



# Charitable-giving Strategies

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According to Giving USA, charitable giving in the United States reached an estimated \$295 billion in 2006, a new record.<sup>1</sup> Individuals face numerous decisions when preparing to give to charities. Not only are a multitude of organizations and causes requesting contributions, but there are various methods, or strategies, of charitable giving. These strategies may be as straightforward as putting cash in a collection basket or as complex as establishing a multigenerational private foundation.

Donors may find it challenging to obtain independent, objective information on the various methods of charitable giving. For example, many brokerage and mutual fund companies emphasize the convenience of donor-advised funds. It should come as no surprise that the same investment companies also manage the assets of these funds. In turn, because many charities prefer to receive donations as soon as possible, they may de-emphasize the merits of some long-term charitable strategies. Clients are looking to their advisors for information and counsel that is completely independent and free of conflicts of interest.

Table 1 provides an overview of the characteristics of six common charitable-giving strategies: outright gifts, donor-advised funds, private foundations, charitable trusts, charitable gift annuities, and bequests at death. A better understanding of these strategies can help donors clarify their priorities and select the most-effective giving method or methods. For many families, imple-

menting a combination of these strategies, versus only one method, may be appropriate.

## Outright Gifts

The least complicated method of giving is for a donor to give to a charity a direct cash donation or an outright gift of assets. It has become increasingly common for donors to make outright charitable gifts of appreciated securities, such as stocks, bonds, and mutual fund shares. Instead of the donor selling the appreciated asset, paying taxes on the realized gains, and then making a reduced cash donation, the donor who makes a direct gift by transferring the assets to the charity eliminates the potential capital gains tax liability. However, if the stock has depreciated since purchase, the asset should be sold to generate a tax loss, and then the cash proceeds should be donated to charity.

Among the first type of assets to consider for a donation are publicly traded appreciated securities that represent a concentration in the donor's investment portfolio. While there are varying interpretations as to what constitutes a concentration, one rule of thumb is an individual security that comprises more than a 15-percent position in a portfolio may subject the owner to excessive risk. Although difficult to quantify, the advantage of lowered volatility in the donor's resulting investment portfolio may be an even greater advantage than the tax savings on capital gains taxes.

Also worthwhile considering for donations are publicly traded securities with significant built-in gains or hard-to-determine tax costs. For long-term appreciated securities, the value of the donation generally is

equal to the average of the security's high and low prices on the date of the gift. However, for securities with short-term capital gains, the income tax deduction is valued at the original purchase cost of the holding, a significant disadvantage.

The income tax deduction for outright gifts of cash to public charities is up to 50 percent of adjusted gross income (AGI), and for long-term appreciated securities it is up to 30 percent of AGI. Donations in excess of these limits may be carried over up to five additional years.

In addition to cash and appreciated securities, other potential gifts include life insurance policies, unimproved property, art, commercial real estate, partnership interests, and collectibles. A donor should discuss with his or her tax advisor the income tax implications of giving these items to charities and any related costs, such as appraisals.

## Donor-advised Funds

Donor-advised funds (DAFs) have become a popular charitable strategy due to their versatility and simplicity of operation. A DAF provides immediate tax benefits of an irrevocable charitable gift, and it also affords the donor time to decide which public charities to support. Because of this structure, DAFs can be particularly attractive to people who would like to initiate a charitable-giving program in a year with a spike in taxable income.

DAFs are separate accounts owned and held by a sponsoring charity, such as a community foundation, educational institution, or a financial institution's charitable organization. The donor receives an income tax deduction, constrained by certain

