Charitable Giving Strategies

CONTENTS

WHY TO GIVE 2

Saving income taxes 3

Saving estate taxes 6

Substantiation and disclosure rules 7

WHICH ASSETS TO GIVE 9

Cash 9

Appreciated stock 9

Insurance 13

Personal residence 15

Vehicle 17

Collectibles 18

HOW TO GIVE 19

Direct gifts and bequests 19

Partial interest gifts 19

Charitable gift annuities 21

Charitable trusts 22

Private foundations 26

Supporting organizations 28

Donor-advised funds 30

WHEN TO GIVE 32

What's the next step? 32

This publication was developed by a third-party publisher and is distributed with the understanding that the publisher and distributor are not rendering legal, accounting or other professional advice or opinions on specific facts or matters and recommend you consult a professional attorney, accountant, tax professional, financial advisor or other appropriate industry professional. This publication reflects tax law in effect as of December 31, 2007. Some material may be affected by changes in the laws or in the interpretation of such laws. Therefore, the services of a legal or tax advisor should be sought before implementing any ideas contained in this Guide. ©2008 CGS 2/08

WHY TO GIVE

There are probably as many reasons to give to charity as there are charities to give to, but they generally can be divided into three broad categories. The first, of course, is supporting an organization or cause you care about. The second is to leave a personal — and often also a family — legacy. Both of these reasons are very personal, and only you and your family can determine how they should impact your charitable giving strategy. But the third reason for giving to charity will require more than just soul-searching. It's to save taxes, and you'll need to be familiar with the subtleties of the tax law to be able to make wise decisions about how charitable giving should fit into your personal wealth management plan.

In this guide, we'll take a close look at how giving to charity can save you both income and estate taxes while achieving your charitable goals. We also will examine the types of assets you might want to consider giving, as well as the pluses and minuses of each. Finally, we'll discuss how to make charitable gifts. The methods presented will help you determine not only how to save the most taxes, but also how to best achieve your other charitable goals, such as supporting your favorite organizations as you wish, leaving a legacy, and even instilling the charitable spirit in your children, grandchildren or other heirs.

Charitable giving is a powerful tax-saving tool not only because you can deduct the contributions for income and estate tax purposes, but because you make them *at your discretion.* For example, you may give the type of assets that will generate the greatest tax savings, such as long-term appreciated assets. Such gifts provide you with not only an income tax deduction, but also the ability to avoid capital gains tax on the appreciation. You also can time your contributions to maximize their tax-saving power, such as by giving in years when you are in a higher income tax bracket.

Giving tip 1

MAKE SURE THE ORGANIZATION IS QUALIFIED

You may deduct contributions only to IRS-qualified organizations. These usually include religious, charitable, educational, scientific or social welfare groups, including, in certain limited circumstances, foreign charities. Make sure any organization you're considering qualifies by looking it up on the IRS Web site, www.irs.gov. If it doesn't qualify, you may lose your tax deduction.

SAVING INCOME TAXES

Charitable contributions are deductible for income tax purposes, but only within certain limits. So, as with any tax deduction, you must know the rules to fully unlock the benefit. Of course, you should always consult with your tax professional to ensure that you are complying with all tax laws.

Why *what* you contribute matters

Cash may be the most obvious contribution, but it may not be the best. Don't overlook other assets you might give that could provide a greater tax benefit. Here are the primary contribution types:

Cash. This is the most straightforward contribution type. The deductible amount is simply the amount you donate less the value of any goods and services you receive in return. For example, if you paid a charitable organization $1,000 to attend its annual gala, and the gala's value was $200, the deductible charitable contribution would be $800. Your receipt from the charity should indicate the value of anything you received in return.

Short-term appreciated property. If you donate appreciated property you have held for one year or less, your charitable deduction is limited to your original cost basis. So, this is generally not the ideal asset to give to charity.

Long-term appreciated securities and real property. If you donate appreciated securities or real estate you've held for more than a year, you can deduct the property's full fair market value (FMV). (See Giving tip 2 on page 4.) You'll avoid having to pay any capital gains tax on the appreciation, which is the FMV less original purchase price. Your deduction would be reduced, however, to the extent of the ordinary income (such as depreciation recapture) you'd recognize if you had sold the contributed property. (See page 9 to learn more about contributing appreciated stock.)

Giving tip 2

UNDERSTAND FAIR MARKET VALUE

Fair market value (FMV) is defined as "the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts." The IRS set this definition as the standard for FMV, and it's used for federal income, gift and estate tax matters, including charitable contribution deductions.

Long-term appreciated personal property. This is property other than securities or real estate that has increased in value, such as jewelry, art and collectibles. If the property is unrelated to the charity's exempt purpose, your deduction is generally limited to the original cost (less depreciation) of the donated asset. You can claim a deduction based on FMV only if the property can be directly used to advance the recipient charity's tax-exempt purpose, such as the gift of a painting to an art museum.

Services. You can't deduct time spent providing charitable services, but you can deduct incidental costs of your charitable work. These include any unreimbursed expenses directly connected with the charitable service. For instance, you can deduct vehicle costs such as tolls, parking fees and mileage.

How your AGI can limit your deduction

Your allowable deduction is limited to a percentage of your adjusted gross income (AGI) for the applicable tax year. You can carry forward any excess contributions for five years, subject to the same annual percentage limits.

There are three percentage limitations — 50%, 30% and 20% — based on the type of property donated and the type of organization receiving the donation. (See Chart 1.) Higher limits apply to cash and ordinary income property gifts. Generally, when donating *appreciated* property to charity, a higher limit applies if you elect to deduct

Chart 1

AGI limitations on charitable contribution deductions[1]

		Private foundations[2]	
	Public charities	**Operating**	**Nonoperating**
Contribution type			
Cash and unappreciated property	50%	50%	30%
Ordinary income property[3]	50%	50%	30%
Long-term capital gains property[4]	30%	30%	20%

[1] *For this purpose, adjusted gross income (AGI) is computed without regard to the deduction for charitable contributions and any deduction for a net operating loss carryback.*

[2] *An operating foundation spends at least 85% of the lesser of its adjusted net income or its minimum investment return in carrying out its exempt activities and meets certain other tests. Others not meeting this definition are nonoperating foundations.*

[3] *Deduction is generally limited to the property's adjusted basis.*

[4] *Generally, the full fair market value of the property is deductible, subject to the percentage limitations.*

Source: *U.S. Internal Revenue Code*

only your basis in the property (the original property cost) than if you choose to deduct the property's FMV.

The limits also generally are higher for contributions to public charities and private operating foundations than for private nonoperating foundations. Public charities include service organizations, such as the Red Cross, the Sierra Club and the American Cancer Society; and most religious organizations, schools and hospitals. Operating private foundations directly engage in charitable activities (as opposed to simply making grants), so they enjoy the same contribution limits as public charities. Private nonoperating foundations are subject to lower contribution limits because of concerns related to potential abuse by donors or foundation officials. But "pass-through" nonoperating foundations that distribute their gift receipts and income promptly can still enjoy the higher limits. (For more on foundations, see page 26.)

Believe it or not, deducting a property's cost basis instead of the FMV can be more beneficial in certain — but rare — circumstances. This usually is advisable only if your contributions would otherwise be limited and it's unlikely that you will benefit from the carryover in the future. Making this decision requires caution and sound professional advice.

Higher income donors also must be wary of limits on itemized deductions, which become a factor above certain AGI levels.

What happens when you're subject to multiple limits?

If you give different types of property to different types of organizations, your charitable donations for a given year may be subject to more than one percentage limitation. In this situation, you must use an ordering process to calculate your total allowable deduction. First, you calculate your overall 50% limitation and then you consider all your 50% donations. Then:

Your 30% donations would be the lesser of:

- 30% of your AGI, or
- The amount of your 50% limitation remaining after considering your 50% donations.

