FACT SHEET

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Better Estate Planning

CHARITABLE GIVING

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Estate planning begins with wise analysis and inventory of one's property and assets. In planning, one exercises the privilege of conserving the estate as well as minimizing costs. Wise planning includes definite plans for the present and future.

Wills, trusts, insurance and savings plans, money plans, plans for operating the business, fair market value, property consideration, beneficiaries, executors, minimizing taxes and administration of an estate are some of the factors considered in planning. This fact sheet explains charitable gifts.

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Giving to charitable organizations has become a part of the American way of life. Because government recognizes the valuable contribution these groups make to society, it encourages giving to such enterprises and allows deductions for gifts on tax returns. There are income, estate and gift tax savings which arise when one gives money to charity. In some instances it may be possible to save money by giving it away.

Most people make gifts to charitable groups because of their appreciation for the type of service which the charity provides. Generally a secondary consideration is the fact that donors also receive tax benefits. While most donors are not motivated to give to charity because of tax benefits, it is important that donors are aware of the role charitable donations play in one's personal and financial planning.

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Initially it is important to consider the type of gift qualifying as "charitable" by taxing authorities. The gift must be made to a qualifying organization generally defined as being engaged in non-profit religious, charitable, scientific, literary or educational endeavors. Gifts given directly to needy individuals and families might indeed be a charitable act, but such direct giving unfortunately does not qualify for a tax deduction. The Internal Revenue code makes a distinction between certain types of charitable organizations and allows a greater income tax deduction for donations to some than it does to others.

Deductions for charitable giving most familiar to taxpayers would undoubtedly be on the annual income tax return. The current tax law allows a donation of up to 50 percent of one's adjusted gross income when giving to churches, hospitals, educational institutions and other charitable organizations. There are, however, certain non-qualifying charitable organizations because of the manner in which their income is derived. Donations to these groups are limited to 20 percent of one's adjusted gross income. An inquiry to one's favorite charity will reveal its percentage category.

There are two basic ways to make a gift to charity. The preferred method from the standpoint of the charitable organization is an outright donation with no restrictions. The second method is to defer the gift, whereby the property is not received until a future time. Giving one's home to a qualified organization, while reserving the right during life to use and live in it, is an example of the latter method.

There are numerous tax advantages of an outright gift to charity. There would be no gift taxation what-

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ever. To the extent that such a gift would reduce one's holdings at death, there may be a savings indirectly in federal estate taxes.

Income tax benefits also flow from charitable giving. Deductions are allowed on the income tax return to the extent they do not exceed 50 percent of the adjusted gross income. In the event of a large gift, the excess over 50 percent can be "carried over" and deducted on the individual's income tax return for 5 succeeding years, again up to 50 percent per year.

Living in a high tax era with a graduated tax rate which gets progressively higher on higher accumulations, it becomes clear that an actual donation has a net cost which is dollars donated less the dollars saved in taxes. The individual with higher income will find that donations cost comparatively less than a person who is in a lower income tax bracket.

Methods of making a deferred gift to a charitable institution take many forms. A deferred gift contemplates that some part or all of the gift will be presently retained by a donor for individual, personal use until a later date when the charity will acquire whatever remains.

The most common method of making a deferred gift is by including a bequest in one's will. A charitable organization is not an heir and if it is to be remembered at death, a will is essential. The value of the gift included in the will reduces the amount of gross estate which death taxes are assessed. Again, if the estate is large enough to be taxable, the savings in taxes reduce proportionately the cost of the gift.

Gifts in wills sometimes postpone the gift to a charity beyond the date of the individual's death, such as when property is left to a surviving spouse for life with the remainder going to charity upon the spouse's death. In this case the value of the remainder interest based upon the surviving spouse's life expectancy from the Internal Revenue Service annuity tables, represents the amount of gift deduction on the estate tax return.

