Grace Global Alliance

An Independent Association of Christian Churches & Ministers

Charitable Giving
An Overview
Tax Year 2017

Prepared for:

Grace Global Alliance

Ministers & Churches

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Considering a Charitable Gift

Charitable giving provides help to those less fortunate than ourselves.

Reasons for Making a Charitable Gift

Many persons make gifts or bequests to charitable organizations for a number of reasons. Some of the more common motivations would include the following:

- Compassion for those in need.
- Religious and spiritual commitment.
- Perpetuation of one's beliefs, values and ideals.
- Support for the arts, sciences and education.
- A desire to share one's good fortune with others.

Whatever the reasons, U.S. tax law is designed to encourage these gifts.

Different Types of Charitable Gifts

Some donors prefer to make outright gifts of cash or other valuable assets to their favorite charities. Other individuals, although they would like to make an outright gift, depend on the income from their assets for their daily needs. Often, such donors decide to wait until they die to transfer assets to a charity, through a will or trust.

However, there are methods which allow a donor to make a gift now, while still retaining an income for life. The most popular of these methods include:

- **Charitable Remainder Annuity Trust**
- **Charitable Remainder Unitrust**
- **Pooled Income Fund**
- **Charitable Gift Annuity**

Another gifting technique assigns an income interest to the charity for a period of years (or the lifetime of a person), after which the remainder passes to the donor's heirs. Gifts made in this manner involve what are known as charitable "lead" trusts.

Potential Financial Benefits of Charitable Gifts

- **Income taxes:** May provide an income tax deduction.[1] In many cases, can avoid or delay payment of capital gains tax.
- **Cash flow:** May increase personal after-tax cash flow.
- **Estate planning:** May increase the amount passing to one's heirs.

[1] Federal Income Tax Law. State or local income tax law may differ.

Charitable Giving Techniques

Gifts to charity during lifetime or at death will reduce the size of the gross estate. An additional benefit of lifetime gifts is that an income tax deduction is available within certain percentage limitations.

Split-Interest Gifts

If the estate owner is not willing or able to contribute the entire asset during lifetime, he or she may consider a split-interest, deferred gift.

The ownership interests in an asset can be split or divided into two parts, a stream of income payable for one or more lifetimes or a term of years (the income interest) and the principal remaining after the income term (the remainder interest).[1] In a split-interest gift, one portion is given in trust for the charity and the other portion is retained.

Charitable Remainder Plans

When the estate owner retains the right to the income but transfers his or her rights in the remainder to a trust, it is called a charitable remainder trust.

To qualify for an income tax deduction the trust must be a unitrust, an annuity trust, a pooled income fund, or a charitable gift annuity.

- **Charitable remainder unitrust:** In this type of trust the donor retains a right to a fixed percentage of the fair market value of the trust assets, with the trust assets being re-valued annually. If the value of the assets increases, so does the annual payout and vice versa.
- **Charitable remainder annuity trust:** This trust is similar to the unitrust but instead pays a fixed dollar amount each year.
- **Pooled income fund:** Assets are transferred to a common investment fund maintained by the charity. Each donor receives annually a share of the income from the fund, in proportion to the contribution made. These annual payments continue for the lifetimes of the donor and spouse. At death, the corpus of the donor's gift, together with any capital gains, passes to the charity. Payments will increase or decrease with the investment performance of the fund.

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[1] Technically, the present value of the income share and the present value of the remainder interest.

- **Charitable gift annuity:** The donor transfers the asset directly to the charity, in exchange for the charity's agreement to pay a fixed lifetime annuity.

The amount of the income tax deduction is dependent upon the percentage of the income interest and the period over which it will be paid (usually the life of the donor and his or her spouse). This is determined from the mortality tables published by the government.

Charitable Income Trusts

The charitable income or lead trust is the reverse of the charitable remainder trust. The income interest is assigned to the charity, usually for a period of years, and then the remainder generally passes to the donor's heirs. The amount of the estate tax deduction and the amount left for the heirs will depend upon the number of years income is to be paid to the charity, the size of the annual payments, and the investment results achieved by the trustee

Charitable Income Tax Deduction

Federal income tax law allows a deduction for gifts to qualified charitable organizations, such as churches, colleges, hospitals, charitable foundations, etc. The actual amount of the deduction is dependent upon several factors:

- **Type of charity:** Does the organization benefit the general public or does it have a more limited or private purpose?
- **Type of asset:** Is the donated item cash, a capital asset with untaxed appreciation, tangible personal property, etc.?
- **Portion of asset given:** Is it a gift of the entire asset or only an interest in the asset, like a remainder interest, which will pass to the charity at some time in the future?
- **When gift is given:** Is the gift being made now or will it occur at some future date, as under the terms of a will or trust?

