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MAPPING A PLANNED GIVING COURSE UNDER THE NEW GOP ADMINISTRATION

EMERGING PHILANTHROPY CONFERENCE

APRIL 27, 2017

GEOPOLITICAL CHANGES HAVE CAUSED THE TERRAIN OF PHILANTHROPY TO SHIFT

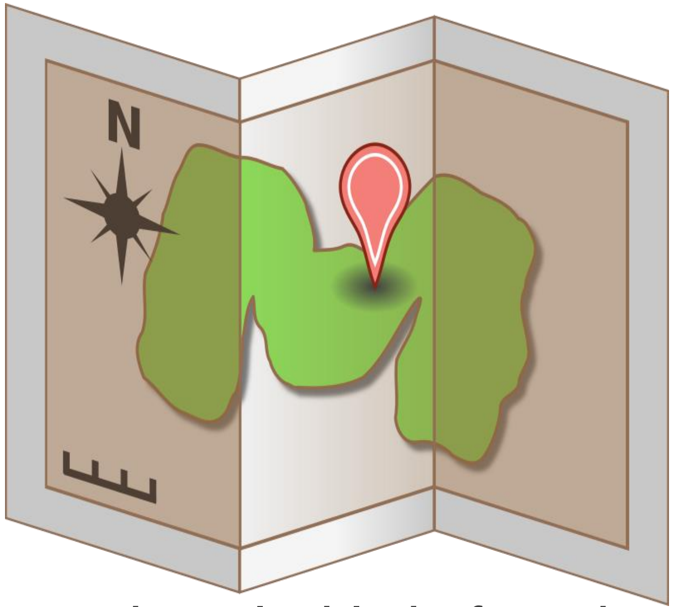
- Global tensions and increased defense spending
- International market conditions (China, OPEC) are a driving force
- New administration in Washington, D.C. with campaign promises that are easier said than done
- Initial burst of U.S. market optimism
- Interest rates rising, but still at historic lows
- Inflation is still low
- The average baby boomer is approaching retirement age, affecting overall economic growth prospects and concern about public financing
- Uncertain shape of U.S. tax reform
- Possible expiration of U.S. Government Funding at April 28
- PA Budget Issues – pension reform, program consolidation, government efficiencies and outcome measurement are key

WE NEED A NEW MAP TO NAVIGATE SUCCESSFULLY

- There are opportunities in change.

- Tried and true Planned Giving Vehicles, (techniques), like Bequests, are always a good idea.

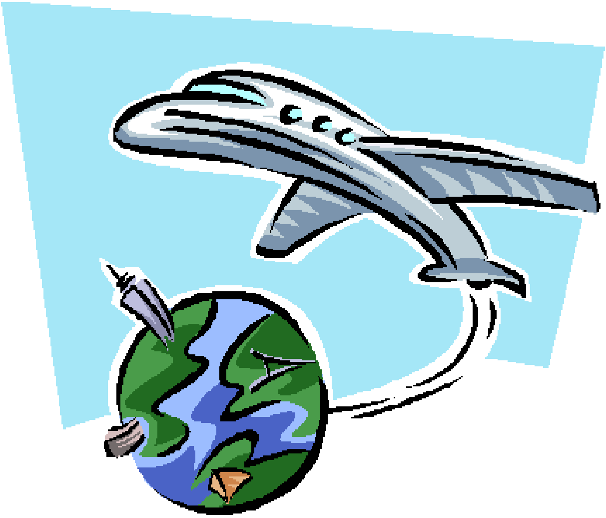
- Certain Planned Giving techniques that rely on higher interest rates may do well as interest rates continue to rise, such as ***Pooled Income Funds***, ***Charitable Gift Annuities*** and ***Charitable Remainder Trusts***.



- Planned Gifts producing an immediate income tax deduction may be valuable before the effective date of Tax Reform. (Life estates, charitable gift annuities, and charitable remainder trusts are examples.)

