CHARITABLE PLANNING IDEAS YOUR CLIENTS CAN USE*

*Mickey R. Davis*** *and Melissa J. Willms****

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** Attorney at Davis & Willms, PLLC, Houston, TX. J.D., University of Texas School of Law, 1982. B.B.A., University of Arizona, 1979.

*** Attorney at Davis & Willms, PLLC, Houston, TX. LL.M., University of Houston Law Center, 1996; J.D., Texas Tech University School of Law, 1992; B.A., University of Texas at Austin, 1987.

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I. INTRODUCTION

Charitable giving forms an important part of many clients' estate plans.[1] A client's interest in undertaking charitable planning, as with many estate planning techniques, is often largely impacted by the advisor's comfort level with, and ability to identify and explain, the various charitable planning tools that are available.[2] It is the rare client indeed that begins her estate planning meeting by telling her attorney that she wants to leave her IRA into a testamentary charitable remainder unitrusts (CRUT) for the benefit of her thirty-year-old spendthrift granddaughter.[3] Even clients that express philanthropic goals are unlikely to appreciate the differences in, for example, establishing a private foundation as compared to using a donor advised fund.[4] This Article is not intended as a treatise on charitable giving; instead, it seeks to (i) provide a resource to understand the basic income and transfer tax issues associated with charitable giving; and (ii) outline some common techniques in a fairly non-technical way, so that planners will have a general familiarity with their use.[5]

II. FEDERAL ESTATE, GIFT, AND GST TAX LAWS

A. Historical Perspective

The last decade has seen tectonic changes in the federal transfer tax system.[6] Following what turned out to be a brief, but optional, repeal of the

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1. *Charitable Giving*, JUSTIA (Oct. 2002), https://www.justia.com/estate-planning/charitable-giving/ [https://perma.cc/AA3K-WQ3V].

2. *See id.*

3. *See id.*

4. Wendy Campos et al., *Compare Donor-Advised Funds to Private Foundations*, MOSSADAMS (Oct. 15, 2021), https://www.mossadams.com/articles/2021/10/donor-advised-funds-versus-privatefoundations [https://perma.cc//BC9B-W287].

5. *See* discussion *infra* Parts III–IV.

6. *See* Kate Dore, *IRS bumps up estate-tax exclusion to $12.92 million for 2023. Here's what that means for wealthy Americans*, CNBC (Oct. 19, 2022), https://www.cnbc.com/2022/10/19/irs-bumps-estate-tax-exclusion-to-12point92-million-for-2023.html [https://perma.cc/WAH6-CXV3].

federal estate tax and basis adjustment provisions in 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRA 2010) re-enacted the estate tax, and re-unified estate, gift, and generation-skipping transfer (GST) tax exemptions, increasing them to $5 million for 2011, with an inflation adjustment in 2012.[7] In 2013, the law was scheduled to revert to the law in effect in 2001.[8]

B. American Taxpayer Relief Act of 2012

The American Taxpayer Relief Act of 2012 (ATRA) nullified the scheduled 2013 reversion of the estate and gift tax rules.[9] ATRA adjusted tax rates and made the changes to gift and estate tax exclusions and GST tax exemptions first enacted in 2010 permanent, while increasing the effective federal estate tax rate on the excess from 35% to 40%.[10] As a result, ATRA reunified the estate, gift, and GST tax laws with an exclusion of $5 million, adjusted annually for inflation after 2011, and capped estate, gift, and GST tax brackets at 40%.[11] At the same time, federal income tax rates were increased for individuals, trusts, and estates to 39.6% for ordinary income and 20% for qualified dividends and capital gain tax.[12] Tax laws are never truly permanent.[13] However, for the first time since 2001, ATRA meant there was no set expiration date for the estate, gift, and GST tax laws.[14] From 2001 to 2013, the estate tax rules had expiration dates, with a possibility that Congress would make them permanent.[15] There was continued uncertainty, but with ATRA's unexpiring exclusions, it meant that it would take an act of Congress to make a change.[16] Then came December 2017.[17]

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7. Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296; Julie Garber, *How the Generation-Skipping Transfer Tax Exemption Works*, THEBALANCE (Jan. 17, 2023), https://www.thebalancemoney.com/exemption-from-generation-skipping-transfer-taxes-3505526#:~:text=This%20exemption%20is%20an%20amount,as%20of%20tax%20year%202022 [https://perma.cc/J8TG-ASYJ].

8. Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296.

9. American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313.

10. *Id.*

11. *Id.*

12. *Id.*

13. *See TAX REFORM: WHICH CHANGES ARE TEMPORARY VS. PERMANENT*, PKFMUELLER (Sept. 2018), https://www.pkfmueller.com/newsletters/tax-reform-which-changes-are-temporary-vs-permanent [https://perma.cc/24DE-MVDW].

14. American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313.

15. Gillian Brunet, *New Estate Tax Rules Should Expire After 2012*, CTR. ON BUDGET & POL'Y PRIORITIES (May 26, 2011), https://www.cbpp.org/research/new-estate-tax-rules-should-expire-after-2012 [https://perma.cc/WAE7-4NFV].

16. American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313.

17. *See* David Floyd, *Explaining the Trump Tax Reform Plan*, INVESTOPEDIA (Jan. 23, 2023), https://www.investopedia.com/taxes/trumps-tax-reform-plan-explained/ [https://perma.cc/NH3T-SDDW].

C. Tax Cut and Jobs Act of 2017

The change in administrations ushered in by the 2016 elections brought about the impetus for further changes to tax rules.[18] The passage of the Tax Cut and Jobs Act of 2017 (TCJA 2017) on December 22, 2017, meant a loss of permanency not only for gift and estate tax rules but for a host of other tax provisions as well.[19] TCJA 2017 essentially doubled the estate and gift tax exclusions and GST tax exemption for persons dying and transfers made between 2018 and 2025.[20] As a result, we have unified estate, gift, and GST tax laws, with an exclusion temporarily set at $10 million, adjusted annually for inflation after 2011, and scheduled to return to $5 million after 2025 but adjusted for inflation after 2011, and a top transfer tax bracket of 40%.[21] For 2022, after applying the inflation adjustment, the exclusion and exemption are $12.06 million.[22] For reference, a chart outlining the estate, gift, and GST tax exemptions since 1916 is attached as Exhibit A.[23]

D. Income Tax Changes

The tax acts outlined above have also made numerous changes to various income tax rules.[24] These rules as they apply to charitable giving are among those in play.[25] The changes have continued, including in legislation enacted last year.[26]

1. Cash Gifts to Public Charities

TCJA 2017 temporarily increased the maximum charitable income tax deduction limits outlined below for cash gifts to public charities to 60% of the donor's contribution base, instead of only 50%; however, for purposes of this Article, they refer to the most favored types of charitable organizations as 50% charities.[27] If cash gifts to these charities made between 2018 and 2025 exceed the 60% limit, any excess is treated as a contribution subject to the 60% limitation for each of the five succeeding years.[28] The 50% limitation

18. Tax Cut and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054.
19. *See id.*
20. *See id.*
21. *See id.*
22. Rev. Proc. 2021-45, 2021-48 I.R.B. 764.
23. *See infra* Exhibit A.
24. *See* discussion *supra* Sections II.A–C.
25. *See* discussion *supra* Sections II.A–C.
26. *See* discussion *supra* Sections II.A–C.
27. I.R.C. § 170(b)(1)(G)(i).
28. *Id.*

for noncash gifts is reduced by the amount of any deduction under the 60% rule.[29]

2. The SECURE Act

The Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 made numerous changes to the manner in which retirement plan benefits must be paid out, both during the participant's lifetime and after the participant's death.[30] In general, the SECURE Act requires that after 2019, distributions must commence when the participant attains age seventy-two, instead of seventy and a half.[31] More dramatically, it eliminates what came to be known as "stretch IRAs" for most beneficiaries of a deceased participant, substituting a requirement that all retirement assets payable to a beneficiary other than the participant's spouse or minor child, or certain disabled or chronically ill participants, be paid out not later than ten years following the participant's death, or five years if the beneficiary is not an individual or certain trusts.[32] While not a change to the charitable giving rules themselves, as discussed below, the loss of stretch IRAs has focused some clients' attention on using charitable planning techniques as a substitute.[33] Proposed Treasury Regulations related to the SECURE Act were issued on February 24, 2022.[34]

3. The CARES Act

The Coronavirus Aid, Relief, and Economic Security (CARES) Act, meant primarily to address the economic fallout of the COVID-19 pandemic in the United States, also made some changes to tax rules.[35] For purposes of this Article, those changes relate primarily to permitting a modest $300 "above-the-line" charitable deduction to be taken even by taxpayers that do not itemize deductions, for cash contributions to most 50% charities other than gifts to donor advised funds.[36] Perhaps more significantly, the CARES Act temporarily eliminated the 60% cap on cash gifts made in 2020 to most

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29. *Id.* § 170(b)(1)(G).

30. *Id.*; Setting Every Community Up for Retirement Enhancement Act of 2019, Pub. L. No. 116-94, 32 Stat. 480.

31. Setting Every Community Up for Retirement Enhancement Act of 2019, Pub. L. No. 116-94, 32 Stat. 480.

32. Stephen Miller, *IRS proposal conforms 401(k) required withdrawals with the Secure Act*, SHRM (Mar. 7, 2022), https://www.shrm.org/resourcesandtools/hr-topics/benefits/pages/irs-proposal-conforms-401k-required-withdrawals-with-the-secure-act.aspx [https://perma.cc/GXSD-TMLM].

33. *See id.*

34. Prop. Treas. Reg. § 105954-20, 87 Fed. Reg. 10504, 10504 (Feb. 24, 2022).

35. *See* Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, § 2204(a)(22), 134 Stat. 281 (2020).

36. *Id.*

50% charities, but excludes donor advised funds and supporting organizations, permitting instead a deduction up to 100% of the donor's contribution base, less the amount of all other charitable contributions allowed as a deduction to the donor for the year.[37] The donor must elect to have this more generous limitation apply.[38] Donations that exceed this amount may be carried forward for up to five years.[39]

4. The Consolidated Appropriations Act

The Consolidated Appropriations Act was also aimed at pandemic relief.[40] Like the CARES Act, it also provided some changes to the charitable deduction rules as they apply to individuals.[41] In particular, the Act extended the 100%-of-contribution-base limitation on cash deductions to public charities to gifts made in 2021.[42] It also replaced the $300 above-the-line deduction for cash contributions to public charities with a permanent $300 deduction, $600 for married taxpayers filing jointly, from adjusted gross income (AGI) in arriving at taxable income for taxpayers who elect not to itemize their deductions.[43]

5. The SECURE Act 2.0

The Consolidated Appropriations Act of 2023 included as part of its many features an update to the SECURE Act, which practitioners refer to as SECURE Act 2.0.[44] While changing a number of retirement plan rules, most notable for purposes of this Article, it provided an inflation adjustment after 2023 for the $100,000 qualified charitable distribution limit, and provides for a new one-time qualified distribution of up to $50,000 to certain split interest entities.[45]

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37. *See* Nicholas Dall, *How The CARES Act Encourages Charitable Giving In 2020*, ANDERS (Aug. 25, 2020), https://anderscpa.com/how-the-cares-act-encourages-charitable-giving-in-2020/?tag=covid-19%2Cfwep%2Cnotforprofit [https://perma.cc/W263-HABV].
38. Coronavirus Aid, Relief, and Economic Security Act, § 2205(a)(1).
39. *Id.*; Dall, *supra* note 37.
40. Consolidated Appropriations Act, Division M–N.
41. Coronavirus Aid, Relief, and Economic Security Act, §§ 2204, 2205.
42. *See What the CARES Act means for your charitable giving in 2021*, FIDELITY, https://www.fidelitycharitable.org/articles/what-the-cares-act-means-for-charitable-giving.html#:~:text=The%20adjusted%20gross%20income%20(AGI,prior%20to%20the%20CARES%20Act) (last visited Feb. 8, 2023) [https://perma.cc/J9TW-7298].
43. I.R.C. § 170(p).
44. Consolidated Appropriations Act of 2023, Pub. L. No. 117-328, 136 Stat. 4459.
45. I.R.C. § 408(d)(8)(G); *see* discussion *infra* Sections IV.D–E.

III. OVERVIEW OF THE CHARITABLE DEDUCTION RULES—THE DRY STUFF

An individual donor who itemizes deductions is entitled to an income tax charitable deduction for contributions to qualified charitable organizations.[46] The deduction, however, is subject to numerous limitations and qualifications which in most cases depend upon: (i) the classification of the charitable organization; (ii) the type of assets contributed to the charitable organization; (iii) the donor's contribution base, which is essentially the donor's AGI; and (iv) the donor's receipt of proper substantiation for the contribution.[47]

A. Public Charities and Private Foundations

There are numerous types of charitable entities.[48] For federal income tax purposes, however, practitioners frequently think of two broad classes of organizations, sometimes called "50% charities" and "30% charities."[49] These names are derived from the traditional limit on the deduction available to donors for cash gifts made to each type of entity, expressed as a percent of the donor's contribution base.[50] A donor is generally entitled to deduct the full amount of the contribution up to 50% of the donor's contribution base for a gift of cash, or unappreciated property, to a 50% charity.[51] These entities are generally organizations described in Code Section 501(c)(3) and classified as Section 509(a)(1), (a)(2), or (a)(3) organizations.[52] These are generally public charities, private operating foundations, and private pass-through foundations, but not most other private foundations.[53] More specifically, a 50% charity includes: (i) churches, conventions, and associations of churches; (ii) schools, colleges, universities, and any other organization that "normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on;"; (iii) organizations that are organized and operated exclusively to hold investments and make expenditures for the benefit of a college or university, are an arm of state or local government and normally receive substantial parts of their support from governments and contributions from the general public;

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46. I.R.C. § 170(a).
47. *See id.*
48. *See* discussion *infra* Section III.A.
49. Edward J. Beckwith, *Primer Charitable Contributions*, 2003 WL 23924320, at *3–4 (Apr. 12, 2003).
50. *See id.*
51. *Id.*; *see also Charitable Giving*, TAX PLAN. FOR INDIVIDUALS QUICKFINDER HANDBOOK 11–1, 2 (2020), https://static.store.tax.thomsonreuters.com/static/samplePages/QIPP18-Sample-Pages-11-1--11-4.pdf [https://perma.cc/H28L-RHD9].
52. I.R.C. §§ 501(c)(3), 509(a).
53. *Id.* § 509(a).

(iv) hospitals and organizations carrying on medical research in conjunction with hospitals; (v) federal, state, and local governments; (vi) organizations receiving substantial parts of their support, apart from revenues generated in the performance of charitable or other exempt purposes, in the form of contributions from the general public or government subsidies; (vii) organizations that normally receive more than one third of their support from gifts, grants, contributions, membership fees, and gross receipts from activities related to the organizations' exempt purposes and do not normally derive more than one third of their support from investment income and after-tax income from unrelated trades or businesses; (viii) satellite organizations of publicly supported charities; and (ix) private foundations that (a) are operating foundations; (b) expend or distribute contributed funds within two and one-half months after the close of the year in which received; or (c) pool contributions in common funds from which donors may direct income and corpus to public charities.[54]

A donor is generally entitled to deduct the full amount of the contribution up to 30% of the donor's contribution base for a gift of cash, or unappreciated property, to a 30% charity.[55] These organizations are typically private foundations, other than private operating foundations or private pass_through foundations.[56] The 30% limitation also applies to gifts by an individual "for the use of," as opposed to gifts directly to, a 50% charity.[57]

So how do you tell what category a specific charity belongs to?[58] One method is to ask the charity for a copy of its IRS "determination letter," which is the notification the charity received from the IRS confirming its charitable status.[59] Another, perhaps more practical, method is to do an online search of the IRS website that includes its cumulative list of charitable organizations.[60] Note that this list excludes most churches and church-affiliated organizations, which are classified as public charities.[61]

B. Assets Contributed

Gifts of cash are generally subject to the limitations mentioned above and outlined in more detail below.[62] When property other than cash is

54. *Id.* § 170(b)(1)(A).
55. *Id.* § 170(b)(1)(C)(ii).
56. *See id.* § 170(b)(1)(F).
57. *Id.* § 170(b)(1)(B).
58. *See id.*
59. *See* I.R.S. Pub. No. 557, Tax-Exempt Status for Your Organization (2023).
60. *See Search for tax exempt organizations*, IRS (Oct. 4, 2022), https://www.irs.gov/charities-non-profits/search-for-tax-exempt-organizations [https://perma.cc/NZM4-3TFV].
61. *See id.*
62. *See* discussion *supra* Section II.D.1; discission *infra* Section IV.A.

contributed, however, the nature of the contributed property becomes important.[63] Three types of property merit special attention.[64]

1. Capital Gain Property

First, if the donor contributes capital gain property, that is, property which if sold by the donor on the date of contribution, would result in long-term capital gain to a 50% charity, the donor may deduct the full fair market value of the gift only up to 30% of the donor's contribution base.[65] For gifts of such property to a private foundation, the deduction is limited to 20% of the donor's contribution base.[66] Moreover, if an individual contributes capital gain property to a 30% charity, the amount of the deduction is limited to the lesser of the property's basis or its fair market value.[67] However, there is a special exception for publicly traded securities.[68] In particular, a donor is allowed to deduct the fair market value, rather than tax basis, for a contribution of "qualified appreciated stock," i.e., stock for which "market quotations are readily available on an established securities market."[69]

2. Tangible Personal Property

If a donor makes a contribution of tangible personal property, the donor is entitled to a charitable deduction equal to the greater of fair market value or basis for a contribution of tangible personal property only if the use of that property is related to the donee's exempt purpose.[70] If the property is not related to the donee's exempt purpose, the donor's deduction is limited to the *lesser* of the property's fair market value or basis.[71] Thus, for example, if a donor contributes an appreciated painting to a private operating foundation that operates a museum, she can deduct the full fair market value of the painting.[72] In contrast, if the donor contributes her yacht to the museum and the museum will sell the yacht because it is not related to its charitable purposes, the donor is limited to deducting the lesser of the yacht's fair market value or the donor's basis in the yacht.[73]

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63. *See* I.R.C. § 170.
64. *Id.*
65. *Id.* § 170(b)(1)(C).
66. *Id.* § 170(b)(1)(D).
67. *Id.* § 170(e)(1)(B)(ii).
68. *See id.* § 170(e)(5)(A).
69. *Id.* § 170(e)(5).
70. *Id.* § 170(e)(3)(A)(i).
71. *Id.* § 170(e)(1)(B)(i).
72. *See id.* §170(e)(1)(B)(i)(I).
73. *Id.*

3. Ordinary Income Property

If a donor makes a contribution of property, the sale or exchange of which would produce a gain other than a long-term capital gain, the amount of the donor's deduction is reduced by the amount of the non-long-term gain.[74] Thus, a donor's deduction is limited to basis if the donor contributes items which, if sold, would generate ordinary income, such as inventory, crops, dealer property, and works created by the donor.[75] In the case of a painting donated by the artist, for example, the deduction is limited to the cost of the artist's materials.[76] Note because only long-term gain is considered when measuring the deduction, the basis limitation applies not only to property that would yield ordinary income but also to property the sale of which would yield a short-term capital gain.[77] In general, this limitation means that if the asset is not a long-term capital asset, a charitable deduction is limited to the asset's basis, its fair market value less its non-long-term capital gain, if sold.[78]

C. The Contribution Base

In general, a donor's "contribution base" is the donor's AGI as defined in Code Section 62, but computed without regard to, that is, ignoring any deduction for "any net operating loss carryback to the taxable year under [Code] Section 172."[79]

D. Substantiation Requirements

Charitable contributions must be substantiated in order to be deductible for federal income tax purposes.[80] The degree of substantiation varies with the amount and nature of the gift.[81] First, if the gift is by cash, check, or other monetary amount, the donor must maintain a bank record or written communication from the charity showing the name of the charity, "the date of the contribution, and the amount of the contribution."[82] Contributions of less than $250 must generally be substantiated by a written document.[83] If cash is given, a cancelled check will suffice.[84] If property with a value less

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74. *Id.* § 170(e)(1)(A).
75. *Id.*
76. *Id.*
77. *Id.*
78. *Id.*
79. *Id.* § 170(b)(1)(H), *see* §§ 62, 172.
80. *Id.* § 170(f)(8).
81. *See id.*
82. *Id.* § 170(f)(17).
83. *See id.* § 170(f)(8).
84. Treas. Reg. § 1.170A-13(a).

than $250 is contributed, a receipt from the charity is generally required.[85] If a receipt is not available, e.g., if clothing or household goods are left at an unattended Goodwill site, other written documentation of the contribution is acceptable.[86] Absent these records, the deduction may be disallowed.[87] Contributions of $250 or more require a written receipt from the charity executed no later than the date that the tax return for the year of the gift is filed or due, if earlier.[88] The receipt must state whether the charity provided any goods or services as consideration for the contribution, and if goods or services were provided, the receipt must also contain a description and good faith estimate of the value of the consideration.[89] If the donor makes non-cash contributions valued at more than $500 but not more than $5,000, the donor must maintain written documentation describing how and when the property was acquired and information relating to the basis of the contributed property.[90]

In addition, the taxpayer must complete IRS Form 8283—Noncash Charitable Contributions—if the amount of the deduction for each noncash contribution is more than $500, or if the taxpayer contributes a group of similar items for which a total deduction of over $500 is claimed.[91] Similar requirements apply for contributions of publicly traded stock with a claimed value in excess of $5,000.[92] For contributions which exceed $5,000, the donor must obtain a qualified appraisal and appraisal summary, unless the donated property is cash or publicly traded securities.[93] The appraisal must be received by the donor before the due date, including extensions, of the return on which a deduction is first claimed.[94] If the contribution is comprised of non-publicly traded stock valued in excess of $5,000 but less than $10,000, or of publicly traded stock, regardless of value, the donor need only obtain a partially completed appraisal summary, a contemporaneous receipt from the charity, and maintain certain records.[95] For contributions over $500,000, the donor must not only obtain a qualified appraisal but must also attach the appraisal to the income tax return, unless the gift consists of money, publicly traded securities, inventory, and certain cars, boats, and planes.[96]

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85. *Id.* § 1.170A-13(b)(1).
86. *Id.*
87. *Id.*; Luczaj & Assocs. v. Comm'r of Internal Revenue, 113 T.C.M. (CCH) 1187 (2012).
88. Treas. Reg. § 1.170A-13(f)(3).
89. *See* Bruce v. Comm'r, 101 T.C.M. (CCH) 1739 (2011); *see also* Durden v. Comm'r, 103 T.C.M. (CCH) 1762 (2012).
90. *See* I.R.S. Form 9283 (Rev. 11-2022).
91. *Id.*
92. Treas. Reg. § 1.170A-13(b)(3).
93. *Id.*
94. I.R.C. § 170(f)(8)(A); *see also* French v. Comm'r, 111 T.C.M. (CCH) 1241 (2016); *Durden*, 103 T.C.M. (CCH) at 1762; 15 West 17th Street LLC v. Comm'r, 147 T.C. 557 (2016).
95. Treas. Reg. § 1.170A-13(c)(2)(ii).
96. *See* Pankratz v. Comm,'r, 121 T.C. (CCH) 1178 (2021).

