

Strategies for Charitable Giving

IDEAS FOR GOOD: RESOURCES FOR EFFECTIVE PHILANTHROPY

Giving can help make the world a better place for ourselves, our children and future generations. Additionally, a well-structured charitable plan can provide benefits to the causes you care about for generations to come. What follows is an introduction to different charitable giving strategies, including some of the financial and estate-planning issues associated with them. Your Morgan Stanley Financial Advisor can work with your attorney and tax advisor to help you make the most of these strategies.

Q. What is a direct gift to charity?

A. You can make an outright gift during your lifetime or leave it through your Will as a bequest. Donations to charity often include various types of assets, such as cash and securities, as direct gifts. A gift to a capital campaign is one example of a popular type of direct gift.

Q. Will I receive a deduction for my direct gift?

A. Direct lifetime gifts may entitle you to a charitable income tax deduction, depending on your income level. For those whose income level qualifies, deductions are generally allowed for up to 50% of the donor's adjusted gross income (AGI), assuming the gift is cash and made to a public charity.¹

Gifts of long-term appreciated property offer potential deductions of up to 30% of AGI.² Any part of the deduction that cannot be used in the year the gift is made can be carried forward for up to five years. A large direct gift may provide a gift-tax deduction equal to the fair market value of the gift.³ Deduction limits may differ for gifts to private foundations.

Q. What are the estate planning implications of direct gifts?

A. If you make a direct gift, it may lower your estate taxes by removing the asset and its appreciation from your estate. For gifts made at death, there could be an estate tax deduction equal to the amount of the gift.⁴

Q. What are the benefits of using life insurance to give to charity?

A. Life insurance provides leverage when gifting, which makes it possible to gift a significant amount at a relatively small cost.

Q. How can I give with life insurance?

A. What follows are several examples of how you can use life insurance to benefit a charity.

- Purchase a life insurance policy and name a charity as the beneficiary. This option may be appropriate if you want to retain the right to revoke a gift. The change would be made by simply updating your choice of beneficiary on the insurance company's beneficiary designation form. While naming the charity as beneficiary does not constitute a deductible charitable contribution, you may receive an estate tax charitable deduction for that portion of the death benefit going to the charity.⁵
- Give an existing policy to a charity. If you were to transfer ownership of an existing life insurance policy to a charity during your lifetime, you would not retain the right to revoke the gift. However, in doing so, you may become eligible to receive a charitable income tax deduction, subject to AGI limits, equal to the policy's fair market value or the net premiums you have paid, whichever is less.⁶
- Give the charity cash to pay premiums for an insurance policy on your life. ►

► The charity would own the policy and be entitled to receive the death benefit. You would likely qualify for a charitable income tax deduction for the gift of cash, subject to AGI limits as discussed earlier.⁷ Some states require the charity to have, on the life of the insured/donor, an “insurable interest”—a potential for monetary loss due to the insured person’s/donor’s death. You should consult your tax or legal advisor to evaluate your state’s law on this matter.

Q. Can I give tangible assets to charity?

A. Many donors decide to give tangible assets, such as art and jewelry, to charity. If the value has appreciated significantly, this type of asset can be a substantial gift while also providing considerable tax benefits to you as a donor. Charitable deductions allowed for this class of assets are based on whether your gift is related to the purpose of the charity to which it is given. You may be entitled to a charitable income tax deduction for the fair market value of the asset if the gift is related to the charity’s mission. Giving a valuable painting to an art museum, for example, may qualify for such a deduction. If your gift is unrelated to the charity’s mission, however, you may be entitled to a lower charitable income tax deduction, one limited to your cost basis, plus any improvements you have made (having the painting mounted with

an expensive frame, for example). In addition, if you created the gifted artwork, you may be entitled to a charitable income tax deduction that is limited to your cost basis.⁸

Q. What are the estate planning implications of tangible-asset gifts?

A. Estate tax deductions may be allowed for the fair market value of the asset, regardless of whether the gift is related to the charity’s mission. The estate tax deduction is generally allowed if you make a gift of tangible assets through your will or a revocable trust.

Q. What about gifts of real estate?

A. When considering gifting real estate to charity, ask yourself fitting questions, such as:

- Are you currently not using this property?
- Does the property fail to meet your investment or social objectives?
- Would a large capital gains tax be due if you sold this property?

If you can answer “yes” to any combination of these questions, the property may be a good candidate for gifting.

