Giving Techniques that Maximize Tax Benefits for the Donor and Enhance the Cause of the Non-Profits in Our Community

Unravel the Alphabet Soup of DAFs, PFs, CRTs and CLTs and Other Charitable Giving Tools

January 12, 2022

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Who is the Community Foundation of the Valleys?

- Connecting San Fernando Valley and Santa Clarita Valley donors to Valley causes and Valley non-profits
- Give local, using donor advised funds (DAFs)

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Why a DAF?

DAFs allow you to maximize tax benefit by contributing in years where you are in a high tax bracket, then distributing to your favorite charities over time as you identify worthy causes

No rush to find charities	California Community Foundation on behalf of Community Foundation of the Valleys (CFV) holds the funds until you advise on charitable giving (Grant Recommendation Form)	Funds are invested such that the fund balance grows over time, less 2% annual fee charged by the CFV

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Why a DAF?

DAF is like a private foundation, only better

- ✓ No legal fees to set up (savings can approximate $8,000)
- ✓ No minimum annual distributions
- ✓ No tax filings
- ✓ No excise taxes
- ✓ No restrictions on activities
- ✓ No corporate compliance, such as Board meetings

Legislation was proposed in 2021 to require that DAF assets be distributed to charities within 15 years, unless funds were with a community foundation and had a balance of less than $1 million (not enacted)

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Four techniques

From simple to complex:

1. Transfer cash to DAF
2. Transfer appreciated assets to DAF
3. Transfer appreciated assets to CRT
4. Transfer appreciated assets to LLC 99% owned by CRT

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Transfer cash to DAF

Impact of the 2017 Tax Act

- New standard deductions of $25,000 may result in fewer charitable gifts due to no incremented tax benefit from charitable deductions
- Bunching itemized deductions may become popular. Make charitable contributions every other year?
- Giving your RMD directly to charity via QCD will achieve the full tax benefit of charitable giving
- Wealthy will continue to itemize
- Maximum federal tax rate now 37% and maximum CA tax rate still 13%; combined tax rate of 50%
- A $100K charitable contribution will save as much as $50K in taxes (50%)
- New 60% limit on cash donations to charity (was 50%)

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Transfer appreciated assets to DAF

- No tax on built-in gain creates a second tax benefit further leveraging the tax savings.
- Works best for substantially appreciated marketable securities, real estate, and even closely held businesses (most DAF's require that assets be sold shortly after contribution).
- A gift of property is subject to a 30% AGI limitation with a 5-year carryover of any excess.
- A $1 million charitable gift of appreciated securities with tax basis of $100K would avoid any tax on the built-in gain of $900K. The tax savings related to the built-in gain would be $300K (Federal capital gain tax of 20% plus CA tax of 13%).
- In addition, the $1 million would be deductible as a charitable gift with a tax savings of as much as $500K (50% tax bracket). The combined tax savings is $800K or 80% of the gift.

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Transfer appreciated assets to CRT

- A charitable remainder trust (CRT) is a split interest vehicle that provides for an annuity to the donor for a period of years followed by a gift to charity at the end of the term (remainder).
- An ideal arrangement is one where the present value of the annuity is 90% of the value of the assets contributed and the present value of the remainder interest is 10% of the original value.
- You can vary the annuity percentage and the term of years in various combinations to achieve the 90–10 ratio. A common arrangement might be a 7% annuity and a 20-year term.

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Transfer appreciated assets to CRT (cont.)

- A $1 million transfer of appreciated securities or real estate (with tax basis of $100K) to a CRT would avoid a tax on the $900K built-in gain on the subsequent sale of the asset. The tax savings would be $300K (33% combined tax rate).
- In addition, the transfer would qualify for a charitable deduction equal to the present value of the remainder interest, for example - $100K, for a further tax savings of $50K (50% combined tax rate).
- Assuming the asset is sold by the CRT in the year of transfer, the total tax savings would be $350K at a time when the present value of the charitable gift is only $100K. That's a tax saving of 350% of the present value of the charitable gift!
- In this case, the donor would receive $70K per year for 20 years or $1.4 million with a present value of $900K.
- CRTs can get complicated, and this presentation tries to make it simple. It's not simple!

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Transfer appreciated asset to LLC 99% owned by CRT (NIMCRUT)

CRT on steroids!

