Unedited transcript of

Charitable Planning

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Speaker(s)

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>>: Welcome everyone back from the other side of the break. Before we jump into charitable planning, we just had one question come in during the break. And that was, is a drafting attorney required to reach out to clients every five to seven years to address review and possible changes to an estate plan? The attorney is not required to do that. But it certainly makes good sense to do that. We talked about engagement letters, and sending a closing engagement letter when everything was done. And the reason for that is basically so it's clear when you can sort of stop the engagement, so if there was ever a question about if it was ongoing, like in this instance, you would be covered. However, if you are building a practice, you don't really want that to be transactional, you want to build relationships with these clients over time, and then hopefully build relationships with their families and things like that. So the way you do that is by proactively reaching out to your clients. So every five to seven years is a good model, because it's going to force them to take a peek at things, it's certainly going to -- you're going to say in there, have your circumstances changed? Do you want to change your fiduciaries? All of those kinds of things. So always makes good sense to do that, and just be in front of your clients so that you are top of mind to them, and it's a good way to generate business as well. However, if there is a law change, which would significantly impact your clients, even if it's clear that your engagement ended at the execution of those documents, I think you have an obligation to send notification out to your existing book of clients that something has happened. Because then you've covered yourself. It's also a good way to stay in front of your clients so you're top of mind. But then their family members can't come back and say, wait a second, there was this huge law change that just

happened, and you never sent mom and dad a letter that this would significantly impact their plan. So in that instance you certainly should proactively reach out to your clients and let them know somethings that happened that would impact their plan. But just a good business practice is to always stay in front of your clients, and you do that by communicating with them on a regular basis. All right. We will now shift gears to charitable planning. Last but not least, Laura, I think you're always last.

>>: It's okay.

>>: we saved the best for last.

>>: Of course.

>>: So Laura is going to finish off the morning with a discussion of charitable planning. Do you want to give everyone a brief intro of yourself? And then we can get started?

>>: Sure. My name is Laura Godine, it's so nice to be here. I really always enjoy this, I certainly enjoy it more when we're able to be together in person. But still really delighted to have the chance to do this together. I cans like Katie started my career as an estate planning attorney in private practice. And did that for just under a decade. And I was particularly interested in philanthropic planning and the charitable side of the work. So I spent a few years after that at the Boston Foundation, which is our local community foundation here, working with clients, advisors, and donors on exclusively philanthropic planning. I'm now the director of wealth planning at Eaton Vance WaterOak Advisors and I do all things not related to our clients' investments. So help with strategy around estate planning, philanthropy and trust services and the like. Can you see my -- this is what we'll be talking about today. I know that -- we'll talk about the charitable deduction, deduction limitations, different kinds of popular giving, direct and vehicles. Split interest trusts, and a quick touch on the IRA qualified charitable distribution. Because there have been so many changes over the last couple years where we -- where you see this little heart icon, that's what I'm using to indicate aspects of the through have been changed under the CARES Act from 2020 that have been extended into 2021. So

some of those extensions are significant as it relates to charitable planning, so I will mention those. And then the little blue diamond icon will indicate changes as a result of the tax cuts and jobs act from 2017 that will expire at the end of 2025. There are also a couple of references with respect to the SECURE Act. Not enough that they deserve their own little icon, but I mention it just because I will mention the SECURE Act change from time to time as well. I think as everyone has probably said, please submit questions, ask questions, and I'll try to pause when it seems sensible, but Katie can always interrupt me happily, happy to be interrupted or to take questions at any point. So the charitable deduction, what the heck is it? It's a pretty basic definition. A charitable contribution is a transfer of money or property to a permissible donee and in the proper form, we'll talk about those forms. And permissible donee is any organization described under section 170c as qualifying for income tax purposes. But what's important to talk about as well is the no-goes. So what people cannot get a charitable deduction for. So here's the list of gifts or contributions for which no charitable deduction is available. The first is contributions to individuals. Very nice, very generous, very wonderful. No deduction. The other is a portion for which the donor receives a benefit. So when you make a contribution, if it's over $75 and then in return you get to go to a fancy dinner, or you get to go to a cool exhibit, or you get any kind of thank you note in exchange. This is the quid pro quo exception. Essentially you make a contribution, but you get something cool back, unless it's of nominal value you don't get to get a deduction for that gift. Contribution of your time or services. Volunteering for an event, or volunteering for anything wonderful. Very generous, wonderful, again, no deduction. This one is obvious, but contributions to nonqualified organizations. So organizations that are not qualified under 170c do not result in a charitable deduction. The biggie for our purposes is the partial interest rule. So you cannot receive a deduction for a contribution of other than your entire interest in the property that you are contributing. We will talk about the exceptions to this rule because there are significant and important and relevant exceptions. But I just want to spend another second on why this rule exists, because it doesn't feel obvious to me why it would exist. Essentially it's because we're talking about not the property itself giving part of property, but part of an interest in that property. So essentially the donor would be giving a charitable interest in part of their

