Estate Planning
Practical Solutions to Common Issues

Strategic Charitable Planning: How should I plan charitable gifts 1) as we approach year-end? 2) Through my estate plan?

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Introduction and Overview

As 2023 winds to a close, many of us may be bombarded with requests to increase charitable giving before year-end. We may be more inclined to donate our time during the holiday season to soup kitchens, clothing drives, and pet shelters. Entreaties for cash donations are likely coming from a Santa on the corner, earnest high school and college students knocking on your door, or, possibly from friends, family and coworkers raising money for causes important to them.

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There could be significant tax advantages to charitable giving but clients likely need guidance to structure their giving strategically. How should practitioners advise charitably-inclined clients as we approach the year-end? What are the benefits and drawbacks of making charitable bequests through an estate plan? What strategies might our clients consider when making lifetime or testamentary charitable contributions? While many of the planning ideas are basic and known to practitioners, such as donating appreciated stock rather than cash, clients continue to be unaware of even these obvious opportunities. Certainly as planning becomes more complex, the likelihood of clients being aware of the opportunities, or being able to implement the planning without professional guidance grows quite small.

Separately, there are several opportunities to integrate charitable planning into estate plans, often beyond some of the obvious steps that are typically thought of. With 2026 coming soon, and the likely significant number of large asset transfers to irrevocable trusts planning for that will entail, practitioners should be alerted to enhancing the charitable giving component of that planning.

Ranked from basic to most sophisticated, the following is a very broad view of the categories available to prospective donors wishing to make charitable contributions:

a. Annual cash donations.
b. In kind donations of appreciated assets.
c. QCDs (qualified charitable distribution) from an IRA to charity.
d. Testamentary bequests and non-charitable trusts (inter-vivos or testamentary) used to make charitable gifts.
e. Charitable Annuities.
f. Charitable trusts (i.e. charitable remainder trusts, charitable lead trusts).

There is a myriad of ways clients can better accomplish their charitable goals (e.g., using donor agreements, permitting charities to be added to non-charitable trusts, etc.) and to improve the tax benefits of charitable giving. This paper will explore a range of planning ideas that practitioners encounter in practice and endeavor to expand the planning with those techniques, and explore and explain some less commonly used techniques that may be helpful in better serving clients.

Annual Cash Contributions

Annual cash donations are attractive for their simplicity. Cash donations do not require valuations because by its nature, cash is not a hard-to-value asset. So long as the cash donation is adequately substantiated with a proper receipt issued by the qualified charitable organization, it will be very difficult, if not impossible, for the IRS to challenge the charitable contribution income tax deduction based on the cash donation. Taxpayers can write a check, use a credit card or deposit cash with the charitable organization, without incurring any fees or expenses that would otherwise be associated with transferring title to a different type of asset. Generally speaking, taxpayers do not need to check in with their tax advisors before making annual cash contributions and very often, they don’t.

Cash is a suitable donation for virtually any charitable organization.

Cash donations are deductible in the year of the contribution by a taxpayer in an amount equivalent to sixty (60%) percent of the taxpayer's adjusted gross income through the end of 2025. Any amount that exceeds 60% of AGI will be carried forward and eligible to be deducted against income over the succeeding five tax years.

Clients who regularly make substantial annual cash charitable contributions may be missing opportunities for larger income tax deductions and estate planning. Further, since cash contributions tend to be more sporadic or made all at once at the end of the year, charitable organizations may not be able to plan for spending priorities on behalf of charitable causes occurring throughout the year without knowing for certain that donations will be made when funds are needed.

<u>How Much Can A Client Afford To Give To Charity</u>?

How much can you give to charity? The answer is often more than you might have thought. Some donors worry whether they will run out of money if they donate too much each year. Fears of financial insecurity are often an impediment to making larger donations. Many prospective donors, especially those living with a health challenge such as multiple sclerosis, are concerned about maintaining adequate assets to deal with future financial uncertainties. Making bequests or gifts of retirement assets on death assures resource are available during your lifetime because testamentary gifts are made in the future on your death. But if access to funds for the future is a concern, there is another way to get financial comfort that may permit accelerating some of those gifts now.

