Greater Manhattan Community Foundation

The Top Ten Charitable Planning Ideas for the Current Environment

October 10, 2012

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THE TOP TEN CHARITABLE PLANNING IDEAS FOR THE CURRENT ENVIRONMENT

I. The Current Climate for Planning

Charitable planning is challenging in the current environment for at least four reasons that have changed charitable planning, focus and strategy:

1. Investment markets have fluctuated wildly since 2000 as interest rates have plunged to historic lows.
2. Income, estate, and gift tax rates decreased significantly under the 2001 Tax Act – but future rates are uncertain.
3. Congress and the IRS have leveled significant attention on charitable gift transactions and the operation of nonprofit entities and created new legislation that changes the rules for giving and nonprofit operation.
4. The press has focused on a number of cautionary tales regaling nonprofits that have misused donor funds.

A. Investment Markets

1. Index Returns

The expanding economy and strong corporate earnings of the 1990s led to unprecedented growth in the securities markets. Unfortunately, the bull market of the 1990s led to a series of bear markets in the first decade of the 2000's. In a survey of 50 to 70 year-old investors conducted by AARP in 2002, 77 percent had lost money in the stock market.[1] Twenty-five percent of that group reported losses of between 50 and 75 of their stock investments.[2] As a result, 21 percent who had not yet retired decided to postpone retirement as a result of their losses, and 10 percent who had retired decided to return to work. Markets have moved up with periodic corrections over the decade. Annual returns from 1999 through 2011 are shown in Table 1.

TABLE 1
MAJOR INDEX RETURNS 1999 – 2004

INDEX	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*
DJIA	25.22%	-6.18%	-7.10%	-16.76%	25.32%	3.15%
S&P 500	19.53%	-10.14%	-13.09%	-23.37%	26.38%	8.99%
NASDAQ	85.5%	-39.29%	-21.05%	-31.53%	50.01%	8.59%
DJ World	31.54%	-17.36%	-21.02%	-15.63%	38.58%	19.23%
Barclays LT Treas.	-15.13%	20.11%	3.5%	14.62%	1.38%	5.06%
ML Muni Master Bond Index	-6.34%	18.10%	4.5%	10.73%	2.54%	5.45%
Barclays Corp. Bond Index	-1.89%	9.1%	10.7%	10.17%	8.31%	5.41%

[1] Brown, S. Kathi, "Impact of Stock Market Decline on 50-70 Year Old Investors", (AARP, December 2002), <http://research.aarp.org>, p. 3.

[2] *Id.* P. 4.

TABLE 1
MAJOR INDEX RETURNS 2005 - 2011

INDEX	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*
DJIA	-0.61%	16.29%	6.4%	-33.8%	18.8%	11.0%	5.5%
S&P 500	3%	13.62%	3.5%	-38.5%	23.5%	12.8%	0.00%
NASDAQ	1.37%	9.52%	9.8%	-40.5%	43.9%	16.9%	-1.8%
DJ World	14.4%	23.01%	11.8%	-46%	37%	10.1%	-16.3%
Barclays LT Treas.	2.7%	1.85%	10.2%	20.64%	-13.17%	9.37%	34.01%
ML Muni Master Bond Index	3.9%	4.4%	4.18%	0.54%	9.4%	2.52%	10.64%
Barclays Corp. Bond Index	2%	4.3%	4.56%	-6.54%	18.68%	9.0%	8.15%

TABLE 2
MARKET SNAPSHOTS

All Time Highs	*High*	*Date of High*	*December 2011*	*Change*
Dow Jones	14,164.5	10/9/2007	12,217.56	-14%
S&P 500	1,565.15	10/9/2007	1,257.6	-20%
NASDAQ	5,048.62	3/10/2000	2,605.15	-48%

2. Interest Rates

As interest rates have declined, the interest paid on bonds, certificates of deposit, checking accounts and other fixed income instruments that seniors and retired donors rely on for living expenses has also declined. For a look at how those rates have fluctuated over the last decade, see Table 3.

TABLE 3
PRIME RATES, QUARTERLY, 1998 – 2012

	2000	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*
Jan 1	8.5%	9.5%	4.75%	4.25%	4%	5.25%	7.25%	8.25%	7.25%	3.25%	3.25%	3.25%	3.25%
Apr 1	9%	8%	4.75%	4.25%	4%	5.75%	7.75%	8.25%	5.25%	3.25%	3.25%	3.25%	3.25%
July 1	9.5%	6.75%	4.75%	4%	4.25%	6.25%	8.25%	8.25%	5%	3.25%	3.25%	3.25%	
Oct 1	9.5%	6%	4.75%	4%	4.75%	6.75%	8.25%	7.75%	5%	3.25%	3.25%	3.25%	
Dec 1	9.5%	5%	4.25%	4%	5%	7%	8.25%	7.5%	4%	3.25%	3.25%	3.25%	

3. The Madoff Chill

In addition to the extreme downturns in the securities and real estate markets the press reported numerous incidences of investment manager fraud, the most significant of which was the Madoff Ponzi scheme with losses of more than $50 billion. In later 2008, an investment manager in New York, Bernard J. Madoff, revealed the $50 billion he had managed for individuals, foundations, corporations, and other investment managers was all a fraud. For decades, he had run a Ponzi scheme in which dollars from new investors were used to pay longer-term investors. The assets and returns shown on statements were all manufactured. When the dust began to settle (the final asset count is not yet complete), Madoff held only several hundred million rather than the $50 billion reported to customers.

One of the remarkable revelations about the Madoff fraud was the number of sophisticated investors and nonprofit organizations on the list of victims. Several foundations and nonprofit organizations were forced to close their doors because of the losses. The story added an extra layer of concern to the investment management process above and beyond the wildly fluctuating market.

1. Estate and Gift Tax Rate Short-Term History

The Economic Growth and Tax Reconciliation Act of 2001 introduced dramatic changes to the estate and gift tax rates and set the stage for future change. As most recall, the gift and estate tax rates were in sync and the exemption amount set at $675,000 at the time the law was enacted. The law:

- Uncoupled estate and gift tax rates, freezing lifetime the lifetime transfer exemption amount (gift tax) at $1,000,000.

- Estate tax exemption amounts moved to $1,000,000, but then gradually increased to $3.5 million in 2009 as shown in Table 3. In 2010, the estate tax is eliminated. Then in 2011, the estate tax reverts to pre-EGTRA exemption amount which was scheduled to be $1,000,000.

- As shown in Table 4, the highest marginal gift, estate and generation skipping tax rates also declined during this period. The changes took place slowly. In 2002, the upper tax rate was reduced to 50 percent and the 5 percent surcharge on large estates was eliminated. From 2003 to 2007, the tax rates fall 1% per year (to 49 percent in 2003, to 48 percent in 2004, to 47 percent in 2005, to 46 percent in 2006, and finally to 45 percent in 2007 through 2009.) In 2010, the estate and generation skipping taxes disappear, while the highest gift tax rate drops to the highest personal income tax rate (35 percent under The 2001 Tax Act). Then the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 changed the rules again.[3] Instead of returning to pre-2001 Act rates, Congress set the exclusion amount at $5,000,000 through December 31, 2012 (indexed for inflation as of 1/1/2012) and the top rate at 35%. (For 2010, taxpayers could use the $5,000,000 exclusion with a step up in basis, or elect the zero tax option with carryover basis.) This is temporary, however, and it is unclear what will happen after December 31, 2012 making it difficult to engage in long-term planning.

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[3] Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, P.L. 111-312 (December 17, 2010).

TABLE 4
SUMMARY OF TAX RATES AND TRANSFER EXEMPTIONS UNDER THE 2001 TAX ACT

Year	*Estate/GST Transfer Exemption*	*Estate/GST Top Tax Rate*	*Gift Exemption Amount*	*Gift Top Tax Rate*
2001	$675,000	55%	$675,000	55%
2002	$1,000,000	50%	$1,000,000	50%
2003	$1,000,000	49%	$1,000,000	49%
2004	$1,500,000	48%	$1,000,000	48%
2005	$1,500,000	47%	$1,000,000	47%
2006	$2,000,000	46%	$1,000,000	46%
2007	$2,000,000	45%	$1,000,000	45%
2008	$2,000,000	45%	$1,000,000	45%
2009	$3,500,000	45%	$1,000,000	45%
2010	$5,000,000 or No Tax with Election with Carryover Basis	35%	$5,000,000	35%
2011	$5,000,000	35%	$5,000,000	35%
2012	$5,000,000	35%	$5,000,000	35%
2013 and beyond	???	???	???	???

Traditionally, few taxpayers have been affected by the estate tax. In the Summer 2005 *Statistics of Income Bulletin*, the IRS reported 1.17% of the 2.4 million decedents who died in that year had taxable estate returns. In that year, estate tax return filing was required with a gross estate of $1 million or greater. See Table 5 for an historical perspective on the number of decedents required to file estate tax returns, and the percentage of taxable returns.

TABLE 5
POPULATION AFFECTED BY ESTATE TAX
SELECTED YEARS BETWEEN 1934 AND 2001[4]

Year	*Number of Deaths*	*Estate Tax Returns Filed*	*Number of Taxable Returns*	*% of Deaths Requiring Estate Tax Returns/Taxable*
1934	983,970	N/A	8,655	NA/.88%
1935	1,172,245	N/A	9,137	N/A/1.08%
1940	1,237,186	N/A	13,336	N/A/1.12%
1944	1,238,917	N/A	13,869	N/A/1.12%
1950	1,304,343	N/A	18,941	N/A/1.45%
1954	1,332,412	N/A	25,143	N/A/1.89%
1960	1,426,146	N/A	45,439	N/A/3.19%
1965	1,578,813	N/A	67,404	N/A/4.27%
1969	1,796,055	N/A	93,424	N/A/5.2%
1976	1,819,107	N/A	139,115	N/A/7.65%
1982	1,897,820	N/A	34,426	N/A/1.81%
1985	2,015,070	N/A	22,326	N/A/1.11%
1990	2,079,034	50,367	23,104	2.42%/1.11%
1995	2,252,471	69,755	31,563	3.1%/1.4%
1996	2,314,690	79,321	37,711	3.42%/1.63%
1997	2,314,245	90,006	42,901	3.89%/1.85%
1998	2,337,256	97,856	47,475	4.19%/2.03%
1999	2,391,398	103,979	49,863	4.35%/2.09%
2000	2,403,351	108,322	52,000	4.5%/2.16%
2001	2,363,100	Unknown	49,911	Unknown/2.11%
2002	2,363,100	Unknown	49,911	Unknown/1.17%

[4] All figures from 1934 through 1985 from Internal Revenue Service, fall 2002 Statistics of Income Bulletin, Table 17, Estate Tax Returns as a Percentage of Adult Deaths, Selected Years of Death, 1934-1999; number of deaths data 1996-1999 from National Vital Statistics Report, Vol. 49, No. 8, September 21,2001, p. 16; 2000 death figures from National Vital Statistics Reports, Vol. 51, No. 5, March 14, 2003, p. 3; data on estate tax returns filed 1990 through 2000 from Spring 2004 Statistics of Income Bulletin, “Federal Estate Tax Returns 1998-2001”.

2. The Charitable Deduction

As Congress struggles with the country's deficit and the current troubled economy, the charitable deduction is a target. Reductions in the value of the deduction have been a part of President Barack Obama's budget proposals since he was elected, and now the deduction is a part of the critical discussions of the National Commission on Fiscal Responsibility and Reform (Deficit Reduction Committee). There is much disagreement about whether limiting the charitable deduction, eliminating the charitable deduction, or imposing new limits on who can use the charitable deduction will impact gifts to charity.

3. IRA Charitable Rollover

The Pension Protection Act of 2006 allowed individuals age 70 ½ or older to make a "qualified charitable distribution" of up to $100,000 from an IRA to qualified public charities in 2006 and 2007 (referred to as the "IRA Charitable Rollover," although that term is misleading). Public charities excluded as a permissible recipient included donor advised funds at public charities and supporting organizations. Donors do not include the amounts transferred in their gross income, nor do they receive a charitable deduction. The provisions of the act apply only to pre-tax amounts in IRAs. The Emergency Economic Stabilization Act of 2008[5] extended this qualified transfer through December 31, 2009 and in late 2010 Congress again extended the transfer through the end of 2011. Now, in 2012, the provision has lapsed but may be renewed before year end.

C. Charitable Giving Potential

Americans' charitable giving habits are documented by AAFRC Foundation *Giving USA 2011*, the 1999 Boston College Social Welfare Research Institute Study, and the Internal Revenue Service 2011 Spring Statistics of Income Bulletin.

1. Giving USA Foundation *Giving USA 2011*

On June 20, 2011, Giving USA Foundation released *Giving USA 2011* reporting charitable gifts of $290.89 billion in 2010. As in years past, individuals accounted for most (81%) of the gifts. Table 7 shows the sources of 2010 charitable gifts, while Table 8 shows the charitable sectors who were the largest recipients of funds.

TABLE 7
SOURCES OF CHARITABLE GIVING, *GIVING USA 2011*

Source	*Amount in Billions*	*Percentage of Total*
Individuals	$211.77	73%
Foundations	$41.00	14%
Bequests	$22.83	8%
Corporations	$15.29	5%
Total	$280.89	100%

[5] Pub. L. No. 110-343, 122 Stat. 3765 (2008).

TABLE 8
RECIPIENTS OF CHARITABLE GIFTS, *GIVING USA 2011*

Sector	*Amount in Billions*	*Percentage of Total*
Religion	$100.63	35%
Education	$41.67	14%
Human Services	$26.49	9%
Public Society/Benefit	$24.24	8%
Health	$22.83	8%
Arts, Culture, and Humanities	$13.28	5%
International Affairs	$15.77	5%
Environment/Animals	$6.66	2%

2. Statistics of Income Bulletin

The IRS publishes an annual *Statistics of Income Bulletin* that includes a state-by-state extraction of data on charitable giving drawn from income tax returns of taxpayers who itemize. The most current report, published in spring 2011, provides data from the 2009 tax year. Americans who claimed itemized charitable deductions (33.3 percent of those who filed returns) gave $157.6 billion to charity in 2009. Table 9 provides a state by state analysis of the number of returns filed, the number of itemized deductions, the number of charitable deductions and the dollar value of the charitable deductions. Table 10 provides figures specific to Kansas compared to national averages.

TABLE 9
ITEMIZED DEDUCTIONS FOR THE TAX YEAR 2009[6]

State	*Number of Returns*	*Number of Taxpayers Taking Itemized Deductions*	*Number of Itemizers with Charitable Deductions*	*Value of Charitable Deductions (in thousands)*
Alabama	2,048,831	601,773	511,434	$2,735,639
Alaska	257,870	92,325	658,848	$295,688
Arizona	2,670,661	950,257	759,219	$2,605,789
Arkansas	1,211,644	297,496	232,289	$1,265,684
California	16,384,130	6,090,371	4,847,741	$19,045,295
Colorado	2,331,974	915,029	723,705	$2,777,990
Connecticut	1,711,715	752,328	620,539	$2,596,436

[6] IRS Statistics of Income Bulletin Spring 2011.