own interest in that property, and also thereby retaining part of the interest. And because of that retained interest, it's possible that the donor could manipulate the value that ultimately goes to charity, or change the value that ultimately goes to charity. So a very simple example would be a donor says I'm going to give you my car, charitable organization, in a year. So I'm going to keep it for a year, and then I'm going to give it to you. And I'm going to -- and I want a charitable deduction because I'm going to give you my car in a year. But in that year the person could totally drive the car into the ground and destroy the car, and would have gotten the deduction that only took into account a one-year worth of ordinary depreciation in the car. So the very basic example, but just as an indication of the principle that this is why we have a rule that generally says that a partial interest is not a deductible gift. But we will talk about the exceptions, because those are the real important parts. The exceptions are, partial interest transfer to certain types of trust. That what we're really going to focus on not in this moment, but later. Because that's where we're talking about split interest trust that you are likely familiar with to some extent, charitable remainder and charitable lead trust. The other exceptions to the general rule are an undivided portion of the entire interest in a property. More like a piece of the property. A vertical slice of the interest. A remainder interest in personal residence or farm. And qualified conservation donation. So those are the exceptions, meaning one can potentially claim a charitable deduction for those partial interest gifts. So now turning to the charitable deduction. The income tax charitable deduction. The federal income tax charitable deduction is available as an itemized deduction subject to certain limits. So this means that it's only available to taxpayers who are itemizing their deductions. If people take the standard deduction, their charitable deductions are not deductible. There's a small asterisks we'll get to about that, but that's generally the rule. The reason why the blue diamond is here is because under the tax cuts and jobs act, the standard deduction was significantly increased to -- in 2021, $12,550 for unmarried individuals, and $25,100 for married filing jointly. The result is that many fewer people are itemizing, and because the charitable deduction is an itemized deduction, fewer people can claim that deduction. But if you're over that threshold, then that's when the charitable deduction kicks in. One way that clients are often getting around this by still being -- still qualifying for the itemized deductions and thereby able to take the charitable

deduction is by some people call it bunching, I've heard it called other things, I can't remember, clumping, something that implies bunching. But where essentially you are accelerating several years of gifts into year one. So you would make -- if you know you're going to make a bunch of gifts of similar size over the next five years, but you wouldn't be qualified for itemizing your deductions, if instead you accelerated that five years and gave all five years worth of those gifts in year one, that might get you over the hump. So that you are able to claim the deduction as an itemized deduction in year one. The little asterisk I was saying before about typically being unable to claim any charitable deduction unless you're itemizing comes under the CARES Act. It came under the care act, but it's sticking around. So it has a heart but I expect it will be that -- it won't be that heart forever. For clients who aren't itemizing, there is now a $300 above the line, or universal deduction available. And that can be claimed for individuals that are making cash gifts to public charities. So donations to private foundations, or donor advised funds, are excluded from that additional benefit. But essentially any gift of cash to a direct charitable organization can receive a $300 above the line deduction for an individual or $600 for married couple, even if they aren't otherwise itemizing their deductions. a nice CARES Act benefit. Turning to the charitable deduction for estate tax purposes, estate and gift tax purposes, if an organization qualifies for an income tax deduction, it also qualifies for a gift or estate tax deduction. So there's no separate code section that just basically says if it works on the one side it works on the other side. Unlike the income tax deduction, which is subject to important limitations that we're going to spend a bit of time on, the estate and gift tax charitable deduction is unlimited. So in theory, one could wipe out and does, do sometimes wipes out their entire estate tax obligation by making a charitable contribution. And the only exception is that the charitable deduction is unlimited, except that it can't exceed the total value of the estate, obviously the IRS isn't going to pay you back for making a charitable gift. This is a juicy section. So the deduction limitations, this applies to the limits placed on the amount someone can deduct for income tax purposes based on charitable giving. So we'll look at the factors that must be considered in computing the limitations, carry forward, one can carry forward, if you can't use the full deduction in one year, we'll have charts for future reference, and we'll touch on how one has to substantiate that actual deduction, not just say