Many people who value the wonderful work their favorite charity does but are worried about making large donations today that may create financial uncertainty in future years. But there is a way many people can get comfortable making larger gifts today, and thereby accelerate the great work your favorite charitable cause does. You can use the approach recommended to determine how much you can donate or gift (e.g. to charities or your children or other donees) the maximum you can right now. Start with a discussion with your wealth adviser (or use online resources) and determine a reasonable target that you want to maintain for your financial security.

For example, you might wish to have an 85% likelihood of not running out of money by age 95. Some people use 100, others much lower ages. A lower age (e.g. 85) might be worrisome in light of increasing longevity, unless there is a specific known medical reason for doing so. Also, determine a confidence level that you would like to have of not running out of money by that age. For example, you might feel that an 85% level is a reasonably secure target. Some people might want a higher figure, but if you review the analysis regularly 85% or perhaps a lower figure might be adequate. Remember, if you review the analysis periodically you can always adjust in the future if you get off the financial track.

With your target set, you can have your wealth adviser and insurance consultant forecast future financial results through age 95 (or whatever age you've selected). Next, your wealth adviser (or online tools) can adjust your budget numbers to determine what is the most money you can give away now, every year, in additional gifts (i.e., what was not reflected in your budget) to children and charities without pushing you below your financial goal of maintaining an 85% likelihood of not running out of money by age 95 (or whatever other targets you've settled on). Consider how long-term care coverage, etc. may impact this.

That provides you with an estimated amount that you can gift each year (to be adjusted as you periodically revisit the numbers) without undermining your financial security. If you haven't gone through that exercise, it is well worthwhile.

Documentation of Charitable Gifts.

The tax laws require that a taxpayer to get a contemporaneous written acknowledgment from the donee charity for gifts of $250+. This must describe the amount of cash and give a description of noncash property, confirm whether the charity provided any goods or services to the donor (and if so, provide an estimate of the value of them).[2] The IRS and Courts have gotten tough on this so that anyone donating should really be certain to adhere to all the requirements of the law if they want to protect their deduction.

In a recent case, the Court affirmed a decision denying the taxpayer a charitable contribution deduction for an airplane because the taxpayer failed to attach a contemporaneous written acknowledgment from the charity to the income tax return.[3]

In another case the court denied a taxpayer a charitable contribution deduction because the taxpayer also did not have a sufficient contemporaneous written record. The Taxpayer contributed a large number of artifacts to a charity using a gift document to transfer ownership. That gift document indicated that the contribution was unconditional and irrevocable (important to assure that the donor parted with all ownership interests in the property) unless the gift agreement provided otherwise. So, the gift agreement was critical to the determination that the donation was made, but it wasn't attached to the donor's income tax return. The IRS challenged the donation as not meeting the requirements and the court agreed. Without the gift agreement it could not be corroborated that the charity did not provide goods or services that would offset the donation.[4]

The Myth of the "U" Shaped Charitable Giving Curve

What does the "U" shaped contribution curve might mean to charitable planning? A study suggested that the assumptions that advisors make about client charitable giving may be misplaced and hence the planning emphasis incorrect.[5] The existence of a "U" shaped charitable giving profile has been discussed in research literature. Some had speculated that the larger giving at higher income levels was based on high income earners being able to afford to make charitable gifts. The high levels of giving on the lower income levels had been attributed to some as due to religious motivations, e.g. poorer consumers tithing, etc. Research suggests that this prior assumption is mistaken and that high levels of charitable giving at lower income levels may in fact be due to a wealth effect. Those with lower income may be retired, have lower income, but significant wealth, and hence their charitable giving is a result of both the desire to give and the wealth to fund such gifts even in the absence of higher income levels. This suggests that for many

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[2] Code Section 170(f)(8).
[3] Izen v. Commissioner, 5th Cir, Docket No 21-60679. Foot faults do matter.
[4] Martha L. Albrecht v. Commissioner, TC Memo 2022-53.
[5] Russell N. James III and Deanna L. Sharpe, "The Nature and Causes of the U-Shaped Charitable Giving Profile", Nonprofit and Voluntary Sector Quarterly 2007 36: 218, http://nvs.sagepub.com/content/36/2/218 .

consumers making charitable gifts tax planning and the related benefits is unlikely to be particularly relevant since the benefit of a charitable income tax deduction at lower income levels might not be significant. With the high estate and gift tax exemptions, might some of these relatively wealthy but lower income consumers be better served by making gifts to higher income family members so they can make the charitable gifts instead? Might this also suggest that planners may need to refocus on non-tax aspects of charitable giving (e.g., donor agreements, naming rights, etc.)?