Your 20% donations would be the lesser of:

- 20% of your AGI, or
- The amount of your 50% limitation remaining after considering both your 50% and 30% donations.

Any remainder can be carried forward. (See Case study I.) When calculating your charitable deduction for any given year, you must account for your current contributions before considering carryover contributions.

Case study I

AGI CONTRIBUTION LIMITS IN ACTION

Eric's adjusted gross income (AGI) this year is $100,000, and he gives his local art museum $30,000 in cash plus appreciated securities (held for over a year) with a cost basis of $15,000 and a fair market value (FMV) of $30,000. His professional advisor, Carol, helps him determine his deduction. First, she calculates the 50% limit ($50,000 or 50% of Eric's $100,000 AGI). Then, from the $50,000 limit, she subtracts Eric's cash donations ($30,000), leaving $20,000. Thus, the 30% limit is automatically reduced from $30,000 ($100,000 AGI × 30%) to $20,000 (the remainder of the 50% limitation). This means Eric can deduct $20,000 of the securities' FMV and carry forward $10,000 as a 30% limit deduction.

Timing contributions to save more

By considering your current and future income tax rates before giving, you can significantly increase the tax benefit of charitable gifts. This is because deductions are more powerful when you're taxed at a higher rate. So if you expect to be in a lower tax bracket next year, making a charitable contribution this year instead of next year would save you some tax dollars.

This strategy also can be effective if you're subject to the alternative minimum tax (AMT) in one year and a higher regular income tax bracket in another.

SAVING ESTATE TAXES

Whether you make charitable gifts during your life or share a portion of your estate with charity, such giving will cut your estate tax bill. Lifetime gifts reduce the size of your estate — and thus reduce estate taxes at your death. Lifetime gifts and direct bequests to charity are fully deductible for estate tax purposes. In other words, unlike AGI-based deductibility limits that apply for income tax purposes, there are no limits on the amount you can contribute and deduct for gift and estate tax purposes. For example, if you leave your entire estate to charity, no federal estate taxes will be due on your estate.

But what about the repeal of the estate tax in 2010? Does that mean charitable giving is no longer needed as an estate tax reduction tool? Absolutely not. First consider that the repeal phases in. (See Chart 2.) And then remember that the estate tax law will

revert to a lower exemption and higher rates unless there's further legislation. Not only is the future of the estate and gift laws still in limbo, but the new limits on the step-up in basis at death that are scheduled to go into effect in 2010 along with the repeal could create new capital gains tax concerns. So charitable giving is still a critical estate and income tax planning tool.

Chart 2
Transfer tax exemptions and rates

Year	Estate and GST tax exemptions[1]	Gift tax exemption	Highest estate, GST and gift tax rate
2007	$ 2 million	$1 million	45%
2008	$ 2 million	$1 million	45%
2009	$ 3.5 million	$1 million	45%
2010	(repealed)	$1 million	35%[3]
2011	$ 1 million[2]	$1 million	55%[4]

[1] *Less any gift tax and GST tax exemptions used during life.*
[2] *The GST tax exemption is adjusted for inflation.*
[3] *Gift tax only. Equal to highest marginal income tax rate.*
[4] *Reverts to 2001 rules. The benefits of the graduated estate and gift tax rates and exemptions are phased out for estates and gifts over $10 million.*

Source: *U.S. Internal Revenue Code*

SUBSTANTIATION AND DISCLOSURE RULES

The IRS requirements for claiming a deduction focus on two key areas: 1) substantiation of donations, and 2) disclosure requirements on goods and services a charity might provide in exchange for a donation.

Charities aren't required to use a particular format for substantiating contributions; such acknowledgments must simply be contemporaneous and in writing, and contain all pertinent information. Generally, a charity must supply substantiation only for separate payments of $250 or more. Thus, if you donate more than $250 in a single year but in payments of less than $250 each, you might not receive substantiation. Moreover, you can't take a deduction for most out-of-pocket cash contributions (such as putting $10 in a Salvation Army bucket, a very difficult

donation to document). To ensure you receive a deduction for any amount of charitable contribution, charge it on a credit card or write a check so you have a form of documentation that the IRS will honor.

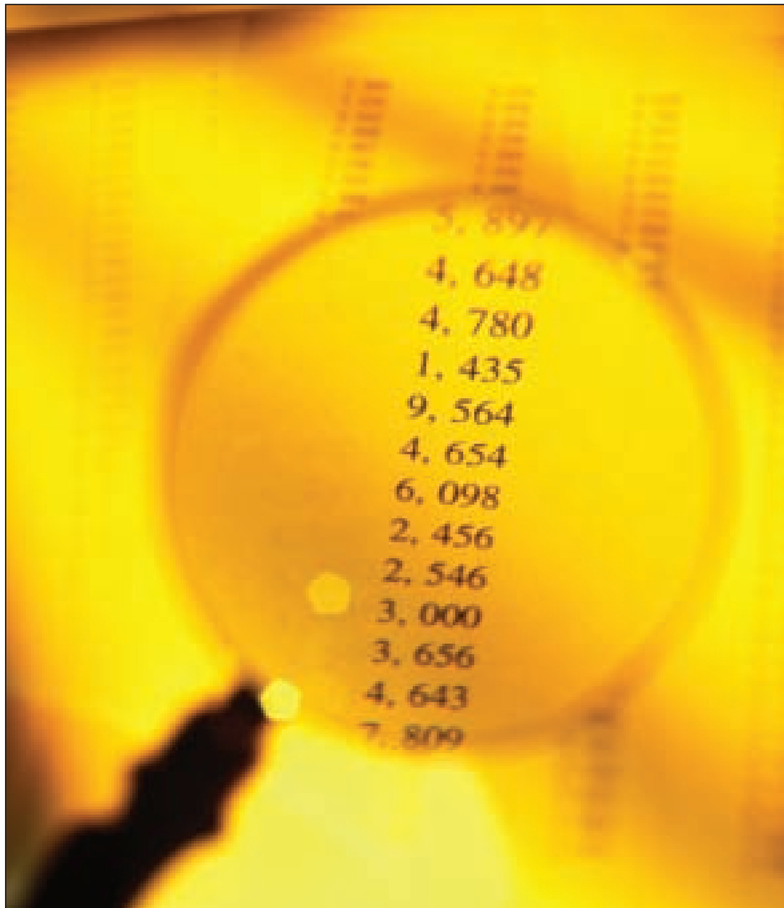
If you claim more than $500 as a deduction for a noncash contribution, you must complete Form 8283 and provide a written description of the property in addition to having the substantiation described above. Noncash contributions exceeding $5,000 (other than publicly traded securities) also must be substantiated with a qualified appraisal performed no earlier than 60 days before the date of the gift. The threshold is over $10,000 for nonpublicly traded securities.

If noncash contributions exceed $500,000, the qualified appraisal must be attached to your return. Moreover, you must aggregate similar items of noncash property for purposes of determining whether reporting thresholds for contributions have been met.

The IRS has the authority to prescribe additional rules requiring more information. Be sure you don't overstate the value of your noncash contributions — you could face a hefty penalty if you do. A representative from the charity must provide a signature to acknowledge the gift and agree to its use or disposition limitations.

A charity that supplies goods or services for a contribution of more than $75 must provide you with a written acknowledgment based on a good-faith estimate of the value of the goods or services. You then can use this estimate to calculate your deduction by subtracting the value of those benefits from the total contribution.

Also, keep in mind that contributions of clothing and household items may not be deducted unless they are in at least "good used condition."



WHICH ASSETS TO GIVE

Once you understand the tax consequences of your charitable gifts, you're better prepared to determine which assets to give. The type of assets you choose is significant not only because the charity will have the assets rather than your family, but because of how much tax is saved by donating one asset vs. another. Keep in mind that, in many cases, the charity will sell the asset. So, though it makes sense to give your art collection or other collectibles to a museum, also think about assets you'd like to sell but that a charity could sell instead and save significant taxes, such as appreciated stock, insurance, your home or possibly even your car.

