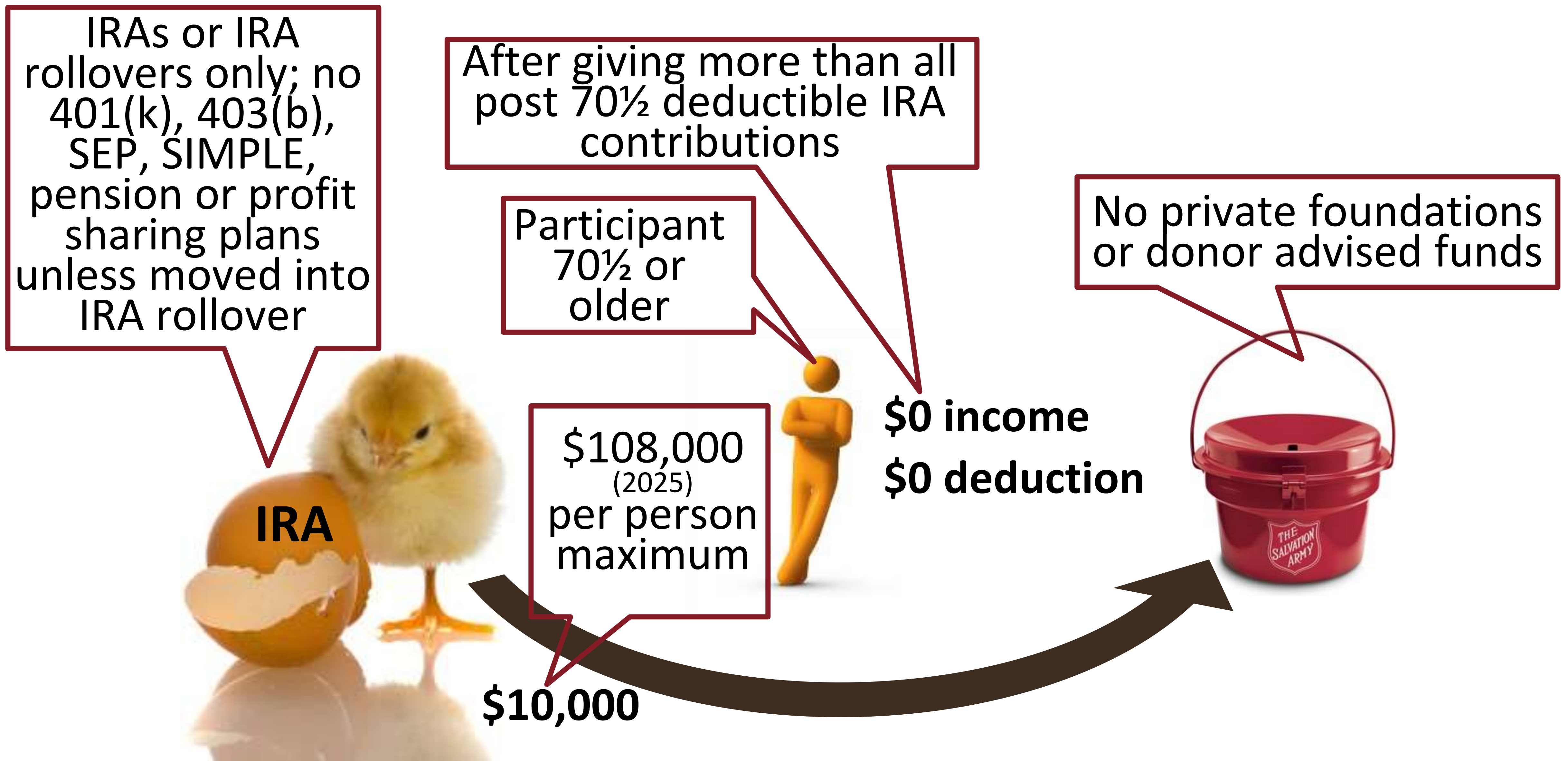
A Qualified Charitable Distribution (QCD) eliminates both the income and deduction

$0 income

$0 deduction

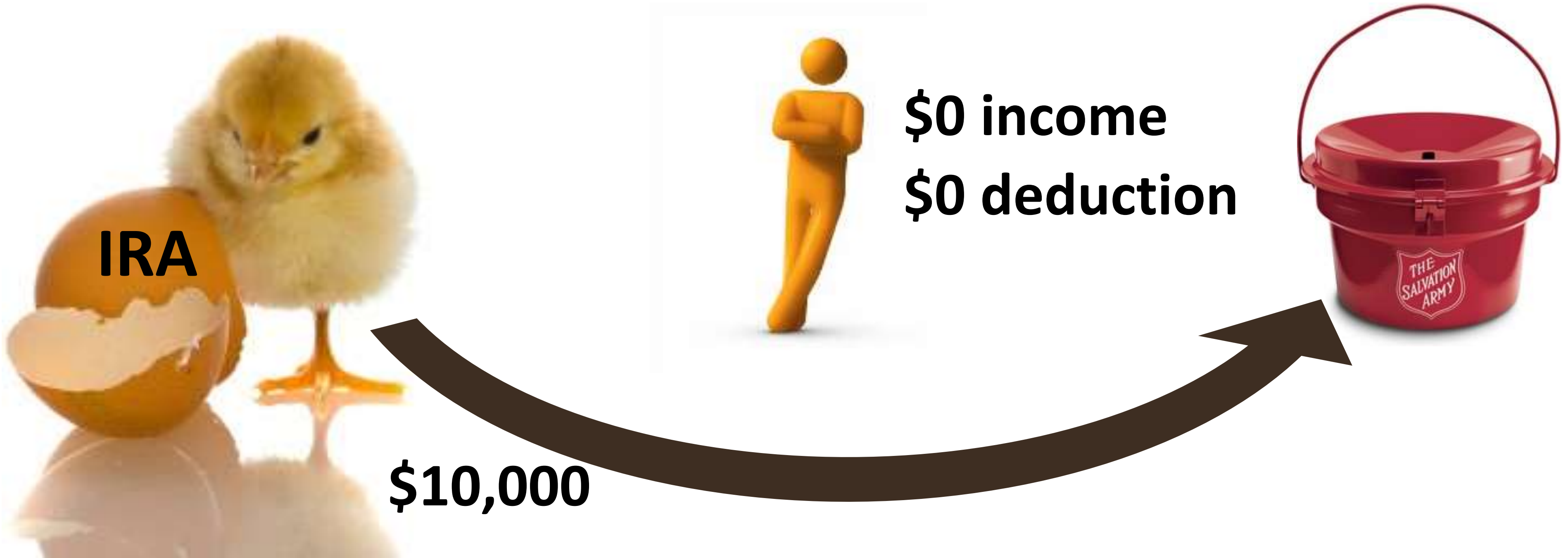
$10,000

Qualified Charitable Distribution (QCD)



Giving beyond or without an RMD

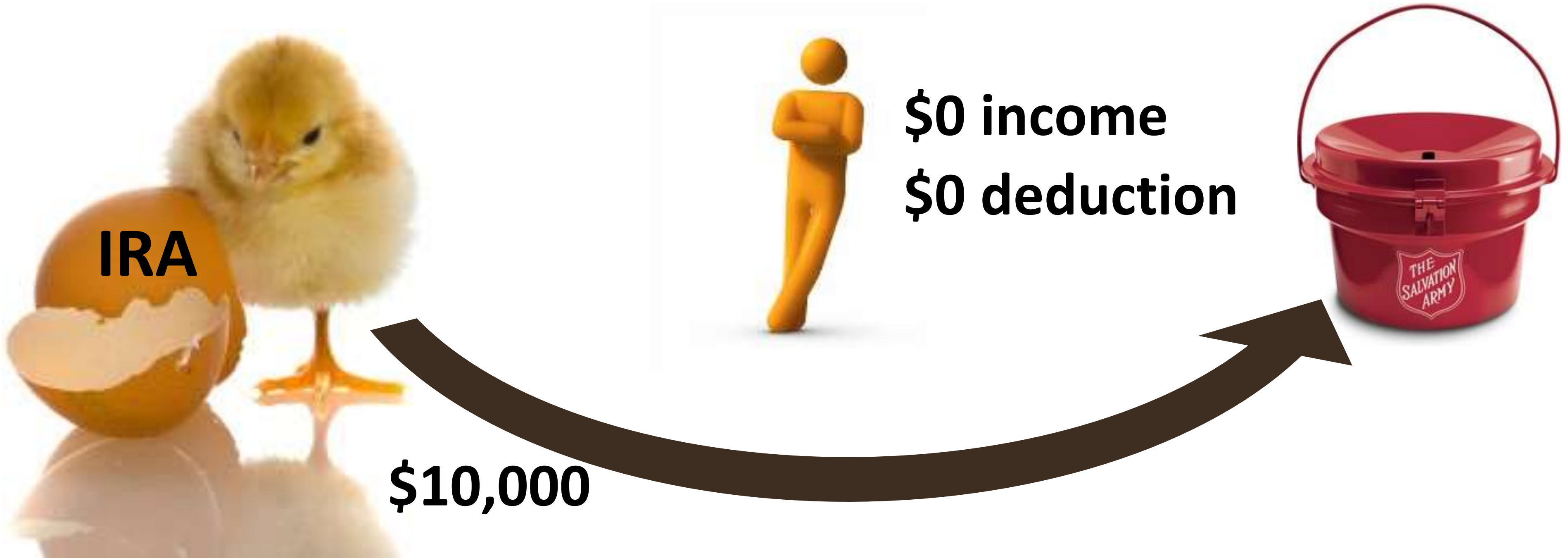
- Income taxes must be paid on this money sometime unless it is transferred to charity.
- Tax avoidance (QCD) is more efficient than a tax deduction.
- It is much more efficient that an unused tax deduction (not itemizing).



