

**CHARITABLE GIVING:  
DOING WELL BY DOING GOOD**

**AND**

**THE LAWYER'S ROLE  
IN THE CHARITABLE GIVING PROCESS**

James C. Provenza, J.D., CPA  
Attorney At Law  
Chicago phone: 847-729-3939  
Rockford phone: 815-298-0664  
E-mail: [jprovenza@provenzalaw.com](mailto:jprovenza@provenzalaw.com)

DOING WELL BY DOING GOOD  
AND THE LAWYER'S ROLE IN THE CHARITABLE GIVING PROCESS

1) Defining planned giving

i) A planned gift is any gift of any kind for any amount given for any purpose-operations, capital expansions, or endowment-whether given currently or deferred if the assistance of a professional staff person, qualified volunteer or the donor's advisors is necessary to complete the gift. In addition, it includes any gift which is carefully considered by a donor in light of estate and financial plans.@

ii) Give and Take, Vol. 20, No. 4, March 1988.

2) More than writing a check.

a) Planned Gifts involve larger sums of money than that involved with simply writing a check in response to an annual fund appeal. It typically involves major thought and life decisions, because the donor is frequently giving capital assets.

3) Who gives and why

a) Unfortunately, not everybody gives to charity. Those who give typically are older (55 or more), have accumulated some assets, and identify with the mission of one or more charitable institutions. Tax considerations are important, but it is not the primary reason that they give. They give primarily because they want to make a difference in the mission of that institution. It is an emotional and spiritual event, rather than a purely rational one.

b) 92% of those who died in 1998 and left some amount to charity did not have a taxable estate. They therefore did not receive any tax benefit. I have never had a client leave money to charity just for a tax break.

4) Various types of planned giving vehicles.

- a) Bequests
- b) Charitable gift annuity
- c) Outright gift of property
- d) Charitable remainder trust
- e) Charitable lead trust
- f) Remainder interest in a residence or a farm
- g) Life insurance
- h) Transfer on death

- i) Gift of appreciated property
  - j) Gift of retirement plan
- 5) Bequests - Most charities get most of their money from bequests after a person dies. Usually, but not always, this person has made donations to the charity during life.
- a) How To Do It:
    - i) Specific Bequest I leave \$5,000 to the United Way of the Rock River Valley.
    - ii) Percent of the residue: % of Estate: I leave 5% of my trust estate to the United Way of the Rock River Valley
  - b) Several points here:
    - i) Make sure you name the charity correctly.
    - ii) If there are both local branches and a national organization, specify which one receives the gift.
    - iii) Make sure it is a qualifying organization.
  - c) Most money (60-80% of all charitable gifts) comes by bequests. With the fall off in estate planning, this may be changing.
- 6) Charitable remainder trusts
- a) Definition - This is an irrevocable trust in which the donor sets up a trust in which income is paid to one or more individuals for their lifetimes or for a term not greater than 20 years. On the death of the last life income beneficiary, the trustee distributes the property to the charities specified in the document. This type of trust must meet certain requirements under the tax laws to qualify. The trust must also meet certain mandatory income distribution requirements. The Attorney General's office has a charitable trust division, and the trust would need to make annual reports. The donor can get a charitable deduction for the value of the remainder interest to charity.
  - b) Two types of charitable remainder trusts:
    - i) Charitable remainder unitrust (CRUT) pays out a minimum of 5% of the value of the property on the first day of the calendar year. The donor can make gifts of property at future times. Assets must be revalued at the beginning of each year.
      - (1) Normal - payout 5% of trust value on first day of calendar year.
      - (2) Net income with makeup Charitable Remainder Unitrust (NIMCRUT) - this

CRUT postpones the distribution of income for some period of time, either because the grantor does not need the income or because the initial asset does not produce sufficient income (i.e. vacant land). After the asset is sold, or the occurrence of some event, the income will be distributed.

(3) Net income only - regulations permit a charitable remainder trust to pay out the lesser of 5% (or whatever the unitrust amount is) or net accounting income only. Net income only trust is only permitted during lifetime.

ii) Charitable remainder annuity trust (CRAT) pays out a minimum of 5% of the value of the property contributed at the time that the trust is set up. The donor may not make future contributions of property.

c) Basic Requirements

i) Trust must be irrevocable if the donor wants a current income tax deduction.

ii) For a remainder annuity trust, there must be no more than a 5% probability that the trust will run out of money during the life of the income beneficiaries.

iii) Minimum payout: The trust must make an annual payout of at least 5% of the value of the property. This percentage is fixed in the trust document. Since the trust is irrevocable, you cannot change it. Most donors choose a figure around 7%.

iv) Maximum payout: the trust's maximum payout is 50%.

v) Value of remainder interest must be at least 10% of total value of property.

d) Advantages

i) Defers capital gains tax

ii) The trust is tax free. This makes it ideal for donors who have highly appreciated property, and wish to donate it to charity. They can donate the property; the trust sells it, pays no capital gains tax, and reinvests the proceeds for greater income to the donor or life income beneficiary. The donor will pay income tax on distributions according to a complex 4 tier system.

iii) Asset management

iv) The donor or life income beneficiary can receive professional asset

management.