CASH

This is the simplest contribution type because all you need to do is write a check. You don't have to transfer stock certificates, titles or other ownership documents, or worry about your basis or determining value for tax purposes.

But with this simplicity comes a price: lost tax-saving opportunities. Often, noncash gifts allow you to save significant taxes, leaving the charity — or you and your family — more.

APPRECIATED STOCK

If you hold appreciated stock you'd like to sell, it almost always makes sense to donate that rather than cash. Giving publicly traded stock can be simpler than giving closely held stock, because the fair market value (FMV) is easier to determine.

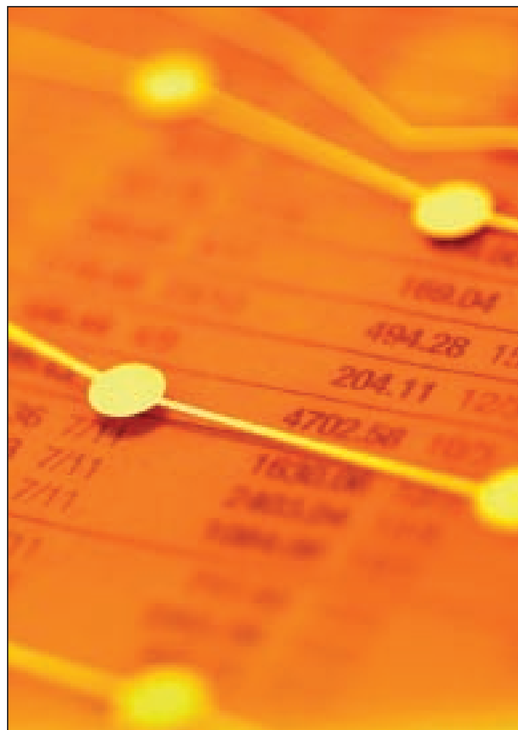
Giving tip 3

THINK TWICE BEFORE GIVING DEPRECIATED STOCK

If you donate securities with a fair market value (FMV) less than your cost, you'll qualify for a contribution deduction equal to only the lower FMV — and you'll permanently lose the capital loss tax benefit. You'll be better off selling the securities and then donating the cash.

Publicly traded stock

Odds are you have at least one publicly traded stock in your portfolio that you wouldn't mind selling. But you may rightly fear the resulting tax bite. If so, consider giving it to charity. You can lower your after-tax cost of charitable donations by contributing stock rather than cash. You receive a tax deduction equal to the stock's FMV; plus, neither you nor the charity has



Case study II

DONATING STOCK RATHER THAN CASH CAN ADD UP TO BIG TAX SAVINGS

Maria told her financial advisor she wanted to donate $50,000 to her favorite charity to reduce her income taxes this year. But her advisor suggested a way she could save even more: Donate long-term appreciated stock. Maria had owned some stock for many years that she had been thinking of selling, because she wanted to diversify her portfolio. If she sold the stock, she would have to recognize $25,000 in gain. So, by giving the stock, she could not only enjoy substantial tax-savings from the income tax deduction, but also avoid the capital gains tax. And with the cash she didn't need to use for the donation, she could buy new stock to diversify her portfolio.

to pay capital gains tax on the appreciation. (See Case study II.) The catch: For the gift to qualify for the full deduction, you must have owned the stock for at least one year. For stock held less than one year, the deductible amount is limited to the cost basis.

You can still benefit from this strategy even if you can't find any stock you're willing to part with. If you have the cash to donate, you can contribute appreciated stock and use your cash to buy more of the same stock. You'll receive a current tax deduction and be able to exchange your low-tax-basis stock for a higher-tax-basis stock.

Compare to stock transfers to family

When considering a stock donation, also look at the tax impact of transferring the stock to family. The impact depends on whether you gift the stock to the loved one during your life or bequeath it at death. A gift will actually be more valuable to, for example, your child if it has a relatively high tax basis. That's because he or she will pay lower potential capital gains tax on the securities' sale. Remember that your tax basis carries over to the gift recipient. For example, if you give your daughter stock in which you have a $100 tax basis and she sells the stock for $200, she will owe tax on the $100 gain. So, during your life, from an income tax perspective it may be better to donate appreciated stock to charity and gift high-basis stock (or cash) to your children.

Giving tip 4

WATCH OUT FOR THE ASSIGNMENT-OF-INCOME DOCTRINE

A rule that can apply in charitable giving situations is the assignment-of-income doctrine. It essentially says that taxpayers who earn income must recognize that income. In other words, taxpayers can't transfer the right to receive income to other parties if events have already occurred fixing their rights to receive it. This doctrine prevents a taxpayer earning salary through his or her own efforts from attempting to transfer the right to receive that salary to another person or entity — possibly someone in a lower tax bracket or a tax-exempt organization.

As an example, let's assume you perform services for a company and instruct the company to make a contribution on your behalf to charity instead of paying you. This is "assignment of income," and the income is taxable to you, for both income and employment tax purposes. The contribution is deductible, subject to the limitations.

By contrast, securities you hold on to for life may ultimately get a "step-up" in tax basis on your death, thus avoiding the capital gains tax. For example, say you have stock with a $100 basis. When you die, the stock is worth $200. If you have bequeathed the stock to your son, his basis generally will be $200. If he sells the stock for $200, he will owe no capital gains tax. Combining this with the fact that there's no income tax deduction to you or your estate for charitable bequests, donating appreciated stock to charity rather than your children offers no income tax advantage.

There are, however, estate tax advantages to bequeathing stock to charity, whether or not the stock is appreciated. And keep in mind the step-up benefit will be limited with the scheduled 2010 estate tax repeal. (See page 7 for more.)

AGI limitations

Indeed, contributing appreciated stock to charity provides many benefits. But be careful: Your contribution deductions are limited according to your adjusted gross income (AGI). You may deduct appreciated property contributions only up to 30% of your AGI, while cash contributions are limited to 50%. (For more on AGI limits, turn to page 4.)

Before making your gift, check to see whether the charity can or will accept such gifts. Because of its tax-exempt status, the charity can either hold the stock as an investment or sell it immediately without any tax impact.

Closely held stock

If you're a family business owner or a shareholder in a closely held business, you may want to gift some or all of your shares. Donating them to charity rather than selling them can make sense because of the potentially significant tax savings.

As with publicly traded stock, you can take a tax deduction for the shares' FMV and avoid capital gains tax that you would owe if you sold the shares.

But remember that the IRS enforces strict rules requiring a qualified valuation for contributions of nonpublicly traded stock of over $10,000. Even if the stock's FMV is known with near certainty, you have to provide the IRS supporting evidence in the form of a formal valuation report.

To make sure you comply with the tax code, engage a qualified valuator to perform an appraisal that includes unbiased, market-based supporting data. Taxpayers donating

closely held stock must obtain a qualified appraisal and include a signed statement from the valuator when they file their tax returns. (See Giving tip 5.) Generally you needn't attach the appraisal itself to your return, but you should keep a copy in case the IRS requests one.

Your valuator will examine the shares you're contributing and the underlying business and summarize his or her findings in a valuation report. For the appraisal to be valid, your valuator must have prepared the appraisal no more than 60 days before the contribution date and have signed and dated the document. Moreover, the valuation fee can't have been based on the stock's value (unless the fee went directly to an IRS-approved nonprofit association). You also must receive the valuation report before the due date of the return on which the deduction for the contributed property is first claimed — or, in the case of a deduction first claimed on an amended return, the date on which the amended return is filed.