GOALS FOR TODAY

- To impart a basic understanding of Planned Giving strategies as ***Development Vehicles***; and
- To impart information on which Planned Giving ***Vehicles*** may get you to your funding destination with the highest return on investment and the least wear and tear.



GLOSSARY

- A small glossary of basic Planned Giving terms has been provided.
- This tool will only give you a baseline from which to conduct discussions with donors. It will not make you an expert.
- The term "alternative facts" is not in the glossary.

LEGISLATIVE UPDATE: HOT TOPICS

- IRA Rollover made Permanent
- U.S. Department of Labor Final Overtime Rule Regulations – still in limbo
- Johnson Amendment Repeal –under debate
- Federal Budget Deadline – April 28
- What Federal Budget Cuts will affect charitable organizations?
  - ◊ State pushback to keep important state programs funded
- Income Tax Reform:
  - Goal is to finish tax reform by August, 2017.
  - No consensus yet, but President and House plans are similar*
    - ◊House Ways and Means Committee has a "Blueprint"
    - ◊ The White House has a "Plan"
    - ◊The Senate is "Working on It".
    - ◊A bipartisan, "Problem Solvers Caucus" has been created. **
    - ◊For Corporations, both the House and President's plans call for tax rate reductions and lower deductions and credits.**

* Gary Fox. Crowe Horvath Tax Reform Guide. www.crowehorvath.com/tax. 4.6.16 **Council on Foundations. WashingtonSnapshot.@www.govt@cof.org.4.13.17

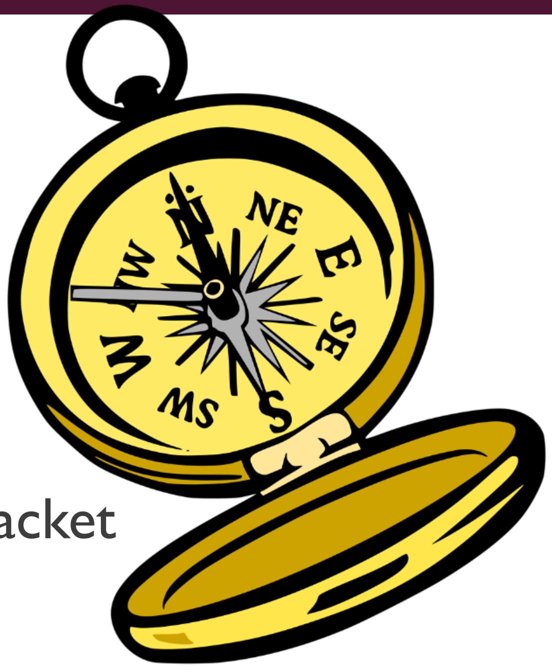
INCOME TAX LAW UPDATE FOR INDIVIDUALS: PRESIDENT TRUMP PROPOSALS

- **Tax Reform-** Some of President Trump's tax <u>proposals</u> are:

The top income bracket from 39.6% to 33% and have two other consolidated brackets at 25% and 12%.

The standard deduction.

Capital gains taxes to 0%, 15% and 20% depending on income bracket



- Put a ceiling of $200,000 on charitable deductions for married couples/ $100,000 for individuals.
- Repeal the federal estate tax.
- Eliminate the 3.8% net investment income tax.
- Eliminate the Alternative Minimum Tax
- Disallow stepped up basis for gains in excess of $10 Million.

INCOME TAX LAW UPDATE FOR INDIVIDUALS: HOUSE BLUEPRINT PROPOSALS

The Republican House Controlled Ways and Means Committee Blueprint proposals:

- Three tax brackets with top rate of 33%
- Eliminate Alternative Minimum Tax
- Eliminate the 3.8% net investment income tax
- Eliminate itemized deductions, except mortgage interest and charitable contribution deductions
- Eliminate the federal estate tax
- Allow individual deductions for 50% of net capital gains, dividends and interest income, producing effective tax rates of 6%, 12.5% and 16.5%, depending on income.

