



United Way of Santa Barbara County

Planned Giving Options for Working Professionals

Business owners, executives, professionals and highly compensated consultants or employees are motivated to save for retirement. They may receive a salary or reliable fees, but total compensation can vary from year to year. During a low income year, working professionals can feel stretched and it may be difficult to save for retirement. In high income years, they face a different problem – limits on how much one can contribute to qualified retirement accounts. Working professionals need to find ways to save despite tax law limits set by Congress. Non-qualified deferred compensation may be an option (if the employer is so inclined) or the personal purchase of a deferred annuity from a commercial insurer could be considered.

However, there are also options for retirement savings that have a philanthropic aspect and generate an income tax charitable deduction (especially useful in a high income year). In this issue, we take a look at planned giving options for high income earners. Each of these options features both a way to save for retirement and a way to help worthy charities. Oftentimes, these working professionals want to help causes and programs that they find worthwhile. These successful people are often looking for a way to accomplish both their personal retirement goals and their philanthropic objectives.

The Limits on Annual Contributions to Qualified Retirement Accounts

Qualified retirement accounts are ideal for retirement savings because contributions can be made with pre-tax dollars and assets grow tax-free within the account. There are a variety of qualified

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retirement accounts, including: the Individual Retirement Account (IRA), 401(k), 403(b), 457, Simplified Employee Pension (SEP), and SIMPLE IRAs. These qualified retirement plans have a limit to the annual contribution an individual can make. Though it is true that persons aged fifty or over may contribute an additional amount for certain plans (called a “catch-up” provision), the limits still can be vexing. There is also an overall limit on the combined total amount that the employer and employee can contribute to defined contribution plans in a single year on behalf of

Qualified Plan Limits for 2009*

IRA	\$5,000	(\$1,000)
SIMPLE IRA	\$11,500	(\$2,500)
401(k)	\$16,500	(\$5,500)
403(b)	\$16,500	(\$5,500)
457	\$16,500	(\$5,500)
SAR-SEP	\$16,500	(\$5,500)

*Provisional amount of additional “catch-up” contribution for taxpayers age 50 and over in parenthesis.

the individual (the lesser of \$49,000 or 100% of compensation in 2009) [IRC Sec. 415(c)(1)(A)].

High income earners interested in incorporating charitable giving into their retirement planning have options. Two of the prominent options are the charitable remainder unitrust and the deferred payment gift annuity.

The Charitable Remainder Unitrust

A charitable remainder trust provides for a specified distribution, at least annually, to one or more beneficiaries for life or for a term of years with an irrevocable remainder interest to go to a qualified charity. The value of the charitable remainder must be at least 10% of the initial value of the assets transferred to the trust as determined at the time the trust is established.

There are two types of charitable remainder trust: the charitable remainder annuity trust (CRAT) and the charitable remainder unitrust (CRUT). The CRAT pays an annuity based on the payout rate set forth in the trust document – a sum certain that is not less than 5% and no more than 50% of the fair market value of all assets initially placed in the trust [IRC Sec. 664(d)(1)(A)]. The distribution to non-charitable beneficiaries will be the same every year. The CRAT is preferred by donors who want a fixed and stable income – a good choice for people who have retired, but not necessarily a good choice for those anticipating retirement.

The CRUT pays an annuity based on the payout rate set forth in the trust document – a fixed percentage that is not less than 5% and no more than 50% of the fair market value of the trust assets as valued every year. [IRC Sec. 664(d)(2)(A)]. The payout reflects the yearly investment performance of the assets inside the trust; the amount of the distribution to non-charitable beneficiaries can change from year to year. This “variable” payout can be a hedge against inflation. And, the CRUT can permit additional contributions to the CRUT in future years. The CRUT is preferred by donors who want an income stream that can keep pace with inflation. The different variations on the CRUT described below give the donor greater flexibility that is valuable in retirement planning.

