A Guide to Planned Giving Terms

Charitable Bequest: The most common form of planned gift, a charitable bequest is a written commitment in a will or living trust to transfer a percentage of an estate, a specific amount, or a specific property to charity. Charitable bequests are by nature revocable, and so have no income tax consequences. They do, however, avoid estate tax and so can cost family members a good deal less than the face amount of the bequest.

Life Insurance Designation: A donor makes a planned gift by asking for a beneficiary designation form and adding a charity as a beneficiary of an existing life insurance policy. At death the policy pays the charity the designated amount free of estate tax. (Many people assume insurance distributions are not subject to estate tax because payments are made directly to heirs and are not subject to probate. But as long as the policy was owned by the decedent, it is included in the decedent's estate for estate tax purposes.)

IRA Designation: A donor names a charity to receive whatever remains of a retirement plan when the donor dies. This method has drawn increasing interest because of the growing size of retirement plans and their vulnerability to both income tax and estate tax. Because IRAs are usually funded with untaxed dollars, heirs are subject to income tax if they receive payments from their deceased parents' IRAs. This double tax may leave heirs with as little as thirty cents on the dollar from an IRA. If left to charity, the retirement plan avoids both estate tax and income tax.

Charitable Remainder Trust (CRT): An irrevocable charitable vehicle that allows donors to transfer assets to the care of a trustee who is then obligated to make payments from the trust assets to the donor and/or the donor's beneficiaries for life, or for a specified term of years. When the income rights of the beneficiaries have expired, the trustee passes what remains in the trust to the charities named as remaindermen of the trust.
Charitable Remainder Trust Tax Benefits: The immediate and future tax benefits that flow to the donor and the donor's estate from a charitable trust result from the trust's irrevocable nature and charitable purpose. Benefits include:

- an immediate income tax deduction. The deduction is always less than the face value of the gift at time of transfer. The face value is multiplied by a discount factor. IRS tables determine the deduction which is based primarily on (1) a measure of the current economy called the Applicable Federal Rate (AFR); (2) the ages and number of the trust's income beneficiaries which will affect how long the charity has to wait to receive its remainder interest, and (3) the payment rate of the trust, which determines how hard the trust has to work for the income beneficiaries;
- bypass of capital gains tax on the sale of appreciated assets. The trust does not incur any capital gains tax when it sells appreciated stock or real estate;

- avoidance of estate tax. Whatever passes from the trust to charity is not subject to estate tax.

Charitable Remainder Trust Payment Benefits: the amount and method of payments to the trust's income beneficiaries are determined when the trust is established. By law the payment must be at no less than 5% and no more than 50% of trust principal. (The 50% rule was established in 1997 as the result of bizarre manipulations of charitable trusts for non-charitable purposes.) Several factors determine the payment rate selected:

- the charitable income tax deduction resulting from the payment rate must be no smaller than 10% of the face value of the gift at time of transfer. (This 1997 rule resulted from the use of charitable trusts to benefit the income beneficiaries for so long a time that the benefit to the charity was disproportionately small.) The longer the charity has to wait and the higher the payment rate to the income beneficiaries, the lower the deduction. A deduction less than 10% of the value of the gift at time of transfer will disqualify the trust immediately;
- the payment rate should meet the financial and philanthropic objectives of the donor. A person age 85, for example, might want a 10% payment rate because of a need for high income over a relatively short life expectancy. Even though the high payment rate might eat into trust corpus, the probability is good that charity will still receive a valuable gift. A person, age 60, might choose a 6% payment rate, hoping that the value of the trust corpus will increase over the years and payments to the trust beneficiaries will increase as well.

Charitable Remainder Annuity Trust (CRAT): The payment rate (at least 5%) is applied to the value of the gift at time of transfer to the trust to determine the annual payment. Once determined, the payment never changes. Older people like this because they have predictable income. Too high a payment rate, however, may disqualify the trust. If there is a 5% or greater probability that over time the impact on trust corpus of making the required fixed payments will leave nothing to charity, the trust is disqualified from the beginning. Example: a trust with a 40-year-old income beneficiary and a payment requirement equal to 11% of the gift will have a greater than 5% probability of exhausting the trust before the charity receives anything.