trust me, that's what it was worth. The factors that you have to take into account when computing the deduction limitations are the value of the property. So you're looking at both fair market value and cost basis. The type of property that's being contributed, so cash, securities, privately held business interests, real estate, et cetera and the type of charity or vehicle that the gift is going into. So is it a public charity, a private foundation? And all three of those factors have to be considered in each instance. So we'll look at how and why. So determining the value. Fair market value versus cost basis. The general rule is that gifts are deductible at fair market value, but there's some important exceptions. The applicable value is determined by the property being contributed and the type of charitable organization or vehicle benefiting. So we can't just determine the value by looking at the type of property. And there are exceptions that will be coming up in a moment, and this painting is a reminder of one of the exceptions. So remember this painting. We'll take a look at the exceptions and we'll -- the painting will make more sense in a second. So again, the general rule is that property is deductible at fair market value, but here are the exceptions. First up is ordinary income property. And that is only deductible at basis. That would include inventory, life insurance, consortium capital gain property or -- short-term property gain created by a donor. Now we turn to our painting. Tangible personal property is deductible at fair market value less gain, meaning basis, unless it's being used by the charity for the charity's exempt purpose. So when property is given for the use of the charity but it's sold within three years, the difference between the deduction for fair market value and basis is recaptured by the taxpayer. And there's no recapture if the charity essentially in good faith said no, we're going to use this for our exempt pump, but they didn't and sold it, you'd have to sort of prove there's a good faith intention that they were going to use the property. And this turns on a concept about related versus unrelated use of the property. So if the property is given to the charity and it is being used for a use that is related to the charity's exempt purpose, then the deduction is a cost -- is a fair market value deduction. So the example that is easiest with the painting is, if somebody gives a painting to a museum, the museum's exempt purpose is in furtherance of the display and appreciation of art. I'm making that up, but something like that for a museum. And the museum takes the painting and displays it as art, that is in furtherance of the nonprofit's exempt purpose, fair market value

deduction is allowable. However if that same donor gave that same painting to a hospital, and the hospital's exempt purpose is not displaying art or art appreciation, but is healing people and other things that hospitals do, and the hospital therefore sold the painting and put the proceeds towards its operating expenses or towards one of its medical purposes, then the deduction would be only for cost basis. Because it was not -- the gift was not used in furtherance of the charity's exempt purpose. So the preceding sides, we're looking at the value of the asset for deduction purposes. And now we're going to look at how much of that value one can actually deduct. So first you establish the value. Are we talking about cost basis or fair market value? We establish that. And now we turn to, okay, so how much of that value can I actually deduct? Again, in order to determine that, you have to look at the type of charitable organizations being benefited and the type of property being contributed. This gets a little funny because of the CARES Act. And because of the tax cuts and jobs act. So stick with me, but it's sort of like -- it's like a haunted house. No, not a haunted house. Like a fun house mirror, where it's like mirror win mirror within mirror. In a typical year, a nonpandemic year, let's say, an individual can't wipe out their entire income tax obligation just by being extraordinarily generous by way of charitable gifting. So you can't ordinarily make gifts and then deduct 100% against your adjusted gross income. However, under the CARES Act, there's a temporary deduction for cash gifts made to public charities for 100% of AGI. So somebody can make a gift equal to their full AGI for 2020, and this was extended into this year for 2021, if it's a cash gift, made to a public charity, they can fully wipe out their tax -- income tax obligation for 2020 and now for 2021. This temporary expansion does only apply to cash gifts, made to public charities. So it doesn't extend to gifts to private foundations or donor advised funds. So that's an extremely temporary rule. Last year and this year, and done. We hope. We hope for pandemic purposes. However, under the tax cuts and jobs act, we also have this other little additional benefit. Which is that a donor can deduct up to 60% against AGI for cash gifts to public charities, in this case that would include donor advised funds, which are public charities. And private foundations. That was an increase from 50% under the tax cuts and jobs act, but will, because it's under the tax cuts and jobs act expire at the end of 2025. So for the next few years, there's additionally even after 2021, this period of time where one can deduct up to 60%