In kind donations of appreciated assets

Tax practitioners working together with wealth advisors might be able to identify an opportunity for charitably inclined donors to make donations using illiquid or highly appreciated property with low basis. For long-term capital gain property, the donor can deduct the fair market value without recognizing the realized gain. Before making such a donation, the donor should confirm:

- The property will be treated as capital property for income tax purposes. If the property is considered to be ordinary income property, such as inventory or depreciation recapture then the charitable contribution deduction will be limited to the property's fair market value less the amount treated as income, essentially the donor's basis in the property.
- The property should have been held by the donor for more than one year in order to qualify as long-term rather than short-term. A donation of short-term capital property is limited to the lesser of the donor's basis in the property or the fair market value.

Coordination between the tax preparer and wealth advisor could be essential in identifying the assets that will result in the largest charitable contribution deduction for the taxpayer.

Taxpayers are permitted to deduct up to thirty (30%) percent of adjusted gross income for in-kind contributions of appreciated property, where the value of the contribution is based on the fair market value of the property as of the date of contribution. To the extent that the value of the donation exceeds 30% of AGI, the taxpayer may carryforward the deduction for up to five (5) years. Prior to making the contribution, it could be advantageous to prepare projections to determine how the deduction might be used by the taxpayer over the course of the current and subsequent years.

While it is most often the case that a taxpayer making gifts of property to charity would benefit the most from using the fair market value of that property in order to calculate the value of the charitable deduction, there are circumstances when using the tax basis of property rather than the fair market value to determine the deduction amount may be advantageous. Please note the following:

- Where tax basis is used to determine the amount of the charitable contribution deduction, the taxpayer may enjoy a deduction of up to fifty (50%) percent of her adjusted gross income, rather than 30% of AGI if the fair market value was used.
- No appraisal will be required to substantiate the charitable contribution deduction.
- Where the taxpayer opts to base deduction amount on the tax basis rather than the fair market value, this election is irrevocable and will apply to all in-kind contributions. For this reason, the

advisors should be enlisted to evaluate all charitable contributions intended in any given year and confirm that the election is advantageous. Preferably, this analysis would be done prior to making any in-kind charitable contributions.

Taxpayers might consider making the election to use the tax basis rather than the fair market value of assets when:

- Obtaining a qualified appraisal of the asset to be donated is cost-prohibitive or difficult.
- The property is only minimal appreciation.
- The election would allow the taxpayer to deduct the full charitable contribution in the year of contribution.

Additionally, a tax preparer might consider recommending the election to deduct basis rather than fair market value on a deceased taxpayer's final income tax return. In such cases, the tax preparer might determine that using the fair market value of the donated property (and limiting the deduction to 30% of AGI) would limit the value of the deduction and result in a carryover charitable contribution that could not be used since the deceased taxpayer has no future tax returns to file. Electing to deduct the basis instead of fair market value in such circumstances could be beneficial and should be considered.

Not all charities can accept in-kind contributions of marketable securities. The recipient charity must have a brokerage account to accept the shares and a Board Approved policy of how to handle investments once received. The taxpayer and their advisors should connect with the intended charity to confirm how the in-kind contribution can practically be made.

Contributions of property (real, tangible, and intangible)

Some of our clients may be charitably inclined but may not be in a position to donate cash or marketable securities. Rather, their preference may be to donate property that is not currently producing income. This leads to certain other challenges for advisors to consider:

- Transfers of real and certain tangible property may require specific legal documentation to effectuate, such as deeds of transfer, assignments, title searches, and other lien searches.
- Generally, charities cannot accept property subject to encumbrances. Our clients will need to satisfy any outstanding debt on the property and resolve any current liens.
- Transfer usually must be of entire interest in real property. As advisors, we may need to have some difficult conversations with our clients about their intentions to use or benefit from the property following a transfer to a charitable organization.
- The donor has additional reporting requirements in order to get a deduction. In most circumstances, the donor will need to obtain a qualified appraisal and include specific substantiation of the charitable contribution with a timely filed income tax return.