E. Benefits Received by Donor

If the donor receives a benefit in exchange for contribution to the charity, special rules apply.[97] Specifically, whenever the donor receives a benefit and the amount received by the charity is more than $75, the charity must provide the donor with a written receipt estimating what amount is attributable to goods and services received by the donor in exchange for the gift.[98] The deduction must be reduced by the value of the goods or services received.[99] If the taxpayer receives a substantial benefit in exchange for its contribution and does not report or specify the value of the benefit it received, then no charitable deduction will be available.[100] If a donor receives contemporaneous written acknowledgment from the charity, the donor may generally rely on the charity's acknowledgment for the fair market value of the consideration received in exchange for the charitable contribution.[101] If, however, the donor knows or has reason to know that the valuation is unreasonable, then the donor may not rely on it.[102]

F. Deduction Carry-Forwards

If a donor's gifts to a 50% charity exceeds the limitation for any taxable year, the excess can be carried forward for as many as five years.[103] The carry-forward is deductible in the next succeeding year in an amount equal to the excess of (i) 50% of the contribution base for the carry-forward year, over (ii) the sum of the contributions to 50% charities for the carry-forward year and carry-forwards from earlier years.[104] Any amount that the donor cannot deduct in the first carry-forward year is then carried forward to the second year, in which it is deductible subject to the same limitation, and so on, for the third, fourth, and fifth years after the year of the gift.[105] If the taxpayer has carry-forwards from two or more years, the oldest carry-forward is used first.[106] Similarly, if gifts for the use of 50% charities and contributions to or for the use of 30% charities exceed the 30% ceiling, the excess is carried forward for up to five years and is deductible in the carry-forward years, starting with the immediately succeeding year, to the extent the 30% ceiling for the carry-forward year exceeds current gifts

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97. I.R.C. § 6115.
98. *Id.*
99. *Id.*
100. *See* Triumph Mixed Use Inv. III v. Comm'r, T.C.M. (CCH) 1329 (2018).
101. Treas. Reg. § 1.170A-1(h)(5).
102. *Id.*
103. I.R.C. § 170(d)(1); Treas. Reg. § 1.170A-10(b).
104. I.R.C. § 170(b)(1)(E)(i).
105. *Id.* § 170(b)(1)(E)(ii).
106. *Id.*

subject to the ceiling.[107] A carry-forward of a contribution to a 50% limit organization must be used before contributions in the current year to organizations other than 50% limit organizations.[108] A comprehensive example of the limitations on using multiple carry-forwards is set out in Treasury Regulation Section 1.170A-10(c)(2).[109]

G. Transfer Taxes

The focus of this Article is on the income tax rules applicable to charitable deductions.[110] The rules applicable to outright gifts to charity for gift, estate, and GST taxes are relatively straight-forward, unless so-called "split interest" transfers such as charitable lead and charitable remainder trusts are involved.[111] For those techniques the rules for which are more complex, the discussion below describes these consequences in more detail.[112]

1. Gift Tax

Section 2522 provides an unlimited gift tax deduction for lifetime transfers to qualifying recipients for public, charitable, religious, and other similar purposes.[113] In effect, the deduction operates as an exclusion.[114] With minor exceptions, the definition of eligible recipients and qualifying transfers are identical to those applicable for federal estate tax purposes, discussed below.[115] Note that the instructions for IRS Form 709 "United States Gift (and GST) Tax Return" provide, "if you are required to file a return to report noncharitable gifts and you made gifts to charities, you must include all of your gifts to charities on the return."[116] This instruction is probably most often "honored in the breach."[117] However, clients that are filing gift tax returns for hard-to-value assets seeking to ensure that the returns meet the adequate disclosure rules for taxable gifts may wish to report all charitable gifts as well.[118] In circumstances when an interest in property is split between charitable and noncharitable recipients, for example, in charitable lead or

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107. *Id.* § 170(b)(1)(B); Treas. Reg. § 1.170A-10(c).
108. I.R.C. § 170(b)(1)(B); Treas. Reg. § 1.170A-10(c).
109. *See* I.R.S. Pub. No. 526, Charitable Contributions (Feb. 24, 2022); Treas. Reg. § 1.170A-10(c)(2).
110. *See* discussion *infra* Parts II–IV.
111. *See* Treas. Reg. § 1.664-1.
112. *See* discussion *infra* Sections III.G.1–3.
113. *See* discussion *infra* Sections III.G.1–3.
114. I.R.C. § 2522.
115. *Id.*
116. *Instructions for Form 709*, I.R.S. 1, 2 (2022) https://www.irs.gov/pub/irs-pdf/i709.pdf.
117. *See id.*
118. *See* Treas. Reg. § 301.6501(c)-1(f).

charitable remainder trusts, special rules apply.[119] If consideration is received for the gift, or a liability is assumed by the charity, the amount of the gift is reduced by the amount of the consideration or liability.[120]

2. Estate Tax

Code Section 2055 provides an unlimited deduction from a decedent's gross estate for bequests, legacies, devises, and transfers to qualifying recipients for public, charitable, religious, and other similar purposes.[121] Qualifying organizations are detailed in Code Section 2055(a).[122] There is no distinction for estate tax purposes as to whether the recipient charity would, for income tax purposes, be a 50% charity vs. a 30% charity.[123] For federal estate tax purposes, bequests to either form are generally deductible in full.[124] The amount of the deduction may not exceed the value of the transferred property that is required to be included in the gross estate.[125] The transfer to charity must be transferred to a charitable donee "by the decedent during his lifetime or by will."[126] No deduction is allowed in circumstances when the donation turns upon the actions of the decedent's beneficiary or an estate's executor or administrator.[127] A charitable transfer must be certain, in fact, and its value must be ascertainable at a decedent's date of death.[128] Treasury Regulation Section 20.2055-2 states "if, as of the date of a decedent's death, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible."[129] Moreover, the amount of the charitable deduction must be reduced by the amount of any estate, succession, legacy, or inheritance taxes that are, either by the terms of the will or local law, assessed against an otherwise deductible transfer.[130] When an interest in property is split between charitable and noncharitable recipients, special rules apply.[131]

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119. I.R.C. § 2522(c)(2).
120. *Id.* § 170(f)(5); Treas. Reg. § 1.170A-1(h).
121. I.R.C. § 2522(a)(1)–(5).
122. *Id.*
123. *Id.*
124. *Id.*
125. *Id.* § 2055(d).
126. Treas. Reg. § 20.2055-1(a).
127. *See* Est. of Moore v. Comm'r, T.C. Memo 2020-40 (2020); Est. of Engelman v. Comm'r, 121 T.C. 54, 70–71 (2003); Est. of Marine v. Comm'r, 97 T.C. 368, 378–79 (1991), *aff'd*, 990 F.2d 136 (4th Cir. 1993).
128. Ithaca Tr. Co. v. United States, 279 U.S. 151, 154 (1929) (transfers to a charity must be "fixed in fact and capable of being stated in definite terms of money"); *Est. of Marine*, 97 T.C. at 375.
129. Treas. Reg. § 20.2055-2(b)(1).
130. I.R.C. § 2055(c).
131. *Id.* § 2055(e)(2).

3. The Generation-Skipping Transfer Tax

Code Section 2642(a) provides that in determining the inclusion ratio for purposes of the GST tax, the denominator of the fraction is reduced by "any charitable deduction allowed under Section 2055 or 2522 with respect to such property."[132] The effect of this provision is to eliminate charitable gifts and bequests from the equation for purposes of calculating the GST tax.[133]

IV. CHARITABLE PLANNING IDEAS YOUR CLIENTS CAN USE

Charitable giving is an important part of estate planning for many clients.[134] Charitable gifts may range from dropping a few dollars into a bell-ringer's pail, to establishing a perpetual private foundation, to creating trusts that benefit both charity and non-charity recipients.[135] When significant gifts are contemplated, clients sometimes seek to spread their gifts out among several charities, or provide funds to charities over multiple years.[136] Sometimes clients know that they want to make charitable gifts but cannot yet decide to whom the gifts should go.[137] Other clients want to make charitable bequests in their wills, but rather than make an outright bequest, they want their children or others to administer funds for ultimate distribution to charity.[138] Still, others may seek to "borrow" some of the tax benefits of charitable giving to enhance their ability to provide long-term financial benefits to their families and other loved ones.[139] Set forth below, arranged roughly in order of complexity, are eight common charitable-giving techniques that your clients might consider in the current tax and economic environment.[140] The first three tools are quite straight-forward, while those that follow require a bit more elaboration.[141]

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132. *Id.* § 2642(a)(2)(B)(ii).
133. *See id.*
134. *See* Jim Miskell, *Charitable Giving & Estate Planning: Why Giving Back Should be Part of Your Estate Plan*, EST. PLAN. L. GRP. OF GA. (Mar. 3, 2020), https://letstalkestateplanning.com/charitable-giving-estate-planning/ [https://perma.cc/2DTP-S4GE].
135. *See id.*
136. *See id.*
137. *See id.*
138. *See id.*
139. *See id.*
140. *See id.*
141. *See id.*

A. Cash Gifts

Cash gifts to charities are deductible, subject to the contribution limits and substantiation requirements outlined above.[142] These gifts are perhaps the most straight-forward and most common form of charitable giving.[143] Cash gifts offer the fewest limits on gifting in terms of percentage limitations.[144] A cash gift can be as simple as dropping cash into a collection plate or donation box.[145] Checks and wire transfers are also treated as cash gifts.[146] A contribution is considered made in the year when a completed gift of the contributed cash is made.[147] Generally, a gift is completed in the year when it is unconditionally delivered to the charitable donee or its agent, and the taxpayer may take the deduction for that year.[148] If a check is mailed that clears in due course, the contribution is treated as having been made on the date that the check is mailed.[149] A mere pledge or promise to make a contribution is not deductible until it is actually paid.[150] A contribution made by credit card is deductible when the charge is made, regardless of when the credit card bill is paid.[151]

B. Gifts of Appreciated Property

1. Gifts to Public Charities

Gifts of appreciated property to public charities or other 50% charities are generally deductible up to 30% of the donor's contribution base.[152] If the contributed property is long-term capital gain property, i.e., a capital asset the sale of which for fair market value at the time of contribution would result in long-term capital gain, the donor is permitted to deduct its full fair market value.[153] Instead, a donor may elect to increase the limit on the deduction for long-term capital gain to 50% of the contribution base, but must then reduce the value of the gift by the long-term gain.[154] The deduction for contributions of short-term capital gain property, i.e., property the sale of which would produce a short-term capital gain, is reduced by the amount of the short-term

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142. *See* I.R.C. § 170(a)(1).
143. *See id.*
144. *See* Treas. Reg. § 1.170A-1(h)(2)(i)(A).
145. *See id.*
146. *Id.*; I.R.C. § 170(a)(1).
147. *See* I.R.C. § 170(a)(1).
148. *See id.*
149. Treas. Reg. § 1.170A-1(b).
150. Rev. Rul. 68-174, 1968-1 CB 81.
151. Rev. Rul. 78-38, 1978-1 CB 67.
152. I.R.C. § 170(b)(1)(C).
153. *See id.*
154. *Id.* § 170(b)(1)(C)(iii).

gain.[155] In other words, the deduction for contributions of short-term capital gain property is generally limited to basis.[156]

2. Gift to Private Foundations

Gifts of appreciated property to private foundations other than operating foundations and pass-through foundations are deductible up to 20% of the donor's contribution base.[157] These gifts are generally limited to the amount of the donor's basis in the contributed property.[158] Note, however, there is an exception to this rule for gifts of appreciated securities.[159]

3. Gain on Sale and Assignment of Income

When donors contribute appreciated property to charity, the charity may sell that property promptly after the gift.[160] For example, a donor might give closely held shares of stock to a public charity, after which the corporation whose stock is given may redeem the stock.[161] In other cases, the donor may be in the throws of negotiating for the sale of the stock of her business, and decide to make a gift of that stock prior to the sale.[162] The desired result is that the donor will be entitled to a gift tax charitable deduction for full fair market value of the stock by making the gift to a public charity, subject to the 30% contribution limit, without paying income tax on the soon-to-be-realized gain.[163] However, if a redemption of the donated stock is agreed upon prior to the gift, it may be treated by the IRS as a dividend distribution to the donor, with the cash proceeds being thereafter treated as transferred by the donor to the charity.[164] Similarly, if the donated asset is subject to a binding agreement to sell to a third party, the IRS may treat the sale as having been made by the donor, requiring the donor to recognize gain on the donated property.[165] Of course, this result is contrary to the donor's objectives of (i) avoiding inclusion of the appreciation element of the donated property in gross income for federal income tax purposes; (ii) obtaining a charitable contribution deduction for the fair market value of the property; and (iii) in the case of a redemption, enabling the corporation to proportionately reduce its earnings

155. *Id.* § 170(e).
156. *See id.*
157. *Id.* § 170(b)(1)(D).
158. *See id.*
159. *See* discussion *infra* Section IV.B.3.
160. *See* I.R.C. § 170(b)(1)(C)(iv).
161. *See id.* § 170(b)(1).
162. *See id.*
163. *See id.*
164. *See id.*
165. *See* Rev. Rul. 78-197, 1978-1 CB 83; Palmer v. Comm'r, 62 T.C. 684 (1974), *aff'd on another issue*, 523 F.2d 1308 (8th Cir. 1975).

and profits upon the redemption of the shares held by the charity.[166] It should be noted that a preexisting understanding among the parties that the donated stock would be redeemed does not convert a post-donation redemption into a pre-donation redemption.[167] Neither a pattern of stock donations followed by donee redemptions, a stock donation closely followed by a donee redemption, nor selection of a donee on the basis of the donee's internal policy of redeeming donated stock suggests that the donor failed to transfer all his rights in the donated stock.[168] However, if a donee redeems shares shortly after a donation, the assignment of income doctrine will apply if the redemption was practically certain to occur at the time of the gift, and would have occurred whether the shareholder made the gift or not.[169]

C. Gifts of Qualified Appreciated Stocks

Despite the limitation on the deductibility of gifts of appreciated property to 30% charities, contributions to those charities of "qualified appreciated stock," i.e., stock for which market quotations are readily available on an established securities market, can be deducted at fair market value instead of being limited to the donor's basis.[170] Making a gift of qualified appreciated stock in effect permits the donor to realize the benefit of the stock's appreciation, by virtue of a higher income tax deduction, without recognizing the built-in gain associated with the stock.[171] Such a mismatch in the tax law is rare, and is frequently taken advantage of by savvy donors.[172]

D. Tax-Free IRA Distributions

The Pension Protection Act of 2006 adopted what was originally a temporary measure that generally permits charitable contributions of up to $100,000 to be made directly from IRAs to public charities.[173] The temporary

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166. *See Palmer*, 62 T.C. at 690–91.

167. *See* Behrend v. U.S., No. 72-1153, 1972 WL 2627, at *2–3 (4th Cir. 1972).

168. *See* Grove v. Comm'r, 490 F.2d 241, 242–45 (2d Cir. 1973) (respecting form of transaction where donee needed to fundraise to support its operations, and over a decade consistently redeemed annual donations of stock for which donor remained entitled to dividends); Carrington v. Comm'r, 476 F.2d 704, 705–06 (5th Cir. 1973) (respecting form of transaction where donee redeemed stock eight days after it was donated); Dickinson v. Comm'r, T.C. Memo. 2020-128 (2020).

169. *See Palmer*, 62 T.C. at 694–95; *see also* Ferguson v. Comm'r, 174 F.3d 997, 1003–04 (9th Cir. 1999) (finding that the shareholder recognizes income from a stock sale where acquisition is "practically certain to occur," rather than the subject of "a mere anticipation or expectation," before the shareholder donates stock).

170. I.R.C. § 170(e)(5).

171. *See id.*

172. *See id.* § 170(e).

173. *Pension Protection Act*, COUNCIL OF FOUND., https://cof.org/content/pension-protection-act (last visited Feb. 22, 2023) [https://perma.cc/T29J-3YRG].

measure, later extended by various legislation, was made permanent as part of the Protecting Americans from Tax Hikes (PATH) Act of 2015.[174] If the requirements outlined below are met, distributions from the IRA to charity count against minimum required distributions that the donor is otherwise obligated to make.[175] By making these distributions directly to charity as opposed to taking the distribution into income and making a cash gift to charity, the donor derives a double benefit.[176] First, the distribution is not treated as an itemized charitable deduction, and so can benefit donors who are utilizing their full standard deduction without itemizing.[177] Second, the distribution is not taken into account in computing the donor's AGI, which could thereby increase the availability of deductions that are tied to AGI such as medical expenses.[178] As a bonus, the exclusion of the distributed amount to charity is not subject to limitation based upon the donor's contribution base.[179]

Clients who hold funds in individual retirement accounts (IRA) and who have charitable objectives have a special opportunity to make distributions directly from the IRA to one or more qualified charities once they attain age seventy and a half.[180] These distributions are made by instructing the IRA custodian to make distributions from the participant's IRA directly to a qualified charity.[181] For clients who have attained age seventy-two, these distributions count as a part, or all, of the donor's minimum required distributions from the IRA for the year of the distribution.[182]

1. Structure

For an IRA distribution to charity to be excluded from the IRA owner's income, the transfer must meet several requirements.[183] First, funds must be distributed by the IRA trustee directly from the IRA to the charity; distributions to an individual who then transmits the funds to a charity do not qualify.[184]

Second, other than an organization described in Section 509(a)(3) or a donor-advised fund, as defined in Section 4966(d)(2), the recipient of the

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174. *See id.*
175. *See id.*
176. *See* I.R.C. § 170(a)(1).
177. *See id.*
178. *See id.*
179. Taxpayer Certainty and Disaster Tax Relief Act of 2020, Pub. L. No. 116-20, 134 Stat. 3038.
180. *See* Setting Every Cmty. Up for Ret. Enhancement Act of 2019, H.R. 1994 116th (1st Sess. 2019).
181. *See* I.R.C. § 170(b)(1)(A).
182. *See Tech. Explanation of H.R. 4, The Pension Protection Act of 2006, as Passed by the H. on July 28, 2006, and as Considered by the S. on Aug. 3, 2006*, 109th Cong. Title XII, A.1 (2006).
183. I.R.C. § 408(d)(8)(B)(i).
184. *Id.*

transferred funds must be a charity described in Section 170(b)(1)(A).[185] As a result, the technique does not apply to distributions to all 50% charities, including donor-advised funds, private foundations, supporting organizations, or split interest trusts, such as charitable remainder trusts or charitable lead trusts.[186]

Third, the transfer must be made on or after the date that the taxpayer attained the age of seventy and a half.[187] However, the provision of the SECURE Act that increased the age of minimum required distributions to seventy-two did not amend the age to qualify for this rule.[188] Nevertheless, for taxpayers who have attained the age of seventy-two, a distribution to charity that qualifies under this rule will be taken into account for purposes of determining the taxpayer's minimum required distribution.[189]

Fourth, the qualifying charitable distribution cannot exceed $100,000 in any year, indexed for inflation for years after 2023.[190] Distributions in excess of that amount are subject to income taxation.[191]

Fifth, only distributions from regular or rollover IRAs qualify.[192] Distributions from simplified employee pensions (SEPs) and Savings Incentive Match Plan for Employees (SIMPLE) IRAs are excluded from this special treatment.[193]

Sixth, the exclusion is available only for distributions that would be included in gross income.[194] Thus, the rules do not apply to the portion of distributions that would be nontaxable, such as certain Roth IRA distributions and distributions attributable to nondeductible contributions.[195] For distributions of those amounts, the normal charitable deduction rules are applicable to the non-taxable portion of the distributions.[196]

Finally, the charitable deduction is available only for contributions that are fully deductible without regard to the percentage limits.[197] Reduction of the charitable deduction for any reason prevents special treatment.[198] Thus, the charitable deduction will be denied if the taxpayer fails to obtain proper substantiation or receives a benefit in exchange for the contribution.[199]

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185. *See id.* §§ 170(b)(1)(A), 509(a)(3), 4966(d)(2).
186. *See id.*
187. *Id.* § 408(d)(8)(B)(ii).
188. Setting Every Cmty. Up for Ret. Enhancement Act of 2019, H.R. 1994 116th (1st Sess. 2019).
189. *See Tech. Explanation of H.R. 4, The Pension Protection Act of 2006, as Passed by the H. on July 28, 2006, and as Considered by the S. on Aug. 3, 2006, 109th Cong.* Title XII, A.1 (2006).
190. I.R.C. § 408(d)(8)(A). The limit was $100,000, unindexed through 2023, but the SECURE Act 2.0 provides for the $100,000 limit to be indexed for inflation for years following 2023. *Id.* § 408(d)(8)(G).
191. *Id.* § 408(d)(8)(A).
192. *Id.*
193. *Id.*
194. *Id.*
195. *Id.*
196. *Id.*
197. *Id.*
198. *Id.*
199. *See* discussion *supra* Section III.D.

With the passage of the SECURE Act, IRA account owners must now reduce their intended qualified charitable contributions by any deductible amounts contributed into their IRAs after age seventy and a half, to the extent they have not already been used to reduce prior contributions.[200] In other words, IRA contributions made after age seventy and a half for which a taxpayer claims an income tax deduction cannot be used to obtain an exclusion by means of contributions to charities.[201] The rules effectively require a last-in, first-out (LIFO) treatment that ensures individuals over seventy and a half years of age contributions will be used first to reduce charitable contributions.[202] Under this rule, taxpayers that make deductible individuals over seventy and a half years of age contributions to an IRA must apply four steps to compute the allowed exclusion: (i) determine current-year distributions made directly to charity; (ii) compute cumulative deductible contributions made by the account owner after reaching age seventy and a half, minus any charitable exclusions disallowed in prior years; (iii) compute the current-year distributions that will be denied exclusion, which will be the lesser of the amount determined in steps 1 and 2; and (iv) determine current-year distributions which will be treated as an excludable from income, the step 1 amount less the step 3 amount.[203] This provision is meant to prevent individuals from deducting traditional IRA contributions, above-the-line deductions that reduce a taxpayer's AGI, and then donating those contributions on a pre-tax basis.[204]

A possible obstacle for clients who wish to make small gifts to numerous charities is a practical one.[205] IRA custodians may be reluctant to make "numerous small gifts—for example, $20 or $50—from an IRA," and a solution is a so-called "IRA checkbook," in which "each check is a distributed directly from the IRA."[206] The IRA account owner simply writes a check for any dollar amount and then mails the IRA check to the charity.[207] The funds are transferred directly from the IRA to the charity, but the IRA checkbook alleviates the administrative burden that would otherwise be imposed on the IRA custodian.[208]

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200. Setting Every Cmty. Up for Ret. Enhancement Act of 2019, H.R. 1994 116th (1st Sess. 2019).

201. I.R.C. § 408(d)(8)(A).

202. *See* H.R. 1994 116th (1st Sess. 2019).

203. *Id.*

204. *Id.*

205. *See* Christopher R. Hoyt, *A Wake-Up Call to Senior Clients*, 157 TR. & EST. 40 (2018).

206. *See id.*

207. *See id.*

208. *Qualified Charitable Distributions: Using Your IRA to Give from the Heart*, HENSSLER FINANCIAL (Dec. 9, 2019), https://www.henssler.com/qualified-charitable-distributions-using-ira-give-heart/ [https://perma.cc/H5LB-6V7M].

2. Income Tax Considerations

Direct transfers of IRA distributions to charity can achieve the donor's charitable objectives and provide distinct income tax benefits to the donor.[209] These benefits come in at least three areas.[210] First, a taxpayer who directs IRA distributions to charity is able to exclude those funds from taxable income without regard to whether he or she itemizes.[211] Second, because the distributions are excluded from the donor's income, other income tax benefits based upon the taxpayer's AGI may be enhanced.[212] Third, limitations based upon a percentage of the donor's contribution base do not apply.[213]

It is noteworthy that charitable contributions are generally of no income tax benefit to taxpayers who do not itemize their income tax deductions, excluding certain cash gifts made after 2019 of up to $300, and up to $600 for married taxpayers filing jointly for gifts made after 2020 who elect not to itemize.[214] The combined effect of the TCJA 2017 increase of the standard deduction to $12,000 on single returns, $24,000 on married joint returns, and $18,000 on head-of-household returns, with even higher thresholds for individuals over age sixty-five, combined with its $10,000 limitation on the deduction for state and local taxes, has resulted in an enormous decline in the number of persons claiming itemized deductions.[215] Direct distributions to charity allow taxpayers over the age of seventy and a half to benefit from these distributions without itemizing or impacting their otherwise available standard deduction.[216]

Example 1: Irving and Inez are both over age seventy-two.[217] Inez is the owner of an IRA, the minimum required distribution for this year is $20,000.[218] They have made no contributions to Inez's IRA after she reached

209. *See id.*

210. *See generally* I.R.S. Pub. 590-B (Apr. 25, 2022).

211. *What is a qualified charitable distribution?*, FIDELITY CHARITABLE, https://www.fidelitycharitable.org/guidance/philanthropy/ (last visited Feb. 7, 2023) [https://perma.cc/N453-JNY3].

212. Sunita Lough, *The IRS Encourages Taxpayers to Consider Charitable Contributions*, IRS (Dec. 13, 2021), https://www.irs.gov/about-irs/the-irs-encourages-taxpayers-to-consider-charitable-contributions [https://perma.cc/6ANH-BYFD].

213. *See What is a qualified charitable distribution?*, *supra* note 211.

214. *See* Lough, *supra* note 212.

215. *How did the TCJA change the standard deduction and itemized deductions?*, URBAN-BROOKINGS TAX POL'Y CTR., https://www.taxpolicycenter.org/briefing-book/how-did-tcja-change-standard-deduction-and-itemized-deductions (last visited Feb. 8, 2023) [https://perma.cc/8DKV-EKFW]; *T18-0009 - Impact on the Tax Benefit of Charitable Deduction of H.R.1, The Tax Cuts and Jobs Act, By Expanded Cash Income Level, 2018*, URBAN-BROOKINGS TAX POL'Y CTR. (Jan. 11, 2018), https://www.taxpolicycenter.org/model-estimates/impact-itemized-deductions-tax-cuts-and-jobs-act-jan-2018/t18-0009-impact-tax (estimating the TCJA would shrink the number of households claiming an itemized deduction for their gifts to non-profits from about 37 million in 2017 to about 16 million in 2018) [https://perma.cc/FJ5P-AEH6].