Giving tip 5

EVALUATE YOUR VALUATOR

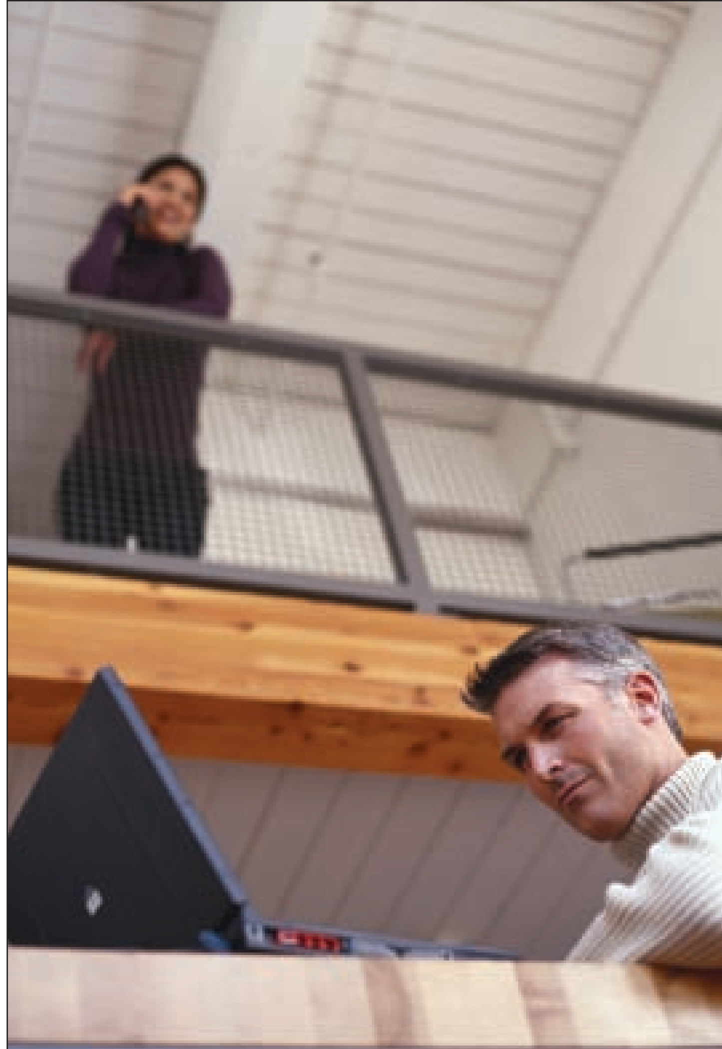
A qualified business valuator (or asset appraiser) is critical to the validity of your valuation (or appraisal). If you don't use one, you may not be entitled to a deduction for your contribution. To be considered "qualified" for tax purposes, the valuator is required to state that he or she:

- Earned an appraisal designation from a recognized organization or otherwise satisfies minimum IRS requirements for experience and education,
- Regularly performs appraisals for compensation, and
- Satisfies other IRS requirements (as prescribed in regulations or other guidance).

Moreover, the valuator must understand that a false or fraudulent overstatement of the value may subject him or her to a civil penalty and nullify the appraisal. Certain people are ineligible to act as a valuator, including you, the charity, a party to the transaction in which you acquired the property to be valued (unless the property is donated within two months of the acquisition date and its appraised value doesn't exceed the acquisition price), certain related parties and employees of any of the above-named parties.

INSURANCE

You may not have thought of donating a life insurance policy to charity, but with proper planning it can make a great gift. Typically in such a strategy, you pay the insurance premiums and the charity is the policy owner and beneficiary, receiving the policy proceeds at your death.



The benefits

Insurance can be an effective wealth management tool because a relatively small cash outlay can produce a comparatively large future benefit. This same advantage becomes even more powerful in a charitable giving scenario.

Plus, the proceeds won't be subject to estate taxes, and you may be eligible for a current income tax deduction, depending on the method used to make the gift. So, by giving a life insurance policy, you may find you can afford to give even more than you had anticipated.

Here are some additional benefits:

- There are no complex details, no red tape.
- If you, at some future date, are unable to make premium payments, the insurance policy may still be continued using one of the policy's options.
- The charity, if it wishes, can make use of the life insurance company's investment opportunities (payment plans).
- The death benefit may be guaranteed and may even increase over time.
- There is no delay in payment of the policy proceeds — the bequest can't be contested.
- There is no shrinkage in the gift because of taxes, fees or probate costs.
- There is no publicity unless you desire it.

As you can see, donating a life insurance policy can be a great way to enhance your giving strategy.

4 ways to donate

There are generally four ways you can use a life insurance policy in charitable giving:

1. ***Charitable bequest plan.*** This may be right for you if you would like to benefit a charity with the future death proceeds of an existing life insurance policy, but don't want to surrender control of the policy during your lifetime. By merely changing your beneficiary to the charity, you retain the ability to enjoy the usual benefits of owning a policy. You continue to pay the premiums, but receive no immediate income tax benefit. The policy is still an asset you own and will be included in your estate. But on your death, your estate will be entitled to a charitable deduction for the full value of the policy proceeds passing to the charity.

2. ***Charitable gift plan.*** You may want to consider this option if you're more interested in receiving a current income tax deduction than in retaining control of an existing life insurance policy. All you need to do is change the policy ownership designations to the charity. The charity can then name itself as beneficiary. Your income tax deduction is based on the lesser of your cost basis or the policy's value. If future premiums are due, you can pay the premiums. There are two ways to do so — either directly to the insurance company or as a cash gift to the charity, which then pays the insurance company. In both cases, the premium amount is deductible as a charitable contribution, but the deduction is subject to different limits depending on how it's paid. Of course, you no longer will enjoy the benefits of owning the policy — these transfer to the charity, and the charity will also receive the policy proceeds on your death. But the policy is removed from your estate for estate tax purposes.

3. ***Charity ownership plan.*** This could be ideal if you make regular cash contributions to a charity and would like an opportunity to leverage smaller gifts into a larger endowment. Under this plan, you can apply for a new policy naming the charity as owner and beneficiary of the policy. As when giving an existing policy for which premiums are still due, you can pay the premium either directly to the insurance company or by a gift to the charity, which then pays the premium.

   As you can see, policy ownership and beneficiary arrangements play an important role in the planning process. You'll also need to consider state insurable interest laws, which could affect the tax consequences of your life insurance policy gift. (See Giving tip 6.)

4. ***Group term life insurance.*** Maybe your employer provides you with a group term life insurance benefit. If you don't have a personal need for the death benefit, you can name a charity as the beneficiary of some or all of the death benefit. There's no income tax deduction available for this, but your estate will receive an estate tax charitable deduction for proceeds paid to the charity at your death.

   A warning: These four strategies won't work if you or a related party benefit — directly or indirectly — from the policy held by the charity (such as by being a beneficiary).

Giving tip 6

CONSIDER INSURABLE INTEREST LAWS

Regardless of your gifting strategy, an important planning consideration is the insurable interest laws in the state where you (or the charity) originally purchased the life insurance policy. Although you make contributions to the charity in cash, and the charity then uses the cash to pay premiums on the policy, it's still your life that the policy is insuring. The charity's insurable interest in the policy could be called into question because insurable interest is typically considered to be based on blood, marriage or financial obligation. This could jeopardize the tax benefit and result in the inclusion of policy proceeds in your estate. So, be sure that a strong case for having an insurable interest is incorporated into any relevant documents.

PERSONAL RESIDENCE

Making gifts to charity during your lifetime almost always offers more tax benefits than transfers occurring after death. But many people don't want to risk their present financial security by donating cash or stock to charity — or their family's future security by donating a life insurance policy. If you're among them, giving a remainder interest in a personal residence could be the answer to accomplishing both charitable and income tax objectives.

Case study III

THE BENEFITS OF DONATING YOUR HOME

Dan is a widower, age 68 and in good health. His $2 million estate consists of a $900,000 IRA, $800,000 in securities and a cash portfolio, and a $300,000 home. He wants to leave his estate primarily to his children but also wants to make a substantial gift or bequest to his favorite charity. Dan is looking for a way to do this simply while being tax smart.