How much can a donor age 70½ + transfer via QCD?

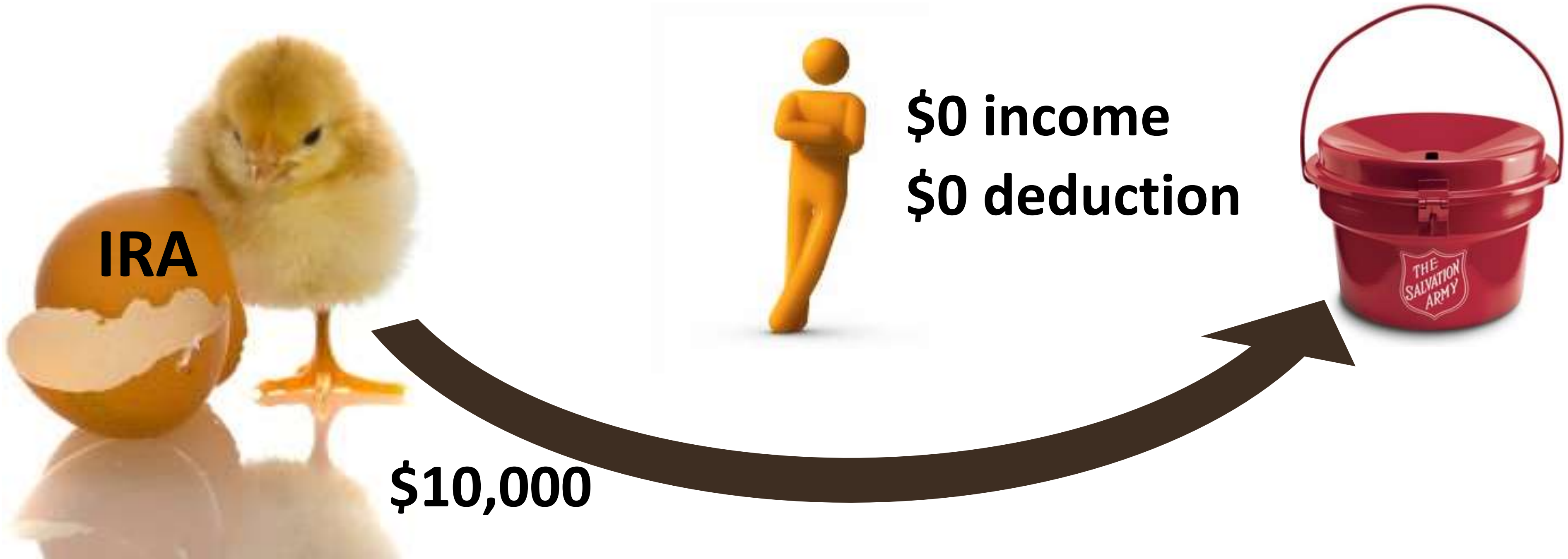
1. If their RMD is $25,000? Answer: $108,000.
2. If their RMD is $0? Answer: $108,000.
3. If their RMD is $200,000? Answer: $108,000.
4. If their RMD is $2 Million? Answer: $108,000.

(Hint: The answer is always $108,000.)

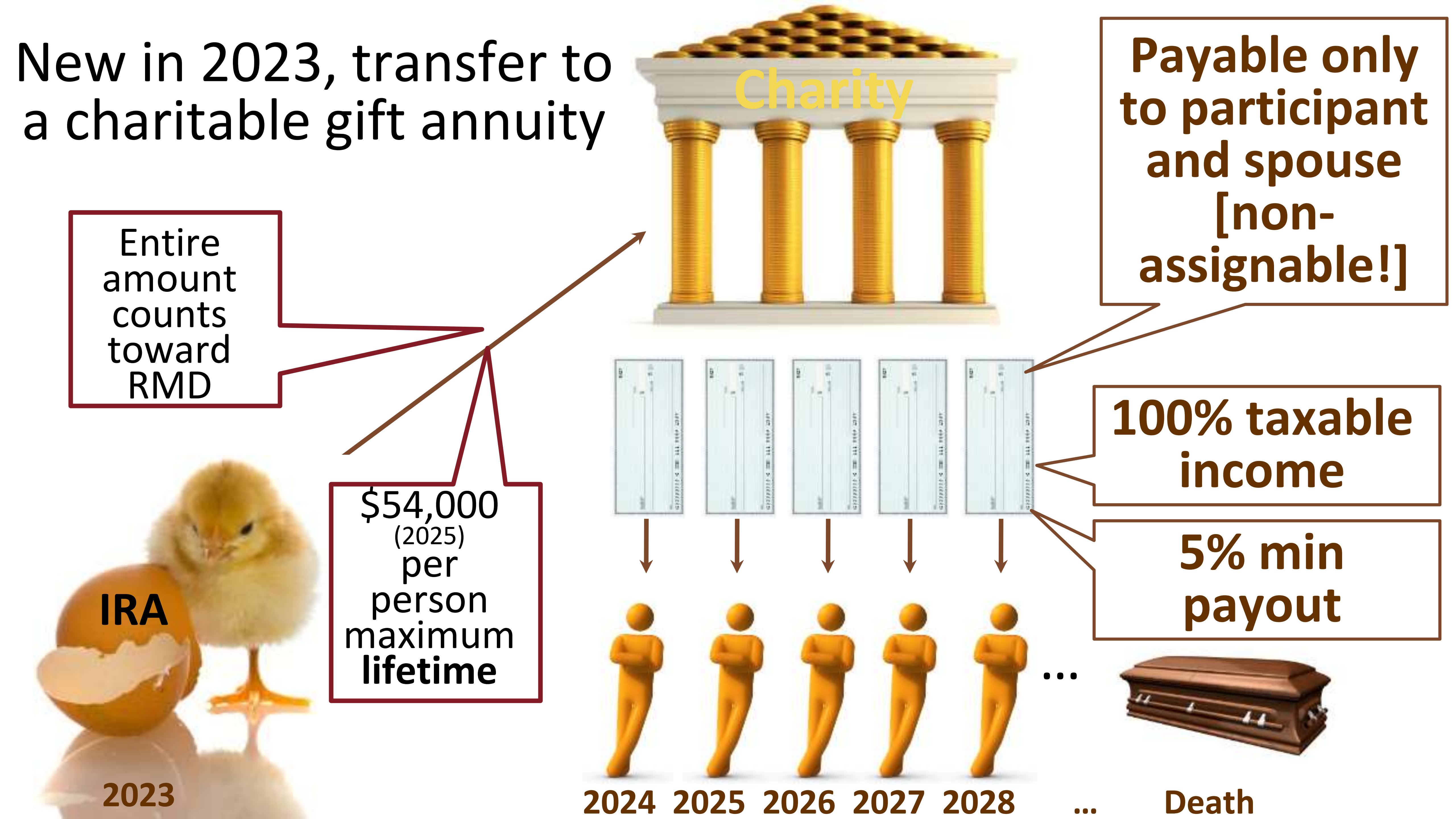


You must first convert other plans to an IRA rollover

- Warning: Any RMD in the year of conversion must be paid out! (The QCD doesn't fix this.)
- Solutions: Convert <u>prior to</u> first year of RMD. Starting talking when approaching age 70 ½, not 73!



New in 2023, transfer to a charitable gift annuity



Beware of the traps

- Don’t use standard CGA document – must be nonassignable
- Must be 5% minimum payout (even when paying both spouses) – ACGA 72-75 + 63 or younger is under this!
- Still 10%+ charitable present value (otherwise it’s not a CGA and you are selling a security)
- Must be completely separate CGA; No joint funding/ combinations/ later additions

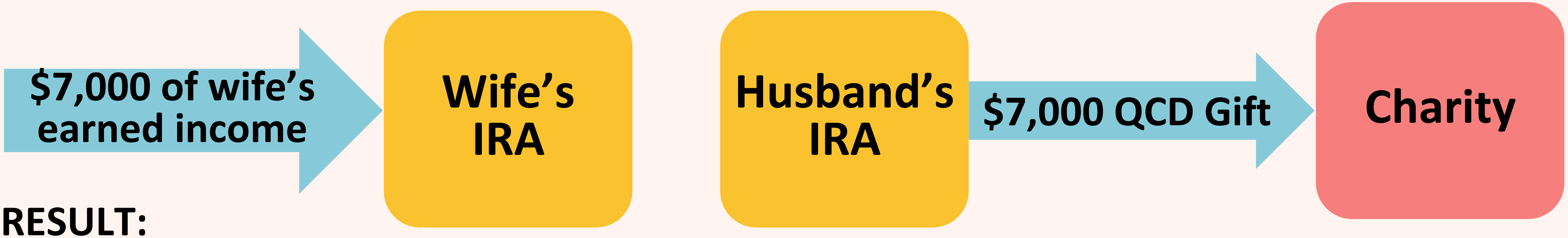
Beware of other issues

- May have CGA requests at odd amounts, exactly matching RMD for the year
- Should you even market this? Is it extra money or just cannibalizing QCDs? Tax benefits are mixed.
- Technically, you can send to a CRT, but currently admin/drafting costs are likely prohibitive

The SECURE Act's "above-the-line" charitable deduction

A donor couple has earned income, but doesn't want to change combined IRA balance

RESULT:
An unusable itemized deduction



RESULT:
An above-the-line $7,000 deduction for Wife's IRA contribution regardless of her age.
No change in combined IRA balance: $7,000 shift from Husband's IRA to Wife's IRA.
A $7,000 reduction in Husband's Required Minimum Distribution with no income recognition.