- v) Charitable deduction for actuarial value of assets going to charity.
- vi) The donor gets a deduction for the actuarial value of the interest that goes to charity, after the death of the life tenants. This is calculated under IRS tables.
- vii) Improved cash flow

If the donor contributes appreciated assets which the trust resells, the life income beneficiary gets a better cash flow than they would have with the original asset. This is because the trust can reinvest the entire proceeds. The donor would have had to sell it, pay tax, and contribute the balance.

e) Disadvantages

- i) Complex requirements, made easier by IRS standard forms.
- ii) The requirements to qualify for a charitable remainder trust are complex. The IRS has laid out many specific requirements that must be met. The IRS found that people writing them made so many mistakes that they provided standardized forms. Fortunately, the IRS has provided some standardized forms (which need some modifications) to make the job easier.
- iii) For CRUT, annual revaluation of assets.
- iv) A major administrative hassle for a remainder unitrust is that the assets must be revalued each year, in order to meet the 5% payout requirement. For hard to value assets, such as real estate, an independent trustee is essential.
- v) For CRAT, no future contributions permitted. Is not true for CRUT.

f) Problems in funding Charitable Remainder Trusts

- i) Mortgaged real estate - the IRS held, in Private Letter Ruling (PLR) 9015049 that a trust that holds mortgaged real estate will not qualify as a unitrust if the trust pays the mortgage. They held that under section 677 the trust income was used to discharge an obligation of the grantor, which made it a grantor trust. The grantor is the owner of a grantor trust, and it therefore does not get an immediate tax deduction. Putting aside whether this is accurate, avoid putting mortgaged real estate into a CRT.

ii) Personal property - funding a CRAT or CRUT with tangible personal property is complex due to various limitations on the deduction. Consider a charitable gift annuity as an alternative.

g) Example 1: Disposing of highly appreciated stock and increasing income.

Mrs. Smith (not her real name) worked at a Fortune 500 company for almost 40 years before retiring. She is about 74, her husband is 79, and they have no children. She now owns 22,500 shares of stock with a fair market value of \$40 per share. Her cost basis is 75 cents per share. She wishes to leave an amount to charity, but wishes to increase her income. The current dividend on this stock is 2%.

Mrs. Smith contributes \$250,000 of stock to a charitable remainder unitrust. This will allow her to contribute additional shares of stock in the future, if she desires. The trust will sell the shares of stock, pay no capital gains tax, and reinvest in investments producing more income. The projections show that she will increase her income by \$7,000 per year after the stock is sold and the money reinvested. It will pay income to her and her husband for their joint and survivor lifetimes, then distribute the principal to five charities named in the document.

Description	If sold and reinvested	If contributed to charitable remainder unitrust
Fair market value of stock	\$250,000.00	\$250,000.00
Cost basis of stock (6250*\$.75)	\$4,687.50	
Gain on sale of stock	\$245,312.50	
Capital gains tax rate	28.00%	
Amount available for reinvestment	\$176,625.00	\$250,000.00

Amount lost to taxes	\$68,687.50	\$0.00
Return on investment	7.00%	7.00%
Income from investments	\$12,363.75	\$17,500.00
Current dividend from shares contributed @2%.	\$5,000.00	\$5,000.00
Increase in income	\$7,363.75	\$12,500.00

In addition, Mrs. Smith gets an income tax deduction of \$33,000. This will save an additional \$10,000 in federal income taxes.

- h) Example 2: Mr. Smith is married to the second Mrs. Smith. He has two children by his first marriage, and wants to make a substantial gift to charity, provide for his second wife, but also to replace for the children what goes to the charity. His largest asset is an IRA of \$750,000.
- i) Analysis: There are two choices available to Mr. Smith. He can contribute the IRA on his death to a QTIP trust, with remainder to charity. Second, he could contribute the IRA to a CRAT or CRUT, with remainder to charity. In either case, he could replace the lost assets by setting up an irrevocable life insurance trust, funded with a second-to-die life insurance policy.
  - ii) Qualified Terminable Interest Property (QTIP) trust: A trust in which the spouse gets only the income for life. The trustee can have discretion to distribute principal, but the spouse's access for his or her own use is otherwise prohibited. The trustee or executor must make an election on the federal estate tax return to have such a trust qualify for the federal estate tax marital deduction.
  - iii) Alternative 1: Contribution to QTIP, with remainder to charity. Distribution of the IRA to a QTIP will generate substantial income in respect of a decedent, taxed at the maximum rate if he contributes the entire amount. The advantage is that the trustee can invade principal for Mrs. Smith. The QTIP is includible in Mrs. Smith's estate, but she gets an offsetting charitable deduction.
  - iv) Alternative 2: Mr. Smith would contribute his IRA to a CRAT or CRUT on his death.