216. I.R.S. News Release IR-2022-201 (Nov. 17, 2022).

217. Author's original example.

218. *See* I.R.S. Pub. 590-B (Apr. 25, 2022); I.R.S. News Release IR-2020-162 (Jul. 17, 2020) (the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) suspended minimum required

age seventy and a half.[219] Other than the minimum required distribution, Irving and Inez's taxable AGI is $60,000.[220] They have sold their home and have only nominal expenses that would be eligible for an itemized deduction.[221] They intend to give $20,000 this year to their favorite charity.[222] If Inez takes her minimum required distribution for 2022, their AGI will increase to $80,000.[223] They will be entitled to a standard deduction of $28,700—their $25,900 inflation-adjusted standard deduction, plus $1,450 for each of them because they are over sixty-five.[224] As a result, their taxable income will be $51,300 with $5,745 in tax remaining.[225] However, if Inez makes the $20,000 distribution directly from her IRA to charity, their taxable income will be reduced by $20,000.[226] They will still be entitled to their full standard deduction, but their tax bill will be reduced by $2,400.[227] If Irving and Inez were in the top 37% bracket, the tax savings would be $7,400.[228] Suppose Irving and Inez itemize deductions and this year have medical expenses of $10,000.[229] Medical expenses are allowed as an itemized deduction only to the extent that they exceed 7.5% of the taxpayer's AGI.[230] If Inez takes her required minimum distribution, their AGI will increase by $20,000, and their medical expense deduction will be reduced by $1,500, increasing their tax bill by $180.[231] A distribution from the IRA directly to charity will not increase their AGI, and as a result, their medical expense deduction will not be reduced.[232] Moreover, if they make other charitable gifts, the distribution from the IRA will not count against the percentage caps for their other gifts.[233]

E. Qualified Charitable Distributions to Split-Interest Entities

The SECURE Act 2.0 introduces a new provision allowing IRA holders who have attained the age of seventy-and-a-half to make a one-time qualified charitable distribution from their IRA to a "split-interest entity."[234] This

distributions for 2020, but the analysis applies in any year that minimum required distributions apply and would apply in any event to Irving and Inez if Inez's IRA were the source of their charitable giving).

219. *See* I.R.S. Pub. 590-B (Apr. 25, 2022).
220. *Id.*
221. *Id.*
222. Author's original example.
223. *See* I.R.S. Pub. 590-B (Apr. 25, 2022).
224. I.R.S. News Release IR-2021-219 (Nov. 10, 2021).
225. Author's original example.
226. *See* I.R.S. Pub. 590-B (Apr. 25, 2022).
227. *Id.*
228. I.R.S. News Release IR-2021-219 (Nov. 10, 2021).
229. Author's original example.
230. I.R.C. § 213(a).
231. I.R.S. Pub. 590-B (Apr. 25, 2022).
232. *Id.*
233. *See What is a qualified charitable distribution?*, *supra* note 211.
234. I.R.C. § 408(d)(8)(f).

change provides a limited opportunity for IRA holders to make charitable contributions while retaining a lifetime income interests in the funds contributed for charitable use.[235]

As noted above, IRA holders who are at least age seventy-and-a-half years of age may make qualified charitable distributions from their IRAs to public charities of up to $100,000 per year; SECURE Act 2.0 introduced a new one-time opportunity for IRA holders to make qualified charitable distributions to split-interest entities including charitable remainder annuity trusts (CRATs), charitable remainder trusts, and charitable gift annuities.[236]

To be eligible for exclusion from income, transfers from the taxpayer to a split-interest entity must satisfy the following requirements:

- the taxpayer must make an election for the contribution to qualify, and must not have made such an election for any prior year;
- the split-interest entity must be funded exclusively by qualified charitable distributions;
- the aggregate amount of allowable funding is $50,000;
- the contribution must be otherwise deductible under Code Section 170;
- any income interest in the split-interest entity must be only for the taxpayer and/or their spouse;
- the income interest must not be assignable; and
- distributions from the split-interest trust must be treated as ordinary income in the hands of the beneficiary taxpayer/spouse (reflecting no return of principal).[237]

Split-interest trusts offer a unique way for charitably minded individuals to make charitable contributions while retaining a lifetime interest in the income generated by the donated funds.[238] The expansion by SECURE Act 2.0 to allow qualified charitable distributions to fund these trusts may make these vehicles even more attractive to IRA holders, despite the limitations currently in place for these transfers.[239]

F. Donor Advised Funds

Clients are drawn to Donor Advised Funds (DAFs) because they can make charitable giving to multiple charities simple over time.[240] A DAF is a

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235. *Id.*
236. I.R.C. § 408(d)(8)(F); see discussion Section IV.D, I.
237. I.R.C. § 408(d)(8)(F)(i)(II), (ii)–(v). The $50,000 amount is indexed for inflation after 2023. *Id.* § 408(d)(8)(G).
238. *See id.* § 408(d)(8)(F), (d)(8)(G).
239. *See id.*
240. *What is a Donor-Advised Fund?*, FIDELITY CHARITABLE, https://www.fidelitycharitable.org/guidance/philanthropy/what-is-a-donor-advised-fund.html (last visited Feb. 8, 2023) [https://perma.cc/AU4B-L239].

cost-effective charitable vehicle that allows a donor to make charitable gifts to multiple charities over a period of time with little administrative responsibility, while obtaining an up-front benefit of maximum charitable income tax deductions.[241] Traditionally, donors have established private foundations to undertake long-term gifting.[242] However, it may take from several weeks to a few months to draft documents to establish a private foundation, file any documents with the state, and apply to the IRS for a tax exemption.[243] Legal and accounting fees may be significant.[244] Then, the donor must comply with extensive reporting rules, being ever-mindful to avoid the excise tax transactions, or quickly to correct any that are violated.[245] Once established, the private foundation will likely be treated as a 30% charity.[246] In contrast, a sponsor public charity may complete and sign governing documents to establish a DAF.[247] The public charity typically has staff available to assist with the paperwork to make the donor's intention clear and ensure all technical requirements that apply to DAFs are followed, at no cost to the donor.[248] Moreover, the DAF is treated as a 50% charity for most purposes.[249]

A DAF is a separate fund that is created and maintained by a qualified sponsoring organization, which in turn, is a public charity.[250] The public charity provides the charitable income tax exemption for the DAF, and it handles all of the administrative paperwork associated with maintaining the DAF's charitable tax-exempt status.[251] As the "Donor Advised" part of the moniker suggests, the donor, or individual designated by the donor, can "advise" the public charity about how much, to whom, and when to distribute from the fund.[252] Technically, when a donor transfers funds to a DAF, the sponsoring charity has legal control over the funds.[253] However, the donor or designated agent retains advisory control over how the funds are ultimately

241. *Id.*

242. *Id.*

243. *See Life Cycle of a Private Foundation - Starting Out*, IRS (Aug. 2, 2022), https://www.irs.gov/charities-non-profits/private-foundations/life-cycle-of-a-private-foundation-starting-out [https://perma.cc/K6D6-VNKV].

244. *Building a Private Foundation: Is it the Right Choice?*, AM. ENDOWMENT FOUND., https://www.aefonline.org/building-private-foundation-it-right-choice (last visited Feb. 8, 2023) [https://perma.cc/9ETZ-YW6E].

245. I.R.S. Pub. 4221-PF (Rev. 8-2014).

246. *Private Operating Foundations*, IRS (Aug. 1, 2022), https://www.irs.gov/charities-non-profits/private-foundations/private-operating-foundations [https://perma.cc/AW57-BNRX].

247. *What is a Donor-Advised Fund?*, *supra* note 240.

248. *See* William J. Culbertson, *Conversion of Private Foundations to Donor Advised Funds and Supporting Organizations*, 22 OHIO PROB. L.J. NL 9 (2012).

249. 34 AM. JUR. 2D *Federal Taxation* § 18967 (2023).

250. *See* Culbertson, *supra* note 248.

251. *See id.*

252. Michael J. Hussey, *Avoiding Misuse of Donor Advised funds*, 58 CLEV. ST. L. REV. 60, 66 (2010).

253. *Id.*

distributed.[254] The donor or agent makes grant recommendations, which are virtually always followed; however, the public charity retains the final say in disbursing funds.[255] Unlike a private foundation, which generally must distribute at least 5% of the value of its assets each year, regardless of its income, a DAF does not legally have to distribute a certain percentage of its funds each year to charitable beneficiaries.[256] This means that a donor may make a contribution in any given year to a DAF and take the charitable income tax deduction in that year but can delay making distributions to charities from the DAF until a future date.[257] In addition, for large or most non-cash donations, the more favorable 50% charity rules apply to DAF contributions, instead of the more limited 30% charity rules applicable to most private foundations.[258] Note, however, that unlike a private foundation, the donor does not get to control the specific investments made by the fund, which are controlled by the sponsoring charity; although, some sponsors allow donors to choose among various funds or types of investments.[259]

1. Structure

To qualify as a DAF, the sponsoring organization must be a public charity, other than a state or political subdivision, not a private foundation, and must maintain one or more district funds that are separately identified by reference to contributions of a donor or donors.[260] The sponsoring organization must separately identify contributions, own and control the fund, and provide advisory privileges to the donor or the donor's designee.[261] The sponsoring organization cannot make distributions "only to a single identified organization or governmental entity."[262] In addition, the organization cannot be an organization described in Code Section 2055(a)(3)–(5), i.e., war veterans organizations, lodge or cemetery corporations, or a Type III supporting organization not functionally integrated.[263] While the sponsoring charity has legal control over the funds, the donor or the donor's designated agent or agents make grant recommendations, which are typically followed by the sponsoring organization.[264] Donors often enter into an agreement with the sponsoring charity which outlines procedures for making distribution recommendations,

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254. *Id.*
255. *Id.* at 91.
256. *Id.* at 80.
257. *Id.* at 62.
258. *Id.* at 76.
259. I.R.C. § 4966(d)(1).
260. *Id.*
261. *Id.* § 4966(d)(2)(A).
262. *Id.*
263. *Id.* §§ 170(f)(18), 2055(e)(5), 2522(c)(5).
264. *See* Hussey, *supra* note 252, at 60.

and in many cases permits, the donor to designate one or more alternate distribution advisors if the donor dies or becomes incapacitated.[265] Designated alternate advisors may allow the DAF to last for multiple generations; although, typically not in perpetuity, as might be the case with a private foundation.[266]

2. Gift Tax Considerations

Gifts made to an eligible DAF after February 13, 2007, are fully deductible for federal gift tax purposes.[267] A gift tax charitable deduction that is otherwise allowable for a contribution to a DAF is allowed only if the taxpayer obtains a contemporaneous written acknowledgment from the sponsoring organization of the DAF that the organization has exclusive legal control over the assets distributed.[268] For this purpose, a "contemporaneous written acknowledgment" is determined under rules similar to Code Section 170(f)(8)(C) substantiation rules discussed above that apply for income tax charitable deduction purposes, which provide that a written acknowledgment is treated as contemporaneous if it is obtained on or before the earlier of (i) the date the taxpayer files a return for the tax year in which the contribution was made, or (ii) the due date, including extensions, for filing the return.[269]

3. Estate Tax Considerations

Similarly, assets passing to a DAF as a result of a donor's death are eligible for a federal estate tax charitable deduction without limitation.[270]

4. Income Tax Considerations

Gifts made to a DAF after February 13, 2007, are deductible to the donor for federal income tax purposes, subject to the limits on deductions applicable to 50% charities.[271] The donor must obtain a contemporaneous written acknowledgement from the sponsoring organization that the organization has exclusive legal control over the assets contributed.[272] Importantly, because the sponsoring organization is a public charity, the contributions are subject to the more favorable income tax limitations associated with public charities, rather than the limitations imposed upon contributions to private

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265. *Id.* at 65.
266. *See* Culbertson, *supra* note 248, at 239.
267. I.R.C. § 2522(c)(5).
268. *Id.*
269. *Id.* § 170(f)(8)(C).
270. *Id.* § 2055(e)(5).
271. *Id.* § 170(f)(18).
272. *Id.*

foundations.[273] Namely, cash contributions to a public charity are deductible up to 50% of a donor's AGI, or 60% for cash contributions made between 2018 and 2025—the 100% limitation for cash gifts in 2020 and 2021 does not apply to gifts to DAFs—and contributions of appreciated property to a public charity are deductible up to 30% of AGI.[274] In addition, a donor may generally deduct the full fair market value of appreciated capital gain property contributed to a 50% charity; although, deductions for contributions of appreciated tangible personal property that do not relate to the exempt purpose of the charity are limited to the donor's basis.[275] For taxpayers who typically rely on taking the standard deduction, and do not typically get to deduct their charitable contributions, a DAF can be a useful tool.[276] Cash flow permitting, a donor could accelerate the next five or ten years' worth of gifts by contributing them to a DAF, itemizing deductions for that year as a result of the large charitable deduction.[277] In succeeding years, the donor returns to taking a standard deduction, having the DAF make the scheduled contributions to the donor's intended charities.[278]

5. Excise Tax Considerations

DAFs, like private foundations, are subject to a number of rigorous rules, the violation of which may subject the sponsoring organization and its managers to excise taxes.[279] However, most supporting organizations have a professional staff and legal counsel available to ensure that those technical rules are followed, so they generally are of no concern to the donor.[280] However, two excise tax provisions are sometimes implicated.[281]

First, the Pension Protection Act of 2006 added a provision making DAFs subject to the excess business holdings rules under Code Section 4943.[282] As a result, if the donor who advises the fund, together with attributed family members, owns 20% or more of stock or interests in a business donated to the DAF, or 35% or more of the stock or interests in a third-party controlled entity donated to the DAF, the excess business holdings rules will apply.[283] These rules generally require the business

273. *See* Hussey, *supra* note 252, at 60.
274. *See id.* at 76.
275. I.R.C. § 1015.
276. Scott E. Swartz, *Highlights, Lowlights and Thoughts on the Law Formerly Known as The Tax Cuts and Jobs Act of 2017*, 29 OHIO PROB. L. J. NL 8 (2018).
277. *See id.*
278. *See id.*
279. *See* I.R.C. § 4943(a)–(b), (e).
280. *See* discussion *supra* Section IV.F.
281. *See* I.R.C. §§ 4943(a), 4967.
282. *See* Pension Protection Act of 2006, Pub. L. No. 109-280, § 1233, 120 Stat. 780 (2006); I.R.C. § 4943(e).
283. I.R.C. § 4943(e)(2).

interests to be sold by the DAF within five years of the contribution.[284] The holding period can be extended to ten years with approval from the state Attorney General and the IRS.[285] If the interests are not disposed of within the appropriate time frame, a tax of 10% of the value of the holdings will apply.[286] If, after the initial tax is levied, the holdings are not sold by the end of the taxable period, an additional tax equal to 200% of the excess business holdings will be imposed.[287]

The second excise tax of concern to donors relates to the incidental benefit rule.[288] A distribution by a DAF that provides more than an incidental benefit to the person advising the DAF results in an excise tax of 125% of the distribution.[289] A DAF's payment of part of a ticket price for a charity event would relieve the donor of the obligation to pay the full ticket price and could result in more than an incidental benefit to the donor.[290] The same notice addressed whether a DAF distribution that satisfies a donor's charitable pledge would confer an incidental benefit to the donor.[291] The IRS noted that it would be difficult for sponsoring organizations to distinguish between binding and non-binding pledges, and hence it adopted some practical guidance.[292] The proposed guidance sets out a three-part test.[293] First, the distribution from the DAF cannot reference the existence of a pledge.[294] Second, the donor may not receive any benefit that is more than incidental.[295] Third, the donor must not claim a charitable deduction for the distribution from the DAF.[296] If all three of the above requirements are met, a contribution made in fulfillment of a pledge will not be treated as a violation of the insubstantial benefit rules, and the donor will not be subject to a 125% excise tax.[297] Notice 2017-73 specifically permits such DAF distributions "regardless of whether the charity treats the distribution as satisfying the pledge," and expressly permits donors to rely on the Notice pending the issuance of regulations or other guidance.[298]

284. *Id.* § 4943(c)(6).
285. *Id.* § 4943(c)(7).
286. *Id.* § 4943(a)(1).
287. *Id.* § 4943(b).
288. *Id.* § 4967(a)(1).
289. *Id.*
290. I.R.S. Notice 2017-73, 2017-51 I.R.B. 562 (Dec. 4, 2017).
291. *Id.*
292. *Id.*
293. *Id.*
294. *Id.*
295. *Id.*
296. *Id.*
297. *See id.*; I.R.C. § 4967(a)(1).
298. I.R.S. Notice 2017-73, 2017-51 I.R.B. 562 (Dec. 4, 2017).

G. Private Foundations

Despite some complexity, forming a private foundation can be an excellent way to establish a legacy for carrying out charitable objectives.[299] As a grant-making organization, a private foundation may enable its founders to control assets and direct efforts to support charitable work.[300] In addition to fulfilling charitable objectives, a private foundation often provides a means to teach younger family members about the importance of philanthropy, stewardship of assets, as well as management, investment techniques, and strategies.[301] Private foundations are subject to numerous requirements to ensure they are operated for purely charitable purposes.[302] In addition, the income tax deductibility of donations to private foundations may have lower limits and more restrictions than contributions to public charities.[303] Nevertheless, private foundations remain popular vehicles for charitable giving.[304]

A private foundation is a legal structure—sometimes a trust, but often a non-profit corporation—that is typically controlled by the donor and their family, and as to which most of the contributions typically originate from the donor or their family.[305] Most private foundations are 30% charities that do not undertake charitable activities directly.[306] Rather, they use their resources to make distributions to publicly supported charities.[307] Contributions by an individual to a private foundation qualify for charitable income, estate, and gift tax deductions, subject to a number of technical restrictions regarding deductibility for income tax purposes.[308] The major advantage of a private foundation is that the founders, and others designated by them, often family members, can control the contributed funds, and decide on an annual basis how those funds will be invested and applied to accomplish charitable

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299. *See* Jason Ramage, *Private Foundations – What to Know*, THESTREET (Sept. 30, 2022, 7:00 AM), https://www.thestreet.com/retirement-daily/your-money/private-foundations#gid=ci02ab50d710002463&pid=donor-advised-funds-the-fastest-growing-charitable-giving-vehicle [https://perma.cc/CK4V-3CXU]; *What is a Private Foundation?*, FOUND. SOURCE, https://foundationsource.com/what-is-a-private-foundation/ (last visited Feb. 7, 2023) [https://perma.cc/GB8M-BLR3].

300. *See What is a Private Foundation?*, *supra* note 299.

301. *See Private Foundation Essentials: A Strategic and Impactful Approach to Philanthropy*, GLENMEDE (Feb. 16, 2022), https://www.glenmede.com/insights/private-foundation-essentials-a-strategic-and-impactful-approach-to-philanthropy/ [https://perma.cc/D7FJ-AGJK].

302. *Id.*

303. *See* Tracy Paglia & Pamela Alexanderson, *How Private Foundations Differ from Public Charities*, MOSSADAMS (Apr. 20, 2021), https://www.mossadams.com/articles/2021/04/private-foundations-differ-from-public-charities [https://perma.cc/4MZ6-MWKU].

304. *See Operating for Impact: Choosing a Giving Vehicle*, ROCKEFELLER PHILANTHROPY ADVISORS, https://www.rockpa.org/guide/operating-impact-choosing-giving-vehicle/ (last visited Feb. 7, 2023) [https://perma.cc/9N3R-6EBX].

305. *See* I.R.C. § 509; *What is a Private Foundation?*, *supra* note 299.

306. *See* I.R.C. § 509.

307. *See id.*

308. *See id.* § 170(a), (b)(1)(A)(vii).

goals.[309] One of the primary advantages of establishing a private foundation is that it offers the donor's family an opportunity to manage an entity that can have a lasting impact on the family's local community, or on the charitable area of their choice.[310] Working together, the older generation has the chance to teach younger family members management and investment techniques and strategies, while instilling their views on the importance of philanthropy.[311] As a result, a private foundation, in addition to serving its charitable purpose, often serves an educational purpose for the younger generation.[312] The private foundation affords a valuable opportunity for younger family members to carry on the goals of the older generation after the older members of the family are gone.[313]

1. Structure

In most cases, creating a private foundation involves either preparing a specialized trust agreement or filing articles of incorporation with the Secretary of State or other appropriate state office to create a non-profit corporation.[314] In addition, to obtain status as a tax-exempt entity, a private foundation must file an IRS Form 1023 application with the IRS to review and approve the private foundation's organizational documents, budget, and plan for contributions and distributions.[315] The corporate structure usually offers more flexibility than a trust because the corporate documents may be easily amended to take into account changing circumstances.[316] Also, unlike a trust instrument, corporate documents can provide for the election of new officers and the formation of new committees to restructure the corporation's internal governance.[317] If corporate purposes are amended, those changes may require the approval of various state officials.[318] An additional advantage of the corporate structure is that the standard of care to which a director is held is often less rigorous than that applicable to a trustee.[319] A trustee may be liable for negligence, but a director benefits from the protection of the

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309. *See What is a Private Foundation?*, *supra* note 299; ROCKEFELLER PHILANTHROPY ADVISORS, *supra* note 304.

310. *See Benefits of Private Foundation*, FOUND. SOURCE, https://foundationsource.com/benefits-of-a-private-foundation/ (last visited Feb. 8, 2023) [https://perma.cc/SH66-S2BW].

311. *See id.*

312. *See id.*

313. *See id.*

314. *See Setting Up a Private Foundation*, FOUND. SOURCE, https://foundationsource.com/setting-up-a-private-foundation/ (last visited Feb. 8, 2023) [https://perma.cc/38MX-4N2F].

315. *See id.*

316. *See id.*

317. Michael W. Reagor, *What's the Best Type of Private Foundation, a Non-Profit or a Charitable Trust?*, DYMOND REAGOR, PLLC (Nov. 26, 2012), https://drc-law.com/whats-the-best-type-of-private-foundation-a-non-profit-or-a-charitable-trust/ [https://perma.cc/KNW3-LWHJ].

318. *See id.*

319. *See id.*

business judgment rule, which generally provides that a director is liable only for acts of self-dealing, willful misconduct, or gross negligence.[320] Most states now have statutes that extend the ability of a non-profit corporation to indemnify its directors.[321]

Although there are a number of significant advantages to the corporate structure, there are certain advantages to using a trust.[322] A trust normally can be established more quickly than a corporation.[323] Depending on applicable state law, a trust may have fewer annual filing requirements, so fewer annual fees and less paperwork may be required.[324] There is no requirement that a trust hold annual meetings or keep minutes of meetings held by the trustees.[325] The creator of the trust may reserve the right to amend the trust to provide for new charitable purposes, and no approval will be required for this type of amendment.[326] For donors who fear that their charitable goals may be altered by future generations, a trust may provide more certainty because trust modifications typically require court action and notification of the state's attorney general or other agency monitoring charities.[327] If a private foundation is to be created after the founder's death pursuant to the terms of the founder's will, the foundation is almost always created as a trust.[328] Some technical federal estate tax concerns may be avoided if the "testamentary foundation," i.e., a foundation created by will, is organized as a trust.[329] The trust may permit the trustees to reorganize the foundation as a nonprofit corporation at a later date if desired.[330]

Broadly speaking, there are three types of private foundations.[331] The "standard private foundation" is the most common type of private foundation and is sometimes referred to as a "family foundation."[332] The standard private foundation, a 30% charity, usually does not carry out any charitable activity itself but is created to hold funds.[333] A portion of these funds must be used

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320. *See id.*; *see also business judgment rule*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/business_judgment_rule (last updated June 2022) [https://perma.cc/RTH2-SDFF].

321. *See Setting Up a Private Foundation*, *supra* note 314.

322. *See id*.

323. *See id.*

324. *See id.*

325. *See id.*

326. *See id.*

327. *See* TEX. PROP. CODE ANN. § 123.002.

328. *See* Carolyn A. Newham, *How to Include Charity In Your Will*, CMTYS. FOUND. OF TEX., https://www.cftexas.org/plan-your-giving/individuals-families/legacy-society/bequests (last visited Feb. 8, 2023) [https://perma.cc/FP4S-AFMT].

329. *See What is a Private Foundation?*, *supra* note 299.

330. *See Requirement for New Form 1023 Eliminated in Some Reorganization Circumstances*, LEAFFER L. GRP. (Nov. 10, 2023), https://leafferlaw.com/resources/requirement-for-new-form-1023-eliminated-in-some-reorganization-circumstances/ [https://perma.cc/K4F6-C585].

331. *See Charitable Giving*, HELSELL FETTERMAN, https://www.helsell.com/faq/charitable-giving/ (last visited Feb. 8, 2023) [https://perma.cc/3GNL-SFR5].