Retirement plan assets inherited by non-charitable beneficiaries are reduced by income tax


A client with a $1MM IRA and a $1MM house wants to leave one to her child and one to charity
Does it matter which goes where?

IRA(child); House(charity)

$1,000,000 House
$1,000,000 to charity

$1,000,000 IRA
-$370,000 (37% federal income tax)
-$133,000 (13.3% California state income tax)

$497,000 to child

SECURE now requires faster withdraw (10 years)

IRA(charity); House(child)

$1,000,000 IRA
$1,000,000 to charity

$1,000,000 House
-$0 (no income tax)
$1,000,000 to child

Leaving the IRA to family with a stretch CRT

PROBLEM

- The non-spouse IRA beneficiary must take it all out (and pay taxes) within 10 years
- These withdrawals may have to start immediately
- Limits tax deferral and tax-free growth

SOLUTION

- Naming a Charitable Remainder Trust (CRT) avoids this limit
- The IRA pays to the CRT with no taxes
- Tax-free growth continues inside the CRT
- Family members pay taxes only on their CRT income which can last for life

Retirement plan charitable beneficiaries

- A public charity
- A private family foundation
- A charitable remainder trust

Bad retirement plan death beneficiaries

- Not Charitable Lead Trusts (because they aren't tax exempt)
- Avoid naming estate as beneficiary with instructions in estate documents (estate itself may have to pay income taxes)

Easy answers to a misunderstood issue

Problem? Charities are not “designated beneficiaries,” so might accelerate RMDs for other beneficiaries.

No problem! Solutions:

- Payout charity share before September 30 of year following participant death.[1]
- Beneficiaries can separate accounts by end of year following participant death.[2]
- If spouse is beneficiary, simply roll that share into spouse’s IRA
- Separate IRAs into a 100% charitable and 100% non-charitable account before death (+ RMDs can be taken from either to match desired plans)

1. Treas. Reg. sec. 1.401(a)(9)-4 Q&A 4(a)   2. Treas. Reg. sec. 1.401(a)(9)-8 Q&A 2(a)

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A retained life estate deed can give the inheritance rights to a charity

Remainder Interest

Unlike a will, a retained life estate deed is not revocable

Transferred by recording a deed

(not by trust or contract)

e.g., “To John A. Donor for life, remainder to Texas Tech Foundation, Lubbock, TX 70409”

Remainder Interest

Donating inheritance rights to personal residences or farmland with a retained life estate deed creates a charitable tax deduction

Includes second homes, vacation homes, even a boat with bathroom, cooking, and sleeping facilities, if used by the donor as a residence

Charitable deduction for remainder interest deed with retained life estate in $1,000,000 of farmland by age 55 donor

11.6% (May 89)

$122,350

0.4% (November 20)

$903,710

Some people use the tax savings to buy life insurance for heirs who weren't going to use the farm or house anyway

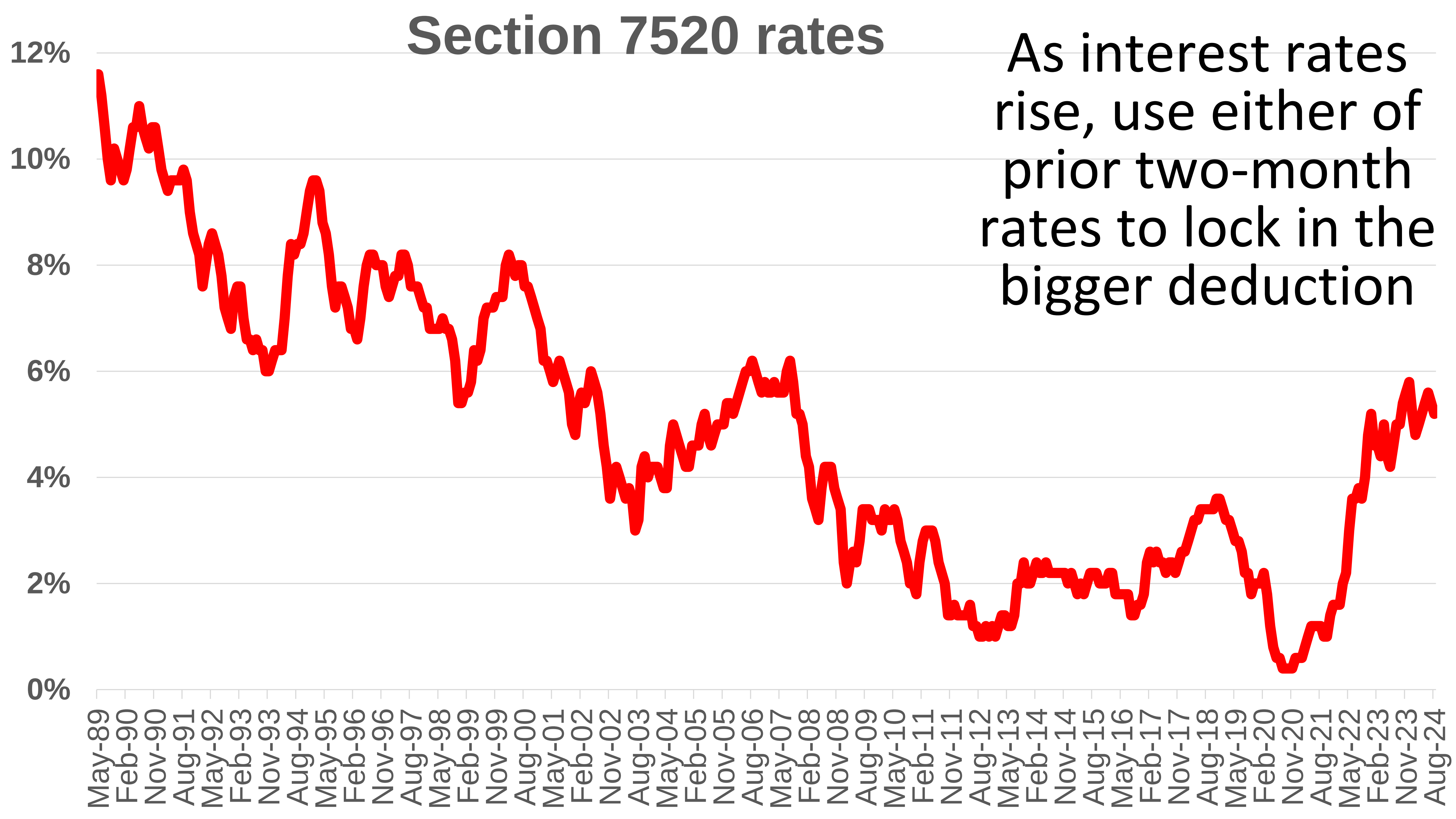
1% = $779,640

2% = $616,350

3% = $494,000

4% = $401,310

5% = $330,320


Section 7520 rates
As interest rates rise, use either of prior two-month rates to lock in the bigger deduction
12%
10%
8%
6%
4%
2%
0%
May-89
Feb-90
Nov-90
Aug-91
May-92
Feb-93
Nov-93
Aug-94
May-95
Feb-96
Nov-96
Aug-97
May-98
Feb-99
Nov-99
Aug-00
May-01
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Feb-20
Nov-20
Aug-21
May-22
Feb-23
Nov-23
Aug-24