State	*Number of Returns*	*Number of Taxpayers Taking Itemized Deductions*	*Number of Itemizers with Charitable Deductions*	*Value of Charitable Deductions (in thousands)*
Delaware	420,472	152,462	123,525	$452,275
District of Columbia	312,067	127,318	103,908	$589,945
Florida	8,910,654	2,573,438	1,957,424	$8,751,644
Georgia	4,447,966	1,650,323	1,318,912	$674,226
Hawaii	648,846	210,873	168,901	$532,778
Idaho	657,773	218,518	170,427	$764,017
Illinois	6,008,183	2,064,335	1,664,208	$6,496,811
Indiana	2,951,362	798,135	622,996	$2,541,813
Iowa	1,392,004	425,422	338,754	$1,220,550
Kansas	1,310,164	395,626	318,586	$1,601,754
Kentucky	1,841,152	531,016	426,577	$1,698,779
Louisiana	1,960,107	474,766	361,924	$1,794,498
Maine	624,567	191,042	141,411	$382,146
Maryland	2,751,233	1,350,889	1,122,018	$4,570,249
Massachusetts	3,171,888	1,271,956	1,029,359	$3,625,190
Michigan	4,534,729	1,462,039	1,203,753	$4,397,164
Minnesota	2,541,797	1,007,554	836,123	$2,922,735
Mississippi	1,241,390	297,841	243,661	$1,345,233
Missouri	2,683,562	813,435	634,946	$2,705,361
Montana	472,039	142,484	107,529	$456,313
Nebraska	846,101	251,958	207,046	$897,851
Nevada	1,243,552	415,432	319,617	$1,135,072
New Hampshire	659,001	235,697	175,813	$479,383
New Jersey	4,236,533	1,861,432	1,550,788	$4,882,544
New Mexico	912,316	235,468	174,923	$655,669
New York	9,116,699	3,333,474	2,790,902	$13,678,331

State	*Number of Returns*	*Number of Taxpayers Taking Itemized Deductions*	*Number of Itemizers with Charitable Deductions*	*Value of Charitable Deductions (in thousands)*
North Carolina	4,144,875	1,440,403	1,196,090	$5,038,232
North Dakota	322,972	63,662	47,336	$216,969
Ohio	5,409,661	1,667,331	1,291,323	$4,355,630
Oklahoma	1,585,616	428,082	336,782	$1,949,952
Oregon	1,732,774	689,337	536,580	$1,807,449
Pennsylvania	6,058,513	1,848,308	1,491,507	$5,438,271
Rhode Island	510,586	183,989	150,863	$394,967
South Carolina	2,024,495	623,959	521,579	$2,410,197
South Dakota	385,157	74,951	56,639	$429,308
Tennessee	2,794,712	675,008	537,929	$3,191,175
Texas	10,848,887	2,706,528	2,073,682	$11,671,425
Utah	1,124,569	444,696	376,022	$2,685,379
Vermont	316,053	93,999	67,583	$209,092
Virginia	3,685,674	1,506,916	1,218,443	$4,927,045
Washington	3,144,952	1,123,687	865,243	$3,370,954
West Virginia	778,130	143,034	101,929	$515,042
Wisconsin	2,728,034	975,142	771,874	$2,327,439
Wyoming	269,357	66,556	44,168	$329,630
United States	141,458,638	47,108,956	37,614,870	$157,643,738

TABLE 10
2009 STATISTICS FROM KANSAS

	Number of Returns	*Number of Taxpayers who Itemized*	*Number of Itemizers with Charitable Deductions*	*Total Value Charitable Deductions*
Kansas	1,310,164	395,626	318,586	$1,601,754
United States	141,458,638	47,108,956 (33.3% of all who filed)	37,614,870 (79.85% of all who itemized)	$157,643,738

3. Boston College Social Welfare Institute

Researchers at the Boston College Social Welfare Research Institute published a study projecting the intergenerational transfer of wealth expected to occur between 1998 and 2052.[7] That study estimates the transfer will range from a low of $41 trillion to a high of $136 trillion, figures substantially higher than the frequently used $10.4 trillion figure developed in the 1990's by Robert Avery and Michael Rendall of Cornell.

The researchers based the simulation model on certain assumptions that included the following:

1. The baseline for household wealth in 1998 was $32 trillion.

2. The growth rate of wealth for the study period will range from 2% (low estimate) to 4% (high estimate) and will occur at a steady rate (no recessions, no high growth years).

3. Household savings, spending over savings, and growth in wealth will occur in certain age bands.

Havens and Schervish further projected that charities will benefit heavily from this transfer in an amount ranging from a low of $6 trillion to a high of $25 trillion. These projections were based in large part on their findings in reviewing trends in estate tax returns. Specifically, they found that:

- The top 1% of taxpayers (measured by income) contributed 33% of total charitable dollars in 1995.

- The top 4% of taxpayers (measured by income) contributed 40% of total charitable dollars in 1995.

- Estates of greater than $5 million contributed an average of 27% of their value to charity in 1995.

- Estates of greater than $20 million contributed an average of 40% of their value to charity in 1995.

[7] A summary of the study can be found at <www.bc.edu/bc_org/avp/gsas/swri/> in the article entitled "Millionaires and the Millennium: New Estimates of the Forthcoming Wealth Transfer and the Prospects for a Golden Age of Philanthropy."

In 2003, responding to concerns raised about economic changes that have occurred since 1998, Havens and Schervish published an updated commentary[8] addressing the impact of slower economic growth, the bear markets of 2000-2003, longer life spans, the tendency to exhaust personal assets (leaving less to transfer) when life spans extend, and other issues impacting their earlier work.[9] They concluded that the $41 trillion estimate was valid and represented the low end of the potential transfer amount.[10]

4. Gap In Giving Patterns

A survey conducted by Independent Sector found that 89% of all households give to charity, and 44% of all adult volunteer.[11] Clearly, giving is an important element of U.S. culture. However, a study conducted by the National Committee on Planned Giving at roughly the same time found that approximately 8 percent of all Americans give to charity through their estates.[12] This represents a huge gap in charitable giving patterns and an opportunity for a discussion of giving in estate planning.

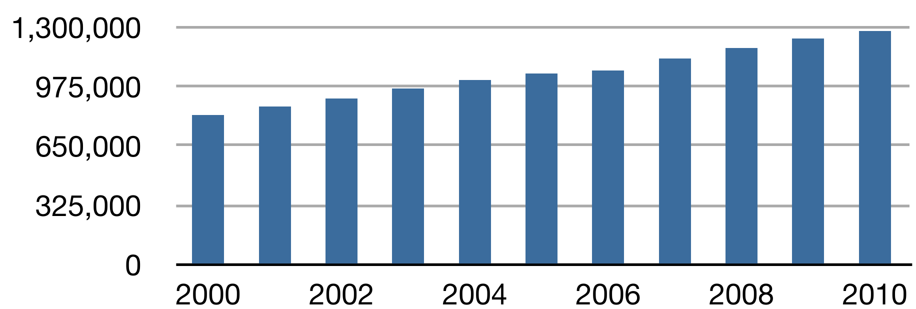
D. Change Has an Impact

The stock market and tax laws do not drive giving, but they do have an impact on the way donors approach planning. Obviously, economic concerns have an impact of potential to give, and the changes in tax laws – which provide the fabric for planning – have an impact on donor's decisions for long-term planning.

E. Number of Charities Increasing

Meanwhile, the number of charities seeking funds from donors is increasing at a rapid rate. And as these charities experience cuts from government funding, foundation grants, and struggling corporations, they will turn to the individuals you currently solicit and depend upon for funds. Table 11 shows the growth in IRC §501(c)(3) entities over time. There were 1,280,739 in 2010, a figure that did not include those charitable organizations such as churches that are not required to apply for 501(c)(3) status.

TABLE 11
GROWTH OF IRC §501(c)(3) ENTITIES 2000 – 2010



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[8] Havens, John J. and Paul G. Schervish, "Why the $41 Trillion Wealth Transfer Estimate is Still Valid," Planned Giving Design Center (Gift Planner's Digest, January 27, 2003), <www.pgdc.net>.

[9] *Id.*

[10] *Id.*

[11] Giving and Volunteering in the United States 2001, Independent Sector, www.independentsector.org.

[12] 2001 Survey of Donors, National Committee on Planned Giving, www.ncpg.org.

F. The Climate in Washington

Scandals in the nonprofit sector have made headlines in the Washington Post, the Wall Street Journal and many more beginning with the William Aramony/United Way news, the New Era Foundation, and more recently, The Nature Conservancy insider dealing and non-cash gift valuation issues. These ongoing issues prompted a series of Congressional hearings, legislative reforms, and dramatic proposed regulations and legislation affecting donors and the nonprofit sector.

1. June 2004: "Charity Oversight and Reform: Keeping Bad Things from Happening to Good Charities"

On June 22, 2004, the Senate Finance Committee met to hear testimony about the abuses in the nonprofit sector recently reported in the press. It was not a good day for charities. Witnesses behind curtains and with electronically altered voices discussed abuses in gifts of non-marketable property such as automobiles, housing abuses, excessive compensation, credit counseling, and self-dealing.

2. Proposals in Staff Discussion Draft

The Senate Finance Committee Staff drafted proposals which set the tone for reform:

✓**Five-year review of tax-exempt status**

- Every fifth year on anniversary of tax determination letter
- Goal to determine whether determination letter should remain in effect
- Looking for changes to articles and by-laws, conflict of interest policies, policies and procedures reflecting industry best practices, accreditation
- Outcome? No upside – only downside, revocation of status

✓**Imposition of private foundation self-dealing rules to public charities**

- Taxes on self-dealing, such as sale, exchange, or lease; lending money/credit; furnishing goods or services;; payments to government officials – unreasonable compensation excluded from the list

✓**Modification of intermediate sanction compensation rules to provide more accountability and ensure independent evaluation**

- Expand definition of disqualified person to include someone with substantial influence over the charity, to include corporations or partnerships where a disqualified person has substantial influence
- Increase taxes for prohibited transactions (self-dealing, jeopardizing investments, taxable expenditures) by an undetermined amount

✓**Creation of compensation rules**

- Limit compensation of private foundation trustees – either eliminate compensation to trustees of non-operating foundations, or limit that compensation to a statutory de minimis amount
- Limit compensation of disqualified persons
- Compensation of disqualified persons at non-operating private foundation (other than employees) must use comparable federal government rates for similar work and time

- Compensation of individuals over $200,000 ($75,000 for disqualified persons) requires the filing of additional attachments with the 990. All compensation exceeding these levels must be approved in advance each year by the board (excluding those with a conflict to the payment)

✓Private foundation grantmaking reforms

- Payment of expenses exceeding 10% of the foundation's expenses would require an additional filing, and the IRS would review it to see if it were "reasonable and necessary" and appropriate for consideration as a qualifying distribution
- Administrative costs above 35% of total expenses would be excluded as a qualifying distribution
- Eliminate excise tax on investment income in years when foundation pays out more than 12 percent of its investment assets
- Prohibit private foundation payments to donor advised funds
- Limit amounts paid for expenses. Expenses for travel, meals, lodging would be capped at the government rate or a separately published charitable rate (public charities would not be restricted to these amounts if the charity's board approves expenses in excess of these amounts and reveals the expenditures on the 990)

✓Increasing and leveraging enforcement

- Give states the right to pursue federal tax law violations with the approval of the IRS
- Make changes to the 990 to make it more transparent, consistent, and easier to monitor
- Add Sarbanes-Oxley type penalties to include requiring a signature by the CEO attesting to the accuracy and completeness of the information
- Double or triple (for larger organizations) fines for the failure to complete and accurate 990
- Limit extensions by classifying extensions of greater than 4 months as a failure to file
- Require all charities to have an independent auditor review the Form 990 and/or annual report; the report would be attached to the Form 990 as a public document
- Exempt organizations with gross receipts over $250,000 would be required to have an independent audit of the organization's financial statements (and must address the organization UBTI). A new auditor must be used at leave every five years. For organizations with income over $100,000 but less than $250,00, the financial statements must be reviewed by a CPA
- Attach a chart showing affiliated exempt and nonexempt organizations with the 990. All charities must file a list of partnership interests.
- Charities with more than $250,000 in gross receipts must include the charity's performance goals (and how well they did in achieving them) for the current and upcoming year.
- Charities would have to report material changes in activities, operations, or structure.
- The charity's expenses would have to report expenses accurately on financial statements and Form 990.
- A charity would have to make its investment public upon request.
- Financial statements would have to be disclosed to the public.
- Charities with a web site would be required to post the information currently required to be disclosed – Form 1023, Determination letters, financial statements

for the five most recent years.
- Audits of tax-exempt organizations and closing agreements would be disclosed without redaction.
- Form 990-Ts would become public, with editing allowed to cover trade secrets.
- Publicly-traded corporations would have to file an annual return showing all gifts over $10,000 (aggregated) for which a charitable deduction is claimed.
- Appropriate a portion of the private foundation investment income tax (or impose a 990/990 PF filing fee) to enforcement.

    - A portion would be allocated to state enforcement
    - Grant funds for charities that train other charities on best practices and inform the public about charities engaged in best practices, with priority to those groups working with small charities
    - The five-year review discussed earlier
    - Accreditation

- Give U.S. Tax Court equity powers to rescind transactions, surcharge trustees, order accountings, substitute trustees, divest assets, stop activities, appoint receivers. The goals are to allow the U.S. Tax Court to remedy any detriment to a charity and ensure the charity's assets are used (and preserved) for philanthropic purposes. The new laws would create a working/review relationships between the state courts and U.S. Tax Court.
- The IRS or a board member may file an action with the U.S. Tax Court to remove an officer.
- A director or trustee may bring action against the charity in the U.S. Tax Court, and must detail actions taken to make corrections at the board/organization level.
- Individuals may file complaints directly with the IRS. There would be a $250 filing fee (or a $10,000 penalty for a frivolous filing).

✓**Requirements for non-profit Governance**

- Board members and trustees would be subject to a standard of care of an "ordinarily prudent person in a like position…under similar circumstances"; the director would have to act in the best interests of the mission, goals, and purposes of the charity; those with special skills or expertise would have a duty to use those enhanced skills. There would be federal liability for breach of these duties.
- When compensation consultants are hired to establish the reasonableness and appropriateness of compensation, that consultant must be hired by and report to the board (and must be independent.) Compensation for management positions must be approved annual and in advance (unless the only compensation change is an inflation adjustment). Compensation must be supported, explained, and publicly disclosed.
- The board must establish management policies and procedures and must review deviations.
- The board must establish, review, and approve program objectives and performance measures, and must approve "significant" transactions.
- The board must review and approve auditing and accounting principles and practices used to prepare the charity's financial statements; the board must also retain and replace the charity's independent auditor (must change every five years).
- The board must review and approve the budget and financial objectives, including significant investments, joint ventures, and business transactions.

- The board must exercise oversight of the charity's operations.
- The board must adopt a conflict of interest policy (which would be disclosed with the 990) – a summary of conflicts determinations would be provided on the 990.
- The board must create and oversee a risk management program – regulatory compliance and liability management.
- The board must establish a whistleblower policy (to address complaints and prevent retaliation).
- Boards would have no less than 3 or more than 15 board members. No more than one of these members may be directly or indirectly compensated by the charity (and that compensated person may not be board chair or treasurer.)
- At least 1 (or 1/5th) of a public charity's board members must be independent.
- Charity boards may not include:

    1. Individuals not permitted to serve on a publicly-traded company board under federal or state law
    2. Individuals criminally convicted of fraud or similar offense for five years after the conviction.
    3. Individuals convicted of a crime under the Federal Trade Commission, USPS, or State Attorney General for actions related to service as an officer or director of a charity for 5 years.

- The IRS would have the authority to remove a member, officer, or employee of a charity who violates the self-dealing, conflict of interest, excess benefit, private inurement, or charitable solicitation laws.
- Create an accreditation process to encourage "best practices" that would drive tax-exempt status, enable participation in CFC campaigns, and provide preference for government grants. This accreditation may occur through the IRS or through separately designated agencies.
- Adopt a federal prudent investor rule that mirrors current state rules.

Note: While Congress has not yet tackled this topic, it may be coming. And the IRS is moving ahead to look at governance issues. The IRS has released CPE materials on its website that provide insight into their perspectives on nonprofit governance issues, an area to which additional attention has been given following reports of misfeasance and malfeasance by nonprofit board members. The IRS links nonprofit governance with compliance on excess benefit transactions and other activities generating excise tax, although it makes clear a "one size fits all" policy is not appropriate. The materials are available on its website at http://www.irs.gov/charities/article/0,,id=208454,00.html.

3. Panel on the Nonprofit Sector

The Panel on the Nonprofit Sector was convened at the encouragement of the U.S. Senate Finance Committee in October 2004. Its goal was to make recommendations on reform, both legislative and non-legislative. The team included more than 175 experts and leaders serving in a variety of nonprofit roles. The committee issued its Interim Report in March 2005. The final report was issued on June 24, 2005 and is available at www.nonprofitpanel.org and encompasses many of the recommendations in the staff draft report and in the Panel's interim report.

4. Senate Finance Committee April 2005: "Charities and Charitable Giving: Proposals for Reform"

The Senate Finance Committee reconvened to receive the report and hear testimony. The Panel on the Nonprofit Sector recommended reforms. The tone at that meeting was decidedly punitive and regulatory.

5. House Ways and Means Hearings: "Hearing on an Overview of the Tax-Exempt Sector"

The House Ways and Means Committee held hearings on April 20, 2005, to provide a better understanding of the issues before the Senate Finance Committee. The hearings focused on the history and growth of the tax-exempt sector, and current enforcement in place to address compliance.

6. Senate Finance Committee June 2005: "The Tax Code and Land Conservation: Report on Investigations and Proposals for Reform"

The Senate Finance Committee, on June 8, 2005, published its investigative report on The Nature Conservancy and conservation easement abuses and made recommendations for change. The Committee took testimony from regulators and parties with an interest in preserving deductions for conservations easements. The full report is available at the Senate Finance Committee website, http://finance.senate.gov.

7. And It Continues

Congress has continued to investigate the nonprofit sector. It focused on nonprofit hospitals in 2006/2007 and then engaged in intense scrutiny of large college and university endowments in 2008/2009. The focus will likely continue, especially for large "profitable" nonprofits with large pools of assets, just as consideration of reduction of tax benefits for wealthier taxpayers making charitable gifts remains an open question.

