CHARITABLE PLANNING

11/25/19

Is Charitable Gifting for You?

As investment executives who specialize in helping our clients meet their financial goals, we understand that you may have questions about the areas you need to focus on during this phase in your life. This special report presents the basics and tax benefits of charitable gifting.

WWW.STONEHEARTHCAPITAL.COM
199 ROSEWOOD DRIVE, SUITE 200 • DANVERS, MA 01923 • {978} 624-3000

Charitable Planning

Charitable giving plays an important role in many people's lives. Philanthropy can provide great personal satisfaction, while benefiting the charities that receive donations. Charitable giving can also give you a current income tax deduction, potentially allow you to avoid capital gains tax, and reduce the amount of taxes your estate may owe when you die.

There are many ways to give to charity. You can make gifts during your lifetime or at your death. You can make gifts outright or use a trust. You can name a charity as a beneficiary in your will, or designate a charity as a beneficiary of your retirement plan or life insurance policy. Also, if your gift is substantial, you can establish a private foundation, community foundation, or donor-advised fund.

The goal of this paper is to outline the various methods of providing charitable gifts and the corresponding tax deduction benefits that come with these various gifting methods. We will also explore some of the more complex methods of charitable giving through the use of trusts and other vehicles.

CHARITABLE GIFTING – THE BASICS

A gift to charity is simply a gratuitous transfer of property to a charitable organization. The key is that your gift must be some kind of property--your time or personal services do not count. There are several different types of property that can be donated to charity, and a gift is limited only by your imagination. The decision to donate to charity is a personal one. Although the IRS does not require that you have any charitable motivation when you donate to charity--you can do it strictly for the tax benefits--most people who decide to donate to charity have a charitable intent.

WHAT ARE THE TAX BENEFITS OF DONATING TO CHARITY?

Through tax legislation, Congress has attempted to encourage charitable giving because it is good social policy. Most every charity depends on individual contributions to remain financially solvent, especially in this era of fewer direct government dollars. As a result, charitable giving has become interconnected with the tax laws, which have grown more and more complex.

Only contributions to IRS-qualified charities are deductible. This means the group meets Uncle Sam's requirements to be classified as a tax-exempt organization. You've probably heard this referred to as 501(c)(3) status, so-called because that is the section of the Internal Revenue Code that governs such groups.

You also can check out groups via various online databases, such as GuideStar[1] and Charity Navigator[2], as well as by using the IRS' own online searchable database of tax-exempt organizations[3].

The higher your tax bracket, the greater your tax savings as a result of making charitable gifts. For example, if a hypothetical donor in the 37% tax bracket makes a donation of $10,000, this person may

[1] www.guidestar.org
[2] www.charitynavigator.org
[3] https://www.irs.gov/charities-non-profits/tax-exempt-organization-search

later qualify for $3,700 in savings at tax time. Compare the same $10,000 gift from someone in the 22% tax bracket who will recognize $2,200 in tax savings.

Congress has sweetened the pot for taxpayers who donate to qualified charities. First, you generally receive an income tax deduction in the year you make the gift. Second, you do not have to worry about gift tax because federal gift tax does not apply to charitable gifts. Third, charitable gifts serve to reduce your taxable estate, thus reducing your potential estate tax liability.

It is this last area--estate tax--where charitable giving may produce the greatest tax benefits. Over the next 30 years, an estimated $8 trillion of assets will pass from one generation to the next, resulting in the assessment of significant estate taxes. One solution to minimize these estate taxes is charitable giving.

Your tax deduction may depend on the type of donation.

- **Cash donation** - If you donate cash, via check or wire transfer, you're generally eligible for an income tax deduction of up to 60% of your adjusted gross income. Under previous tax law, the limit was 50% of your adjusted gross income. With the new tax law, you can now give up to 60 percent of your income.[4]

  For example, if your adjusted gross income is $50,000 and you give $35,000 to a qualifying charity, you won't be able to deduct your full charitable gift in the tax year in which you give. You can claim only up to $30,000, which is 60% of $50,000.

  However, the other $5,000 isn't lost. You can claim the excess donation amount on your next year's tax return. You have up to six years of "rollovers" to claim the full charitable gift.