The Tax Reform Act of 1969 requires that a charitable deduction be allowable for a remainder to charity *only* if the transfer is:

- A remainder interest in a charitable remainder annuity trust, a charitable remainder unitrust or a pooled income fund

- A remainder interest in a personal residence

- A remainder interest in a farm

- A transfer of an undivided portion, not in trust, of the decedent's entire interest for the entire term of his interest

Life insurance policies are very flexible property items and represent an excellent way of charitable giving. Giving old policies no longer needed for family security will reduce cash inflow into one's estate at death, avoiding extra taxation. Of course, in an estate of lesser value, insurance is one sure method of having liquid assets on hand to pay off debts, and the cash inflow may be extremely desirable.

The tax benefits of giving life insurance policies vary. A donation of one's life insurance policy is a gift of its replacement (cash surrender) value. That value is deductible on one's income tax as a charitable donation. When one continues to pay premiums on a policy given to charity, such premiums are deductible on income tax. In giving insurance, the policy itself must be given away beyond the donor's effective power to control it.

In making property donations having an appreciated value, a donation was formerly allowable for the whole value of the donated property. In this way one could avoid tax on its increase in value and get a charitable deduction for the "paper profit." Recent tax reform laws have modified this approach slightly but it is still worth considering even though the tax benefits have been diminished.

The so-called "Bargain Sale" whereby property having an appreciated value was sold to a charity at cost formerly gave a charitable tax deduction for the increased value. This increase was not taxed as income. However, Congress has curtailed these previous benefits.

Corporations are taxed on corporate profits, and the dividend income is taxed again from those receiving it. If a person is the owner of a closely held corporation, it is usually advantageous for the corporation to make gifts the owner might otherwise desire to make before the money goes through two taxing steps. The gift is deductible entirely by the corporation up to 5 percent of its taxable income.

Farmers should consider donating crops to charitable causes. If the crop is produced and sold, an income tax arises on the profit. The usual sale price is a charitable deduction against other income and no income tax results on the profit. Note that the costs of producing the donated crop are not tax deductible.

Philanthropic enterprises are becoming aware of the benefits that can be derived when the public is aware of the tax aspects of charitable giving. These organizations have devised methods of helping those who wish to donate to them on a deferred basis.

Charitable and religious organization representatives can explain more fully the benefits of certain donative arrangements such as gift annuity trust, life income from a pooled income fund or a charitable remainder unitrust.

The gift annuity trust operates on the principle that the charity takes the donor's money and returns it at a small fixed monthly rate as long as the donor lives. The rate is low enough that the annuitant can never live long enough to get all of the investment back. On the average using the accepted, IRS-approved rate of return tables, it is estimated that one-half of the investment will find its way into the charity's work. Therefore, an annuity contract will generate an income tax deduction for about half of the investment. The income to the annuitant is largely tax free (one's own money is being returned) and only that small portion which represents investment income is taxed to the annuitant. For elderly people the rate of return is higher and this may not be a particularly good method of charitable giving for a young person.

Arranging a life income from a pooled income fund or a charitable remainder unitrust involves contractual arrangements whereby property is given to a church or other charity in exchange for a lifetime income. At death the property invested belongs to the charity. The recent tax reform provisions made some new requirements for this type of gift arrangement and the particular tax benefits now available should be considered fully when this type investment is contemplated.

Three basic ways of making a deferred gift to charity are summarized in the following paragraphs.

Charitable Remainder Unitrust. Husband and wife donors could transfer money or other holdings to a trustee who would pay them an income for as long as either or both are alive. Upon death of the last survivor, the transferred property would belong to the charitable institution. Assets would be kept in a single fund and donors would draw payments based on a fixed percentage of the trust's asset value, determined on a yearly basis. Percentage paid to them must be at least 5 percent.

If the donors transferred $100,000 in cash to a charity, they would specify that 5 percent of the value of trust assets be paid to them yearly. The first year they would receive $5,000. In succeeding years, they would get more or less than $5,000, depending on the increase or decrease in yearly value of the trust holdings.

From a tax standpoint, this arrangement has several advantages:

- The $100,000 contribution may be deducted up to 50 percent of adjusted gross income and can be carried over into the next 5 years. In other words, the donors can spread out the $100,000 in tax deductions over 6 years.