- Some property donations may cause the charitable organization to incur costs trying to sell them or adapt to a specific use. Any charitable contribution of real or tangible property should be closely coordinated with the intended charitable organization.
- Some property donations may involve potential liability issues (i.e. contaminated land) that may need to be resolved prior to donation.

As with other in-kind charitable donations, the deduction taken by the taxpayer may be based either on the fair market value or the tax basis of the property, subject to AGI limitations. Many recent cases finding against the taxpayer have hinged on invalid or incomplete substantiation to support a charitable deduction. The tax preparer and other advisors need to be cautious when taxpayers make in-kind transfers of real or tangible property to charitable organizations. Preparers should be cautious about some common errors in substantiating charitable contribution deductions when real or tangible property is donated:

1. The charity should issue a statement identifying any "goods or services" obtained by the taxpayer in exchange for the donation. This statement should be included in the contemporaneous written acknowledgment provided by the charitable organization to the taxpayer. The value of the charitable contribution deduction should be reduced by the value of any such goods or services received by the taxpayer.
2. Confirm whether Form 8283 is required to be included with the taxpayer's timely filed income tax return in order to substantiate the charitable contribution deduction. The tax preparer should be sure to provide a complete appraisal summary and complete all sections required by the form instructions.
3. To the extent that a qualified appraisal is required to substantiate the value of the charitable contribution deduction, the appraisal must be done no earlier than sixty (60) days prior to the transfer from the taxpayer to the charity. Further, the taxpayer must receive the completed, signed qualified appraisal not later than the due date of their federal income tax return (including extensions).
4. In order to be considered a "qualified" appraisal, the appraisal must be signed by a qualified appraiser and use an appropriate appraisal method to value the property being transferred.
5. The fee for the qualified appraisal must be paid by the donor but fees are not deductible.

Charitable organizations are subject to very specific reporting rules and requirements related to receipt and disposition of tangible personal property from prospective donors. Specifically, contributions of tangible personal property are subject to the related use rule: Property given to a charity that uses such property in its exempt functions (related use) is fully deductible at fair market value (subject to AGI limitations). However, if the charity uses the property for a purpose unrelated to the charitable activities for which the organization was granted its tax-exempt status, the charitable deduction is limited to the lesser of the fair market value or the donor's basis. Note that this rule only applies to tangible personal property NOT real property or intangible property (like stock).

Example to illustrate the "related use" rule: Donor purchases artwork at auction for $2,000. The artwork is later contributed to a children's hospital.

> Scenario 1: The hospital sells the artwork for $10,000. The donor can only take a deduction for $2,000.
> Scenario 2: The hospital hangs the artwork in its lobby to greet the patients and their parents. The donor can take a deduction for $10,000.

Donors can be subject to substantial penalties for failure to abide the related use rules and meet the strict substantiation requirements for contribution deductions of tangible personal property. Prior to contribution of tangible personal property, the donor should coordinate with the intended charity to confirm the use that the charity will make of such property.

Crypto Donations

If Taxpayer A donates cryptocurrency for which a charitable contribution deduction of more than $5,000 is claimed, a qualified appraisal is required under section 170(f)(11)(C) to qualify for a deduction under section 170(a).

A qualified appraisal is not required for donations of certain readily valued property specifically set forth in the Code and regulations, namely: cash, stock in trade, inventory, property primarily held for sale to customers in the ordinary course of business, publicly traded securities, intellectual property, and certain vehicles.[6] Cryptocurrency is none of the items listed in section 165(g)(2), and therefore does not satisfy the definition of a security in section 165(g)(2).[7]

Qualified charitable distributions from an IRA

Qualified charitable distributions ("QCDs") allow taxpayers who are older than 70½ to avoid including income up to One Hundred Thousand ($100,000) dollars from their IRAs by having amounts transferred directly from their IRA to a qualified charitable organization. The benefit, therefore, does not come to the taxpayer in the form of a charitable contribution deduction but rather in the above-the-line reduction of taxable income, which generally results in a more significant tax benefit, particularly when the QCD is made from amounts required to be paid by the IRA to the taxpayer as part of the taxpayer's required minimum distributions.