- **Long-term appreciated assets** - Donating long-term appreciated securities potentially allows you to maximize capital gains tax advantages, which could help you reduce taxes and ultimately give more to charity. If you have long-term appreciated assets, such as stocks, bonds or real estate, you have an opportunity to further maximize your deduction. By donating these types of assets directly to charity, you generally won't have to pay capital gains, and you can take an income tax deduction in the amount of the full fair-market value, up to 30% of your adjusted gross income (AGI). A charitable deduction can be taken in the current year for gifts made to a private foundation up to 20% of AGI. The 20% limitation applies to gifts of capital gain property to non-50% charities (e.g., most family-funded private foundations).

HOW TAX REFORM HAS IMPACTED CHARITABLE GIVING

The Tax Cut and Jobs Act (TCJA) passed on December 22, 2017 has created new rules to consider when planning and determining the tax benefits of charitable contributions. Tax deductions for charitable contributions require taxpayers to itemize their deductions on Schedule A of their tax returns. Itemizing deductions on a tax returns makes sense when your total deductions from itemizing will exceed the standard deduction that is offered to all taxpayers. You either take the standard deduction or itemize deductions on Schedule A. Specifically, the TCJA included two changes that has impacted the amount of people who benefit from itemizing deductions. First, the standard deduction was increased, and secondly, the new tax law put a cap on the amount of state and local income tax that can be deducted.

[4] A charitable contribution of cash or short-term capital gain property contributed to a private foundation or considered "for the use of" is limited to the lesser of 30% of the taxpayer's AGI or 50% of the AGI less 60% and 50% contributions.

The new tax law nearly doubled the standard deduction from $12,700 in 2017 to $24,400 in 2019 for married couples, filing jointly, ($12,200 in 2019 for single filers)[5]. The cap on the deductible amount of state and local income taxes has decreased the amount of itemized deductions for millions of taxpayers, thus making it more advantageous use the increased standard deduction when filing taxes. Since charitable donation deductions are part of a taxpayer's itemized deductions, if a taxpayer takes the standard deduction instead, the tax benefits of charitable donations are lost.

One way to work around this change is to employ a strategy referred to as "bunching" for charitable donations. This refers to a method where you would give multiple years' worth of charitable donations in one year, so as to increase your itemized deductions above the standard deduction amount. In the other years, you would not make charitable contributions and take the standard deduction instead.

The strategy is best illustrated through an example. Let's say a married couple filing jointly has $100,000 of taxable income. The couple has $20,000 of itemized deductions before charitable contributions. The couple plans to make $6,000 of annual charitable contributions in both tax-year 2019 and 2020.

Making a $6,000 donation in each of those two years, and itemizing both years, would yield $52,000 of combined tax deductions over the two years ($26,000 of deductions each year). But let's say the couple decides to bunch $12,000 worth of charitable contributions into 2019, and took the $24,400 standard deduction in 2020. That approach would yield $56,400 of total deductions — $4,400 more — over the two years, which equates to greater tax savings.[6]

WHAT OPTIONS DO YOU HAVE FOR CHARITABLE GIFTING?

AN OUTRIGHT GIFT:

In the typical situation, your gift will be for the charity's benefit only, and the charity will take possession of the gift immediately. This type of gift is called an outright gift. This arrangement satisfies the general rule that a gift to charity must be paid to the charity in the form of money or property before the end of the tax year to be deductible for income tax purposes.

SPLIT INTEREST GIFT IN TRUST

Another option is for your gift to be split between a charity and a noncharitable beneficiary. Here, one party (usually the noncharitable beneficiary) receives the use of the donated property for a specific period of time, which means he or she is paid a certain sum every year out of the donated property. Then, after this time period is up, the remaining property passes to the charity. Such gifts can be used to provide for a dependent child or a surviving spouse. In this arrangement, the charity's right to enjoyment

[5] The standard deduction is $1,300 higher for those over age 65.
[6] *Uncharitable Giving,* by Greg Iacurci, Investment News, November 9, 2019.

and possession of the gift is delayed because the noncharitable beneficiary has the first interest in the donated property. Ordinarily, this delay would mean no current tax deductibility for your gift. However, the tax laws provide approval of such arrangements as long as the gift is set up as one of a number of special trusts expressly created for this purpose. If your split interest gift is set up as one of these trusts, you receive federal income, gift, and estate tax deductions.