Because Dan is counting on his IRA and securities for income and flexibility, and wishes to continue to live in his home, an outright gift to charity isn't an appealing option. Dan is, instead, considering gifting a remainder interest in his home to his favorite charity.

Based on the current value of the residence and Dan's age, he will be able to receive a charitable income tax deduction of $138,000, using the IRS discount rate (the Section 7520 rate), which for purposes of this example is presumed to be 6%. Dan will need to get a qualified appraisal of his home because the charitable deduction will exceed $5,000. Also, in calculating the present value of the remainder interest, Dan may choose the 7520 rate for the month in which he makes the gift or for either of the two preceding months. The remainder interest will be valued higher and the charitable deduction will be larger if a lower 7520 rate is used.

The benefits

The present gift of a remainder interest in your home will result in three tax benefits:

1. Based on the current value of the residence and your age, you can receive a charitable income tax deduction for the present value of the remainder interest.

2. Your gift of the remainder interest in your home will also qualify for a gift tax charitable deduction, so you won't have to pay gift tax on the transfer.

3. Your home's title will pass to charity on your death, and no estate tax will be owed on it.

Income tax rules contain a specific exception that allows you to: 1) make a gift to charity of your home or vacation home that won't take effect until your death, and 2) receive a current income tax deduction for the present value of the remainder interest. Of course, the definition of home also includes a condominium as well as a cooperative apartment. In fact, under the right circumstances, a house boat, a yacht or a motor home would qualify as a personal residence. The donation of a remainder interest in a farm also is allowed under this rule.

(See Case study III for an example of these tax benefits in action.)

This planning technique also can be flexible to meet your specific needs. For example, if you determine that the gift of your home's entire value was too large, you could leave the charity a fractional portion of the remainder interest.

Another alternative is to give the right to use the personal residence after your death to someone else before the charity receives it. However, this would significantly

decrease the value of the remainder interest, and could cause a gift tax. The person receiving the right to live in the house after your death would be receiving a gift of a future interest, so the gift wouldn't qualify for the annual exclusion and would either use up part of your lifetime gift tax exemption or create gift tax liability.

Similarly, an IRS ruling allows you to give a remainder interest to a charity and an individual as tenants in common. The charitable deduction would be based only on the charity's share, and there would be a gift to the individual. This type of donation should be handled carefully to ensure it's allowed.

What if you still have a mortgage on the home?

A mortgage on the residence at the time of the gift may make the well-intentioned gift more complicated. The contribution of the mortgaged property would be considered a bargain sale, with you "receiving" an amount equal to the outstanding debt on the property. The result is a potential gain to you.

Additionally, the outstanding mortgage affects the value of the income tax deduction. If the existing term of the mortgage extends beyond your life expectancy, the gift to charity is, in theory, subject to a liability. If you die at the expected age, the remainder interest will pass to charity subject to the unpaid mortgage balance. Accordingly, your income tax deduction should be reduced as a result of the mortgage on the property. If the residence is your principal residence, and you otherwise qualify, the sale of a remainder interest may qualify for the $500,000 gain exclusion ($250,000 for single taxpayers) upon the sale of your home. Consult your tax advisor if you're in this situation.

VEHICLE

If you donate a qualifying vehicle valued at more than $500 and the charity doesn't use it, but sells it, the amount of the donation is limited to the amount of sales proceeds.

There are detailed requirements for reporting vehicle donations and sales. The charity must provide you a written acknowledgment (with a copy to the IRS) certifying whether the vehicle was sold or retained for use by the charity. Your name and identification number must be provided, as well as the vehicle's identification number. If the charity sells the vehicle, details concerning the sale must be reported within 30 days of the sale. The charity also must disclose whether it provided goods or services as consideration for the vehicle, and it must make a good-faith estimate of such value given to you in connection with the vehicle donation.

These rules don't apply, and the vehicle's FMV may be claimed, if:

- The vehicle was used for a significant charitable purpose,
- The vehicle was sold for substantially less than FMV in furtherance of a charitable purpose (such as a bargain sale to a low-income person needing transportation), or
- The charity makes material improvements to the vehicle.

Charities that fail to provide a timely acknowledgment or that knowingly provide a false or fraudulent acknowledgment face penalties.

COLLECTIBLES

If you're a collector, consider giving from your display case instead of your investment portfolio. Gains on collectibles are taxed at a higher rate than that which applies to gains on most long-term property — so you save taxes at a higher rate than if you had sold the collectible. You get a deduction for your gift's full market value, subject to certain threshold limitations for adjusted gross income (AGI).

But choose the charity wisely. For you to receive a deduction equal to FMV rather than your basis in the collectibles donated, the item must be consistent with the charity's purpose, such as an antique to a historical society. Plus, you must abide by complex rules relating to the recapture of a prior FMV contribution if property you donate isn't used in the organization's "exempt purpose."

If you contribute works of art with a collective value of $5,000 or more, you'll need to get a qualified appraisal, and if the collective value is $20,000 or more, a copy of the appraisal must be attached to your tax return. Only one qualified appraisal is required for a group of similar items contributed in the same taxable year — provided the appraisal includes all the required information for each item. Any item of property not included in a group of similar items must have a separate qualified appraisal. Your appraiser must provide the appraisal summary on the IRS-prescribed form, which you must attach to your return. Finally, if an individual item is valued at $20,000 or more, you also must, upon request, provide a photograph of that item.

HOW TO GIVE

After you know the "why" and "which" of your charitable giving strategy, you must next consider the "how." That is, how do you intend to give away your assets? For many people, simple cash or property donations are fine initially. But as their charitable, tax and estate planning goals grow, they may eventually require a more sophisticated means of giving. Fortunately, a wide variety of charitable vehicles exist that can provide some remarkable financial benefits — for both you and your chosen charity.

DIRECT GIFTS AND BEQUESTS

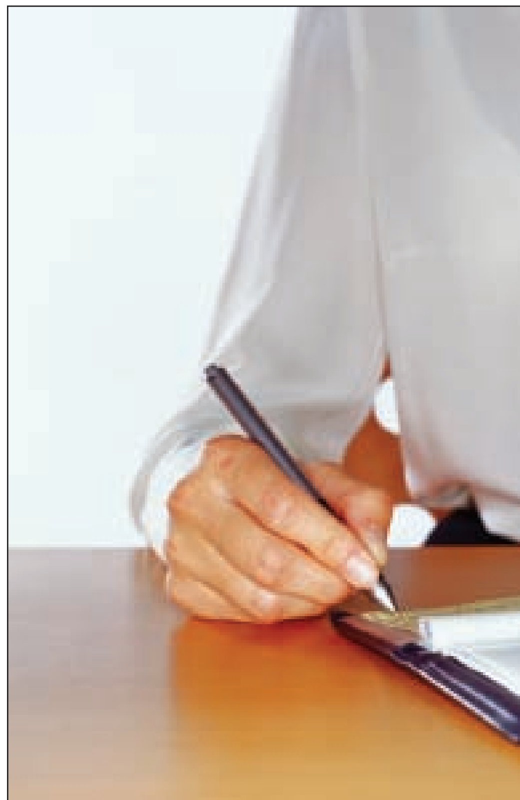
A direct gift is just that: a charitable donation that goes directly from you to a charity. Because such contributions are generally fully deductible, the more you donate to charity, the more tax benefit you receive — as long as your itemized deductions exceed the standard deduction and your donations don't exceed adjusted gross income (AGI) limits.

Keep in mind, however, that some high-income taxpayers may, due to the phaseout of itemized deductions, lose some benefit of making charitable contributions.

A charitable bequest is also a direct gift, but it occurs after death, generally via your will. A bequest gives you flexibility and privacy, because it's revocable and easily modified as long as you're alive. Such a gift is also 100% deductible for estate tax purposes.