IMPACT OF GOP TAX REFORM PROPOSALS

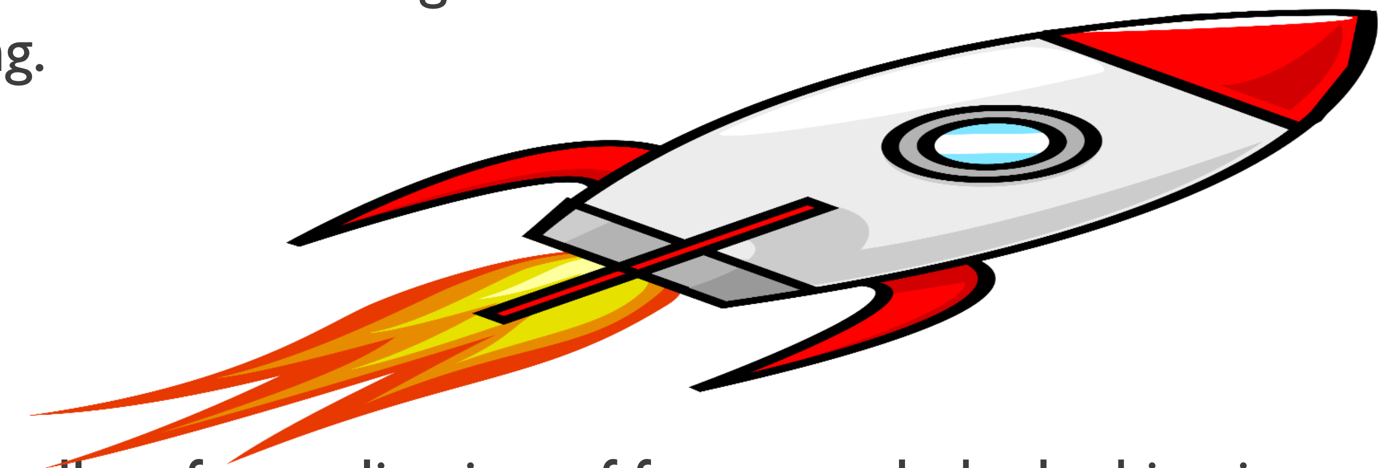
Mixed, but overall a negative impact at higher income levels:

- Individuals at mid to lower income levels may have more disposable income and can make more charitable gifts.

- But those in higher income brackets may find the charitable deduction *less* valuable. With a higher standard deduction, less people will itemize, hence, less of a need to give to charity for tax purposes. The removal of the 3.8% Medicare surcharge tax on capital gains may reduce incentives to donate appreciated long-term capital gain property. At very high income levels, the limit on the charitable deduction and the removal of the federal estate tax diminish incentives for tax-wise giving.

OPPORTUNITIES IN THE CURRENT LANDSCAPE

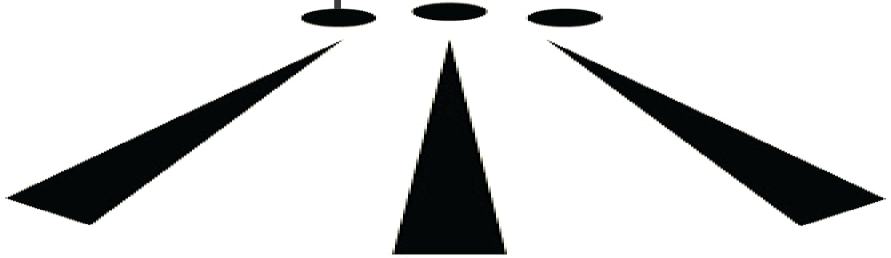
- The impact of tax reform won't happen immediately, so donors can be encouraged to ***speed up*** their giving, in order to take advantage of the current value of tax deductions for charitable giving.



- Charitable giving ***Vehicles*** that allow for realization of future goals, by locking in a strategy today, may be attractive to donors.