II. Charitable Planning Developments That Followed the Hearings

A. American Jobs Creation Act of 2004[13]

1. New Intellectual Property/Patent Laws

The IRS has identified intellectual property gifts as an area open to abuse. In early 2004, the 2004, the IRS published an information release and notice warning of increased scrutiny of such gifts.[14] The law governing the deductibility of patents and intellectual property was then changed under The American Jobs Creation Act of 2004.[15] Under current law, the charitable deduction for a gift of intellectual property ("any patent, copyright (other than a copyright described in section 1221(a)(3) or 1231(b)(1)(C)), trademark, trade name, trade secret, know-how, software (other than software described in section 197(e)(3)(A)(i)), or similar property, or applications or registrations of such property"[16]) is limited to the lesser of the patent's market value or the donor's basis.[17] However, if the donor notifies the donee of the intent to treat the charitable contribution as a qualified intellectual property contribution, the donor may deduct "qualified donee income" received on the patent or intellectual property in the years of receipt for the legal life of the interest, or through the 10th anniversary of gift.[18] These deductions are only allowed to the extent the aggregate of statutory percentages of income (the statute provides a table) exceeds the

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[13] Pub. L. 108-357, 118 Stat. 1418.

[14] IR-2003-131, Notice 2004-7, 2004-3 I.R>B. 310

[15] Pub. L. No. 108-357 , 118 Stat. 1418 (2004).

[16] IRC §170(e)(1)(iii).

[17] *Id.*

[18] IRC §§170(m)(2), (8).

donor's original contribution.[19] In May, 2005, the IRS issued guidance and temporary regulations for intellectual property contributions.[20]

2. New Vehicle Donation Laws

Many national and local charities actively solicit gifts of used vehicles, many of which are handled through third-party firms serving as the charity's agent in the transaction and paid a percentage of the sale amount.[21] As an increasingly number of charities began to solicit used vehicles, observers inside Congress and the IRS became concerned about potential abuse. These concerns were heightened by a December 2003 General Accounting Office report that found taxpayers were taking overstated deductions for vehicle donations.[22] The GAO examined 54 transactions to compare the donor's charitable deduction to the net proceeds received by charity. In two thirds of the transactions, the charity received 5 percent or less of the amount claimed by the taxpayer. In December, the IRS issued a taxpayer alert explaining how taxpayers can avoid problems when gifting automobiles to charity.[23]

Within a year of this report, legislation was in place to address vehicle donation valuation. Effective January 1, 2005, Section 884 of the American Jobs Creation Act sets out new rules for valuation of donated vehicles exceeding $500.[24] When a donor contributes a vehicle to charity exceeding $500, special substantiation and valuation rules apply.[25]

- *The sales rule*. If the charity sells the vehicle (outside of the three exceptions listed below), the donor's deduction is limited to the gross sales proceeds. The substantiation from the charity – provided within 30 days of the sale – must contain:[26]
    - The taxpayers name and tax identification number;
    - The vehicle identification number
    - A certification the vehicle was sold in an arm's length transaction between unrelated parties.
    - The gross sales proceeds
    - A statement that the donor may not deduct more than the gross sales proceeds.

- *The significant intervening use exception*.[27] A donor may deduct the vehicle's market value on date of gift if the charity plans to use the vehicle in a significant manner, such as in a "Meals on Wheels" program. In this case, the charity must provide an acknowledgement certifying the intended intervening use of the vehicle, the expected duration of that use, and a statement the

[19] *Id.*

[20] Notice 2005-41, T.D. 9206, 70 FR 29450, May 23, 2005

[21] In Letter Ruling 200230007, the IRS confirms that a gift to a for-profit firm that receives and sells the property as the agent of the charity is a gift "to": a charity and qualifies for an income tax deduction under IRC Section 170(a) provided the gift is properly substantiated and otherwise complies with the regulations. See also Rev. Rul. 2002-67, 2002-47 I.R.B. 873.

[22] Vehicle Donations: Benefits to Charities and Donors, but Limited Program Oversight, Report to the Committee on Finance, U.S. Senate, GAO-04-73 (Nov. 2003).

[23] IR-2003-139.

[24] Pub. L. No. 108-357, 118 Stat. 1418, IRC §170(f)(12).

[25] The sales rule and first two exceptions are set out in IRC §170(f)(12); the third exception is created and all rules amplified in Notice 2005-44, 2005-25 IRB 1.

[26] IRC §170(f)(12)(B).

[27] IRC §170(f)(12)(A)(ii).

vehicle will not be sold before the end of its intended use. The statement must be provided within 30 days of contribution.

- *The material improvement exception.*[28] A donor may deduct the vehicle's market value on date of gift if the charity plans to make major repairs or improvements to the vehicle that significantly increases its value. (A material improvement is not considered application of paint, removal of dents and scratches, cleaning or repairing upholstery, or installation of theft devices, and the improvement cannot be funded through a payment from the donor.) To support the deduction, the charity must provide an acknowledgement within 30 days of the date of contribution certifying the intended material improvement and statement the vehicle will not be sold before that material improvement is made.

- *The transfer or below-market-sale to a needy person exception.* The new legislation contained a provision allowing the Secretary to issue guidance or regulations allowing exceptions for the use of vehicles in direct furtherance of the charity's charitable purposes.[29] In Notice 2005-25, the IRS made an exception where the vehicle is either transferred or sold at below market price to a "needy individual." For example, the charity might give or sell the vehicle to an individual participating in a Welfare to Work Program, so that the needy individual can use the car to get to a job. (Selling the vehicle and using the sales proceeds for charitable purposes will not suffice.) The substantiation – which should be provided no more than 30 days after date of contribution – must contain certification that the charity will give the vehicle to a needy individual or that it will be sold to a needy individual at a price significantly below fair market value, and that the transfer will be in direct furtherance of the charity's mission.

When vehicles with a value of $500 or less are donated to charity, the general rules governing substantiation and valuation are applicable. A used-car pricing guide that provides pricing for like cars (same make, model, year) sold in the same area may suffice.[30] The valuation must take into consideration the car's condition at the time of gift.[31]

B. Pension Protection Act of 2006, H. R. 4[32]

On August 17, 2006, President Bush signed the Pension Protection Act of 2006 (H. R. 4) which included a charitable IRA rollover provision, as well as other charitable incentives and reforms. The charitable incentive of greatest interest to donors and advisors allows individuals to make annual transfers not exceeding $100,000 from traditional and Roth IRAs directly to most public charities (donor advised funds, §509(a)(3) supporting organizations, and private foundations are excluded) without including the amount in gross income. The provision, for donors age 70 ½ or older and for amounts that would otherwise be included in gross income, is applicable through 2007. Donors who may receive the greatest benefit from the new law include those who prefer to use tax burdened assets for lifetime gifts, those who have exceeded the 50% giving limitations, and those who do not itemize.

Other charitable incentives in the bill included an increase in the charitable deduction for businesses that contribute food inventory, a basis adjustment to the stock of S Corporations that contribute property to charity, an extension of the enhanced deduction for qualified book inventory to

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[28] *Id.*

[29] IRC §170(f)(12)(F).

[30] One of the most well-recognized used-car pricing guides is the Kelly Blue Book, <www.kbb.com>.

[31] Rev. Rul. 2002-67, 2002-47 I.R.B. 873.

[32] http://thomas.loc.gov;

public schools (for C Corporations), and an increase in the charitable deduction limit for certain qualified conservation gifts. Each of these provisions is available through 2007.

There were more charitable reforms than charitable incentives in the bill. The reforms included an increase in excise taxes applicable to certain charities, recapture of the deduction value represented by the difference between cost basis and market value of a related use tangible personal property gift when the gift is not ultimately used for the charity's exempt purpose, an excess benefits transaction tax on amounts paid from a donor-advised fund or a type III supporting organization to certain related parties, application of the excise tax on excess business holdings to donor advised funds, increased substantiation requirements for gifts to donor advised funds, and new rules (including a directive to Treasury to create new payout requirement regulations) for type III supporting organizations which are not "functionally integrated type III supporting organizations".

Update #1: On October 3, 2008, the Congress passed and President Bush signed the Emergency Economic Stabilization Act of 2008, H.R. 1424 which extended the Lifetime IRA Transfer to Charity, the basis adjustment to the stock of an S corporation making a charitable contribution of appreciated property, and the enhanced deduction for contributions of food inventory, book inventory, and certain computer equipment and software through December 31, 2009.

Update #2: On September 24, 2009 the Treasury issued proposed regulations for Type III supporting organizations that implemented the changes in the Pension Protection Act of 2009.[33] Specifically, the following were addressed:

- How to qualify as a Type III Supporting Organization
- Requirement to notify the Type III's supported organizations
- The responsiveness test
- The integral part test (for functionally integrated Type IIIs)
- The integral part test (for non-functionally integrated Type III's)
- Distribution requirements for non-functionally integrated Type III's
- Transitional relief

C. Where's the Report from Treasury on Donor Advised Funds and Supporting Organizations? (The Dog Ate My Homework)

Section 1226 of the Pension Protection Act of 2006[34] directed Treasury to undertake a study of donor advised funds and supporting organizations for the purpose of identifying areas of abuse and making recommendations on reforms to address those areas of abuse, and to report back in one year (August 17, 2007). As set out in IRS Notice 2007-2,[35] the areas for review included the following:

1. Whether charitable contribution deductions are appropriate in light of the use of assets contributed to these organizations
2. Whether donor-advised funds should be required to distribute a specified amount for charitable purposes
3. Whether retaining certain rights with respect to transferred assets (including advisory rights with respect to making grants or investing assets) is consistent with treating the transfers as completed gifts

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[33] REG-155929-06; 74 F.R. 48672-48687.

[34] Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006).

[35] The notice solicited comments from the public.

4. Whether issues identified in paragraphs 1-3 are also issues for other forms of charities or charitable donations.
5. The advantages and disadvantages of these organizations, compared to other charitable giving arrangements
6. How to determine the amount of a charitable contribution deduction for transfers to these organizations if the transferor retains certain rights, receives certain benefits, or the property is not readily convertible to cash
7. The effects of new legislative provisions (including applying excess benefit transaction taxes) on the practices of these organizations and their donors
8. Appropriate payout requirements for these organizations
9. Advantages and disadvantages of perpetual existence for these organizations
10. Whether issues identified in paragraphs 5-9 are also issues for other types of charitable giving arrangements

Following passage of the Act, the IRS issued a notice with interim guidance, and an advance notice of rule making on supporting organizations summarized below.

- IRS Notice 2006-109, Interim Guidance Regarding Supporting Organizations and Donor Advised Funds was published shortly thereafter focusing on four areas:
    - Criteria for private foundations that make distributions to supporting organizations that allow the foundation to determine if the supporting organization is a Type I, Type II, or Type III (and further distinguishing between a functionally-integrated Type III or non-functionally integrated Type III);
    - Clarification of the effective date for the new IRC §4958(c)(3) excise tax on excess benefit transactions with supporting organizations;
    - Exclusion of certain employer-sponsored disaster relief funds from definition of a donor-advised fund; and
    - Clarification of how the IRS will apply the new IRC §4966(a) excise taxes (relating to payments made pursuant to educational grants awarded prior to August 17, 2006)

- IRS Announcement 2007-87, Payout Requirements for Type III Supporting Organizations That Are Not Functionally Integrated, Advance Notice of Rulemaking. This proposal included four terms that included a proposed functionally integrated test for Type III Supporting Organizations, a payout requirement for non-functionally integrated Type III supporting organizations that would follow the minimum distribution rules for private, non-operating foundations, [36] the type of information a Type III supporting organization must provided to its supported organizations to demonstrate responsiveness, and modified requirements for Type III supporting organizations organized as trusts (the responsiveness test),

However, the final shoe has not dropped. To date, the Treasury has not brought the report of abuse and potential abuse back to Congress as direct by the Pension Protection Act of 2006. The reporting date was August 17, 2007, so now, over two years later, we're still waiting. We have not yet

[36] IRC §4942 qualifying distribution requirements; valuation of assets for the purpose of computing the distribution requirement would also follow the private foundation rules.

seen proposed regulations affecting donor advised funds. We're also waiting to see the additional regulations or even legislation recommended as a "fix." We'll continue to wait.

III. The Courts

A. National Heritage Foundation – The Saga Continues

The National Heritage Foundation, a community foundation by type, was created in the 1960's by J.T. ("Dock) Houk. The Foundation is primarily comprised of donor advised funds which the Foundation encourages donors to treat like "mini-foundations" under the administration and management of the National Heritage Foundation. Over the years, the Foundation has been singled out for its aggressive practices that appear to benefit individuals over charities, many of which have resulted in legislation to stop the practices going forward. For example, the Foundation paid commissions to advisors who referred donors who created charitable gift annuities. The Foundation allowed donor advisors to take fees for their roles on the advisory boards of the funds (now prohibited under the Pension Protection Act of 2006). And the Foundation promoted reverse charitable split-dollar arrangements, which the IRS prohibited in 1999, attaching confiscatory taxes on charities making premium payments for these plans.

The IRS position of charitable reverse dollar arrangements left many charities promoting such plans with premium payments contributed by donors with no way to make the premium payments for the insurance without triggering the penalties. Two donors, Dr. and Mrs. Mancillas, sued the National Heritage Foundation alleging mismanagement and misrepresentation. Responding to the charitable reverse split dollar opportunity promoted by National Heritage Foundation, popular from 1997 to 1999, the Mancillas agreed to contribute $85,000 a year to NHF and understood the funds would be used to purchase three policies benefiting a trust created for their sons and the Mancillas Family Foundation at NHF. The Mancillas entered the agreement with NHF in December, 1997. In 1999, the IRS enacted new regulations designed to eliminate the charitable deduction for such contributions and penalize nonprofit transactions involving life insurance purchases split between charitable and non-charitable purposes. The Mancillas continued to make annual premium payments through 2003 anticipating the funds would be applied to the split dollar arrangements. However, the National Heritage Foundation changed the insurance beneficiaries on two of the policies to benefit the convent and allowed the third policy to lapse. In the lawsuit, the Mancillas claimed they were not aware the arrangement was illegal or that National Heritage Foundation had changed the beneficiaries.

In 2008, a Texas jury awarded Dr. and Mrs. Juan Mancillas a $6.2 million judgment against the National Heritage Foundation (NHF) involving the Foundation's application of funds contributed pursuant to a charitable split dollar life insurance arrangement. On January 24, 2009, the National Heritage Foundation filed for Chapter 11 Bankruptcy, not only because of the Mancillas verdict, but also because of a poorly-secured $14 million loan to a company that created the software used by the Foundation.[37] The loan was funded by contributions made by advised fund donors and charitable gift annuity donors.

The case is important because it comes at a time that Congress is focusing on charitable abuses of donor advised funds. Further, National Heritage Foundation's treatment of its charitable gift annuity pools, and the resulting bankruptcy filing, was featured in a *Wall Street Journal* article, "Donors Find Gift Annuities Can Stop Giving."[38] The article created alarm among charitable gift annuitants and also caught the attention of Congress, even though it is rare when a charitable gift annuity pool quits paying its annuitants.

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[37] The loan was secured by the source code for the fund accounting software; at the time of the filing, the company had not made any payments on the loan since 2006.

[38] Spector, Mike and Shelly Banjo, "Donors Find Gift Annuities Can Stop Giving," The Wall Street Journal (May 12, 2009), http://online.wsj.com/article/SB124208562045708743.html.

This case also has potential to raise the visibility of donor advised funds – and potential problems for donors when charities go bankrupt. Donors who created donor advised funds with NHF filed claims as creditors in the bankruptcy court. In early September, however, the court dismissed most of the DAF claims since they had relinquished ownership of the funds in contributing to NHF in exchange for a charitable deduction. Several creditors remain who have asked for a rescission of their gifts based on NHF misrepresentations at the time of contribution. While the facts in this case can easily be distinguished from most transactions between community foundations and donors, it stands to create headlines that may dampen donor interest.

B. The Increasing Number of Donor Lawsuits – And the Potential Impact on Charities

Nonprofits are struggling to retain donor confidence in their ability to objectively and conscientiously administer gifts in accordance with donor directives. Community foundations can provide that added layer of assurance of compliance, and also have cost-effective options to make a change (through the foundation's cy pres power) in accordance with donor goals.

Judging by the increasing number of lawsuits over the last ten years, charities are having a harder and harder time honoring donor commitments. The following five cases provide some perspective.

1) *William Robertson, et. al. v. Princeton University, et. al.*[39]

Charles S. and Marie H. Robertson[40] contributed $35 million in A & P stock to Princeton University in 1961 to create a supporting organization to fund the Woodrow Wilson School of Public and International Affairs "where men and women dedicated to public service may prepare themselves for careers in government service, with particular emphasis on the education of such persons for careers in those areas of the Federal Government that are concerned with international relations and affairs."[41] The Foundation, with assets of roughly $900 million in recent years, provided funds for the Woodrow Wilson School and also funded other budgets, including a $13million principal distribution to build Wallace Hall, a building designed to house the expansion of the Woodrow Wilson School as well as the Sociology Department and other programs.