Note that while QCDs may be made from an IRA or from inactive SEP or SIMPLE plans, QCD transfers may not be made from other qualified retirement plans such as 401ks or defined benefit plans. Prior to undertaking such a transfer, the taxpayer should confirm that they have the correct plan.

[6] See section 170(f)(11)(A)(ii)(I); Treas. Reg. section 1.170A-16(d)(2)(i).
[7] Chief Counsel Memorandum Number: 202302012 Release Date: 1/13/2023.

The following is a quick refresher of the rules governing the qualified charitable distributions from IRAs in the wake of enactment of the SECURE Act:

- Donor must be 70 ½ or older.
- Donation directly from IRA to charity in a "trustee-to-trustee" transfer. In other words, no transfer may be made to the donor before it goes to the charity.
- The IRA may distribute either cash or stocks to the charity as part of a QCD transfer.
- A QCD may be made from required minimum distributions, thereby reducing the amounts that are required to be included in the donor's adjusted gross income for the year of contribution.
- The maximum amount of a QCD is $100,000, regardless of the amount of the required minimum distribution owed to the taxpayer from the IRA.
- A QCD may not be made to a private foundation or donor advised fund. The QCD must be made directly to a charitable organization.
- Donation is not subject to AGI income limits.

The SECURE Act permits an individual who is still working to make tax deductible contributions to an IRA after age 70½. In such circumstances, any QCD made by the taxpayer must be reduced by the value of the tax deductible contributions made to the IRA after the taxpayer had turned 70½.

By way of example, consider a taxpayer named Sam who worked throughout the tax years 2021 and 2022. In each of those years, Sam contributes $20,000 to an IRA. Sam turns 70½ at the beginning of 2022 and retires at the end of 2022. In 2023, Sam decides to coordinate with his IRA Plan Administrator to transfer $100,000 directly to a charity with the intention of making a QCD. Assuming that the transfer in 2023 otherwise qualifies as a QCD, the value of the QCD will be reduced from $100,000 to $80,000, in order account for the contribution to Sam's IRA that he made in 2022 after he turned 70½.

Testamentary bequests and donations through a (non-charitable) trust

An estate is entitled to a charitable deduction for the value of property included in the gross estate that passes to a qualified charity under provisions established by the decedent while living (through a will, trust agreement, or by beneficiary designation). The key is that the deceased person must have decided during lifetime to make the charitable gift that would be finalized at death.

While percentage limitations do not apply to estate tax charitable contribution deductions, taxpayers should evaluate whether they might receive a greater benefit to making contributions during their lifetimes in order to get an income tax benefit rather than waiting until death.

To assist the Estate in taking the charitable contribution deduction, a charitable organization should provide an agreement or other acknowledgment to the Executor/Trustee that:

- the charitable gift received will be used exclusively for charitable purposes;
- that no private individual benefitted from the contribution; and

- that the gift will not be used for political activities

The following is an excerpt from our whitepaper entitled "Why should I engage in planning now? Nothing is going to change, and the exemption is so high?," from September 2023:

Have Trust Make Charitable Gifts

Properly planned charitable distributions from trusts can provide income tax advantages. This will require advanced planning for the requirement that distributions must be from gross income, avoiding discharging a legal obligation (e.g., binding pledge) of the settlor (as in some trusts that might create an issue of estate inclusion), and other steps may be required. So, with planning and care, charitable gifts can offer income tax advantages. The charitable purpose must be specified in the governing instrument. This is known as the "governing instrument requirement." The IRS has taken the position that a charitable beneficiary cannot be added later through non-judicial modification or other change as that is not the original instrument. It may be feasible to still garner a charitable contribution deduction by having the trust invest in a partnership that makes charitable contributions which then flow back to the trust on Schedule K-1 from the partnership.