WHAT IS PLANNED GIVING AND HOW WILL IT GET YOU FROM HERE TO THERE?

- Planned giving is any technique that allows a donor to make a tax-wise gift during life or at death, as part of a financial or estate plan.
- Planned Giving ***Vehicles*** can be used to complement and even drive your overall Development plans.
- Planned Giving ***Vehicles*** can help individual donors to reach their goals.



CURRENT GIFTS TO CHARITY (WITH PLANNING)

- Cash (checks)
- IRA Charitable Rollover (Now a permanent opportunity.)
- Stock (Publicly Traded or Closely Held)
- Real Estate
- Life Insurance

WHO IS THE BEST PROSPECT TO USE PLANNED GIVING IN SUPPORT OF YOUR CHARITY?

- Those who are extremely loyal to your Charity;
- Those who are repeat givers;
- Those who have stocks and bonds, real estate or other assets that are not paying much in income, and those who understand the value of and need a current charitable deduction.

These qualities are not mutually exclusive.

CATEGORIES OF PLANNED GIFTS

- Outright gifts that use appreciated assets as substitutes for cash. (current)
- Gifts that return financial benefits to the Donor
- Gifts payable to a beneficiary upon the death of the donor

TYPES OF PLANNED GIFTS

- Bequests
- Beneficiary Designations, including Life Insurance
- Life Insurance
- Pooled Income Funds
- Charitable Gift Annuities
- Charitable Lead Trusts & Charitable Remainder Trusts
- Life Estates

BEQUESTS

- Relatively easy.
- By will
- Effective at death
- Will language is important: "I give and bequeath _______(description) to ________, (you, Charity, at your proper name, address and EIN)", or,

  "all [or a percent of the value of] the rest, residue and remainder of my estate", or, "If X predeceases me, I give such property to [your Charity]."
- Inform donors, in simple ways, how to do this:

  "Have you considered making a gift to _______(us) in your will?"
- Recognize realized bequests
- Leverage bequest commitments for other planned gifts

BENEFICIARY DESIGNATIONS

- Very Logical: pass outside will/probate
- Pensions, IRAs, Bequests in combination with Trusts
- Existing Life Insurance Policies where the donor no longer needs the coverage
- New Life Insurance Policies where the Charity is the beneficiary, or

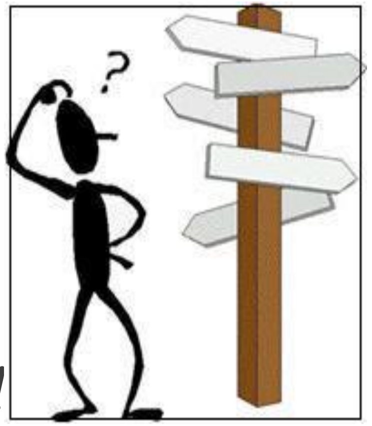
  where the Donor makes gifts and the charity pays premiums
- Pension and tax rules can make these more difficult than they seem

ESTATE PLANNING AND PLANNED GIVING

- A discussion of bequests is generally made as part of Estate Planning
- Estate Planning and Planned Giving go hand-in-hand
- Planned Gifts can be made during life or posthumously, to benefit beneficiaries now and later, for instance, Charitable Gift Annuities
- Estate Planning discussions can involve "legacy building" for those who are charitably minded

BENEFICIARY DESIGNATION EXAMPLE

- High income donor with history, and a goal, of giving to your charity
- Donor has virtually no cash to make a current gift
- Donor also has a goal of saving for his children's education
- Donor has yet another goal for a comfortable retirement



Is this Donor going in two many directions at once? *Not Necessarily!*

<u>Here is how the Donor can be in the driver's seat on all of his goals at once:</u>

Donor designates percentage of retirement funds or life insurance policy to Charity; lowers tax during retirement; gives later, not now, and so has more current cash to pay for children's educational needs with out-of-pocket funds.