Charitable Remainder Unitrust (CRUT): The donor selects a percentage (at least 5% and no more than 50%) that, once selected, is used at a fixed date each year to determine payments. If the value of the trust rises, so will the payments; if the value of the trust declines, so will the payments. Those wanting a hedge against inflation often choose the unitrust. They usually select a payment below the expected total return of the trust. Their hope is that corpus will grow and their payments will increase over the years. If this strategy works, the charity also benefits from a larger gift when the trust terminates.

Charitable Gift Annuity: This is a contract between a donor and a charity. The charity pays the donor a fixed amount for life in return for the donor's gift of cash or stock (some charities accept real estate). The payment is determined primarily by the age of the annuitant. Most charities follow payment rates suggested by the American Council on Gift Annuities. Older donors like gift annuities because of the relatively high payments that are backed by the charity itself and the simplicity of annuity contracts.

Charitable Pooled Income Fund: This is a device established by a charity that operates much like a mutual fund. Donors open accounts in the fund and receive their proportionate share of whatever income the fund produces. At death, what remains in a donor's account is passed to charity. The pooled income fund offers many of the same tax and income advantages of a charitable remainder trust, but its accounts are simpler to establish and can be set up with a gift as small as $5,000. When interest rates are low, however, pooled income funds are not popular with donors. Income is narrowly defined as income and dividends. Growth of corpus is never shared with the donor.

Family Charitable Lead Trust (CLT): A charitable device to which a donor irrevocably transfers assets. The trust then makes agreed upon payments for a specific period of time to charity. After the payment period, what remains in the trust passes to the donor's family. The charitable lead trust is often described as a charitable remainder trust in reverse: the charity gets income and the family gets trust corpus, instead of the other way around. This device is not used nearly as often as charitable remainder trusts because of its somewhat speculative nature. But it has successfully saved some families thousands of dollars in estate taxes while allowing them to make lifetime contributions to a favorite charity. The more families are faced with estate tax problems, the more likely lead trusts will come into greater favor.
Family Charitable Lead Trust (CLT) Tax Benefits: Family charitable lead trusts provide gift and estate tax benefits rather than income tax benefits. The donor, by transferring an asset to the trust, is making an irrevocable future gift to heirs. The transfer triggers a gift tax. But the commitment by the trust to make annual payments to charity before the heirs receive anything from the trust triggers a simultaneous gift tax deduction which in some cases completely offsets the gift tax. After the trust terminates, assets remaining in the trust pass to the heirs without any additional estate or gift tax. Families wishing to reduce estate tax and to benefit charity typically fund the trust with assets that are likely to appreciate in value. These assets are held in the trust and not sold. (Unlike a charitable remainder trust, charitable lead trusts do not bypass capital gains tax on the sale of appreciated assets.) The gift tax is triggered with when the initial transfer is made to the trust. When the trust assets pass to heirs years later, no further tax is due, even if the assets in the trust have grown greatly in value.

Charitable Life Estate: An irrevocable commitment by a donor to transfer a personal residence or farm to a charity, usually at death, while the donor retains the right to live on the property for life. Once entered into, the life estate agreement triggers an income tax deduction which is based on the value of the property and the age of the individuals holding the life estate. The donor retains responsibility for maintenance, taxes, and other expenses. The charity may not take possession of the property until the life estate expires. Life estate agreements are suitable for individuals who plan to leave a personal residence or farm to charity and who have sufficient resources so that they are not dependent on the sale of the residence to meet their needs. Before entering into a life estate agreement, nonprofit organizations usually consider carefully the value of the property and any liabilities, financial or personal, the prospective life tenants may have. The nonprofit organization, after all, is becoming a landlord, and needs to be assured that the game is worth the candle.