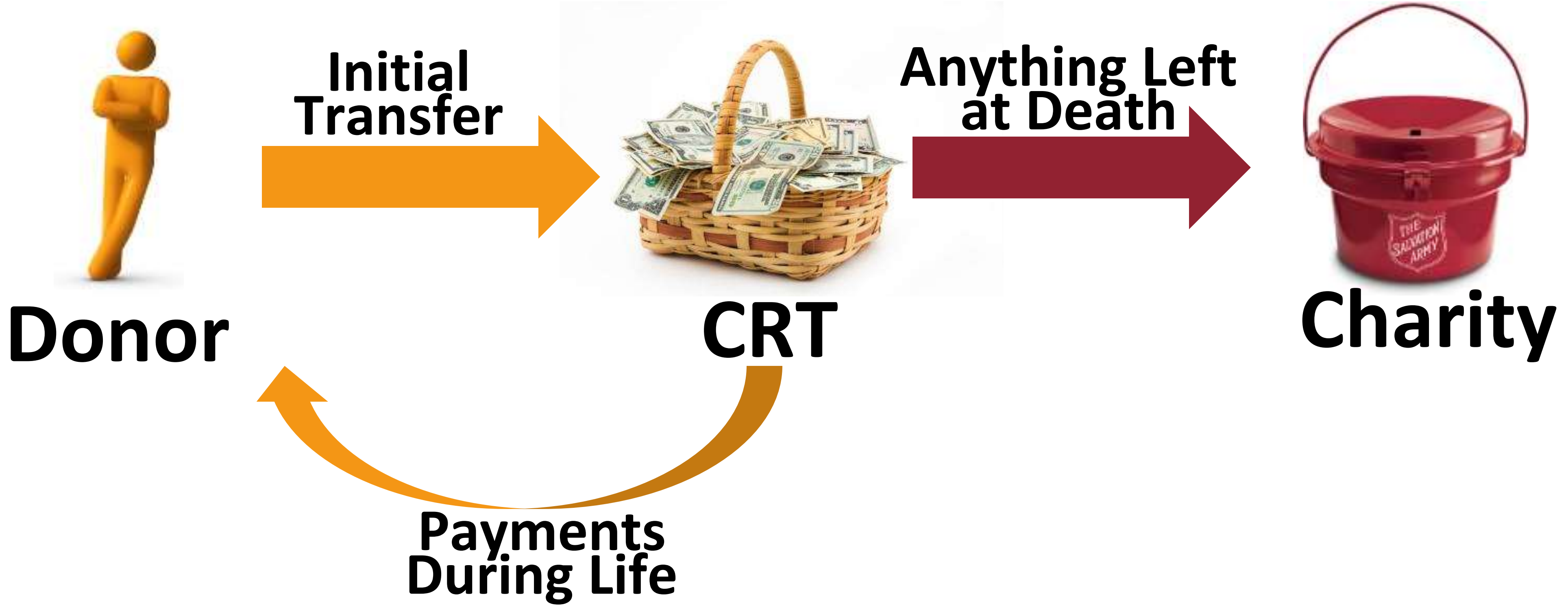
Leaving land to charity **by will**

- Revocable
- $0 income tax deduction

Leaving land to charity **by retained life estate deed**

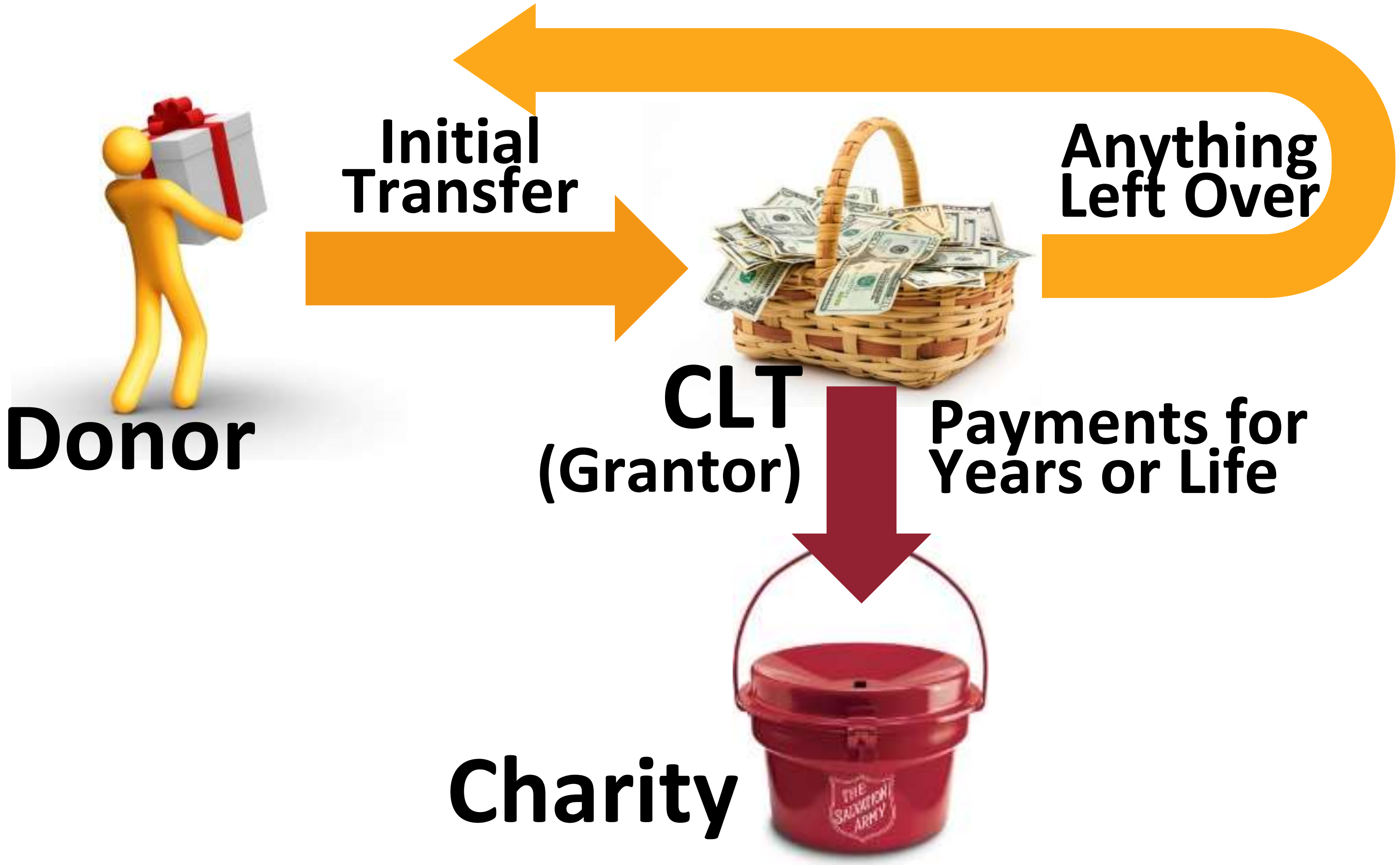
- Irrevocable
- Immediate income tax deduction
- Immediately increases donor’s available cash by lowering taxes

Charitable Remainder Trusts generate an immediate tax deduction, even though donor can manage assets and receive income for life



Grantor CLT

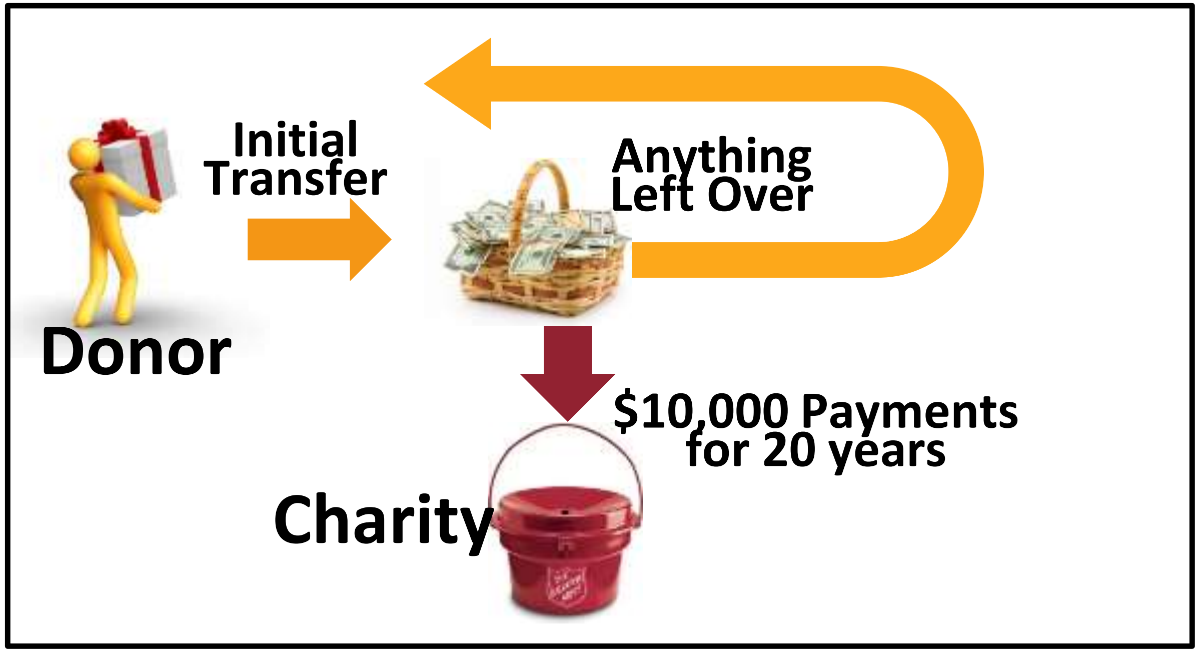
Donor immediately deducts present value of all future projected payments to charity



Funding $10,000/year gifts through a 20-year grantor CLAT (returning remainder to donor) creates an immediate deduction

- **$191,841 at 0.4%** §7520 rate
- **$134,903 at 4%** §7520 rate
- **$98,181 at 8%** §7520 rate

See iclat.net



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Roth conversions and charitable planning can work together to match

$1MM in standard IRA (withdraws are taxable)

Roth Conversio

$1MM in Roth IRA (withdraws are tax free and no owner RMD)

Conversion creates $1MM in immediate taxable income

Where can I find offsetting deductions?