CHARITABLE REMAINDER TRUST

Using a charitable remainder trust, you donate property to the trust. You receive regular payments from the trust for a specific number of years or your lifetime. You are generally taxed on distributions to you from the trust. At the end of the trust period, the remaining assets are paid to the charitable organization. For this reason, the charity's interest is described as a remainder interest.

You may also qualify for a current income tax deduction on the estimated present value of the remainder interest that will eventually go to charity. And even though you cannot take your gift back once it's in the trust, you can change the charity that will eventually receive your gift.

There are two types of Charitable Remainder Trusts:

- **CRAT (charitable remainder annuity trust)**
  A CRAT is a split interest gift between a noncharitable beneficiary and a charitable beneficiary. The noncharitable beneficiary has the first interest, and the charity has the remainder interest or second-in-line interest. The trust pays out a fixed amount of income every year (an annuity) to the noncharitable beneficiary for the term of the trust, and the remaining assets pass to the charity at the end of the term.

- **CRUT (charitable remainder unitrust)**
  A CRUT is a split interest gift between a noncharitable beneficiary and a charitable beneficiary. As with a CRAT, the noncharitable beneficiary has the first interest, and the charity has the remainder interest. However, instead of paying out a fixed amount each year, a CRUT pays the noncharitable beneficiary a fluctuating amount each year, depending on the value of the trust assets for that year. This amount is calculated as a percentage of the assets in the trust on a specified date each year. At the end of the trust term, the remaining assets pass to the charity.

Benefits of a charitable remainder trust[7]

Donor

- Receives an income tax deduction for the actuarial value of the remainder interest of the trust in the year it is formed.
- The entire amount deposited to the trust and its subsequent growth is removed from the donor's estate.
- Capital gains on assets transferred to the trust are not recognized.

Charity

- Receives any assets remaining at the end of the trust period free from estate taxes.

Beneficiaries

[7] Source: Vanguard

- Receive a predictable income stream.

Why use a charitable remainder trust?

A charitable remainder trust takes advantage of the fact that lifetime charitable giving generally results in tax savings when compared to testamentary charitable giving. A donation to a charitable remainder trust has the same estate tax effect as a bequest because, at your death, the donated asset has been removed from your estate. Be aware, however, that a portion of the donation is brought back into your estate through the charitable income tax deduction.

Also, a charitable remainder trust can be beneficial because it provides your family members with a stream of current income — a desirable feature if your family members won't have enough income from other sources.

For example, you create a $1 million charitable remainder trust. The trust provides that a fixed annual payment be paid to your beneficiaries for a period not to exceed 20 years. At the end of that period, the entire trust principal goes outright to ABC Charity. To figure the amount of the charitable deduction, you have to value the remainder interest going to ABC Charity, using IRS tables. This is a complicated numbers game. Trial computations are needed to see what combination of the annual payment amount and the duration of annual payments will produce the desired charitable deduction and income stream to the family.

CHARITABLE LEAD TRUST

A charitable lead trust is a split interest gift between a noncharitable beneficiary and a charitable beneficiary. With a charitable lead trust, you place money or income-producing assets in the trust. The charitable organization receives regular payments from the trust for the duration of the trust. At the end of the trust period, the remaining assets are paid to you or to your heirs. This can help reduce, or in some cases even eliminate, estate taxes on appreciated assets that are eventually transferred to your heirs.

Benefits of a charitable lead trust[8]

Donor

- Receives an income tax deduction equal to the present value of the income stream paid to the charity at the time the trust is funded.
- The entire amount deposited to the trust and its subsequent growth is removed from the donor's estate.
- Capital gains on assets transferred to the trust are not recognized.

Charity

- Receives a predictable income stream.

Beneficiaries

- Receive any assets remaining at the end of the trust period free from estate taxes.

Why use a charitable lead trust?

[8] Source: Vanguard

The charitable lead trust is an excellent estate planning vehicle if you are optimistic about the future performance of the investments in the trust. If created properly, a charitable lead trust allows you to keep an asset in the family while being an effective tax-minimization device.