During his lifetime, Mr. Robertson grew unhappy with the Foundation's spending patterns and the low numbers of students engaged in pursuit of diplomatic service, expressing his concerns in writing. The school dismissed his concerns explaining the world of diplomacy was no longer the same. Marie Robertson died in 1972 and Charles Robertson died in 1981. Their son William S. Robertson, his sisters Katherine Ernst and Anne Meier, and cousin Robert Halligan – also unhappy about the application of Foundation funds – filed a lawsuit in July 2002 to redirect funds to other universities that could fulfill the donors' goals. The suit alleged the school intentionally violated the donors' intent and further claimed Princeton was engaged in self-dealing with regard to the Foundation's investments and distribution of funds. The lawsuit involved numerous depositions and other discovery, costing Princeton over $40 million in expenses through December 2008 when the suit was settled.[42] The settlement required Princeton to transfer $90 million plus interest to the Foundation.[43]

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[39] Docket No. C-99-02, Superior Court of New Jersey, Chancery Division: Mercer County

[40] Mrs. Robertson was the daughter of the founder of the A & P grocery chain.

[41] The language setting out the Foundation's purpose is taken from its Certificate of Incorporation. To provide context, in 1961 the U.S. and Russia were engaged in a cold war, the United States was involved in Vietnam, and President Kennedy was asking American to: "Ask not what your country can do for you – ask what you can do for your country."

[42] Hathirimani, Raj, "Robertson Lawsuit Most Expensive in University History," *The Daily Princetonian*, www.dailyprincetonian.com (November 19, 2004); the lawsuit was settled on December 10, 2008 and approved by the court on December 12, 2008.

[43] "Robertson Lawsuit Settled," http://paw.princeton.edu/issues/2009/01/28/pages/7658/index.xml.

2) *Howard v. Administrators of the Tulane Educational Fund*

From 1886 to 1901, Josephine Louise Newcomb contributed over $3.6 million to create the Sophie Newcomb College in Tulane University to advance "the cause of female education in Louisiana." The gift, worth approximately $75 million in today's dollars, established the first separate college for women in a university in the United States. After Katrina temporarily closed Tulane in the Fall of 2005, the Trustees voted to merge Newcomb College into Tulane and to absorb its endowment.

Two heirs of Josephine Newcomb – Parma Howard and Jane Smith – filed suit to enforce Ms. Newcomb's intent in maintaining a separate college. The district court judge dismissed the Newcomb heirs' lawsuit holding they had no standing to enforce the gift;[44] this ruling was affirmed by Louisiana Fourth Circuit Court.[45] The heirs appealed, and on July 1, 2008, the Louisiana Supreme Court vacated the dismissal and remanded the case to the trial court to allow the descendants of Ms. Newcomb to proceed with the lawsuit to enforce the gift's terms. In August 2008, a second lawsuit was filed in the district court of the Parish of Orleans by another Newcomb descendant, Susan Henderson Montgomery, also seeking to enforce the terms of the gift.[46] Ms. Montgomery filed a Motion for Summary Judgment with the Civil District Court in New Orleans which was denied in August 2009. Ms. Montgomery appealed, and in October 2010 the Fourth Circuit Court of Appeals in a 3-2 decision denied the appeal finding "Ms. Newcomb's will created an unconditional bequest to the Administrators of the Tulane Educational Fund."[47] The case history and court filings can be found at www.newcomblives.com.

3) *The Barnes Foundation's Petition to the Orphan's Court to Change Settlor's Intent*

Dr. Albert C. Barnes established the Barnes Foundation in 1922 to house his extensive Impressionist, Post-Impressionist and early Modern art collection (including many masterpieces with a collective current value of $6 billion) and to educate the working class about art. The collection – which was assembled and mounted by Dr. Barnes – was located in a modest structure in Merion, Pennsylvania, a Philadelphia suburb. Dr. Barnes arranged the paintings and designed the art education curriculum himself. He did not intend to have the entity operate as a traditional museum.[48]

Dr. Barnes died in 1951. In 1991, the trustees went to court to amend the Foundation's governing documents which prevented the trustees from selling or loaning the art in the collection.[49] While the lawsuit – which cost the Foundation about $10 million in expenses – did not result in a change in the Foundation's by-laws, the Judge did allow the Foundation to take the art on tour raising about $16 million for renovations.[50]

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[44] *Howard v. Administrators of the Tulane Educational Fund*, unreported, Civil District Court, Orleans Parish, No. 2006-4200, Div. B-15.

[45] *Howard v. Administrators of the Tulane Educational Fund*, 970 So. 2nd 21 (Ct. App. 4th Cir. October 22, 2007).

[46] *Montgomery v. Administrators of the Tulane Educational Fund*, unreported, Civil District Court, Orleans Parish, No. 08-8619, Div. B-I.

[47] This lawsuit is still unfolding and further developments may have occurred after this article was written. Please check for recent developments at www.newcomblives.com.

[48] According to the Foundation's press release the Foundation has a 3-year horticulture program, and a 2-year art and esthetics program with a 1-year seminar extension.

[49] Solis-Cohen, Lita, Maine Antiques Digest, March 2004 <http://www.maineantiquedigest.com/articles/mar04/barnes0304.htm>.

[50] *Id.*

In September 2002, the financially-strapped trustees filed another lawsuit seeking permission to move the art collection from the Merion building to a new building (to be constructed) in downtown Philadelphia; in addition, it asked the Court to allow it to expand the number of trustees from 5 – as designated by Dr. Barnes in the governing documents – to 15.[51] In early 2004, the Court approved the increase in the number of Trustees, deferring the decision on the move until other options to raise funds were explored. Then, on December 13, 2004, the Court of Common Pleas of Montgomery County, Pennsylvania, Orphans' Court Division granted the Trustees' request to move the Foundation's art gallery from Lower Merion Township, Pennsylvania to a new location in downtown Philadelphia. The court's 41-page published opinion[52] acknowledged the changes ran counter to the terms of the Foundation's 1922 charter and governing documents but noted there was "no viable alternative" for the financially-compromised charity.[53] An appeal to the ruling filed by an art student at the Foundation was dismissed by the Pennsylvania Supreme Court for lack of standing.[54]

4) *Tennessee Division of the United Daughters of the Confederacy v. Vanderbilt University*

In 1913, the Tennessee Division of the United Daughters of the Confederacy entered into the first of a series of gift agreements with George Peabody College for Teachers ("Peabody College") to raise $50,000 for the construction of a dormitory, a portion of which would provide rent-free housing for students of Confederate ancestry. The agreements spelled out key restrictions on the gift, including the requirement the dormitory bear the name of "Confederate Memorial Hall." The dormitory was completed in 1935, and for many years Peabody College, and Vanderbilt University following its merger with Peabody, abided by the terms of the gift. In 2002, however, Vanderbilt's President decided to rename the building (feeling "Confederate" created a marketing problem for the University).

The United Daughters of the Confederacy, who were not consulted about or informed of the change, filed a lawsuit to compel Vanderbilt to honor the terms of the gift agreement. At trial, the court granted Vanderbilt's motion for summary judgment finding the obligation to comply with the gift agreements was "impractical and unduly burdensome." The Court of Appeals of Tennessee, however, reversed the trial court and upheld the gift agreement.[55] It gave Vanderbilt two choices: 1) either abide by the terms of the agreements between the United Daughters of the Confederacy and Peabody College; or 2) return the present value of the original gift to the United Daughters of the Confederacy. Vanderbilt decided not to appeal the decision and to honor the gift terms.

5) *Fisk University v. Georgia O'Keeffe Foundation*

In 1949, Georgia O'Keeffe, the widow of Alfred Stieglitz (and executrix of his estate), transferred the Alfred Stieglitz collection of 97 photographs and paintings to Fisk University in Nashville, Tennessee subject to a restriction that Fisk University would not at any time sell or exchange the pieces of the collection. Ms. O'Keeffe then contributed four additional pieces that were part of her personal collection for a total of 101 pieces. In 2005 Fisk University filed a petition in the Chancery Court of Davidson County asking the court to invoke the legal doctrine of *cy pres* to permit the sale of two of the paintings in

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[51] *Id.*

[52] *The Barnes Foundation,* No. 58,788 (12/13/04).

[53] Blum Debra E., "Court Ruling Could Influence Restrictions Donors Place on Bequests," *The Chronicle of Philanthropy* (January 6, 2005; "Court Allows Barnes Foundation To Move Collection to Philadelphia," *Nonprofit Issues,* December 16, 2004 – January 15, 2005 <www.nonprofitissues.com/public/features/leadfree/2004dec2-IS....>

[54] Blum Debra E., "Pennsylvania's Highest Court Allows Multibillion-Dollar Art Collection to Move," *The Chronicle of Philanthropy* (April 28, 2005).

[55] *Tennessee Division of the United Daughters of the Confederacy v. Vanderbilt University*, 174 S. W. 3rd 98, 203 Ed. Law Rep. 396 Ct.App., 2005.

the college citing the cost of maintaining the collection and other financial needs. The Georgia O'Keeffe Foundation originally filed to block the action; in 2006, the Georgia O'Keeffe Museum filed a petition, granted by the Court, to substitute the Museum for the Foundation, alleging the Museum was Georgia O'Keeffe's successor in interest and seeking through counterclaim to have the collection transferred to the Museum through right of reverter. In 2007, the Tennessee Attorney General was permitted to join the proceedings to protect the interests of the people of Tennessee.

A settlement with the Georgia O'Keeffe Museum involving a sale of several of the paintings was rejected, as was an outside offer from Crystal Bridges – Museum of American Art, Inc. involving the purchase of an undivided 50% interest that would allow the Crystal Bridges Museum and Fisk to share the college. In a pre-trial motion, the Court ruled the *cy pres* doctrine was not applicable because O'Keeffe had specific rather than general charitable intent when she transferred the collection to Fisk and that the Court had the power to order reversion if the Georgia O'Keeffe Museum could demonstrate Fisk breached the gift conditions. Following trial, the Court ruled that none of Fisk's actions had yet violated the gift terms and imposed an injunction that Fisk comply with the gift terms. Fisk appealed,[56] and in July, 2009 the Court of Appeals reversed the Trial Court's determination the Georgia O'Keeffe Museum had standing to sue finding the Museum had no right of reversion in either the 97 pieces transferred to Fisk from Mr. Stieglitz's Estate by Ms. O'Keeffe using her power of appointment, or the four pieces from Ms. O'Keeffe's personal collection gifted to Fisk.[57] The Court also found the Trial Court erred in dismissing the University's petition for *cy pres* relief after determining *cy pres* was not applicable because Ms. O'Keeffe's charitable intent was specific rather than general. The Trial Court did not determine *cy pres* relief was appropriate, but remanded the petition to the Trial Court for that determination.[58]

IV. Ten Top Charitable Planning Ideas for Current Environment

A. Idea #1: Accelerating Charitable Gifts

Sometimes the simplest planning concepts generate the most profound results. As the gift and estate tax rates shift under the schedules legislated in the 2001 Tax Act (EGTERRA) and slated income tax reductions are accelerated in the 2003 Tax Act (JGTRRA), planners must review assumptions made about tax benefits of planned gifts in current estate plans and consider changing the timing – and the form – of those gifts to maximize taxpayer benefits.

According to a recent IRS report in the Statistics of Income Bulletin, *Recent Changes in the Estate Tax Exemption Level and Filing Population*, there has been a dramatic drop in the number of estate tax returns filed since the 2001 Act. Estate tax filings dropped from 108,071 in 2001 to 45,070 in 2005, a drop of more than 58%.[59]

- *Accelerate gifts destined for charity that generate no income.* The easiest gifts to accelerate are those designated for charity under a will or will substitute that produce no current income. Classic examples include life insurance policies owned by the donor designating charity as the beneficiary, or valuable art collections headed for a museum (especially if the donor is downsizing and is concerned about the ongoing cost of insuring and safeguarding the assets).

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[56] A copy of the appeal can be found on the Tennessean website at http://www.tennessean.com/assets/pdf/DN115593814.PDF.

[57] Slip Copy, 2009 WL. 2047376, Tenn. Ct. App., July 14, 2009 (No. M200800723 COAR3CV).

[58] *Supra.*

[59] Raub, Brian G. Recent Changes in the Estate Tax Exemption Level and Filing Population, Fall 2007 Statistics of Income Bulletin, Figure C, p. 115.

- *Accelerate a testamentary gift of a home or farm by making a retained life interest gift*. A similar, but often overlooked asset is a home designated for charity under a will. The donor may want to transfer the home to charity today, retaining the lifetime right to remain in the home, and take a charitable deduction for the remainder interest.

  When a donor makes a gift of a remainder interest gift in a home or farm, it is impossible to know whether he may need to sell the real estate and move to an assisted care or long-term skilled nursing facility prior to death. The real property used for the gift may be his asset of greatest value, or simply the asset needed, to ensure housing needs are met. There are at least five ways to handle this problem.

  1. *A bargain sale of the residence*. If the donor knows he will need to sell the residence at the time the gift is in the planning process, a bargain sale may meet his goals. This means that the donor can sell the remainder interest to charity for a price that is less than the fair market value of the remainder interest. The donor can use the cash received from the sale portion to fund his housing needs. The sale triggers recognition of capital gain on the sale portion of the transaction under the bargain sale rules.

  2. *A bargain sale of the remainder interest*. If the donor knows he will need some cash from the transaction, he can consider a bargain sale of the remainder interest, instead. This transaction triggers capital gains on the non-charitable portion of the transaction under the bargain sale rules.[60]

  4. *A bargain sale of the residence or the remainder interest in the residence in exchange for a charitable gift annuity.* If the donor needs income, he may make a bargain sale of the residence or the remainder interest in the residence in exchange for a charitable gift annuity. This transaction triggers capital gains for the non-charitable portion of the transaction under the bargain sale rules.[61]

  5. *A sale during the donor's life term*. If the need is not identified until well into the life interest, the donor and charity may decide to sell the home and split the proceeds of the sale. The donor will receive the proceeds attributable to his life interest remaining in the property, and the charity will receive the balance. Since many charities plan to sell the property upon receipt, this will allow the charity to receive the cash earlier than expected, and will provided the donor with needed cash. This transaction triggers capital gain on sale of the asset.

- *In 2006 and 2007 donors age 70 ½ or older were allowed to make a gift of up to $100,000 in assets from an IRA under the Pension Protection Act of 2006.* This option may be extended through extender legislation in 2008, but is currently not an option.

There is no single rule applicable to every client. Every taxpayer's personal and tax situation is different. The planner must consider the client's age and family obligations, the potential need to call on the assets, the need for flexibility, and his or her charitable objectives as well as the value of the tax deduction to the donor. Successful planning is predicated on careful consideration of the options, and selecting the gift plan that maximizes the charitable and tax benefits to the donor.

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[60] *Id.* See Ltr. Rul. 8134106.

[61] *Id.* See Ltr Ruls. 8120089, 8305075 and 8806042.

B. Idea #2: Estate Gifts of IRD Assets

Income in respect of a decedent (IRD) creates unique opportunities for charitable planning. IRD assets – including IRAs, savings bonds, untaxed compensation, or any asset on which income tax is due at death – are often avoided by gift planners because of unpleasant tax consequences if transferred during life. In an estate, however, these assets can work magic when used to make charitable gifts.

1. The Basic Principles of IRD Planning

IRD is the term defining income that has accrued but not taxed at a decedent's death. These assets reach beneficiaries with a tax burden; the decedent's estate, the named beneficiary, or person or entity to which the asset is properly distributed is responsible for payment.[62] The untaxed income has the same character in the hands of the recipient it had in the hands of the owner.[63] Since the highest estate tax rate in 2009 is 45%, and the highest federal income tax rate is 35%, the two taxes can take a significant bite out of the asset's value at death.[64]

The goal of using IRD assets in testamentary charitable planning is simple: give the most highly taxed assets to charity, leaving the non-taxed assets for heirs. If the transfer is structured properly:

- The estate receives a charitable estate tax deduction for the gift to charity;
- The income in the property is allocated to the charity, an entity that pays no tax; and
- The non-charitable beneficiaries receive estate assets with a stepped-up basis and no inherent tax burden.

Many commonly-held assets have IRD, including the following:

✓ *Retirement plans*, such as qualified employee benefit plans, Keoughs, IRAs, and other retirement benefits funded with pre-tax income. This would not include defined benefit plans (where there is the right to certain benefits but no ownership or right of disposition of the assets funding those benefits), Roth IRAs, or portions of retirement plans funded with after-tax dollars.

✓ *Savings bonds* with accrued, untaxed income. The most common form of bond with untaxed income is the EE (Patriot) Savings Bond, which is purchased at a discount of face value, and accrues interest for up to 30 years. Until August 31, 2004, it was possible to convert EE Bonds to HH Bonds without triggering tax on the accrued income; the Treasury no longer allows such a conversion. It was also possible until August 31, 2004 to defer interest on HH Bonds; this option, too, has been eliminated.

✓ *Deferred compensation*.

✓ *Compensation earned – but not received* – before death. This includes any payment for remaining vacation or sick time accruing to the decedent.

✓ *Accounts receivable*, earned but not received before death.

✓ *Unrecognized income from annuities*, such as deferred annuities.

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[62] IRC § 691(a)(1).

[63] IRC § 691(a)(3).