At the time of making the gift, you may be eligible for a charitable income tax deduction equal to the fair market value of the real estate, subject to AGI limits. However, if the property has been owned less than one year, the charitable income tax deduction is generally limited to your cost basis, plus any improvements you made.⁹

Q. Can I give my residence to charity, but continue to use it for my lifetime?

A. Yes, a current deed can be created that transfers ownership of your property to a charity upon death. When the deed is recorded (according to the laws of the state in which you reside at the time), you may be entitled to a charitable income tax deduction for the fair market value of the property, less the value of your right to use the property for the rest of your life. The fair market value of the property at death is normally excluded from your estate.

Q. What are split interest vehicles and how do they benefit donors?

A. Split interest vehicles are used to designate two beneficiaries: a current beneficiary and a remainder beneficiary. The current beneficiary receives an annual payout stream from the trust, typically you during your lifetime. The remainder beneficiary receives the assets left in the trust at the conclusion of its term. Here is a description of the four major types of split interest vehicles.

CHARITABLE GIFT ANNUITIES.

A charitable gift annuity is a special type of agreement designed to provide you with the benefits of a traditional annuity while giving the underlying asset to charity. In exchange for a gift of cash or securities (some states allow the gift of closely-held stock or property), you would receive annuity payments for life from your selected charity. The lifetime annuity payments will start at the time of your choosing. Typically, you would receive an income tax deduction equal to the gift given to charity, less the present value of the lifetime annuity payouts.¹⁰ Each annuity payment to you would be, generally, partially income-tax-free. If the gift is a long-term capital gain asset, such as publicly traded stock,

Example of Income Tax Deduction

	AMOUNT OF GIFT	ADJUSTED GROSS INCOME (AGI)	ALLOWABLE DEDUCTION	CARRY FORWARD
Gift of Cash	\$50,000	\$100,000	50% of AGI	\$0
Gift of Stock	\$50,000	\$100,000	30% of AGI	\$20,000

For Illustrative Purposes Only. Discuss with your tax and legal advisor before implementing any particular strategy.

the annuity payouts you receive may be partially income-tax-free, partially taxed as ordinary income and partially taxed as long-term capital gain. Many charitable gift annuity programs permit donations as low as \$10,000.

CHARITABLE REMAINDER TRUSTS.

A charitable remainder trust (CRT) is a tax-advantaged vehicle that enables you, as donor, to give to charity, diversify assets and receive annual payouts. If you have been holding onto appreciated assets for fear of paying a high capital gains tax, you could transfer the assets to a CRT and possibly avoid immediate capital gains on the transfer. In addition, the trust would provide you with any annual payout stream. At the end of the payout term, the remainder of the assets would be left to charity.

Creating a CRT could provide you with an income tax deduction as well. The deduction would be based on the fair market value of the gift, less the present value of your payout stream. It would also be determined by the nature of the gift, the type of charity receiving the gift and your AGI. There may be income tax due on the annual payouts to you. As donor, you determine the term of the trust, which can last for your lifetime, or for a fixed term of up to 20 years. You can also choose the level of annual payouts to be paid by the trust. Typically, the maximum payout rate depends upon the length of the trust or the life expectancies of the income recipients, but it cannot exceed 50%; the minimum payout is 5%.¹¹ When your payout term ends (often at death), whatever is left in the trust is distributed to the charity (or charities) of your choice.

CHARITABLE LEAD TRUSTS. Charitable lead trusts (CLTs) are generally more attractive in periods of low interest

rates. A CLT works as follows: You would fund the trust, preferably with an asset expected to appreciate; the charity receives a fixed annual payout from the trust; and the remainder goes to your beneficiaries at the end of the charity's payout term. The primary benefit of a CLT lies in its gift tax consequences. The value of the donor's initial gift to the trust is determined by a government-set rate, the term of the trust and the payout to charity. When the government-set rate is low, the value of the donor's gift is reduced for gift-tax purposes. Unlike charitable remainder trusts, CLTs are not tax-exempt entities. Depending on the type of CLT, you may be able to take a charitable income tax deduction at the time you make the gift; either you, as donor, or the trust must pay capital gains tax when the charity sells the trust assets; or you or the trust must pay income tax on any income generated in the trust.

