Tax Tips

Deferred Charitable Giving

If you are charitably inclined, there are tax-advantaged ways to make a gift to a favorite charity while enjoying the income from that gift for your lifetime. Many educational and charitable organizations offer plans that combine the benefits of an immediate income tax deduction and lifetime income from the charitable gift. In most cases, you can make the gift in cash or securities. Here is a brief overview of the major types of deferred charitable gifts.

(1) A pooled income fund is probably the most common type of deferred giving plan. It closely resembles a mutual fund. When you make a gift to a pooled income fund, it is merged with gifts of other donors, and you receive your allocable share of the income earned by the fund. Distributions from the fund are usually made quarterly and are taxable as ordinary income. There is no guarantee as to the rate of earnings; that depends on the fund's success. You get an immediate income tax deduction in the year in which you make a gift to a pooled income fund. The amount of your deduction depends on a combination of your age and the fund's highest rate of earnings in the previous three years. The deduction will be less than the full value of your contribution, because it represents the present value of the funds that the charity will withdraw from the fund after your death.

(2) In a charitable remainder unitrust (CRUT), a separate fund is set up to hold your gift until your death, at which time it will become the charity's property. You decide at the outset on the annual percentage of the fair market value of the assets that you are to receive as income for life. For example, you may make a $50,000 gift to a CRUT and specify an 8% return. Your annual income will be $4,000. If the value of the CRUT assets drops in the next year to only $40,000, your income that year will be $3,200. If the value goes up to $60,000 in the following year, your income that year will be $4,800. Unlike a pooled income fund, a CRUT is handled individually. Therefore, the charity may require a much larger initial contribution to a CRUT than to a pooled income fund. Just as with a pooled income fund, your deduction for a gift to a CRUT will be less than the full value of your contribution.

(3) A charitable remainder annuity trust (CRAT) is similar to a CRUT in that your gift to the charity is placed in an individual trust. The CRAT provides an annual payment of a fixed dollar amount for your lifetime. This differs from a CRUT, which provides a fixed percentage of the asset value. For example, say that you make a $50,000 gift to a CRAT that will pay you $4,000 a year for life, after which the trust principal passes to the charity. If the CRAT earns less than $4,000 a year, it will sell assets to make up the difference. If it earns more than $4,000, it will pay you $4,000 and add the excess to the trust principal. Your income tax deduction from a gift to a CRAT is based on your age and the amount of your annual payment. As a rule of thumb, the older you are, the larger the deduction, and the greater the annual payment, the smaller the deduction.

(4) In a charitable gift annuity, you make a gift to charity in exchange for a guaranteed income for life. This is very much like buying an annuity in the commercial marketplace, except that you get an immediate charitable deduction equal to the excess of what you paid over what the annuity is worth, based on IRS tables. Unlike the pooled income fund, CRUT, and CRAT, your income from the charitable gift annuity is an obligation of the charity that does not depend on investment results. The rate of return on your gift annuity is not variable, as in a pooled income fund, or negotiable, as in a CRUT or CRAT. Instead, it is most likely to come from a table based on your age at the time of the gift. A portion of each year's payment is tax-free, because the tax law allows you to recover your original payment over your life expectancy. In the year when you buy the annuity, you get a charitable deduction for a portion of the purchase price, determined from an IRS table geared to your age.

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Richard Scrivanich, Partner

For Harvey & Parmelee LLP