



United Way of Santa Barbara County

Planned Giving in Difficult Economic Times

In difficult economic times, people tend to tighten their financial belts. In the fall of 2008, the individual savings rate increased to its highest level since 2002 in response to the bad economic news. Today, a sense of thrift and sacrifice has become paramount in personal financial planning.

Lower personal spending and reduced household budgets have had an impact on individual charitable giving. The Center on Philanthropy at Indiana University published its *Briefing on the Economy and Charitable Giving* in December 2008. The authors linked charitable giving trends to economic indicators such as the GDP, the S&P 500 and reported individual income. In predicting the level of charitable giving at this time, the authors noted that the amount of giving can decline in periods of recession and can decline considerably in long recessions.

However, the authors also noted that most households continue to give during times of financial insecurity. The desire to help and support favorite charities remains strong. And, it is especially true that charities need this help and support today more than in other years.

In this newsletter, we discuss different options for planned giving in difficult economic times. There are two types of giving that fit this description:

- Giving at little or no present cost, and
- Giving that could be advantageous in the present down market.

One (or more) of these options may provide a way for your clients to continue their positive philanthropic efforts through lean years.

Charitable Lead Trust

One method of charitable giving that has a distinct advantage during an under-performing economy is the charitable lead trust (CLT). A CLT is an irrevocable

an income, estate and gift tax
service for attorneys and other
professional advisors

TECHNIQUES

Second Quarter 2009

In this issue:

- Charitable Lead Trust
- Charitable Bequest
- Charitable Gift of a Life Insurance Policy
- Altering a Charitable Pledge
- Charitable Gift of Services
- Charitable Gift Annuity

trust established to pay a charity an annual income consisting of a specified dollar amount or a percentage of trust assets as determined every year. At the end of the trust term (either a term of years or as based on a measuring life), the CLT assets are distributed to non-charitable beneficiaries.

There are two types of qualified CLTs: grantor CLT and non-grantor CLT. The grantor CLT distributes the assets (back) to the grantor at the end of the trust term. The non-grantor CLT distributes the trust assets to family members at the end of the trust term. The advantage of the non-grantor CLT is the enhanced ability to transfer assets to family members (it is often called a “family lead trust”).

A primary reason for the viability of non-grantor CLTs is the historically low applicable federal rate (AFR). The AFR is published by the Treasury department every month to value annuities, life interests or interests for terms of years and remainder or reversionary interests. The AFR is important because a low AFR increases the present value of the charity’s income interest which reduces the valuation of trust assets expected to go to non-charitable beneficiaries. Moreover, if the trust corpus appreciates during the trust term, the appreciation escapes transfer taxation when it ultimately passes to family members. The AFR for February 2009 was 2.0%.

A second reason for the viability of a non-grantor CLT is the advantage gained by utilizing assets with depressed values. If the grantor believes that the value of the assets in the CLT will improve during the term of the trust, the grantor has the advantage of a lower transfer tax valuation at the time he or she puts the assets into the CLT.

A third and possibly most important advantage is that the CLT benefits the charity immediately with annual payments. As noted, charities are having a difficult time, and the philanthropic boost of the CLT is more direct than a charitable gift annuity or a charitable remainder trust.

Charitable Bequest

Bequest giving is the most popular form of planned giving. Donors appreciate the simplicity of naming a worthwhile charity in their will. And, donors continue to utilize the asset during their lifetime. A bequest is a way to memorialize their commitments to charity, so including a charity in estate plans has a strong appeal to many donors. Even though it may be difficult to make a significant gift today, these donors can plan for a very significant gift from their estate.

Nearly any asset can be used to make a charitable bequest, but certain types of property are uniquely appropriate for bequests.

Tangible personal property

Tangible personal property (e.g., artwork, collections, antiques, etc.) may be given to a charity by bequest. Bequests of tangible personal property qualify for the estate tax charitable deduction for the current full appraised value without regard to whether the charity puts the property to a "related use" as is required for the income tax charitable deduction.

Ordinary income property

Ordinary income property (e.g., artwork owned or a copyright held by the original artist creator) given by bequest is also deductible at the current full appraised value for purposes of the estate tax charitable deduction. The reduction of the deemed amount of the contribution to cost basis required for the income tax charitable deduction does not apply for estate tax purposes.

Depressed value property

Since heirs cannot benefit from a step-up in basis with depressed property, property that has experienced a loss in value may be particularly appropriate for a charitable bequest.

