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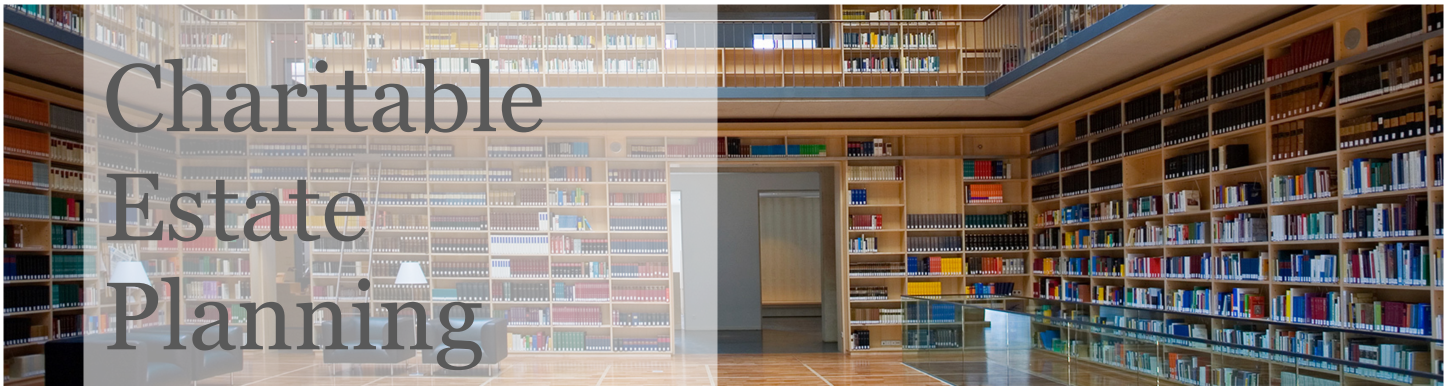
Helping You Plan, Protect & Prosper



Charitable Deduction

Gifts or bequests of cash or property to or for the use of a qualified charity are generally entitled to a 100% deduction when calculating transfer taxes, such as gift, estate, and generation-skipping transfer taxes. This is in contrast to the charitable income tax deduction, which is limited to certain percentages and subject to phase-out for high income taxpayers. It is the deductibility of the gift for income or transfer tax purposes that makes charitable gifts and bequests so important when developing estate planning strategies.

Options at Death

There are essentially three places where a person can transfer property at death. It can go to the family, the government, or charity. Most people want as much of their property as possible to go to their family; however, because taxes are mandatory above specified exclusion amounts, it may be difficult to avoid taxes altogether for individual estates over $11,180,000 (2018).

Zero Estate Tax Strategies

Example: assume that H & W have a $31,160,000 estate when they die. Subtracting the decedents' combined Applicable Exclusion Amounts (AEA) of $22,360,000 (in 2018), leaves $8,800,000 subject to estate tax at 40%, generating a federal estate tax for the government of $3,520,000. This would leave a total of $27,640,000 for the children.

For those who would prefer that the $3,520,000 not go to the government, they could leave the amount in excess of the $22,360,000 combined AEAs – $8,800,000 -- to their favorite charity, or perhaps to their family foundation. However, this method would reduce the amount the children would receive to the combined applicable exclusions of $22,360,000. H & W can solve this problem by having previously established an irrevocable wealth replacement trust that owns an $8,800,000 survivorship life insurance policy on their lives. In this scenario, the children would receive the full $31,160,000 -- less the cost of insurance premiums -- the charity gets $8,800,000 and the government gets zero.

A Sampling of Charitable Planning Strategies

Other charitable planning strategies involve reducing the estate by making lifetime or testamentary transfers to charity, again coupled with a wealth replacement strategy using life insurance in trust for the benefit of a decedent's family. Charitable gifts may include outright gifts, charitable gift annuities, charitable lead trusts (CLT), charitable remainder trusts (CRT), qualified conservation easements, pooled income funds, and charitable gifts of a remainder interest in a personal residence. Except for outright gifts, most of these methods allow a donor or his/her beneficiary to retain an interest in the gifted property, while transferring an income or remainder interest to charity. If done correctly, these techniques provide a tax deduction for the portion of the gift that passes to charity.

Here are some examples:

1. ***Gift of real property:*** X owns real estate that he does not occupy, nor does he have plans to develop it. Each year, he pays taxes, insurance, and maintenance, yet the property is not increasing in value. To reduce the outward cash flow, he could donate the property outright to charity, thereby, eliminating his expenses and indirectly increasing his cash flow. Assuming he owned the property for more than a year, he would not have to recognize any capital gains, nor would he experience any change in lifestyle. By using a wealth replacement trust, he could restore the value of the gifted property for the benefit of his family after his death
2. ***Gift of real property to NIMCRUT:*** If, instead of a gift of real property outright to charity, X could gift the property to a net income with make-up charitable remainder trust (NIMCRUT) that he establishes, he would receive a partial income tax deduction and retain an income stream from the NIMCRUT once the real property is sold and the proceeds are invested. Again, a wealth replacement trust could be used to benefit the family. X could use a charitable gift annuity in lieu of a NIMCRUT to achieve similar benefits.
3. ***Leave IRA or qualified plan assets to charity:*** At death, IRA or qualified plan benefits may be subject to income and estate taxation. One way to avoid the significant taxation that may occur at death on assets in an IRA or qualified plan would be to bequeath the plan benefits to charity or designate a charity as beneficiary of the plan. These qualified benefits would not be taxable to the decedent's estate or the charity.[1] In anticipation of this strategy at death, a wealth replacement trust could be previously established to restore to the family the amount bequeathed to charity.
4. ***Leverage charitable gifts with life insurance:*** One way for a charitably-minded person to leverage charitable gifts would be for the charity to purchase a permanent life insurance policy on the donor's life, assuming the charity has an insurable interest. The donor would pay the premiums with annual, tax deductible donations. Any cash value build-up in the policy would be available for use by the charity, and the death proceeds could be used for any charitable purpose or, within limits, for a specific use in accordance with the donor's wishes.

[1]See PLRs 9818009, 200002011, and 200652028. A private letter ruling (PLR) is issued by the IRS National Office in response to a specific request from a taxpayer as to the tax consequences of a proposed transaction. A PLR applies tax laws to specific facts only, is solely for the taxpayer who requested it, and should not be relied upon as authority by other taxpayers. Additionally, PLRs may later be revoked by the IRS. As such, PLRs do not carry the stamp of law, but they do give an indication of the IRS's current thinking towards a specific type of transaction. All references to PLRs in this current comment are for informational purposes only.

Insights and Caveats

- Charitable estate planning strategies are seemingly infinite. However, they form a cornerstone when planning for very wealthy individuals and families, especially when the family establishes its own private foundation.

- Funding of a wealth replacement trust will vary depending upon which charitable technique is used. In most cases there will be income tax savings from the charitable contribution that can provide an excellent funding source. Some techniques, such as a charitable remainder trust or charitable giftannuity, provide an income stream; and some techniques, such as an outright gift of real property, provide savings from no longer having to pay certain expenses. However it is funded, a wealth replacement trust in combination with a desired charitable gift can provide significant benefits for the charity and the family.

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