Price & Farrington's Estate and Tax Planning *Fast*Faxts

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Estate, Tax , Business and Wealth Planning for Advisors and Clients

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Estate and Tax Planning Strategies for Charitable Giving: *Doing Well by Doing Good.*

Making charitable contributions allows you to benefit others and yourself. How you make the contributions is important. The Internal Revenue Code gives taxpayers bigger breaks for certain kinds of donations than for others. Here are some smart ways to maximize the tax and estate planning benefits of charitable giving:

Strategy: *Donate appreciated securities instead of cash.* Giving cash is an expensive way to make a donation because you're giving money that has already been taxed. A better idea is to give securities that have increased in value since you bought them. You get a tax deduction for the full market value of the securities and you avoid capital gains tax on their growth.

Example: To fulfill your annual $500 pledge to the March of Dimes, you donate $500 worth of shares in a stock you bought several years ago for $200. If you cashed in these shares, you would owe $45 in tax (15% rate on a $300 capital gain) for a net of $455. As a result, when you donate the shares, you get a $500 tax benefit for an asset worth only $455 to you. You must have owned the appreciated assets for more than 12 months to get the full write-off. Otherwise, your deduction will be limited to your basis (tax cost) in the securities.

Remember that annual deductions for gifts of appreciated property are limited to 30% of your adjusted gross income.

Strategy: *Donate appreciated securities equivalent to your next three to five years' contributions to a local charitable trust.* You can deduct the securities' entire market value in the year you make the contribution and you can designate how and when the funds are disbursed by the charitable trust. The charity doesn't pay capital gains tax on the sale. The March of Dimes (or any IRS-related charity) can sell the shares tax-free and keep the full $500.

Charitable thoughts…

· There are two kinds of people, the givers and the takers. The takers eat well. The givers sleep well.

· Hear about the frustrated wealthy golfer who donated a set of fourteen golf clubs to a local charity? All but one had a swimming pool with it.

· You can't take it with you. You never see a U-haul following a hearse.

***Strategy:* Deduct membership dues paid to a charity to the extent you receive nothing in return.** If you do receive something in return, its value must be subtracted from the gift. Example: If you receive a magazine subscription, the value of that subscription is subtracted from the dues to calculate your charitable deduction. The same is also true when you receive items of nominal value, such as jackets or shirts.

***Strategy:* Get tax breaks for doing volunteer work.** You can't deduct the value of your time or the services you provide as a volunteer, but you can deduct many expenses. Here are some examples…

- You can deduct actual out-of-pocket costs, including any supplies you buy.
- When you host a fundraiser, the cost of invitations, food, drink and other expenses is deductible.
- You can deduct any driving you do for a charitable organization (14 cents per mile) plus tolls and parking fees.
- When you attend a convention of a qualified charity as a chosen representative, you can deduct unreimbursed expenses including reasonable amounts for meals and lodging.
- Travel costs are deductible if you take an active role in leading a trip for a tax-exempt group, such as the Boy Scouts.

***Strategy:* Set up your own charitable foundation.** Contributions of appreciated securities are tax deductible. You control the timing and method of distribution and to whom, as long as the recipient is a fully recognized charity (see IRS Publication 78, *Cumulative List of Organizations*, at *www.irs.gov*, or call 877-829-5500). You can even pay yourself or family members a reasonable salary for operating the foundation.

"I'm donating a portion of your tip to charity."

Contributions to charities are required to equal a minimum of 5% of foundation assets each year, and contributions, once made, cannot be used for any other purpose.

Private charitable foundations have been increasingly abused by taxpayers, which has elevated the IRS's scrutiny of them.

Strategy: *Make a bequest to your private charitable foundation in your will.* The payments to the foundation will completely escape estate tax, and your family members can administer the foundation for years afterwards. They can use payments from the foundation to make charitable donations they would have made from their own funds, thus preserving their cash.

Strategy: *Charitable remainder trusts (CRTs)* can provide you with income and tax deductions when you fund the trusts with appreciated assets. A CRT can sell the assets tax free and pay you—or you and your spouse—income for life. You get an upfront charitable deduction for the charity's remainder interest based on the full value of the assets you donate. Your tax deduction is reduced by the present value of the lifetime income that you and your spouse will receive. The trust pays no tax on the capital gains resulting from the sale of appreciated stocks, which allows 100% of the proceeds of sale to be reinvested.

You can also consider setting up a unitrust CRT**.** This format lets you revalue the CRT's assets each year. As value increases, you can adjust the distribution accordingly. Another option is a CRT annuity trust, where the annual withdrawal amount Is fixed.

Strategy: ***When you donate art and collectibles*** to meet your charitable commitments, you can deduct the full value of the gifts when the items are used in the charity's main activity or for its primary purpose. Examples: You give a painting to a university or use it in an art appreciation course. Or you give a collection of 9th-century magazines to a research library. This deduction does not apply to self-created work, for which the deduction is limited to your basis.

