USING CHARITABLE CONTRIBUTIONS TO ENHANCE YOUR ESTATE PLAN

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I. USING CHARITABLE CONTRIBUTIONS IN YOUR ESTATE PLAN

It is an American tradition to support charitable causes, and Congress has determined that the federal income, gift, and estate tax laws should support this tradition by providing significant tax benefits to charitable donors. Although studies have shown that donors are not primarily motivated by tax considerations, there are many strategies donors should consider to maximize their charitable gifts and "give smarter."

Charitable deductions can significantly reduce the value of an individual's gross estate for federal estate tax purposes. The deduction can be utilized in many ways, including through wills, IRAs and 401(k) plans, or trusts. The value of the deduction is typically equal to the fair market value of the property donated. The deduction is subtracted from the gross estate at death before the estate tax rate is applied to the remaining value. To take advantage of the deduction, the property must be given to a qualified charitable organization. Certain vehicles, such as split-interest trusts, have the ability to help individuals meet their charitable goals while also still providing for themselves and their loved ones.

II. CHARITABLE SPLIT INTEREST TRUSTS

Split-interest trusts are, essentially, hybrid trusts that have both charitable and noncharitable beneficiaries. When done right, the transfer of assets to a split-interest trust will still qualify for a charitable deduction, even though a benefit is provided for a non-charitable beneficiary. For example, suppose a donor creates a split-interest trust, a charitable remainder annuity trust (discussed in more detail below), where the only non-charitable beneficiary is a spouse. Under this arrangement, the annual fixed annuity payments to the surviving spouse qualify for the marital deduction and the remainder interest to the charity also receives a charitable deduction.

There are two main types of Charitable Split-Interest Trusts: Charitable Remainder Trusts and Charitable Lead Trusts. Although similar, the timing of the charitable and non-charitable bequests differ under each.

a. CHARITABLE REMAINDER TRUSTS

The Charitable Remainder Trust (CRT) is a split-interest trust in which the non-charitable beneficiary receives an income interest until death, or for a specific term not to exceed 20 years, with the remainder going to the charitable organization. CRTs are excellent vehicles for charitably inclined taxpayers looking to create an income stream for a term of years or for life, defer income taxes, generate an income tax deduction, and reduce federal estate tax exposure. Because a CRT is a tax-exempt entity, assets held in the trust are not subject to income tax and the taxpayer only pays tax to the extent that the distributions from the CRT consist of taxable income.

CRTs can be made either as a Charitable Remainder Annuity Trust (CRAT), where the non-charitable beneficiary is provided a fixed annuity payment, or as a Charitable Remainder Unitrust (CRUT), where the non-charitable beneficiary is provided a fixed percentage payment based on the fair market value, determined annually, of the property within the CRUT. Under both a CRAT and a CRUT, the annuity or unitrust payment must be paid annually to the non-charitable beneficiary.

CRATs and CRUTs also have slight differences in rules regarding how assets may be contributed and how payments may be made. In terms of contributions, CRATs allow no further contributions to be made after the initial gift, while CRUTs allow additional contributions to be made after the initial gift. CRATs and CRUTs also differ in how the annuity or unitrust payments may be made. For CRATs, when income is insufficient to meet the annual annuity payment, the remainder of such annual annuity payment is paid out of the principal. For CRUTs, there are various options when income is insufficient to meet the annual fixed percentage payment:

- The CRUT can pay the remainder from principal (a standard CRUT).
- The CRUT can pay the lesser of net income or a fixed percentage (a net income CRUT or "NICRUT").
- The CRUT can be structured with a make-up provision for any shortfall of net income (a net income makeup CRUT or "NIMCRUT"). The NIMCRUT pays the lesser of net income or a fixed percentage each year but requires that any shortfalls between net income and the fixed percentage be accumulated and "made up" in subsequent years in which the income exceeds the fixed percentage.