Income Tax Savings

The gift of an asset to a charity generally results in a federal income tax deduction,[1] which should decrease the tax due and increase the amount of net after-tax income for the year. However, charitable contributions are not always 100% deductible against an individual's federal income tax liability.

Limits on Annual Charitable Deduction

Federal law limits the amount that is deductible for the year in which the gift is made, based upon one's adjusted gross income (AGI). If the limit is exceeded for the year, any excess deduction can generally be carried forward for up to five years.

If combined charitable contributions for the year do not exceed 20% of AGI, they may all be deducted. If, however, contributions exceed 20% of AGI, the deduction may be limited to 50%, 30% or 20% of AGI, depending upon the type of property given and the type of charitable organization receiving the gift. In no event can the deduction exceed 50% of the donor's adjusted gross income for the year.

[1] The discussion here concerns federal tax law. State or local income tax law can vary.

- **50% limit:** This limit applies to contributions to public charities, i.e., most churches, hospitals, colleges, etc., unless the gift is of capital gain[1] property and the deduction is taken for the fair market value, in which case a 30% limit will apply. The 50% limit is available for gifts of capital gain property if the deduction is limited to the cost basis of the asset.
- **30% limit:** This limit applies to gifts for the use of any charitable organization and gifts (other than capital gain property) to non-50% type charities.
- **20% limit:** This limit applies to gifts of capital gain property to non-50% type charities.
- **Patents and Intellectual Property:** A donor's deduction for gifts of patents and other intellectual property is limited to the lesser of the taxpayer's basis or the fair market value of the property. An additional deduction may be available for a limited number of future years if the donee organization realizes income from the gifted property and certain requirements are met.

Limits on Itemized Deductions

As AGI increases, federal law also acts to reduce certain itemized deductions, including charitable contributions. In addition to individual "floors" (such as the 2% of AGI limitation on certain miscellaneous itemized deductions), there is also an "overall" limitation on itemized deductions. Under this overall limitation, the otherwise allowable total of itemized deductions is reduced by 3.0% of the amount by which a taxpayer's AGI exceeds a threshold amount. This reduction may not exceed more than 80% of the otherwise allowable deductions.

For 2017, these thresholds are: (1) $313,800 (Married Filing Jointly); (2) $287,650 (Head of Household); (3) $261,500 (Single); and $156,900 (Married Filing Separately).

Income Tax Deduction for Split-Interest Gifts

Determining the federal income tax deduction for a "split-interest" gift, i.e., a charitable remainder or charitable lead trust, can be complicated. The key factors involved are:

- How long the charity must wait before it benefits; and

[1] Capital gain property as used here applies to capital assets held long-term (at least 12 months and one day).

- How much income is paid to the beneficiaries each year; and
- The prevailing interest rates at the time of the gift (as indicated by the applicable federal rate).

Seek Professional Guidance

The counsel and guidance of a CPA, IRS Enrolled Agent, or other qualified tax professional is strongly recommended.

Charitable Gifts and Estate Taxation

Gifts to a charity or to a charitable remainder trust can reduce one's taxable estate by not only the value of the gift but also its potential appreciation. If the donor retains the right to the income, as in a charitable remainder trust, the estate tax savings will not be as large. However, the donor (or donors) may choose to make gifts of the income each year to children, grandchildren or to a trust on their behalf. If certain requirements are met, these gifts will qualify for the annual gift tax exclusion of $14,000[1] from each donor to as many qualified beneficiaries as there are under the terms of the trust.

The chart below illustrates the potential savings, based on a hypothetical situation.

Assumptions:

Current estate size: $6,500,000
Estate growth rate: 6.00%
Value of charitable gift: $1,000,000
Year of death: 2017
Applicable credit: $2,141,800

Years From Now	Taxable Estate		Federal Estate Tax[2]		Estate Tax Savings With Gift
	Without the Gift	With the Gift	Without the Gift	With the Gift	
Now	$6,500,000	$5,500,000	$404,000	$4,000	$400,000
5	$8,698,466	$7,360,241	$1,283,387	$748,096	$535,290
10	$11,640,510	$9,849,662	$2,460,204	$1,743,865	$716,339
15	$15,577,628	$13,181,070	$4,035,051	$3,076,428	$958,623
20	$20,846,381	$17,639,245	$6,142,552	$4,859,698	$1,282,854
25	$27,897,160	$23,605,289	$8,962,864	$7,246,116	$1,716,748
30	$37,332,693	$31,589,201	$12,737,077	$10,439,681	$2,297,396
35	$49,959,564	$42,273,477	$17,787,826	$14,713,391	$3,074,435

Note: If both the income from the trust and the income tax savings from the charitable deduction are given to an irrevocable trust (or to adult children) to purchase life insurance on the life of the donor, one is able to transfer a substantial amount of money to one's heirs which is not subject to either income tax or estate tax.

