MCF Private Trust

Charitable Giving Strategies and Opportunities

People have a number of different reasons for charitable giving. Some give to support their personal values, such as specific interests, others due to concerns about a legacy, and some with a view to philanthropic intent combined with estate planning opportunities. Regardless of the intent, though, charitable giving is a highly personal decision, and your clients should discuss their plans not only with their families and loved ones, but also with their financial, tax, and legal advisors. In this newsletter, we discuss how the recently passed Tax Cuts and Jobs Act (the "Act") dramatically alters the income tax landscape for your clients' philanthropic practices, and review two of the last remaining true tax shelters available.

The Act substantially changes the rules for your clients who make outright gifts of cash or other assets. The act lowers individual income tax rates, which will reduce the value of all charitable deductions. Moreover, the cap on deductibility of state and local income taxes, combined with the increase in the standard deduction, will significantly reduce the number of taxpayers who will itemize deductions.

A way to maximize the value of charitable giving is to bunch outright donations into fewer larger gifts made every few years in order to exceed the standard exemption and get credit for the gifts. This can be done efficiently by using a donor advised fund. A large contribution could be made every 3 to 5 years, pushing the deduction amount over the standard deduction and thus giving credit for the gift. Then the donor can make their regular annual charitable gifts from the donor advised fund. The tax deduction is taken when the funds go into the fund, not when payment is made to the charity, so the contribution-deduction years can be bunched, while the distributions can still be made annually, which may be important to charities that rely on the regular donations for cash flow. Consider providing your clients more information on donor advised funds, as well as estimating client deductions and how bunching may help the deductibility of their charitable contributions.

Charitable Lead Trusts

Another way to achieve the bunching of deductions is through the use of a charitable lead trust (CLT). These trusts are designed for those who have assets or funds in excess of that on which they need to live, and can commit that excess to providing a regular payment stream to charity. The tax benefits available with a CLT generally hinge on two considerations: 1) whether the trust is considered owned by the grantor and therefore produces a charitable deduction, and 2) whether the remainder interest reverts to the grantor or is paid to third parties, such as the grantor's family. In the typical CLT trust situation, the grantor receives a charitable contribution in the year the trust is created that is equal to the net present value of the income stream passing to the charity. At the end of the term, the trust assets will revert either to the grantor or their estate, or be distributed to a remainder beneficiary named in the trust, such as a child or grandchild. As noted earlier, a CLT may allow the grantor to achieve the desired bunching effect mentioned earlier, and if properly drafted may also provide additional benefits in the form of estate and gift tax exclusions (although the remainder interest would be includible in the grantor's estate).

Charitable Remainder Trusts

A charitable remainder trust (CRT) is, in some ways, a mirror reflection of the CLT, in that it can provide a guaranteed source of income to the grantor (and other noncharitable beneficiaries such as the, if so drafted), and the remainder interest is paid to a charity. However, many of the rules that govern the operation and taxation of CRTs differ significantly from those applicable to CLTs. For example, a CRT is a tax-exempt entity, while a CLT is not.

Like a CLT, the CRT is a split interest trust consisting of an income interest, which is paid to the donor or other beneficiary during the term of the trust, and a remainder interest, which will pass to the designated charity. A CRT may be a charitable remainder annuity trust, or CRAT, where the amount received by the income beneficiaries does not change over the years, or more commonly a charitable remainder unitrust, or CRUT, where the income beneficiaries receive a stated percentage of the trust's assets each year.

A CRT can be a very powerful strategy for a client with significantly appreciated assets, as the donor will not realize gain when the property is transferred to the trust. Since the CRT is tax exempt, it pays no tax if it sells the donated property to realize its appreciated value. Moreover, the donor receives an income and gift tax deduction equal to the net present value of the remainder interest that will pass to charity. This is the beauty of a CRT – it can provide a substantial current charitable deduction to the grantor of the trust, provide a substantial stream of income to the grantor and their beneficiaries, and the appreciation realized when appreciated assets are sold by the charity will go forever untaxed.

All of these strategies have detailed requirements that can be traps for the unwary and can lead to some very unintended and unfortunate consequences. For this reason, it is important for you as an advisor to bring in qualified experts to plan a tax strategy around a client's charitable giving program. Before embarking on such a strategy, however, you first need to have a conversation with your client about their visions and plans for realizing their philanthropic goals, and how those integrate with their overall wealth management strategy.