332. *See id.*

333. *See id.*

each year to make contributions or grants to other charities, or in some cases, to make grants to individuals.[334] Most standard private foundations receive their funds from one or only a few sources, e.g., an individual, a family, or a corporation.[335] A standard private foundation does not, therefore, generally engage in any sort of fundraising, nor does it typically apply to receive grants from other charities.[336] The standard private foundation is subject to all the excise tax rules in Code Sections 4940–4945, and it is subject to the strictest limitations on income tax deductibility.[337]

In contrast to a standard foundation, a "private operating foundation" is a foundation that itself engages in charitable activities rather than merely making grants to other charitable organizations or individuals.[338] Typically, private operating foundations operate museums, libraries, nursing homes, and historic preservation sites.[339] Although a private operating foundation is subject to most of the same excise tax rules applicable to private foundations, a major benefit to donors is that a private operating foundation is typically a 50% charity.[340] As a result, donors may take advantage of significantly more liberal income tax deduction rules generally applicable to gifts to publicly supported charities.[341] An additional benefit of a private operating foundation, as opposed to a standard private foundation, is that the requirements for the charitable payments it must make each year are less onerous, so that it need not invade corpus in years when it has a poor investment return.[342]

A third type of foundation may be thought of as a "conduit" or "pass-through" foundation.[343] This type of foundation is one through which all contributions must flow out to charitable entities within two and one-half months after the end of the conduit foundation's tax year in which the contributions were received.[344] Although a conduit foundation, like a standard private foundation, is subject to all the excise tax rules outlined below, the more favorable rules available to 50% charities governing the deductibility of contributions to publicly supported charities apply to contributions to a conduit foundation.[345] Because of the flow-through requirement, the endowment of a conduit foundation can never grow, and

334. *See id.*
335. *See* Newham, *supra* note 328.
336. *See id.*
337. *See* I.R.C. §§ 4940–4945.
338. *See* Newham, *supra* note 328.
339. *See* Jason Born, *What is a private operating foundation, and should we consider using this option?*, NAT'L CTR. FOR FAM. PHILANTHROPY (June 14, 2017), https://www.ncfp.org/knowledge/what-is-a-private-operating-foundation/ [https://perma.cc/SVEP-3LFV].
340. I.R.C. § 4942(j)(3)(B)(i).
341. *See id.*
342. *Id.* § 4942(j)(3)(B)(ii).
343. *Id.* § 170(b)(1)(F)(ii).
344. *Id.*
345. *See id.* § 170(b)(1)(B)(ii).

therefore, many of the advantages of creating and maintaining a standard private foundation are unavailable.[346]

2. Gift Tax Considerations

Gifts made by a donor to a private foundation are eligible for an unlimited federal gift tax charitable deduction.[347] To obtain a gift tax charitable deduction, the foundation must be organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes to foster national or international amateur sport competitions, but only if no part of its activities involve the provision of athletic facilities or equipment, the encouragement of art, and the prevention of cruelty to children or animals.[348] The exemption is unavailable if any part of the foundation's net earnings inure to the benefit of any private shareholder or individual, if the private foundation is disqualified for tax exemption under Section 501(c)(3) by reason of attempting to influence legislation, or if the foundation participates in, or intervenes in—including the publishing or distributing of statements—any political campaign on behalf of, or in opposition, to any candidate for public office.[349]

3. Estate Tax Considerations

Testamentary bequests, or other transfers of assets included in a donor's estate that pass to a private foundation upon the donor's death, are generally subject to an unlimited federal estate tax charitable deduction.[350] To be eligible, the private foundation must be organized and operated according to the rules for eligibility for gift tax purposes outlined above.[351] Assets transferred to a private foundation during the donor's lifetime are generally not subject to inclusion in the donor's estate for federal estate tax purposes.[352] However, if the donor effectively controlled the private foundation at death, or within three years of his or her death, the assets contributed by the donor are technically included in the estate.[353] The inclusion is offset by a corresponding estate tax charitable deduction under Code Section 2055, so no estate tax should be due on those assets.[354]

346. *See id.* § 170(b)(1)(F)(ii).
347. *Id.* § 2522(a).
348. *Id.*
349. *Id.* §§ 501(c)(3), 2522(a)(2).
350. *Id.* § 2055.
351. *Id.* § 2055(a)(2).
352. *Id.* § 501(c)(3).
353. Rev. Rul. 72-552, 1972-2 C.B. 525 (1972).
354. I.R.C. § 2055(d).

Inclusion does, however, have two incidental effects.[355] First, the necessity to file an estate tax return for the donor's estate is determined based upon the value of the gross estate, plus adjusted taxable gifts.[356] Inclusion of private foundation assets could thereby require the filing of an estate tax return if the value of those assets causes the donor's gross estate to exceed the filing threshold.[357] Second, because those assets are included in the donor's estate, the assets held by the foundation will receive a new cost basis.[358] Although private foundations are generally exempt from paying income tax, a private foundation's investment income, on which they may pay a 1.39% excise tax, includes capital gains.[359] The basis adjustment resulting from including the foundation's assets in the donor's estate may thus minimize this tax on the sale of appreciated assets.[360]

4. Income Tax Considerations to the Donor

A gift to a private foundation may qualify for an income tax charitable deduction based upon the nature of the property given.[361] However, contributions to private foundations, at least to standard grant-making foundations, are subject to a number of restrictions relating to income tax deductibility.[362] As noted above, cash contributions are generally deductible up to 30% of the donor's contribution base, while contributions of appreciated property are generally deductible up to only 20% of the donor's contribution base.[363] If the 20% or 30% limitation is exceeded, the excess deduction may be carried forward for five years.[364] In addition to the percentage ceiling placed on deductions, a donor's deduction is limited for contributions of some types of appreciated property to a standard grant-making private foundation.[365] In particular, if a donor contributes property other than money or publicly traded securities, the donor is generally limited to deducting the cost basis for all contributions of long-term capital gain property.[366]

Example 2: Fred has established a standard private foundation.[367] Fred makes a gift of real estate to the foundation which Fred has owned for many

355. *Id.* §§ 6018(a)(1), 1014(b)(9).
356. *Id.* § 6018(a)(1).
357. *Id.* § 6018(a)(1).
358. *Id.* § 1014(b)(9).
359. *Id.* § 4940(a).
360. *See id.*
361. *Id.* § 170(a)(1).
362. *Id.* § 170(b)(1)(F)(i)–(iii).
363. *Id.* § 170(b)(1)(B)(i), (D)(i)(1).
364. *Id.* § 170(b)(1)(B)(ii), (D)(ii).
365. *Id.* §170(b)(1)(F)(iii).
366. *Id.* § 170(c).
367. Author's original hypothetical.

years.[368] The property originally cost $100,000, but now has a fair market value of $1 million.[369] Under current law, Fred will be permitted to deduct only $100,000 for income tax purposes.[370] He will, however, be able to deduct the full $1 million for gift tax purposes so that there will be no gift tax as a result of the contribution.[371] If appreciated property is contributed at death, the full value of the property will likewise qualify for the federal estate tax charitable deduction.[372] If, instead, Fred had contributed stock in a publicly traded company worth $1 million and a basis of $100,000, he would be entitled to deduct the entire $1 million value of the stock, subject to the percentage limitations and carry forward rules outlined above.[373]

5. Income Taxation of the Private Foundation

A private foundation is generally exempt from paying federal income tax on the income it receives.[374] However, private foundations, other than operating foundations, are subject to a 1.39% excise tax on their net investment income.[375] Net investment income generally includes interest, dividends, rents, royalties, and net capital gains, reduced by expenses incurred to earn this income.[376] Prior to 2020, the excise tax was imposed at a rate of 2%, reduced by 1.39% any year in which a foundation exceeded the average historical level of its charitable distributions.[377] The excise tax rate was reduced if the foundation's qualifying distributions—generally amounts paid to accomplish exempt purposes—equaled or exceeded the sum of: (i) the amount of the foundation's assets for the taxable year multiplied by the average percentage of the foundation's qualifying distributions over the five taxable years immediately preceding the taxable year in question, and (ii) 1% of the net investment income of the foundation for the taxable year.[378] In addition, the foundation could not have been subject to tax in any of the five preceding years for failing to make the minimum qualifying distributions required under Code Section 4942.[379]

In addition, Code Section 511 provides that a private foundation must pay tax on its unrelated business taxable income (UBTI), which is defined as net income from any trade or business activity that is not related to the exempt

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368. *Id.*
369. *Id.*
370. I.R.C. § 2055.
371. *Id.*
372. *See id.* § 4940.
373. *See id.*
374. *Id.* § 501(c).
375. *Id.* § 4940(a).
376. *Id.*
377. *Id.* § 4940(a) (amended).
378. *Id.* § 4940(e), (g).
379. *Id.* § 4942.

purposes of the private foundation.[380] In general, if a private foundation generates any revenues other than passive investment income, which includes rents, royalties, dividends, and interest, or if it generates investment revenues from property that was acquired or improved by means of third-party borrowing, the foundation could be subject to this income tax.[381] Capital gains are also typically exempt if the acquisition of the property generating the capital gain is not debt-financed.[382] Investments in pass-through entities, notably partnerships and LLCs, can be problematic.[383] If the pass-through entity generates income from a trade or business that would be UBTI if realized directly by the private foundation, the private foundation's share of that income will be taxable as UBTI.[384]

6. Excise Tax Considerations

Standard private foundations and private operating foundations, and their managers, are subject to a number of rigorous rules regarding their governance, known as the "excise tax provisions."[385] These provisions, contained in Code Sections 4940–4945, impose harsh penalties on foundations that do not comply with the rules.[386] Congress adopted the excise tax provisions to correct perceived abuses of privately controlled foundations, and to ensure that a minimum percentage of a foundation's assets are distributed each year.[387] The 1.39% tax on net investment income described above is generally thought of as being used to pay for the IRS's cost in administering these rules.[388] The excise tax provisions preclude a substantial contributor to a private foundation from committing certain acts of "self-dealing."[389] In addition, a private foundation is limited as to the percentage of an active trade or business it may hold.[390] Furthermore, the assets of a private foundation may not be invested in such a way that would jeopardize those assets nor may the private foundation expend its assets in other than a certain prescribed manner.[391] In addition to these excise taxes, private foundations and their managers can be subject to enhanced penalties—in the form of high 100% or 200%—excise taxes for failing to cure violations.[392] If there are repeated or flagrant violations, a third-tier tax,

380. *Id.* § 511(a)(1).
381. *See id.* § 512(b)(1), (4).
382. *See id.* § 512(b)(4), (5).
383. *See id.* § 512.
384. *See id.*
385. *See id.* §§ 4940–4945.
386. *See id.*
387. *See id.*
388. *Id.* § 4940(a).
389. *See id.* § 4941.
390. *Id.* § 4943(a)(1).
391. *See id.* § 4943.
392. *Id.* § 4941(b).

which is in the nature of an income tax, is assessable at any time.[393] Ultimately, willful, repeated, and flagrant violations can result in the involuntary termination of private foundation status.[394]

Under Code Section 4940, an excise tax of 1.39% is generally imposed on the net investment income of a standard private foundation each year.[395] The tax due is reported on IRS Form 990-PF.[396] Certain private operating foundations are exempt from the 1.39% excise tax.[397] A private foundation must file IRS Form 990-PF each year by the 15th day of the fifth month following the end of its fiscal year.[398] Form 990-PF reports financial information about the foundation, including contributions received for the year, capital gains, investment income, expenses, and "qualifying distributions" made by the foundation for the year.[399] A "qualifying distribution" is generally any amount paid to a charitable organization or to carry out or accomplish a charitable, religious, educational, or scientific purpose, or any other purpose set forth in Section 501(c)(3).[400]

Prior to the application of the flat 1.39% rate in 2020, the rate was 2%, but standard private foundations could reduce their tax rate to 1% if they made qualifying distributions during the tax year at least equal to the sum of: (i) the foundation's assets for that year multiplied by the average percentage payout for the five preceding tax years, and (ii) 1% of the foundation's net investment income for the year.[401] For example, assume a private foundation had assets of $1 million and an average payout of 7% for the five preceding years.[402] If the foundation made qualifying distributions of $70,000 plus 1% of its net investment income for the tax year, the excise tax payable by the foundation would have been 1% rather than 2%.[403] A foundation was not eligible for the excise tax rate reduction if in any of the five preceding years it failed to make sufficient qualifying distributions.[404]

Code Section 4941 sets forth a list of specific forbidden acts of self-dealing between a private foundation and certain donors to a private foundation, as well as members of the donor's family, other individuals like foundation managers, and entities controlled by them.[405] These individuals

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393. *See id.* § 507.
394. *Id.* § 507(a)(2).
395. *Id.* § 4940(a).
396. *I.R.S. Form 990-PF*, IRS 1, 1–13, https://www.irs.gov/pub/irs-pdf/f990pf.pdf (last visited Feb. 23, 2023) [https://perma.cc/BM23-WQQS].
397. I.R.C. § 4940(d)–(e).
398. IRS, *supra* note 396.
399. *Id.*
400. I.R.C. § 501(c)(3).
401. *Id.* § 4940(e)(2)(a)(i)–(ii).
402. Author's original hypothetical.
403. I.R.C. § 4940(e)(2)(a)(i)–(ii) (amended 2019).
404. *Id.* § 4940(e)(2)(B) (amended 2019).
405. *Id.* § 4941(a)(1)–(2).

are defined as "disqualified persons."[406] The self-dealing rules impose an excise tax not only on the foundation, but also on any disqualified person who knowingly engages in any act of self-dealing.[407] The rate of taxation begins at 10% of the amount involved with respect to the act of self-dealing and increases to 200% of the amount involved if the act is not corrected within a designated period of time.[408] Any foundation manager who knows of the self-dealing and allows it to continue is also subject to imposition of the excise tax on self-dealing, up to 50% of the amount involved in the self-dealing.[409] The maximum tax imposed on the foundation manager, however, is $20,000 for any single act of self-dealing.[410] A disqualified person is defined in Code Section 4946 as:

> (1) a substantial contributor to the foundation, i.e., generally, anyone who contributes more than $5,000 to a private foundation if that amount is more than 2% of the total contributions received by the foundation for its taxable year;
> (2) a foundation manager, i.e., any officer, director, trustee, or certain employees or agents of the private foundation;
> (3) the owner of more than 20% of a corporation, partnership, trust, or unincorporated enterprise that is a substantial contributor to the foundation;
> (4) a member of the family of any individual described in (1) through (3) above;
> (5) a corporation, partnership, trust, or estate, if a person listed in (1) through (4) above holds more than a 35% interest in the entity; or
> (6) a government official.[411]

Under Code Section 4941, "self-dealing" includes the following acts, whether direct or indirect: (i) "the sale, exchange, or leasing of property between a private foundation and any disqualified person"; (ii) the lending of money between a private foundation and any disqualified person; (iii) "the furnishing of goods, services, or facilities between a private foundation and" any disqualified person; (iv) the payment of compensation "by a private foundation to a disqualified person"; and (v) "the transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation."[412] In most cases, the "fairness" of a self-dealing transaction is

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406. *Id.* § 4946(a)(1).
407. *Id.*
408. *Id.* § 4941(a)–(b).
409. *Id.*
410. *Id.* § 4941(c)(2).
411. *Id.* § 4946(a).
412. *Id.* § 4941(d)(1).

not relevant.[413] For example, if a company that is controlled by a disqualified person leases office space to her private foundation for $1 per year, that transaction is a prohibited act of self-dealing, even though the rent is substantially below market rates.[414] The Treasury Regulations related to Code Section 4941 set forth a number of exceptions to these all-encompassing rules against self-dealing.[415] One of the most important exceptions allows a private foundation to pay compensation to a disqualified person for personal services actually performed by that person, as long as the services are reasonable and necessary to carrying out the exempt purpose of the private foundation, and as long as the compensation is reasonable.[416] As a result, the creator of a private foundation or members of the founder's family may be employed by the foundation and paid reasonable compensation.[417] Employment by the foundation may be an additional advantage to consider in creating a private foundation.[418] Care must be exercised in determining a reasonable salary, however, because salaries paid must be reported on Form 990-PF and will be scrutinized by the IRS.[419] Industry groups review and publish compensation averages that may be viewed as a guide to the reasonableness of compensation paid.[420]

A standard private foundation may not accumulate all of its income.[421] Each year, it is required to make certain qualifying distributions as set forth in Code Section 4942.[422] If the foundation does not comply with the rules governing the qualifying distributions, it is subject to an excise tax.[423] Like the tax on self-dealing, the tax imposed on a private foundation for failure to make adequate distributions increases if the foundation fails to cure the problem within a specified time.[424] Part of the calculation of the amount that a standard private foundation must distribute each year is its "minimum

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413. *See generally* Andrew F. Tuch, *Reassessing Self-Dealing: Between No Conflict and Fairness*, 88 FORDHAM L. REV. 939, 976–77 (2019) (detailing the benefits and drawbacks of analyzing self-dealing through a fairness scheme).

414. I.R.C. § 4941(d)(2)(H).

415. *Id.* § 4941(d)(2).

416. *Id.* § 4941(d)(2)(E).

417. *Id.*

418. *See generally* Melissa Vance, *Understanding Forms 990-PF instructions and the basics of private foundations*, THOMSON REUTERS (June 6, 2022), https://tax.thomsonreuters.com/blog/understanding-form-990-pf-instructions-and-the-basics-of-private-foundations/ (providing helpful background information on Form 990-PF) [https://perma.cc/9HA2-5QGE].

419. *See id.*

420. *See* I.R.C. § 4942(a) (imposing a 30% tax on accumulated income).

421. *See* Colleen Ramires & Claire Kidd, *Overview of Private Foundations: Definitions, Income Classifications, and More*, MOSSADAMS (Mar. 30, 2021), https://www.mossadams.com/articles/2021/03/setting-up-a-private-foundation#:~:text=Qualifying%20distributions%20by%20private%20foundations,and%20treated%20as%20qualifying%20distributions (detailing types of qualifying distributions) [https://perma.cc/6HGX-WN8H].

422. I.R.C. § 4942(e)(1).

423. *Id.* § 4942(a)(1).

424. *Id.* § 4942(a)(2).

investment return."[425] In general, the minimum investment return equals 5% of a foundation's net investment assets.[426] Specifically, the minimum investment return is calculated by multiplying the aggregate net fair market value of the foundation's assets that are not used directly for charitable purposes by 5%.[427] The minimum amount that a standard private foundation must distribute each year to be in compliance with Code Section 4942 "distributable amount," is the foundation's minimum investment return, less any excise tax it pays pursuant to Code Section 4940, and less any UBTI tax it pays.[428] If a standard private foundation makes qualifying distributions that exceed its distributable amount, the excess distributions may be carried over and used to reduce the amount the foundation would otherwise be required to pay out over the following five years.[429] If the foundation fails to make its required distribution, the initial excise tax equals 30% of the income of the private foundation not distributed as required in the tax year or within the next tax year.[430] A second-tier tax, equal to 100% of the undistributed income, is imposed if the foundation fails to make the necessary qualifying distributions within a specified period of time.[431] A third-tier tax may be imposed by the IRS if there have been previous violations, or if the violation for which the current tax is imposed is willful.[432]

Code Section 4943 generally provides that for any corporation conducting a business that is not substantially related to the charitable purposes of a private foundation, the combined holdings of the private foundation and all disqualified persons are limited to 20% of the voting stock in the corporation.[433] In addition, the combined holdings of a private foundation and all disqualified persons in any unincorporated business, other than a sole proprietorship, that is not substantially related to the exempt purposes of the foundation are limited to 20% of the beneficial or profit interest in the business.[434] In the case of a sole proprietorship, a private foundation can have no permitted holdings unless the business of the sole proprietorship is substantially related to the exempt purposes of the foundation.[435] If unrelated third parties have effective control of the business, the percentage limitation on the combined holdings of the private foundation and all disqualified persons is increased to 35%.[436] The provisions related to

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425. *Id.* § 4942(e)(1).
426. *Id.* § 4942(e).
427. *Id.*
428. *Id.* § 4942(d).
429. *Id.* § 4942(g)(2).
430. *Id.* § 4942(a)(1).
431. *Id.* § 4942(a)(2).
432. *Id.*
433. *Id.* § 4943(c)(2)(A)(i).
434. *Id.* § 4943(c).
435. *Id.*
436. *Id.* § 4943(c)(2)(B).

excess business holdings are subject to a variety of exceptions and special rules that must be examined in detail if the 20% or 35% limitation is exceeded.[437] Regardless of the holdings of disqualified persons, if the private foundation itself, together with any related private foundations, holds an interest of 2% or less in an unrelated business, it will not be required to divest its holdings.[438] If the private foundation acquires excess business holdings by gift or bequest, it will generally have five years to dispose of those holdings before any excise tax is imposed.[439]

Code Section 4944 provides that a private foundation may not invest its assets in any manner that could jeopardize the carrying out of any of its exempt purposes.[440] If the foundation does make "jeopardizing investments," a tax equal to 10% of the amount so invested is imposed initially, and a second-level penalty of 25% may be imposed if the situation is not corrected before the 10% excise tax is assessed or a notice of deficiency for that tax is mailed.[441] The following types of investments may be carefully scrutinized for a lack of reasonable business care and prudence: trading in securities on margin; trading in commodity futures; investing in working interests in oil and gas wells; buying "puts," "calls," and "straddles;" buying warrants; and selling short.[442] To correct a jeopardizing investment, a private foundation must sell or otherwise dispose of the investment, and the proceeds of the sale or disposition must not be invested in a way that jeopardizes the carrying out of the foundation's exempt purposes.[443] Code Section 4944 does not apply to an investment given to, as opposed to being purchased by, the private foundation.[444] In addition, it does not apply to "program-related investments," i.e., investments, the primary purpose of which is to accomplish one or more of the private foundation's charitable purposes, and no significant purpose of which is the production of income or the appreciation of property.[445]

Standard private foundations typically achieve their charitable aims by distributing funds to qualified public charities.[446] Code Section 4945's taxable expenditure rules play a central role in the operation of a private foundation.[447] These rules preclude a private foundation from making expenditures: (i) to carry on propaganda or to attempt to influence legislation;

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437. *Id.* § 4943(c)(2)(C).
438. *Id.*
439. *Id.* § 4943(c)(7).
440. *Id.* § 4944(a).
441. *Id.* § 4944(a)–(b).
442. *See* Treas. Reg. § 53.4944-1(a)(2).
443. I.R.C. § 4944(e)(2).
444. *See id.* § 4944(a)–(b).
445. *Id.* § 4944(c).
446. *See Private Foundations*, IRS (Aug. 8, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/private-foundations [https://perma.cc/Z4VX-W7B9].
447. *See* I.R.C. § 4945(d).

(ii) influence the outcome of any specific public election or to carry on any voter registration drive; (iii) as a grant to an individual or to another private foundation, unless certain rigorous requirements are met; or (iv) for any purpose other than the charitable purposes described in the Code.[448] The taxable expenditure rules impose significant burdens on a private foundation's ability to make grants, including scholarships, to individuals.[449]

To make a grant to an individual, the private foundation must obtain advance approval from the IRS that its grant-making procedure awards grants on an objective and nondiscriminatory basis.[450] In addition, the private foundation must show that the grant constitutes a scholarship, fellowship, prize, or award; or that the purpose of the grant is to: (i) achieve a specific objective; (ii) produce a report or other similar product; or (iii) improve or enhance a literary, artistic, musical, scientific, teaching, or other similar capacity, skill, or talent of the grantee.[451] In addition, if a private foundation makes a grant to another private foundation, the grantor foundation must exercise what is known as "expenditure responsibility."[452] This means that the grantor foundation is responsible for exerting all reasonable efforts to establish adequate procedures: (i) see that the grant is spent solely for the purpose for which it was made; (ii) obtain full reports from the grantee as to how the funds are spent; and (iii) make detailed reports as to such expenditures to the IRS.[453] If the foundation makes a distribution to an individual without having prior IRS approval of its grant-making procedure, or if the foundation makes a distribution to another foundation without exercising expenditure responsibility, an initial tax of 20% is imposed on a private foundation's taxable expenditures.[454] In addition, a tax of 5%, up to a maximum of $10,000, is imposed on a foundation manager who knowingly agrees to the expenditure.[455] If the improper expenditure is not corrected, a second-level tax of 100% of the amount of the taxable expenditure is imposed on the foundation.[456] A second-level tax of 50%, up to $20,000, is also imposed on a foundation manager who does not agree to the correction.[457]

A table summarizing some of the differences between DAFs and private foundations is attached as Exhibit B.[458]

448. *Id.*
449. *Id.* § 4945(d)(3).
450. *Id.* § 4945(g).
451. *Id.*
452. *Id.* § 4945(h).
453. *Id.*
454. *Id.* § 4945(a).
455. *Id.* § 4945(a)(2), (c)(2).
456. *See id.* § 4944(a)–(b).
457. *Id.*
458. *See* discussion *infra* Part V; Exhibit B.

H. Charitable Lead Annuity Trusts

A charitable lead annuity trust (CLAT) is a trust designed to benefit charities for a specified period of time, with any trust assets remaining at the end of the trust's term passing to non-charitable beneficiaries.[459] When interest rates are low, a properly structured CLAT can ultimately pass most of its investment gains to heirs, while reducing or eliminating gift and estate taxes.[460] A CLAT may be thought of as a charitable analog to a grantor retained annuity trust (GRAT) that returns an annuity payment to the grantor.[461] Unlike a GRAT, a donor who establishes a CLAT typically gives everything away, first to charity for a set period of time and then to the donor's favorite non-charitable beneficiaries, typically junior family members or other loved ones.[462]

Most CLATs are created by senior family members who establish a trust that provides for annual payments, typically of a fixed amount, to charity for a fixed term.[463] Whatever is left in the trust at the end of the term is generally earmarked for junior family members or other loved ones.[464] Of course, it makes little sense for a client to set up a CLAT unless he or she is charitably inclined.[465] However, for clients with charitable objectives who own assets that they expect to appreciate at rates higher than current IRS interest rates, these trusts can be better than giving the assets away outright because they can also permit a tax-free, or at least tax-advantaged, transfer of wealth to the next generation.[466] There is more than one way to structure a CLAT.[467] For example, the trust terms and tax treatment will vary, depending on whether the client wants to receive an upfront income tax charitable deduction.[468] The availability of the deduction can be especially important to clients who will have a "liquidity event" with resulting high taxes in a single year.[469] The trade-off, however, is that taxes payable in later years may potentially go up.[470]

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459. *See* Richard Yam, *Charitable lead annuity trusts (CLATs)*, WEALTHSPIRE (Dec. 3, 2020), https://www.wealthspire.com/blog/clat-charitable-lead-annuity-trusts/ [https://perma.cc/9F6L-MHXM].