Where can I find offsetting deductions?

Put money into a

- Charitable remainder trust
- Charitable lead trust (grantor)
- Charitable gift annuity
- Donor advised fund
- Private foundation

Or give a remainder interest in a residence or farmland to a charity

Charitable deductions may be limited (with five-year carryover) to 20%, 30%, 50%, or 60% of income depending on gift and recipient

If I have unused deductions, how can I pull future income into current year?

If I have unused deductions, how can I pull future income into current year?

With a Roth conversion

$1MM in standard IRA (withdraws are taxable)

Roth Conversio

$1MM in Roth IRA (withdraws are tax free)

Conversion creates $1MM in immediate taxable income

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Charitable planning devices such as Charitable Gift Annuities, Gifts of Remainder Interests in Homes and Farms, and Charitable Remainder Trusts produce amazing tax advantages, reducing income taxes, capital gain taxes, and estate taxes

But they also reduce heirs' inheritance

Life insurance can diminish this concern

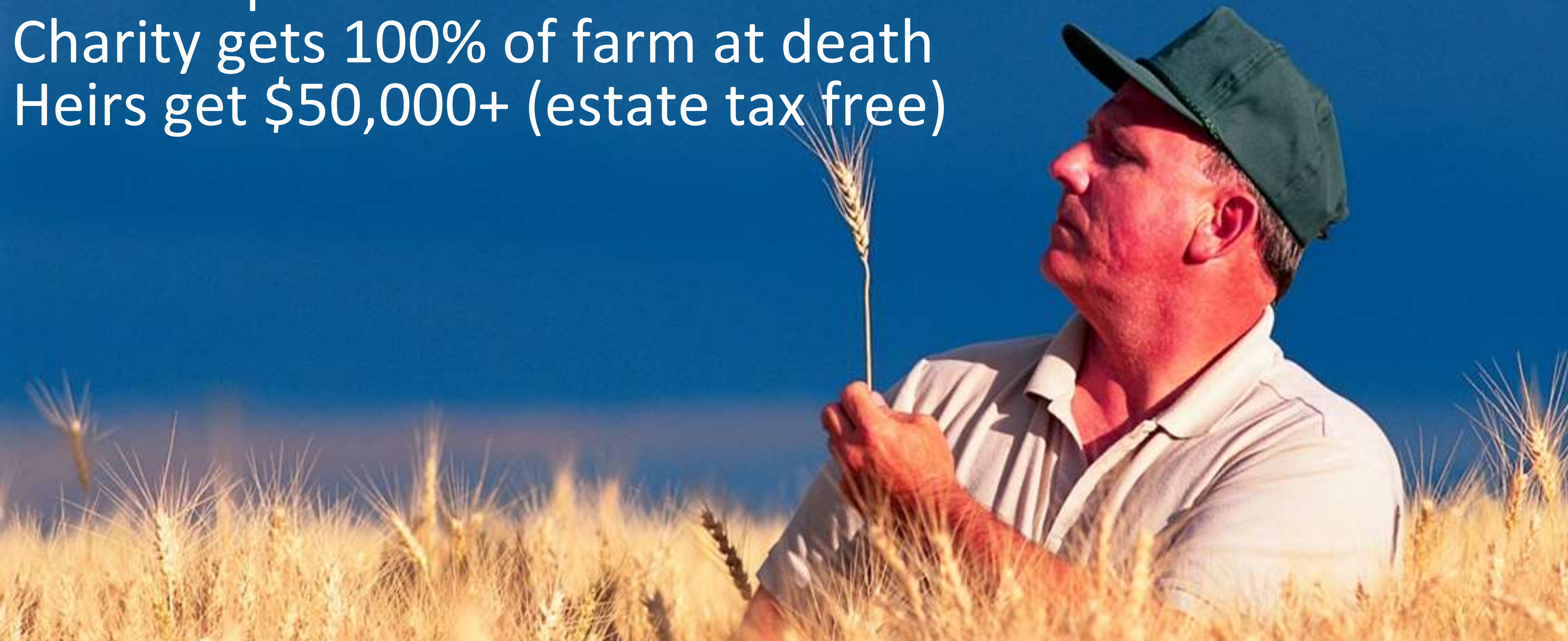
John, age 65, at 37% income tax rate, owns $100,000 of farmland which he would like to use for the rest of his life then leave to charity, but he also wants to benefit his heirs

Giving the remainder interest to charity creates a deduction the value of which will purchase a paid-up policy of about $50,000+.

John keeps lifetime use of farm

Charity gets 100% of farm at death

Heirs get $50,000+ (estate tax free)



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A client holds a large, highly appreciated asset that generates little income (like developable land or non-dividend paying stock). How can she convert it to income generating property?

Option 1: Sell it. Pay the capital gains tax. Earn income on the remaining amount.

$1,000,000 stock

$1,000,000 gain (if zero basis)

<u>$238,000 tax</u> (23.8% fed + ?% state)

$762,000 left to invest

Option 2: Transfer to a CRT. Earn income for life on the full amount.

$1,000,000 stock

$1,000,000 gain (if $100,000 cost)

$0 tax (CRT pays no tax)

$1,000,000 left to invest

Can it pay to be charitable?

Priscilla wants to sell a $1,000,000 non-income producing zero-basis asset then spend the interest income of 5% while leaving principal for heirs. Her federal tax rates are:

capital gains (23.8%)
income (37%)
estate (40%)

Sale

$1,000,000 asset
-$238,000 capital gains tax

Client uses $38,100/year
($762,000 X 5% return)

Heirs receive $457,000
($762,000-$304,800 est. tax)

CRUT

$1,000,000 asset
$0 capital gains tax

$1,000,000 in 5% unitrust pays $50,000 annually + a charitable tax deduction of $300,000 worth $111,000

+ ILIT

Client pays $111,000 initially and $10,000 annually for a $400,000 ILIT-owned policy (including post-crummey gift taxes)

Client uses $40,000/year

Charity receives $1,000,000 remainder

Heirs receive $400,000
(tax free from ILIT)

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Tax Free Growth Environments

- Growth inside a donor advised fund is tax free
- Growth inside a charitable remainder trust is tax free (only distributions are taxed)
- Growth inside a private foundation is tax limited (1.39% rate)
- AUM fees allowed in CRTs and PFs, but soon might have to be paid from other taxable accounts for DAFS

Tax free growth environments increases AUM

Year	DAF	Standard account
@ simple 10% returns	Tax free	Tax @ 37% Fed + 5% state
0	$10,000	$10,000
1	$11,000	$10,580
2	$12,100	$11,194
3	$13,310	$11,843
4	$14,641	$12,530
…	…	…
18	$55,599	$27,589
19	$61,159	$29,190
20	$67,275	$30,883