PARTIAL INTEREST GIFTS

If you're ready to go beyond direct gifts or bequests, yet not quite ready for more advanced vehicles, consider giving a partial property interest directly to charity. Partial gifts provide an income tax deduction for the interest passing to charity (valued as of the date of the gift), allow a charitable gift tax deduction, exclude the property from your estate for estate tax purposes, and may offer other deductions for substantially improving the property. And unlike more sophisticated vehicles, they're relatively inexpensive and simple to carry out.



But, for gifts of tangible personal property, you won't be allowed a deduction unless immediately before the donation you (or you and the charity) own the entire interest.

You may restrict the charity's use of the property. For example, you can require the charity to sell the property or pass the title to another charity, or you may give the charity the right to keep it. You also can provide that the charity will lose the property if it attempts to sell or place a mortgage on it, allows others to use it for reasons other than its intended use, or alters it. Donors often use this type of restriction when the gift is a residence with historic or architectural significance.

Generally, you can use one of three methods to make a partial gift:

1. ***Giving a remainder interest.*** A gift of a remainder interest involves dividing the ownership of an asset between a current ownership interest and a future ownership interest. You keep the current ownership interest and give away the future or remainder interest. For example, your home, vacation home or farm is each a good candidate for giving a remainder interest to charity. (See page 16 for more information on donating a personal residence.) You may split the remainder interest among multiple charities or a mix of charities and individuals. By giving a remainder interest, you can choose to have your property pass directly to the charity or first to someone else and then to the charity, either at your death or at a fixed time.

Giving tip 7

DONATE ARTWORK USING FRACTIONAL INTERESTS

If you wish to give a work of art you own to a museum, you may use fractional interests. (Certain restrictions apply.) For example, suppose you give a one-third interest in a painting to charity. The charity will then have the unrestricted right to use the painting for four months of the year. The charity isn't required to take possession of the painting; it simply must have the right to do so. The charity's right to possess the painting must take place within one year of the gift's date.

2. ***Donating a fractional interest.*** A gift of a fractional interest involves dividing the ownership of an asset into fractions. For example, you keep two-thirds of an asset and give one-third to charity. A vacation home or items of tangible personal property that have a significant value are assets to consider for a fractional interest gift. (See Giving tip 7.) If you and the charity later sell the property or replace it with another property type, the charity will be entitled to share in the proceeds or the new property.

   Your gift must be a portion of your entire ownership in the property. For example, if you have a right to use a vacation residence during your lifetime, you could donate one-third of your interest in the use of the property for your life to charity. If you own the property outright, however, you can't donate just the use of the property to charity for your lifetime. Donations to charities of a fractional interest in tangible personal property are subject to additional restrictions. Talk with your tax advisor before using this giving strategy.

3. ***Granting a conservation easement.*** A conservation easement is a permanent restriction on the use of property you own that furthers the objectives of a tax-exempt organization whose goals generally relate to the environment or historical preservation. For example, you could restrict development of vacant land or façade changes to a historic building. You must grant the easement to a qualified organization that would be able to enforce it, such as a charity or government organization. For determining your charitable deduction, the easement's value is the difference between the value of the property before and after you grant it. Talk with your tax advisor so you'll be mindful of the myriad rules that make these types of contributions somewhat complicated.

CHARITABLE GIFT ANNUITIES

Many people who wish to donate substantial assets during their lifetimes are concerned about maintaining a consistent income flow while minimizing taxes. One of the most accessible and least complicated ways to accomplish that goal is through a charitable gift annuity. It allows you to reinvest your appreciated property, avoid a current capital gains tax and do a good deed — all while ensuring you have sufficient retirement funds. And unlike many retirement savings plans — such as 401(k)s and IRAs — there

are no limits on how much you can contribute to a gift annuity. The annuity is relatively easy to set up and allows for tremendous flexibility. In fact, it's actually one of the oldest forms of gifts that let you retain income.

Simply put, a charitable gift annuity is a legal agreement between you and a charity in which you give money, securities or real estate, and in return the organization agrees to pay you a fixed income for life. Several factors determine the actual amount of the annuity you receive, including:

- Your age at the time of the gift,
- The rate of return the charity expects to earn,
- The gift amount, and
- Whether the payments will begin immediately or be deferred to a later time.

By using the charitable gift annuity, you can defer any capital gains on appreciated property given to the charity. You recognize a portion of the gain, but only as you receive annual payments. And you report your capital gain over your life expectancy. Also, the charitable gift annuity defines a portion of each payment you receive as a tax-free return of principal. In addition, you can claim an income tax charitable deduction in the year you set up the annuity. Your current tax deduction is based on the present value of the gift portion that will pass to the charity. You can carry forward any excess deduction for five years.

Also consider how a charitable gift annuity may affect what you leave to your spouse after your death. Fortunately, you may name your spouse — or a child or someone else — as the successor beneficiary to you. The number and age of any additional beneficiaries will be taken into account when the annuity payout and the gift's value are calculated.

CHARITABLE TRUSTS

It may seem impossible to fulfill two wishes at once, especially when it comes to giving to charity and dividing your estate. But a charitable trust can enable you to do just that — give back to your community and leave assets to family members or other beneficiaries. Generally, these trusts take two forms. And

the key difference between the two is when the charity receives your donation — either during the trust's term or at the end.

Charitable remainder trusts

A charitable remainder trust (CRT) is a great way to give to charity and reduce your taxable estate. In many ways, it serves as your own vehicle designed to operate like a charitable gift annuity, but all under your control. To create one, you donate assets to an irrevocable trust, name one or more charities as the remainder beneficiaries, and name yourself or someone else as the income beneficiary. The CRT trustee invests the trust assets. The trust makes annual distributions to the income beneficiary, who pays the tax on the distribution to the extent that the trust has ordinary income first, capital gains next.

You can structure the trust to terminate on your death or after a set number of years (often called a term limit). Assets remaining in the trust at your death aren't included in your estate for federal estate tax purposes.

And here's where a particularly valuable benefit comes into play. If you transfer an asset to the trust that has appreciated in value, the trustee can sell it without incurring capital gains tax and then reinvest the proceeds in income-producing assets — preferably those that provide greater diversity, less risk and perhaps more income than the one you originally donated. (See Case study IV on page 24.)

When you contribute to a CRT, you'll receive an immediate (same year) income tax deduction. The deduction is equal to the present value of the trust's

Giving tip 8

PROVIDE FOR YOUR KIDS WITH A CRT

A potential drawback to using a charitable remainder trust (CRT) is that, by donating some of your wealth to charity, you're removing it — or a percentage of it — from your children's inheritance. One solution: With the income you receive from your CRT, buy a life insurance policy and place it in an irrevocable life insurance trust (ILIT). On your death, the ILIT's proceeds pass to your children estate tax free.

Another issue related to CRTs and kids is if you have a disabled child who is unable to care for him- or herself. In such a case, you can combine the advantages of a CRT and a support trust to ensure that your child is financially secure after your death or disability. A support trust (also called a special needs trust) provides annual funds that cover care for a beneficiary who is disabled (or has other special needs) as long as he or she is alive. You can set up a CRT with the support trust as its income beneficiary, so that all cash distributions from the CRT will go into the support trust. The CRT won't terminate until the deaths of both you and your disabled child.

When using this technique, consult with your tax advisor. The trust can be designed in such a way so that the child remains eligible for state and federal benefits.

assets that will pass to charity after the trust terminates. If the term limit is a fixed number of years, present value is fairly easy to project using an IRS-determined discount rate. If it's a lifetime trust, your tax advisor will use actuarial tables to calculate present value.

The IRS has established minimum and maximum annual CRT distribution amounts. The amount of the annual cash distribution to the income beneficiary depends on which type of CRT you create:

1. ***Charitable remainder unitrust (CRUT).*** This arrangement pays out a fixed percentage — 5% at minimum — of the trust assets' fair market value (FMV) as determined each year. The assets may go up or down in value, and the annual payout will fluctuate accordingly. You share in the investment risks and rewards through the changes in the payout each year. If the trust value decreases, the annual distribution will also decrease.