460. *See id.*

461. *See* Davis & Willms, *Fifteen Tools Every Estate Planner Should Know How to Use*, STATE BAR OF TEX. 28TH ANN. EST. PLAN. STRATEGIES COURSE (2022).

462. *See Charitable lead trusts*, FIDELITY CHARITABLE, https://www.fidelitycharitable.org/guidance/philanthropy/charitable-lead-trusts.html (last visited Feb. 15, 2023) [https://perma.cc/8RCH-7QDR].

463. Davis & Willms, *Estate Planning for Married Couples in a World with Portability and the Marital Deduction*, SA016 ALI-CLE 255 (2019).

464. *See* Yam, *supra* note 459.

465. *See id.*

466. *See id.*

467. *See id.*

468. *Id.*

469. *See id.*

470. *Id.*

Example 3: Charlie, sixty-one, sold his business this year for $10 million.[471] He started the business years ago on a shoestring, so he has a large built-in capital gain.[472] In addition, part of the purchase price was for a "non-compete" agreement, which will be ordinary income to Charlie.[473] He contributes $1 million to a twenty year CLAT in March 2022.[474] He structures the CLAT to pay out 5% of the value of the assets initially contributed to the trust, so the CLAT will pay his favorite charity $50,000 per year for the next twenty years.[475] Charlie was already contributing this much to the charity, so he no longer needs to budget for that from his other funds.[476] In addition to benefiting charity over the long run, Charlie gets a $850,030 income tax deduction this year, which goes a long way toward offsetting the income-tax bill he triggered earlier in the year.[477] The remaining value of $149,970, Charlie will treat as a gift by Charlie to the remainder beneficiaries of the CLAT.[478] Charlie will use part of his $12.06 million lifetime gift tax exclusion, and if he has not used up his exclusion, he will not have to pay gift tax on the gift to his kids.[479] If the trust invests its assets at an average return of 8% per year, the trust will have nearly $2.4 million in it at the end of the twentieth year, even after paying $50,000 per year to Charlie's favorite charity.[480] This property will pass to Charlie's kids at a cost of only $149,970 of Charlie's gift tax exclusion.[481] One caveat that clients have to remember: once you put money into one of these trusts, you cannot get it back, so the trust must be irrevocable.[482]

Some—most famously Jacqueline Kennedy Onassis—leave instructions in their will to create CLATs after death.[483] However, when setting one up while alive, individuals may select the moment to act.[484] When interest rates are low, they are very attractive.[485] The charity benefits from the annual annuity, and if the market outperforms the IRS rate over the term of the CLAT, heirs benefit too.[486]

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471. Author's original hypothetical.
472. *Id.*
473. *Id.*
474. *Id.*
475. *Id.*
476. *Id.*
477. *Id.*
478. *Id.*
479. *Id.*
480. *Id.*
481. *Id.*
482. Treas. Reg. § 1.170A-6(c)(2)(i)(A).
483. *Id.*
484. *See* Jonathon Morrison, *Elevating Your Estate: A Lesson from Jackie Kennedy*, FORBES: MONEY (Aug. 19, 2022, 7:00 AM), https://www.forbes.com/sites/forbesfinancecouncil/2022/08/19/elevating-your-estate-and-legacy-a-lesson-from-jackie-kennedy/?sh=3c3403901f3c [https://perma.cc/V3MC-AS9W].
485. *See* Yam, *supra* note 459.
486. *See id.*

1. Structure

In the usual case, senior family members transfer assets to the CLAT.[487] The trust pays a fixed dollar amount to one or more charities for a specified number of years.[488] Alternatively, the CLAT may be structured to last for the lives of (a) the senior family member; (b) his or her spouse; and/or (c) a lineal ancestor, or spouse of a lineal ancestor, of all of the remainder beneficiaries, or a trust in which there is less than a 15% probability that individuals who are not lineal descendants will receive any trust corpus.[489] Unlike a GRAT or a charitable remainder trust, a CLAT is not subject to any minimum or maximum payout.[490] The CLAT may provide for an annuity amount that is a fixed dollar amount, increasing during the annuity period, as long as the value of the annuity is ascertainable at the time the trust is funded.[491] Instead of paying a fixed dollar amount, the trust can be set up to pay a set percentage of the value of its assets each year, in which event it is called a charitable lead unitrust (CLUT).[492] In inflationary times, a CLAT tends to pass more property to remainder beneficiaries than a CLUT, so a CLAT is the more common structure.[493] The CLAT can be created during the senior family member's lifetime or upon their death pursuant to their will or revocable trust.[494] The charity receiving payments may be a public charity or a private foundation, but in the case of a private foundation in which the grantor is involved, the grantor cannot participate in any decisions regarding the property distributed from the CLAT to the private foundation or the distribution of that property from the private foundation to the ultimate charity.[495] In order to prevent this participation, the foundation's organizational documents should be reviewed and modified accordingly.[496] The IRS has issued annotated sample trust forms and alternate provisions that meet the requirements for inter vivos and testamentary CLATs.[497]

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487. *See id.*
488. Treas. Reg. § 1.170A-6(c)(2)(i)(A).
489. *Id.*
490. *Id.*
491. *See* Rev. Proc. 2007-45, 2007-29 I.R.B. 89.
492. Treas. Reg. § 1.170A-6(c)(2)(i)(B).
493. *See Charitable lead trusts*, *supra* note 462.
494. *See id.*
495. *See* Yam, *supra* note 459.
496. *See* I.R.C. §§ 2036(a)(2), 2038; Treas. Reg. § 25.2511-2(b) (1958); I.R.S. Priv. Ltr. Rul. 200537020 (Jun. 2, 2005); I.R.S. Priv. Ltr. Rul. 200138018 (Jun. 25, 2001); I.R.S. Priv. Ltr. Rul. 200108032 (Nov. 28, 2000).
497. *See* Rev. Proc. 2007-45, 2007-2 CB 89 (inter vivos CLATs); Rev. Proc. 2007-46, 2007-2 CB 102 (testamentary CLATs).

2. Gift on Formation

When the senior family member contributes assets to a CLAT, he or she makes a taxable gift equal to the present value, based on IRS tables, of the remainder interest that will pass to the non-charity beneficiaries.[498] The gift of a remainder interest to a CLAT is a gift of a future interest, so no annual exclusion can be used to shelter the gift tax.[499] CLATs can be structured so that the gift or estate tax on the remainder interest will be small or non-existent.[500] This result is accomplished simply by ensuring that the present value of the payments to be made to charity, using IRS rates at the time the trust is formed, are nearly equal to the value of the initial contribution.[501]

3. Setting the Interest Rate

The value of the non-charity beneficiaries' interest is calculated using the Section 7520 rate in effect for the month that the assets are transferred to the CLAT.[502] The transferor has the option, however, to use the Section 7520 rate in effect for either of the two months preceding the transfer.[503] To make the election, the grantor attaches a statement to his or her gift tax return identifying the month to be used.[504] Because IRS rates are published around the third week of each month, the grantor in effect has the option of picking from four months of Section 7520 rates, including rates in the current month, preceding two months, and the succeeding month, by delaying the transfer for a week or two.[505]

4. Income Tax Issues

One of the most important considerations related to the structure of a CLAT is the income tax effects.[506] If the CLAT is structured as a grantor trust for income tax purposes, then the grantor is entitled to receive an up-front income tax charitable deduction equal to the present value, based on IRS

498. I.R.C. § 2522(c)(2)(A); Treas. Reg. § 25.2522(c)-3(c)(2)(vii).
499. I.R.C. § 2503(b)(1).
500. Robert A. Wesley & David M. Barral, *Planning with Charitable Lead Trusts*, TAX ADVISER (Dec. 1, 2021), https://www.thetaxadviser.com/issues/2021/dec/planning-charitable-lead-trusts.html [https://perma.cc/6PWU-KKSN].
501. *Id.*
502. I.R.C. § 7520.
503. *Id.* § 7520(a).
504. Treas. Reg. § 25.7520-2(b).
505. *See* I.R.C. § 7520(a).
506. *See* Scott E. Testa, *Charitable Planning: CRTs, CLTs, and the Increasing Payment CLAT*, J. ACCT. (July 1, 2010), https://www.journalofaccountancy.com/issues/2010/jul/20102678.html [https://perma.cc/35BG-SQED].

tables, of the interest passing to charity.[507] The charitable deduction is typically subject to the 30% of AGI deduction limitation, since the gift is treated as a gift for the use of charities.[508] Beware of other limits on the income tax deduction if property other than cash, such as marketable securities, is contributed to the CLAT.[509] Of course, to get this deduction, the CLAT has to be a grantor trust, which means that the grantor must pay tax on all of the CLAT's income during its term.[510] If a grantor trust structure is chosen, the grantor gets no additional deduction for amounts paid by the trust to the charity during the term of the CLAT.[511] In addition, if the grantor toggles off grantor trust treatment, the consequence is the same as if the grantor died during the term of the CLAT.[512] If the CLAT is not structured as a grantor trust, then the grantor is not entitled to any income tax charitable deduction for amounts paid to charity.[513] Instead, the CLAT is responsible for the payment of the income taxes attributable to any income earned by the CLAT, and the CLAT itself receives an income tax deduction for the amount paid to charity each year.[514]

5. Death During Term

If the grantor dies during the term of the CLAT, none of the trust assets will be included in the grantor's estate because the grantor has not retained any interest in the trust.[515] However, as noted above, estate inclusion might occur if the grantor is involved with the decisions regarding distribution of the property from the CLAT to a private foundation in which the grantor is involved or distribution of that property from the private foundation to the ultimate charity.[516] If grantor trust treatment was used to give the grantor an initial income tax deduction, and if the grantor dies, or grantor trust treatment is otherwise terminated, during the trust term, the grantor must recapture income equal to the value of the deduction he previously received less the present value of trust income on which he paid tax, discounted to the date of contribution to the trust.[517]

507. I.R.C. § 170(f)(2)(B).
508. Treas. Reg. § 1.170A-8(a)(2).
509. *See* I.R.C. § 170(e).
510. *Id.* § 170(f)(2)(B).
511. *Id.*
512. *Id.*
513. *Id.*
514. *Id.* § 642(c)(1).
515. *Id.* § 2036 (assets in a reversionary CLAT in which the CLAT returns any remaining assets to the grantor at the conclusion of the CLAT term would be included in the estate of a grantor who dies during the term).
516. *Id.* §§ 2036(a)(2), 2038; *see, e.g.*, I.R.S. Priv. Ltr. Rul. 143184-04 (June 2, 2005).
517. *Id.* § 170(f)(2)(B).

6. Benefit to Heirs

At the end of the annuity term, the assets remaining in the CLAT pass to one or more non-charity beneficiaries, such as the senior family member's children or other family members, as well as one or more trusts for their benefit.[518] If, over the annuity term, the CLAT generates total returns higher than the Section 7520 rate in effect when the CLAT was created, the excess growth passes to the non-charity beneficiaries free from any estate or gift tax.[519] This benefit is especially attractive in a low interest rate environment.[520] For example, for a trust established in March 2022, all investment returns in excess of 2% per year ultimately pass to the donor's intended non-charity beneficiaries with no gift or estate tax.[521] The gift is enhanced if the CLAT is structured as a grantor trust because such a trust retains all of its income and gains in excess of the annuity payment unreduced by any federal income tax.[522]

7. GST Tax Issues

The grantor is technically permitted to allocate a portion of his or her GST tax exemption to the CLAT at the time the CLAT is funded in an amount equal to the taxable gift.[523] If the CLAT is structured so that the taxable gift is small or non-existent, the GST tax exemption allocated to the CLAT would be nearly zero.[524] Unfortunately, the actual amount of GST tax exemption allocated to the CLAT is determined not when the CLAT is funded, but when the CLAT terminates.[525] The amount of GST tax exemption allocated upon funding is treated as having grown at the Section 7520 rate in effect for the month of the funding and not at the actual rate of growth of the trust assets.[526] Therefore, there is at least some adjustment to the exemption that was initially allocated.[527] If the value of the non-charity remainder interest exceeds the GST tax exemption initially allocated to the CLAT, as increased by the prevailing Section 7520 rate, the grantor can allocate any portion of

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518. MICHAEL J. FEINFELD, PLANNING AN ESTATE: A GUIDEBOOK OF PRINCIPLES AND TECHNIQUES § 14:37 (4th ed. 2022).
519. *Id.*
520. *Id.*
521. *See id.*
522. *See* I.R.C. § 170(f)(2)(B).
523. *See id.* § 2632(a); Treas. Reg. § 26.2632-1(a), (b)(4).
524. Julie Garber, *The Federal GST Tax: Exemption and Rate Table 2000-2022,* THE BALANCE: TAXES (Feb. 11, 2022), https://www.thebalancemoney.com/federal-gst-tax-exemption-and-rate-table-3505633 [https://perma.cc/DA4P-QR8T].
525. I.R.C. § 2642(e)(1).
526. *Id.* § 2642(e)(2).
527. *Id.*

his or her then-remaining GST tax exemption to the excess at the time the charitable interest terminates.[528]

8. CLATs and Business Interests

There can be complications if the CLAT is funded with interests in a closely held entity such as a family limited partnership (FLP), membership units in an LLC, or non-voting shares in a private corporation.[529] CLATs generally are subject to the same rules as private foundations.[530] If the charitable portion of the CLAT is valued at greater than 60% of the fair market value of the assets contributed to the CLAT, the "excess business holding" rules apply.[531] In that case, for example, the CLAT may face an excise tax if it does not divest itself of the FLP units within five years of their contribution to the CLAT.[532] An attempt to sell the FLP units may prove to be difficult for the CLAT because the only willing buyers may be members of the donor's family.[533] The rules against self-dealing, which apply even if the value of the charitable interest is less than 60% of the fair market value of the CLAT, would prevent a sale to a family member.[534] Furthermore, if a valuation discount is applied in valuing a gift of FLP units to a CLAT, additional complications may arise if the charitable beneficiary of the CLAT is a private foundation that is controlled by the donor or his or her family.[535] In that event, an overly aggressive discount, which substantially reduces the required annuity payments to the foundation, may be viewed as an act of self-dealing on the part of the trustees of the CLAT.[536]

I. Charitable Remainder Trusts

A charitable remainder trust (CRT) is somewhat akin to a CLAT, but with the roles of charitable and non-charity beneficiaries reversed.[537] This fundamental difference means that CRTs serve a different purpose and are subject to their own unique set of rules.[538] Like a CLAT, a CRT is a

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528. *See* Treas. Reg. § 26.2632-1.

529. *See* N. Todd Angkatavanich et al., *The Rising Tide Carry CLAT,* WEALTH MGMT.: EST. PLAN. (Sept. 22, 2016), https://www.wealthmanagement.com/charitable-giving/rising-tide-carry-clat [https://perma.cc/N8GB-M7F8].

530. *Id.*

531. I.R.C. §§ 4943, 4947(b)(3)(A); Treas. Reg. § 1.170A-6(c)(2)(i)(D).

532. I.R.C. § 4943(c)(6).

533. *See id.*

534. *Id.* § 4941.

535. *See id.*

536. *See id.*

537. *See* Michael V. Bourland & Jeffrey N. Myers, *The Charitable Remainder Trust*, 2 J. TAX PRAC. & PROC. 24, 25 (2000).

538. *Id.*

split-interest trust with both charitable and non-charity beneficiaries.[539] With a CRT, however, one or more non-charity beneficiaries receive the initial term interest, sometimes called the "lead" interest, in the form of annuity or unitrust payments for the lifetime of one or more persons or for a fixed term of not more than twenty years, with any remaining property passing to one or more charities at the end of the trust term as the remainder beneficiary.[540] The donor establishes the trust by transferring cash or other property to the trust and establishing the trust's terms, including naming the trustee and specifying the beneficiaries.[541] The donor may retain the term interest, or may give the term interest to another non-charity beneficiary.[542] Unlike a CLAT, a properly structured CRT is exempt from federal income tax; although, non-charity beneficiaries may be taxed on CRT distributions described below.[543] Since the roles of charitable and non-charity beneficiaries are reversed, as one might expect, CRTs transfer the most to non-charity beneficiaries when interest rates are high.[544]

The term interest payable to the non-charity beneficiary must be in the form of annuity or unitrust payments and may not simply be an income interest.[545] Congress was presumably concerned that if the term interest were structured so that a non-charity beneficiary would receive all the income of the trust, the trustee could manage the assets so as to maximize income for the donor's family and minimize the long-term growth of the assets ultimately passing to charity.[546] This could result in abuse with very little correlation between the amount of the charitable deduction and the amount ultimately passing to charity.[547] By requiring an annuity or unitrust interest, Congress ensured donors would receive charitable deductions only for amounts likely passing to charity.[548]

Example 4: Craig and Cristin, both age seventy, have a condo that they bought years ago as a vacation property.[549] As their children got older and moved away, they converted it into a rental property.[550] Although it provides cash flow of about $30,000 per year and is taxed as ordinary income, it also provides Craig and Cristin with the headaches that come with being

539. *Id.*
540. *Id.*
541. *See id.*
542. *See id.*
543. I.R.C. § 664(c)(1).
544. *Charitable remainder trusts*, FIDELITY CHARITABLE, https://www.fidelitycharitable.org/guidance/philanthropy/charitable-remainder-trusts.html (last visited Feb. 23, 2023) [https://perma.cc/D4S9-CN87].
545. *See id.*
546. *See id.*
547. *See id.*
548. *See id.*
549. I.R.C. § 664(b).
550. *See* Bourland & Myers, *supra* note 537, at 24.

landlords.[551] The current value is about $1 million and their cost basis is only $200,000.[552] As a result, if they were to sell the property, they would recognize a gain of $800,000.[553] Even if depreciation recapture does not result in tax at a higher rate, the capital gain tax on the sale would be $160,000—20% of the $800,000 gain—leaving them only $840,000 to invest.[554] Craig and Cristin have always been charitably inclined.[555] After talking the issues over with their estate planner, they decide to contribute the condo to a CRUT and let the trustee sell the property.[556] Because the CRUT is tax-exempt, no capital gains will be due on the sale, and the trust will be able to invest the entire $1 million sales proceeds.[557] After crunching some numbers, Craig and Cristin decide to take back a 6% annuity—$60,000 per year—from the CRUT for their joint lives. Based upon their other investments, Craig and Cristin think that the trust could average about a 7% return on its investments, so the 6% payment will actually grow a bit over time.[558] In any event, $60,000 is twice their current income from this asset and more than the amount they would receive if they simply invested their net $840,000 sales proceeds at 7%.[559] Contributing the condo to the CRUT in March 2022 allows Craig and Cristin to compute their charitable deduction using the March 2022 Section 7520 rate of 2%.[560] Using these figures, the present value of the amount passing to charity will generate a current income tax charitable deduction of $89,546.[561] In addition, distributions in excess of the CRUT's current annual ordinary income will be taxed at favorable capital gains rates until Craig and Cristin have received total capital gain distributions of $800,000.[562] Distributions in excess of cumulative ordinary income and capital gains will be tax free to Craig and Cristin.[563] If Craig and Cristin live to their projected life expectancy of eighty years, their favorite charity will receive over $1.3 million, even after the CRUT pays Craig and Cristin $60,000 plus per year.[564] In addition, even if they outlive their life expectancies, they will still receive the unitrust payment until they both pass away.[565]

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551. *Id.*
552. *Id.* at 24–25.
553. Author's original hypothetical.
554. *Id.*
555. *Id.*
556. *Id.*
557. *See* I.R.C. § 664.
558. *Id.*
559. *Id.*
560. *Id.* § 7520(a) (showing income tax deductions are maximized when interest rates are higher; gifts to split interest trusts entitle the donors to use the interest rate in effect for the month of the gift or in either of the prior two months).
561. *See id.*
562. *See id.*; author's original hypothetical.
563. *See* I.R.C. § 7520; author's original hypothetical.
564. *See* I.R.C. § 7520; author's original hypothetical.
565. *See* I.R.C. § 7520; author's original hypothetical.

1. Structure

As noted above, the interest passing to non-charity beneficiaries must take the form of a fixed annuity or a fixed percent of the trust's assets.[566] A charitable remainder annuity trust (CRAT) is a CRT in which the annual payments to the non-charity beneficiary are in the form of a fixed annuity.[567] The annuity is expressed in terms of a fixed dollar amount or a fixed percentage between 5% and 50% of the fair market value of the assets on the date the trust is established.[568] Thus, regardless of how the trust assets appreciate or depreciate, the amount passing to the non-charity beneficiary is fixed.[569] In other words, the charity alone, as the remainderman, participates in the appreciation or depreciation of the trust assets.[570] If the trust assets grow faster than the Section 7520 rate, more wealth passes to the charity than what was calculated at the time the trust was created.[571] If the assets depreciate significantly, the charity may not receive anything at all; although, for CRATs, the actuarial value of the charity's interest at the start of the CRAT must be at least 10% of the value of the contribution.[572] A CRUT is a CRT in which the annual payments to the non-charity beneficiary are in the form of a fixed unitrust.[573] The unitrust is expressed in terms of a fixed percentage between 5% and 50% of the fair market value of the assets revalued on the same day each year of the trust term.[574] Thus, the amount paid to the non-charity beneficiaries each year may increase or decrease as the assets appreciate or depreciate each year.[575] In other words, both the non-charity beneficiary and the charity participate in the appreciation or depreciation of the trust assets.[576] CRTs more often take the form of a CRUT than a CRAT.[577] With either structure, unlike a non-grantor CLAT, the CRT does not generally pay income tax on taxable income it receives.[578] Instead, when distributions are made to the non-charity beneficiaries, those beneficiaries report the distributions as income to the extent that the trust has received but has not previously distributed taxable income, according to the worst-in-first-out (WIFO) hierarchy.[579]

566. I.R.C. § 664(d)(1).
567. *See id.*
568. *See id.* § 664(d)(1)(A).
569. *See id.* § 664(d)(1); Treas. Reg. § 1.664-2.
570. I.R.C. § 664(d)(1); Treas. Reg. § 1.664-2.
571. Treas. Reg. § 1.664-2.
572. *Id.*
573. I.R.C. § 664(d)(2).
574. *Id.* § 664(d)(2)(A).
575. Treas. Reg. 1.664-3.
576. I.R.C. § 664.
577. *See id.*; Treas. Reg. 1.664-3.
578. I.R.C. § 664.
579. *See* discussion *infra* Section IV.I.2.