**TABLE 1** Charitable Giving Strategies

	OUTRIGHT GIFTS	DONOR-ADVISED FUNDS (DAF)	PRIVATE FOUNDATIONS (PF)
May Be Practical for Those Who	Want gifts to go immediately to charities and who are comfortable with evaluating charities.	Want more flexibility in the timing of gifts. Want a tax-deduction (especially in a year with high income) and administrative simplicity. May want to create a legacy and remain anonymous. Have large holdings in highly appreciated stock.	Want to involve family in an ongoing legacy of philanthropy. Want an income tax deduction (especially in a year with high income). Want maximum control over investments and grants. Have large holdings in highly appreciated stock.
Typical Dollar Minimum	None	\$15,000	\$1 million
Donor Start-Up Costs	None	Usually none	\$5,000+
Donation Recipients	Not-for-profit organizations	Qualified public charities recommended by donor and approved by an independent board of sponsoring charity.	Not-for-profits and may include individuals and foreign charities if strict criteria are met.
Donor's Income Tax Deduction Based on	Fair-market value for cash and publicly traded long-term appreciated securities. Special rules for other assets.	Fair-market value for cash and publicly traded long-term appreciated securities. Special rules for other assets.	Fair-market value for cash and publicly traded long-term appreciated securities. Tax cost for most other donations.
Tax Deduction Limits for Donated Cash	50% of adjusted gross income (AGI), with a five-year carryover for excess contributions.	50% of AGI, with a five-year carryover for excess contributions.	30% of AGI, with a five-year carryover for excess contributions.
Tax Deduction Limits for Long-Term Appreciated Securities	30% of AGI, with a five-year carryover for excess contributions.	30% of AGI, with a five-year carryover for excess contributions.	20% of AGI, with a five-year carryover for excess contributions.
Cash Flow to the Donor	None	None	None
Ongoing Tax Implications	The assets are removed from the donor's estate.	Donor does not need to file a separate return for the entity. No excise tax.	None to the donor. Private foundation files an annual tax return and pays up to 2% excise tax on investment income, including capital gains.
Investments	Not applicable	Sponsoring charity liquidates the investment. Donor recommends investments often from a limited menu.	The donation usually is liquidated and diversified. Wide latitude within fiduciary responsibilities.
Administration	Not applicable	Relatively simple tasks for donor as assisted by sponsoring charity.	Trustees responsible for investments, tax returns, administration, and compliance with self-dealing rules.
Control and Governance	Use of the gift may be restricted if the charities agree, such as for an endowment.	Donor recommends grants, but sponsoring charity decides. Donor and others may add to DAF. Nominated successors may assume donor's role.	Donor and appointed family have complete control of grantmaking and investment decisions, subject to self-dealing rules. Complex IRS compliance.
Time Horizon	Unless restricted by common agreement, the charity has full access to the gift.	Donor may name family and/or friends as advisors and successors. Has the potential to be perpetual.	Has the potential to be perpetual.
Privacy	Donor may request confidentiality.	Donor may remain anonymous if desired.	Tax filing is a public record of contributors, assets, grants, trustee names, and staff salaries.

CHARITABLE REMAINDER TRUSTS (CRT)	CHARITABLE GIFT ANNUITIES (CGA)	CHARITABLE BEQUESTS AT DEATH
Want to support one or more charities, receive income, and get a partial income tax deduction. Have holdings in highly appreciated stock.	Want to support one charity at a time, receive predictable fixed income, and get a partial income tax deduction.	Want to maintain full control over personal assets until death and then help charities. Have taxable estates with large retirement-plan assets.
\$250,000	\$5,000	None. May be a specific asset, dollar amount, or estate percentage.
\$2,000+. Often drafted with other estate-planning documents.	None	Included in the cost of having an attorney draft a will and possibly a revocable trust.
After the passing of the beneficiaries or a certain time period, remaining value of CRT distributed to charities or DAF chosen by the donor.	Charity invests a portion of donation to provide lifetime income to donor(s) and receives remainder portion as a gift.	Charities (outright gifts), DAF, PF, CRT, and/or CGAs.
Ordinarily fair-market value adjusted for the gift's present value.	Fair-market value, adjusted for the gift's present value.	Fair-market value if donated outright. Adjusted for the gift's present value if gifted to a CRT or CGA.
50% of AGI, with a five-year carryover for excess contributions.	50% of AGI, with a five-year carryover for excess contributions.	Unlimited estate tax deduction.
30% of AGI, with a five-year carryover for excess contributions.	30% of AGI, with a five-year carryover for excess contributions.	Unlimited estate tax deduction for the donation's market value.
Payment may be fixed (annuity trust) or variable (unitrust). Payouts and projected residual value must meet IRS criteria.	Fixed-dollar amount for the life of the donor(s). Donor has the option to delay the income's start date.	None. A CRT or CGA created at death may provide income to other individuals.
Depending on the earnings of the CRT, the beneficiary may be subject to income tax on the payments.	Income is a mix of ordinary income, capital gains, and tax-free return of principal.	Not applicable unless a CRT or CGA is created at death.
Donation is liquidated and diversified. Wide latitude within fiduciary responsibilities.	Charity assumes investment risks and has a legal obligation to pay income backed by its own assets.	Charity usually liquidates gift when received outright.
Trustees responsible for investments, tax returns, administration, and compliance with self-dealing rules.	Charity has responsibility for administration and costs.	Gift distributed by personal representative of the estate or trustee of the revocable trust.
Trustee may be the donor, another person, and/or a trust company. Donor may add to a unitrust.	Charity cannot be changed. CGAs may not be issued in every state.	Use of the gift may be restricted.
For the life of the current income bene(s) or for a stated term (20 years maximum). Possibility of a DAF as the remaining charity.	After the life of the current income bene(s), the charity has full use of all assets. The donor may defer the start of the annuity income.	Unless restricted, charity has full access to the gift.
Trustee often provides copy of trust agreement and annual statements to remainder charities.	Donor may request confidentiality.	Gifts made through wills are public, and generally private if made through trusts.