[64] Most states also impose a state estate tax and income tax. The state estate tax can be claimed in part or in whole as a credit against the federal estate tax; the state income tax adds an additional overall tax burden to the IRD.

- ✓ *Remaining installment sale payments*.
- ✓ *Accrued interest* on stocks and bonds due at date of death.

Sometimes the inclusion of these assets in an estate is predictable. Retirement plans and savings bonds, for example, may comprise a large percentage of a decedent's assets. In other cases, the inclusion of the asset is not anticipated. An installment sale, for example, may have been executed after the estate plan was prepared. Only a few of these IRD assets will be explored in detail. However, the principles of IRD planning are equally applicable to all assets with this form of income.

2. Retirement Plan Gifts

Retirement plans represent a major asset in many estates due to two factors. First, companies that formerly offered defined benefit plans now find it less expensive to provide defined contribution plans. Defined benefit plans – often referred to as pension plans – require a company to maintain an actuarially calculated reserve to pay retirees a specific annual benefit for life. The retired employee does not own the assets generating the benefit, and the cash flow normally ceases at the death of the retiree. Define contribution plans allow a company to make a retirement contribution that vests (or becomes owned by) the employee after a specific period of service. The employee is then responsible for investing the assets to generate a sufficient return in retirement. Many of these plans allow employees to defer income to further build retirement assets. Second, the bull market of the 1990s increased the presence of retirement plans in estates. Individuals who had not yet retired found their plans grew dramatically, with or without additional contributions; those who had retired found the plans grew faster than required withdrawals were made.

a. Retirement Plans with Income in Respect of a Decedent (IRD)

Profit Sharing Plans: A profit sharing plan is funded on a defined contribution basis, meaning that the company decides each year how much it will contribute. Employees become vested with ownership depending upon years of employment and the terms for vesting set out in the plan. Once an employee is vested, the funds are the property of the employee and can be distributed, if funds remain at death, through a beneficiary designation.

IRC Section 401(k) Plans: A 401(k) plan allows an employee to contribute pre-tax earned income to the plan. Many times profit sharing plans include a 401(k) feature so that employees may grow retirement savings through profit sharing contributions and 401(k) contributions. 401(k) assets are owned by the employee and any funds remaining in these plans can be distributed through a beneficiary distribution. The plan document may limit the manner of distribution so it is important that the plan owner and advisor be familiar with plan limitations.

IRAs: IRAs may be the most common form of retirement plan. Contributions to IRAs accumulate and grow tax-free. Distributions from the fund are taxed as ordinary income. Assets remaining at death are the property of the taxpayer and may be distributed in accordance with beneficiary designations.

Keoghs: Keogh plans are structured much like IRAs, but are tax-deferred retirement savings plans for the self-employed. Participants in Keoughs are subject to the same restrictions on distribution (between ages 59 1/2 and 70 1/2) as are participants in IRA's.

b. Plans Not Characterized as Income in Respect of a Decedent

Pension Plans: Pension plans are company-funded retirement packages for employees. The traditional pension plan is a defined benefit plan, meaning that the employee, once vested, receives defined benefits from the plan at retirement. These benefits may continue for the life of the employee, or the life of the employee and his or her spouse. But the employee does not own the plan assets and cannot generally distribute those assets. The benefits cease at the employee's death, or at the second to die of the employee and his or her spouse.

Roth IRA: Roth IRAs are not included in the group of retirement plans with IRD. Roth IRAs are funded with after-tax dollars. The assets in the plan then accumulate, and are distributed, tax-free. Taxpayers were allowed to covert standard IRAs to Roth IRAs by paying the tax due and making an election to move the funds. While these assets can still be used to make charitable gifts, the gift does not carry the double tax benefit – avoiding ordinary income tax and estate tax – that gifts of IRD retirement plans generate.

c. Retirement Plan Gift Options

Retirement plans that offer opportunities for charitable planning include, but are not limited to, the following options.

✓ *Lifetime Outright Gift to Nonprofit Organization*

The only way to make a gift to charity under current law is to take a distribution from the plan, pay income tax on that distribution, make the gift to charity, and take a charitable deduction for the gift. Several obstacles prevent the taxpayer from receiving a $1 for $1 charitable gift credit for the gift. First, the charitable deduction is available only if the taxpayer itemizes (a group that in 2008 included 33.33 percent of all taxpayers). Next, many taxpayers receive limited benefit from itemized deductions because of the application of the three percent rule (reduced by legislation to 1% in 2008 and 2009, and eliminated in 2010).[65] This rule requires the taxpayer reduce the dollar value of allowable itemized deductions by the lesser of:

- 1% of the taxpayer's adjusted gross income in excess of $166,800 (2009); or
- 80% of the itemized deductions.

And finally, there may be other tax items on the taxpayer's return (such as prior year credits or carry forwards) that prevent the use of the deduction.

If the taxpayer has an excessive amount of funds in the IRA, he or she may choose to withdraw funds, pay the tax and make the gift to charity. If so, consider these ways to maximize that decision.

1. The withdrawn funds can be contributed to charity in exchange for an IRA. This generates a charitable deduction to cover part of the tax, removes the funds from the estate and generates an income in retirement.

2. The withdrawn funds can be contributed to a charitable remainder trust. If the taxpayer funds a charitable remainder trust, it is best to use appreciated funds and use the cash from the retirement fund distribution to replace the stock at a higher basis.

3. The taxpayer can make an outright distribution to charity. Again, the taxpayer should use appreciated stock, using the cash from the retirement plan distribution to replace the stock at a higher cost basis.

✓ *Lump Sum Distribution from Profit Sharing Plan Used to Fund Charitable Remainder Trust*

In the facts of Letter Ruling 200202078, the donor retired and received his retirement plan assets in the form of an in-kind distribution of company stock and other assets. He rolled a portion of the in-kind

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[65] IRC § 68.

distribution into an IRA and received the balance of the shares outright. He transferred a portion the non-rollover shares to a charitable remainder trust. The taxpayer recognized ordinary income on the non-rollover shares to the extent of the retirement plan's basis in the stock. The net unrealized appreciation (the value of the shares in excess of the basis) was characterized as long-term capital gain. The IRS ruled that the contribution of the shares to charitable remainder trust did not trigger ordinary income or capital gain to the donor, and would not trigger tax to the donor or the trust upon subsequent sale (absent any unrelated business taxable income or a prearranged sale). This ruling was consistent with two earlier rulings involving retirement plan transfers to charitable remainder trusts.[66]

✓ *Outright Gift to Community Foundation at Death*

Retirement plan assets may also be used to make an outright gift to a community foundation. Community foundations offer donors a variety of options.[67] The transfer agreement can reserve the right to advise on distributions from the funds to the decedent's spouse and/or children, thereby providing family members with a means to make charitable distributions that they choose. (Advised Fund) The transfer can be made to a field of interest fund to benefit a particular area of the taxpayer's interest such as healthcare, education, welfare reform, etc. (Field of Interest Fund). The transfer can be made to a designated fund, designed to distribute funds annually to specific organizations. (Designated Fund) Or the transfer may be made to an unrestricted fund labeled with the donor's name.

✓ *Outright Gift to Private Foundation at Death*

When a donor has substantial funds to contribute to charity, the taxpayer may want to consider creating and funding a private foundation.[68] A private foundation is used by many families to teach family members about philanthropy and to control the distribution of charitable dollars. The consequence of a distribution to a private foundation is that some tax may be due. Private foundations are generally considered to be one of the lowest forms of charitable life simply because they are subject to regulations and excise taxes that public charities are not required to bear. One of those taxes is an excise tax due on the foundation income, defined as interest, dividends, rents, and royalties. The distribution of retirement plan assets to the private foundation may create taxable income if the proceeds are subject to the 2 percent excise tax on investment income.[69]

✓ *Testamentary Outright Gift to Nonprofit Organization*

One of the simplest ways to maximize distributions from retirement plans is to name a charitable organization as beneficiary of all or part of the remainder. A distribution to charity of retirement assets at death (through beneficiary designation) avoids payment of both income and estate tax.

Generally speaking, when a client is making both charitable and non-charitable distributions from an estate, the charitable distributions should be made from IRD assets such as a retirement plan. The simple act of making a bequest from a retirement plan rather than the estate generally increases the net assets available for family. The distribution, especially when it represents only a portion of the assets,

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[66] See also LR 199919039, LR 200038050, and LR20035017.

[67] Get information about community foundations, and locate a community foundation in your community, by contacting The Foundation Center, <http://fdncenter.org>, or the Council on Foundations, <www.cof.org>.

[68] "Large" is a relative term. Private foundations are not cost-effective for assets of less than $1,000,000 and are really most appropriate at $3,000,000 to $5,000,000. See McCoy, Jerry J. and Kathryn W. Miree, *The Family Foundation Handbook (2008 Edition)* (CCH: 2007) for a full discussion of funding and managing family foundations.

[69] See IRC § 4940; See Ltr. Rul. 9341008 (July 14, 1993) and Ltr. Rul. 9838028; also see a different result for IRD from savings bonds under Rev. Rul. 80-118, 1980-1 CB 254.

should be structured to preserve elections of the individual beneficiaries receiving the remainder of the retirement assets. Consider these three options.

- *Create a separate IRA* to hold the gift to charity, and designate the charity as the sole beneficiary of that IRA. While this is no longer necessary to maximize recalculation options, it may make the client's wishes clearer and to ensure the distribution is made prior to the required distribution date.

- *Designate a share of the IRA* to the charitable beneficiary(ies).

- *Make the assets payable to the estate and draft the will to specifically allocate the IRA to the charitable share.*[70] Consider this sample language:

    - ✓ *An in-kind distribution* – "I direct that my IRA held at Merrill Lynch be distributed to XYZ Charity." Note: this alternative is also appropriate for other IRD assets such as savings bonds, accounts receivable, etc. This will have the effect of having the charity or CRT recognize the income from the IRD asset.[71] If the charitable recipient is a public charity or charitable remainder trust, no income tax will be due.

    - ✓ *A non-pro-rata distribution* – A non-pro-rata distribution means that the will specifically directs that the IRD asset be allocated to a particular beneficiary's share rather than have it split on a pro-rata basis among all estate beneficiaries. Sometimes state law and/or the will may allow an executor the discretion to make non-pro-rata distributions. If this is the case, and the executor elects to distribute the IRD assets to charity, it may be possible to avoid taxable income on distribution.[72] However, if either the state law or the will gives the executor this power, a distribution of the IRD assets to a specific beneficiary may trigger the tax as a taxable exchange among the beneficiaries.[73] The safest way to do this is to address the issue directly.

    - ✓ *Language directing that the bequest be made with IRD assets to the extent possible* – This language provides the greatest protection. The will might say: "I instruct that all of my charitable gifts, bequests and devises shall be made, to the extent possible, from property that constitutes 'income in respect of a decedent' as that term is defined in the Internal Revenue Code."[74] This allows the executor to claim a deduction for the IRD in the portion of the IRD assets passing to charity. Without the language, the estate is limited to an estate tax deduction for the property and will not be able to claim an income tax deduction.[75]

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[70] PLR 200452004 ruled an estate's assignment of IRAs to a charity as part of the residuary share of an estate would not cause the estate (or any estate beneficiary) to have taxable income.

[71] IRC § 691(a); Reg. § 1.691(a)-4(b)(2); Rev. Rul. 64-104, 1964-1 C.B. 223.

[72] Ltr. Ruling 9537011 (June 16, 1995).

[73] Rev. Rul. 69-486, 1969-2 C.B. 159.

[74] This language was recommended by Professor Christopher Hoyt, professor of law at the University of Missouri (Kansas City) School of Law in a presentation made at the National Conference on Planned Giving in October, 1999.

[75] *Crestar Bank v. IRS*, KTC 1999-279 (E.D. Va. 1999); *Van Buren v. Commissioner*, 89 T.C. 1101 (1987); *Riggs National Bank v. U.S.*, 352 F.2d 812 (Ct. Cl. 1965).

Retirement plan proceeds should not be used to satisfy a debt or pledge, such as a capital campaign obligation. If plan proceeds are pledged on an enforceable debt or loan, the estate will be required to pay tax on the distribution.[76] Also remember that spousal consent is required for distributions from corporate retirement plans that are not paid to the spouse. Spousal consent is not required for distributions from IRAs.

✓ *Testamentary Gift in Exchange for Charitable Gift Annuity*

In an important 2002 ruling,[77] the IRS allowed a taxpayer to name a charity as the designated beneficiary of an IRA in exchange for a testamentary charitable gift annuity payable to a named individual beneficiary. Previous to this ruling, the IRS had approved designating a charitable remainder trust as the beneficiary of an IRA, but had not ruled on a similar arrangement with a charitable gift annuity. In this ruling, the court made four determinations: the IRA would not generate unrelated business income for the charity, the IRA would be included in the owner's gross estate for estate tax purposes, the estate could claim a deduction for the charitable portion of the charitable gift annuity, and the IRA proceeds would be income in respect of a decedent (IRD) to the charity, not the owner's estate. Unfortunately, the IRS did not discuss the potential IRD impact on the annuitant. This ruling adds a simpler option for IRA owners who want to create a life income arrangement for an heir at death.

✓ *Testamentary Gift to Charitable Remainder Trust*

Another way to structure retirement plan distributions is create a testamentary charitable remainder trust for the benefit of family members. Since a charitable remainder trust does not pay tax, the retirement assets are not subject to income tax.[78] Then, the estate will receive a charitable deduction for the charitable portion of the charitable remainder trust. Table 12 compares the result of an outright gift of a $250,000 retirement plan to family (for a $4,000,000 estate) and the gift of that retirement plan to a 5%, 20-year charitable remainder trust for family. The calculation assumes the gift was made in April 2012 (1.4% CFMR).

If the spouse is named as the sole beneficiary of the charitable remainder trust, his or her interest will qualify for the marital deduction[79] so that estate tax is avoided altogether at the taxpayer's death. The assets can then distribute income annually to the decedent's wife, or children. If the sole beneficiary is the decedent's spouse, a marital deduction is available so that all taxes are avoided.[80]

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76 *John T. Harrington Estate*, 2 TCM 540, Dec. 13, 1943, 405 (M)

77 Ltr. Rul. 2002230018.

78 Although it is important to note that the retirement plan distributions are considered to be Tier I income and may impact the taxation of payments to beneficiaries of the charitable remainder trust.

79 IRC § 2056(b)(8).

80 Ltr. Rul. 9253038.

TABLE 12
COMPARISON OF $250,000 RETIREMENT PLAN TRANSFERRED TO FAMILY AND TO 20-YEAR 5% CRUT (ASSUMING $4,000,000 ESTATE, 35% TAX BRACKET, 15% CAPITAL GAINS BRACKET)[81]

	$250,000 Bequest of Retirement Plan to Family	*$250,000 Bequest of Retirement Plan to 5%, 20-Year CRUT*
Total Estate	$4,000,000	$4,000,000
Total Taxes on $250,000 Retirement Plan	$87,500	$0
Effective Tax Rate on Retirement Plan (federal taxes only)	35%	$0
Net Bequest	$162,500	$250,000
Net Savings vs. Bequest		$87,500

3. Savings Bonds

U. S. Savings Bonds, first introduced in 1935, are a widely held asset. More than 55 million Americans own savings bonds with a value in excess of $186 billion.[82] Since many of these bonds have accrued, untaxed interest, these assets are popular for testamentary charitable planning.

There are three types of savings bonds issued by the United States Government: Series EE/E Bonds, Series I Bonds, and Series HH/H Bonds.[83]

- ✓ *Series EE Bonds.* Series EE Bonds (formerly Series E Bonds) are savings bonds issued at a discount by the U.S. Government.[84] For example, a purchaser pays $50 to purchase an EE Bond with a $100 face value. The bond matures at face value and then continues to accrue interest for up to 30 years.[85] Purchasers can elect to report the accrued interest on the bonds annually or to defer recognizing income until redemption; most chose to defer. When holders of Series EE/E Bonds with deferred income contribute the bonds to a charity during life, the gift is valued at the full fair market value of the bond (rather than the discounted value paid for the bond), but the donor must report the accrued interest (as ordinary income) in the year of the gift.[86] Conceptually, this is the opposite tax result from a gift of appreciated stock for which the donor receives a charitable deduction equal to market value and avoids the capital gains tax on the appreciation.[87] A donor would generally be better off to simply make a gift of cash.

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[81] Calculations made using PGCalc, 4-22-2012.

[82] <www.aarp.org/financial-investsave/Articles/a2002-10-08-ussavingsbonds.html>.

[83] For detailed information on United States Savings Bonds, go to <www.publicdebt.treas.gov/sav/sav.htm>.

[84] For savings bonds redemption values, six month earnings as an annual yield, and yield from issue date for Series EE/E bonds can be found at www.publicdebt.treas.gov/sav/savreport.htm>>.

[85] Bonds purchased before November 1965 accrue interest for up to 40 years.

[86] Reg. § 1.170A-4(a)(3).

[87] Actually, the result is generally much worse, since the gain avoided on gifts of appreciated securities is long-term capital gain, while the income recognized on disposition of E or EE Bonds is taxed as ordinary income.