For example, you create a $1 million charitable lead trust. The trust provides for fixed annual payments of $50,000 (or 5 percent of the initial $1 million value of the trust) to ABC Charity for 25 years. At the end of the 25-year period, the entire trust principal goes outright to your beneficiaries. To figure the amount of the charitable deduction, you value the 25-year income interest going to ABC Charity. To do this, you use IRS tables. Based on these tables, the value of the income interest can be high — for example, $900,000. This means that your estate gets a $900,000 charitable deduction when you die, and only $100,000 of the $1 million gift is subject to estate tax.

POOLED INCOME FUND

A pooled income fund is a split interest gift between a noncharitable beneficiary and a charitable beneficiary. Like the CRAT and CRUT, the noncharitable beneficiary has the first interest and the charity has the remainder interest. A pooled income fund is managed by the charity (much like a mutual fund) and is made up of donations from several donors. The charity pays the noncharitable beneficiary a fluctuating amount each year, depending on the value of the fund in that year. These income distributions are made to the noncharitable beneficiary for his or her lifetime, after which the portion of the fund assets attributable to the noncharitable beneficiary is severed from the fund and used by the charity for its charitable purposes.

BARGAIN SALE

A bargain sale in the context of charitable giving is a sale to charity at a bargain price (i.e., a price below the fair market value of the item sold, fair market value being the price a willing buyer would pay a willing seller in an arm's length transaction). The difference between the sale price and the actual fair market value of the asset equals your donation to charity. A bargain sale involves two separate transactions for tax purposes: a sale and a charitable gift. The IRS treats each event as a separate transaction. Consequently, each is reported separately on your income tax return.

PRIVATE FOUNDATION

Donors with sufficient resources may want to create a private foundation. A private foundation is a separate legal entity (often named for the donor) than can endure for many generations after the original donor's death. The donor creates the foundation, then transfers assets (typically appreciated assets) to the foundation, which in turn makes grants to public charities. The donor and his or her descendants retain complete control over which charities receive grants.

DONOR-ADVISED FUND

Similar in some respects to a private foundation, a donor-advised fund (DAF) offers an easier way for a donor to make significant charitable gifts over a long period of time. A DAF refers to an account that is held within a charitable organization. Though they can bear the donor's name, donor-advised funds are not operated as separate entities like private foundations, but are merely accounts held by the fund. Once the donor has transferred assets to the account, the charitable organization becomes the legal owner of the assets and has ultimate control over them. The donor can only advise--not direct--the charitable organization on how the donor's contributions will be distributed to other charities.

How does a donor-advised fund work?

One benefit of a donor-advised fund account is that it can be set up easily. Upon establishing the account, the donor makes contributions of assets, which may include cash, marketable securities, and other types of assets, depending on the fund. The required minimum contributions vary from fund to fund, but are usually less than those required by private foundations.

During life, the donor (or the donor's designee) can make ongoing, non-binding recommendations to the fund as to how much, when, and to which charities grants from the fund should be made. The donor may suggest that, upon death, grants be made to charities named in his or her will or other legal instrument such as a revocable living trust. Or, the donor may designate a surviving family member(s) to recommend grants. However, the fund is not obligated to follow any of the donor's suggestions — hence the name "donor-advised fund." As a practical matter, though, the fund will generally follow a donor's wishes. Distributions to grantees are typically identified as being made from a specific donor's account, but they can be made anonymously at the donor's request.

LIFE INSURANCE

A gift of life insurance enables you to donate more than you might currently have available and results in a larger future gift to the charitable organization. If the charity is named as owner and beneficiary of the policy, you can receive an income tax deduction for the premiums you pay, within certain limits.

CHARITABLE CONTRIBUTIONS FROM IRAs

The Pension Protection Act of 2006 first allowed taxpayers age 70½ and older to make tax-free charitable donations directly from their IRAs. By making a qualified charitable distribution (QCD) from an IRA directly to a qualified charitable organization, older IRA owners were allowed to exclude up to $100,000 annually from gross income. These gifts, also known as "charitable IRA rollovers," would otherwise be taxable IRA distributions. The law was originally scheduled to expire in 2007, but was extended periodically through 2014 by subsequent legislation and finally made permanent by the Protecting Americans from Tax Hikes (PATH) Act of 2015.