Income in respect of a decedent

Income in Respect of a Decedent (IRD) is inherited property that would have been taxable income to the

decedent if the decedent had received it before death. Common examples of IRD are an IRA that was tax deductible or a qualified plan such as a 401(k) plan where contributions were made on a pretax basis. Since the earnings have never been taxed, IRD is subject to federal income tax. And, if the estate of the decedent is subject to federal estate tax, IRD is an estate asset and is also subject to federal estate tax.

Donating IRD assets to a charity through a bequest can both create an estate tax charitable deduction and eliminate the negative income tax component because a qualified charity that receives the IRD assets is exempt from federal income tax. This is a significant tax-saving strategy but can be complex and requires the skill of a knowledgeable tax professional.

Charitable Gift of a Life Insurance Policy

Charitable gifts of life insurance can enable a donor to substantially increase the potential amount of his or her gift while enjoying attractive tax advantages. Plus, a charitable gift of life insurance is a cost-effective way to make a major planned gift. A donor has three basic choices in planning a gift of life insurance:

Gift of an existing policy

A simple, outright gift of an existing life insurance policy can qualify for the income tax charitable deduction. To do so, the donor should assign all rights to charity (naming charity as policyowner and beneficiary). If the donor retains any rights in the policy after the assignment, such as the right to borrow cash values or to change the beneficiary, the result would be a gift of a "partial interest" that would not qualify for the income tax (or gift tax) charitable deduction.

When an individual gives a life insurance policy to charity, the amount of his or her charitable contribution is deemed to be the lesser of:

- The fair market value of the policy, or
- The donor's basis in the policy.

Gift of a new policy

The donor may apply for a new policy on his or her life, with the charity as the original policyowner and beneficiary. The fair market value of a newly issued policy is the initial premium that was paid to put the policy in force. And a newly issued life insurance policy can substantially leverage the size of a donor's gift. To secure such a policy, funds should be donated to the charity, and the charity should be applicant, owner and beneficiary of the new policy. However, be sure to check state laws regarding insurable interest.

There are two major benefits of making the charity the applicant. The first benefit is that the initial premium

amount donated to the charity may be deducted. If the donor had bought the policy and then donated it, the fair market value of the policy on the date of donation would likely be lower than the donor's premium (cost basis), and would permit only the lower deduction.

The second advantage of making the charity the applicant is that, because the donor will never have held any incidents of ownership in the policy, its value will not be included in the donor's gross estate at death.

Naming the charity as a beneficiary

If a donor does not desire to make an immediate gift with respect to an existing policy, the donor may retain ownership and control of the policy but name a charity as beneficiary for part or all of the death benefit. This will not produce any income tax charitable deduction at the time the beneficiary designation is made, but it will result in an estate tax charitable deduction for the death proceeds passing to the charity at the insured donor's death.

A Two-Part Approach: Sell a Depreciated Asset and Donate the Proceeds to Charity

A charitable gift of depreciated stock is not a good choice. The stock has lost value and the donor who gives a depreciated stock to charity has a deduction for the fair market value of the stock, not the original price paid for the stock. However, an individual can deduct

investment losses, so he or she could sell the stock and deduct the loss. Then the individual could donate the proceeds from the sale of the stock to a charity.

Normally, the time that donors utilize this planning approach – combining a sale of a depreciated stock with the charitable donation of the sale proceeds – is the end of the year. Individuals make changes and reposition their investments after assessing the performance of the investments during the year. But the financial markets are less predictable so this may be a year-round approach.

Charitable Gift of Services

Donors that have reduced cash or property contributions to charity during this economic downturn may see volunteering services as an attractive option. However, no matter what a client would pay for what the donor can do, the same services contributed to a charity are not deductible as a charitable contribution. Nor does a donor that permits a qualified charity free use of office space or other property generate a deduction; this is a gift of a partial interest in the property. But, a donor that incurs reasonable expenses while volunteering for a qualified charity can deduct those unreimbursed expenses. And mileage is deductible – for 2009, the donor can deduct \$.14 for every mile traveled in his or her own vehicle while conducting service for the charity.

Charitable Gift Annuity

The charitable gift annuity is a great favorite with donors because of its relative simplicity and flexibility to complement personal financial planning. A charitable gift annuity is both a gift and an annuity – it is treated like a bargain sale for tax purposes. The donor enjoys a charitable deduction for the part that is considered the gift, and the donor (or the annuitant the donor names) receives a lifetime payout.