Series EE Bonds could be converted to HH Bonds (see below) through August 31, 2004, without triggering tax on the accrued interest in the bond.[88] However, the bond could not be transferred to another (charitable or non-charitable) beneficiary at this point without triggering the tax.[89] Likewise, Series EE/E Bonds cannot be reregistered in the charity's name during life without triggering the tax. The only way to avoid recognition of ordinary income on these bonds is to transfer them to charity through a specific bequest under the will (or, if the bonds are held in a revocable trust, through a testamentary disposition to charity in that trust).[90] A specific bequest of the bonds will shift the accrued income to charity and avoid taxation as income in respect of a decedent in the donor's estate.[91] This is not possible when bonds are owned jointly with right of survivorship, since these bonds will pass to the survivor and will not be subject to the terms of the will. The survivor of the two interests may leave the bonds to charity under will.

- ✓ *Series HH Bonds.* Series HH/H Bonds are savings bonds issued at face value that pay annual interest. When donors contribute Series HH/H bonds to charity during life, the gift is valued at the full fair market value of the bond. If, however, the HH/H bonds have been converted from EE/E bonds (and the interest was deferred, rather than paid, on conversion), the gift to charity will trigger the deferred ordinary income accrued during the period the donor owned the EE/E bonds.[92] Until August 31, 2004, the owner had an option to reinvest interest on these bonds; that is no longer possible.[93]

- ✓ *Series I Bonds.* Series I Bonds are the most recent addition to the savings bond options. These bonds, first offered in September, 1998, are sold at face value and pay interest that is adjusted twice a year to reflect increases in the Consumer Price Index for all Urban Consumers (CPI-U). Interest is compounded semi-annually. The bonds have a thirty year maximum, but may be redeemed for cash after a six-month holding period. The interest on the bonds is deferred for federal tax purposes during the life of the bond. The Bonds are exempt from state and local income taxes. The gain in these bonds is taxed as ordinary income in the year of maturity, redemption, or disposition. Therefore, these assets make poor gifts for charity during life, but make excellent gifts to charity under will.

Savings bonds may be owned in one of three ways: sole ownership, joint ownership, or sole with remainder beneficiary.[94]

- ✓ *Sole ownership* implies the bond is in a single individual's name; that bond will become a part of the owner's estate on death.

- ✓ *Joint ownership* gives full rights of ownership to both individuals. Either named owner can redeem the bond or exercise elections. Registering a bond jointly transfers ownership outside of the probate process at the first death; at the death of the survivor, the asset becomes a part of that individual's estate assets.

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[88] <www.publicdebt.treas.gov/sav/savinvst.htm>.

[89] See Letter Ruling 8010082 for a discussion of this result.

[90] See Ltr. Rul. 8010082 (December 13, 1979) for further information on EE/H bonds. Also see Ltr. Rul. 9507008, where IRS ruled that savings bonds in a revocable trust with testamentary provisions used to discharge pecuniary bequest to charity triggered recognition of income in respect of decedent in the trust.

[91] IRC § 691(a)(1).

[92] Ltr. Rul. 8010082.

[93] <www.publicdebt.treas.gov/sav/savinvst.htm>.

[94] See the Treasury web site cited earlier.

- ✓ *Sole ownership with a designated surviving beneficiary* leaves ownership rights with the registered owner, but names a beneficiary at death, again allowing the bond to bypass probate. This also allows a deferral of the tax on accrued income since the income will not be taxed until the bond is redeemed.

The accrued income in the bonds is classified as IRD. It is recognized when the bonds are disposed of, redeemed, or reach maturity, which occurs first.[95] The tax is generally paid by the named recipient. There is one exception to the rule. The executor may make an (irrevocable) election to report the interest on the decedent's final income tax return.[96] This option may create a better net result for the beneficiaries if the decedent's income tax rate is lower than the estate's. It is not recommended when a public charity (or private foundation) is designated to receive the bonds since it will result in payment of taxes when otherwise none would be due.

Savings bonds can be used in the same manner as retirement benefits in testamentary charitable plans. This includes the following options:

- ✓ Make a specific devise of the bonds to a public charity (no income or estate tax should be due), a private foundation (a 2 percent/1 percent tax is paid by private foundations on all income), a community foundation advised fund, or other direct charitable beneficiary. This is best accomplished by including specific language to this effect in the will.

- ✓ Make a specific devise of the bonds to a testamentary charitable remainder trust. The charitable estate tax deduction for the charitable portion of the gift (the non-income portion) will reduce the estate tax, and the charitable remainder trust's tax exempt status (a charitable remainder trust pays no tax unless the trust has unrelated business taxable income) allows it to avoid tax on the accrued bond income. To ensure this result, the savings bonds should be transferred to the charitable remainder trust and redeemed inside the trust. (If the bonds are redeemed by the estate, the income will likely be included on the estate's income tax return. It is unclear whether the estate can claim a deduction when the proceeds are then transferred to the charitable remainder trust.)

4. Other Common IRD Assets

Many other assets offer testamentary charitable planning opportunities. Consider these commonly held assets:

- ✓ *Deferred Annuity with Death Benefit.* Deferred annuities are designed to grow tax-free and provide a steady retirement income. The annuity can be structured as a fixed amount (paying a guaranteed amount over a specified period of time) or as a variable amount (allowing the owner to move among various investment options, benefiting from the increase in investment value). The variable deferred annuity has generally been more popular because it is more flexible. Most variable deferred annuities provide a guaranteed death benefit that insures distributions will equal at least as much as is contributed.

- ✓ *Deferred Compensation.* Deferred compensation is income earned – but not paid – until retirement or separation of employment. Taxpayers may voluntarily defer income through 401(k) plans (any amounts contributed by the employer are also considered deferred compensation). In addition, deferred compensation may include unpaid vacation time and sick leave. The compensation is taxed on receipt rather than when earned.

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[95] Reg. § 1.691(a)-2(b); Rev. Rul. 4-104, 1964-1 C.B. 223.

[96] Rev. Rul. 68-145, 1968-1 C.B. 203.

- ✓ *Unpaid Compensation*. Unpaid compensation may come in a variety of forms. It may include the decedent's last paycheck, unpaid bonuses, or outstanding fees and commissions. These income items will be included on the decedent's 706 Estate Tax Return rather than his tax return since the income tax year ends with his death.

- ✓ *Accounts Receivable*. Many professionals – doctors, lawyers, veterinarians – will have accounts receivable at date of death representing invoices generated, but unpaid. These items are considered income in respect of a decedent.

- ✓ *Uncollected Proceeds of a Sale, or the Balance of an Installment Sale.*[97] Uncollected proceeds of a sale or the balance of an installment sale are considered IRD. These amounts may be sizable for taxpayers with large inventories of real estate, privately held securities, or other saleable assets.

C. Ideas #3 and #4: Gifts of Closely-Held or Family Owned Businesses

The family business is the single most important asset held by many individuals – for financial and emotional reasons. The business may represent the family's most significant source of income and also contribute to its stature in the community. In addition, a first generation owner may feel the business represents his life's work, uniquely reflecting his or her business principles.

Family businesses – C Corporations, S Corporations, LLCs, LLPs, partnerships, and other less formal arrangements – are often the largest single asset of wealthy clients. Consider these statistics:

- Family businesses represent 80 to 90 percent of all business entities.[98]
- Family businesses contributed 64% of GDP and employed 62% of the U.S. work force.[99]
- The generational transfer attrition rate is high. 70 percent do not survive to the second generation; 88 percent do not make it to the third generation; and 97 percent do not make it to the fourth generation or beyond.[100]
- A surprising 19 percent of family business participants have not created an estate plan other than writing a will; only 37% have strategic plans; and 85% of those that have identified successors pointed to family members.[101]
- Leadership of 39 percent of family enterprises will change hands over the next five years.[102]

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[97] IRC § 691(a)(4).

[98] J. H. Astrachan and M. C. Shanker, "Family Businesses' Contribution to the U.S. Economy: A Closer Look," Family Business Review (September 2003).

[99] *Id.*

[100] Joseph Astrachan, Ph.D., editor, *Family Business Review*, www.ffi.org.

[101] University of Southern California Marshall School of Business, Facts On Family Businesses, <www.marshall.usc.edu>.

[102] Raymond Institute/MassMutual American Family Business Survey (2003).

- Wealth holders in family owned firms are interested in passing their wealth to the next generation, as well as their values. They want their descendants to earn their income and engage in philanthropy through giving and volunteering.[103]

1. Idea #3: Gift of Closely-Held C Corporation to Charitable Remainder Trust Prior to Sale

Many of today's business owners have built their own companies and own all or the majority of the stock in their non-publicly traded corporation. As the business owner reaches retirement age he often sells the business. As a part of this planning process, the small business owner should consider combining personal charitable goals with the disposition of the business by gifting some of the closely held stock to a charitable remainder trust. The capital gain on the shares gifted to the charitable remainder trust will not be taxed, and the charitable deduction can help shelter gain on shares sold outside the trust. The trust's shares can later be purchased by the purchaser of the business at a fair market value.[104] In the example shown in Table 12, the donor is age 68, and spouse is age 65, the gift occurs in May, 2012 (1.6% CFMR), the business has a total value of $5,000,000 and a basis of $1,000,000, and the gift to the 5% charitable remainder unitrust for their joint lives is $500,000.

TABLE 13
C CORPORATION STOCK TO CHARITABLE REMAINDER TRUST
$5,000,000 Market Value of Closely Held Business; $1,000,000 Tax Basis of Shares;
68 Year Old Donor with 65 Year Old Spouse; $500,000 5% Charitable Remainder Unitrust[105]

STEP ONE $500,000, 5% CRUT	*STEP TWO Sale of Remaining Shares to Purchaser*	*STEP THREE*
$500,000 Gift	$4,500,000 Sale	Purchaser buys $500,000 of stock from CRUT
$100,000 Tax Basis	($900,000) Tax Basis	
$178,040 Charitable Deduction	$3,600,000 Gain	
$25,000 First Year's Income	$540,000 Tax at 15%	

2. Idea #5: Reducing Accumulated Earnings With Gift of Closely Held C Corporation Stock to Charitable Remainder Trust; Corporation Purchases Shares from Trust with Accumulated Earnings

In another scenario, the closely held corporation may have many accumulated earnings that will be taxed to the recipient if distributed. In this case the charitably inclined business owner may want to contribute shares of the closely held stock to a charitable remainder trust. The closely held corporation can then use its accumulated earnings to buy back the stock and retire it as treasury stock. Key points include the following:

1. *If structured properly, there is no constructive dividend to the contributing shareholder and no adverse consequences to the corporation.*

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[103] Bankers Trust Private Banking/Deutsche Bank, Wealth with Responsibility Study (2000).

[104] Note: You must avoid a prearranged/step transaction. There can be no repurchase agreement at the time of the contribution of the shares to the charitable remainder trust.

[105] Calculations made in December 2009, 3.2% CFMR.

2. The majority corporate owner/donor may still be the majority owner after the gift with planning.
3. *If the interest is less than a majority interest in the corporation, the IRS may require a minority discount be applied to the appraised value of the shares.*
4. *The redemption offer must be made to all stockholders. Even though all shareholders are offered the opportunity, the trust may be the only shareholder to redeem.*
5. There cannot be a prearranged sale agreement with this transaction.[106]

D. Ideas #5 and #6: Using Charitable Gifts to Fund Retirement

It is easy to understand the popularity of charitable gift annuities as a planned giving option.

- Charitable *gift annuities are easy for charities to explain and donors to understand.*

- The *gift provides the donor with a guaranteed, specific income stream*. Often this income stream is higher than the donor can receive from a certificate of deposit, a U.S. Treasury bond, or other investment.

- The *transaction is part gift*, meaning that in creating a charitable gift annuity the donor also makes a gift to a favorite charity.

- The *gift generates a charitable income tax deduction for the donor* in the year in which the gift is made[107]

- The *transaction creates beneficial capital gain treatment* for the donor who contributes appreciated property.

- *Creating the gift is simple*, requiring a one or two-page governing instrument supplied by the charity.

1. Idea #5: Current Pay Charitable Gift Annuity

Many retired individuals – or those planning for retirement – create charitable gift annuities to generate more income. In this example, Doug and Anita Jones, ages 70 and 71, used a maturing certificate of deposit to create a charitable gift annuity. The certificate of deposit had a renewal rate of 1.5% ($375); the charitable gift annuity provided a yield of 5.2% ($1,300). In addition, $396.50 of the charitable gift annuity payment is ordinary income, while the remaining $903.50 is tax-free return of income.

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[106] For the latest ruling on the assignment of income issue, see *Gerald A. Rauenhorst, et ux. v. Commissioner, 119 T.C. 9 (7 Oct 2002)*. In these facts, the taxpayers owned stock in a closely-held company and warrants allowing the purchase of additional shares. The taxpayers were approached by a purchaser interested in acquiring taxpayers' stock and warrants. Following the purchase offer, the taxpayers assigned the warrants to four charities and sold their remaining stock to the purchaser. The four charities, in unrelated transactions, also sold their warrants to the purchaser. On audit, the IRS assessed the taxpayers with the capital gain on the warrants as an anticipatory assignment of income. The court dismissed the IRS claim, relying on the test in Revenue Ruling 78-197 that attributes income to the donor only if the donee, after receipt of the gift, is legally bound or can be compelled to sell. Since the charities had the option to sell, but were not obligated to do so, the capital gains were properly attributed to the charities.

[107] Gift annuities involve an outright gift to charity deductible under IRC § 170(c). The contract element of the life interest is addressed in IRC §§ 501(m)(3)(E), -(5),514(c)(5).

TABLE 14
CHARITABLE GIFT ANNUITY FOR COUPLE AGES 70, 71[108]

Contributed amount:	$25,000.00
Charitable deduction:	$ 4,716.25
Annuity amount (5.2%)	$ 1,300.00
Tax-free payments:	$ 1,008.80
Ordinary income:	$ 291.20

2. Idea #6: Create a Series of Deferred Charitable Gift Annuities

Deferred charitable gift annuities offer a donor a way to make a series of contributions to a charity during high-income-earning-years in exchange for a series of charitable deferred gift annuities whose payments begin during retirement. Those payments can be structured so that they all begin on the same date. For example, a 45-year old donor who contributes $25,000 a year for a deferred gift annuity, beginning at age 45 and continuing through age 54 will receive an income tax deduction totaling $55,512.75 over the course of the ten years, and will receive payments of $25,175 per year from age 65 for life.[109]

TABLE 15
45 YEAR-OLD DONOR MAKING ANNUAL $25,000 PAYMENTS
AGE 45 THROUGH 54

Age at Date of Gift	*Amount of Contribution*	*CGA Rate * Notes the rate had to be reduced from published rates to meet the 10% test*	*Charitable Deduction*	*Annual Payment Single Gift*	*Cumulative Annual Payments All Gifts*
45	$25,000	9.55568%* (11.%)	$2,500.25	$2,389.20	$2,389.20
46	$25,000	9.3779%* (11.1%)	$2,500.25	$2,344.48	$4,733.68
47	$25,000	9.2%* (10.6%)	$2,500.25	$2,300.00	$7,033.68
48	$25,000	9.0229%* (10.2%)	$2,500.50	$2,225.76	$9,259.44
49	$25,000	8.847%* (9.8%)	$2,500.50	$2,211.76	$11,471.20
50	$25,000	8.6721%* (9.5%)	$2,500.50	$2,168.04	$13,639.24
51	$25,000	8.498%* (9.1%)	$2,500.50	$2,124.52	$15,763.76
52	$25,000	8.3248%* (8.7%)	$6,423.75	$2,250.00	$18,013.76
53	$25,000	8.1521%* (8.4%)	$2,500.50	$2,038.04	$20,051.80
54	$25,000	7.9796% (8.1%)	$2,500.25	$1,994.92	$22,046.72

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[108] Calculations made in May 2012, 1.6% CFMR..

[109] Calculation assumes all gifts made in May 2012 (1.6% CFMR), increasing age by 1 year for each calculation, assuming payments begin at age 65.

As an alternative, the donor can structure the payments so that the cumulative payments increase over retirement years by setting staggering start dates for the payments. This increase in payments will help the recipient overcome the effects of inflation during the retirement years.

A variation on the deferred gift annuity theme is the flexible deferred charitable gift annuity. Letter ruling 9743054 allows greater flexibility in the structure of deferred charitable gift annuities. This ruling allows a donor to contribute funds in exchange for a deferred charitable gift annuity and to retain the right to select the date on which the payments begin. The later the payment begins, the larger the annual payment will be. This allows the client control of the date payments start, and the amount of those payments. The following example shows the deferred payment options at various dates for a 45 year-old donor who creates a $25,000 flexible deferred charitable gift annuity.