A CRT increases assets

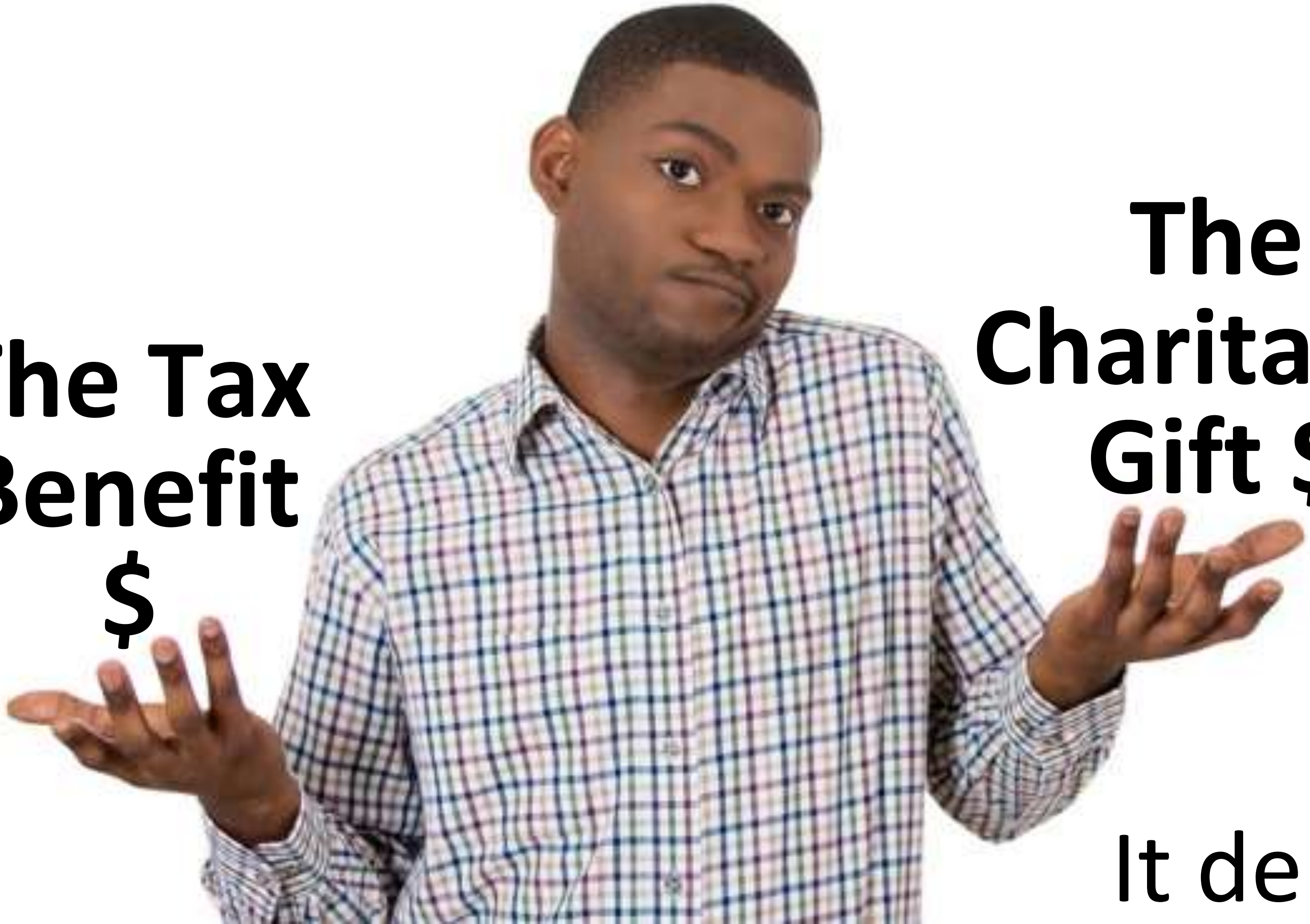
↑ No upfront capital gains tax at sale

↑ Tax deferred growth (only distributions taxed)

↑ Immediate tax deduction

↑ Post-mortem management by family with DAF/PF beneficiary

Will a maximum payout CRUT (with appreciated assets) give more after-tax dollars to donors & heirs than a direct investment with no charitable gift?



The Tax Benefit $

The Charitable Gift $

It depends…

Direct Investment v. Max-Payout

Monte Carlo Simulation of 3,000,000 retirement lifetimes

- **Age 60 male & 55 female**
- **Vary life span** (2012 IAM Table)
- **Vary returns** (historic large cap std. dev.)
- **Annual consumption 2.8% of initial investment then inflation adjusted**
- **20% basis asset**

Yeoman, John C. (2014). The economics of using a charitable remainder trust to fund a retirement portfolio. *The Journal of Wealth Management,* 40-50.

Direct Investment (No Charitable Gift)	Max Payout CRUT
(run out of money) **Failure** **9.9%**	(any payment below projected consumption) **Failure** **7.9%**
(Average PV of initial $) **Consumed** **52.88%**	(Average PV of initial $) **Consumed** **53.10%**
(Average PV of initial $) **for Heirs** **47.12%**	(Average PV of initial $) **for Heirs** **61.48%**

1. Never give cash
2. Use the charitable swap
3. Learn “bunching” and other new tricks
4. Give retirement RMD first and more at death
5. Take deductions today for transfers tomorrow
6. Match deductions with Roth conversions
7. Buy life insurance with tax deductions
8. Earn more by avoiding capital gains tax

9. Grow tax free

10. Maintain wealth over multiple generations

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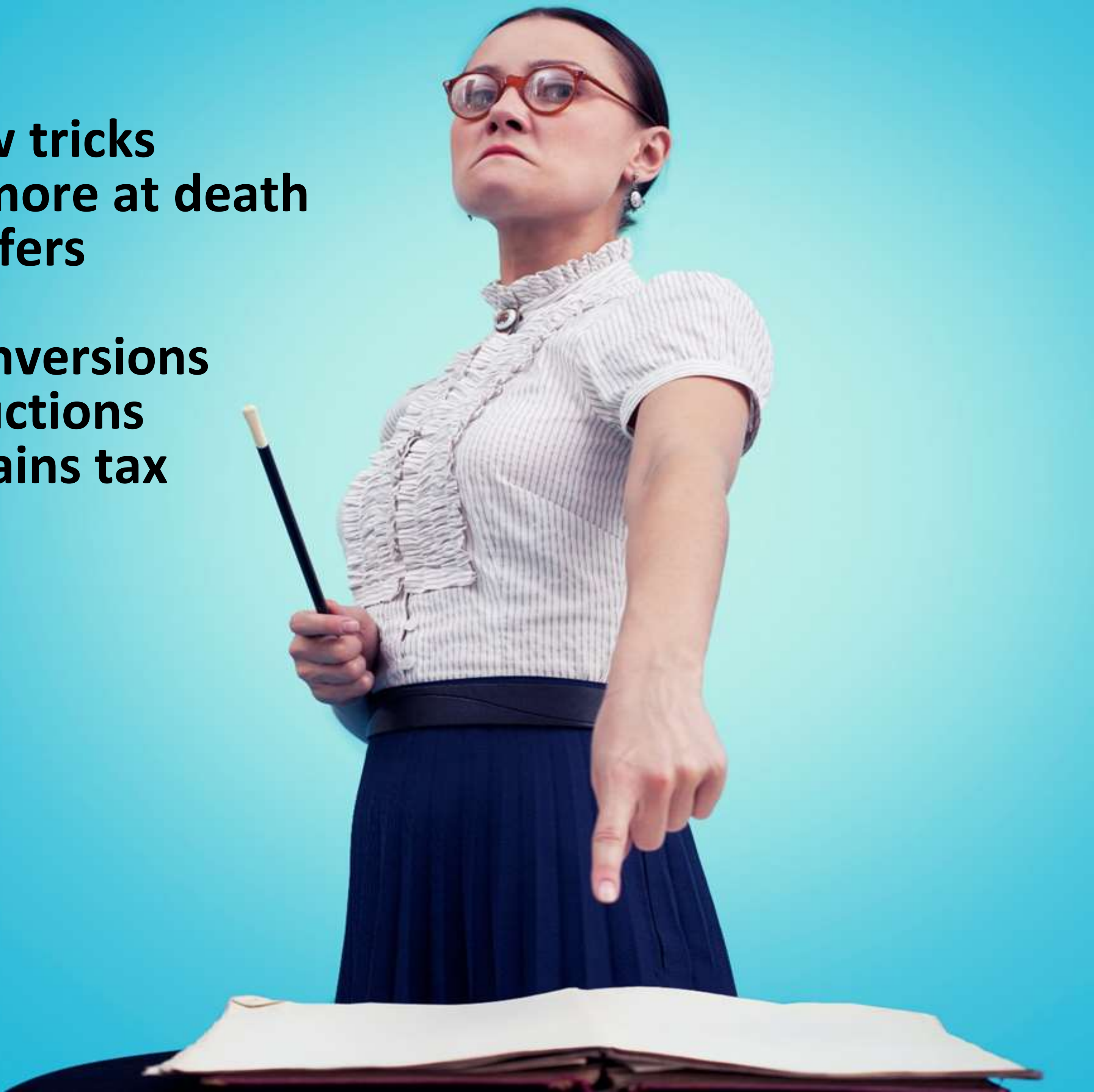


Keeping wealth together for many generations is difficult

1. The government takes a chunk of the assets at each generation
2. The rest is divided into smaller pools at each generation for each beneficiary
3. The government then takes a chunk of all subsequent earnings
4. At some point you will have a greedy, spendthrift heir

A donor advised fund or private foundation holds money and distributes charitable grants

Multi-generational management

Inheritance

- Small pools after division by 1/n children and estate tax
- Taxation at each generational transfer
- Taxation on all earnings
- Risk of greedy spendthrift heirs

Private Foundation/DAF

- Big pool with no division
- No estate tax
- No capital gain tax
- No or minimal income tax
- Family management (soft power)

P.F. Permitted Transactions

Foundation can hire an insider to perform necessary professional or managerial services (called "personal services") if compensation is reasonable

- Investment advice
- Legal work
- Accounting/tax services
- Banking
- Administrative assistance

The Council on Foundations' *Foundation Management Report* contains compensation information for various positions

P.F. Permitted Transactions

Reimbursements of reasonable and necessary expenses such as meals and travel

- **Travel to foundation board meetings for board members (and junior board members who perform some functions in that role)**
- **Travel to grantees or potential grantees sites to investigate current or potential awards**

Private foundations allow for unlimited multi-generational, nearly tax-free (1.39%) control of wealth, with ongoing ability to provide insider travel and employment for professional/ management services, and limiting charitable activities to founder’s desires

Donor Advised Fund

- No minimum payout
- Minimal setup & administrative expense
- Expected control of grants
- Investment management allowed with many financial institutions
- Legislatively newer

Private foundation

- 5% minimum payout
- Significant setup & administrative expense
- Actual control of grants
- Investment management always allowed
- Legislatively stable
- Family members can be employed by or be reimbursed by the foundation