POOLED-INCOME FUNDS. A pooled income fund allows you to "pool" together cash or securities to create one large gift for charity. The charity then reinvests these assets as a pool. The fund's annual income is paid to you or your beneficiaries, based on

your share and/or each beneficiary's share of the pool. Upon the death of the fund's beneficiary or beneficiaries, the remaining share of the pool is transferred to the charity.¹²

Pooled-income funds generally are beneficial for investors who wish to make small gifts to charity (subject to the charity's own minimum requirements) while still receiving income from the gifts. A donor to a pooled-income fund is generally entitled to a charitable income tax deduction for the amount the charity is expected to receive at the donor's death. As the donor, you generally would not be required to pay gift tax on contributions to the pooled-income fund, unless the income is received by someone other than you or your spouse (assuming your spouse is a U.S. citizen). If you were to set up a contribution to the fund to be made at death, the estate may receive an estate tax charitable deduction for the projected value of the trust at the end of its term. If the fund were set up this way, you would designate a lifetime income beneficiary. Discuss your individual situation with your tax or legal advisor and review any and all disclosure statements to determine eligibility.

Techniques of Charitable Giving

	CHARITABLE GIFT ANNUITY	POOLED-INCOME FUND	CHARITABLE REMAINDER TRUST	PRIVATE FOUNDATION	DONOR-ADVISED FUND
Cost to Set Up	None	None	Moderate	High	None
Cost to Maintain	None	None	Moderate	High	Low
Generates Income	Yes	Yes	Yes	No	No
High Control	No	No	Yes	Yes	Yes
High Complexity	No	No	Yes	Yes	No

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Q. When should I consider using a professional trustee?

A. It may be possible for you or a family member to act as trustee of a trust that you establish. However, many individuals may not have the time or expertise to effectively perform the duties and responsibilities of a trustee. Charitable trusts and foundations often have additional administrative and investment management requirements that, if not performed correctly, may jeopardize their charitable and financial benefits.

Q. Can I make provisions for my family and give significant assets to charity?

A. One concern that many donors have in gifting significant assets to charity is that the assets will no longer be available for the family. The following technique may help to ensure the family will be left with an inheritance, too. Using the savings from your charitable income tax deduction and any payouts received from one or a combination of the charitable vehicles discussed, you can gift an annual amount to an irrevocable life insurance trust. The trust would purchase a life insurance policy on your life. At death, the life insurance proceeds could be distributed to the trust's beneficiaries—presumably your

family members. Assuming the trust is established correctly (mainly, that you hold no ownership interest in the life policy), the proceeds are not taxed for income or estate tax purposes.

Q. What is a donor-advised fund?

A. A donor-advised fund provides a flexible way to give donations to nonprofit organizations. You make an irrevocable, nonrefundable contribution of cash or securities to the fund. You can then direct the fund's administrator as to which qualified organizations grants should be made, the amount of the grants and when grants should be paid. You can also appoint a family member or friend to continue making grants from a donor-advised fund after your death. Assets in a donor-advised fund are typically managed by a professional investment advisory firm. This provides you with the opportunity to potentially increase the value of your contributions to the fund, which could result in larger grants in the future to your choice of nonprofit organizations. You may be entitled to a charitable income tax deduction for the amount contributed to a donor-advised fund, subject to AGI limits. Any unused portion may be carried forward for up to five years.

Q. What are the benefits of a private family foundation?

A. A private family foundation is a tax-advantaged charitable entity created for the purpose of direct gifting. Private foundations are usually set up by individuals or families wishing to make substantial gifts to charity, while maintaining ultimate control of how grants are made. If you were to set up a private family foundation (it can be established during life or at death), you would contribute assets to the foundation and choose the trustees or directors who will make the grants to worthy charities. You could choose to be actively engaged in managing the foundation or have family members join or succeed you in that management. You might enjoy significant income, gift and estate tax deductions for making substantial contributions to a private family foundation. Creation of a foundation during your lifetime may provide both an income tax and a gift tax charitable deduction. Testamentary gifts offer a dollar-for-dollar estate tax deduction. For these potential benefits, however, you must be willing to bear the legal and accounting costs associated with the creation and maintenance of a foundation.

¹IRC Sec. 170(b)(1)(A)

²IRC Sec. 170(b)(1)(C)(i)

³IRC Sec. 2522, 2512(a)

⁴IRC Sec. 2055

⁵Rev. Rul. 76-143, 1976-1 C.B.63

⁶Ltr. Rul. 8042104

⁷IRC Sec. 170(b)(1)(A)

⁸IRC Sec. 170(e)(1)(B)(i)

⁹IRC Sec. 170(e)(1)(A)

¹⁰Reg. Sec. 1.170A1(d)(1)

¹¹IRC Sec. 664(d)(1)(A)

¹²Reg. Sec. 1.642(c)-5(b)

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