The Net Income CRUT with a Make-up Provision

The net income unitrust (NICRUT) makes an income payment each year equal to the lesser of

the unitrust percentage of the trust’s fair market value (as re-valued annually) or the total income generated by the trust that year. So, if the assets within the trust do not produce income that exceeds the payout percentage, the NICRUT will pay only the income and not pay from its principal. Of course, if the assets within the NICRUT produce no income, there is no payout from the NICRUT.

The net income CRUT with a make-up provision (NIMCRUT) is a NICRUT with an additional feature: Every year that the NIMCRUT pays less than the amount determined by the payout percentage, the shortfall is recorded. If a shortfall happens more than one year, there can be an accumulation of this payout potential. In subsequent years, if the trust generates income in excess of the amount determined by the payout percentage, the excess amount can be paid out as a “make-up” to the extent of that accumulated shortfall amount.

The advantage to using a NIMCRUT for retirement savings is to achieve growth in the early years of the trust (while the non-charitable beneficiary continues to work), then later switch to income producing investments (about the time the non-charitable beneficiary retires).

The “Flip” CRUT

The Flip CRUT is a hybrid CRUT: a NICRUT that “flips” into a straight CRUT. A trigger event converts the CRUT from the net-income version into the straight CRUT. For example, a donor funds a CRUT with a parcel of real estate. The trigger event is the completed sale of the real estate. The real estate itself generates no income so the NICRUT makes no payments from the trust. When the real estate sells, the trustee invests the proceeds in equities that produce returns that will enable the trust to satisfy the required payouts.

Not every event can be a “trigger” event – acceptable triggers for a Flip CRUT include:

- A specific date
- The sale of a specific asset or assets
- The occurrence of some event outside the control of an individual (birth, death, marriage, divorce of a particular person)

Of course, retirement on a specific date could be set as the trigger for a Flip CRUT.

The Deferred Payment Gift Annuity

The regular charitable gift annuity arrangement provides that annuity payments begin no later than one year after the date of the gift. Working professionals often do not need or want immediate additional income, but they do want the relief of an income tax deduction during their higher earning years. A deferred charitable gift annuity allows donors to delay the starting date of annuity payments. The longer the deferral period, the higher the annuity rate. And, the longer the deferral period, the greater the income tax charitable deduction which is available to the donor the year the gift is made. If a donor cannot use the entire amount of the deduction, the unused deduction carries over into the next tax year (up to five years total for the carry-over). By deferring the annuity payments, the donor is able to get more tax relief needed during high earning years and receive a larger income stream when the donor will have a greater need for a steady fixed income.

The Flexible Deferred Charitable Gift Annuity

A deferred charitable gift annuity may include a provision in the agreement that allows the annuity starting date to be determined by the donor at

some future time – creating a flexible deferred charitable gift annuity. In PLR 9743054, the IRS has approved a deferred gift annuity that did not specify a firm starting date for the annuity payments. The donor established the annuity at age 50, and could elect to have payments begin at any time after age 55 and before age 80. Note that the gift annuity agreement between the donor and the charity specified a different payment amount (rising with the deferral of the start date) for each possible age at which payments might begin. The income tax charitable deduction allowed for the gift was based on the lowest possible deduction that would be available at the earliest annuity starting date (i.e., age 55 in this case). See also PLRs 200449003 and 200742010.

Commuted Payment Gift Annuity

Typically, a charitable gift annuity must make its payments over a lifetime (one or two lifetimes) rather than a term of years [IRC Sec. 514(c)(5)]. However, a charitable gift annuity agreement can contain a provision to permit the donor to commute the lifetime of payments to a fixed number of equal payments that, in total, have the same present value as the lifetime income interest. The donor must execute the commutation clause before payments are to begin.

Usually, the commuted payment gift annuity serves as a way to pay a student's college tuition and expenses (i.e., four equal payments for four years of college). But people who retire earlier (say age 62) than certain streams of income (pension, social security) are scheduled to begin (say at age 66) could use the commuted payment gift annuity in their retirement planning to provide a stop-gap measure.

