



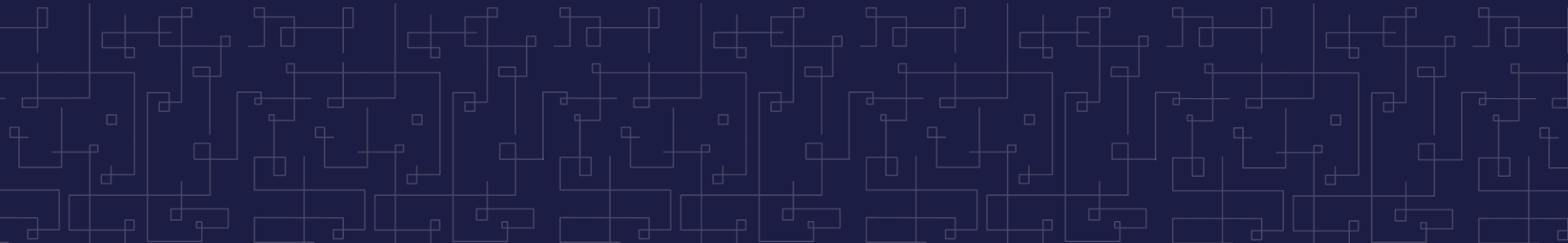
Thinking Beyond Retirement Income for Split-Interest Charitable Gifts

NWPGRT

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Current Tax Planning Environment



Unified Estate/Gift Tax Credit

- TCJA set the exemption amount as \$10 million, indexed for inflation (under prior law exemption was \$5 million indexed for inflation)
- 2021 exemption = \$11.7 million, top rate = 40%
- Approximately .1% of Americans subject to federal estate tax at current exemption amount
- 2000 = \$675,000 federal transfer tax exemption, top rate = 55%
- Indexed for inflation = approx. \$1 million in 2020

Proposed Anti-Clawback Regs

- Sunsets in 2025 so 2026 amount will be \$5 million (indexed for inflation may be approximately \$6.8 million)
- Formula for calculating estate tax
 - $\text{Current estate} + \text{lifetime gifts} = \text{total estate} - \text{exemption}$
- Under this formula gifts made prior to sunset would be “clawed” back into estate at death
- Nov. 2018 IRS issued proposed regs that clarified that taxpayers would receive the benefit of the higher exemption amount for gifts made prior to sunset/ finalized in Nov. 2019 IR-2019-189

Income tax

- In 2000 top federal income tax rate was 39.6%, top capital gains tax rate was 15%
- In 2021 top federal income tax rate is 37%, top capital gains tax rate is 23.8% (including Medicare surtax)
- Appreciated asset planning as a continued priority often leads advisors to look at charitable tax planning for philanthropic clients

State Transfer Tax

- Almost half of the states have some form of state level estate or inheritance tax
 - Exemptions are typically much lower than the federal exemption amount
- Only 2 states have state level gift tax- Connecticut and Minnesota
- Creates incentive to make lifetime gifts in many states

Charitable gifts during life > than at death

- Mrs. A gives charity \$100,000 at death
 - Removes \$100,000 from estate, saving potentially \$40,000 in federal estate tax
- Mrs. A gives charity \$100,000 during life
 - Removes \$100,000 from estate, saving potentially \$40,000 in federal estate tax
 - Receives income tax deduction of \$100,000, saving potentially \$37,000 in income tax

Charitable Income Tax Deduction

- Public Charities
 - Cash- 60% AGI if no stacking, 50% if stacking
 - Appreciated Assets- 30% AGI
- Private Foundations
 - Cash- 30% AGI
 - Appreciated Publicly Traded Securities- 20% AGI
 - Mean value on date of gift
 - Other Appreciated Assets- 20% AGI
 - Lesser of market value or basis
- Coronavirus legislation election for 2020-21 up to 100% of AGI deduction
 - Cash gifts only to public charities
 - No donor advised funds or supporting orgs

Step up in basis at death

- Basis = original cost of asset +/- some adjustments (capital improvements, depreciation, etc.)
- On sale of appreciated capital gains asset the difference between the sale price and the basis is what is subject to taxation
- Lifetime transfers = carryover basis
- Transfers at death = fair market value on date of death (stepped up) basis