POOLED INCOME FUND

HIGH TEST

- A pooled income fund is a trust maintained by a Charity, into which various Donors contribute and which pays an income to those Donors; sometimes for life.
- A pooled income fund can be built around the shared interest of several Donors.
- Donors retain an income interest. The non-charitable beneficiary, which could be a child, spouse or even the Donor, gets a pro rata share of the income earned by the trust for life.
- Donor gets a current income tax deduction for the gift, based on the age(s) of the beneficiary(s) and on the fund's rate of return.
- At the death of the last non-charitable beneficiary linked to any particular Donor, that prorated share of the investment pool is withdrawn and given to the Charity.

POOLED INCOME FUND ADVANTAGES AND DISADVANTAGES

- **Advantages:**
- Allows a Donor to convert assets into future income
- Immediate tax deduction
- Donors may be able to "cash out" if other ***Vehicles*** look more attractive
- May be attractive in building a base of Donors who are too young to take full advantage of a Charitable Gift Annuity, or another ***Vehicle*** that returns income
- Younger Donors may like the ability to take a charitable deduction ***now,*** and have a stream of income over a long period of time, where the **rate of return is likely to continue to increase**
- Pooled feature allows administrative expenses to be shared among several Donors

Disadvantages:

- Tax reporting is complicated
- Return may be too low for Donors who are age-eligible for better rates from other donative ***Vehicles****

**Pity the Poor Pooled Income Fund. PG Calc. www.pgcalc.com*

EXAMPLE –POOLED INCOME FUND

- A couple, aged 65, having three adult children, transfers a $2 Million piece of real estate to a Pooled Income Fund within a Community Foundation.
- The couple receives income for life and their 3 children also will receive income for their lives.
- The couple takes a charitable income tax deduction for $1.2 Million.
- The Community Foundation can sell the real estate and pay no capital gains tax.
- The couple uses the tax savings to buy a large insurance policy, naming the children as beneficiaries. The children's inheritance has exponentially increased.
- This option may work well with a Donor who has a large liquidity event or who wishes to sell appreciate assets.*

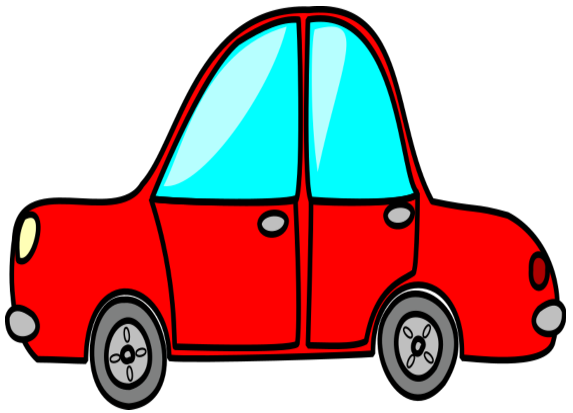
*Randy Fox. Planned Giving Design Center at CMU. "The Best Kept Secret in Planning and Why it is Important to You." http://cmu.pgdc.3.23.17 (originally published in Planned Giving Design Center on 3/21/17.)

CHARITABLE GIFT ANNUITIES

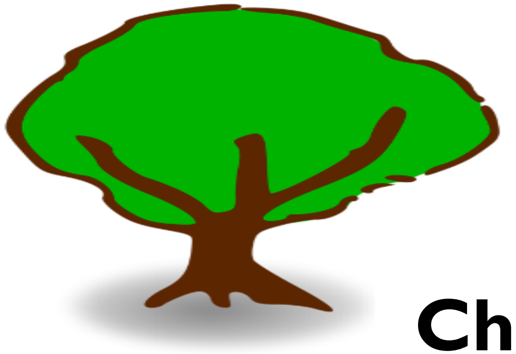
- A contractual agreement in which the donor makes a gift and the Charity promises to pay one or two annuitants payments for life
- A CGA can be set up with relatively small amounts, ($5,000 - $50,000), depending on the Charity's policy
- Annual payment depends on ages and rates
- Can use cash, securities or tangible personal property to set up the CGA
- Charity should set a minimum gift level
- Charity can calculate risk/benefit of CGA program
- Charity should use a rate no higher than recommendations from American Council on Gift Annuities ("ACGA")
- Charity should consider an outside CGA manager

