Wealth Preservation through Philanthropy

By: Leon H. Rittenberg, Jr.

I. INTRODUCTION

Philanthropy may be used as a tax device to **increase** family wealth while simultaneously supporting religious, educational and other charitable institutions. Innovative planning techniques include such vehicles as charitable remainder trusts, lead trusts, bargain sales, gift annuities, donations to public charities, donations to private foundations, donations to donor advised funds and the naming of charities as the beneficiary of tax qualified retirement plans. In addition, there are many variations to these alternatives, such as a NIMCRUT, a FLIP Unitrust, and even a combination of various alternatives.

This is a fun area of the law since everybody wins!

II. CHARITABLE REMAINDER TRUSTS

A charitable remainder trust is an irrevocable trust in which a non-charitable beneficiary receives income and, at the termination of the income interest, the remaining trust corpus is either delivered to a public charity or a private foundation. A donor may transfer cash or appreciated property to an irrevocable inter vivos charitable remainder trust, which trust may sell the appreciated property without paying capital gains taxes. The donor (if the trust owns publicly traded securities) can even serve as the trustee. The donor will benefit from both an income tax savings by creating a charitable remainder trust during life and estate tax savings by reducing his taxable estate.

In addition, the donor may convert non-income producing appreciated assets into income producing assets at no tax cost, may increase his income, and diversify his investments without creating taxable income through this flexible entity.

Charitable remainder trusts include a charitable remainder unitrust which pays a specified percentage of the value of the trust principal each year to the non-charitable beneficiary.
It also includes a charitable remainder annuity trust which pays a specified dollar amount each year to the non-charitable beneficiary. A NIMCRUT is a charitable remainder unitrust which distributes to the income beneficiary the lesser of the trust's income or a specified percentage of the value of the trust principal each year. However, it can include a make up provision. A FLIP unitrust is a charitable remainder unitrust which includes some of the provisions of a NIMCRUT but at a predetermined time the net income distribution limitation is removed. This is an excellent vehicle to use for retirement planning.

Insurance is an excellent vehicle to use in conjunction with charitable remainder trusts in order to replace the trust corpus that ultimately goes to a charity. This can, depending upon the needs of the client, be acquired in trust or outright by the donor's beneficiary but funded by the donor.

III. CHARITABLE LEAD TRUST

A charitable lead trust is essentially the reverse of a charitable remainder trust. It is an irrevocable trust in which the charitable beneficiary receives income, but at the termination of that income interest, the trust corpus is distributed to a non-charitable beneficiary. This vehicle can be used as an estate tax saving method for transferring assets to grandchildren.

IV. NAMING A CHARITY AS A RETIREMENT PLAN BENEFICIARY

Retirement plan assets are usually subjected to both income and estate taxes since the income is defined as income in respect of a decedent. Therefore, the total taxes due at death on retirement plan assets not transferred to a spouse can be approximately 80% of the value of these assets. It is often beneficial to name a charity as the beneficiary of these assets and thereby avoid incurring these taxes. The charitable beneficiary can be a private foundation controlled by the decedent's family and used as a vehicle for the decedent's descendants future charitable contributions and, if need be, to even fund a reasonable salary for the family member managing the foundation.

V. CHARITABLE GIFT ANNUITY

A charitable gift annuity is a contract that can be created in less than one page. The creator or purchaser of the annuity can obtain an income tax deduction for a substantial portion of the annuity cost. The annuity can be acquired with appreciated securities without incurring immediate capital gains taxes and a portion of the annuity may be received tax free or subject only to capital gains taxes.

VI. DONOR ADVISED FUND - SUPPORTING FOUNDATION

The tax laws provide greater benefits to a public charity than to a private foundation. Therefore, under certain circumstances, the better financial planning vehicle is through a public charity than through a private foundation. Not only can tax benefits be greater, but also administration expenses can be less onerous. A supporting foundation is a nonprofit entity that gains public charity status by being affiliated with a public charity. It is a separate entity with its own governing instruments and its own board of directors, but a majority of the board of directors is designated by the public charity. A donor advised fund is merely a fund created by the taxpayer and deposited with a public charity. As a practical matter, the donor is able to direct how said funds are disbursed, i.e. to what charities they are given, and can have some input as to how the funds are invested. However, the public charity must have the final say and legal control.

VII. PRIVATE FOUNDATION

A donor can create an inter vivos private foundation and obtain, in effect, both an income tax deduction and an estate tax deduction for the amount contributed to the private foundation. In addition, the taxpayer, by donating appreciated securities to this foundation, rather than selling them, may also save capital gains taxes. Space does not permit including a chart showing the effect of making an indirect gift to children through the creation of a supporting foundation. However, a donor can make an indirect gift through his supporting foundation which actually results in the donee's utilizable funds being significantly greater than the funds donated to the foundation, albeit most of the funds must ultimately be utilized for charitable purposes, with the exception that a reasonable salary may be paid the foundation managers who may be family members.

VIII. LAGNIAPPE

It is better for a donor to bequeath an asset to his or her spouse rather than directly to a charity in the event that the donor wants to make a charitable bequest. The reason for this is that a spousal bequest is free of estate taxes in the same manner as a charitable bequest. However, if the donor makes the bequest to his or her spouse and the spouse then makes an inter vivos donation to the donor's favorite charity, then the spouse obtains an income tax deduction in the amount of the donation. This results in both an income tax and an estate tax donation for a so-called charitable bequest while if the donor makes a charitable bequest directly, then the income tax deduction is not available.

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