2. ***Charitable remainder annuity trust (CRAT).*** This trust type, on the other hand, pays out a fixed percentage — again a 5% minimum — of the initial value of trust assets, so that the payout dollars remain constant through the trust's life, to the extent assets are sufficient.

A CRUT is generally a more popular option because its payouts vary with asset value, thus protecting the value of its assets against inflation. The IRS has set maximum distribution percentages for both types of CRTs. Basically, the present value of the remainder interest going to charity must be at least 10% of the initial value when you contributed the property to the trust. In other words, the IRS doesn't want you to use the CRT as a gift that is likely to leave little or nothing for the charity.

To that end, two other types of CRUTs — the net income with make-up CRUT (NIMCRUT) and the flip CRUT — can be useful alternatives. Under a NIMCRUT, the income beneficiary receives the lesser of either the net income earned by the trust during the year or a fixed-percentage amount. A make-up account is established for

Case study IV

A CRT'S CAPITAL GAINS ADVANTAGES

Lynn holds $1 million of stock with a low basis. Her dilemma: If she sells the stock, she'll owe considerable capital gains tax. So she sets up a charitable remainder trust (CRT) that pays her 7% of the trust's annual value. When the trust ends in a decade, the remaining trust assets will pass to a charity. Meanwhile, the trust can sell the stock and reinvest the proceeds. When Lynn receives her income payment, it will be taxed to her in the manner in which the charity earned the money — ordinary income is distributed first, then any accumulated capital gains, then tax-exempt income and finally principal.

Lynn also may benefit from a charitable deduction, because her gift's value is determined using IRS tables that factor in her age and life expectancy, beneficiaries' ages, the trust's term, current interest rates, and the payout rate. If her lifetime interest according to the IRS tables is $600,000, she can deduct $400,000 ($1 million – $600,000) the year she makes the gift. She will report the annual distributions from the CRT (to the extent they represent income) on her personal income taxes.

years when the trust pays less than the percentage amount, and any shortfall is made up in years the trust earns more income than the percentage amount.

If you want to benefit the income beneficiary and the charitable beneficiary more equally, consider a flip CRUT. It begins as a NIMCRUT and can be funded with an unproductive asset, allowing the trustee to make smaller (or no) payments to the income beneficiary in years the trust is earning little or no income. Once the asset is sold, the trust "flips" to a traditional CRUT, which then pays the income beneficiary the fixed-percentage amount, allowing the trustee to invest for total return.

Charitable lead trusts

Essentially, a charitable lead trust (CLT) is the reverse of a CRT. It's an irrevocable trust that gives one or more charities, as opposed to you or another beneficiary, the "annuity" or "lead" interest. The CLT's remainder interest passes (either outright or in trust) to you, your children or other noncharity beneficiaries. You can establish a CLT during your lifetime or at death, through your will or trust, and receive a gift or estate tax deduction for the interest passing to charity.

To start your CLT, you place assets into a trust giving one or more charities an annuity interest for a specified term. You can either stipulate which charities will receive annual distributions or let the trustees or a distribution committee decide. (You shouldn't serve as trustee.) Designating a philanthropic or donor-directed fund or a private foundation as the charitable recipient will increase flexibility. But beware: This increased flexibility and control could cause the trust to be included in your estate for tax purposes if you die during the trust's term.

When you create a CLT, you get a gift or estate tax charitable deduction depending on whether you do it during life or at death. Furthermore, how you calculate the gift or estate tax deduction depends on whether the charitable lead interest is a guaranteed annuity or a unitrust. Annuity payments are calculated as a percentage of the original trust principal, while unitrust payments are

Case study V

A CLT'S GIFT TAX DANGERS

A trust's type affects the amount you can deduct and can sometimes lead to a gift that exceeds your available gift tax exemption. For example, Steve creates a charitable lead unitrust with $2 million. His chosen charity receives a 7% annual payout for 20 years. His children will be the beneficiaries at the end of the trust term. Assuming IRS tables value the income stream at nearly $1.5 million, based on a rate of 5%, the remaining $500,000 will be considered a gift.

Remember, you can transfer up to your lifetime gift tax exemption ($1 million) without incurring a gift tax. Fortunately for Steve, this gift, combined with other gifts he has made in the past, falls under the $1 million limit, so he owes no gift tax on this transfer. And, if the trust earns an 8% return over the 20 years, the principal will exceed $2.4 million, which will go to Steve's children free of estate tax. Steve will have provided quite a benefit from his foresight.

calculated annually based on an annual revaluation of the trust. The charitable gift or estate tax deduction equals the present value of the annuity or unitrust interest that passes to charity.

Bear in mind that creating a CLT during your life can result in a taxable gift equal to the value of the remainder noncharitable interest. Because the remainder interest in a CLT is a future interest, the taxable gift portion doesn't qualify for the gift tax annual exclusion. But you can apply your lifetime gift tax exemption or marital deduction to such transfers. So properly structuring the trust can reduce or even eliminate gift tax. (See Case study V.)

Transferring highly appreciated assets to a CLT may make a testamentary lead trust (one created at death via your will) preferable to a trust established during life. Why? Because assets transferred to a CLT created at the time of your death receive a step-up in basis (at least before the scheduled estate tax repeal — see page 7). This will reduce the capital gains tax owed by the trust or by the remainder beneficiaries when the assets are sold. Unlike a CRT, a CLT is fully taxable. Either you (as the grantor) or the trust itself will owe tax.

Moreover, if the remainder interest in the CLT passes to your grandchildren or other future generations, the generation-skipping transfer (GST) tax will apply. The rules will differ, though, depending on whether the trust is an annuity trust or a unitrust.

PRIVATE FOUNDATIONS

Many people find giving occasional gifts satisfies their charitable inclinations. Meanwhile, others opt for annuities, partnerships or trusts to meet their goals — both charitable and financial. But, for still others, philanthropy is a far more serious endeavor, often involving recurring substantial gifts of $1 million or more. Gifts of this size may signal the need for control and general oversight by an ongoing organization. For this latter group, a private foundation can be an ideal mechanism for managing a large, continuous charitable giving program.

In its simplest form, a private foundation is a charitable, grant-making organization that is privately funded and controlled. It must file an annual tax return (IRS Form 990-PF) and pay a 2% excise tax on net investment income. A reduced tax rate

of 1% applies if foundation distributions exceed a certain payout rate; this is generally based on foundation asset value and the income that such assets can produce.

Foundation dangers — and benefits

If a foundation observes all the rules, the excise tax on net investment income is the only tax it will ever pay. But a foundation may be on the hook for additional taxes if it's caught:

- Self-dealing — when certain disqualified persons engage in specific forbidden transactions,
- Failing to distribute income — under the law, a private foundation is required to annually distribute at least 5% of the aggregate value of its investment assets, less any acquisition debt,
- Maintaining business holdings exceeding the limitation (greater than 20% of a corporation's stock),
- Making investments that jeopardize its charitable purpose, or
- Engaging in prohibited taxable expenditures — such as political lobbying, election campaigns and certain nonqualifying grants to individuals.

As long as a private foundation steers clear of these dangers, it will enjoy a tax-advantaged status along with an array of other benefits. For example, because a private foundation is typically established to manage a long-term charitable gifting program, it may, in turn, highlight the philanthropic presence and identity of the donor within the community and a particular charitable cause. It can also create a family charitable legacy while protecting individual family members from the pressures of other charitable appeals. Finally, a private foundation can serve as an appropriate mechanism for controlling charitable distributions as well as determining which charities the foundation will benefit.

Types and structures

When a private foundation is established, two issues need to be addressed. First, what type of private foundation should the donor establish? And second, how should he or she structure it? There are generally three types of private foundations:

1. ***Nonoperating.*** The most common type, a nonoperating foundation means a donor, or group of donors, makes contributions to the foundation, which then makes grants to a charity (or several). In this case, the donor has no direct participation in any charitable work. There are several variations of this foundation type.