TABLE 16
$25,000 DEFERRED FLEXIBLE GIFT ANNUITY; 45 YEAR-OLD DONOR;[110] Payments Calculated Using Age 65 As Calculation Point, and Age 60 as First Option to Withdraw
Charitable Deduction: $2,500.25

Effective Start Date	*Age at Start Date*	*Annuity Amount*
9/10/2027	60	$1,758.48
9/10/2028	61	$1,862.36
9/10/2029	62	$1,976.04
9/10/2030	63	$2,100.72
9/10/2031	64	$2,237.84
9/10/2032	65	$2,389.20
9/10/2033	66	$2,556.76
9/10/2034	67	$2,742.96
9/10/2035	68	$2,950.72
9/10/2036	69	$3,183.48
9/10/2037	70	$3,445.28
9/10/2038	71	$3,741.12
9/10/2039	72	$4,077.12
9/10/2040	73	$4,460.60
9/10/2041	74	$4,875.00

[110] Calculations made in May 2012 (1.6% CFMR) based on ACGA rates in effect at date of gift (rates effective as of July 1, 2011).

E. Idea #7: The Value of Non-Grantor Charitable Lead Trusts in This Environment

A charitable lead trust is an irrevocable trust that provides income payments (calculated as a fixed annuity amount or as a percentage of the trust's annual market value) whose term is measured by a fixed term of years, one or more lives, or a combination of the two. At the end of the term, the assets either return to the grantor (or his/her spouse) or to other designated non-charitable trusts.

There are two types of charitable lead trusts: grantor and non-grantor.[111] Grantor lead trusts are those lead trusts with greater than a five percent probability the assets will return to the grantor (or the grantor's spouse) at the end of the trust term; the donor receives a charitable income tax deduction in the year of the gift, but must pay taxes on the trust's income over the term. Non-grantor lead trusts are the more common form. These trusts do not return the assets to the donor at the end of the term, but rather pass them to others, generally children or grandchildren. While the donor does not receive a charitable income tax deduction, he does receive a charitable gift tax deduction that reduces the value of the property passed to heirs or other recipients.

As with most gift forms, it is dangerous to be prescriptive in how and when to use the non-grantor charitable lead trust. Charitable lead trusts fit the needs of only a small percentage of the population, whether in grantor or non-grantor form. Grantor charitable lead trusts are the most rare and in this environment – when it appears tax rates will rise over the next few years (but nothing is certain) – may become rarer. Non-grantor trusts, however, will always be of interest to those with wealth exceeding the estate tax deduction limits who want to maximize the amounts they pass to heirs and also have charitable intent. The following observations are applicable to non-grantor lead trusts and may be helpful in the current uncertain environment.

- *The low interest rate environment is especially beneficial for lead trusts.* This is because the lower the rate reduces the calculated value of the remainder (and increases the value of the charitable deduction).

TABLE 17
COMPARING THE IMPACT OF THE CHARITABLE FEDERAL MIDTERM RATE ON THE CHARITABLE DEDUCTION

20-Year Term, 5% Payout	*Gift Tax Deduction 1.4% CFMR*	*Gift Tax Deduction 5.8% CFMR*
Charitable Lead Annuity Trust	$866.950	$582,920
Charitable Lead Unitrust	$636.270	$620,250

- *The tumultuous securities and real estate markets also offer lead trust opportunities.* As noted earlier, the securities markets hit historic lows in March 2009. On March 9, 2009 the Dow Jones Industrial Average closed at 6,547, and on December 25, the DJIA closed at 10,520, a 60.68% increase in 9 months. Donors who created charitable lead trusts with marketable securities in March 2009 when market values were low were able to transfer assets to heirs at discounted values. While that specific opportunity has disappeared, there are still many examples of both marketable securities (like financial stocks) and real estate that may have greater than average opportunities for appreciation.

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[111] Charitable lead trusts, like charitable remainder trusts, received their unique structure as a result of the Tax Reform Act of 1969. Prior to 1969, donors could create a trust that paid an income stream to charity over the term of the trust and have the assets return to them at the end of the trust and would receive both an income tax deduction for the income stream and exclude the trust income from their tax returns. This "double" tax benefit was eliminated in 1969.

- *Another technique that takes advantage of low asset markets is the Shark-Fin charitable lead annuity trust.*[112] The shark fin trusts use variable-payment annuity trusts (see the model charitable lead annuity forms with this option) that load the final payment in the last year allowing the trust to maximize the growth of its underlying assets over the term. This works well when funding the trust with undervalued assets, especially when combined with low CFMR rates to maximize the gift tax deduction.

- *Be careful about the math.* The most difficult aspect of recommending charitable lead trusts – especially grantor lead trusts – is running the calculations that measure the benefits to the donor and the donor's family since the tax environment is in a state of flux and will always be in flux. The dramatic changes in tax levels (income, estate, and gift) driven by the 2001 Tax Act, and the certain changes ahead in income, estate, and gift tax levels with the expiration of that 2001 Tax Act are simple examples of an uncertain field of play. Even short-term charitable lead trusts – used for capital campaign payments or to accelerate deductions for ongoing charitable gifts into a single year – can get caught. This simply means that marginal benefits to the donor may not be worth the risk.

- *If appropriate and beneficial, consider generating both income and gift tax deductions with the non-reversionary grantor charitable lead trust.* Several letter rulings[113] have recognized the non-reversionary grantor charitable lead trust, which is a charitable lead trust that terminates to a non-charitable beneficiary (other than the grantor/grantor's spouse) but contains an intentional reservation of a grantor power – such as the power to reacquire trust property and substitute power of equivalent value – that causes the trust to be taxed to the donor over the term. This creates not only an income tax deduction for the donor-retained power, but also a gift tax deduction for the transfer to heirs or other non-charitable beneficiaries. The power should not be so great that it causes the gift to be treated as incomplete (such as a power to revoke the gift). The asset should also be excluded from the donor's estate so long as the retained rights have no estate tax implications.

F. Ideas #8 and #9: Using Charitable Gifts to Meet Family Needs

1. Idea #8: Individuals with Special Needs

Sometimes a parent or grandparent is faced with the responsibility of taking care of a disabled child. While federal or state medical assistance is available for those with no assets, families like to provide for special needs when possible without eliminating the possibility of outside coverage. In this case, the planner may want to couple a charitable remainder trust with a special needs trust.

A special needs trust involves a transfer of assets to a trust to make specific types of payments to the trust beneficiary without disqualifying that beneficiary for public assistance benefits such as SSI and Medicaid. There are three ways that this trust may be structured.

- It can be created by a family member, with the family member's funds, for the benefit of the disabled individual.
- It can be created through a court proceeding using the disabled individual's funds.
- It can be part of a pooled fund managed by charity.

[112] "Jim Grote, "Shark-Fin CLATs vs. the Bears – Charitable Giving in Down Times," Planned Giving Design Center, www.pgdc.com.

[113] Letter Rulings 9224029, 9247024; Reg. §20.2031-7(d).

✓ *A Special Needs Trust Created By a Family Member.* One of the most common approaches to creating a special needs trust is to create a trust for the benefit of a disabled individual using a family member's (not the disabled beneficiary's) funds. The trust must be created by a family member other than the trust beneficiary. In other words, Charles cannot take the assets left to him by his parents and create this type of trust. However, his parents could have created such a trust during life, or at death under their wills. The trust must also have a trustee, which can be anyone qualified to serve under state law other than the beneficiary. Once established, the trustee makes distributions to the beneficiary to meet the needs listed in the trust.

The government specifically recognizes special needs trusts, so long as they meet these requirements:

- It must be established by a family member (other than the beneficiary).
- It must be managed by a trustee (who is not the beneficiary).
- It must give the trustee absolute discretion to make distributions.
- It should not give the beneficiary more income or resources than permitted to qualify for benefits.
- It can only be used to provide supplementary needs.
- It must provide instructions for final arrangements (funeral expenses).
- It directs what will happen to assets left in the trust at death.
- It must protect assets from credits or agencies seeking funds to pay debts of the beneficiary or beneficiary's family.

✓ *Special Needs Trust Created by the Court.* Sometimes an individual who is disabled enough to qualify for social security owns assets and needs protection. In these cases, a special needs trust can be established by the disabled person's parent, grandparent, legal guardian or the court. This type of trust is permitted only if the individual is under age 65 at the time of creation of the trust. The trust is structured to make the same forms of discretionary payments but has one major distinction. At the death of the beneficiary, the funds remaining in the trust must first be used to repay any benefits that have been paid on the beneficiary's behalf.

✓ *Pooled Trusts*. Non-profit organizations in some states offer pooled special needs trusts. These non-profit serves as trustee, manages the money, and makes the distributions to the beneficiary. At the beneficiary's death, any remaining assets are held for the benefit of other disabled individuals. This type of trust can be funded by the beneficiary or the beneficiary's parents. However, all assets are transferred to the trust and are owned by the nonprofit.

The trust may make payments that contribute to the quality of life, rather than the essentials of life – such as vacations, eye glasses, a motorized wheelchair, or entertainment – but should not make payments for basic needs (housing, food, clothing) or fixed monthly payments that exceed set income limits. If it does, government benefits may be reduced or eliminated.

There have been several letter rulings from the IRS that allow a donor to pay the income stream of a charitable remainder trust to a special needs trust (or to make the distributions from the trust to meet special needs).[114] Normally, the charitable remainder trust distribution must be paid directly to the individual. Under the rulings, the distribution was allowed to be paid to a special needs trust, which then distributed the funds in a discretionary fashion to the disabled beneficiary. This allows a donor to create a charitable remainder trust to benefit both the disabled child as well as the charity.

[114] See, for example, Revenue Ruling 76-270, 1976-2 C.B. 194.

There is one caveat. This plan requires creation of two trusts: a special needs trust and a charitable remainder trust.[115] Further, taxpayers cannot rely on a letter ruling and must obtain their own ruling to be safe. Therefore, this arrangement is a bit more expensive than the normal trust creation.

2. Idea #9: Providing Support for Parents

An increasing use of charitable remainder trusts and gift annuities is to fund needs of elderly parents. Increasing nursing home costs and health care costs often result in an unanticipated depletion of assets requiring that children fund the cost of lodging and care. Create a charitable remainder trust with an income stream to the parents. This allows a child to receive a charitable deduction for the gift and to provide a stream of income to a parent. Gift tax must be paid (or unified credit used) on the value of the income stream created for the parent. In this example, the children created a $100,000 6.1% charitable gift annuity for the joint lives of parents, ages 78 and 82. This gift occurred in May 2012, 1.4% CFMR. The results are shown in Table 18.

TABLE 18
$100,000 6.9% CHARITABLE GIFT ANNUITY FOR AGES 78 AND 82

Principal Amount	$100,000.00
Charitable Deduction	$ 41,009.00[116]
Annual Income to parents (6.1%)	$ 6,100.00
Tax-free portion	$ 4,575.00
Ordinary income portion	$ 1,525.00

F. Idea #10: Options in Family Philanthropy

Philanthropy is becoming an important element of the financial and estate planning process because it allows donors and their families to express values and structure their planning to support those values.

- Family philanthropy allows parents to pass values to their children and grandchildren.
- It allows families to be more effective in giving, by discussing charitable objectives and allocating funds to their highest priorities. In short, it allows focus in giving.
- It teaches newcomers to giving to be thoughtful and effective in their giving.
- It allows the family to exert leadership role in the community through a visible, focused giving program.
- It can increase the level of giving within the family. Those who know more about the charitable organizations in their community are more likely to support those organizations financially.

There are many ways to achieve family philanthropy. These vary from the more complex family foundation or supporting foundation to a family meeting at which outright gifts are planned.

[115] For a ruling involving discretionary payments from the charitable remainder trust (without creating a separate special needs trust, see Revenue Ruling 77-73, 1977-1 C.B. 175.

[116] The gift portion is $58,991.

1. Family Foundations

A family foundation is a form of private foundation, which is a tax-exempt entity that makes grants for charitable purposes. Establishing a family foundation is a big step. It requires creation of an entity – either a trust or nonprofit corporation; the qualification of that entity as a tax-exempt organization; an annual tax return; detailed record keeping; and management of assets and grants within the rules established by the Internal Revenue Code.

Why would a family establish a foundation? There are both tax and non-tax benefits. The tax benefits are easy to describe. The donor receives a charitable deduction for gifts to the foundation. The deduction is received in the year of the gift, although grants to charities may be made in subsequent years. However, it is the non-tax benefits that most donors find attractive.

- The donor, or the donor's family, maintains ongoing control of contributions.
- The foundation becomes a permanent memorial with the family's name.
- It provides an institutionalized, yet flexible, method of giving.
- It allows the donor to endow a giving program.
- It provides the donor and the donor's family privacy and insulation from solicitation.
- It provides a platform or forum for the personal development of younger family members.

Family foundations have disadvantages as well.

- A private foundation is treated like a second class charitable citizen. This treatment is reflected in the restrictions and taxes imposed on this charitable form as well as in the limitation of charitable incentives. For example, private foundations are not a qualified recipient of the charitable IRA rollover permitted under the Pension Protection Act of 2006.
- A foundation is expensive to establish and maintain.
- The foundation's income and gains are taxed.
- Donors have lower contribution limits.
- There are rules restricting self-dealing, jeopardizing investments, concentrations of business interests with heavy penalties. (These penalties were doubled under the Pension Protection Act of 2006.)
- The foundation is required to make minimum distributions annually, or face heavy penalties. (These penalties were doubled from 15% to 30% under the Pension Protection Act of 2006.)
- The penalties referenced attach to both the foundation and the foundation manager.
- The Pension Protection Act of 2006 restricted private foundation grants. Grants made to Type III Supporting Organizations that are not "functionally integrated Type III Supporting Organizations" as defined by the Pension Protection Act of 2006 will not be considered qualifying distributions.

2. Supporting Organization

A supporting organization is a nonprofit entity that is closely tied to a specific public charity. In some cases, the Board of Directors of the supporting organization is appointed by its beneficiary public charity (known as the "supported organization") or is appointed in the same manner as the governing board of the supported organization. In other cases, the board of the supporting organization is selected in some other manner involving less direct control and supervision by the supported organization. Where such a relationship exists, the supporting organization is said to be "operated in connection with" its supported organization(s).

When Congress created the present tax rules governing private foundations in 1969, it had to define the various categories of charitable entities that would be subject to those rules. Public charities – colleges, churches, publicly supported entities and the like were viewed as not needing the special scrutiny these rules produce, so these categories were excluded. The necessary involvement of the public in charities of this type was viewed as providing sufficient checks and balances to avoid the abuses with which Congress was concerned. A university, for example, is subject to scrutiny by its alumni, students, and the interested public, one or more of whom will be likely to call attention to any improper actions attempted by the university administration. By contrast, Congress concluded that purely private entities (i.e., private foundations) had no such public oversight, so they were viewed as needing the oversight the new rules provided.

Those extremes at one end of the scale or the other left some organizations in the middle. They had a special relationship with one or more charities, but were still formed and funded by private individuals outside the charities. Congress decided in 1969 that an entity of this sort would be allowed to qualify as a public charity, but only if its relationship with its beneficiary organization(s) was sufficiently close and it was not "controlled" by private interests. These entities are known as "supporting organizations" and are described in §509(a)(3) of the Internal Revenue Code.

There are three types of supporting organizations, known as "Type 1", "Type 2", and "Type III". Types 1 and 2 are closely tied to the organizations they support. Type III Supporting Organizations, however, are operated "in connection with" the supported charity, providing a much looser (and more appealing) relationship for donors who want the advantages of a public charity, but the control associated with a primate foundation. A supporting foundation is sometimes used instead of a private foundation because it carries the benefit of public (rather than private) status, yet it is a separate tax-exempt entity that can carry the family name and values. The most flexible form of supporting foundation for family purposes is a foundation that supports a community foundation and thus maintains flexibility in its grantmaking, while drawing on the community foundation for advice and guidance in making grants.

The Pension Protection Act of 2006 has negatively affected the attractiveness of Type III supporting organizations for many individuals with the imposition of a number of new rules, summarized below. There were additional rules applicable to all Supporting Organizations not listed here because they are lengthy and not as onerous.

- A foreign charity may not be a supported organization.
- The law directs Treasury to create regulations that impose a minimum payout requirement on Type III Supporting Organizations.
- Type III Supporting Organizations are subject to the excess business holdings excise tax (Code §4943). This means it will not be difficult to place – and hold – family businesses inside Type III's.
- There are new reporting requirements for Type III's, mandating that these organizations provide certain information to the entities they support each year.
- "Functionally integrated" Type III Supporting Organizations are not subject to the minimum payout and excess business holdings requirements. The concept of what is "functionally integrated" is a new one created in the law, and will likely be defined through Regulations issued by Treasury. The Joint Committee Technical Explanation[117] describes a functionally integrated supporting organization as one that does not just make grants to its supported organization, but one that conducts activities related to the supported organization's mission, such as a blood bank operated by a hospital.

[117] The summary prepared by the Joint Committee is excellent and can be found at http://waysandmeans.house.gov – click "H.R.4" under "Hot Topics."

