

**GIFTING STRATEGIES AND OPPORTUNITIES FOR
TAX EXEMPT ORGANIZATIONS**

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Introduction.

Section 501(c) of the Internal Revenue Code sets forth the rules governing tax exempt organizations. Section 501(c)(3) exempts organizations involved in charitable, scientific, religious and educational organizations from income tax. These exempt organizations are required to spend certain percentages of donations and income on their stated purposes, and the amount of political and lobbying activity is limited.

As a matter of public policy, Federal and State Governments encourage individuals and businesses to give to exempt organizations by allowing them to deduct contributions from their gross income on their income tax returns. Of course, there are rules regarding receipts, gift valuations, and the size of the gift that can be made.¹

Competition for Charitable Donations

The competition for donations from tax exempt organizations continues to grow. On a daily basis, donors receive solicitations from their churches and

¹ Donor's gifts to public charities, private operating foundations, and certain private foundations may deduct contributions representing up to 50% of the donor's adjusted gross income if the individual itemizes on his tax returns. Individuals giving private foundations may generally deduct contributions representing up to 30% of their adjusted gross income. Corporations may deduct all contributions to 501(c)(3) organizations up to an amount normally equal to 10% of their taxable income.

synagogues, their alma maters, or an invitation to a 5K run or golf outing for a charity.² It is therefore important for exempt organizations which depend significantly on private donations to understand the different and creative ways that donors can make gifts so that they can craft strategies to maximize their fundraising efforts.

Exempt Organizations should consider joining forces with other organizations with similar missions. With the proliferation of charitable organizations, a new group can often become an established name under another organization's banner, without the need for infrastructure and overhead.

Finally, exempt organizations need to clearly communicate to its donors how each gift is to be used by the organization. Organizations have internal competing goals – short-term operating and program needs versus long-term capital (new buildings) and endowment needs. Exempt organizations need to prioritize their fundraising when requesting funds, and they need to have controls in place to ensure that funds are properly designated by a donor.

Basic Charitable Gifting Strategies.

a. Cash. All exempt organizations appreciate gifts of cash. No additional actions need to be taken, like selling stock or art. For the donor, it is also simple: the cancelled check becomes the receipt, and the entire amount is deductible from donor's gross income, within limits noted in footnote 1.

²The growth in United States 501(c)(3) organizations in the past three years has been 15%.

b. Gifts of Stock. Publicly traded stocks are great gifts for an exempt organization to receive. The only requirement for the charitable organization is to have a brokerage account so that stock gift can be held or sold.

For the donor, there can be many benefits to a gift of appreciated stock. One may be the avoidance of capital gains on the stock. For example, let's suppose the donor purchased one share of stock for \$10 in 1970, and the current market value is \$110. The capital gains on the stock is \$100, which would result in a 15% federal capital gains tax, and a state capital gains tax of between 5-10%. If this share of stock is gifted to an exempt organization, the donor receives the benefit of a \$110 deduction, and avoids the capital gains tax on the share of stock. The exempt organization does not pay the capital gains tax when the stock is sold.

c. Beneficiary designations. Many donors are reluctant to give up control of significant assets while they were still alive. The same donors, however, may feel more comfortable making gifts after their passing by changing their beneficiaries on certain accounts. For example, a donor can have a certificate of deposit (CD) with a bank that permits a POD, or a payable on death, beneficiary designation. This can be a charity, school, or other exempt organization. This charitable gift reduces the taxable estate.

Similarly, an individual can make a gift of their IRA or 401(k) account or a percentage of the account to a charity or charities upon their passing. This provides the donor with the comfort level that they will have sufficient assets while they are alive while also fulfilling their charitable intents after their death.

Donors can also be creative with life insurance policies. When a donor has an insurance policy, they can make the exempt organization a beneficiary of some or all of the death benefit of the policy. For example, the beneficiary designation could say my spouse receives 50%, my children receive 35%, and an exempt organization receives 15% of the death benefit.

There are also interesting types of policies out there known as “One-Pay” policies. A One-Pay policy is a gift to the charity of a sum of money which is a one premium policy. For example, a donor could make a one-time gift of \$10,000 to an exempt organization. The school, church or charity use the gift to purchase a life insurance policy on the donor for a fixed benefit amount when the donor dies. One-Pay policies are excellent ways for exempt organizations to begin to build their endowments and long-term capital funds. Obviously, the amount of the death benefit depend on the age and insurability of the donor.