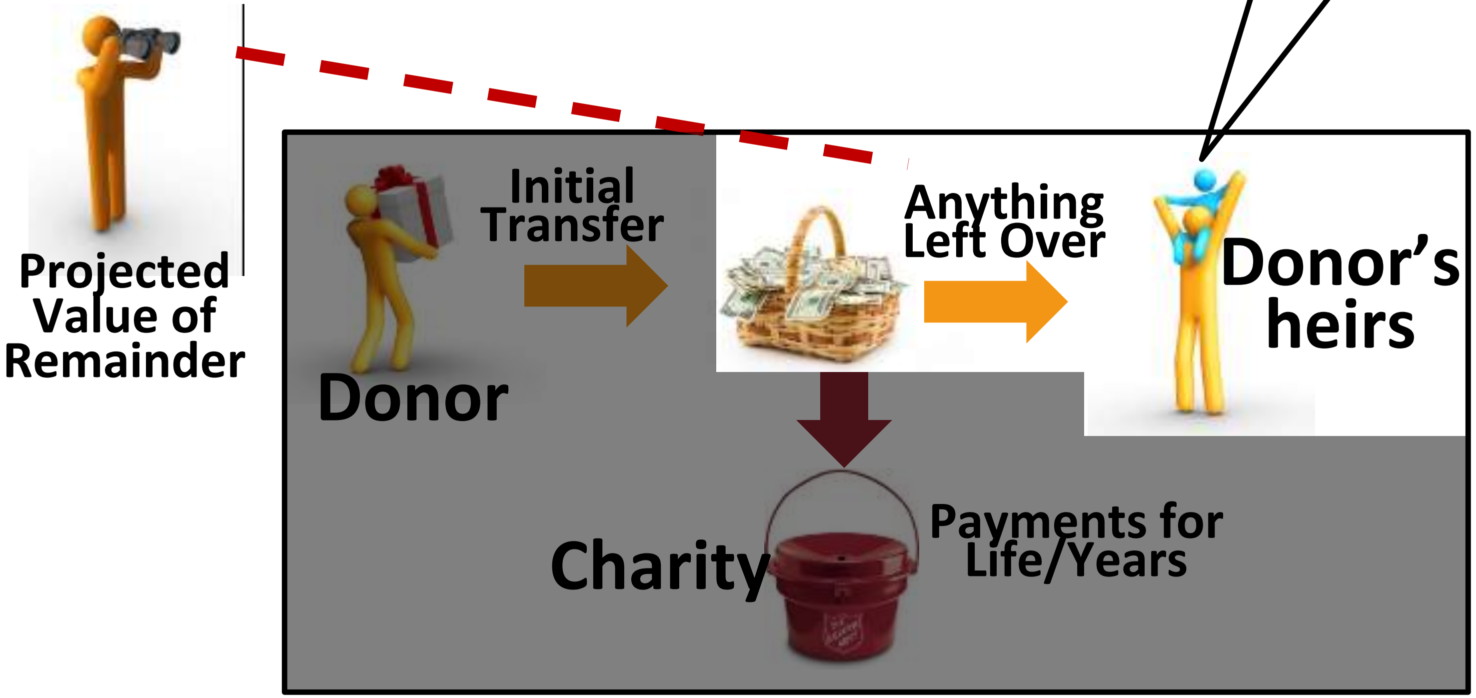
Non-Grantor Charitable Lead Trust

Donor gives money from which charity receives payments, with remaining amount going to family members

Using non-grantor Charitable Lead Trusts to cut gift and estate taxes

Gift taxes are paid on the present value of the **PROJECTED** remainder going to the heirs

Gift taxes are not paid on the **ACTUAL** remainder that eventually goes to the heirs