A CRUT can also be structured to "flip" from a NICRUT or NIMCRUT to a standard fixed percentage upon certain non-discretionary trigger events, such as the sale of unmarketable assets, death, divorce, marriage, or the birth of a child. These types of CRUTs are referred to as "flip-CRUTs."

A CRT also must pass a probability of exhaustion test. The CRT fails to qualify if, at the creation of the CRT, the probability that the remainder beneficiary (the charity) will not receive any property is greater than 5%. The probability of exhaustion is calculated by using the current Section 7520 rate (sometimes called the "hurdle" rate) and mortality tables. CRTs are generally more beneficial in higher interest rate environments, as the higher the applicable Section 7520 rate becomes, the higher the value of the charitable interest, thus creating a greater potential income tax deduction. A higher Section 7520 rate also increases the likelihood of the CRT passing the exhaustion test.

<u>Example</u>: A 65-year-old donor wishes to generate a lifetime income stream on funds that grow tax free and ultimately benefit his favorite charity upon death. The donor transfers $1,000,000 to a lifetime CRUT in 2023 that pays out 5% each year. Upon establishing the CRUT, the donor receives a charitable income tax deduction of approximately $444,540 (assuming a 5.4% Section 7520 rate applicable during the month of contribution). If we assume the CRUT assets grow at a 7% rate each year, and the donor dies 15 years after establishing the CRUT, (i) the donor receives annual unitrust distributions ranging from $50,000 in the first year to over $62,000 in the last year of his life, (ii) the more than $1,320,000 remainder value of the CRUT passes to his favorite charity, and (iii) the remainder value of the CRUT passing to charity is not subject to federal estate tax. *See **Exhibit A** for more details on this example CRUT calculation*.

b. CHARITABLE LEAD TRUSTS

The Charitable Lead Trust (CLT) can be thought of as the reverse of the CRT because the charitable organization receives the income payments with the remainder going to the non-charitable beneficiary, hence the name Charitable *Lead* Trust. CLTs are excellent vehicles for charitably inclined taxpayers who have no need for a current income stream from the contributed assets and are looking to provide a current benefit to a charity, generate an income tax deduction, reduce federal estate tax exposure, and ultimately pass the assets onto certain non-charitable beneficiaries. Unlike CRTs, a CLT is not a tax-exempt entity, and income earned on assets held in the trust is subject to income tax.

If the CLT is a "grantor" trust, the taxpayer reports CLT income on his or her tax return and pays the income tax liability. If the CLT is not a "grantor" trust, the CLT files its own income tax return and pays the income tax liability.

If the CLT is a "grantor" trust:

- The donor reports CLT income on his or her tax return and pays the income tax liability.
- The donor receives a charitable deduction for income and gift tax purposes in the year the CLT is created and funded. The value of the deduction if equal to the amount of the initial present value of the payments the CLT will make to the charitable beneficiary over the term of the trust.
- The donor does not receive income tax deductions for the annual payments made to the charitable beneficiary.

If the CLT is NOT a "grantor" trust:

- The CLT files its own income tax return and pays the income tax liability.
- The donor does not receive a charitable deduction for income tax purposes for the first year the trust is created and funded.
- The CLT receives a charitable deduction each year for the payments the CLT makes to the charitable beneficiary.
- The donor receives a gift tax charitable deduction for the initial present value of the payments the CLT will make to the charitable beneficiary over the term of the trust.

CLTs contain a guaranteed annuity or unitrust interest, which refers to the right to receive a determinable amount at least annually for a specific term or for the life of individuals living at the time of the donor's death. As with CRTs, there are both Charitable Lead Annuity Trusts (CLATs) and Charitable Lead Unitrusts (CLUTs). In terms of contributions, CLATs allow no further contributions to be made after the initial gift, while CLUTs allow additional contributions to be made after the initial gift. However, unlike CRUTs, CLUTs have no options for net income provisions such as NICRUTs or NIMCRUTs.

CLTs are generally more beneficial in lower interest rate environments, as the lower the applicable Section 7520 rate (sometimes called the "hurdle" rate) becomes, the lower the value of the non-charitable interest, and thus less lifetime estate and gift tax exemption is consumed at the inception of the CLT.