In Conclusion

Planned giving can provide a way to save more than what would be possible in a qualified retirement account and do more for favored charities. The pairing of a life income gift that starts in the future plus an always useful current income tax charitable deduction can make one of these planned gifts a dynamic and very fulfilling part of a retirement plan. Working professionals who are charitably minded should know all the options when saving for retirement.

Comparison of a Regular and a Deferred Payment Gift Annuity

Donor Age:	60
Applicable Federal Rate:	2.8%
Gift Amount:	\$100,000
Payout Frequency:	Annual
Gift Date:	June 1, 2009

Regular Charitable Gift Annuity (payments begin on July 1, 2009):

Annual Payout:	\$5,000
Charitable Deduction:	\$25,611

Deferred Payment Gift Annuity (payments begin on July 1, 2016):

Annual Payout:	\$7,000
Charitable Deduction:	\$32,511

Note: A low applicable federal rate results in a lower charitable deduction, but also a higher exclusion ratio and a higher tax-free return of principal for each payout.

New Tax Developments

Grantor Charitable Lead Annuity Trust that Distributes Appreciated Property Realizes Capital Gain

A grantor charitable lead annuity trust (CLAT) guarantees an annuity to a charity and the grantor is taxed on the income the CLAT receives. The IRS recently issued a private letter ruling regarding the income tax consequences that result from a distribution of appreciated securities from the CLAT made to satisfy the annuity payment to the charity. Specifically, the issue concerned whether an annuity payment made with appreciated marketable securities would trigger a gain to the grantor or the trust.

The party requesting the PLR asked the IRS to support the idea that Rev. Rul. 55-410, 1955-1 C.B. 297 would apply wherein the satisfaction of a pledge with appreciated property did not give rise to taxable gain – just as when an individual makes a charitable gift of appreciated securities, the capital gain is not realized. The IRS disagreed and stated that annuity payments made by a CLAT were not the same as the payment to satisfy a pledge. Rather, the annuity payments from a CLAT constituted a legal right to the charity, not a mere promise. And a distribution made to satisfy a right to receive a specified dollar amount is a taxable exchange. Since income incurred by a grantor CLAT is attributable to the grantor, the grantor would be taxed on the appreciation as capital gain.

PLR 200920031

New Mortality Tables for Use under IRC Sec. 7520

IRC Sec. 7520 requires the Treasury to periodically update the mortality tables used to value annuities, interests for life or terms of years, and remainder or reversionary

interests. A new set of mortality tables (2000CM) was issued on May 1, 2009.

These new tables generally reflect longer life expectancy as compared to the older tables. This longer life expectancy reduces the value of remainder interests and increases the value of lifetime interests and annuities. The difference for planned gifts is a smaller charitable deduction for charitable remainder trusts, charitable gift annuities, pooled income funds and gifts of a remainder interest in a residence or farm.

IRB 2009-20 (T.D. 9448)

Expiration of the Carryover of Excess Charitable Contribution into Future Tax Years

A recent Tax Court case raised the issue of the carryover contribution amount permitted under IRC Sec. 170(d)(1). There is a limit on the amount of a charitable contribution that a donor can deduct in a given year as a percentage of the donor's adjusted gross income. However, a donor could carry over the amount of a cash charitable contribution that exceeds the donor's "contribution base" into future tax years. The excess amount is considered a charitable contribution paid in each of the successive years (up to five years).

In this case, the taxpayer argued that the excess amount could be taken in whatever manner he chose within the five year period. The Court disagreed and ruled that some portion of the deduction will expire each year whether it is used or not. And, this is true even if the taxpayer chooses to take the standard deduction in a given tax year.

Gregory A. Maddux et. ux. v. Commissioner: T.C. Summ. Op. 2009-30; No. 8072-08S, Mar. 4, 2009.

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