2. Variations on the Payout Theme

Instead of describing the payment to the non-charity beneficiaries strictly in terms of a unitrust or an annuity, a CRT may cap distributions based upon the trust's income as measured under state law.[580] One version of this technique is a net income with make-up charitable remainder unitrust (NIMCRUT).[581] A NIMCRUT is a CRUT in which the non-charity beneficiary's payment each year is the *lesser* of the unitrust amount or the trust's net income, measured under state fiduciary income tax principles rather than federal income tax principles.[582] Any excess fiduciary accounting income in a particular year may be used to make up for years in which the income was less than the unitrust amount.[583] Thus, for example, assume that in year one the unitrust amount is $100,000 but the net income is only $30,000.[584] The non-charity beneficiary would receive only $30,000, a difference of $70,000.[585] Then, if in year two, the unitrust amount is $110,000 but the net income is $140,000, the non-charity beneficiary will receive $140,000, which is the unitrust amount of $110,000 plus a $30,000 make-up as a result of the $70,000 deficit in year one.[586] If in year three the unitrust amount is $120,000 but the net income is $200,000, the non-charity beneficiary will receive $160,000, equal to the unitrust amount of $120,000, plus a make-up amount equal to the remaining $40,000 of the $70,000 deficit in year one.[587] The economics of the NIMCRUT can be very powerful if the trust assets are managed appropriately, thereby giving the non-charity beneficiary a mechanism for deferring income tax.[588]

For example, in the early years of the NIMCRUT, the trustee might invest trust assets in long-term growth assets that produce little or no fiduciary accounting income.[589] In that event, the non-charity beneficiary would receive little or no annual payments but would accrue a large make-up amount for future distributions.[590] Since CRTs are generally exempt from income tax, in the early years, little or no income tax will be paid.[591] Then, in the later years of the trust term, perhaps when the non-charity beneficiary is retired and in a lower income tax bracket, the trust assets could be invested in high-yield assets, producing income well in excess of the unitrust

580. I.R.C. § 664.
581. *Id.* § 664(d)(3)(B); I.R.S. Priv. Ltr. Rul. 200218008 (May 3, 2002).
582. I.R.C. § 664(d)(3)(B); I.R.S. Priv. Ltr. Rul. 200218008 (May 3, 2002).
583. I.R.C. § 664(d)(3)(B).
584. *See id.*
585. *See id.*
586. *See id.*
587. *See id.*
588. *See id.*
589. *See id.*; I.R.S. Priv. Ltr. Rul. 200218002 (May 3, 2002).
590. I.R.C. § 664(c)(1).
591. *See id.* § 664(d)(3)(B).

amount.[592] If the trust yield is high enough in those later years, the non-charity beneficiary could then cash in on the make-up accruals and receive large distributions from the trust.[593] Only the actual receipt of distributions in later years, e.g., during retirement, triggers income tax to the non-charity beneficiary.[594]

While to a certain extent, using a NIMCRUT may permit the trustee to control investments in a manner designed to modify distributions, the IRS has expressed its concerns about the potential for the abuse of such discretion.[595] A properly structured and administered NIMCRUT entitles the donor to the same income, gift, and estate tax charitable deductions as the donor would receive for a CRUT with the same unitrust percentage.[596]

3. Gift on Formation

If the donor creates a CRT during lifetime and retains the lead interest, no taxable gift is made at the time the CRT is established.[597] However, if the lead interest is set up to benefit one or more of the donor's family members or other non-charity beneficiaries, the present value of the lead interest is a taxable gift made by the donor at the time the trust is established.[598] The present value of the charitable remainder interest qualifies for the gift tax charitable deduction.[599] Because of the mechanics of how the present value of the lead interest is calculated, CRTs are particularly attractive when interest rates are high.[600] The present value of the remainder interest essentially reflects growth of the trust assets at the assumed interest rate under Code Section 7520.[601] The value of the lead interest is essentially what is left after subtracting the value of the remainder interest from the total value of the assets transferred to the trust.[602] Thus, if the Section 7520 rate is high, the present value of the remainder interest will also be high and the value of the

592. *See id.* § 664.
593. *See id.*
594. *See id.* § 664(e).
595. *See, e.g.*, Rev. Proc. 97-23, 1997-1 C.B. 654 (announcing the IRS would not issue rulings on whether a contribution to a NIMCRUT qualifies for an income tax deduction under Section 664 where the grantor, trustee, beneficiary, or a person related or subordinate to any of them controls the timing of the CRT's receipt of trust income from a partnership or a deferred annuity contract).
596. *See Charitable Remainder Trusts*, IRS (Aug. 22, 2022), https://www.irs.gov/charities-non-profits/charitable-remainder-trusts [https://perma.cc/3T72-DD4X].
597. *See Charitable lead trusts*, FMR, LLC (2023), https://www.fidelitycharitable.org/guidance/philanthropy/charitable-lead-trusts.html [https://perma.cc/DUSW-9DY4].
598. *See id.*
599. I.R.C. § 2522(c)(2)(A).
600. *See id.*
601. *Id.* § 7520.
602. *Id.*

lead interest will be low.[603] As a result, CRTs are usually more attractive when the Section 7520 rate is high.[604]

4. Setting Interest Rate to Value the Gift

The value of all non-charity beneficiaries' interest is calculated using the Section 7520 rate in effect for the month that the assets are transferred to the CRT.[605] The transferor has the option, however, to use the Section 7520 rate in effect for either of the two months preceding the transfer.[606] To make the election, the donor attaches a statement to his or her gift tax return identifying the month to be used.[607] Because Section 7520 rates are published around the third week of each month, the donor has the option of picking from four months of Section 7520 rates, including the rate in the current month, the preceding two months, and the succeeding month.[608] The interest rate used to value the gift has nothing to do with the interest rate used to measure the payout rate to the non-charity beneficiary, which must be between 5% and 50% of the initial trust value for a CRAT or between 5% and 50% of the annual trust value for a CRUT.[609]

5. Income Tax Issues for the Donor

If the CRT is established during the donor's lifetime, the donor will receive an income tax charitable deduction in the year the CRT is established.[610] In general, contributions to charitable organizations can be deducted for federal income tax purposes in an amount up to 50% of the donor's contribution base.[611] For cash contributions to public charities made between 2018 and 2025, TCJA 2017 increased the annual limit to 60% of the taxpayer's contribution base.[612] A special 30% limitation applies to contributions of capital gain property, other than publicly traded stock, and to contributions "for the use of" any charitable organizations.[613] The 30% limit can be avoided by the donor agreeing to include any capital gain portion

603. *See* Kelly Baumbach et al., *Volatile economic signals present opportunity for beneficial re-evaluation of estate and business plans*, BAKER TILLY US, LLP (May 15, 2022), https://www.bakertilly.com/insights/volatile-economic-signals-present-opportunity-for-re-evaluation [https://perma.cc/SPQN-TX3T].

604. *See id.*

605. *See id.*

606. I.R.C. § 7520(a).

607. Treas. Reg. § 25.7520-2(b).

608. *See* I.R.C. § 7520.

609. *See id.*

610. *Id.* § 170(f)(2)(A).

611. *See Charitable Contribution Deadlines*, IRS (Aug. 25, 2022), https://www.irs.gov/charities-non-profits/charitable-organizations/charitable-contribution-deductions [https://perma.cc/WAJ5-NRNW].

612. I.R.C. § 170(b)(1)(G).

613. *Id.* §§ 170(e), 179(b)(1)(C).

of the transferred property in the donor's income.[614] Gifts of cash or ordinary income property to most private foundations are deductible only up to 30% of the donor's base.[615] Furthermore, contributions of capital gain property, other than publicly traded securities, to most private foundations are subject to an even more stringent percentage limitation—20% of the donor's contribution base.[616]

The donor's charitable income tax deduction is based on the actuarially determined present value of the remainder interest passing to charity, as computed using a complex calculation taking into account the value of the contributed property, or its basis for capital gain property other than marketable securities, which is the Section 7520 rate, i.e., assumed rate of growth, and the amount of the annuity or unitrust percentage.[617] However, neither the donor nor the donor's estate will receive an income tax deduction if the CRT is created as a testamentary gift.[618] The percentage limitation on the donor's income tax deduction for amounts passing to charity varies depending upon whether the charitable remainder beneficiary is a 50% public charity or a 30% private foundation.[619] In other words, CRTs generally borrow their status as 50% charities or 30% charities based upon the status of the charitable remainder beneficiary.[620] That is, if the charitable remainder beneficiary must in all events be a public charity, the donation to the CRT is subject to the rules for 50% charities.[621] If, however, the remainder beneficiary or alternate charitable beneficiary is a private foundation, the more restrictive rules for donations to 30% charities control.[622]

6. Income Tax Issues for the CRT

If properly formed, a CRT is generally not subject to income tax on any taxable income that it receives during its term.[623] However, if the CRT receives unrelated business taxable income (UBTI), described in Section 512, is subject to an excise tax on that income equal to 100% of the UBTI.[624] This confiscatory income tax means that trustees of CRTs must be able to identify and avoid trust investments that produce UBTI.[625] The UBTI rules are

614. *Id.* § 170(b)(1)(C)(iii) (noting that this election could be beneficial if the capital gain is taxed at 20% and the increased charitable deduction offsets ordinary income taxed at 37% (the top income tax rates applicable in 2022)).
615. *Id.* § 170(b)(1)(B).
616. *Id.* § 170(b)(1)(D), (e)(5).
617. *See id.* § 7520(a).
618. *See id.*
619. *See Charitable Contribution Deadlines*, *supra* note 611.
620. *See id.*
621. *See* Paglia & Alexanderson, *supra* note 303.
622. *See, e.g.*, Rev. Rul. 79-368, 1979-2 C.B. 109; Priv. Ltr. Rul. 9818028.
623. I.R.C. § 664(c)(1).
624. *Id.* § 664(c)(2)(A).
625. *See id.* §§ 512(b)(1), (b)(4), 664(c)(2)(A).

technical, but investments in dividend-paying stock or interest-bearing obligations do not produce UBTI unless the acquisition of the investment is financed by debt.[626] Gain on the sale of the investment will also be exempt if the acquisition is not debt-financed.[627] However, there are some types of investments that can cause a CRT to have income that would be treated as UBTI, which can prove to be traps for unwary trustees.[628] It is unlikely that a CRT would directly operate a business that could generate UBTI.[629] In addition, a CRT is not eligible to hold stock in an S corporation.[630] As a result, corporate stock held by a CRT should be C corporation stock, and the dividends will not be treated as UBTI, unless the acquisition of the stock is financed by debt.[631] However, investments in other pass-through entities, notably partnerships and LLCs, can be problematic.[632] If the pass-through entity generates income from a trade or business that would be UBTI if realized directly by the CRT, the CRTs share of that income will be UBTI to the CRT.[633] Another problem area for CRTs is debt-financed income.[634] Income from investments that are subject to acquisition indebtedness, as defined in Section 514, is treated as UBTI, even if the income is passive in nature.[635] Debt-financed income includes income from investing in securities traded on margin.[636] Investing in a real estate investment trust (REIT) might permit indirect ownership of debt-financed property without generating UBTI.[637]

7. Income Tax Issues for Non-Charity Beneficiaries

Distributions to non-charity beneficiaries are frequently taxed to those beneficiaries.[638] Distributions assume the same tax character in the hands of the non-charity beneficiaries as they have in the hands of the trust, applying

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626. *See id.* § 512(b)(1), (4).

627. *See id.* § 512(b)(4), (5).

628. *See* David Wheeler Newman, *Now CRTs Can Have UTBI!*, MSK (Mar. 2, 2007), https://www.msk.com/newsroom-alerts-152 [https://perma.cc/4T3J-54HF].

629. *See id.*

630. I.R.C. § 1361(e)(1)(B)(iii).

631. *See* Jonathan Ackerman, *The CRT Stock Redemption Strategy for Philanthropic and Business Succession Planning*, P'SHIP FOR PHILANTHROPIC PLAN. 5, 5, https://www.ackermanlaw.net/PPP_Journal_Ackerman.pdf (last visited Feb. 15, 2023) [https://perma.cc/G56W-X5DR].

632. *See* Andrew L. Whitehair & Robert Venables, *UBTI Reporting Requirements for Partnerships and S Corporations*, THE TAX ADVISER (Aug. 1, 2015), https://www.thetaxadviser.com/issues/2015/aug/ubti-reporting-requirements-for-partnerships-s-corporations.html [https://perma.cc/NYB5-JEPH].

633. I.R.C. § 664(c).

634. *Id.*

635. *Id.* § 512(b)(4).

636. *See, e.g.*, Bartels Tr. for benefit of Cornell U. ex rel. Bartels v. United States, 617 F.3d 1375, 1359 (Fed. Cir. 2010).

637. *See* I.R.S. Priv. Ltr. Rul. 122714-98 (Sept. 24, 1999) (noting income from REIT is treated as dividend income and therefore not taxable as UBTI).

638. *See Charitable Remainder Trusts*, *supra* note 596.

a flow-through analysis.[639] However, unlike simple and complex trusts, distributions are not deemed to come pro rata from each class of income earned by the trust.[640] Rather, distributions are deemed to be made from the following categories of income received by the trust from its inception and not previously distributed: ordinary income, capital gain, and tax-exempt income.[641] In addition, short-term capital gains are deemed to be distributed before long-term capital gains.[642] After all these categories of receipts have been distributed, distributions are deemed to come from the trust principal.[643] The hierarchy has the effect of forcing out income taxed at the highest effective income tax rate first, with distributions taxable at lower rates being deemed distributed only after all higher rate income received by the trust has been subject to tax.[644] This hierarchical system is sometimes referred to as a (WIFO) allocation of income.[645]

8. Complying with Technicalities

The IRS enforces technical details related to preparing a CRT agreement and administering the trust.[646] There must be a written trust agreement, the trust must have its own taxpayer ID number, and the trustee must file annual information returns.[647] Two of the private foundation excise tax rules apply to private foundations and CRTs—those imposing excise taxes on self-dealing and taxable expenditures—and the trust agreement must contain provisions that prohibit a trustee from violating these rules.[648] The CRT must have at least one non-charity beneficiary.[649] The remainder beneficiaries must be one or more charities described in Section 170(c), to which contributions are income tax deductible.[650] While the exact charity does not have to be named in the governing instrument, the character of the charity must be specified.[651] If specific charities are named, the trust instrument must provide that if named charities are not qualified at the time the trust distributes its

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639. Thomas W. Bassett, *A Primer on Charitable Trusts (Part I)*, AM. BAR ASS'N (Sept. 21, 2021), https://www.americanbar.org/groups/taxation/publications/abataxtimes_home/21sum/21sum-prp-bassett-charitable-trusts/ [https://perma.cc/52ZZ-XKW4].

640. *See* I.R.C. § 664(b).

641. *Id.*

642. Treas. Reg. § 1.664-1(d)(1)(i)(b).

643. I.R.C. § 664(b).

644. *Convert Appreciated Assets into Income with a Charitable Remainder Trust ("CRT")*, SCHWAB CHARITABLE (Aug. 4, 2020), https://www.schwabcharitable.org/public/file/P-12104960 [https://perma.cc/7Z8B-7EFH].

645. Bassett, *supra* note 639.

646. *See Charitable Remainder Trusts*, *supra* note 596.

647. *Id.*

648. I.R.C. §§ 508(e), 4947(a)(2).

649. *Id.* § 664(d)(2)(A).

650. *Id.* §§ 170(c), 664(d)(1)(D), (2)(D).

651. *See* Treas. Reg. § 1.664-2.

assets on termination, the trustee must instead distribute the funds to a qualified alternative charity elected in a manner set out in the trust agreement.[652] In addition, the term of the CRT must not exceed twenty years or the lives of one or more persons.[653]

A CRAT must distribute a fixed amount or fixed 5%–50% of the initial trust value each year, and a CRUT must pay a fixed 5%–50% of the net fair market value of the trust's assets valued each year.[654] In either event, the charity's interest in the trust cannot be nominal.[655] For contributions to CRTs after July 28, 1997, the present value of the remainder interest in a CRT must at its inception be a least 10% of the net fair market value of the property contributed to the trust.[656] The IRS has provided sample provisions that may be included in the governing instrument of a CRAT providing for annuity payments payable for one or more measuring lives followed by trust assets being distributed to one or more charitable remaindermen.[657] Unlike a CRUT, a CRAT will be disqualified if the value and length of the annuity create more than a 5% probability that the remainder will not exist when the non-charity interest terminates.[658] Having all the right features in the trust agreement is not determinative by itself.[659] If the trust instrument is not administered in accordance with its terms, the IRS may disqualify the CRT.[660]

Certain promoters suggested a transaction in which, after the formation of the CRT, all of the non-charity beneficiaries could sell their interest in the CRT to a third party, thereby receiving the value of their interest with very little or no taxable gain.[661] The IRS called into question this technique, labeling it as a "transaction of interest" to the extent that it sought questionable tax benefits by manipulation of the uniform basis rules under Treasury Regulation Section 1.1015-5.[662] In 2017, the Treasury amended those regulations to essentially eliminate the touted benefit of the transaction.[663]

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652. *Id.* §§ 1.664-(2)(a)(6), -3(a)(6); *see also* Rev. Rul. 76-7, 1976-1 C.B. 179 (allowing grantor to retain a special power of appointment to change identity of charitable beneficiary who would take at death of non-charity beneficiary); I.R.S. Priv. Ltr. Rul. 9818027; I.R.S. Priv. Ltr. Rul. 9826021; I.R.S. Priv. Ltr. Rul. 9826022.

653. I.R.C. § 664(d)(1)(A), (2)(A).

654. *Id.*

655. *Id.* § 664(d)(1)(D).

656. *Id.* § 664(d)(1)(D), (2)(D).

657. Rev. Proc. 2016-42, 2016-34 IRB 269.

658. Rev. Rul. 77-374, 1977-2 C.B. 329.

659. *See generally* Michael Seto & David Jones, *Self-dealing and other Tax Issues Involving Charitable Remainder Trusts*, IRS (1996), https://www.irs.gov/pub/irs-tege/eotopicg96.pdf (discussing other tax issues involving CRUTs) [https://perma.cc/47AW-34CM].

660. *See* Est. of Atkinson v. Comm'r, 115 T.C. 26, 30 (2002), *aff'd*, 309 F.3d 1290 (11th Cir. 2002).

661. *See* William A. Grady & Gary A. Plaster, *Supercharge the sale of your business with a charitable remainder trust*, BAKER TILLY US, LLP (Oct. 31, 2022), https://www.bakertilly.com/insights/supercharge-sale-business-charitable-remainder-trust [https://perma.cc/6DQE-EVY3].

662. I.R.S. Notice 2008-99, 2008-47 I.R.B 1194; Treas. Reg. § 1.1015-5.

663. *See* Treas. Reg. § 1.1014-5(b).

9. Benefit to Heirs

If the grantor retains the non-charity interest in the CRT, then there is no direct benefit from the CRT to the grantor's family.[664] At the end of the annuity term, the assets remaining in the CRT pass to charity.[665] That means, of course, that the children or other non-charity estate beneficiaries will receive less from the grantor than if the property donated to the CRT was not otherwise earmarked for charity.[666] However, if the donor has a taxable estate, the loss to the non-charity beneficiaries is only 60% of the value of the property, using the current estate tax rate of 40%.[667] If the donor wishes to minimize this loss, the donor might consider using some or all of the income tax savings that result from the formation of the CRT to fund a life insurance policy, perhaps owned by an irrevocable life insurance trust, to restore the wealth that would otherwise pass to those beneficiaries.[668] Of course, if the non-charity beneficiaries of the CRT are family members or other loved ones, those beneficiaries receive a direct benefit in the form of the annuity or unitrust payments made to them.[669]

10. Estate Tax Issues

The actuarial value of the charity's remainder interest in the CRT qualifies for the federal estate tax deduction.[670] If the CRT does not meet the technical requirements for deduction, the Code provides that the deduction may nevertheless be obtained if a "qualified reformation" of the trust is undertaken in a timely fashion.[671] A qualified reformation is generally defined as a change of a governing instrument by reformation, amendment, construction, or otherwise that changes a reformable interest into a qualified interest.[672] This only occurs if: (i) any difference between the actuarial value, determined as of the date of the decedent's death, of the qualified interest, and the actuarial value of the reformable interest does not exceed 5% of the actuarial value of the reformable interest; (ii) in the case of a CRT, the non-remainder interest, before and after the qualified reformation, terminated at the same time, or any other interest, the reformable interest and the

664. *See id.* § 1.1015-5.
665. Mickey R. Davis, *Davis's Texas Estate Planning Forms* ch. 4 § 6 (2022).
666. *See id.*
667. *See id.*
668. Michael V. Bourland & Jeffrey N. Myers, *Charitable Remainder Trusts*, SFA2 ALI-CLE 999 (2001).
669. *Id.*
670. I.R.C. § 2055(e)(2)(A).
671. *Id.* § 2055(e)(3)(A).
672. *Id.*

qualified interest are for the same period; and (iii) the change is effective as of the date of the decedent's death.[673]

11. GST Tax Issues

A transfer to a CRT is a taxable gift, or if occurring at death, is a taxable transfer, to the extent of the actuarial value of the non-charity beneficiary's interest.[674] However, the transfer itself is not a GST, even if all of the non-charity beneficiaries are grandchildren or other skip persons because the interest held by the charity is treated as being held by a non-skip person.[675] Moreover, a CRT is not a "GST Trust" for purposes of the deemed allocation rules of Section 2632(b).[676] However, distributions to grandchildren are taxable distributions under Section 2611(a)(1).[677] Accordingly, unless the grantor or the executor of a deceased grantor's estate allocates GST exemption in an amount equal to the taxable transfer, GST tax will be payable.[678] Thus, for example, assume that grandma contributes $1 million to a CRUT for her granddaughter to pay a 6% annuity for twenty years, with the remainder passing to charity.[679] Assume further that the amount of the gift that qualifies for the gift tax charitable deduction is $296,783.[680] As a result, grandma will have made a taxable gift of $703,217.[681] If grandma allocates $703,217 of her GST tax exemption to the transfer, the trust's inclusion ratio will be zero, so no GST tax will be owed when distributions are made from the CRUT to the granddaughter.[682]

12. CRTs and Business Interests

In addition to the potential exposure to the 100% tax on UBTI described above, there can be other complications if a CRT is funded with interests in a closely held entity such as an FLP, membership units in an LLC, or shares in a private corporation.[683] In particular, like CLATs, CRTs generally are subject to many of the excise tax rules that are imposed upon private foundations.[684] If the charitable portion of the CRT is valued at greater than

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673. *Id.* § 2055(e)(3)(B); *see* I.R.S. Priv. Ltr. Rul. 201949007 (Dec. 6, 2019).
674. *See* Davis, *supra* note 665.
675. *See* I.R.C. §§ 2612(c)(1), 2652(c)(1)(C).
676. *Id.* § 2632(c)(3)(B)(5).
677. *Id.* § 2611(a)(1).
678. *Id.*
679. Author's original hypothetical.
680. *Id.*
681. *Id.*
682. *Id.*
683. Stephen H. Gariepy, *Making the Most of Split-Benefit Charitable Gifts in a Low Interest Rate Environment*, 19 OHIO PROB. L. J. 49 (2008).
684. *Id.*

60% of the fair market value of the assets contributed to the CRT, the excess business holding rules will apply.[685] In that case, the CRT may face an excise tax if it does not divest itself of the offending ownership interests within five years of their contribution to the CRT.[686] However, attempts to sell FLP or other interests in closely held businesses may prove to be difficult because the only willing buyers may be members of the donor's family.[687] The rules against self-dealing, which apply even if the value of the charitable interest is less than 60% of the fair market value of the CRT, typically prevent a sale to a family member.[688] In addition, if transferred interests are sold shortly after the contribution in a pre-arranged sale, the IRS will likely argue that the grantor should be taxed on the gain under the assignment-of-income principles.[689]

J. Charitable Gift Annuities

A charitable gift annuity is a deferred charitable giving technique similar to a charitable remainder trust in that the donor makes a current gift which provides a lifetime benefit to a non-charity beneficiary, with any funds donated in excess of the cost of the transfer to the non-charity beneficiary passing to charity.[690] Rather than establishing a trust, however, a charitable gift annuity is a contract between the donor and a charity, akin to an annuity contract entered into with an insurance company.[691] The donor may fund the charitable gift annuity with cash, appreciated securities, or possibly other assets.[692] In return, the non-charity beneficiary, typically the donor or the donor's spouse, receives a fixed stream of payments from the charity for the rest of the non-charity beneficiary's life, or the lives of two non-charitable beneficiaries.[693] At the same time, the donor is entitled to take a tax deduction for a portion of the donation—amount given, less the value of the retained annuity.[694] A charity may lose its tax-exempt status if it is engaged in the business of offering commercial annuities.[695] However, the Code makes an exception which permits a charity to offer a donor a charitable gift annuity in exchange for a contribution if certain technical requirements are met.[696]

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685. I.R.C. §§ 4943, 4947(b)(3)(A); Treas. Reg. § 1.170A-6(c)(2)(i)(D).
686. I.R.C. § 4943(c)(6).
687. *See id.* § 4941.
688. *See id.*
689. *See* discussion *supra* Section IV.B.3.
690. 44 Tex. Jur. 3d *Charitable Gift Annuities* § 7 (2023).
691. Richard L. Fox, *Charitable Planning to Avoid New 3.8% Tax on Investment Income*, 40 EST. PLAN. 3, 13 (2013).
692. *Id.*
693. *See id.*
694. I.R.S. Priv. Ltr. Rul. 200922013 (May 29, 2009).
695. *See id.*
696. I.R.C. § 501(m)(5).

Many large nonprofit organizations, including a number of universities, offer charitable gift annuities.[697] First, the donor makes a donation to a single charity and enters into an agreement with the charity to provide a lifetime annuity payment to one or more "annuitants" for life.[698] Typically, the annuitants are the donor, or the donor and the donor's spouse.[699] The charity may set the gift aside in a reserve account in which it invests.[700] Based on the age of the annuitant at the time of the gift and prevailing interest rates, the annuitant receives a fixed monthly, quarterly, or annual payout for the rest of the annuitant's life.[701] Unlike a CRT, the charity does not need to wait for the annuitant to die before receiving the donated property.[702] It does, however, take on the obligation to pay the annuity.[703] Charitable gift annuities are typically established by individuals or couples, who are typically the annuitants.[704] Depending on the charity, the annuity can be funded with cash donations, but it may also be funded with gifts of securities or other assets.[705] Minimum gifts for establishing a charitable gift annuity may be as low as $5,000 but are often much higher.[706] In addition to obtaining an income stream for life, the donor may also be eligible to take an income and gift tax charitable deduction at the time of the original gift based on the estimated amount that will eventually go to the charity after all the annuity payments have been made.[707] A portion of the annuitant's payment is typically income tax-free for a period of time based on the annuitant's actuarial life expectancy.[708]

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697. Timothy L. Horner & Hugh H. Makens, *Securities Regulation of Fundraising Activities of Religious and Other Nonprofit Organizations*, 27 STETSON L. REV. 473, 474 (1997).

698. Michael Sander, *Are Charitable Gift Annuities Subject to Rescission Under Ohio's Insurance Law?*, 13 OHIO PROB. L.J. 91A (2003).

699. *See Charitable Gift Annuities*, ENDOWMENT DEV. SERVS., https://www.endowdevelop.com/etech_pal/Content/charitable_gift_annuities/charitable_gift_annuities.htm (last visited Feb. 13, 2023) [https://perma.cc/4KBD-WYC9].

700. *See About Gift Annuities*, AM. COUNCIL ON GIFT ANNUITIES, https://www.acga-web.org/about-gift-annuities (last visited Feb. 13, 2023) [https://perma.cc/EY3W-H2T4].

701. *See* I.R.C. § 72(c)(3); *Current Gift Annuity Rates*, AM. COUNCIL ON GIFT ANNUITIES, https://www.acga-web.org/current-gift-annuity-rates (last updated Jan. 2, 2023) [https://perma.cc/29QS-R8FU].