To establish charitable trust arrangement, consider the following suggestions:

County or state Extension offices can provide information and help with personal financing and estate planning. They also have other sources of information and assistance.

Some charities, including universities, church denominations and foundations have special representatives and programs to help persons carry out charitable plans with maximum income and tax advantages. Ask your favorite charity or school for information. Obtain the counsel and assistance of an attorney, accountant, bank trust officer or other qualified estate planner. Procedures necessary to insure smooth transfer of an estate and protection of income and tax benefits are very

Table 1. Advantages of tax qualified charitable remainder giving programs

Unitrust	Pooled income fund	Annuity trust
• Kept in separate fund	• Kept in a pooled fund	• Kept in a separate fund
• Annual payment not less than 5% of total trust paid to income beneficiary	• Annual or more frequent income payout can be made	• Assures fixed income
• Income from both spouses as long as they live	• Income from both spouses as long as they live	• Charitable income tax deduction permitted in part
• Capital gains tax saving	• Excellent hedge against inflation	• Avoids estate tax
• Good hedge against inflation	• Higher returns in good years	
• Avoids estate tax	• Income tax advantages similar to unitrust	
	• No estate tax problems	

Upon death of income beneficiaries, all remaining property goes to charitable institution.

exacting and should be handled only by qualified persons.

Remember, too, that there is risk involved in any gift of this nature because the management of one's assets are turned over to someone else. Verify the soundness of the charitable organization with which you are dealing.

- Suppose the contribution is in the form of appreciated securities (such as stocks and bonds) worth $100,000 but which originally cost $25,000. Donors can avoid income tax on the gain of $75,000; however, the income tax charitable deduction on appreciated stock is limited to 30 percent of adjusted gross income each year. The deduction can still be spread over an additional 5 years, if necessary.

- Income from the unitrust is taxable, but depending on how the trust earns its increased value, the donors' income may not be taxed as ordinary income but rather at the more desirable, capital gains rate.

- Morever, in a unitrust arrangement, the donor is allowed an income tax deduction based upon age and percentage withdrawn as income. Larger deductions are allowed to contributors in higher age brackets. A higher annual income reduces the size of the gift left to charity upon the death of the donor. Deductions on income tax also are lower.

- Donors can enjoy substantial estate tax savings because the value of the unitrust is never included in gross estate value at death.

Pooled Income Fund. Donors also can make life income contracts with their favorite charity. A gift is pooled with other gifts received by the charity and invested to produce income. In exchange, donors receive annual income earned by their gift. For example, if a $100,000 gift earned 6.5 percent, donors receive $6,500 that year. Upon the death of the last survivor, the charity owns the gift outright.

There is no guarantee on the minimum amount of annual income one can expect from this arrangement. A 5 percent return seems conservative; with good management and a growing economy, returns should be higher.

Charitable Remainder Annuity Trust. Here, a fixed dollar return on the investment is guaranteed. The annuity trust has a variety of estate, gift and income tax advantages which can be beneficial to people needing a guaranteed return.

The cost of giving when examined realistically by 20th century tax policies is not as high as one might think. Ways exist whereby one can provide for retirement years and also enjoy seeing an estate working in a worthwhile and satisfying way for the benefit of others while a person is still living.

Remember, gifts to charity are completely tax deductible at death on one's estate tax return, and no gift tax is ever paid on a gift made during life to a qualified charity. The deduction for a charitable donation is limited only on income tax. In those instances one may still give generally up to 50 percent of his annual income. Gift giving to charity reduces the estate and lessens the impact of taxation which is assessed on a graduated basis, making the amount of tax greater on larger holdings. Giving to charity is an excellent method of tax reduction through estate reduction. Giving to charity in some instances does not cost, but it pays. The satisfaction gained from seeing good accomplished in the world through a gift, plus saving that which might otherwise be lost, makes intelligent giving to charity worthy of one's most careful attention. Charity still offers excellent benefits to persons wanting to avert the heavy impact of death and income taxation.

See table 1 for advantages of tax qualified, charitable remainder giving programs.

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