Taxable income of a non-grantor trust is determined in a manner like that of an individual taxpayer but is subject to several special rules. One of those is that a charitable contribution deduction is allowed under Code Sec. 642(c) in contrast to that for individuals. for its gross income paid for a charitable purpose. The trust's charitable contribution deduction reduces the trust's taxable income but also may reduce its DNI.

A significant advantage to making charitable contributions through trusts rather than personally is that the deduction is not subject to any percentage limitations.

In a recent private letter ruling[8] the IRS granted a trust an extension of time9 to make an election to treat distributions of gross income made by the trust to one or more charitable organizations during the taxable year as if made in the preceding taxable year. In the PLR, the trust filed its federal income tax return on a calendar year basis and made distributions to one or more charitable organizations during the year after the year in which it wanted a deduction. The trust intended to have the contributions treated as though paid in the prior year as permitted under Code Sec. 642(c)(1) but, due to inadvertence, the trust's election was not timely filed.

65-Day Rule

Trusts also may offer the most efficient platform for charitable income tax planning by their ability to shift income out of the trust within 65 days after the close of the trust's tax year,[10] to obtain an

[8] PLR-110205-23, May 16, 2023.
[9] Pursuant to Treas. Reg. § 301.9100-3 of the Procedure and Administration Regulations.
[10] Section 663(b).

unlimited income tax charitable contribution deduction.[11] The 65 day rule provides unique planning opportunities, for clients using irrevocable non-grantor trusts to make charitable contributions.

Include Power To Add Charitable Beneficiaries in Grantor Trusts

Modern irrevocable grantor trusts may include a number of provisions to assure that the trust is characterized as a grantor trust for income tax purposes and to provide the settlor indirect access to the value inside the trust. While the swap or substitution power is the most common technique to achieve grantor trust status another common technique is to give a person the right to add a charity to the class of trust beneficiaries. This is also another means to provide the settlor indirect benefit from the trust by permitting the addition of charities that the settlor might wish to support from trust assets, so long as there is no discharge of a personal pledge by the settlor from trust assets.

Many modern trusts include a position called a trust protector who might be granted a power to add charitable beneficiaries. Care is in order. If the trust protector is acting under the instrument in a fiduciary capacity

Charitable annuities

Charitable annuities may be an option for making lifetime charitable gifts while retaining an income stream. The donor contributes a gift of cash or other property in exchange for an annuity. The value of the charitable gift is based on the life expectancy of the donor and the annuity amount to be paid. The donor can take an immediate income tax deduction for making the transfer.

Because the cash or other property is donated at the time that the charitable annuity is created, the asset itself will be outside of the donor's estate for estate tax purposes. As a result, the donor's future taxable estate will be reduced by the remainder value of the contributed property.

Charitable annuities are administered by the charity in accordance with state regulations, making it simpler to manage than charitable trusts.

Charitable trusts (i.e. charitable remainder trusts, charitable lead trusts

Tax preparers who notice that clients are making substantial annual cash contributions may wish to discuss other opportunities for charitable giving with the client. Specifically, a client who writes very large checks to a charity on an annual basis likely also has some estate tax planning needs. A practitioner might explore with the client whether there are any charitable trust or other strategies available to accomplish both charitable giving and estate planning objectives.

[11] Section 642(c).

Charitable trusts work by separating current and future interest in property so that each interest can be given to either a noncharitable or a charitable beneficiary, depending upon which type of charitable trust. A current interest in property is measured in terms of years (up to 20) or may be based upon the lifetime of one or more noncharitable beneficiaries. The future (or remainder) interest in property is the value of the property after the current interest has expired.

There are two different kinds of split-interest charitable trust strategies that our clients might consider using: a charitable lead trust and a charitable remainder trust. Each of these different kinds of trusts works by splitting the value of property devised to the trust into a current interest and a future interest. The trust identifies a charitable beneficiary class and the non-charitable beneficiary class. The terms of the trust will describe which class is the current beneficiary and which class is the future beneficiary, as follows:

	Charitable Remainder Trust (CRT)	Charitable Lead Trust (CLT)
Current Interest	Donor / Noncharitable Beneficiary	Charity
Future Interest	Charity	Donor / Noncharitable Beneficiary

There are numerous ways that charitable trusts might be structured, depending upon the specific goals of any taxpayer. Further, such trusts may be created through a lifetime trust or at death under a will or similar testamentary instrument. Lifetime transfers usually provide greater tax benefits than testamentary bequests because the donor will receive both an income tax and gift tax charitable deduction.