2. ***Operating.*** With this type, the foundation may have direct involvement in charitable causes while retaining its inherent tax benefits. This is despite the fact that it, in some respects, operates similarly to a public charity. To qualify as an operating foundation, an organization also must meet several requirements and tests.

3. ***Company-sponsored.*** This type can be used when the majority of contributions are from a for-profit corporate donor. Generally, this type operates like a nonoperating foundation. It's usually managed by corporate officers and has the added benefit of allowing some contributions to accumulate over time. Doing so can help the foundation make continual grants when corporate profits are low — a time when, ordinarily, contributions would otherwise be forgone.

After careful thought is given to the type of foundation to be established, you should consider the foundation's structure. Like types, there are three structures that donors apply to their foundations: 1) nonprofit corporations, 2) trusts, and 3) unincorporated associations. Several factors must be weighed when you decide which structure is best. Generally, if you intend to keep the foundation in existence permanently, a nonprofit corporation or trust may be a good choice. Otherwise, unincorporated associations best suit shorter-term foundations.

Ultimately, a private foundation may be the right tool for accomplishing your charitable and estate planning objectives. But, seek professional advice — the rules are complex and the penalties for violating them stiff.

SUPPORTING ORGANIZATIONS

The complexity of the rules governing private foundations and the restrictions placed on them under the Internal Revenue Code (IRC) have inspired more than a few prospective givers to search for an alternative. One such option is a supporting organization.

Just as its name suggests, this organization supports or benefits one or more public charities. You and your family, as donors, can provide grants and distributions to your favorite charities by establishing a supporting organization that allies itself with those charities.

The income tax deduction for charitable contributions to supporting organizations is limited to a higher AGI percentage than that for contributions to private foundations — 50% rather than 30%. Also, contributions of real estate and nonmarketable appreciated property to supporting organizations may be deducted based on FMV, and not on tax basis, as in the case of private foundations.

For an organization to qualify as a supporting organization, it must meet four tests:

1. Independent parties must have control — you and your family, as donors, can't run the organization. The IRS plans to scrutinize this requirement in light of perceived abuses by donors who retain indirect control of supporting organizations.

2. The supported charity or charities must have either a significant voice in the supporting organization or the supporting organization must qualify as a charitable trust, in which the supported charity has the power to enforce the trust terms. In addition, the supporting organization must apply substantially all of its income for the charity's use, or perform services the charity would normally perform itself.

3. The supporting organization must be limited to the specified charities' approved charitable purposes.

4. The supporting organization must actually benefit the charity through its operations.

If these tests are met, you may establish your supporting organization as either a corporation or a trust. Then you must determine which of the three IRC-authorized supporting organizations is appropriate:

1. A supporting organization operated, supervised or controlled by a designated charity,

2. A supporting organization supervised or controlled in connection with the designated charity or charities, or

3. A supporting organization operated in connection with the charity or charities.

This third type is usually the most attractive from a control standpoint because it allows independent parties (whom you and your family may select) to run the supporting organization. Even if you can't control the supporting organization, you can still exercise considerable influence if you and your family make up a substantial minority of the organization's board of directors and you also select the independent directors.

DONOR-ADVISED FUNDS

Without question, setting up a private foundation or supporting organization can allow dedicated philanthropists to achieve their generous goals in a tax-advantaged manner. But these vehicles can be time-consuming as well — and they may require several million dollars to make it worthwhile. A simpler way to achieve much the same effect is a donor-advised fund (DAF).

How they work

A DAF is a charitable account you set up in your name — for example, the John Smith Charitable Gift Fund. The account is held by an organization — such as a community foundation, university or charitable arm of an investment firm — that administers the funds and makes the grants. Your DAF is a component of that organization. Although the account is in your name, the funds belong to the organization.

A DAF allows you to contribute assets and claim a charitable deduction in the same tax year. In addition, you can make recommendations to the organization that holds the DAF as to which charities it should distribute the funds to. When you do so, you can name a

Case study VI

A DAF LEADS TO DEFT ESTATE TAX SAVINGS

For tax planning purposes, contributing appreciated property — including real estate interests — to a donor-advised fund (DAF) allows you to avoid capital gains tax and claim a deduction for the property's market value up to 30% of the donor's adjusted gross income. For example, John Smith, who is in the highest income tax bracket, contributes securities with a value of $100,000 to his DAF. He paid $20,000 for the securities three years ago and has a gain of $80,000.

By deducting $100,000 from his taxable income, John saves substantial income tax. He also saves the capital gains tax he would have paid if he had sold the property. In addition, he reduces the value of his taxable estate by $100,000, potentially saving his family thousands of dollars more.

particular charity, or even several. Or you may specify a broad category of nonprofit organizations — such as those that support the arts, promote literacy or alleviate homelessness. Public charities will help you select appropriate charities in the category that you designate. A DAF can make grants in your name or anonymously.

Most DAFs charge an administrative fee ranging from around 0.5% to 2% of the account balance. Some require you to maintain a minimum balance, but many do not. DAFs have a minimum initial donation, typically between $10,000 and $25,000. But some DAFs allow you in for as little as $1,000, while others require at least $250,000. You can make subsequent contributions at any time, usually in increments of $1,000.

The tax advantages

Although you may take immediate tax deductions for your donations (which are irrevocable), a DAF needn't distribute your donation in the same year. For example, suppose your alma mater is planning a 100th anniversary event next year. You would like to make a donation next year to the college's scholarship fund, but you need the tax deduction this year. You can contribute the money to the DAF now and advise the fund that you would like the money donated to the college next year, but still take an immediate deduction. The organization that holds the fund invests the money in financial markets, and in some cases will allow you to recommend investments.

In addition to the immediate tax deduction and reduction in your taxable estate, a DAF has another advantage. You can deduct contributions of long-term appreciated assets at FMV, which lets you avoid paying capital gains tax. (See Case study VI.) By contrast, you can deduct certain contributions of appreciated assets to a private foundation only at your cost basis.

Looking toward the future, you can name a successor advisor for each DAF, usually someone in your family. This advisor will continue making grant recommendations — and hopefully donations — when you die or if you become incapacitated. This provision lets you keep your philanthropic activities alive and in your family for future generations.

A word of caution: DAFs have attracted the attention of both the IRS and Congress due to perceived abuses where the donor has control over how funds are spent. Work closely with your tax advisor to make sure your DAF is organized and operated within IRS rules.

WHEN TO GIVE

giving to charity should be an ongoing process. You must not only develop and implement a plan that reflects your current financial situation and charitable inclinations, but also review and update that plan so it fits any changes in your circumstances or beliefs. Truth is, you just never know what may occur to alter how much you have to give or where you wish to direct your funds.

For example, a sudden windfall of cash could allow you to donate more than you ever thought possible. But if you fail to plan properly, you may lose out on some tax advantages of your donation — or even suffer added tax liability. And that may inhibit you from donating so generously in the future.

WHAT'S THE NEXT STEP?

Of course, charitable giving is about more than reducing taxes; it's about promoting ideas you believe in, overcoming society's woes and improving the world we live in. But with ongoing tax law changes, doing good has never been more complex. And regularly revisiting your charitable plan is now more critical than ever, for both your recipients' good and your own.

To this end, keep a running list of the areas and issues that most affect your giving. What type of donation would fulfill you personally? How do your charitable aims fit in with your personal financial objectives and your goals for benefiting your loved ones? Also consider more practical issues. How much can you afford to give, and what's the most tax-favorable way to donate?

As you ponder these questions, jot down a few notes about things you want to look at more closely and discuss. It may be easy for you to put off developing a detailed charitable plan — or updating it in light of changes in tax law or your situation. But if you stay involved, you'll be able to give more and maximize the benefits of donating.

Call us with any questions you have about the concepts, vehicles and strategies represented here. We would welcome the opportunity to discuss your situation and help you better understand how to carry your charitable plan forward.