<u>Example</u>: We return again to the 65-year-old donor. This time he wishes to provide an annual income stream to his favorite charity and reduce his estate tax exposure upon death. He transfers $1,000,000 to a "grantor" CLAT that pays out at 5% each year for 15 years. Upon establishing the CLAT, the donor receives a charitable gift tax deduction of approximately $505,230 (assuming a 5.4% Section 7520 rate applicable during the month of contribution). Assuming the trust assets grow at a 7% rate each year, (i) the donor receives a large charitable deduction for income tax purposes in the year the CLAT is established, (ii) the charity will receive annual annuity distributions of $50,000 (5% of the $1,000,000 gift) for 15 years, (iii) the more than $1,502,000 remainder value of the CLAT passes to his heirs while using approximately $494,770 in gift tax exemption, and (iv) more than $1,007,000 passes to the donor's heirs free of federal estate and gift tax. *See* ***Exhibit B*** *for more details on this example CLAT calculation*.

III. PRIVATE FOUDATIONS AND DONOR-ADVISED FUNDS

As an alternative to direct giving, donor-advised funds and private foundations have become popular vehicles for charitable giving for those wishing to leave a legacy. Though donor-advised funds and private foundations are similar, there are key differences to understand when deciding which route to take.

a. DONOR-ADVISED FUNDS

A donor-advised fund (DAF) is a giving account established by a donor that is administered by a public charity - usually a community foundation or the charitable arm of a financial institution. The gift to a DAF is irrevocable. However, in most cases, the charity follows suggestions and advice from the donor on how the assets are to be invested and how they will be distributed to charity.

For many families, establishing a donor-advised fund makes more sense than starting a private foundation. The benefits of DAFs include the following:

- **Low Administrative Costs**. Many DAFs are created at no initial cost and involve low maintenance fees. Private foundations typically incur substantial start-up costs, require yearly tax returns, and require yearly board meetings.
- **Maximum Tax Benefit**. Donors to DAFs enjoy tax deductions on amounts up to 60% of their adjusted gross income (AGI), while gifts to private foundations are limited to 30% of a donor's AGI. For both DAFs and private foundations, if donations exceed the applicable AGI limits, they can be carried over to subsequent tax years for a period of five years (subject to certain limitations).
- **Privacy**. Private foundations are required to file detailed public tax returns that disclose the names of donors, board members, staff, and grant recipients. DAF donors, fund advisors, and grantees can be kept private at a donor's request.

b. PRIVATE FOUNDATIONS

A private foundation is a nonprofit charitable entity created and controlled by the donor. The donor is tasked with ensuring that the foundation follows IRS regulations in order to maintain its nonprofit status and receive the desired tax benefit.

Private foundations may be a better fit than a DAF when donor control is a key factor. As the name implies, DAFs only grant advisory privileges to the donor. While most DAFs approve grant requests regularly, this is not assured. For those who plan to give large amounts, this may be a risk they are unwilling to take.

Additionally, flexibility is another reason private foundations may be preferential to DAFs. Generally, private foundations allow a wider range of investment options for gifted assets. Private foundations are also able to give to a wider variety of beneficiaries, including individuals, scholarship programs, and other foundations. DAFs are usually limited to giving to 501(c)(3) public charities.

IV. THE BENEFIT OF GIFTING APPRECIATED PROPERTY

Rather than gifting cash to a charitable organization, a more tax advantageous strategy is to donate appreciated stock and avoid capital gains tax that would be due on sale of the stock. For example, assume a donor wishes to make a $100,000 gift to a charity, and has $100,000 worth of Tesla stock purchased for $100 per share that is now trading at $500 a share. If the donor sold the stock and then donated the cash proceeds, they would incur $80,000 worth of taxable capital gains income in addition to the $100,000 given to the charity. By donating the stock, the donor avoids the capital gains tax entirely.