702. *See* Treas. Reg. § 1.664–4(a)(5) (2019); Ken Dike, *Ask the Expert: Charitable Gift Annuities and Charitable Remainder Trusts*, JEWISH FAM. & CHILD.'S SERVS. (June 9, 2021), https://www.jfcs.org/ask-the-expert-charitable-gift-annuities-and-charitable-remainder-trusts/ [https://perma.cc/DMZ5-VRPX].

703. *See What is a charitable gift annuity?*, FIDELITY CHARITABLE, https://www.fidelitycharitable.org/guidance/philanthropy/charitable-gift-annuity.html (last visited Feb. 13, 2023) [https://perma.cc/2K55-EL4P]; Alexander Drapatsky, *Charitable Gift Annuities: An Especially Attractive Alternative*, AM. BAR ASS'N. 1, 1–2, https://www.americanbar.org/content/dam/aba/publishing/aba_tax_times/02spr/06-drapatsky.pdf (last visited Feb. 13, 2023) [https://perma.cc/U9MP-5QR5].

704. *See What is a charitable gift annuity?*, *supra* note 703.

705. *See id.*

706. *See id.*

707. *See id.*

708. *See id.*

Example 5: Angie and Arthur, both age sixty-seven, have a portfolio of appreciated publicly traded stocks worth $500,000, with a cost basis of $300,000.[709] The portfolio typically generates about a 4% return—$20,000 per year—but the return is subject to market fluctuations and is fully taxable to Angie and Arthur.[710] Angie and Arthur plan to retire next year, so they expect that their income tax bracket will be lower in future years.[711] They are grateful to Mega University of the West (MUW), which provided them each with an education, and they would like to leave funds to MUW as part of their estate plan.[712] Instead of leaving MUW a bequest in their wills, Angie and Arthur decide to enter into a charitable gift annuity agreement with MUW.[713] Based on current returns and Angie and Arthur's ages, in exchange for their contribution, MUW will pay Angie and Arthur a fixed annuity of 4% per year for their joint lifetimes—$20,000 per year.[714] Not only will they continue to receive a comparable return on their investment but the return will not vary with the market, not be entirely taxable, will be assured for their joint lifetimes, and will generate a current income tax deduction in the year of the gift, when their tax rate is at its expected peak.[715] Under current rules, about $9,163 of each year's payments will be a tax-free return of basis, $6,109 will be capital gain, and only $4,728 will be ordinary income until 2041 when Angie and Arthur will have recovered their entire basis.[716] Payments received after that date will be taxable as ordinary income.[717] They will also receive an income tax charitable deduction of just over $147,000.[718] If they agree to delay the first payment for a year, however, their annuity would increase to about $20,500, and their charitable deduction would increase to about $159,000.[719]

1. Structure

A donor may make a gift to charity and receive in exchange a contractual agreement to pay one or more persons, often the donor or the

709. Author's original hypothetical.
710. *Id.*
711. *Id.*
712. *Id.*
713. *Id.*
714. *See Actuarial Tables*, IRS, https://www.irs.gov/retirement-plans/actuarial-tables (last updated May 9, 2022) [https://perma.cc/W35T-5N3S]; *About Gift Annuities*, *supra* note 700.
715. *See id.*
716. *See The Pros and Cons Of Charitable Gift Annuities*, LINEWEAVER FIN. GRP., https://www.lineweaver.net/the-pros-and-cons-of-charitable-gift-annuities (last visited Feb. 14, 2023) [https://perma.cc/F56X-WWNF].
717. *See Donor Guide to Gift Annuities*, AM. COUNCIL ON GIFT ANNUITIES, https://www.acga-web.org/donor-guide-to-gift-annuities (last updated June 28, 2022) [https://perma.cc/3EGM-DV4V].
718. *See id.*
719. *See id.*; I.R.C. § 170(c); ENDOWMENT DEV. SERVS., *supra* note 699.

donor's spouse, an annuity for life.[720] Such an arrangement, known as a charitable gift annuity, is similar to a CRAT.[721] However, unlike a CRAT, no trust is involved, and the gifted assets are typically not segregated from the charity's general assets.[722] The donor and the charity simply enter into a contract that spells out the terms of the annuity.[723] The annuity is typically expressed as a fixed percentage of the fair market value of the assets on the date the gift is made.[724] Regardless of how the donated assets appreciate or depreciate, the amount passing to the non-charity beneficiary is fixed.[725] In other words, the charity alone receives the benefits or detriments of appreciation or depreciation of the donated assets.[726] The value of the property donated, less the value of the annuity, is a charitable gift eligible for an income tax charitable deduction and a gift or estate tax charitable deduction.[727]

2. Gift on Formation

If the donor is the annuitant and the annuity is properly structured to be eligible for the gift tax charitable deduction, there is no taxable gift when the annuity contract is entered into.[728] If the donor names someone other than the donor as the annuitant, the present value of the annuity is a taxable gift at the time the contract is entered into.[729] The value of the annuity is ordinarily determined by reference to the IRS tables for annuities.[730] Factors determining the value of the annuity are: (i) the life expectancy of the annuitant; (ii) the amount of the annuity; (iii) the rate of Section 7520; (iv) when the annuity begins; and (v) how often the annuity is payable.[731] With regard to the Section 7520 rate, the donor can elect the rate for the

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720. *See About Gift Annuities*, *supra* note 700.

721. *See* I.R.C. §§ 72(c)(3), 501(c)(3); *Get a tax deduction plus guaranteed income for life with a charitable gift annuity*, SCHWAB CHARITABLE (Aug. 4, 2020), https://www.schwabcharitable.org/maximize-your-impact/develop-a-giving-strategy/align-your-giving-vehicles/charitable-gift-annuity [https://perma.cc/3F64-BDW7].

722. *See* discussion *supra* Section IV.I; Jeff Lyndenberg, *Fixed Payment Life Income Options: The Gift Annuity v. The Charitable Remainder Annuity Trust*, PG CALC (Mar. 15, 2019), https://www.pgcalc.com/support/knowledge-base/pg-calc-featured-articles/fixed-payment-life-income-options-gift-annuity-v [https://perma.cc/PY4P-YCJ4].

723. *See* Lyndenberg, *supra* note 722.

724. *See id.*; *What is a charitable gift annuity?*, *supra* note 703.

725. *See About Gift Annuities*, *supra* note 700.

726. *See id.*

727. *See Support charities and receive lifetime income with a charitable gift annuity*, FID. (Dec. 3, 2021), https://www.fidelity.com/learning-center/personal-finance/charitable-giving/charitable-gift-annuity [https://perma.cc/P5KP-LF93].

728. *See Donor Guide to Gift Annuities*, *supra* note 717.

729. I.R.C. § 2523(f)(6) (noting if the annuitant is or includes the donor's spouse, the gift may qualify for a gift tax marital deduction).

730. *See Actuarial Tables*, *supra* note 714.

731. *See id.*; I.R.C. § 7520(a); *Charitable Gift Annuities*, *supra* note 699.

month of transfer or either of the two months preceding the transfer.[732] Donors wanting to maximize their current charitable deductions will want to choose the highest of those rates to minimize the present value of the annuity.[733] The present value of the charitable remainder interest qualifies for the gift tax charitable deduction.[734] Although the charitable deduction for the issuance of a charitable gift annuity is lower when the Section 7520 rate is low, the amount of each payment excluded from income under Section 72 will be higher.[735] With the higher standard deduction, fewer taxpayers are benefited by itemizing deductions, and a non-itemizer will often care more about how much income is tax free than about the charitable deduction.[736] Those donors will want to elect to use the lowest available Section 7520 rate.[737]

3. Setting the Annuity Rate

A charity that will buy property or accept cash in exchange for a gift annuity is free to bargain for any type of ratio of contribution to sale features.[738] The donor's charitable income tax deduction and the amount of the annuity payment excluded from the donor's income will vary with the agreed upon annuity rate, but there is no limitation on how this rate is chosen as far as the donor is concerned.[739] Commonly, a charity will offer an annuity rate under a gift annuity so as to receive a contribution, the actuarial value of which is at least one half of the value of the property involved.[740] The terms and rates used by most charities are those established by the American Council on Gift Annuities, formerly the Committee on Gift Annuities.[741] The rates set by that organization are determined by market rates of interest and the age of the annuitant.[742] Generally, these rates produce a charitable deduction of 40%–60% of the value of the transferred property.[743] Some charities seek to price charitable gift annuities more aggressively by offering gift-to-sale ratios that are closer to those available with a contribution to a charitable remainder trust.[744] These charities may, for example, offer

732. *See* I.R.C. § 7520(a).
733. *See id.*
734. *Id.* § 2522(c)(2)(A).
735. *Id.* §§ 72, 7520.
736. *See id.* § 2522(c)(2)(A).
737. *See id.* § 7520; *see also* § 2522(c)(2)(A).
738. *See* I.R.C. § 2522.
739. *See id.*; *see also* § 72.
740. *See About Gift Annuities*, *supra* note 700.
741. *See id.*
742. *See* I.R.C. § 72.
743. *See* Drapatsky, *supra* note 703.
744. *See id.*

annuities worth up to 90% of the fair market value of a cash contribution.[745] A donor who is flexible about the particular donee and feels confident about the charity's financial solvency to honor the annuity payment, may choose to negotiate with several charities to seek the most desirable gift-to-sale ratio.[746]

4. Income Tax Issues for the Donor

If a properly structured charitable gift annuity is established during the donor's lifetime, the donor will receive an income tax charitable deduction in the year the annuity is established.[747] The deduction is measured by the value of the property contributed, less the value of the non-charitable annuity.[748] The charitable income tax deduction is computed using a complex calculation taking into account the value of the contributed property, or its basis for capital gain property other than marketable securities, the Section 7520 rate, the assumed rate of growth for the month of the gift or at the donor's option for either of the two preceding months, and the amount of the annuity.[749] The percentage limitation on the donor's income tax deduction for amounts passing to charity varies depending upon whether the charity is a 50% public charity or a 30% charity private foundation.[750] The charity must provide a written statement that informs the donor that the amount of the contribution that is deductible for federal income tax purposes is limited to the excess of the amount of any money and the value of any property other than money contributed by the donor over the value of the goods or services provided by the organization, and must provide the donor with a good faith estimate of the value of the goods or services.[751] When the annuitant receives payments, the annuitant must report a portion of each payment as a return of the donor's basis, as ordinary income, and as capital gain, if appreciated property is given in exchange for the annuity.[752] This approach means that the donor avoids recognition of the entire capital gain in the year of the contribution.[753] In fact, only a portion of the capital gain will ever be recognized.[754] Specifically, the donor's basis must be allocated between the

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745. I.R.C. § 514(c)(5)(A). The charity will want to ensure that value of the annuity exceeds 90% of the value of the contributed property. *Id.*

746. *See Donor Guide to Gift Annuities*, *supra* note 717.

747. *See* Treas. Reg. § 1.170A-1.

748. I.R.C. § 170(f)(10)(D); *see also* Treas. Reg. § 1.170A-1(d)(1) (noting neither the donor nor the donor's estate will receive an income tax charitable deduction if the charitable gift annuity is established as of the donor's death as a testamentary gift.

749. *See* I.R.C. § 7520(a).

750. *See* Abbey M. Magnuson & Jason J. Kohout, *CARES Act Changes to the Charitable Income Tax Deduction*, FOLEY & LARDER LLP (May 11, 2020), https://www.foley.com/en/insights/publications/2020/05/cares-act-changes-charitable-income-tax-deduction [https://perma.cc/BN3V-JT33].

751. I.R.C. § 6115(a).

752. *See* Treas. Reg § 1.1011-2.

753. *See id.*

754. *Charitable Gift Annuities*, *supra* note 699.

gift and sales portions of the transaction.[755] The percentage of the capital gain attributable to the charitable deduction is not recognized.[756] The payments under a charitable gift annuity may start immediately or be deferred for a stated number of years in order to increase the payments to the annuitant once they begin.[757] The allocation of the payments received on a deferred annuity between ordinary income and capital gains is somewhat different from that of payments on an immediate annuity because the present value of the annuity is different.[758] Payments under a deferred annuity will be larger and will usually produce a somewhat greater amount of ordinary annuity income than an immediate charitable gift annuity.[759]

5. Securing the Annuity

Typically, the obligation to pay the annuity is simply a general unsecured obligation of the charity.[760] In those cases, the donor should understand that the certainty of receiving annuity payments is entirely dependent upon the creditworthiness of the charity issuing the annuity.[761] By the same token, the charity takes a risk that the annuitant may outlive life expectancy by a long period, or that investment returns on the contributed assets or other charity investments might under perform.[762] The donor cannot generally collateralize the payment of the annuity with the property contributed.[763]

Section 2522(c)(2) provides when a donor transfers a remainder interest in property to a charitable organization and has retained an interest in the same property, no gift tax charitable deduction is allowed for the interest passing to charity unless it is in a qualified form: CRAT, CRUT, or a pooled

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755. *See id.*

756. Treas. Reg. § 1.1011-2(a)(4). If a donor transfers property to a charity that is subject to indebtedness, the donor must include the amount of the indebtedness in the amount realized for purposes of determining the donor's gain on the transaction, even if the charity does not agree to assume or pay the indebtedness. Treas. Reg. § 1.1011-2(a)(3). Moreover, a client cannot undertake a tax-free rollover or a Section 1035 exchange of a commercial annuity for a charitable gift annuity without recognizing gain on the transfer of the commercial annuity. I.R.C. § 1035. Although Code Section 1035(a)(3) provides that like-kind exchange can be made with an annuity contract for another annuity contract, that section applies only the exchange of one commercial annuity contract for another. *Id.*

757. *See, e.g.*, I.R.S. Priv. Ltr. Rul. 200449033 (Dec. 3, 2004); I.R.S. Priv. Ltr. Rul. 9743054 (Aug. 1, 1991).

758. *See* John Egan, *Immediate vs Deferred Annuity: What's The Difference?,* FORBES (Nov. 22, 2023 3:03 pm), https://www.forbes.com/advisor/retirement/immediate-vs-deferred-annuity/ [https://perma.cc/R3HU-727S].

759. *See id.*

760. *See What is a charitable gift annuity?*, *supra* note 703.

761. Shawn Plummer, *The Charitable Gift Annuity*, ANNUITY EXPERT, https://www.annuityexpertadvice.com/charitable-gift-annuity/ (last visited Feb. 15, 2023) [https://perma.cc/UM2Z-RFCJ].

762. *Gift Annuity Risk Analysis Options*, PG CALC. 1, 1 https://www.pgcalc.com/pdf/featured-article-july-2013.pdf (last visited Feb. 15, 2023) [https://perma.cc/GP7G-LF2U].

763. *See* I.R.C. § 2522(c)(2).

income fund.[764] However, so long as the annuity is payable from the general assets of the charity and not from the assets transferred, the IRS has ruled that the donor has not retained an interest in the transferred property, and the donor will receive a gift tax charitable deduction for the value of the property transferred less the present value of the annuity received.[765] When charities receive donations to fund charitable gift annuities, the vast majority simply invest the proceeds in a balanced investment portfolio of stocks, bonds, and cash allocated similarly to their endowment.[766]

It is possible for charities, and to some extent donors, to put off the financial and actuarial risks associated with a charitable gift annuity by having the charity acquire a commercial annuity from a highly rated insurance company, sometimes called "reinsuring" the gift annuity liability.[767] Reinsurance is typically done by the charity's purchase of a commercial single premium immediate annuity.[768] A fully reinsured life-only immediate annuity pays the charity an amount equal to the contractual gift annuity payment as long as the annuitant is alive.[769] As a result, both the investment and longevity risks are transferred to the life insurance company issuing the commercial annuity.[770] However, the commercial annuity is paid to charity, which may have other obligations to pay, and not directly to the annuitant, so the annuity payment itself is not fully guaranteed.[771]

6. Income Tax Issues for Non-Charity Beneficiaries

Unlike a CLAT, distributions to non-charity beneficiaries do not depend upon post-gift income earned from the contributed assets, nor do they depend upon the character of that income in the hands of the charity.[772] Rather, the tax treatment of annuity distributions are fixed at the time the annuity is entered into, based upon a modified application of the annuity rules under Section 72.[773] For example:

> If a donor makes a gift of cash to fund a gift annuity, a portion of each distribution from the annuity is taxed as ordinary income and a portion of

764. *Id.*
765. Rev. Rul. 80-281, 1980-2 C.B. 282.
766. Frank Minton, *Maximizing the Benefits From Your Gift Annuity Program*, NAT'L CONF. ON PLANNED GIVING 113, 116 (Oct. 23, 2003), https://www.pgdc.com/files/ncpgpdf/Maximizing_the_Benefits_from_Your_Gift_Annuity_Program.pdf [https://perma.cc/TU89-UE2S].
767. *Managing the Financial Liability of a Charitable Gift Annuity Program*, AM. COUNCIL ON GIFT ANNUITIES 1, 8 (Apr. 2015), https://www.pgcalc.com/sites/default/files/ACGA%20Managing%20liability%20in%20a%20CGA%20program%20-%204.2015.pdf [https://perma.cc/2AYV-VD9U].
768. *Id.*
769. *Id.*
770. *Id.*
771. *See* I.R.S. Priv. Ltr. Rul. 200884014 (Apr. 22, 2002).
772. *See* discussion *supra* Section IV.H.8.
773. I.R.C. § 72.

> the annuity is a tax-free return of principal. The division of the interests in the annuity between the charitable and non-charitable interests is critical in determining how the annuity will be taxed.[774]

For purposes of making the computation, the investment in contract is the amount of consideration paid for the annuity.[775] The charitable deduction represents the value of the contributed property less the present value of the annuity, and "the share of the annuity which funds each of these present values dictates how the annuity is taxed."[776] In general, a three-step approach is used:

> Calculate the life expectancy of the single annuitant or the joint life expectancy of the two annuitants. This life expectancy is also the number of full annuity payments the gift annuity is expected to make during its term without taking into account the payment frequency. In gift annuity circles, this value is called the expected return multiple. . . .[c]alculate the expected return to be paid. This is the total face value of all the annuity payments expected to be made during the annuity term. This total equals the annuity amount multiplied by the expected return multiple. . . .[c]alculate the exclusion ratio, which is the fraction of each annuity payment that is considered excluded income rather than ordinary income. The exclusion ratio equals the investment in contract divided by the expected return. The exclusion ratio is merely spreading out the return of the dollars used to buy the annuity (investment in contract) over the annuitant's life expectancy.[777]

If the annuity is funded with cash, the principal is considered a non-taxable return of basis, and the rest of the annuity is taxed at ordinary income tax rates.[778] If a donor uses appreciated property to purchase the gift annuity, the portion of the gift constituting capital gain must be realized.[779] The donor is required to report the capital gain in the year the gift is given if the donor is not the primary annuitant.[780] However, it is common for the donor to be the primary annuitant, in which case the donor may recognize gain over the donor's life expectancy, instead of the year the gift was given.[781] To receive this treatment, the donor must be the only annuitant or the donor and a designated survivor annuitant must be the only annuitants, and the annuity

774. *Unlocking the Mystery of the Taxation of Charitable Gift Annuity Payments: Part III*, PG CALC (Jan. 7, 2014), https://www.pgcalc.com/support/knowledge-base/charitable-gift-annuity/unlocking-mystery-taxation-charitable-gift-annuity [https://perma.cc/6UNN-42CD].
775. *Id.*
776. *Id.*
777. *Id.*
778. *Id.*
779. *Id.*
780. *Id.*
781. *Id.*

must not be assignable except to the charity.[782] In that event, the donor's basis is allocated between the investment in contract and the charitable gift, which is the deduction.[783] The donor must recognize "the amount of capital gain that bears the same ratio to the donor's total gain in the funding asset as the investment in contract bears to the fair market value of the property."[784] The total reportable gain is a percentage of the investment and equals the amount of gain from the funding asset.[785] One must then take this percentage and multiply it "by the excluded portion of each year's annuity payment" to establish the capital gain for the year.[786] Once the entire capital gain has been recognized, the capital gain portion then becomes tax-free income until the donor's entire basis in the contributed property is recovered.[787] Any amounts received after the expiration of the life expectancy of the annuitant(s) are taxed as ordinary income.[788] If all the annuitants die, or the annuity is assigned to the charity, before all of the investment in the contract is recovered, a deduction is allowed to the annuitant on their final income tax return.[789] In addition, if the annuitant dies before the entire capital gain has been reported, then the unreported gain is not taxed.[790] However, if the donor dies before the entire amount of gain has been reported, a surviving annuitant must continue to report gain until all the gain has been reported.[791] In most cases, in determining the period over which gain may be reported, the life expectancy of the survivor annuitant may not be taken into account.[792] For gifts of joint or community property in which the annuity is paid to both donors and then to the survivor because both annuitants are donors, presumably the gain may be recognized proportionally over the joint life expectancy of the two donors.[793]

7. Tax Issues for the Charity

While there are no set federal rules for structuring charitable gift annuities from the donor's standpoint, if a charity acquires property in exchange for debt, then, subject to certain exceptions, the income earned from that debt-financed property, including gains recognized on its sale, constitutes "unrelated business taxable income," which is taxed to the

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782. *Id.*
783. *Id.*
784. *Id.*
785. *Id.*
786. *Id.*
787. *Id.*
788. *Id.*
789. I.R.C. § 72(b)(2).
790. *Id.*
791. Treas. Reg. § 1011-2(a)(4)(iii).
792. *Id.* § 1011-2(a)(4)(ii).
793. *Id.* § 1011-2(a)(4)

otherwise tax-exempt charity.[794] Fortunately, the Code provides an exception for charitable gift annuities.[795] To come within the safe harbor for this arrangement, however, the arrangement must meet five requirements: (i) the annuity paid to the annuitant(s) must be the only consideration given for the gift; (ii) the value of the annuity must be less than 90% of the value of the gift; (iii) the annuity must be payable over the lifetime of one or two persons who are living at the time that the annuity is issued; (iv) the annuity agreement cannot guarantee a minimum amount of payments or specify a maximum amount of payments; and (v) the payments cannot be adjusted by reference to the amount of income earned from the contributed property.[796] As a result, charitable gift annuities are virtually always structured to comply with these rules.[797] Because a charitable deduction is involved, the donor can elect to use a Section 7520 rate from one of the preceding two months, but that election may not be binding for purposes of the 10% test as applied to the charity because the test is performed "at the time of the exchange" of property for the gift annuity.[798] When interest rates are low, some gift annuities for younger annuitants, even those issued at American Council on Gift Annuities (ACGA) recommended rates, may not pass the 90% test.[799]

The ACGA reports that the rates that became effective on July 1, 2020, will result in a charitable deduction of more than 10% if the Section 7520 rate is 0.6% or higher, whatever the payment frequency.[800] If the Section 7520 rate is less than 0.6%, the deduction will be less than 10% when annuitants are below certain ages.[801] For example, the current recommended gift annuity rate for a joint and survivor annuity for two persons aged sixty is 3.6%. Using quarterly payments and applying, for example, the November 2020 Section 7520 rate of 0.4%, the actuarial value of the charitable remainder was only 7.8%.[802] The March 2022 AFR of 2% produces an actuarial value for such taxpayers of 25.877%.[803] It is important for the charity to make certain that gift annuities issued to younger annuitants be adjusted so that the actuarial value of the remainder is more than 10%.[804]

794. I.R.C. § 513.
795. *See id.*
796. *See id.* § 514(c)(5); Treas. Reg. § 1.514(c)-1(e)(1).
797. *See* I.R.C. § 514(c)(5); *see also* Treas. Reg. § 1.514(c)-1(e)(1).
798. *See* I.R.C. § 7520.
799. *See id.* § 514(c)(5); *see also Current Gift Annuity Rates*, *supra* note 701.
800. *Current Gift Annuity Rates*, *supra* note 701.
801. *Id.*
802. *See* I.R.C. § 7520.
803. *See id.*
804. *See id.* § 514(c)(5).

8. Benefit to Heirs

If the donor retains the annuity, then there is no direct benefit from the charitable gift annuity to the donor's family.[805] At the end of the annuity term, the annuity simply ends, and the donated assets belong to the charity.[806] That means that the children or other non-charity estate beneficiaries will receive less from the donor than if the property donated in exchange for the annuity was not otherwise earmarked for charity.[807] However, if the donor has a taxable estate, the loss to the non-charity beneficiaries is only 60% of the value of the property, using the current estate tax rate of 40%.[808] As with a CRT, if the donor wishes to minimize this loss, the donor might consider using some or all of the income tax savings that result from creation of the charitable gift annuity to fund a life insurance policy, perhaps owned by an irrevocable life insurance trust, to restore the wealth that would otherwise pass to those beneficiaries.[809] Of course, if the non-charity beneficiaries of the charitable gift annuity are family members or other loved ones, those beneficiaries receive a direct benefit in the form of the annuity payments made to them.[810]

9. Estate Tax Issues

If the charitable gift annuity is created at the death of the donor, the value of the contributed property, less the actuarial value of the annuity, qualifies for a federal estate tax charitable deduction.[811] Analogous to the gift tax rule, the limitations on split-interest gifts under Section 2055(e)(2) do not apply to charitable gift annuities because there is no split gift.[812] The annuitants retain no interest in the contributed property.[813] The contribution is simply offset by the value of the consideration paid—the present value of the annuity.[814]

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805. *See* Arielle M. Prangner, *Implications of Termination of Grantor Trust Status*, 13 EST. PLAN. & COM. PROP. L. J. 443, 456 (2021).