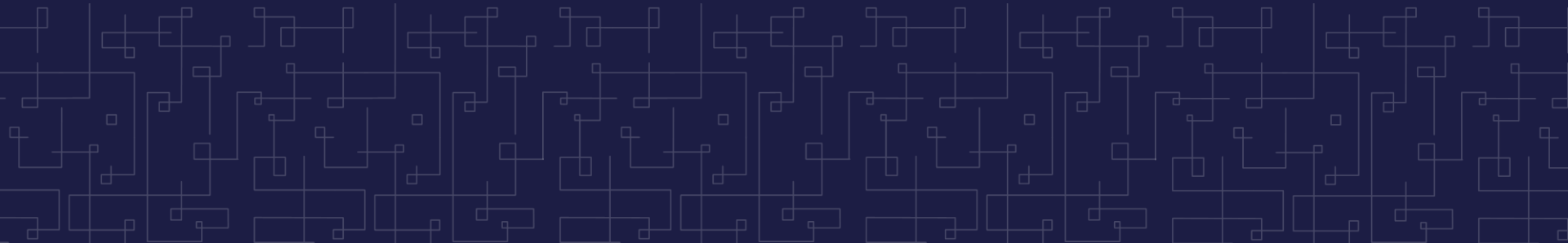
Stepped up basis example

- Mrs. Smith – net worth of \$10 million
- Transfers \$4 million of stock portfolio to her kids now to use up her “extra” exemption and get estate to \$6 million before 2026 (Portfolio has basis of \$2 million)
- Dies unexpectedly in 2021
- Exemption will be \$11.7 million so giving away the \$6 million during life was unnecessary
- Stock transferred to kids at carryover basis of \$2 million so if they sell the stock will recognize a \$2 million gain subject to capital gains tax of up to approx. \$600k in tax
- If stock had transferred on death would have received stepped up basis of \$4 million and had \$0 in capital gains tax on sale of stock
- Silver lining- If they live in a state with state level estate tax but no gift tax

Setting the Stage

- Pro's for accelerated giving
 - Increased exemption amount set to sunset in 2025 (good possibility it may be reduced even sooner)
 - Taxable gifts during life may save transfer taxes in states that have estate or inheritance tax but no gift tax
 - Charitable gifts during life > charitable gifts at death
- Cons for accelerated giving
 - Lack of liquidity and carry-over basis on lifetime gifts of appreciated assets while transfers at death receive a stepped-up basis

Life Income Vehicles as Transfer Tax Tools



Charitable Remainder Trust

- Charitable gifts during life > charitable gifts at death
 - If funded during life donor receives an income tax deduction for remainder value
- Taxable gifts during life may save transfer taxes in states that have estate or inheritance tax but no gift tax
 - Makes a current taxable gift to the income beneficiaries (if no right to revoke interests)
- Increased exemption amount sunsets in 2025
 - If the donor doesn't retain the right to revoke income beneficiaries' distributions, a current taxable gift is made to the income beneficiaries at the time of funding
 - If donor is not the beneficiary and no retained power, removes the assets from their estate by making current taxable gift
- Transfers at death receive a stepped-up basis
 - CRT is tax exempt so mitigates the loss of step up

Charitable Remainder Trust

- Trust that pays income stream to noncharitable beneficiaries and remainder to charity
- Term of years up to 20 or lifetime of beneficiaries
- Irrevocable
- Donor can deduct present value of charitable remainder
- Charitable remainder must be at least 10% of present value
- Tax exempt
- Defer capital gains on sale of appreciated property
- Income stream is taken off pre-tax proceeds
- Even with low 7520 rate (low deduction calculation) can be good tax planning
 - Defers capital gains through 4 tier carry out

Charitable Remainder Trust

- Can be funded with real estate, appreciated publicly traded securities (concentrations), and closely held business interests (no S corp)
- Multiple beneficiaries (can include class of living and ascertainable beneficiaries)
- Sprinkle power with independent trustee
- Charitable income beneficiary
- Deduction doesn't qualify for 2021's 100% of AGI election
- Flip provisions
 - Real estate
 - Can also be used to defer unitrust payouts
 - Can be specific date or triggering event not within anyone's direct control

Charitable Gift Annuity

- **Charitable gifts during life > charitable gifts at death**
 - If funded during life donor receives an income tax deduction for difference between amount paid and present value of annuity
- **Taxable gifts during life may save transfer taxes in states that have estate or inheritance tax but no gift tax**
 - Makes a current taxable gift to the income beneficiaries (if no right to revoke payments)
- **Increased exemption amount sunsets in 2025**
 - If the donor doesn't retain the right to revoke income beneficiaries' distributions, a current taxable gift is made to the income beneficiaries at the time of funding
 - If donor is not the beneficiary and no retained power, removes the assets from their estate by making current taxable gift
- **Transfers at death receive a stepped-up basis**
 - Trigger gain if fund a CGA for others with appreciated assets so the CRT works better if dealing with appreciated assets

