PRESENTED AT

68th Annual Taxation Conference—Estate Planning Workshop

December 4, 2020
Austin, TX (Virtually)

CHARITABLE PLANNING IDEAS YOUR CLIENTS CAN USE

Mickey R. Davis

Mickey R. Davis
Melissa J. Willms
Davis & Willms, PLLC
Houston, TX

mickey@daviswillms.com
281.786.4500

CHARITABLE PLANNING IDEAS YOUR CLIENTS CAN USE

I. Introduction 1
II. Federal Estate, Gift, and GST Tax Laws 1
A. Historical Perspective. 1
B. American Taxpayer Relief Act of 2012, P.L. 112-240. 1
C. Permanency. 1
D. Tax Cut and Jobs Act of 2017, P.L. 115-97. 1
E. Income Tax Changes. 2
1. Cash Gifts to Public Charities 2
2. The SECURE Act 2
3. The CARES Act 2
III. Overview of the Charitable Deduction Rules—The Dry Stuff 2
A. Public Charities and Private Foundations. 3
B. Assets Contributed. 4
1. Capital Gain Property 4
2. Tangible Personal Property 4
3. Ordinary Income Property 4
C. The Contribution Base. 4
D. Substantiation Requirements. 4
E. Benefits Received by Donor 5
F. Deduction Carry-Forwards. 6
G. Transfer Taxes 6
1. Gift Tax 6
2. Estate Tax. 6
3. The Generation-Skipping Transfer Tax 7
IV. Charitable Planning Ideas Your Clients Can Use 7
A. Cash Gifts 7
B. Gifts of Appreciated Property 7
C. Gifts of Appreciated Stocks 8
D. Tax-Free IRA Distributions 8
1. Structure 8
2. Income Tax Considerations 9
E. Donor Advised Funds 10
1. Structure 11
2. Gift Tax Considerations 11
3. Estate Tax Considerations 11
4. Income Tax Considerations 11
5. Excise Tax Considerations 11
F. Private Foundations 12
Specifics 12
1. Structure 12
2. Gift Tax Considerations 13
3. Estate Tax Considerations 13
4. Income Tax Considerations to the Donor 13
5. Income Taxation of the Private Foundation 14
6. Excise Tax Considerations 15
G. Charitable Lead Annuity Trusts 17
1. Structure. 18
2. Gift on Formation 19
3. Setting the Interest Rate 19
4. Income Tax Issues. 19
5. Death During Term 19
6. Benefit to Heirs 19

7. GST Tax Issues 20
8. CLATs and Business Interests 20
H. Charitable Remainder Trusts 20
1. Structure 21
2. Variations on the Payout Theme. 21
3. Gift on Formation 22
4. Setting Interest Rate to Value the Gift 22
5. Income Tax Issues for the Donor. 22
6. Income Tax Issues for the CRT 23
7. Income Tax Issues for Non-Charity Beneficiaries 23
8. Complying with Technicalities 24
9. Benefit to Heirs 24
10. Estate Tax Issues 24
11. GST Tax Issues 25
12. CRTs and Business Interests 25
I. Charitable Gift Annuity 25
1. Structure 26
2. Gift on Formation. 26
3. Setting the Annuity Rate 27
4. Income Tax Issues for the Donor. 27
5. Securing the Annuity 28
6. Income Tax Issues for Non-Charity Beneficiaries 28
7. Tax Issues for the Charity 29
8. Benefit to Heirs 29
9. Estate Tax Issues 30
10. GST Tax Issues 30
11. Funding a Charitable Gift Annuity with an IRA 30
J. CRTs and Retirement Plan Benefits 30
V. Conclusion 32

EXHIBIT A: Historical Estate & Gift Tax Exclusion and GST Tax Exemption Amounts & Top Tax Rates (1916-2021) 33
EXHIBIT B: Comparison of Donor Advised Funds and Private Foundations 34

CHARITABLE PLANNING IDEAS YOUR CLIENTS CAN USE

Mickey R. Davis and Melissa J. Willms
Davis & Willms, PLLC

I. INTRODUCTION

Charitable giving forms an important part of many clients' estate plans. Our experience, however, is that a client's interest in undertaking charitable planning (as with many estate planning techniques) is often largely impacted by the advisor's comfort level with, and ability to identify and explain, the various charitable planning tools that are available. It is the rare client indeed that begins her estate planning meeting by telling her attorney that she wants to leave her IRA into a testamentary CRUT for the benefit of her thirty-year-old spendthrift granddaughter. Even clients that express philanthropic goals are unlikely to appreciate the differences in, for example, establishing a private foundation as compared to a using a donor advised fund. This paper is not intended as a treatise on charitable giving. It does, however, attempt (i) to provide a resource to understand the basic income and transfer tax issues associated with charitable giving; and (ii) outline some common techniques in a fairly non-technical way, so that planners will have a general familiarity with their use.

II. FEDERAL ESTATE, GIFT, AND GST TAX LAWS

A. Historical Perspective.

The last decade has seen tectonic changes in the federal transfer tax system. Following what turned out to be a brief (optional) repeal of the federal estate tax and basis adjustment provisions in 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, P.L. 111-312, 124 Stat. 3296 (2010) ("TRA 2010") re-enacted the estate tax, and re-unified estate, gift, and GST tax exemptions, increasing them to $5 million for 2011, with an inflation adjustment in 2012.[1] In 2013, the law was scheduled to revert to the law in effect in 2001.