[1] 2017 value. This amount is subject to adjustment for inflation in future years.

[2] Calculated as if death occurred in 2017.

Charitable Remainder Unitrust

A Charitable Remainder Unitrust (CRUT) is an irrevocable trust which pays a fixed percentage of the value of its holdings each year to a beneficiary such as the donor of the trust assets, his or her spouse, child, etc. Unlike the fixed dollar payment of a charitable remainder annuity trust, the unitrust payments will fluctuate with the changing asset balance in the trust, reflecting year-to-year investment performance.[1]

After the death of the income beneficiaries or at the end of a set number of years (no more than 20), whatever assets remain in the trust are distributed to the charities named in the trust. Unlike a Charitable Remainder Annuity Trust (CRAT), additional contributions to a CRUT are allowed in later years, if desired.

CRUT Variations

The standard form of CRUT requires payment of the full stated percentage throughout the life of the trust, even if assets must be liquidated. Other CRUT variations include:

- **Net-Income CRUT:** A CRUT may be drafted to pay out less than the established percentage if the trust income during the year is less than the required payout percentage. This shortage can be made up in later years when the trust earns more than the required payout percentage.
- **"Flip" CRUT:** Under IRS regulations, a CRUT may begin life as a net-income trust, and, at some pre-determined future date or triggering event, permanently convert ("flip") to a standard unitrust. A "flip" CRUT is an option for an individual seeking a current income tax deduction, tax-deferred buildup and increased income at a later date.

Income Tax Considerations

The charitable income tax deduction is based on the current value of the charity's right to receive the trust assets at some time in the future. Three factors are involved:

- The estimated length of time, which the charity must wait; for example, a term of years (like 10, 15, 20, etc.) or for the donor's or other person's lifetime.

[1] Assets must be revalued each year to determine the payout amount.

- The percentage rate payable to the income beneficiaries each year and how frequently it is paid, e.g., annually, monthly, etc. The higher the rate of payout, the less there will be for the charity; and, therefore, the smaller the charitable deduction.
- The current investment return, as determined by the IRS. These are called the IRC 7520 mid-term rates.[1]

These factors are applied to government tables to determine the current value of the charitable deduction. If the charitable deduction exceeds a certain percentage of the donor's adjusted gross income in the year of the gift, the excess must be carried over to future years.

Gift Tax Considerations

If the income from the CRUT is payable to someone other than the donor, it may be subject to federal gift taxation. If certain requirements are met, the income gift can be made to qualify for the annual gift tax exclusion of $14,000[2] per beneficiary. Also, the marital deduction will usually eliminate any tax on payments to the donor's spouse.

Estate Tax Considerations

The value of the interest passing to the charity is deductible from the gross estate. If there are income beneficiaries other than the donor and his or her spouse, there may be an estate tax on the value of this income interest.

Some states allow a surviving spouse to "elect" to receive a portion of the deceased spouse's estate. Such laws are designed to prevent the surviving spouse from being completely disinherited. If state law allows assets in a CRUT to be used to satisfy the surviving spouse's election, the CRUT could cease to qualify as a charitable trust under federal law. As a result, previous income tax deductions can be lost and the assets in the trust could be added back to the deceased spouse's estate.[3]

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[1] This rate changes monthly.

[2] 2017 value. This amount is subject to adjustment for inflation in future years.

[3] The IRS originally provided a "safe harbor" for this situation in Revenue Procedure 2005-24, with a grandfather date of June 28, 2005. In Notice 2006-15, however, the federal government extended the June 28, 2005 date until "further guidance is issued by the Internal Revenue Service."

Almost Everyone Benefits

A taxpayer can contribute an asset (usually highly appreciated and low income producing) to a CRUT and receive a current income tax deduction. The trustee can sell the appreciated asset without paying any capital gain tax and can then reinvest the entire proceeds at a higher rate of return. The trust will often pay out a higher return than the donor previously received. This, coupled with the federal income tax deduction, can create a substantial increase in cash flow.