806. *See id.*

807. *See* Jeanne L. Newlon, *Developments Involving Grantor Trusts*, 16 ALI-ABA EST. PLAN. COURSE MATERIALS J. 27, 53 (2010).

808. *See* I.R.C. § 2001.

809. *See id.*

810. *See id.*

811. *See id.* § 2055(e)(2).

812. *See id.* § 170(f)(3)(A).

813. *See id.*

814. *See How do the estate, gifts, and generation-skipping transfer taxes work?*, TAX POL'Y CTR. 1, 1–3, https://www.taxpolicycenter.org/sites/default/files/briefing-book/4.11.1-how_do_the_estate_gift_and_generation-skipping_transfer_taxes_work_0.pdf (last visited Feb. 23, 2023) [https://perma.cc/R2JT-ANDP].

10. GST Tax Issues

A transfer to a charity in exchange for a charitable gift annuity may give rise to a taxable gift, or if occurring at death, is a taxable transfer to the extent of the actuarial value of the annuity if the annuitant is someone other than the donor.[815] If the annuitant is not a skip persons for GST tax purposes, the transfer is not a GST.[816] However, if the annuitant is a grandchild or other skip person, the donor or decedent will have made a GST at the time of the annuity agreement based upon the present value of the annuity.[817] Factors mitigating against payment of GST tax include the fact that with interest rates very low, few charitable gift annuities pass the 10% test desired by the charity if the annuitants are very young.[818] In addition, the transferor can always allocate available GST tax exemptions to the transfer.[819]

11. Funding a Charitable Gift Annuity with an IRA

As part of its 2019 year-end funding legislation, Congress adopted the SECURE Act.[820] The SECURE Act generally requires persons dying after 2019, who name a non-spouse Designated Beneficiary, to distribute the entire plan or account to the beneficiary on or before the last day of the year containing the tenth anniversary of the account owner's death.[821] "Stretch IRAs" were thus eliminated for most Designated Beneficiaries.[822] A possible way to continue a long-term payout to a beneficiary may involve using the IRA to fund a charitable gift annuity at the death of the IRA owner.[823] In Private Letter Ruling 200230018, a taxpayer proposed to enter into an agreement with a qualified charity providing the taxpayer would name the charity as the sole beneficiary of his IRA.[824] In exchange, the charity agrees

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815. *See* Kim Borwick, *Generation-Skipping Trust*, ANNUITY.ORG (Dec. 22, 2022), https://www.annuity.org/retirement/estate-planning/generation-skipping-trust/ [https://perma.cc/PZN3-EAVR].

816. *See id.*

817. *Current Gift Annuity Rates*, *supra* note 701.

818. *See Generation-skipping tax: How it can affect your estate plan*, U.S. WEALTH MGMT., https://www.usbank.com/wealth-management/financial-perspectives/trust-and-estate-lanning/generation-skipping-tax-affect-on-estate-plan.html (last visited Feb. 23, 2023) [https://perma.cc/RDE4-YNA6].

819. *See* I.R.C. § 401(a)(9)(H)(iii).

820. Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019, Pub. L. No. 116-94, 133 Stat. 3137, 3137 (2019).

821. *See* Daniel Gilham, *Eliminating the Stretch IRA Was a Mistake—Here's How We Move On*, BLOOMBERG TAX (Nov. 2, 2022 3:46 A.M.), https://news.bloombergtax.com/tax-insights-and-commentary/eliminating-the-stretch-ira-was-a-mistake-heres-how-we-move-on [https://perma.cc/PHZ6=275D].

822. *See id.*

823. Kenneth H. Dike, *Goodbye to the Stretch-IRA and Hello to Testamentary Charitable Gift Annuities and Testamentary Charitable Remainder Trust*, CLIFFORD SWAN (Nov. 17, 2020), https://www.cliffordswan.com/blog/goodbye-to-the-stretch-ira-and-hello-to-testamentary-charitable-gift-annuities-and-testamentary-charitable-remainder-trusts [https://perma.cc/99D6-JPY2].

824. I.R.S. Priv. Ltr. Rul. 200230018 (Jul. 26, 2002).

to pay a third party an annuity over the life expectancy of the third party, beginning upon the death of the IRA owner.[825] The IRS noted that the IRA would be fully includable in the IRA owner's estate for federal estate tax purposes, but the owner's estate would receive a federal estate tax charitable deduction equal to the value of the IRA less the actuarial value of the annuity to be paid to the third party as of the IRA owner's date of death.[826]

K. CRTs and Retirement Plan Benefits

Persons who are owners and beneficiaries of IRAs and qualified retirement plans are generally subject to rules that require them to take minimum required distributions after attaining age seventy-two.[827] When IRA or retirement account owners die, their beneficiaries must also take minimum required distributions.[828] For persons dying before 2020 having a child, other individual, or certain qualifying trusts as a beneficiary, known as a Designated Beneficiary, the beneficiary was permitted to take distributions from the retirement plan or account beginning the year following the account owner's death over the life expectancy of the Designated Beneficiary.[829] Designated Beneficiaries who rolled inherited retirement funds into an inherited IRA could thus postpone or stretch the period over which distributions were taxed for their life expectancy.[830] The effect of the changes made in the SECURE Act is to limit tax-free growth and accelerate the income taxation of retirement plan benefits after the participant's death because the beneficiary must generally include the amount of each distribution into income taxed at ordinary income rates.[831] In those states in which inherited IRAs are exempt from attachment by the beneficiary's creditors, the SECURE Act may also greatly reduce the period of time during which such assets remain exempt from attachment by creditors.[832]

A trust for individuals can qualify as a Designated Beneficiary so long as the trust satisfies a number of technical requirements.[833] Broadly speaking, qualifying trusts come in two categories, both of which are sometimes referred to as "see-through" trusts because they qualify for Designated Beneficiary status based upon looking through the trust to identify the

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825. *Id.*
826. *Id.*
827. *IRS reminds those over age 72 to start withdrawals from IRAs and retirement plans to avoid penalties*, IRS (Dec. 12, 2022), https://www.irs.gov/newsroom/irs-reminds-those-over-age-72-to-start-withdrawals-from-iras-and-retirement-plans-to-avoid-penalties [https://perma.cc/SXMQ-JDK4].
828. *Id.*
829. *See* I.R.C. § 401(a)(9) (detailing special rules for beneficiaries who are the spouse of the account owner and beneficiaries who have no life expectancy).
830. *See* Gilham, *supra* note 821.
831. Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019, Pub. L. No. 116-94, 133 Stat. 3137, 3137 (2019).
832. *Id.*
833. Gilham, *supra* note 821.

ultimate individual beneficiaries.[834] These two categories of see-through trusts are often referred to as (i) "conduit trusts," from which all amounts distributed from qualified plans are immediately distributed to one or more individuals; and (ii) "accumulation trusts," which may accumulate retirement distributions, so long as all of those distributions are ultimately distributable to one or more identifiable individuals.[835] Prior to the SECURE Act, amounts payable to a conduit trust were required to be distributed from the account to the trustee and immediately thereafter to the conduit beneficiary based upon the life expectancy of the conduit beneficiary.[836] Amounts payable to an accumulation trust were required to be distributed from the account to the trustee over the life expectancy of the oldest identifiable individual beneficiary, but the trustee could thereafter pay or accumulate those funds as the trust instrument provided.[837] After the SECURE Act, life expectancies of individual beneficiaries may still be relevant for beneficiaries of participants who die after their required beginning date, but the ten-year rule will generally limit this benefit.[838] While the account owner's spouse and minor children, and certain disabled or chronically ill beneficiaries, may qualify for longer payouts, in most other cases, all amounts will be required to be distributed by the end of the year containing the tenth anniversary of the employee's death.[839]

Under the SECURE Act, a conduit trust provides few benefits.[840] In most cases, retirement assets must be withdrawn by the trustee under the ten-year rule, and will be immediately paid out of the conduit trust to the beneficiary as received.[841] Accumulation trusts might still be used because even when retirement funds are required to be paid from the account to the trustee within ten years of the account owner's death, those retirement

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834. *Id.*

835. *See* Treas. Reg. § 1.409(a)(9)-4 (proposing new regulations for designated beneficiaries of participants who die after their required beginning date).

836. *See 50 State Inherited IRA Chart*, AM. COLL. TR. & EST. COUNSEL (Sept. 2018), https://www.actec.org/assets/1/6/50_STATE_INHERITED_IRA_CHART.pdf?hssc=1 (detailing that as of 2018, 24 states exempted inherited IRAs from attachment by beneficiaries' creditors) [https://perma.cc/CA6D-T7LB].

837. *See* Kim D. Garcia, *Trust as IRA Beneficiaries—Planning Issues Post SECURE Act*, DIVERSIFIED TR. (Nov. 15, 2021), https://diversifiedtrust.com/blog/trust-as-ira-beneficiaries-are-they-compatible/ (providing helpful background information on designated beneficiaries) [https://perma.cc/K9WD-E27C].

838. *See How the SECURE Act Impacts IRAs Left to a Trust*, FIDELITY (Dec. 5, 2022), https://www.fidelity.com/viewpoints/wealth-management/insights/iras-left-to-a-trust#:~:text=There%20are%204%20requirements%20to,to%20be%20designated%20beneficiaries%20themselves (detailing the requirements of a see-through trust) [https://perma.cc/UCE8-5VS5].

839. *Id.*

840. Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019, Pub. L. No. 116-94, 133 Stat. 3137, 3176 (2019).

841. *Id.*

distributions may thereafter be accumulated in the trust.[842] The trustee can then generally exercise discretion as to the timing of distributions.[843] In the meantime, the trust's assets will continue to obtain creditor protections for the trust's beneficiaries.[844] But the faster payout requirements that the SECURE Act imposes will almost certainly subject any benefits that are accumulated by an accumulation trust to very high income tax rates.[845] Complex trusts pay federal income tax at the top rate on retained income in excess of $13,450, while single beneficiaries do not reach the top income tax bracket until their taxable income exceeds $539,900, both using 2022 tax brackets.[846]

A CRT, if named as a beneficiary of a client's IRA or qualified retirement plan, may in large measure circumvent the effects of the SECURE Act.[847] First, CRTs are exempt from income tax.[848] As a result, payment of the retirement benefits to the trustee of the CRT will not result in immediate income taxation of the retirement plan benefits.[849] Instead, as with a stretch IRA, the benefits will be taxed only when distributed from the CRT to the beneficiary, which may be over the beneficiary's life expectancy or over a period not to exceed twenty years.[850]

Second, the income earned as a result of the CRT's investment of retirement funds and other trust assets will likewise not be taxed currently, but instead, as with a stretch IRA, will be taxed only when distributed to the beneficiary.[851]

Third, unlike a conduit trust that must distribute retirement funds immediately, a CRT can withdraw the funds from the plan or account to the CRT at any time during the five years following the account owner's death.[852] Those funds can then be accumulated in the CRT, subject only to the CRT payout requirements.[853] If the CRT is structured as a NIMCRUT,

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842. *See generally* Steven Hartnett, *Conduit or Accumulation Trust*, AM. ACAD. EST. PLAN. ATT'Y, https://www.aaepa.com/2016/01/9893-2/ (last visited Feb. 14, 2023) (weighing the benefits of conduit trusts and accumulation trusts) [https://perma.cc/BRV4-H4AA].

843. *Id.*

844. Madalyn Davis, *The SECURE Act: Accumulation Trusts*, GRISSOM LAW, LLC (Jan. 14, 2020), https://grissomlawfirm.com/secure-act-accumulation-trust/ [https://perma.cc/3PRM-NYTT].

845. *Id.*

846. *How the SECURE Act Impacts IRAs Left to a Trust, supra* note 838.

847. Davis, *supra* note 844.

848. Julie Garber, *Estate and Trust Tax Rates and Reporting Rules for Tax Year 2022*, BALANCE (Jan. 27, 2023), https://www.thebalancemoney.com/2020-income-tax-brackets-estates-and-trusts-3504855 [https://perma.cc/TXA5-EUT5].

849. *Charitable Remainder Trust as a Beneficiary of IRA*, BURNER L. GRP., P.C. (Feb. 3, 2021), https://burnerlaw.com/charitable-remainder-trust-as-beneficiary-of-ira/ [https://perma.cc/JLX6-TXB7].

850. *Id.*

851. *Id.*

852. *Id.*

853. *Charitable Remainder Trust*, IRS, https://www.irs.gov/charities-non-profits/charitable-remainder-trust (last visited Feb. 13, 2022) [https://perma.cc/88RB-4TEG].

distributions would not be required until the trust earned net fiduciary accounting income.[854]

Finally, the assets accumulated in the CRT will remain exempt from attachment by creditors of the CRT's non-charity and charity beneficiaries, so long as the CRT has customary spendthrift protections.[855] As an added benefit, for clients with taxable estates, the actuarial value of the charity's remainder interest in the CRT qualifies for the federal estate tax deduction.[856] These benefits make naming a CRT as a beneficiary of retirement plans and IRAs compelling, especially for clients whose estate plans seek to benefit charities.[857]

Why aren't more people using a CRT as a beneficiary of retirement plans and accounts?[858] The benefits outlined above come with a number of limitations and disadvantages.[859] First, not all clients are interested in benefitting charity, and the charity's interest in the CRT cannot be immaterial.[860] The charity's interest must be at least 10% of the value of the trust's assets as of its inception, valued by applying actuarial principles.[861]

Second, paying funds into an accumulation trust permits the trustee to exercise discretion over the amount and timing of distributions of trust income and principal to its beneficiaries and permits the trustee to sprinkle distributions among multiple beneficiaries if the trust so provides.[862] A CRT, on the other hand, in most cases requires the trustee to make annual payments to the beneficiary without regard to such factors as the beneficiary's need for distributions, tax situation, creditor exposure, or marital stability.[863]

Third, a CRT must meet two mathematical tests that essentially prevent trusts for some beneficiaries from ever qualifying as a CRT.[864] In particular, the payout to a trust beneficiary must be at least 5% per year.[865] In addition, the charity's actuarial interest in the CRT must be at least 10%.[866] With the

854. *NIMCRUT: What Is It and How Does It Work?*, VALURLIBR., https://learn.valur.io/nimcrut/ (last visited Feb. 13, 2022) [https://perma.cc/9NJJ-6YNJ].

855. *See Understanding Charitable Remainder Trusts*, EST. PLAN. (Nov. 25, 2020), https://www.estateplanning.com/understanding-charitable-remainder-trusts [https://perma.cc/W67M-3CP9].

856. I.R.C. § 2055(e)(2)(A); *see* I.R.S. Priv. Ltr. Rul. 199901023 (Oct. 28, 2998) (explaining the I.R.S. has taken the somewhat dubious position that if the non-charitable portion of the transfer to the CRT generates estate tax, the I.R.S. deduction for estate taxes provided under Section 691(c)(1)(A) of the Code is not available to offset the taxable income reported by the CRT beneficiaries).

857. EST. PLAN., *supra* note 855.

858. *See* discussion *supra* Section IV.K.

859. *See* discussion *supra* Section IV.J–K.

860. *See Charitable Remainder Trust*, *supra* note 853.

861. *See id.*

862. *Accumulation Trust*, LEGAL INFO. INSTI., https://www.law.cornell.edu/wex/accumulation_trust#:~:text=Accumulation%20trust%20is%20a%20type,withdrawing%20all%20of%20the%20assets (last visited Feb. 12, 2022) [https://perma.cc/PD6T-R2TD].

863. *See* IRS, *supra* note 853.

864. *See id.*

865. *See id.*

866. *See id.*

March 2022 Section 7520 rate at 2.0%, if the intended beneficiary is younger than twenty-seven years of age at the trust's inception, the trust cannot meet both the 5% payout test and the 10% remainder interest test; and for a twenty-seven year old, a 5% CRUT meets the 10% test only by having the payout begin a full twelve months after the trust is funded.[867] A CRUT with a fixed term of twenty years must offer an 11.093% payout without violating the 10% test.[868] In general, for CRUTs lasting the beneficiary's lifetime, the older the beneficiary, the higher the percentage payout may be.[869] For example, if the beneficiary has attained the age of fifty at the inception of the CRUT, a 9.84% unitrust payout can be provided without violating the 10% remainder test—nearly the same maximum percentage for a twenty-year term CRUT.[870]

Finally, if the beneficiary dies early, the remaining funds in the CRT pass to charity early.[871] For example, a client might set up three separate CRTs for his children in their thirties.[872] If one of the children survives the client but dies shortly thereafter, the remaining trust assets will pass immediately to charity.[873] The trust could not meet the 10% remainder interest test if it was designed to continue for the children's children, or in many cases, the client's other children.[874] Using rates in effect in March 2022, a three-life CRUT might work if all beneficiaries were over age forty; a two-life CRUT with a 5% payout could satisfy the test for two beneficiaries who are, say, thirty-eight and forty.[875] While the limitations set out above might serve as an impediment to some clients, using a CRT as a retirement plan beneficiary may be well suited for the right client.[876]

V. CONCLUSION

Charitable giving forms an important part of many clients' estate plans.[877] However, most clients do not know the myriad of estate planning tools available to assist them in achieving their charitable objectives.[878] The rules for obtaining a federal income tax deduction for gifts to charity can be

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867. I.R.C § 7520.
868. *Id.*
869. Matthew D. Blattmachr et al., *Using a Charitable Remainder Trust as the Recipient of Qualified Plan and IRA Interests*, MIDATLANTICFELLOW 1, 14 (2020), https://midatlanticfellowsinstitute.org/wp-content/uploads/2020/08/Using-a-Charitable-Remainder-Trust-as-the-Recipient-of-Qualified-Plan-and-IRA-Interests.pdf [https://perma.cc/YHY2-E7U3].
870. *See id.* at 15.
871. *See id.* at 8.
872. *See id.* at 1.
873. *See* I.R.C § 7520.
874. *See id.*
875. *See id.*
876. *See id.*
877. *See* discussion *supra* Section IV.K.
878. *See* discussion *supra* Part I.

complex for all but the simplest gifts of cash to charity.[879] Having a working knowledge of the charitable contribution rules, as well as a level of comfort with and ability to identify and explain various charitable planning tools, can greatly facilitate an advisor's ability to assist clients in achieving their objectives in the most tax-advantaged fashion.[880] This Article serves as a resource both to understand the basic income and transfer tax issues associated with charitable giving and to describe some common charitable giving techniques to give estate planners some familiarity with their use.[881]

879. *See* discussion *supra* Part II.
880. *See* discussion *supra* Part II.
881. *See* discussion *supra* Part IV.

Exhibit A
Historical Estate & Gift Tax Exclusion and GST Tax Exemption Amounts & Top Tax Rates (1916-2022)[882]

Year	Estate Tax Exclusion	Gift Tax Exclusion	Gift Tax Annual Exclusion	GST Tax Exemption	Top Estate/ GST	Top Gift Tax Rate
1916	$50,000	No Gift	None	No GST Tax	10%	0%
1917	$50,000	No Gift	None	No GST Tax	25%	0%
1924	$50,000	$50,000	$500	No GST Tax	40%	25%
1926	$100,000	No Gift	None	No GST Tax	20%	0%
1932	$50,000	$50,000	$5,000	No GST Tax	45%	34%
1934	$50,000	$50,000	$5,000	No GST Tax	60%	45%
1935	$40,000	$40,000	$5,000	No GST Tax	70%	53%
1938	$40,000	$40,000	$4,000	No GST Tax	70%	53%
1941	$40,000	$40,000	$4,000	No GST Tax	77%	58%
1942	$60,000	$30,000	$3,000	No GST Tax	77%	58%
1977	$120,000	$120,000	$3,000	1st GST Tax	70%	70%
1978	$134,000	$134,000	$3,000	1st GST Tax	70%	70%
1979	$147,000	$147,000	$3,000	1st GST Tax	70%	70%
1980	$161,000	$161,000	$3,000	1st GST Tax	70%	70%
1981	$175,000	$175,000	$3,000	1st GST Tax	70%	70%
1982	$225,000	$225,000	$10,000	1st GST Tax	65%	65%
1983	$275,000	$275,000	$10,000	1st GST Tax	60%	60%
1984	$325,000	$325,000	$10,000	1st GST Tax	55%	55%
1985	$400,000	$400,000	$10,000	1st GST Tax	55%	55%
1986	$500,000	$500,000	$10,000	1st GST Tax	55%	55%
1987	$600,000	$600,000	$10,000	$1,000,000	55%	55%
1998	$625,000	$625,000	$10,000	$1,000,000	55%	55%
1999	$650,000	$650,000	$10,000	$1,000,000	55%	55%
2000	$675,000	$675,000	$10,000	$1,030,000	55%	55%
2001	$675,000	$675,000	$10,000	$1,060,000	55%	55%
2002	$1,000,00	$1,000,00	$11,000	$1,100,000	50%	50%
2003	$1,000,00	$1,000,00	$11,000	$1,120,000	49%	49%
2004	$1,500,00	$1,000,00	$11,000	$1,500,000	48%	48%
2005	$1,500,00	$1,000,00	$11,000	$1,500,000	47%	47%
2006	$2,000,00	$1,000,00	$12,000	$2,000,000	46%	46%
2007	$2,000,00	$1,000,00	$12,000	$2,000,000	45%	45%
2008	$2,000,00	$1,000,00	$12,000	$2,000,000	45%	45%
2009	$3,500,00	$1,000,00	$13,000	$3,500,000	45%	45%
2010	$5,000,00	$1,000,00	$13,000	GST Tax	35%	35%
2011	$5,000,00	$5,000,00	$13,000	$5,000,000	35%	35%
2012	$5,120,00	$5,120,00	$13,000	$5,120,000	35%	35%
2013	$5,250,00	$5,250,00	$14,000	$5,250,000	40%	40%
2014	$5,340,00	$5,340,00	$14,000	$5,340,000	40%	40%
2015	$5,430,00	$5,430,00	$14,000	$5,430,000	40%	40%
2016	$5,450,00	$5,450,00	$14,000	$5,450,000	40%	40%
2017	$5,490,00	$5,490,00	$14,000	$5,490,000	40%	40%
2018	$11,180,0	$11,180,0	$15,000	$11,180,000	40%	40%

882. *See* discussion *supra* Section II.C.

2019	$11,400,0	$11,400,0	$15,000	$11,400,000	40%	40%
2020	$11,580,0	$11,580,0	$15,000	$11,580,000	40%	40%
2021	$11,700,0	$11,700,0	$15,000	$11,700,000	40%	40%
2022	$12,060,0	$12,060,0	$16,000	$12,060,000	40%	40%
2023	$12,920,0	$12,920,0	$17,0001	$12,920,000`	40%	40%

Exhibit B
Comparison of Donor Advised Funds and Private Foundations[883]

Feature	**Donor Advised Fund**	**Private Foundation**
Start-up Time	May be established immediately.	May take several weeks to a few months to draft documents to establish the foundation, file the documents with the State, and apply to the IRS for a tax exemption.
Start-up Costs	None, although the financial service company charges a fee to the donor advised fund.	Legal and accounting fees may be significant to prepare the legal documents and IRS tax exemption applications.
Creating the Fund	Established by the public charity supporting the donor advised fund.	Non-profit corporation or trust must be established.
Tax Exempt Status	Donor advised fund borrows the supporting public charity's tax-exempt status.	Must apply to the IRS to obtain tax exempt status.
Recommended Size	$5,000 or more.	Substantial assets (typically $500,000 +) required to justify cost.
Limitation on Charitable Income Tax Deduction for Cash Gifts and Marketable Securities (Subject to Carryforward for Any Excess Contributions)	50% of adjusted gross income for cash (60% for years 2018 – 2025 for cash only contributions); 30% of adjusted gross income for appreciated stock.	30% of adjusted gross income.
Limitation on Charitable Income Tax Deduction for Gifts of Appreciated Real Estate (Subject to Carryforward for Any Excess Contributions)	Tax deduction available for full fair market value of real property, limited to 30% of adjusted gross income.	Tax deduction for property other than cash and marketable securities limited to lower of cost or fair market value, and limited to 20% of adjusted gross income.
Donor Control	Donor makes grant recommendations, which are typically always followed; however, final decision rests with public charity supporting the donor advised fund. Donor has no control over investments.	Donor retains complete control over investments and grant-making, subject to IRS requirements.
Public Disclosure	No required public disclosure; donor may make anonymous gifts or receive recognition if desired.	Annual tax returns and filings disclosing gifts are open for public inspection.

883. *See* discussion *supra* Section IV.G.1–6.

Annual Distribution Requirements	None.	Must pay out at least 5% of asset value each year for charitable purposes, regardless of annual income.
Annual Taxes	None.	Generally, exempt from income tax, but subject to an excise tax of 1.39% of net investment income, including net capital gains.
Annual Tax Filing	Public charity supporting the donor advised fund files an annual return, which includes the information regarding the donor advised fund.	Must file IRS Form 990-PF. May be required to file IRS Form 4720 and pay excise taxes on certain activities or income.