- NIMCRUT limits annuities to lesser of net income of trust or the annuity rate.
- Net income of CRT can be defined as cash distributions from LLC to CRT. Annuities and resulting income taxes are driven by the cash distributions from the LLC. Deferring cash distributions allows profits to build up in LLC with no tax consequences. Power of tax-free compounding! NIMCRUT allows donor to catch up on annuities later. Donor controls cash distributions to CRT as managing member of LLC.
- DAF can be named the remainder beneficiary (need to instruct CFV on charitable wishes after you pass away).

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Other Charitable Giving Techniques

Charitable Lead Trust (CLT)

- Contribute assets to a CLT where the DAF receives for example, a 5% annuity for 10 years and your children receive the remainder in say 10 years
- A Grantor CLT may achieve a large charitable deduction in first year based on present value of annuity using the low AFR discount rate, but must pay income taxes on all income of trust. The gift of the remainder interest to the children may use less lifetime exemption than a direct gift to the children in say 10 years. However, no opportunity to avoid capital gain tax on contributed assets.

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Other Charitable Giving Techniques

Charitable Lead Trust (CLT) (continued)

- A Non-Grantor CLT, either while living or at death, allows the transfer of the remainder interest to children/heirs, using much less of the gift/estate tax exclusion (leveraged gift). However, no charitable deduction for donor.

Bequest to Charity (DAF?) pursuant to will or living trust

- Reduces estate tax if estate is valued at more than $12,060,000 (adjusted annually for inflation). Also, defers gift to charity until donor is confident that funds will not be needed for living expenses.

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Other Charitable Giving Techniques

Bequest to Charity (DAF?) pursuant to will or living trust (continued)

- Would need to advise DAF on charitable wishes after you pass away
- No income tax savings.

Make charity (DAF?) one of the beneficiaries of your retirement plan or IRA

- Similar to a bequest but with the added benefit of no income tax related to plan distributions received by charity

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Other Charitable Giving Techniques

Contribute home to charity (DAF?) but retain the right to live in home during your lifetime (life estate)

- Claim immediate charitable tax deduction for a large portion of the value of your home, depending on your life expectancy
- Avoid capital gain on sale of your home
- Would need to advise DAF on charitable wishes after you pass away
- Modest fees to CFV for services rendered until death

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Community Foundation of the Valleys

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Convert Your Client's Highly Appreciated Assets to Cash Without Any Tax!

Presented by: Heath B. Goldman, President/CEO

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Test Question

If you had 1 penny and it doubled every day over 30 days, how much money would you have after 30 days?

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ANSWER:

$10,737,418

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Test Question

If you had 1 penny and it doubled every day for 30 days, and you paid 20% tax on the growth each day how much money would you have after 30 days?

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ANSWER:

$455,172

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CONSIDER A TAX-EXEMPT TRUST

Also known as

Charitable Remainder Trust

or Wealth Preservation Trust

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Facts of the Case

- John and Mary Jones
- 55 years of age
- Asset value of $2,000,000
- Cost basis of $0

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Sell Property and Keep Proceeds

- Capital Gains Tax = $800,000
- Net Proceeds = $1,200,000
- Annual Income @7% = $84,000
- 30 Year Lifetime Income = $2,520,000
- Estate Tax = $480,000
- $2,520,000, $720,000, 0, $1,280,000

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Gifts to CRT

- Capital Gain Tax = $0
- Tax Refund = $78600
- Net Proceeds = $2,000,000
- Annual Income @7% = $140,000
- 30 Year Lifetime Income = $4,200,000
- Estate Tax = $0
- Gift to Charity = $200,000-$2,000,000
- Asset Replacement Premium (If Desired) $400,000
- $3,878,600, $2 Million, $2 Million, Zero

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Summary of Results

	CRT & ILIT	Sale Proceeds
Life Benefits	$3.88 Million	$2.52 Million
Children	$2.0 Million	$720,000
Net to Family	$5.88 Million	$3.24 Million
To Charity	$2 Million	Zero
Net Benefits	$7.88 Million	$3.24 Million
Total Tax Cost	Zero	$1,280,000
CRT/ILIT Benefit Advantage: More Than 2:1		

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Questions ?

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