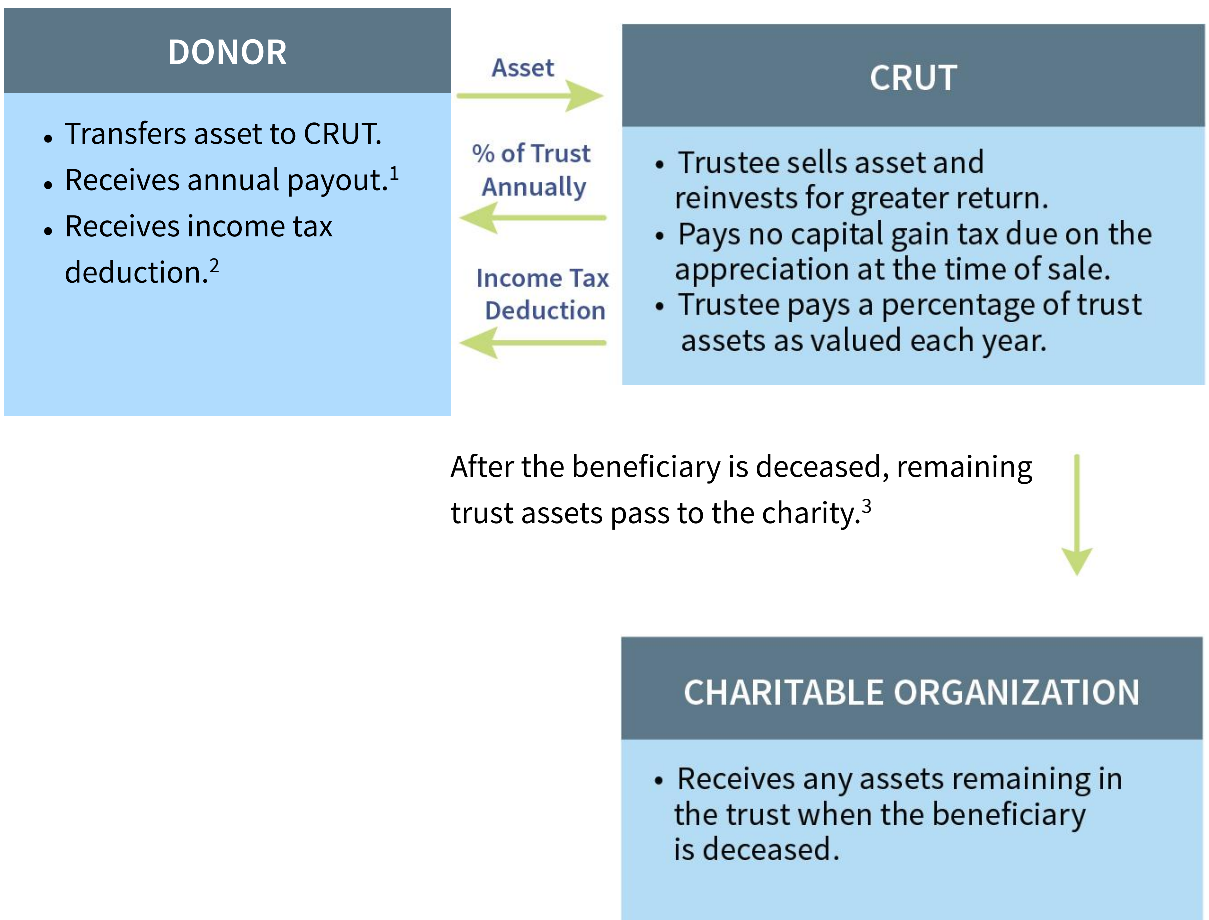
Thus far, the only ones to lose are the donor's heirs. To solve this problem, many taxpayers use a portion of the increased cash flow to purchase a life insurance policy (outside of the estate) to replace the value of the asset placed in the trust. This arrangement lets almost everyone benefit.

Party	Benefit
Donor (and spouse)	Increased cash flow during retirement years
Children/heirs	Same size or larger inheritance (with insurance)
Favorite charity	Receives remaining assets after donor's death
Internal Revenue Service	Receives less income and estate tax

How a Charitable Remainder Unitrust Works

The donor transfers an asset to the trustee of the charitable remainder unitrust (CRUT) and receives a set percentage of the trust value for each year thereafter. A current income tax deduction is also available.

When the donor or other named beneficiary dies or the trust term ends, the remaining trust assets pass to one or more designated charities.



[1] The annual annuity payout is taxed under a four-tier system. Generally speaking, ordinary income is paid first, followed by capital-gain, other income, and trust principal.