Income tax for charitable contributions through charitable trusts are limited:

- The value of the interest (either current or future interest) being conveyed to the charity.
- 30% of adjusted gross income.

<u>Charitable Remainder Trusts</u>

With a charitable remainder trust, the current or income interest is paid to a noncharitable beneficiary and the remainder will be paid to a qualified charitable organization. For lifetime charitable remainder trusts, the donor often retains the current interest either for a term of years or for life. The donor or a noncharitable beneficiary can receive lifetime income from the trust that exceeds the actual earnings of the trust while also enjoying income tax and gift tax charitable contribution deductions for the present value of the remainder interest that will be passed to charity.

A lifetime CRT is considered a “charitable entity” for income tax purposes, so income earned at the trust level will not subject to income tax. Distributions from a charitable remainder trust to the donor or noncharitable beneficiary will be taxable based on general ordering rules, with income from the current and all preceding tax years considered, as follows:

a. Ordinary income earned in the current tax year
b. Capital gains earned in the current tax year
c. Undistributed ordinary income earned in a prior tax year
d. Undistributed capital gains earned in a prior tax year
e. Nontaxable income
f. Distribution of principal (nontaxable)

A noncharitable beneficiary should expect to receive a Schedule K-1 from the charitable remainder trust in each year when distributions are made.

Because charitable remainder trusts are considered charities which are not taxed on income earned, there will be no tax due by the CRT on the sale of appreciated asset. For this reason, advisors may wish to discuss the benefits of using a CRT to defer gain on the sale of a highly appreciated asset. Gain on the sale of an asset is essentially held at the CRT trust level and only recognized by the noncharitable beneficiary as the CRT distributes the gain over the initial noncharitable term of the trust.

Advisors need to be aware of the assets that cannot and should not be used to fund a charitable remainder trust, as follows:

- Assets the trustee is obligated to sell
- Tax-exempt securities
- S corporation stock
- Partnership interests
- Personal residence
- Encumbered real estate
- Tangible personal property
- Options
- Private equity and Venture capital funds

Charitable Lead Trusts

A charitable lead trust (a “CLT”) may be an interesting option for a client who regularly makes large contributions to charity on an annual basis. By making a larger transfer in one year to a CLT rather than spacing the contributions out over time, the donor could potentially increase the value of the charitable contribution deduction, subject to the limitation that the charitable deduction cannot exceed 30% of the donor’s adjusted gross income in the year of the transfer.

A grantor CLT provides the donor the satisfaction of contributing to a favorite charity without permanently giving up the asset. With a grantor CLT, the donor funds the trust and identifies herself as the remainder beneficiary after the initial charitable term. The income of the trust is taxed to the donor (usually at lower

rates than if taxed within the trust). The 3.8% net investment income tax applies at the grantor, rather than the trust, level. The donor receives an immediate income tax charitable deduction for the value of the charity's interest in the trust.

Prior to recommending a grantor CLT strategy, the practitioner should discuss the disadvantages with the donor:

- The donor must recognize trust income during the charitable term, even though the income will not be distributed to the donor.
- If the donor dies or the grantor trust status terminates before the end of the charitable term, the benefit of the income tax charitable deduction must be recaptured. This is not likely a good strategy for a donor with a shorter life expectancy.
- The charitable contribution deduction is limited to thirty (30%) percent of the donor's adjusted gross income in the year of contribution.

A non-grantor charitable lead trust might be advantageous for some taxpayers, particularly those who have already used up their lifetime exemption from estate and gift taxes. Non-grantor CLTs are often structured to result in a tax-free gift to the donor's heirs at the end of the charitable term. These trusts differ from the grantor CLT in that the donor will not receive a charitable contribution deduction by funding a non-grantor CLT. Rather, the benefit to the donor is that the donor's annual taxable income will be reduced annually by the amount of income earned on the asset transferred to the trust. Essentially, the donor neither receives nor reports the income earned by the asset contributed to the non-grantor CLT. Instead, the non-grantor CLT reports all income earned and may take an annual deduction for the amounts paid to the charitable organization as required by the trust instrument.