Just like gifts of appreciated stock, certain charitable bequests of tangible personal property, such as valuable artwork, also avoid taxation of any capital gains appreciation that has accumulated since the initial purchase of the property. To receive the most advantageous charitable deduction, one that is worth the full fair market value of the property, the gift must be made to the charity for a use that is related the purpose or function of its tax-exempt charitable purpose.

<u>Example</u>: Assume an art collector has a small collection of valuable paintings that she has accumulated over the years. One of these paintings was created by a now famous artist who was unknown when she originally bought the painting for $5,000. Since the purchase, the painting has increased to a present value of $100,000. One of her favorite hobbies is to visit the local art museum, a qualified charitable organization, whenever they showcase a new series of artwork. Because of all of the great moments that the museum has provided the donor, she decides to make a gift. Rather than gifting cash or other property to the museum, she could donate the work of art that she purchased from the famous artist years ago. Because she donated the painting to an art museum whose charitable purpose is related to showcasing and educating art, the donor would avoid all capital gains tax that the painting has accumulated and receive a charitable deduction worth the full fair market value of the painting.

V. RETIREMENT ACCOUNTS

a. QUALIFIED CHARITABLE DISTRIBUTIONS FROM IRAs

Taxpayers who are required to take required minimum distributions (RMDs) from their IRA may be able to significantly reduce their tax bill by making Qualified Charitable Distributions (QCDs) from their IRA. A QCD is a direct transfer from an IRA to a qualified charity. The QCD amount is not included in the taxpayer's income and satisfies the taxpayer's RMD requirement for the year. QCDs are limited to the amount that would otherwise be taxed as ordinary income, and are also capped at a maximum of $100,000 per year. To count towards the RMD for a particular year, a QCD must be made by the RMD deadline, generally December 31.

b. ESTATE TAX AND RETIREMENT ACCOUNTS

Tax deferred retirement accounts, such as traditional IRAs and 401(k)s, are not the most estate tax-efficient vehicle for transferring wealth. Such retirement accounts have built-in income tax which is deferred. However, for estate tax purposes, the value of the account includes this deferred income tax. This means estate tax may be assessed at 40% (current rate in 2023) on the full value of the account, even though the deferred income tax burden will ultimately be paid in the future. Unfortunately, this significantly increases the overall tax burden on such funds when an account owner has a taxable estate.

One solution to this problem presents itself when the account owner is charitably inclined. When deciding which assets to use to fund their charitable bequests, the tax deferred retirement accounts should be strongly considered. A properly bequeathed traditional retirement account would qualify the entire account value for a charitable deduction, thus reducing the overall tax burden on the donor's estate. Further, the charity would be able to access the entire value, as the charity would not have to pay the deferred income tax.

VI. STACKING CHARITABLE CONTRIBUTIONS

When an individual or married couple files their federal income tax return, they deduct from their income the greater of their itemized deductions or the standard deduction to lower their tax bill. Because the Tax Cuts and Jobs Act of 2017 significantly increased the standard deduction to $13,850 for single filing taxpayers and $27,700 for joint filing taxpayers (in 2023), millions of taxpayers have chosen to take the standard deduction instead of itemizing their deductions.

Since charitable gifts are included in itemized deductions, they may no longer provide a tax benefit for many taxpayers. This is especially true for those who have paid off their homes and do not have mortgage interest available as an itemized deduction. Fortunately, one way to ensure that charitable contributions still result in a tax benefit is to bunch, consolidate or stack charitable contributions.

For example, a married couple generally contributes $15,000 to charity annually. Since the Tax Cuts and Jobs Act went into effect in 2017, the donor couple has claimed the standard deduction. If the donors set aside $15,000 for three years, claim the standard deduction in those three years, then make $45,000 of charitable contributions in the fourth year, they will be able to deduct the entire $45,000 charitable contribution as an itemized deduction.