The lifetime payout is determined by the prevailing rates the charity sets by age. Like a commercial annuity, part of the payment is tax-free to the recipient for the duration of the annuitant's life expectancy. As noted above, the AFR is extremely low. At the time the gift annuity is established, the tax-free return of principal is measured. And a low AFR results in a larger tax-free portion to the annuitant.

Given these difficult economic times, many individuals might appreciate the fixed payout of a charitable gift annuity. After considering how a charitable deduction and larger tax-free component can bolster the effective payout rate of the charitable gift annuity, this might be an opportunity for donors to both give to charity and help themselves.

Altering a Charitable Pledge

A pledge is a donor's promise to make a gift to a charity in the future. Whether the charity wants to legally enforce a donor's unmet pledge is a difficult choice. Unfortunately, an inability to fulfill a pledge may become a more common instance during difficult economic times. There are, however, solutions to this problem:

- Defer payments
- Reduce the amount of the pledge
- Give a different asset (e.g., a valuable collectible instead of cash or appreciated securities)
- Change the form and timing of the gift (e.g., switch to a bequest)
- Help the charity to fundraise instead of personally giving

New Tax Developments

Naming a charity as a beneficiary for a deferred compensation plan does not compromise the corporation's deduction

A corporation requested a private letter ruling on the issue of whether naming a qualified charity (a 501(c)(3) organization) as a beneficiary of an employee's deferred compensation would preclude the deduction of the compensation pursuant to IRC Sec. 404(a)(5).

The IRS determined that, ultimately, if the spouse makes a qualified disclaimer with respect to the employee's deferred compensation or predeceases the employee, naming a qualified charity as the designated beneficiary of the deferred compensation will not preclude the employer's deduction of the compensation pursuant to IRC Sec. 404(a)(5).

PLR 200905016

Charitable gift annuity rates suggested by the ACGA are lowered

The American Council on Gift Annuities (ACGA) publishes recommended rates for charities. The ACGA promulgates its rates based on actuarial assumptions with the idea that after the investment of the entire gift, the residuum will be at least 50% of the initial gift amount, if the annuitants live only to their life expectancies. Recently, the Board of Directors of the ACGA approved a recommendation from the Rates Committee to reduce the charity's expected return assumption for investing the assets from 5.75% to 5.25%. A new rate schedule has been developed reflecting this change.

Recommended rates have been lowered by .4% to .7% at each age with a maximum rate of 9.5% at ages 90 and above. The new rates will qualify at all ages at an AFR of 2.4% or above. The new rate recommendations are effective on February 1, 2009. In the case of deferred gift annuities, there may be a few instances in which rates based on the ACGA's suggested schedule and methodology do not qualify when the AFR is quite low. In those instances, the deferred rates would have to be reduced to qualify.

www.ACGA-web.org

Treasury issues supplemental actuarial tables to account for sub-2.2% AFR

In Notice 2009-18, the Treasury provides supplements to the actuarial tables prescribed under Sec. 7520 of the Internal Revenue Code. The actuarial tables are used to value annuities, terms certain, reversions, and remainders. The interest rate required for these computations is 120% of the mid-term Applicable Federal Rate for the month of valuation (or, for transfers for charitable purposes, the interest rate for either of the two months preceding the month of valuation).

Recently, 120% of the mid-term Applicable Federal Rate fell below 2.2% (2.0% in February 2009). None of the published tables provides factors for the interest rates below 2.2%. This notice furnishes extensions to the existing tables for interest rates below 2.2%.

Notice 2009-18, 2009-10 IRB 1 (11 February 2009)

This newsletter is for information and discussion purposes only. It is provided with the understanding that the publisher does not intend to render legal, accounting or tax advice. Each professional must evaluate the tax and financial consequences of each individual situation. While the publisher has been diligent in attempting to provide accurate information, the accuracy of the information cannot be guaranteed. Laws and regulations change frequently, and are subject to differing legal interpretations. Accordingly, the publisher shall not be liable for any loss or damage caused or alleged to have been caused by the use or reliance upon the information in this newsletter.



**United Way
of Santa Barbara County**

Judy Goodbody, CFRE
Gift Planning Services Officer

320 East Gutierrez Street
Santa Barbara, CA 93101
Tel 805/965-8591, ext. 120
Fax 805/962-3461
jgoodbody@unitedwaysb.org
www.unitedwaysbgift.org