against AGI for cash gifts made to public charities. But now let's look at what happens in a nonpandemic, nontax cuts and jobs act year. So most of the time a donor can deduct up to 50% for noncash gifts to public charities and private operating foundations. A private operating foundation is as opposed to a private nonoperating foundation, a private operating foundation is a private foundation that runs programming like a nonprofit. So direct services for individuals. A private nonoperating foundation is what we think of more typically when we think of a private family foundation. So a grant making foundation. So I just want to make that distinction when we talk about private operating versus private nonoperating foundations. So the typical 50% limitation applies to ordinary income property, short-term capital gain property, property unrelated to the charity's purpose, so our painting given to our hospital -- or if the donor elects to deduct basis rather than fair market value, on a gift of long-term gain property. And all of those types of property would get a cost basis deduction. The 30% limitation, meaning that a donor can deduct up to 30% of AGI for gifts of certain other types of property to public charities that don't qualify for the 50% limitation. So this would include most nonoperating private foundations. Like family foundations that we think of as grant making foundations. Veterans organizations, fraternal societies, and nonprofit cemetery. The property that we're talking about in this case is long-term capital gain property to a 50% charity, or for the use of. So the most common example, and this is what we typically see, is a gift of publicly traded stocks to a public charity or donor advised fund. Most of our clients give appreciated securities to charitable beneficiaries or donor advised funds. Those are considered 3% charities. So very often what we're helping clients figure out is if I give this appreciated security, how much can I deduct this year? And we'll talk about the carry forward. But usually we're in this 30% limitation arena. The loser of the group is the 20% limitation. So other capital gain property contributed to an organization that doesn't qualify for the 50% limitation. And the deduction is limited to basis, other than for publicly traded securities. So -- and I don't mean to stay that as the loser of the group, I just mean this is the lowest deductibility. This is representative of privately held business interests contributed to nonoperating private foundations. So this is actually pretty common too, if somebody is -- has private business interests and they also have a private family foundation. If that contribution is subject to the 20%

deduction limitation. It can be very cumbersome to keep these in mind. This is too much, I would say, to keep in mind. So I'm going to have a fun chart in just a moment. But I just want to mention the carry forward. So for all of these, there is a five-year carry forward. If somebody cannot deduct the full value because they've bumped up against their AGI limit, they can carry forward the excess deduction for five years. It will retain its character as the original percentage limitation, so if it was 50%, 30%, or 20%, that's how it will carry forward. And one has to use their current year gift before they can reach back and use their carryover amounts. Excess carry forwards expire at death, so it doesn't translate over into an estate tax deduction. Oh, this is my little picture of a tree and acorns. So this is my illustration of a reminder that if a squirrel has too many acorns in its mouth one year, it's too much, then it hides them, now we all know they forget where they put them, but in our example they know where they put them and they use those the next year. A carry forward of a qualified conservation contribution can be carried forward for 15 years. The rest is just five years. Here's the chart. So this is basically everything that I just said so far in the last however many minutes. But I think this can be really helpful. This chart is more complicated this year because of the 100% CARES Act expansion. But in any event, I keep this handy because I don't want to have to remember what percentage limitations apply to what, or I just want to make sure if I'm on the phone with a client and they ask a question I can quickly refer to it. I have the little asterisk next to the painting to remind us of that -- that that limits us to cost basis deduction if the contribution of tangible personal property is made to an organization that sells it and isn't using it in furtherance of its exempt purpose. So how do we actually substantiate that deduction? How do we prove that the value we're saying our client or we can deduct is that -- is actually that value? The forms that apply in this case are forms 8283 and 8282. A deduction for under $250 doesn't require any kind of receipt from the charity, the donor has to have reliable records to show that they've made that gift. But there's no submission of anything else required. For a gift that you're claiming a deduction of over $250, the charity is required to provide an acknowledgment. They don't have to say what the gift was or how much it was for, but they have to acknowledge the gift in writing. Over those amounts is when we start to get into the world of forms 8283 and 8282. They're out much order, 8283 gets filed first, 8282 gets filed second. I don't