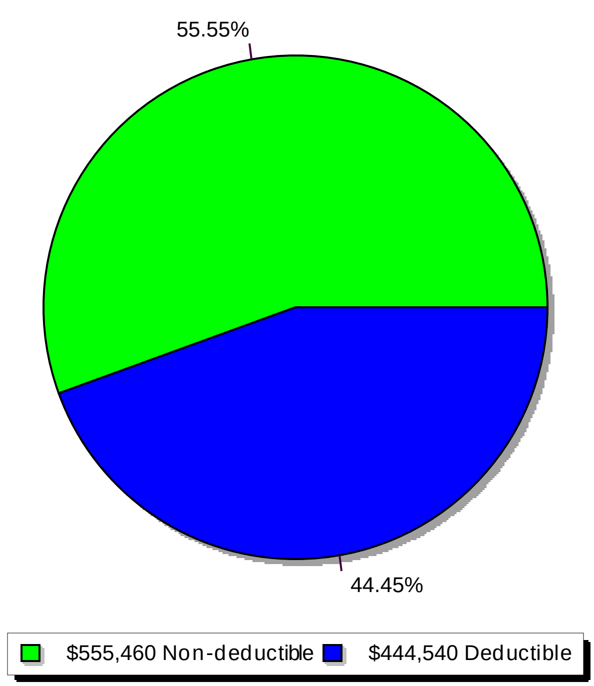
EXHIBIT A - CRUT Calculation

Charitable Remainder Unitrust

Trust Type:	Life
Transfer Date:	10/2023
§7520 Rate:	5.40%
FMV of Trust:	$1,000,000
Growth Rate:	7.00%
Income Rate:	0.00%
Optimized:	No
Percentage Payout:	5.00000%
Payment Period:	Annual
Months Val. Precedes Payout:	0
Lives:	1
Ages:	65
CRUT Type:	Normal

Payout Sequence Factor:	1.000000
Adjusted Payout Rate:	5.000%
Remainder Factor:	0.44454
Present Value of Remainder Interest = $1,000,000.00 x 0.44454:	$444,540.00
Donor's Deduction:	$444,540.00
Donor's Deduction as Percentage of Amount Transferred:	44.454%

Deduction as Percentage of Amount Transferred



Charitable Remainder Unitrust

Year	Beginning Principal	Principal Growth	Income Rec'd/Accr'd	Distribution	Remainder
1	$1,000,000.00	$66,500.00	$0.00	$50,000.00	$1,016,500.00
2	$1,016,500.00	$67,597.25	$0.00	$50,825.00	$1,033,272.25
3	$1,033,272.25	$68,712.60	$0.00	$51,663.61	$1,050,321.24
4	$1,050,321.24	$69,846.36	$0.00	$52,516.06	$1,067,651.54
5	$1,067,651.54	$70,998.83	$0.00	$53,382.58	$1,085,267.79
6	$1,085,267.79	$72,170.31	$0.00	$54,263.39	$1,103,174.71
7	$1,103,174.71	$73,361.12	$0.00	$55,158.74	$1,121,377.09
8	$1,121,377.09	$74,571.58	$0.00	$56,068.85	$1,139,879.82
9	$1,139,879.82	$75,802.01	$0.00	$56,993.99	$1,158,687.84
10	$1,158,687.84	$77,052.74	$0.00	$57,934.39	$1,177,806.19
11	$1,177,806.19	$78,324.11	$0.00	$58,890.31	$1,197,239.99
12	$1,197,239.99	$79,616.46	$0.00	$59,862.00	$1,216,994.45
13	$1,216,994.45	$80,930.13	$0.00	$60,849.72	$1,237,074.86
14	$1,237,074.86	$82,265.48	$0.00	$61,853.74	$1,257,486.60
15	$1,257,486.60	$83,622.86	$0.00	$62,874.33	$1,278,235.13
16	$1,278,235.13	$85,002.64	$0.00	$63,911.76	$1,299,326.01
17	$1,299,326.01	$86,405.18	$0.00	$64,966.30	$1,320,764.89
Summary:		$1,292,779.66	$0.00	$972,014.77	$1,320,764.89