3. Donor Advised Funds

Donor advised funds are one of the most rapidly growing areas of giving. A donor advised fund is an arrangement with a publicly supported charitable organization that allows an individual or family to establish a fund from which distributions will be made to other charitable organizations. For tax purposes, the donor has made a gift to the public charity sponsoring the fund. Because that donee is a public charity, such a gift qualifies for the most favorable tax treatment possible. The donor and his or her family retain the right to make non-binding recommendations or advice to the sponsoring charity as to how their fund will be applied. The sponsoring charity is free to accept or reject that advice and the donor is thus left with no real legal control over his or her fund. As a practical matter, the donor's advice is typically followed unless the recommended grantees are not properly qualified organizations, but this may not satisfy the donor who wants to call the shots personally, without consulting or advising anyone else. This is offset to some extent by a principal advantage of the donor advised fund – all administrative matters – such as record keeping, preparation of checks, tax returns, etc. – are handled by the sponsoring charity. Thus, there is no expense to the donor for such items, and the donor need not be bothered.

Traditionally, community foundations have been the principal suppliers of donor-advised funds, and virtually every community foundation offers this option. Included in this group are organizations such as United Jewish Appeal affiliates and other similar units serving non-geographic communities. Most community foundations offer grantmaking assistance to their donor advised funds, as well as insight into charitable needs in the community. A particular donor may or may not welcome such grant making assistance, but the community foundation's familiarity with prospective grantee organizations can help the donor avoid mistakes and accomplish the desired goals more easily.

Another type of charitable entity has grown rapidly in popularity in the last few years – the commercially-sponsored donor-advised fund or, as it is sometimes called, "gift fund." These funds are typically formed by a mutual fund group or similar financial institution. The largest – Fidelity Gift Fund – was organized in 1993 and closed 2005 with assets of $3.05 billion.[118] Commercially-sponsored donor-advised funds may offer some grant making assistance to donors, but their principal selling point is that they function much like a private foundation but at a lower-cost and provide all the tax benefits available for contributions to a public charity. Because they do not have other charitable operations of the sort conducted by a community foundation, university or other donor-advised fund sponsor, gift funds may be less likely to question a donor's advice or otherwise attempt to exert influence. Whatever the differences may be in a particular situation, these entities are like the similar funds offered by community foundations in that they cannot provide the unlimited donor control that is inherent in a private foundation.

The Pension Protection Act of 2006 has made dramatic changes to donor advised funds that will diminish their attractiveness for some donors. The changes are designed to improve accountability and to eliminate private benefit. The Act begins by providing a statutory definition of a donor advised fund:[119]

> (2) DONOR ADVISED FUND-
>
> `(A) IN GENERAL- Except as provided in subparagraph (B) or (C), the term `donor advised fund' means a fund or account--
>
> `(i) which is separately identified by reference to contributions of a donor or donors,
>
> `(ii) which is owned and controlled by a sponsoring organization, and
>
> `(iii) with respect to which a donor (or any person appointed or designated by such donor) has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in such fund or account by reason of the donor's status as a donor.

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[118] The annual report can be found at the Fidelity Charitable Gift Fund website at www.charitablegift.org.

[119] New Code §4966(d)(2).

`(B) EXCEPTIONS- The term `donor advised fund' shall not include any fund or account--

`(i) which makes distributions only to a single identified organization or governmental entity, or

`(ii) with respect to which a person described in subparagraph (A)(iii) advises as to which individuals receive grants for travel, study, or other similar purposes, if--

`(I) such person's advisory privileges are performed exclusively by such person in the person's capacity as a member of a committee all of the members of which are appointed by the sponsoring organization,

`(II) no combination of persons described in subparagraph (A)(iii) (or persons related to such persons) control, directly or indirectly, such committee, and

`(III) all grants from such fund or account are awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the board of directors of the sponsoring organization, and such procedure is designed to ensure that all such grants meet the requirements of paragraphs (1), (2), or (3) of section 4945(g).

The Act imposes the following changes on donor advised funds:

- New rules for contributions to donor advised funds. Deductions are only allowed where the sponsoring organization is a qualified charity described in Code §170(c) other than a private foundation. Also, additional substantiation requirements are imposed requiring a specific statement that the sponsoring organization has exclusive legal control over the contributed assets.
- The excess business holdings under Code §4943 are applicable to donor advised funds. In applying the rules, “disqualified persons” include donors, donor advisors, members of the family of either, or a 35% controlled entity of such person.
- The Act prevents a grant, loan, compensation, expense reimbursement or other similar payment from a donor advised fund to a donor, donor advisor, or related person. These payments will be treated as excess benefit transactions under the intermediate sanction rules.
- A new excise tax is imposed on certain types of distributions to natural persons or any person for a non-charitable purpose.
- If a distribution results in a “more-than-incidental benefit” to a donor or a donor advisor, or any related person who provides advice regarding the distribution, there is an excise tax imposed equal to 125% of the amount of the benefit against both the person who advised the distribution and the recipient of the benefit. If a manager of the sponsoring organization agreed to make the distribution knowing it would confer the benefit, the manager will be subject to a 10% tax (not to exceed $10,000).

The Pension Protection Act of 2006 also directed the Treasury Department to conduct a study of Donor Advised Funds and Supporting Organizations and report back to the Congress within a year. This could signal additional legislation, depending on the results of that study.

4. The Junior Board

A junior board is simply a younger group that acts in an advisory role on in the distribution of grants. The junior board concept is appropriate for family foundations, supporting foundations, donor advised funds or even family giving. Normally a junior board is assigned a specific amount of income to distribute, and is given a list of potential organizations qualified to receive a distribution. The junior board is then responsible for conducting research, holding its own grant meetings, and making recommendations on how the limited pool of funds will be distributed.

The junior board should have leadership from members of the family. The education should focus on the grants process, the research, and even follow-up. The leadership can do as much or as little of the research as appropriate for the age of the junior members. There is a wealth of information on charitable organizations on the Internet, and some of the junior members may be more skilled than senior members in using this resource. The goal is to begin to make the junior board members aware of needs, focused on the benefit created by grants made by the foundation, and accustomed to the balancing process required to allocate funds. This training should build community values, educate children about needs and resources, and help move them from an inward focus to an outward community focus.

V. Talking to Clients About Charitable Objectives

Planned gifts have assumed greater relevance in the current economic environment. Donors – especially those with strong charitable intent –want to continue giving but are reluctant to give up current assets. Alternative giving options, such as bequests, beneficiary designations, and all forms of life income gifts, are a welcome solution. Therefore, planned gifts are assuming more prominence in comprehensive campaigns and ongoing giving programs.

A. Include Gift Planning as an Element of the Personal Planning Discussion

The most successful gift planners (charities and professionals) use planned gifts as a tool to achieve charitable goals, rather than as an independent planning discipline. Gift planning expands donor options, and can work for every charity with the discipline and preparedness to handle the gifts.

B. Work With Clients to Identify Personal Goals

Motivation refers to the reasons a donor makes a gift; objectives refer to the results the donor wants to achieve in making a gift. A discussion of the gift's quantifiable results is often easier since it deals with objectives factors rather than the intangible feelings behind the gift. Sometimes objectives in making a gift are easy to articulate. Consider the following examples.

EXAMPLE 1: Oseola McCarty was an African-American sixth-grade dropout from Mississippi who made a living as a laundress. She lived frugally, saved her earnings, and made a $150,000 gift to the University of Southern Mississippi to establish a scholarship fund to enable other African-American women without resources to attend college.

EXAMPLE 2: Bill Gates, one of the world's richest men, has contributed over $21 billion to a family foundation. Among his multiple objectives were the eradication of polio in the world and the improvement of public education quality in the United States.

EXAMPLE 3: Walter Annenberg, one of the world's top philanthropists before his death in 2002, gave away in excess of $1 billion during his lifetime.[120] He gave because: "Giving is a mark of citizenship."[121] His objective in giving, which focused on institutions of higher education, was to improve the quality of and access to higher education in the United States.

These stories illustrate generosity in giving, as well as a focus on giving. One of the advisor's greatest challenges is to integrate the specific goals of the donor in a gift arrangement that is flexible enough to meet the needs of charity and stand the test of time. This ongoing conflict between the goals of

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[120] Ann Marsh, They Don't Expect To Take It With Them, Forbes 400, at 130 (Oct. 13, 1997).

[121] *Id.*

the donor and the needs of charity is beneficial in encouraging dialogue about the structure of the gift. If, after discussion, the charity has no interest in the gift as restricted or designed, the advisor should either counsel the donor to modify the gift of help the donor identify a charity with that specific need.

In addition, the donor may have personal goals and objectives in making a gift. He may want to achieve a tax deduction for the gift. Since the deduction will depend on the form of the property contributed, the form of the gift created, and the donor's adjusted gross income, the advisor must determine whether that goal is achievable. On the other hand, the donor may want to generate additional income in retirement from a gift.

Wealthy donors may have more complex planning goals. A survey, conduct by Paul G. Schervish and John J. Havens at Boston College, found that the very wealthy have a strong interest in controlling the timing, direction, and level of giving to charitable organizations. Therefore, much of their giving (63 percent) is directed through donor-advised funds, trusts and family foundations.[122] Researchers felt this pattern indicated a realization that financial needs and charitable interests change over time and that their charitable giving mechanisms must be able to respond to these variances.

1. Tax and Financial Incentives in Planning

While the tax benefits are not generally the primary motivation for a gift, they do provide a tangible bonus for those who contribute to charity. It is difficult to establish general rules concerning the value of tax incentives to an individual donor since results will vary depending on the gift, the donor, and the following factors:

- *The charitable deduction depends in part on the form of property contributed* (cash, securities, real estate, tangible personal property), the donor's basis in that property (short-term loss, long-term loss, even, short-term gain, long-term gain), the type of gift made (current outright gift, current split-interest gift), and the donor's adjusted gross income (to determine the 20 percent, 30 percent, and 50 percent limits for the charitable deduction in the year.

- *Some gifts avoid income tax on capital gains on contributions, while others simply defer the gain.* Often, the result depends on the facts rather than the form of the gift. For example, capital gains on appreciated property contributed to a charitable remainder trust are not taxed because the trust is non-taxable (However, this income becomes part of the trust's accounting records and may eventually be distributed to the trust beneficiary as a part of the annual distribution stream and therefore subject to tax.) Contribution of appreciated long-term capital gain property to charity in exchange for a charitable gift annuity is treated as a bargain sale so long as the interest is non-assignable; the gain attributable to the donor's share of the gift (the present value of the annuity stream) is deferred and distributed over the expected life of the donor.[123] Contribution of long-term capital gain property to charity in exchange for a gift annuity for the benefit of someone other than the donor is taxed to the donor in the year of the gift.[124]

- *Many gifts made currently create multiple tax deductions, such as an income tax deduction, and a gift tax or estate tax deduction*. For example, a gift of a retirement plan to charity through beneficiary designation may avoid both income and estate tax on the gift. A grantor lead trust creates an income tax deduction for the donor, while a non-grantor lead trust creates estate

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[122] Schervish, Paul G. and John J. Havens, The Mind of the Millionaire: Findings from a National Survey on Wealth with Responsibility, in New Directions in Philanthropic Fundraising, Understanding Donor Dynamics: The Organizational Side of Charitable Giving, edited by Eugene R. Tempel, No. 32 (Summer 2001), pp. 75-107 (a copy of the paper is available at www.bc.edu/bc_org/avp/gsas/swri/swri_features_recent_papers.htm.

[123] Reg. §1.1011-2(a)(4)(ii).

[124] Reg. 1.1011-2(a)(4)(i).

and gift tax (but no income tax) deductions for the donor. The planner must be careful to explore all ramifications of the gift and explain the benefits to the donor.

- *The value of a charitable gift made through an estate is easier to calculate since the gift generates a dollar for dollar deduction for the charitable portion of the gift.* However, life income gifts, such as a charitable remainder trust created for a child, are not fully excluded from estate taxes since the portion representing the income interest for the children will be included in the estate. In addition, donors with non-taxable estates receive no benefit from the charitable deduction.

2. A Checklist for Goal Setting

Many clients have difficulty establishing goals for planning. Use the worksheet at Appendix A to lead them through the process of setting goals and prioritizing those goals. Common planning goals may include:

- Providing for sufficient assets for spouse and family and addressing special needs.

- Providing for children. This requires a discussion of the amount or nature of the property to be left to the child, and the form of the gift. The client should review whether the child is capable of financial asset management or if an advisor or trustee should be appointed.

- Providing for grandchildren. This also requires a discussion of how much and in what fashion. Can they handle financial asset management? Would a professional trustee be of benefit?

- Providing for special educational, rehabilitation, medical or remedial provisions that should be made for one or more dependents.

- Providing for the care of extended family members. Do you have any special concerns or needs that should be addressed in providing for your parents? Are there any other extended family members (or siblings?) that require special help?
- Creating a way to maintain control or allow for flexibility. How important is the ability to provide direction and meet needs?

- Establishing family values and philanthropic goals that are important.

- Support specific charities that the client has supported during his or her lifetime.

The worksheet allows the client to accomplish several goals. First, he is able to articulate priorities in planning. Second, he is prompted to quantify the costs of meeting those goals. For example, many individuals have not thought about the cost of providing for long-term health care, or providing a college education, or even the amount that they want to leave their children after death. The goal-setting process allows donors who have not quantified those goals to take the next step to talk with a financial planner, a CPA, or other professional that can help assign a dollar amount to a priority goal. Finally, he is able to take action to achieve goals, or make alternate plans if the goals cannot be met.

3. Helping the Client Discuss Charitable Objectives

Many professionals are not comfortable raising the issue of charitable giving. These questions are designed to make that process easier. These questions may be incorporate into an intake questionnaire to identify charitable objectives.

- *Do you have charitable organizations that you currently support on an annual basis?*

- *Do you want to include a gift to any of these organizations or other charitable organizations as a part of your estate plan?*

- *If there were a way to make a gift to charity largely out of federal estate tax dollars, would you be interested in exploring options to accomplish that goal?*

If you want to explore the client's charitable planning goals and objectives in more detail, ask these questions.[125]

- *What are your values? What have been the principles that have guided how you have lived your lives, raised your family run your business?*

- *What charitable interests have you pursued as an outgrowth of your values?*

- *What have you learned from your giving? What would you do differently? Would you feel confident expanding your giving?*

- *What has been the most satisfying charitable gift that you have made? Why?*

- *How do you view your wealth in connection to your community, to society?*

- *What role has philanthropy played in your family? What role should philanthropy play? What value would it bring to your children and grandchildren?*

- *What core values would you like to express through your giving? What do you want to stand for?*

- *When they think about the challenges facing your community, what are your major concerns?*

- *Are any of these or should any of these concerns be the focus of your giving?*

- *What would you like to accomplish with your giving? What do you think is possible?"*

The key is to ask the questions to allow the client to express charitable giving in terms of a priority. If you raise the issue and the client is not interested, move on. If you raise the issue and the client does express an interest, then there is an opportunity to integrate charitable giving in the overall estate plan.

4. Encourage Ongoing Review

Planning is a continuous process. The donor should review his plans on at least an annual basis, or when important changes occur. Consider a few of the most common change scenarios.

✓ **Change in Assets**

- Purchase of a major asset
- Sale of a major asset
- Loss of significant amounts in asset value in the financial markets
- Gained significant amounts in asset value in the financial markets
- Inherited assets

[125] Breiteneicher, Joe, "Advisor's Enthusiasm Helps To Shape Client's Charitable Role," *Trusts & Estates* (August, 1996), p. 32.

✓ **Change in Income Level**

- Got a new job
- Lost a job (or two jobs in double income families)
- Interest rates (and your income) decline significantly
- Interest rates (and your income) increase significantly
- Illness, disability causes increase in expenses

✓ **Change in Work Status**

- Key wage earner retires
- Key wage earner is disabled
- Job change

✓ **Change in Family Status**

- Marriage
- Divorce
- Children born
- Child marries
- Child disabled
- Grandchildren born
- Death of immediate family member

V. Final Thoughts

Effective planning is about meet client goals. Charitable planning allows the planner to combine goals to create the most effective result. Charitable planning after the 2001 Tax Act still offers many opportunities to meet donor needs, and provide a tax-reduction incentive. Incorporate questions about charitable goals in your intake questionnaire, and call any of today's sponsoring charities for more information or help in gift planning.

APPENDIX A
INDIVIDUAL GOAL SETTING WORKSHEET

Setting goals for care of family and distribution of funds is important. Use this chart to list your goals, and indicate the dollar figure required to fund those goals.

Priority	*Goal*	*$$ Required*
	Provide for personal lifestyle.	$
	Provide for family care and lifestyle.	$
	Provide for assets for children. Note: determine if that gift should be outright or in trust.	$
	Provide for assets for grandchildren.	$
	Provide for elderly parents or family.	$
	Provide for family members with disabilities or other special medical needs.	$
	Provide for charities supported during life.	$
	Provide for the U. S. Government's programs and activities through a gift to the Internal revenue Service.	$
	Other	$
		$
		$
		$
	TOTAL:	