[2] This deduction may have to be spread over more than one year, if it exceeds certain percentage of income limitations.

[3] If a surviving spouse “elects” to claim a part of a deceased spouse’s estate, the income and estate tax benefits of a CRUT may be lost.

Charitable Remainder Annuity Trust

A Charitable Remainder Annuity Trust (CRAT) is an irrevocable trust which pays a fixed dollar amount each year to a beneficiary, such as the donor of the trust assets, his or her spouse, child, etc. This fixed dollar amount is determined by applying the trust's stated percentage payout, e.g., 5%, 6%, etc., to the value[1] of the assets initially transferred by the donor.

After the death of the income beneficiaries or at the end of a set number of years,[2] whatever assets remain in the trust are distributed to the charities named in the trust. If additional contributions are desired in later years, new trusts must be established.

Income Tax Considerations

The charitable income tax deduction is based on the current value of the charity's right to receive the trust assets at some time in the future (a remainder interest). There are several factors in determining this value:

- The first factor is the estimated length of time which the charity must wait; for example, a term of years (like 10, 15, 20, etc.) or for the donor's or other person's lifetime.
- Another factor is the percentage rate payable to the income beneficiaries each year and how frequently it is paid, e.g., annually, monthly, etc. Obviously, the higher the rate of payout, the less there will be for the charity; and, therefore, the smaller the charitable deduction will be.
- The current rate of return on investments as determined by the applicable federal (midterm) rates (AFR) is also an important factor.[3]

All of these factors are applied to government tables to determine the current value of the charitable deduction. If the charitable deduction exceeds a certain percentage of the donor's adjusted gross income for the year of the gift, that portion must be carried over into future years.

[1] In cases of hard to value assets like real estate, a qualified appraisal is required to support the values.

[2] If a set number of years is chosen to determine the term of the trust (instead of the lifetime(s) of one or two beneficiaries), the maximum term is 20 years.

[3] This rate is subject to change monthly.

Gift Tax Considerations

If the income from the CRAT is payable to someone other than the donor, it may be subject to federal gift taxation. If certain requirements are met, the income gift can be made to qualify for the annual gift tax exclusion of $14,000[1] per beneficiary. Also, the marital deduction will usually eliminate any gift tax on payments to the donor's spouse.

Estate Tax Considerations

The value of the interest passing to the charity is deductible from the gross estate. If there are income beneficiaries other than the donor and his or her spouse, there may be an estate tax on the value of this income interest.

Some states allow a surviving spouse to "elect" to receive a portion of the deceased spouse's estate. Such laws are designed to prevent the surviving spouse from being completely disinherited. If state law allows assets in a CRAT to be used to satisfy the surviving spouse's election, the CRAT could cease to qualify as a charitable trust under federal law. As a result, previous income tax deductions can be lost and the assets in the trust could be added back to the deceased spouse's estate. The IRS originally provided a "safe harbor" for this situation in Revenue Procedure 2005-24, with a grandfather date of June 28, 2005. In Notice 2006-15, however, the federal government extended the June 28, 2005 date until "further guidance is issued by the Internal Revenue Service."

Almost Everyone Benefits

A taxpayer can contribute an asset (usually highly appreciated and low income producing) to a CRAT and receive a current income tax deduction.

The trustee can sell the appreciated asset without paying any capital gain tax and can then reinvest the entire proceeds at a higher rate of return.

The trust will often pay out a higher return than the donor previously received. This, coupled with the income tax deduction, can create a substantial increase in cash flow.

Thus far, the only ones to lose are the donor's heirs. To solve this problem, many taxpayers use a portion of the increased cash flow to purchase a life insurance policy (outside of the estate) to replace all or part of the value of the asset placed in the trust. This arrangement lets almost everyone benefit.

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[1] 2017 value. This amount is subject to adjustment for inflation in future years.