Charitable Gift Annuity

- Bargain sale purchase of an annuity through a contract
- Governed by state law
- Over 90% of charities that issue CGAs use American Council on Gift Annuities rates
- Tax free income (based on basis)
- Secure fixed income
- Capital gains deferral
- Donor receives income tax deduction of amount transferred minus present value of annuity
- Deduction may be eligible for coronavirus legislation 100% of AGI election (per Russell James <https://sharpenet.com/cares-act-and-charitable-gift-annuities/>)

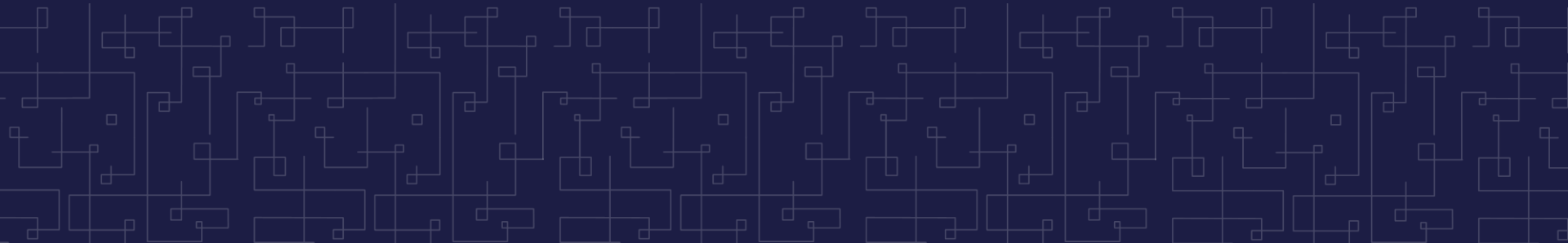
Charitable Gift Annuity

- Can be purchased for someone else
 - If no right to revoke payments, completed gift is made
- Rate will be based on age of annuitant
- Donor will receive income tax deduction
- Capital gains deferral is not available if donor is not annuitant
- Annuity for someone else is still tax free based on donor's basis
 - Low interest rate opportunity as tax free amount is more

CRT vs CGA

- CRT usually favored if:
 - Funded with appreciated assets (when purchasing for someone else)
 - Beneficiaries are young
 - Want Trustee in charge of allocating funds each year
- If none of these apply:
 - Charity may still prefer CRTs based on size of gifts vs pool (potential liability)
 - Could negotiate rate down
 - Client may prefer CGAs due to no set up costs and more certain income
 - Client may prefer CGA based on family dynamics (could also use multiple CRTs)

Other Non-Retirement Income Uses



Testamentary CRTs and CGAs

- Funded at death
- Used to provide for a loved one and make a gift to charity
- Reasons for using
 - Keyword – “control”
 - Spendthrifts
 - Beneficiaries other than family where you want to direct remainder
 - Benefit client’s charities and legacy
 - Stretch IRA alternative (CRT)
 - SECURE Act was passed in December, 2019

Other Charitable Remainder Trusts

- Wealth replacement paired with life insurance
 - Income tax planning for sale of appreciated asset while also not reducing amount to heirs at death
- Divorce (TCJA changed the rules around deductions for alimony)
- Sale of business (PLR 200720021)
 - CRTs can be funded with LLC, Limited Partnership, or closely held C Corp stock
 - Business may redeem shares or interest
 - Must avoid pre-arranged sale
- Art and collections
 - Unrelated use so deduction limited

Charitable Gift Annuities- Beyond Retirement Income

- Accelerated Bequest
 - Very Deferred CGA (as presented at 2018 ACGA conference by Robert Sharpe)
 - Include letter of direction to future fiduciaries about charitable intent
- CGA for caretaker/friend/sibling

CGA Case Study

- Mr. Selfmade is a 59 year old high income earner
- Would like to make a \$1 million bequest to charity
- His mother is 82 and has no assets and very little income
- She lives in a retirement home that costs \$5,000 a month
- Mom's CGA rate is 7% so to get to \$60,000 a year he would need to fund annuity with \$860,000
- Income tax deduction of \$420,000
- Makes a taxable gift to mom of approx. \$440,000 (increased exemption)

CGA Case Study

- Any ordinary income paid is taxed at mom's much lower tax bracket
 - If mom outlives expectancy 100% of income is ordinary income
- Mr. Selfmade can change bequest to pay the difference between amount realized from CGA and \$1 million
- Income to mom continues if Mr. Selfmade predeceases



“Change is the only constant in life”
-Herclitus