know why. So the donor files form 8283 in the year the gift was made. And then the receiving charity files form 8282 if the asset they received is sold within three years of having received it. Failure to file the 8283 in particular is a big deal, and it can result in disallowance of the deduction and a penalty. And often this is what we're talking about larger charitable gifts. So it gets so important to make sure that your client is working with a really great CPA or tax preparer and can help guide them through this along with you.

>>: Laura, we have a question come in. Could you please define what a donor advised fund is?

>>: Oh, I would love to. And I will. In a couple, maybe two slides from now. I'm sorry, I started talking about them before defining them. But I have a slide on that I think in maybe two slides from now. So thank you. So for gifts for which you're claiming or trying to claim a deduction of between 500 and $5,000, form 8283 section A reports particular information about these gifts. I won't necessarily read the rest of this slide, but I just put these benchmarks here so that if usual talking to somebody and they mention a particular value, and a character asks which parts of the form need to be filled out here. There's a section A and a section B, and you have to fill out one or the other based on the character of the property and the value. So types of giving. We generally think of direct giving as making a one-time contribution directly to a public serving charity. So directly making a gift to a religious organization, a scientific organization, a school, something that you think of as a charitable organization, directly making that gift, either writing a check, cash, transferring securities, the actual end organization is getting that gift. The donor receives the charitable tax benefit, because a public purpose is being served. I put the little CARES Act incentive here just as a refresher that direct gifts of cash directly to O.s, this is where we're talking about as opposed to gifts made to donor advised funds or private foundations, gut those additional CARES Act incentives. Donor advised funds. Okay. So a donor advised fund is a philanthropic vehicle, it has to be established at a public charity, and the mechanics are very straightforward. The donor makes a charitable contribution, receives an immediate tax benefit, and then can recommend grants out to their favorite organizations over time. The charitable organizations that sponsor or host

or administer donor advised funds come in a few categories, and I'll describe each of them a little bit more on the next slide. Yes, the next slide. National gift funds, fidelity, Schwab, van garden, they all have gift funds. Community foundations, which I'll describe in a minute, and single-issue providers. I'll talk more about what I mean by that in a minute too. Two donor advised funds are subject to certain rules that were originally created to govern the scrutiny around private foundations and those include the excess benefit rule and excess business holding rules. The excess benefit rule essentially means that you can't get a charitable contribution if you're also getting a benefit. So there are limits on gifts you can make from donor advised funds if it comes back around to help the donor in some way. The excess business holding rule essentially says that a donor advised fund applies to private foundations too but can't own more than 20% of a particular business holding. More than 20% can't account for the fund. The way this functions, our couple here, penny and Cash donate assets that can be any -- shouldn't say it can be any kind of property, but most donor advised funds can accept most kinds of property. They get an immediate tax deduction if they're eligible for it. The assets are invested, ideally they grow, tax-free, in this charitable environment. And the family, they recommend grants from the donor advised fund out to their favorite charitable causes over time. So even though they get the deduction in year one, the moment of contribution, and they can add to it over time and get more deductions over time as they add to it, they don't actually have to send those dollars out into the community at that same moment. So it can grow, it can be mull if I generational, philanthropic giving vehicle, and it is there for the family to make grants out of over the passage of time. So I will mention that there are typical kinds of sponsoring organizations, meaning the kinds of charities that house donor advised funds, the first is the national gift funds. So financial institutions that have started donor advise funds programs. The distinction of these is that they're usually done most economical, so they usually have the lowest fee associated with it. And consequently they usually have the lowest level of support services around philanthropic knowledge and programmatic expertise. So it might be that over a -- if you have a million dollar fund maybe you have someone that can help you make decisions about the kinding of organizations that you want to contribute to, but it's really there as a transactional vehicle that you sort of use as a charitable account, but you can direct gifts out of. Single-