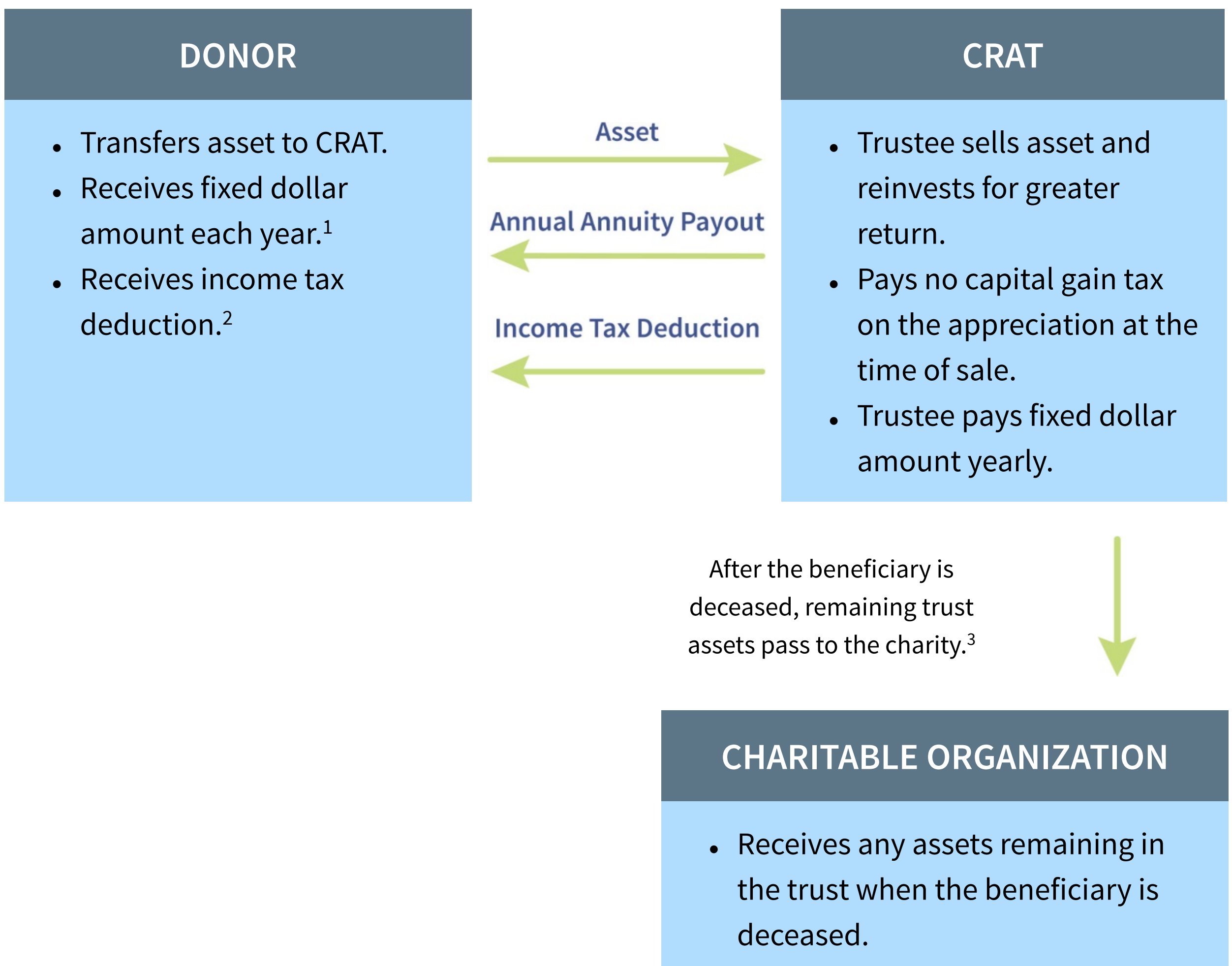
Charitable Remainder Annuity Trust

Party	Benefit
Donor (and spouse)	Increased cash flow during retirement years
Children/heirs	Same size or larger inheritance (with insurance)
Favorite charity	Receives remaining assets after donor's death
Internal Revenue Service	Receives less income and estate tax

How a Charitable Remainder Annuity Trust Works

The donor transfers an asset to the trustee of the charitable remainder annuity trust (CRAT) and receives a fixed dollar amount for each year thereafter. A current income tax deduction is also available.

When the donor or other named beneficiary dies or the trust term ends, the remaining trust assets pass to one or more designated charities.



[1] The annual annuity payout is taxed under a four-tier system. Generally speaking, ordinary income is paid first, followed by capital-gain, other income, and trust principal.

[2] The income tax deduction is based on a government determined applicable federal rate and may have to be spread over more than one year, if it exceeds certain percentage of income limitations.

[3] If a surviving spouse "elects" to claim a part of a deceased spouse's estate, the income and estate tax benefits of a CRAT may be lost.

Charitable Gift Annuity

When a donor transfers an asset to a charity[1] in exchange for an income for one or two lives, it is called a charitable gift annuity.

The income tax deduction from this arrangement will vary depending on the age of the donor, the payout rate and the applicable (mid-term) federal rate (AFR) (which is determined monthly).

