Clarity Wealth Advisors
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Gifting Strategies

Hello!

With it being the holiday season, we thought having this month's newsletter highlight charitable contributions and gifting strategies would be timely. There are various ways to make charitable donations and different requirements depending on the type of asset that is donated.

In addition to making regular charitable donations, there are other vehicles available for individuals that want to make ongoing donations to various charities (donor advised funds) and for those that want to transfer a large dollar amount (in the form of cash, property, or securities) to a charitable trust and either receive income for a specified period or over their lifetime or have the charity receive the income. The feature of both of these strategies are listed below and there is also a chart (attached) comparing the different types of charitable trusts.

Charitable Gifting

Last year, Americans gave $291 billion to charitable organizations. There are many benefits to giving to charities including helping others that are less fortunate and a feeling of inspiration that giving provides. In addition, there can be a potential tax benefit to the donor.

For individuals who make donations to qualified tax-exempt organizations that have a 501(c)(3) tax-exempt status, they may be entitled to a charitable contribution deduction on their income tax if they itemize their deductions. There are some organizations, including churches and other religious organizations, that are not required to obtain 501(c)(3) status from the IRS. As the donor's income tax bracket increases, the real cost of the charitable gift decreases, making contributions more attractive for those in higher tax brackets.

Types of Donations

Aside from cash donations, there are other assets that can be contributed to charitable organizations. These include real estate, highly appreciated securities, collectibles, vehicles, clothing, household items, and life insurance policies. For appreciated property, including securities, the donor must have owned it for at least one year in order to be able to take a deduction for the fair market value (FMV) at the time of donation. If held for less than 12 months, only the cost basis of the property is allowed to be taken as a deduction.

Timing of Donations

A contribution to a qualified charity is deductible in the year in which it is paid. By mailing a check to the charity, this constitutes payment as well as a contribution made on a credit card is deductible in the year it is charged to the card, even if payment to the credit card company is made in a later year.

Tax Deduction Limits

The tax deduction for charitable contributions may be limited as there are certain limits to charitable contributions, as well as general limits on itemized deductions. They range between 20-50% of one's adjusted gross income (AGI) depending on the type of asset donated. Charitable contributions in excess of these limits can be carried over to the following tax year. The excess contributions can be carried over for a maximum of five years.

Recordkeeping

- ***Cash Contributions -*** For cash contributions of $250 or more, one must have a written confirmation from the charitable organization which includes the name of the charity as well as the date and amount of the donation.

- ***Non-Cash Contributions*** Donations of non-cash items of $500 or less require documentation that proves the value of the items.

For donations of more than $500, Form 8283 will need to be completed and attached to the donor's federal tax return. On this form, the recipient is identified, the fair market value of the item at the time of donation, as well as the donor's cost basis.

Special Provision for Individuals with RMD

For those individuals age 70.5 and over, each year, they are subject to taking out required minimum distributions (RMD) from their retirement plans such at IRAs and 401(k) accounts by the end of the year. For 2011, one can make direct qualified charitable distributions (QCDs) of up to $100,000 of their RMD. The amount directed to the charity will not be considered taxable income to the individual as would usually be the case with withdrawing their RMD.

Other Forms of Charitable Gifting

Donor Advised Funds

This is a charitable giving vehicle where an individual or entity makes an irrevocable, tax-deductible contribution of personal assets to a charity and at any time thereafter can recommend grant distributions to qualified charitable organizations. Donor advised funds allow donors to take a federal income tax deduction up to 50% of AGI for cash contributions and up to 30% of AGI for appreciated securities.

Benefits:

- Ability to receive one group of securities that can benefit multiple charities.
- Separation of tax planning and charitable giving as the donor receives a tax deduction when contribution is made, but donations to a charity can be made later.
- One contribution can benefit multiple charitable organizations while only requiring one tax documentation letter.

Charitable Remainder Trusts (CRTs)

These irrevocable trusts allow the donor to convert highly appreciated real estate or securities into income for life or a specified term without incurring capital gain taxes when the asset(s) is/are sold. The appreciated asset is transferred into an irrevocable CRT and then subsequently sold by the trustee. The proceeds are reinvested, and the donor and/or another designated beneficiary(ies) receive income that predetermined period. When the trust terminates, the remainder will be given to the charitable organization.

Within a CRT, there are two ways they can be set up. A charitable remainder uni-trust (CRUT) is structured where the income the beneficiary receives is a set percentage of the value of the trust's assets, which is revalued each year. Alternatively, it can be a charitable remainder annuity trust (CRAT), where the income payments are fixed and determined when the trust is initially set up.

The benefits of CRTs include the donor or beneficiary receiving income for life or for a specified period, being able to convert a potentially low-yielding asset into providing a higher dividend yield, not having to pay capital gains tax, receiving a tax deduction for the assets transferred to the trust, and reducing one's estate.

Charitable Lead Trusts (CLTs)

For these irrevocable trusts, the donor transfers highly appreciated assets to a trust for a specified term. It is referred to as a lead trust since the charitable organization is entitled to the income from the trust each year. The remainder beneficiary then receives the remainder interest and at the time the trust term is completed, the remaining amount goes to the donor's heirs.

There are two forms of CLTs. A charitable lead uni-trust (CLUT) provides the charity with a percentage of the trust's value each year, which will likely vary year after year due to market fluctuation. Second, with a charitable lead annuity trust (CLAT), the donor sets a fixed annual gift for the charity to receive.

Advantages of CLTs include that the donor selects the term of the trust and this can provide a strategic approach to passing the assets at a specific time to their heirs. It is a great tool for the donor to transfer assets to their heirs at a reduced gift and estate tax cost. The assets in a CLT are removed from the donor's taxable estate, resulting in any future appreciation in value being in the heirs' estate rather than the donor's estate.