HOW QCDs WORK

You must be 70½ or older in order to make QCDs. You request to make a distribution directly from your IRA (other than SEP and SIMPLE IRAs) to a qualified charity. The distribution must be one that would otherwise be taxable to you. You can exclude up to $100,000 of QCDs from your gross income each year. And if you file a joint return, your spouse (if 70½ or older) can exclude an additional $100,000 of QCDs.

> ***Note***: You don't get to deduct QCDs as a charitable contribution on your federal income tax return — that would be double-dipping.

QCDs count toward satisfying any required minimum distributions (RMDs) that you would otherwise have to receive from your IRA, just as if you had received an actual distribution from the IRA. However, distributions that you actually receive from your IRA (including RMDs) and subsequently transfer to a charity cannot qualify as QCDs.

Important considerations for QCDs

- A QCD cannot be made to a private foundation or a donor-advised fund.
- A QCD cannot be made in exchange for a charitable gift annuity or to a charitable remainder trust.

ESTATE PLANNING AND CHARITABLE GIVING

When developing your estate plan, you can do well by doing good. Leaving money to charity rewards you in many ways. It gives you a sense of personal satisfaction, and it can save you money in transfer taxes.

A few words about transfer taxes

The federal government taxes transfers of wealth you make to others, both during your life and at your death. Generally, the federal gift and estate tax is imposed on transfers in excess of $11,400,000 (in 2019) and at a top rate of 40 percent.

You may also be subject to state transfer taxes.

Careful planning is needed to minimize transfer taxes, and charitable giving can play an important role in your estate plan. By leaving money to charity, the full amount of your charitable gift may be deducted from the value of your gift or taxable estate.

BEQUESTS

A bequest is a gift left to a charity after the donor's death. Donors can make bequests by means of a will, revocable trust, or beneficiary designations on accounts or life insurance policies. It is, in many ways, similar to an immediate gift, except that it occurs at a future date (the death of the donor). As a result, the donor has full use of the gift during his or her lifetime. The donor will not receive an income tax deduction at the time the bequest is documented. However, the estate can claim a deduction for the full amount of the bequest from the estate tax return.

The easiest and most direct way to make a charitable gift is by an outright bequest of cash in your will. Making an outright bequest requires only a short paragraph in your will that names the charitable beneficiary and states the amount of your gift. The outright bequest is especially appropriate when the amount of your gift is relatively small, or when you want the funds to go to the charity without strings attached.

CONCLUDING THOUGHTS

Giving strategically can benefit both you and the charitable organization you choose, and could potentially benefit your heirs. A properly planned gift might enable you to realign your investment portfolio, help diversify your holdings, increase your cash flow — and help leave a greater legacy.

Whatever gifting strategy you choose, planned giving can be very rewarding. It's wonderful to see your gift at work and to receive tax benefits as well.

While trusts offer numerous advantages, they incur up-front costs and ongoing administrative fees. The use of trusts involves a complex web of tax rules and regulations. It is recommended that you enlist the counsel of an experienced estate planning professional and your legal and tax advisors before implementing such strategies.

If you would like to discuss your personal financial situation, please do not hesitate to give our office a call at (978) 624-3000. We would be happy to talk to you.

Sincerely,

David Juliano CLU, ChFC, RICP
Senior Financial Advisor
David@stonehearthcapital.com

Footnotes and disclosures:

Stonehearth Capital Management, LLC is a Registered Investment Advisor. Registration does not imply a certain level of skill or training.

Opinions, estimates, forecasts and statements of financial market trends that are based on current market conditions constitute our judgment and are subject to change without notice.

This material is for information purposes only and is not intended as an offer or solicitation with respect to the purchase or sale of any security.

Investing involves risk including the potential loss of principal. No investment strategy can guarantee a profit or protect against loss in periods of declining values.

Diversification cannot guarantee a profit or protect against loss in a declining market.

Opinions expressed are not intended as investment advice or to predict future performance.

Past performance does not guarantee future results.

Consult your financial professional before making any investment decision.

Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance.

All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. Please consult your financial advisor for further information.

These should not be construed as investment advice. Neither the named representative nor the named Broker dealer or Investment Advisor gives tax or legal advice. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. Please consult your financial advisor for further information.

By clicking on these links, you will leave our server, as they are located on another server. We have not independently verified the information available through this link. The link is provided to you as a matter of interest. Please click on the links below to leave and proceed to the selected site.