The following charts illustrate the income tax deduction at various ages and AFRs. Each example assumes a cash gift of $100,000. The payouts vary with the age of the donor.[2]

Age 55 / 4.0% / $4,000		⇦ Recommended Payout ⇨		4.4% / $4,400 / Age 60
AFR Table Rate	Total Charitable Deduction	Income Excluded from Taxation[3]	Total Charitable Deduction	Income Excluded from Taxation[3]
1.4%	$16,284	$2,937	$20,457	$3,300
2.0%	22,694	2,712	25,823	3,078
2.4%	26,548	2,577	29,087	2,942

Age 65 / 4.7% / $4,700		⇦ Recommended Payout ⇨		5.1% / $5,100 / Age 70
AFR Table Rate	Total Charitable Deduction	Income Excluded from Taxation[3]	Total Charitable Deduction	Income Excluded from Taxation[3]
1.4%	$28,111	$3,613	$35,819	$4,037
2.0%	32,312	3,401	39,009	3,836
2.4%	34,898	3,271	40,991	3,711

[1] In most states, a charity must be licensed to grant a gift annuity.

[2] Many charities follow the suggested payout rates developed by the American Council on Gift Annuities, 1260 Winchester Parkway, Suite 205, Smyrna, GA, 30080-6546. Tel: (770) 874-3355.

[3] The amount shown represents that portion of the annual payment due to recovery of the donor's basis in the annuity. Once the basis has been completely recovered, all additional payments are fully taxable.

Charitable Gift Annuity

Age 75 / 5.8% / $5,800		⇦ Recommended Payout ⇨		6.8% / $6,800 / Age 80
AFR Table Rate	Total Charitable Deduction	Income Excluded from Taxation[1]	Total Charitable Deduction	Income Excluded from Taxation[1]
1.4%	$41,861	$4,689	$47,309	$5,605
2.0%	44,262	4,495	49,080	5,419
2.4%	45,772	4,373	50,205	5,297

Note: Table calculated using ACGA "recommended" Single Life Gift Annuity rates effective January 1, 2012

[1] The amount shown represents that portion of the annual payment due to recovery of the donor's basis in the annuity. Once the basis has been completely recovered, all additional payments are fully taxable.

How a Charitable Gift Annuity Works

The donor transfers an asset to a charity and each year thereafter receives an annuity, i.e. a payment in a fixed dollar amount. The annual payment is set at the time the gift is made. A current income tax deduction is also available.

When the donor or other named beneficiary dies, the charity has no further financial obligations to pay.

DONOR

- Transfers asset to charity.
- Receives annual payout.[1]
- Receives income tax deduction.[2]

Asset →

← Annual Annuity

← Income Tax Deduction

CGA

- Charity sells asset and reinvests for greater return.
- Charity pays no capital gain tax on the appreciation at the time of sale.[3]
- Charity pays a fixed dollar amount, established at time of gift each year for lifetime of beneficiary.

After the beneficiary is deceased the charity has no further obligations to pay.

[1] Annuity payments are part return of principal (nontaxable), part ordinary income and (if any) part capital gain. Once a donor has recovered his or her basis, the annuity payments are fully taxable.

[2] This deduction may have to be spread over more than one year if it exceeds certain percentage of income limitations.

[3] If certain requirements are met, the donor may recognize any capital gain ratably over the time period the annuity is expected to be received. Otherwise, the donor must recognize all capital gain in the year the annuity transaction is entered into.

Taxation of a Charitable Gift Annuity

Payments received from charitable gift annuities are taxed in the same manner as commercial annuities, i.e., using the annuity exclusion ratio. However, many individuals prefer the fixed, predictable income and upfront income tax deduction received when funding a gift annuity. This often gives them an advantage over payments from pooled income funds or charitable remainder trusts, from which the income may be fully taxable.

A portion of each payment from an annuity is considered to be a return of principal and is, therefore, exempt from income tax. Also, when funded with appreciated property, a portion of the payment will be taxed at capital gains rates.

Payment Allocation

The chart below illustrates the allocation of payments from a charitable gift annuity as various types of income. The examples are based on the following set of assumptions.