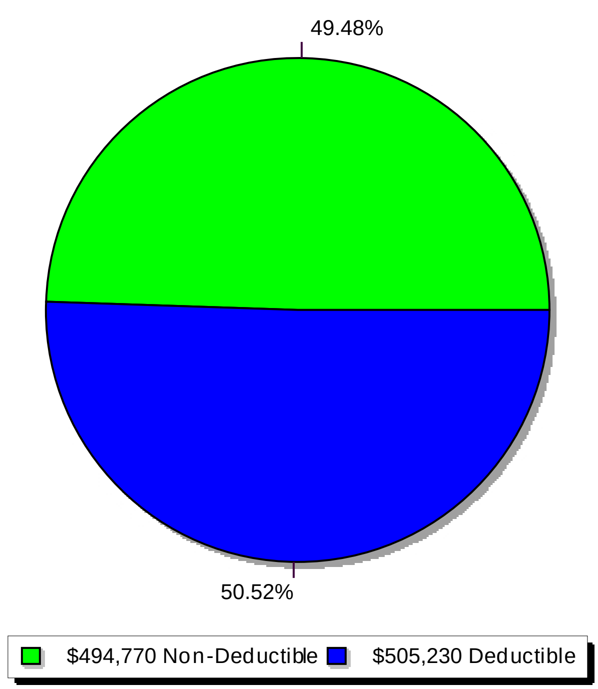
<u>EXHIBIT B</u> - CLAT Calculation

Charitable Lead Annuity Trust

Trust Type:	Term
Transfer Date:	10/2023
§7520 Rate:	5.40%
FMV of Trust:	$1,000,000
Growth of Trust:	7.00%
Optimized:	No
Percentage Payout:	5.00000%
Payment Period:	Annual
Payment Timing:	End
Term:	15
Total Number of Payments:	15
Exhaustion Method:	IRS
Vary Annuity Payments?	No
Economic Schedule Compounding:	Annual

Annual Payout:	$50,000.00
Annual Payment:	$50,000.00
Term Certain Annuity Factor:	10.1046
Payout Frequency Factor:	1.0000
Present Value of Annuity:	$505,230.00
Remainder Interest = FMV of Trust less PV of Annuity:	$494,770.00
Charitable Deduction for Income Interest:	$505,230.00
Donor's Deduction as Percentage of Amount Transferred:	50.523%

Deduction as Percentage of Amount Transferred



Charitable Lead Annuity Trust

Year	Beginning Principal	7.00% Growth	Payment	Remainder
1	$1,000,000.00	$70,000.00	$50,000.00	$1,020,000.00
2	$1,020,000.00	$71,400.00	$50,000.00	$1,041,400.00
3	$1,041,400.00	$72,898.00	$50,000.00	$1,064,298.00
4	$1,064,298.00	$74,500.86	$50,000.00	$1,088,798.86
5	$1,088,798.86	$76,215.92	$50,000.00	$1,115,014.78
6	$1,115,014.78	$78,051.03	$50,000.00	$1,143,065.81
7	$1,143,065.81	$80,014.61	$50,000.00	$1,173,080.42
8	$1,173,080.42	$82,115.63	$50,000.00	$1,205,196.05
9	$1,205,196.05	$84,363.72	$50,000.00	$1,239,559.77
10	$1,239,559.77	$86,769.18	$50,000.00	$1,276,328.95
11	$1,276,328.95	$89,343.03	$50,000.00	$1,315,671.98
12	$1,315,671.98	$92,097.04	$50,000.00	$1,357,769.02
13	$1,357,769.02	$95,043.83	$50,000.00	$1,402,812.85
14	$1,402,812.85	$98,196.90	$50,000.00	$1,451,009.75
15	$1,451,009.75	$101,570.68	$50,000.00	$1,502,580.43
Summary:	$1,000,000.00	$1,252,580.43	$750,000.00	$1,502,580.43