>> “CHARITABLE GIVING STRATEGIES” CONTINUED  
limitations, in the year the contribution is made to the DAF. Unlike some other charitable strategies, DAFs do not provide any ongoing cash flow to the donor or other individuals.

An additional advantage of DAFs is the potential for the donor to involve family members or others in the grant-making process without some of the administrative complexities and expenses of a private foundation. The donor may name family members and/or friends as advisors and successors to the fund, thereby creating the potential for the fund to last in perpetuity. While the donor and/or his representatives make recommendations on the fund’s investments (usually from a limited menu) and grants to qualified public charities, the decisions are made by the sponsoring charity. It is rare for the sponsoring charity to deny the recommendations, and examples of when the charity has done so should be discussed.

### Private Foundations

Private foundations (PFs) are a popular and effective method for wealthy families to create a family legacy of philanthropy through their own private charity. In contrast to broadly supported public charities, PFs typically are created and supported by a single high-net-worth family.

One of the key advantages of PFs is that the donor and/or board members can exercise maximum control over the investments and grants. The donor typically hand-selects the foundation’s private board, which frequently consists of the donor and his or her children. Unlike a DAF, a PF’s grant recipients may include individuals and foreign charities if strict criteria are met.

Disadvantages of PFs include legal and administrative expenses, excise taxes on net investment income (not to exceed 2 percent), detailed record keeping, complex tax reporting, and potential family conflicts. The PF’s tax filing is open to the public and contains details

about contributors, assets, grants, trustees’ names, and staff salaries. Additionally, the Internal Revenue Service (IRS) is less generous with the calculations for charitable deductions to a private foundation.

While many private foundations have less than \$1 million in assets, the suggested minimum for a new PF is \$1 million to justify the initial and ongoing costs and administration. Those considering converting an existing PF to a donor-advised fund should seek qualified counsel.

### Charitable Remainder Trusts

Charitable remainder trusts (CRTs) combine the opportunity to fulfill charitable objectives and to provide cash flow for the donor or other named beneficiaries. Drafted by an attorney, the trust receives securities (often highly appreciated publicly traded stock), unleveraged real estate, cash, or other assets from the donor. Closely held stock and low-basis shares of a publicly traded company stock that has been distributed from a retirement plan also are good donations for a CRT. The trustee liquidates the assets, then invests in a diversified portfolio.

The trust’s income beneficiaries receive regular distributions equal to a fixed percentage of the trust’s fair market value (unitrust) or a fixed dollar amount (annuity trust). Unitrusts have the potential advantages of receiving additional donations and distributing larger cash flows when the investments perform well. Unitrusts are a hedge against inflation, and annuity trusts are a hedge against down markets.

One of the main advantages of a CRT is the donor’s flexibility in determining who receives the trust’s cash flow. Income beneficiaries may include not only the donor but the donor’s spouse or children, a trust for the benefit of individuals, a corporation, or a partnership. In the case of an unmarried couple, each person could establish an estate plan that creates a CRT at death for the benefit of the survivor.

The donor’s income tax deduction is based on an IRS formula that takes into account the ages of the income beneficiaries, the payout of the trust, and an IRS index rate known as the applicable federal rate. While the tax deduction also is subject to limits based on the donor’s adjusted gross income, unused deductions may be carried forward up to five additional years. The cash flow to the beneficiaries ordinarily is a combination of ordinary income and capital gains that are generated inside the trust.