There would be no income tax on contribution to the trust. The disadvantage here is that the trustee cannot invade principal for Mrs. Smith's benefit. If she has sufficient other assets, this may not be a serious problem. Assuming a 7% return on the IRA, she would receive a significant amount of income each year. (Do not include any non-charitable beneficiaries except Mr. and Mrs. Smith!)

- i) In each case, the Irrevocable Life Insurance Trust will provide wealth replacement to Mr. Smith's children free of any tax. Mr. Smith will need to decide which alternative best fits his goals.

#### 7) Charitable lead trust

- a) Is the opposite of a charitable remainder trust. Charity receives income for a specified time period, and then the balance goes to individuals.
- b) This form is relatively rare. The income tax advantages are not as favorable as for charitable remainder trusts. The trust is not tax exempt. Only about 6500 in existence.
- c) Is generally used only by the wealthiest individuals to accomplish specific tax objectives along with the charitable giving purposes.

#### 8) Gift of a remainder interest in a farm or residence

- a) The donor can live in the residence for a specified period, usually for life
- b) Charity gets the home after the donor's death
- c) Donor gets a deduction for the value of the remainder interest
- d) Deduction calculated similar to a charitable remainder trust
- e) Need a written agreement about responsibilities

#### 8) Life insurance

- a) Most common way is to name the charity as a beneficiary of the policy.
- b) Donor can also transfer ownership of the policy and get a deduction for the cash surrender value
- c) Donor gets an additional deduction when pays the premium

- d) Not all organizations accept ownership of the policy. Check with the organization.
- 9) Transfer on death instrument
- a) Operates much like a beneficiary designation
  - b) Can be used for CDs, securities and other investments
  - c) Advantages and disadvantages?
- 10) Gifts of appreciated securities
- a) Must hold for one year or more
  - b) Get a deduction for the fair market value of the security
  - c) Nobody pays capital gains tax
- 11) Gift of retirement plan
- a) Name the charity as beneficiary of the IRA, etc.
  - b) No income tax payable on amount going to charity
  - c) More income tax efficient than paying to individuals
  - d) Donor must change the beneficiary designation
- 12) The lawyer's role in charitable giving.
- a) Lawyers need to be pro-active in asking clients whether they want to leave any amount to charity. Clients rarely bring up the subject on their own. Charitable giving is not confined to the rich. Remember that 92% of the charitable bequests from decedents in 1998 came from those without taxable estates.
  - b) Most of the time, clients will say no. Usually, this is because they don't have a charity that they feel strongly about. In addition, most want to leave everything to their children.
  - c) Look at a client's tax return. If you see larger amounts in the charitable itemized deductions, the client may be a good candidate for a testamentary charitable gift.
  - d) Learn the rules. If you find a client who wants to give something to charity, they will

want you to explain how they might give to charity. Studies have shown that our clients want us to know and explain this information.

- e) If planned giving officers know that you are supportive of charitable giving, they will refer clients to you. They don't expect you to solicit gifts on their behalf, because this would be unethical. They want you to give them a fair hearing.
- f) Suggesting the concept of charitable giving is not undue influence, unless you suggest a specific charity to which you have some relationship.

13) How to engage clients in the conversation

- a. Do not ask, "Do you want to leave any amount to charity." I asked the question that way for 20+ years and always got the same answer: No.
- b. When you talk about charitable giving, you need to remember that you are often planting seeds. You may not get a yes the first time, but you have them thinking about it.
- c. A better way to ask the question: Are there any organizations that have made an important difference in your life, such as a church, hospital, or school?
- d. Your clients may say, "Yes, but . . ." "They often want to give their children every advantage. In this case, ask this question: "Would your children miss 1% of your estate?" I think the honest answer in virtually all cases is no, they won't miss 1%. You may think 1% is not a lot, but it can still make a big difference to the organization.
- e. When I started asking the questions in the new way, I found more people were willing to make charitable gifts.

## CASE STUDIES

Case 1: From the ISBA List serve:

Client with no wife or children wants to leave a remainder interest in his residence to a religious organization. His questions:

How do I proceed?

What considerations do I have to think about?

What are the advantages and disadvantages?

Case 2: Donor goes to her lawyer and asks lawyer to insert a bequest into her will for a local organization. Lawyer declines and suggests that she name the organization as a transfer on death beneficiary on a CD?

Why would the lawyer respond as he did?

What are the advantages and disadvantages?