B. American Taxpayer Relief Act of 2012, P.L. 112-240.

At the last minute, the scheduled 2013 reversion of the estate and gift tax rules was nullified by the American Taxpayer Relief Act of 2012, P.L. 112-240, 126 Stat. 2313 (2013) ("ATRA"). ATRA adjusted tax rates and made the changes to the gift and estate tax exclusions and the GST tax exemptions first enacted in 2010 "permanent," while increasing the effective federal estate tax rate on the excess from 35% to 40%. As a result, ATRA reunified the estate, gift, and GST tax laws with an exclusion of $5,000,000, adjusted annually for inflation after 2010, and a top estate, gift, and GST tax bracket of 40%. At the same time, federal income tax rates were increased for individuals, trusts, and estates to 39.6% for ordinary income and to 20% for qualified dividends and capital gain tax.

C. Permanency.

As we all know, tax laws are never truly permanent. However, for the first time since 2001, ATRA meant there was no set expiration date for the estate, gift, and GST tax laws. From 2001 to 2013, the estate tax rules had expiration dates with a possibility that Congress would make them "permanent." There was continued uncertainty about "will they or won't they," but with ATRA's unexpiring exclusions, it literally meant that it would take an act of Congress to make a change. And then came December 2017.

D. Tax Cut and Jobs Act of 2017, P.L. 115-97.

The change in administrations ushered in by the 2016 elections brought about the impetus for further changes to tax rules. The passage of the Tax Cut and Jobs Act of 2017, P.L. 115-97, 131 Stat. 2054 (2018) ("TCJA 2017") on

[1] Of course, a client may make lifetime use of his or her GST tax exemption without making a corresponding taxable gift, or may make a taxable gift without allocating GST tax exemption. As a result, at death, the remaining amount of these exemptions may be unequal or out of sync.

December 22, 2017,[2] meant a loss of "permanency" not only for gift and estate tax rules, but for a host of other tax provisions as well. TCJA 2017 essentially doubled the estate and gift tax exclusions and GST tax exemption for persons dying and transfers made between 2018 and 2025. As a result, we have unified estate, gift, and GST tax laws with an exclusion (and GST tax exemption) temporarily set at $10,000,000, adjusted annually for inflation after 2011 (scheduled to return to $5,000,000 after 2025, but adjusted for inflation after 2011), and a top transfer tax bracket of 40%. For 2020, after applying the inflation adjustment, the exclusion and exemption are $11,580,000.[3] For reference, a chart outlining the estate, gift, and GST tax exemptions since 1916 is attached as Exhibit A.

E. Income Tax Changes.

The tax acts outlined above have also made numerous changes to various income tax rules. These rules as they apply to charitable giving are among those in play. The changes have continued, including in legislation enacted this year. For example:

1. Cash Gifts to Public Charities. TCJA 2017 temporarily increased the maximum charitable income tax deduction limits outlined below for cash gifts to public charities to 60% of the donor's contribution base, instead of only 50% (although for purposed of this paper, we'll still referred to the most favored types of charitable organizations as "50% charities"). If cash gifts to these charities made between 2018 and 2025 exceed the 60% limit, any excess is treated as a contribution subject to the 60% limitation for each of the five succeeding years. The 50% limitation for noncash gifts is reduced by the amount of any deduction under the 60% rule. IRC § 170(b)(1)(G).

2. The SECURE Act. The Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019, P.L. 116–94, made numerous changes to the manner in which retirement plan benefits must be paid out, both during the participant's lifetime and after the participant's death. In general, the SECURE Act requires that after 2019, distributions must commence when the participant attains age 72 (instead of 70 ½). More dramatically, it eliminates what had come to be known as "stretch IRAs" for most beneficiaries of a deceased participant, substituting instead a requirement that all retirement assets payable to a beneficiary other that the participant's spouse or minor child, or certain disabled or chronically ill participants, be paid out not later than 10 years following the participant's death (or five years if the beneficiary is not an individual or certain trusts). While not a change to the charitable giving rules themselves, as discussed below, the loss of stretch IRAs has focused some clients' attention on using charitable planning techniques as a substitute.

3. The CARES Act. The Coronavirus Aid, Relief, and Economic Security Act, P.L. 116-136, also known as the CARES Act, a law meant primarily to address the economic fallout of the COVID-19 pandemic in the United States, also made some changes to tax rules. For purposes of this paper, those changes relate primarily to permitting a modest ($300.00) "above-the-line" charitable deduction to be taken even by taxpayers that do not itemize deductions, for cash contributions to most 50% charities (as described below) other than gifts to donor advised funds. IRC § 62(a)(22). Perhaps more significantly, the CARES Act temporarily eliminates the 60% cap on cash gifts made in 2020 to most 50% charities (but excluding donor advised funds and supporting organizations), permitting instead a deduction up to 100% of the donor's contribution base (described below), less the amount of all other charitable contributions allowed as a deduction to the donor for the year. The donor must elect to have this more generous limitation apply. Act § 2205(a)(1). Donations that exceed this amount may be carried forward for up to five years. *Id.*

III. Overview of the Charitable Deduction Rules—The Dry Stuff

An individual donor who itemizes deductions is entitled to an income tax charitable deduction for contributions to qualified charitable organizations. IRC § 170(a). The deduction, however, is subject to numerous limitations and qualifications which in most cases depend upon: (i) the classification of the charitable organization; (ii) the type

[2] The technical name of the Act is "An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018", but "AAPRPTIIVCRBFY 2018" seems to be a remarkably unhelpful acronym. Some have suggested "the Act Formerly known as TCJA 2017," or perhaps its abbreviation, "AFKATCJA."

[3] Rev. Proc. 2019-44, 2019-47 IRB 1093 § 3.41.

Title search: Charitable Planning Ideas Your Clients Can Use