Upon termination of the trust, the assets are transferred to the donor’s named charities. Potential remainder charities include a donor-advised fund or private foundation, creating the opportunity for family or others to stay involved with charitable decisions. Typically, a minimum funding of \$250,000 is advised to generate an income stream and tax deduction large enough to justify the cost of creating and maintaining a CRT.

### Charitable Gift Annuities

A charitable gift annuity (CGA) may be an appropriate giving strategy when the donor desires to receive predictable income in addition to assist a particular charity. In exchange for a donation, the charity provides the donor with a contractual life income paid monthly or quarterly. A portion of the donation is invested by the charity to generate the established income, and the remaining portion qualifies as a present-interest gift to the charity. The charity assumes the investment risks and has a legal obligation to pay the income from its own assets.

Cash and appreciated securities commonly are used to fund CGAs. Because the donor has an interest in the cash flow to be received from the annuity, the charitable gift deduction is less than the market value of the donated assets. Often the donor has the option to defer the start date of the annuity’s cash flow.

The charity provides the donor with the valuation of the gift and the

annual tax information on the characteristics of the income received. The cash flow received by the designated individual usually is a combination of ordinary income, capital gains, and tax-free return of principal.

Additional advantages of a CGA include the simplicity of making a single contribution, the lack of up-front and ongoing administrative costs and duties for the donor, and low minimums (\$5,000 for example). However, the donor cannot assist more than one charity at a time, and, once the annuity is issued, the charity may not be changed.

### Charitable Bequests at Death

Individuals who want to maintain maximum control over their personal assets and/or minimize certain taxes may provide for charities through a carefully prepared will, living trust, and beneficiary designations. Potential bequests at death include all of the aforementioned strategies: outright gifts, donor-advised funds, private foundations, charitable remainder trusts, and charitable gift annuities.

A general guideline in estate and income tax planning is that family members ideally should receive "advantaged assets" and charities "disadvantaged assets." Advantaged assets do not generate an income tax liability to an estate or family and receive a step up in basis at the owner's death. Examples include stocks, real estate, and personal property.

Alternatively, an income tax problem usually is created for those who inherit stock options, savings bonds, certain annuities, installment notes with a gain, and retirement assets such as IRAs and 401(k) plans. Current tax laws make it more efficient to donate these disadvantaged assets after the death of the owner.

Unless changed by Congress, estates in excess of \$2 million until the end of 2008 and in excess of \$3.5 million in 2009 are subject to estate tax rates of 45 percent. The value of disadvantaged assets can disintegrate under the combined damage of estate and income taxes. However, estates receive an unlimited charitable deduction for the market value of donated assets. Individuals with taxable estates and sizable balances in disadvantaged assets should be especially diligent about regularly updating their estate plans, including any charitable bequests.

Additional charitable giving strategies such as charitable lead trusts, supporting organizations, and pooled income funds are used less frequently than the above strategies. Charitable lead trusts, most of which are taxable, sometimes are combined with CRTs in a plan for a very large estate. The Pension Protection Act of 2006 made supporting organizations much less attractive, and pooled income funds have decreased in usage.

Whatever an individual's age, income, net worth, or family situation, one or more of these strategies

may be effective tools to implement charitable priorities and goals. The more complex the giving strategies and the donated assets, the more essential that donors receive objective and independent counsel from qualified investment advisors, estate-planning attorneys, CPAs, and tax experts. In the final analysis, the donor, his or her family, and the charities will reap the rewards of careful research, thoughtful planning, and thorough execution. **M**

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### Disclaimer

*Please be aware that the information in this article is offered only for educational and informational purposes. It is not intended and should not be construed as opinions or recommendations for legal, investment, or tax matters. Charitable, investment, and tax issues should be discussed in advance of decisions with the donor's CPA, attorney, and investment advisor to determine the best course of action for their specific situation. Innovest's appreciation goes to Jeffrey S. Watkins, CPA, J.D., of EKS&H in Denver, CO, for his assistance with this article.*

### Endnote

1. *Giving USA 2007*, Giving USA Foundation™, 2007, see <http://www.aafc.org>.