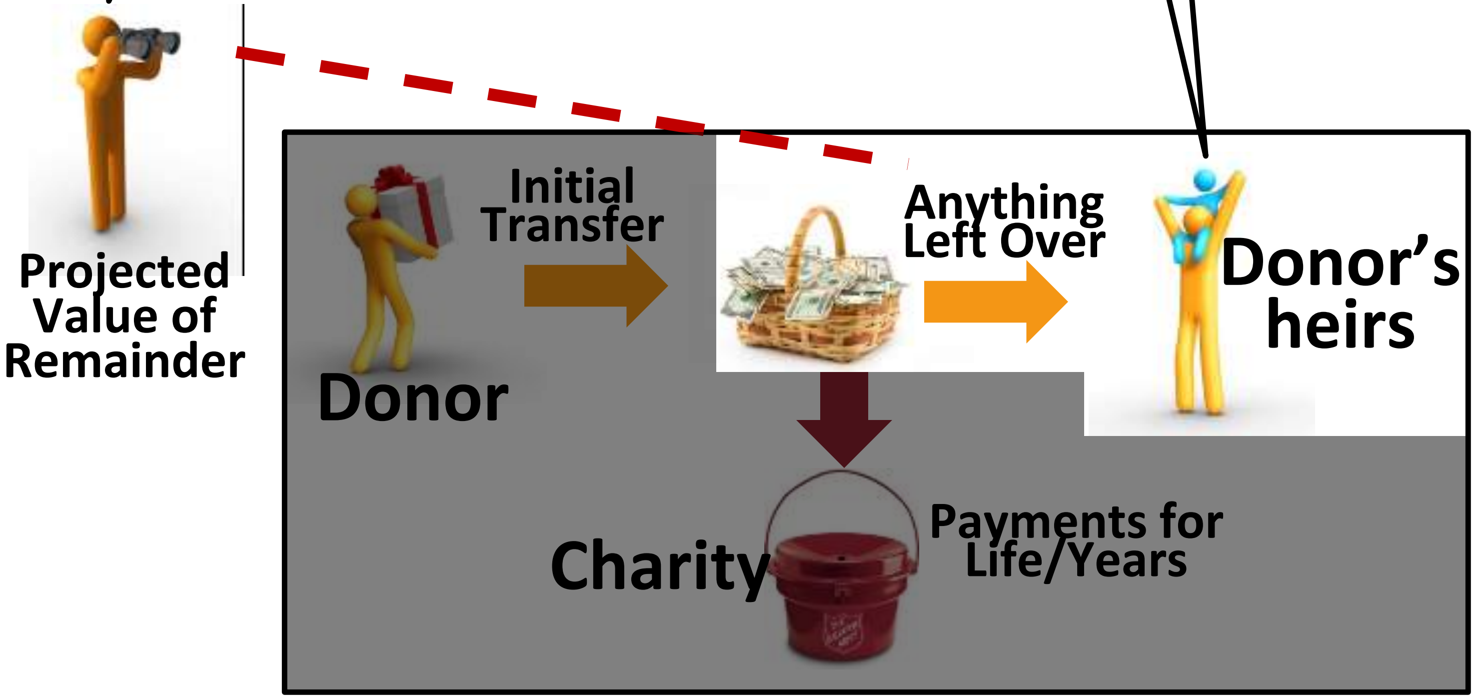
If the **ACTUAL** amount

is higher than the

PROJECTED amount,

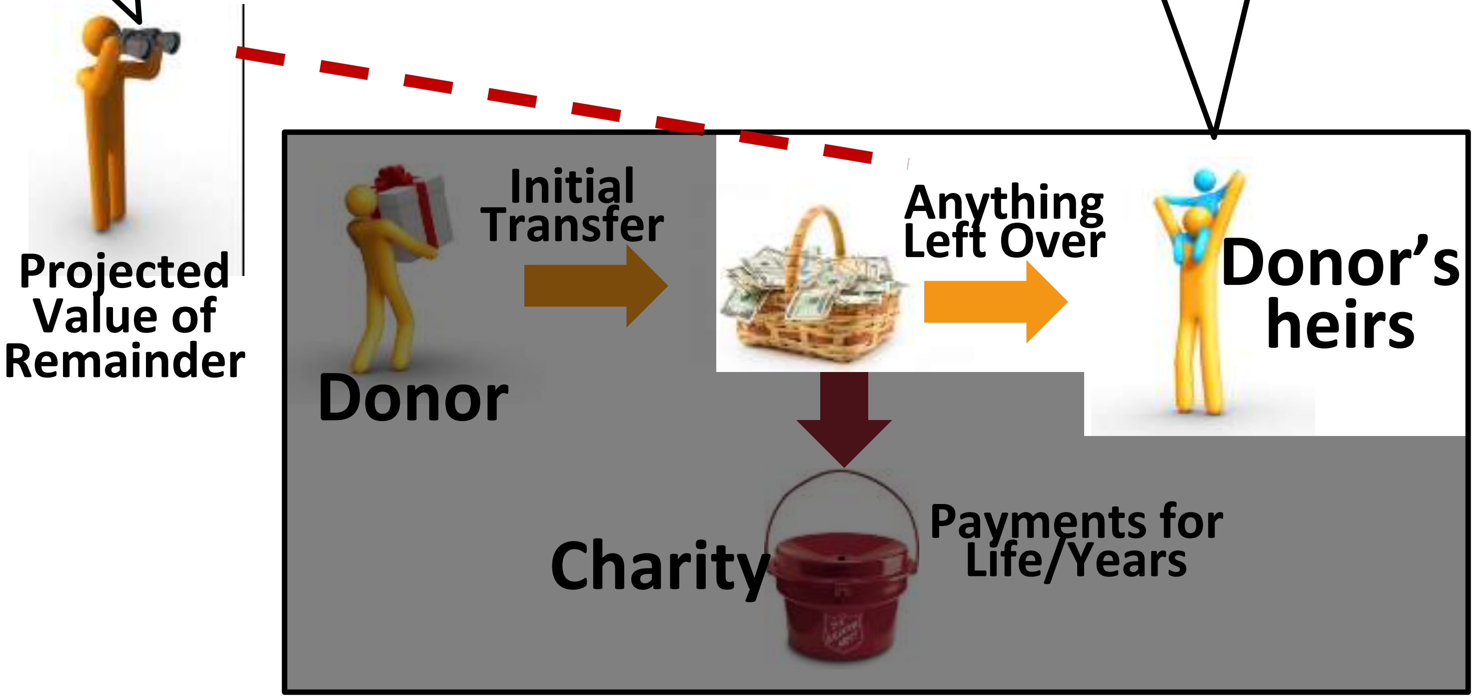
this part goes to heirs

tax free



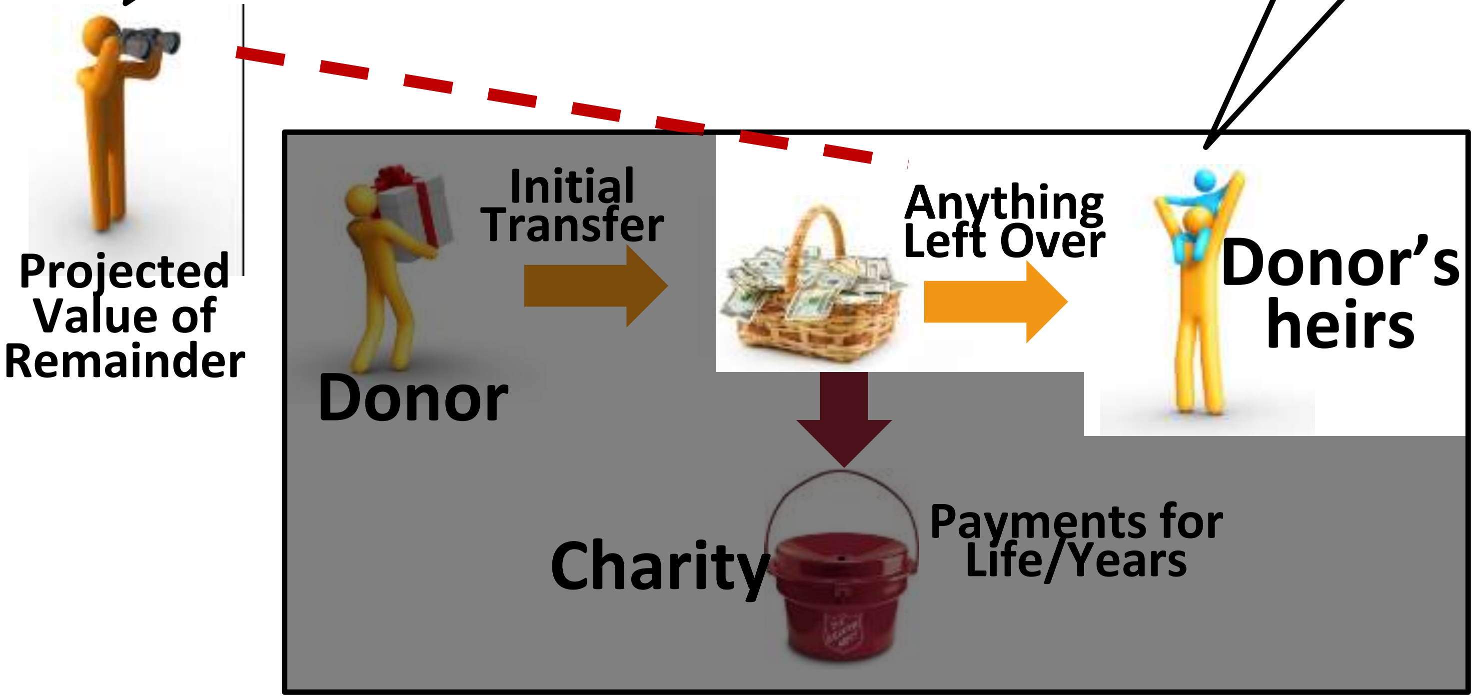
The **PROJECTED** remainder assumes investment growth at the **INITIAL** §7520 rate

If actual growth is greater than the §7520 rate, the **ACTUAL** remainder will be greater than projected



The **PROJECTED** remainder of $10MM at 0.4% §7520 with $521,266/year charitable payments for 20 years is $0, resulting in $0 gift taxation

If actual growth is 8%, the **ACTUAL** remainder will be $22,755,415



At 4% §7520, zeroes out at $761,387 annual gifts and transfers $23,666,559 remainder at 10% actual return

If the charitable gift *(or bequest)* was already planned, the zeroed-out CLAT *(or zeroed-out testamentary CLAT)* provides a no cost chance at tax-free transfers to family

Advanced charitable strategies to preserve wealth

- Lifetime and testamentary transfers to private foundation
- CRT (spigot) paying for life (if desired for consumption) then to family foundation
- Zeroed out CLT that pays charitable interest to family foundation, excess growth to children
- Multi-generational: Testamentary CRT, income to kids, then to private foundation run by grandkids

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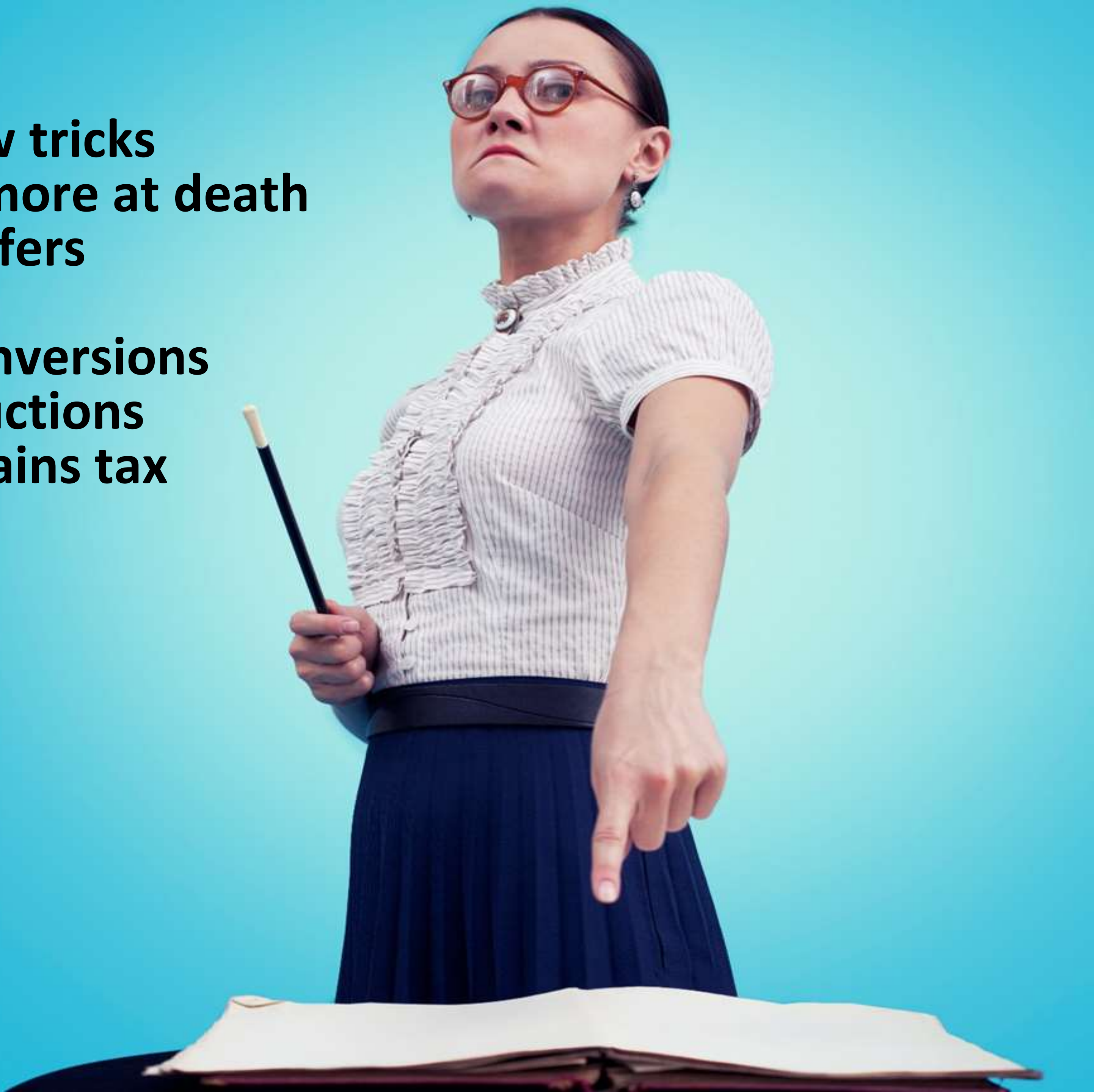

The Top 10 Rules

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For free links to all my slides, videos, papers, books, connect on LinkedIn! (Russell James, Texas Tech University)