The donor should consult with a qualified tax practitioner to project the potential income tax liability. Non-grantor trusts (including CLTs) are subject to federal income taxes at the highest income tax rate of 37% plus 3.8% net investment income tax on income over $14,450 in 2023. The trust claims a charitable deduction for the annuity or unitrust amount required to be paid to the charity. While the non-grantor CLT is not subject to the percentage limitations that apply to individuals for income tax charitable deductions, the charitable contribution deduction will be limited if any trust income is unrelated business taxable income (UBTI).

Trust Administration

Practitioners need to educate clients about the importance of properly administering charitable trusts once created. For example, an institutional trustee was held not to be liable for the exhaustion of a charitable remainder annuity trust ("CRAT") from annuity payments to the grantors. The corporate trustee issued regular statements to the beneficiaries that disclosed all relevant information to the beneficiaries understanding the trust's performance. These disclosures tolled a special shorter statute of limitations. The court found that there should be no liability as the depletion of trust assets resulted from a combination of market conditions and the required annuity payments. As to the beneficiaries' claims that the trustee had guaranteed the CRAT would provide payments for life, the trust terms negated such a claim.

How many individual non-professional trustees provide regular reports to beneficiaries? Likely very few. What can be done to educate the individual trustees as to the importance of regular reporting to minimize their liability? Might updated Monte Carlo forecasts reflecting possible outcomes of trust payouts on trust performance and duration provide further insulation for trustees?

Trustees who simply send trust statements and disclosures to every potential beneficiary in the class may be going overboard in their zealous pursuit to disclose. The Restatement Third Sec. 82 provides: "…because of differences in trust and beneficiary circumstances preclude imposing precise, universal rules in all of these matters, the trustee's duty is to exercise reasonable judgment in deciding when, about what, and to whom information is required to be provided." Trustees should not blindly ignore beneficiary circumstances and the totality of the trust instrument in favor of mass disclosures.

When assisting clients with yearend charitable planning, perhaps practitioners might remind clients of the importance of administering existing charitable trusts.

A donor-advised fund vs. private foundation

For those clients who wish to make a large charitable contribution in a year when their income is much higher than usual, a client may wish to use either a donor advised fund (a "DAF") or a private foundation, to accomplish the following goals:

- Donor can make large charitable contributions in year when income is much higher than usual.
- A DAF or foundation can spread out charitable grants over time while getting tax deduction in a specific year.
- The donor can donate highly appreciated investments or cash (in some cases, privately held investments).
- Donor can leave a legacy for family to continue to make grants after death.

Both a DAF and foundation are subject to stringent requirements and regulations. However, the primary benefit of using a DAF instead of a private foundation is that the DAF is administered by an investment advisor whereas the private foundation is often administered by the donor and the donor's family. Foundations are heavily scrutinized and are more expensive to administer than DAFs. Most investment advisors will allow the donor to name the DAF and will provide for opportunities for the donor and the donor's family to make decisions about charitable giving. Essentially, a DAF has many of the benefits of running a private foundation without much of the burdens.

Conclusion and Practitioner Action Steps

T'is the season for charitable giving! Some may be motivated to give by a sober review of the past year and resolutions as yet unmet. For others, perhaps year-end charitable giving is just something they've always done. Donations made in December account "for roughly one fourth (26%) of annual nonprofit

revenue."[12] Making large charitable contributions for the sake of supporting worthy causes is admirable but clients who consult with their tax advisory team first might be able to accomplish significant tax advantages. Rather than taking a SALY, or "same-as-last-year" approach, to charitable giving, a client educated by members of their professional advisor team might leverage charitable gifts into significant tax opportunities through focused, deliberate charitable planning.

[12]Huntsberger, Alex. 10 Year-End Giving Statistics Every Fundraiser Should Know for 2023. https://neonone.com/resources/blog/year-end-giving-statistics/ (visited 11/18/2023), citing statistics provided in: https://mrbenchmarks.com/#fundraising (visited 11/18/2023).