issue provider, that's what I refer to with respect to religious affiliate philanthropies. National Christian Foundation, combined Jewish philanthropies, universities that host donor advised funds, many do. So these O.s, some may provide philanthropy support services above a certain level, and one thing to be aware of with respect to some of the single-issue providers is that they sometimes have other rules associated with where the grants can go. So typically a donor advised fund will permit a grant as long as it's permissible under the IRS's view to any charitable organization. Sometimes single-issue providers require that a portion of gifts goes to either the university or program of the university if it's university or something like that. So just a question to ask in those circumstances. And then community foundations. So community foundations are public charities that are place based, nonprofits, the Boston foundation is Boston's local community foundation. There's also a Cambridge Community Foundation, a Brookline Community Foundation, probably one in every area where you live. Generally speaking they're grant making public charities, so they gather assets from many generous people, in a few ways. One is often through an endowment and the community foundation has areas much programmatic expertise where they decide where the grants go from that endowment, and many host donor advised funds. For those donor-advised fund holders, they provide significant and impressive philanthropy support service and programmatic expertise. There are also other funds people can contribute to through donor advised funds. Private foundations are separate legal entities that have to be approved as the IRS as a 501(c)(3). Unlike community foundations which receive -- which are -- which receive many, many donations from the public, private foundations receive their funds from one or very few sources like the family or a business. Private foundations are less popular than they once were. They're still popular, all of these vehicles are, they give maximum control of investments in grants, and they have many -- many people use them because they think their family will participate in this as a philanthropic vehicle for many generations to come. And they're subject to these pretty stringent rules because they come from bun funding source, and there's a tax benefit associated with it, the IRS looks at them pretty carefully. So there's an excise tax that gets paid, at least 5% of the value must be distributed every year. They have to file tax bids and they're subject to these private foundation rules that I've listed as

self-healing, exist excess business holdings, jeopardy investments, you can't invest in something that's pretty risky, taxable expenditures, meaning you can only make permissible deductible grants out of the private foundation. This is obviously just a cursory overview of these instruments, but I will also share a side by side comparison, because often clients are asking what's the difference between a donor advised fund and a private foundation, which one should I do and why, and so this is an easy kind of just reference chart for future reference. I think -- I talked about most of this, but essentially just I guess I'll go through some of the highlights quickly. The start-up oftentimes is a significant difference. So for a donor advised fund usually it can be established within 24 hours. Private foundation, you have to hire an attorney to draft a trust document, essentially, and get it approved by the IRS as a final 1c3 so that, take months. The income tax deductions are more favorable for private -- for donor advised funds than for private foundations, because donor advised funds are public charities. The ongoing administrative fee varies with which donor advised fund option you select, because of how I describe the varying levels of support services that you might receive. But they are almost universally less expensive from a fee perspective than a private foundation, because the private foundation running this entity and responsible for all of the associated expenses, unlike benefiting from the economies of scale at a donor advised fund sponsoring organization. No excise tax due for donor advised funds, there's this flat 1.39% excise tax due for private foundations. And the rest is there, it won't -- I'm just watching my time, so eel keep going. But this is a nice one to keep on hand for quick questions that come in as well. Split interest trusts. So this is plucking back from the beginning where we were talking about exceptions to the partial interest rule. So this is our primary exception to the partial interest rule. These are trusts that are considered split interest because they have both charitable and noncharitable beneficiaries. For a charitable remainder trust, many like the name suggests, the donor contributes property to an irrevocable trust for a term of years or for a life, and two interests are created. The lead income interest is an annuity payment to a noncharitable beneficiary. And then the reminder interest goes to the charitable beneficiary, one or more charitable beneficiaries. Charitable lead trusts also an irrevocable trust, created in this instance to -- the leading interest is the charitable interest. And the remainder benefit