ADVANTAGES OF CHARITABLE GIFT ANNUITIES

- Donor gets immediate charitable deduction, (Encourage Donors to move quickly!)
- Donor can defer capital gains
- Donor can experience a partial tax-free recovery and income for life. Donor is entitled to an income tax deduction equal to the difference between the value of the contribution and the present value of the annuity
- CGA can be deferred with possibly better tax results
- Interest rates are better than many other investments, even now
- CGA can be a retirement substitute for high earners
- Gift passes outside of Donor's estate
- The gift is irrevocable
- Charity gains with volume of CGA's – risk can be calculated

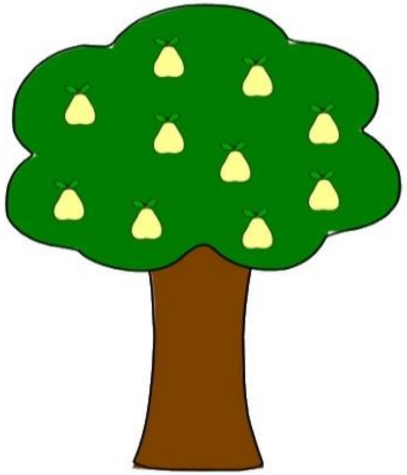


CHARITABLE TRUSTS

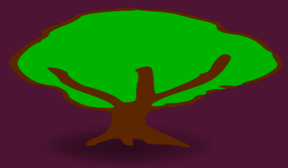


Charitable Remainder Trusts

Charitable Lead Trusts



CHARITABLE REMAINDER TRUSTS (CRT)



- Donor gives the "Tree" but not the "Fruit"
- Donor gets an immediate charitable deduction
- Donor can avoid or defer long term capital gains
- CRT can be intervivos (transferring assets during donor's life) or testamentary (established by will or trust provision to take effect at death of donor)
- A CRT can be complicated
- Interest rates have somewhat improved for use of CRTs but are still somewhat low. Nevertheless, CRTs are a good option today to accomplish tax saving.

(This option may be attractive to a Donor older than 50, with moderate to high net worth, who is interested in income and tax benefits, who holds appreciated securities or other property and who wants to remove that property out of his or her estate.)

CHARITABLE REMAINDER TRUSTS : TWO TYPES - (“CRAT” & “CRUT”)

- With a CRAT, Donor gets a fixed annuity for life or a period of years (not more than 20)
- Additions to the gift cannot be made
- A CRUT is similar to a CRAT, but payout varies
- Select percentage payout – Fixed percentage of value
- More flexible than CRAT
- Can make additions
- Possible retirement ***Vehicle*** – No 401 (k) or IRA limits

EARLY TERMINATION OF A CRT

- Some beneficiaries (usually the donors who set up the CRT) discover later that they no longer need the CRT income.
- Methods of termination of a CRT:

  -Cash out (Actuarial Split)

  -Total or Partial Gift to Charity of CRT Income Interest, post-termination
- *Wells Fargo Bank v. Cook:* be careful of stock market and CRT payout.

CHARITABLE LEAD TRUST

- This ***Vehicle*** has *many* possibilities
- Charity receives income interest; the payment of the income interest leads or precedes the payment of the remainder interest to donor or family
- Donor's remaindermen get principal when trust expires. (Donor gives away "fruit" to Charity but keeps the "tree" bearing the fruit)
- Changes in the stock market, increasing but still low AFRs, and changes in the federal gift and estate gift tax make CLTs an attractive alternative for Donors
- Annuity vs. Unitrust
- Irrevocable
- Some CLTs (e.g., Grantor Lead Trust) result in immediate charitable deduction
- Some CLTs can be structured to have increasing payouts

(Prospects for use of a Charitable lead trust include those with high net worth, who want to provide an inheritance to children and also make gifts to Charity.   Also, anyone who wants to make current charitable gifts but retain the principal for a future event, such as retirement needs, medical and nursing home expenses.)