Assumptions:

Amount contributed: $100,000
Age of beneficiary: 75
Payout rate: 5.8%
Applicable federal rate (AFR): 1.4%

Assuming a Cash Contribution of $100,000

Years	Annual Income	Ordinary Income	Exempt Income	Long-Term Capital Gain
1-12.5	$5,800	$1,111	$4,689	$0
Thereafter	$5,800	$5,800	$0	$0

Assuming a Stock Contribution with Basis of $50,000

Years	Annual Income	Ordinary Income	Exempt Income	Long-Term Capital Gain
1-12.5	$5,800	$1,111	$2,344	$2,344
Thereafter	$5,800	$5,800	$0	$0

Note: The donor will also receive a current income tax deduction of approximately $41,860.[1]

[1] This deduction assumes funding on the first day of the last quarter and a prorated payment due on December 31st.

Appreciated Capital Assets

Appreciated capital assets held long-term may be exchanged for a charitable gift annuity without taxation of the unrealized capital gain at time of transfer (much like a charitable remainder trust) unless an income beneficiary other than the donor and his or her spouse is named. In such cases, the full, unrealized gain is taxable to the donor/grantor.

Charitable Remainder Trust Numerical Tests

Charitable remainder trusts (CRTs), including charitable remainder annuity trusts (CRATs) and charitable remainder unitrusts (CRUTs), are subject to a complex maze of law and regulation. The failure of a CRT to meet all requirements the law imposes can result in it being disqualified as a "charitable" trust, with negative income, gift, and estate tax consequences, as well as defeating the donor's charitable intent.[1]

Numerical Tests

A number of these requirements involve specific numerical tests:

- **5% probability test:** This test, which applies only to CRATs, measures the theoretical possibility that a non-charitable beneficiary might live long enough to exhaust the assets in the trust, leaving nothing for the charity.[2] Using a complicated mathematical formula, and government interest and longevity tables, the probability of exhausting the assets is calculated at the time property is transferred to the trust. If the probability of exhaustion is greater than 5%, no income or estate tax deduction is allowed.

- **5% minimum payment test:** This test concerns the minimum annual payment which must be made from a charitable remainder trust. For CRATs, federal law requires the payment to be not less than 5% of the initial fair market value of all property placed in the trust. For CRUTs, the law requires the minimum payment to be a fixed percentage, not less than 5%, of the net fair market value of the CRUT's assets, valued annually.

- **50% payout limitation test:** Federal tax law limits the annual payout from a CRAT to no more than 50% of the initial net fair market value of property in the trust. For CRUTs, annual payments are limited to no more than 50% of the net fair market value of the trust's assets, valued annually. A CRT which fails this test will be treated as a complex trust, with all income taxed to either the trust or its beneficiaries.

[1] The discussion here concerns federal tax law. State or local law may differ.

[2] With a CRUT, exhaustion of the trust assets is considered impossible as payments from the trust are based on a percentage of trust assets, not a fixed dollar payment.

- **10% minimum charitable benefit:** There is a minimum benefit that must ultimately pass to the charity. For CRATs, this minimum is 10% of the initial net fair market value of all property placed in the trust. For CRUTs, the remainder interest passing to the charity must be at least 10% of the net fair market value of trust property, valued as of the date the property is contributed to the trust.

Seek Professional Guidance

Because of the complexity of the law and regulations governing charitable remainder trusts, individuals considering a CRT are strongly advised to consult with an attorney, CPA, IRS enrolled agent, or other competent financial professional. Also, many charitable organizations have professionals on their staffs that can provide insight and guidance in designing and implementing charitable remainder trust planning.

Life Insurance Charitable Plan

For the individual who would like to make a substantial bequest to his or her favorite charity, but does not have sufficient assets to fulfill this desire, a charitable plan consisting of a life policy should be considered.

The policy owner (typically, the insured) can transfer an existing life insurance policy to the charity or contribute the funds necessary to purchase a new policy. Additional tax-deductible contributions can be made to help the charity pay the annual premium. This not only spreads out the amount to be given, but allows one to experience the feeling that comes from sharing with others on a more frequent basis.

If circumstances change, the insured can discontinue making the gifts and the charity will either continue the payments or surrender the policy for the cash values.

Note: Merely naming a charity as a beneficiary of a policy will not produce an income tax deduction, since the owner (insured) still has the power to surrender the policy.

The income tax deduction is limited to the lesser of:

- Donor's cost basis (premiums paid less dividends received in cash and policy loans outstanding); or
- The policy's value, which varies with type of policy.
    - **Ordinary life:** The interpolated terminal reserve (roughly cash value) plus any pre-paid premium.
    - **Paid-up policy:** Present cost of a comparable policy at the donor's current age.
    - **New policy:** The gross premium just paid.
    - **Term insurance:** The portion of premium that is still unearned by the insurer.

[1] This is generally funds to purchase a new policy and a small annual contribution to pay premiums.

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