goes to the donor or to noncharitable beneficiaries. Both charitable remainder and charitable lead trust come in two general categories with respect to the leading interest either in the form of an annuity interest or a unity trust interest. And we'll talk about those in a moment. The terms of the trust differ. So charitable remainder trust can be established for measuring live or life, or a term of years with a maximum of 20. Charitable lead can also be established for a term of years, but there's no limit on the term of years, or measuring life or live -- or a combination. So for the lifetime person X, followed by Y number of years. So CRATs pay out a fixed amount that is determined based on the value of the initial contribution. It must be at least 5%, but no less -- sorry. At least 5% but no more -- yes, but -- no more than 50%. So between 5-50% of the initial fair market value comes out as the annual payment to the noncharitable beneficiary. The value -- you have to pass two tests in order to be qualified as a charitable remainder annuity trust. The first is the actuarial value. So the value of the charitable remainder has to be at least 10% of the value of the assets contributed. You figure that out using an online program. There are programs you plug the numbers in and it says you passed the 10% rule or no, you failed. And if you failed it means you're giving away too much in the annuity percentage. The second test is the probability of exhaustion test. Essentially it's not a craft if there is more than a 5% chance that the funds will be exhausted before the trust ending. Again, that gets Kirked out and entered by a program, and it tells you if you pass or fail. There's this newer rule where the crafts created after August 8th, 2016, have the option to include an early termination provision. Which essentially says that if the next annuity payment will cause this trust to fall below 10% of the original value, then it will terminate. So that there's no chance that it will ever fall below that amount. So you can just essentially trigger that at the time as you're calculating the distributions. Charitable remainder union i trust. A CRUT. It pays the income beneficiary of a fixed percentage of the FMV of the trust assets valued annually. It is subject to the 10% minimum remainder interest rule, but there's no 5% exhaustion test because the charity is getting the lead interest. So nobody cares about the remainder interest. I'm just kidding. So the IRS isn't worried charity isn't going to get enough. Very quick note, there are three common variations on the CRUT. And they are common. So I just wanted to mention them. The first is the neck nubbing CRUT, some call the my CRUT. It pays out

the lesser of the trust's net income or the unitrust percentage. It's often suitable for donors who are focused on providing the charity with the maximum amount of principle at the end, because it's paying out the lesser amount to the noncharitable beneficiaries and saving the most for the end. It's also suitable if a trust is going to be funded with low yielding property, which is expected to pass intact to the charitable organization like real estate. If the chair at the is going to actually use the real estate. The second variation is a NIMCRUT, Net Income with a Makeup Provision. Essentially It's Income in One Year exceeds the unitrust amount, that excess gets paid out to compensate for prior years in which there was a shortfall. There's also a FLIPCRUT. It starts as a NIMCRUT or FLIPCRUT, and upon a triggering event it flips into a regular CRUT. The flip has to be triggered on a specific day that -- or event that can't be controlled by somebody. So a sale date of an unmarkable security, a beneficiary's birthday, a marriage, something like that. Birth of a child. A very -- the most common example is the sale date of a stock, a closely held company. Once the FLIP is flipped, you can't unflip it. Reverse FLIP is not permitted. Looking at the income tax consequences, the donor receives an income tax charitable deduction when the property is transferred into the charitable remainder trust. We use the 7520 rate, which prescribes the value of an annuity or interest for life for a term of years or the remainder of revisionary interest. It's 120% of the federal rate. CRUTs typically yield larger charitable deductions than CRATs when the payout percentage exceeds the 7520 rate in effect when the gift is made. CRATs are responsible -- responsive to fluctuations in the 7520 rate, so a lower 7520 rate yield as smaller charitable deduction for the remainder interest of the CRAT. CRUTs are generally not responsive to changes in the 7520 rate, unless the term is based on the life expectancy of a very young beneficiary, but in that case the CRU the will often fail the 10% rule because the young beneficiary's anticipated to live so long, by the end of their life there's likely not enough left for the charity. A little bit more about the income taxation. I'm not going to run out, don't worry. The income taxation for the noncharitable beneficiaries, there's no gain recognition on funding. The income paid to beneficiaries is subject to taxation when the funds come out and go into the hands of the beneficiary based on the source of the funds used to make up that payment. And the dollars paid to the beneficiary retain their tax character, it uses it as a four-tier tax payout system, so first