Here's a trap: If, at the time of the donation, it is reasonably anticipated that the charity will sell the property you donate to it, your deduction is limited to your basis in the property—usually, what you paid for it—rather than the full appreciated value. As self-defense, you should shop around for a charity that will use your gift in its main activity. You can also protect your deduction by getting a letter from the charity stating how it intends to use your gift.

Strategy: ***Use a charitable lead trust*** to make annual distributions to a charity while reserving the assets for your children (or grandchildren or other beneficiaries). This creates a current tax deduction for the present value of the charitable deductions. It also lets you transfer the assets to your non-charitable beneficiaries later at a reduced gift tax value because if the assets appreciate, the growth is transferred to your beneficiaries free of gift and estate taxes. These trusts are not intended to provide significant income tax benefits to the grantor.

Strategy: ***Make a charitable bequest*** in your will or living trust that reduces your taxable estate (it's taxable if it exceeds $1.5 million in 2004 and 2005, when assets are not left to a spouse). The charitable bequest directly reduces the amount of your estate that is subject to the estate tax. If the bequest is a share in a business or real estate, however, the estate's charitable deduction might be lower than the asset value in the gross estate. Check this out with your tax advisor.

Strategy: ***Bequeath IRAs and pension funds to charities.*** Generally, the value of an IRA or pension is included in your gross estate and the recipient pays income taxes on the IRA or pension withdrawals. Leaving the funds to a charity avoids income tax as well as the estate tax. If you can choose which funds to leave to charity, you will want to consider selecting an IRA or pension over assets that are not double taxed.

Strategy: ***Give assets to charity during your lifetime,*** not after death. A lifetime charitable contribution reduces your taxable estate and can produce a lifetime income tax deduction, reducing the cost of the contribution. Lifetime giving is also fun.

Strategy: ***Gifts valued at $5,000 or less do not need formal appraisals.*** Contributions over $5,000 need written appraisals, and the appraiser must sign IRS Form 8283, *Noncash Charitable Contributions*. You should use an experienced, qualified appraiser who is familiar with the strict appraisal requirements of the IRS. You can request a special IRS statement of value for gifts of property worth $50,000 or more. Note: Appraisals are not necessary for donations of publicly traded securities, regardless of their value.

Strategy: ***Contribute a qualified "conservation easement"*** and receive a full tax deduction for the current fair market value of the easement. A conservation easement is a permanent restriction on the use of real property. Examples: Empty lots or open space used for soil drainage or wildlife preservation, or a historic building façade.

Sidebar

Use an IRA to be Charitable...and Still Leave More to Your Heirs

Making bequests from your IRA or other tax-deferred retirement account can produce the best overall tax result. The payoff? Deferred income tax can be entirely avoided and you may be able to pass appreciated assets to other heirs who will inherit with a tax-saving step-up in basis.

Example. Jane White is a widow with an estate of $3 million, half in an IRA and half in highly appreciated securities and real estate. She wants to leave $1.5 million to her children and $1.5 million to charities. If the appreciated assets go to charity and the IRA goes to the kids, no federal estate tax will be due under current law. But the children will eventually have to pay income tax on the IRA money as it is withdrawn. At a 35% rate, the ultimate tax bill could be $500,000.

Here is a better approach: Leave the IRA to charity and the appreciated assets to the kids. There will be no estate tax and they will inherit the appreciated assets with a step-up in basis under current law. They would never owe capital gains tax on the appreciation that occurred during Jane's lifetime. The estate passes tax-free, saving hundreds of thousands of dollars.

Here's a cautionary note: planning for charitable bequests at death is the opposite of planning for lifetime donations. While you're alive it often makes sense to give away appreciated assets and let your tax-deferred retirement money continue to compound.

Strategies. There are four ways to make charitable contributions from a retirement plan: (1) Leave your IRA directly to charity; (2) Leave your IRA to your spouse, who will leave it to charity at his/her death; (3) Leave your IRA to a marital trust with all distributions going to your surviving spouse. At his/her death, whatever remains goes to charity; and (4) Leave your IRA to a charitable remainder trust (CRT) which can pay income to any person you want to name, with the charity receiving the remainder interest. (Contact us or go to www.pricefarrington.com to learn more about how CRTs work).

Outright bequests are best if you aren't married of if the bequest is a relatively small part of your estate. If you're married, your spouse might not want to give up the IRA to charity. If you're confident your spouse will be able to handle the IRA wisely and make the appropriate charitable bequest, simply leave the IRA to your spouse. In many situations you'd be better off using a trust, which provides control and protection.

What if you want to leave only $100,000 or $50,000 to charity (not the one-half of a $3 million estate we've been talking about)? Other strategies involve naming co-beneficiaries or splitting your IRA. More about this in a future *Fast-*Faxts. ■

As always, let us know how we can help you help your clients plan better.

For more information, please visit us on the web at www.pricefarrington.com.

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