IMPACT OF THE APPLICABLE FEDERAL RATE (AFR)

In creating a CLT, the present value of the total gift to Charity must be valued over the life of the CLT. The IRS determines the present value by analyzing:

- the amount that will be paid to the Charity as the "lead" interest;
- the time period for which the trust exists (at least 4-5 years would be good for the Charity);
- and the expected return on investments for the trust assets. The IRS uses the Applicable Federal Rate (AFR) as the expected investment rate. This is based on U.S. Treasury Rates, which have been low in recent years.
- The current AFR is 2.6% in April, 2017. Rates are rising, but have been at historic lows for 8-9 years, hitting an all-time low of 1% in 2012.* This atmosphere of low interest rates results in higher gift tax deductions.

*www.acga-web-org.4.18.17

CHARITABLE LEAD TRUST EXAMPLE

Qualified Nonreversionary Nongrantor Charitable Lead Trust

Donor: Mrs. Bigheart wants to support her alma mater, The Best University. She also wishes to provide for her children and wishes to transfer as many assets to them as she can; as tax-efficiently as possible.

Roadmap to Success: Donor will transfer a $2,000,000 building to a charitable lead annuity trust. The trust will pay a $100,000 annuity amount to Best University for a period of 16 years. Then, the trust assets will be distributed to Donor's children.

Destination Reached: Donor will receive a gift tax deduction for her charitable gift of nearly $1,380,000. The net taxable gift of $620,000 to her children can be offset by Mrs. Bigheart's unified gift and estate tax credit. The children will receive the property, including any appreciation that occurs over the trust period, free of gift and estate taxes.

Based on an example from the Planned Giving Design Center at http://www.pgdc.com (2015)

LIFE ESTATES

USED:

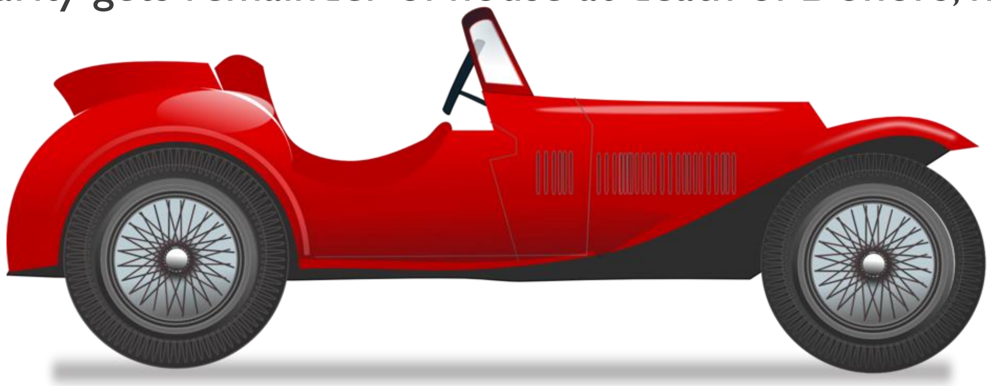
- Title transfers to charity
- Donor keeps usage for life (e.g., house, farm, etc.)
- Donor maintains property and pays taxes
- Donor receives immediate charitable deduction
- Charity should have good gift acceptance policies, ensuring that such gifts are of value – (If you don't want the gift, politely decline!) Gifts of real estate can be complex.
- Special care is required for valuation- an appraisal is needed

(Life Estates may be a good option for those 70 and older who want a large income tax savings now, who own the asset outright, but who want to live in or retain the asset for life. Tax benefits include a charitable deduction and avoidance of capital gains taxes.)