comes out ordinary income, then capital gain, then tax-exempt income, and the remainder is tax-free, return of principle. One note is that some clients consider naming charitable remainder trusts as beneficiaries of IRAs to create a version of a stretch payout now that we have the SECURE Act. That now says that most nonspousal beneficiaries of inherited IRAs can no longer stretch the distributions out over the course of their lifetimes, and rather have to take the full value of the account within 10 years. But if you imagine if you're charitably inclined and don't want to necessarily saddle your children with that -- the incomes tax hit from the IRA, some people name a charitable remainder trust as a beneficiary of the IRA, that can stretch it out over the course of their lifetime. Of course children would only have access to the income and Avenue death the assets would revert to charity. So it has to be somebody interested in, that but it's one interesting tool that people have been using. Gift and GST tax consequences of charitable remainder trusts do exist. So giving the taxable income interest to a noncharitable beneficiary other than a U.S. citizen spouse is a taxable gift. The gift might not be currently payable to the extent the donor has exemption left, and they can allocate exemption. A gift to a charitable remainder trust has GST consequences if the noncharitable beneficiary is a skip person. In this instance, GST exemption can be allocated upon funding. For estate tax purposes, the remainder value is typically not includable in the donor's gross estate. If the donor retains an interest for a term of years and dies before that term's expiration, the value of the property is included in the estate, but then there's an offsetting deduction allowed for the remainder value. Oh, my goodness. Okay. Charitable lead trusts, let me just see what makes the most sense. I'm going to quickly brush by --

>>: We have 10 extra minutes built in at the end for questions, really. So you can just --

>>: I hate going over my time, though. But thank you, maybe I will by one minute. So unlike charitable remainder trusts, there's no minimum or maximum annuity or unitrust payout rate applicable. So do whatever you want. Charitable lead annuity trusts, we already know the difference between the annuity payment and the unitrust payment so I won't necessarily go deep into that. The interesting thing with charitable lead

annuity trusts is that they can be zeroed out so that the gift tax charitable deduction fully offsets the gift. That is not really possible in a CLUT, because you don't know how much is going to be going to charity to fully offset the gift. May, when establishing a charitable lead trust is whether it will be a grantor or nongrantor charitable lead trust. So that's just something to be aware of. The grantor charitable lead trust allows an immediate income tax deduction subject to the deduction limitations that we talked about, the 50%, 30%, and 20%, and then all income is taxed to the grantor with no offsetting charitable deduction. Nongrantor charitable lead trust, there's no income tax charitable deduction, it's its own separate entity that gets its own deductions over time, and the grantor, the assets are out of the grantor's estate. Last thing. The QDOT. This used to be something that every year was it or was it not going to happen. Now it's been made permanent, the rule is that you can direct up to $100,000 directly from an IRA to a charitable organization, and it can count against one's required minimum distribution. So essentially it isn't as though you get a charitable deduction for it, you just aren't taxed on the income. So ordinarily you'd be required to take out your client -- your client would be required to take out a minimum distribution and pay the incomes tax. If they don't need that money, up to $100,000 of it can go directly to a charitable organization. They don't get a charitable deduction, but they're not taxed on the income. And they have to be 70½ or older, interestingly that remained the age required for qualified charitable distribution IRA rollover, even though the SECURE Act increased the IRA required minimum distribution age to 72. And I think that's it. I think we did it, Katie!

>>: Yay, we did it! The other question I had in was please explain the excise tax for private foundations. Which I think was just that flat 1.39 or --

>>: Yeah. Exactly. And it used to vary between one and 2%, and people got really frustrated with that. I was confusing and sometimes you would be the 1% and sometimes you would be the 2%. It didn't vary between 1 and 2%, it was one or 2% depending, and they just decided to make it that flat amount. For everybody.

>>: Excellent. I think that does it for our charitable question.

>>: Thank you.

>>: Thank you very much. As always, for doing this presentation.

>>: My pleasure.