LIFE ESTATE EXAMPLE

Donors: Mr. and Mrs. Fan, and their children, are huge fans of Vintage auto racing and residents of Squirrel Hill, PA. Donors want to move to Florida, are of a charitable mindset but also want to provide for their adult children. They also want to return to the 'Burgh for the Vintage Grand Prix each year; Donors want their kids to get their $1.5M estate.

Formula "One" Roadmap to Success: Donors buy condo in Florida with no state income tax; donate life estate in Squirrel Hill House to Charity; entire family uses house, especially during the week of the Pittsburgh Vintage Grand Prix. Donor pays house expense during lifetime; Charity gets remainder of house at death of Donors; kids get the rest of the estate.



Destination Reached: Donors get a place to stay; Donors get tax deduction; kids get $1.5M estate; Charity gets the house, eventually, and can sell, realizing income. (Or, Charity can use the house for visiting dignitaries, and future Donors to Charity Racing).

GIFT ACCEPTANCE POLICIES

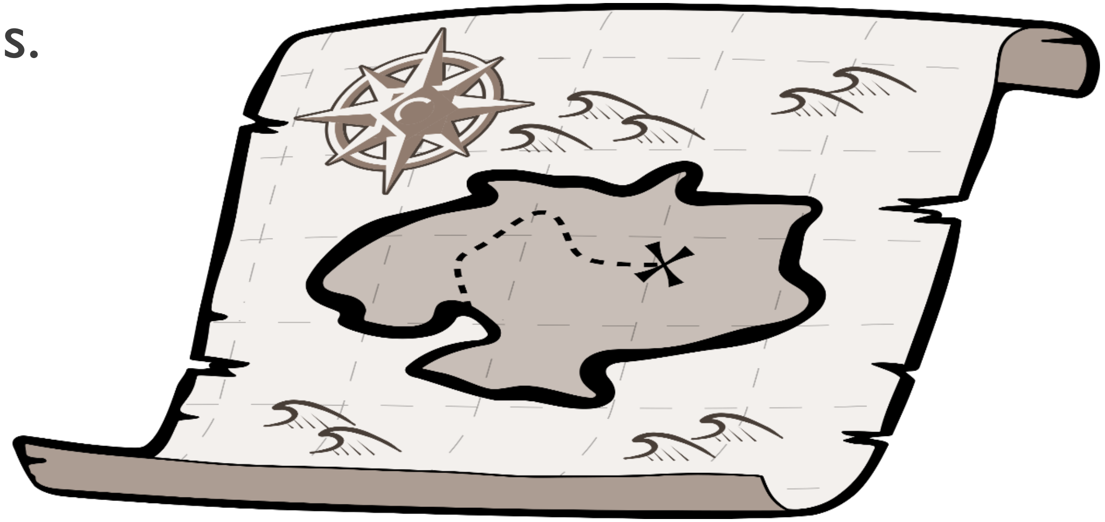
Good gift acceptance policies are important with many planned giving ***Vehicles***, and especially so with life estate gifts.

Critical Elements of Gift Acceptance Policies Include:

- The mission statement of the charity;
- The purpose of the gift acceptance policy;
- The organization's policy with respect to gift restrictions;
- The types of gifts, forms of gifts and sizes of certain gifts that the charity will accept;
- Reporting requirements;
- The charity's adherence to ethical standards;
- The gift acceptance committee;
- The recommendation for donor to use independent advisors (legal, accounting, and financial);
- Circumstances in which the charitable organization will engage its own legal counsel; and
- Review of the gift acceptance policy.

ARE WE THERE YET?

- Planned Gifts, especially Bequests, CGA's, CRTs, CLTs, Pooled Income Funds and Life Estates are good additions to fundraising efforts during the current economy.
- Your charity can use planned giving ***Vehicles*** to help drive your Donors and your Charity to your intended destinations.



QUESTIONS:

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Thank You!