This strategy can also be coupled with the stock gift strategy discussed above. The donor makes a stock gift in the amount of \$10,000 of appreciated securities and obtains a full deduction for that gift, while avoiding the capital gains taxes on the appreciation of the stock. The organization converts the stock to cash, and purchases a policy on the donor’s life. When the donor dies, the organization receives the death benefit.

Advanced Charitable Giving.

a. Last Wills and Testaments and Trusts. It is relatively simple for a donor to make a specific bequest in their will or irrevocable trust so that a gift passes to an exempt organization at their death. Yet Wills and Trusts fall into the advanced category for several reasons. First, the donor needs to complete their estate plan. Second, spouses and minor children have special protections in estate law that may run contrary to a charitable bequest. Finally, heirs can challenge a Will or Trust on the grounds that a donor is incompetent or that someone exercised undue influence over the donor.

Despite these issues, which can be addressed with proper planning, testamentary gifts are essential for the long-term health and viability of exempt organizations. An organization cannot depend on testamentary gifts for current cash flow, but they are essential for funding capital projects like buildings and renovations. Gifts from estates are one of the prime ways in which exempt organizations endow scholarships and create new programs.

For the donor, these testamentary gifts reduce their taxable estate. With federal and state estate tax rates ranging between forty five and fifty five percent, many individuals prefer to see their assets used for charitable or educational purposes instead of used for taxes. Testamentary gifts are not subject to the limits described in footnote 1.

b. Charitable Gift Annuities. A charitable gift annuity is a contract (as opposed to a trust) under which an exempt organization, in return for a transfer of cash, marketable securities or other property, agrees to pay a fixed sum of money each year for a period measured by one or two lives (not a fixed term of years). A person who receives payments is called an “annuitant” or “beneficiary.” For federal and state income tax purposes, a portion of the payments is considered to be a partial tax-free return of the donor's gift, which is spread in equal payments over the life expectancy of the annuitant(s). The contributed gift, given irrevocably, becomes a part of the organization's assets, and the payments are guaranteed by the organization. The exempt organization must maintain some reserves for the anticipated annuity payments.

The amount of the payment to the donor varies based on their age(s). Standard rates are provided by the American Counsel on Gift Annuities (“ACGS”), which are the standard for many States.

Here is an example: a donor (age 80) and spouse (age 78) make a \$100,000 donation to an exempt organization to purchase a charitable gift annuity. The ACGA rate requires a 9%, or \$9,000 annual payout based on their ages. Assuming that the combined life expectancy is 8 years, the total projected payout is \$72,000, which has a present value of approximately \$53,000. That would make the donor's tax deductible gift \$47,000 (\$100,000 less \$53,000). From a federal income tax standpoint, for each payment of \$9,000, 53% is treated as a return of capital and 47% is treated as taxable income to the annuitant when received.

c. Charitable Trusts. During a Donor's lifetime or by Will, the Donor makes an irrevocable gift to a Trust. The Trust pays annual amounts to the Donor or his beneficiaries for either a fixed term or for the donor's life. When the term expires or the donor dies, the Charity receives the balance of the gift. This is called a Charitable Remainder Trust. A Charitable Lead Trust does the opposite - income from the gifted asset goes to the charity during the donor's life, and the balance of the trust assets revert to the donor's beneficiaries.

A charitable remainder or lead trust can be an Annuity trust or a Unitrust. An Annuity Trust pays a fixed sum to the beneficiaries, whereas a Unitrust pays a fixed percentage of the fair market value of the trust assets to the beneficiaries.

The entire gift to the Charitable Trust is not deductible. Similar to the Charitable Gift Annuity, the gift is calculated to be the remainder or the income that the exempt organization will receive from the gift, based on tax and life expectancy tables.

Unfortunately, Charitable Trusts were abused in the past. As a result, some exempt organizations received little or no benefit from the gifts. Congress addressed this problem with the Tax Reform Act of 1997, which imposed strict rules on the pay-out schedules to ensure that exempt organizations received a minimum percentage of the donation.

d. Property Gifts. Gifts of real and personal property have received a lot of attention in recent years from the IRS. Many organizations would be excited to receive ten percent of a large tract of land that may be developed in the next five years. There are several major issues, but two in particular that impact the tax exempt organization.

The first issue is the valuation of the gift. Donors want to maximize their charitable gifts for income and estate tax planning. What is ten percent of that office building worth? How about that piece of artwork? If the organization accepts the value placed on the gift by the donor, it could find itself in the middle of a tax controversy with the IRS. Appraisals and gift tax returns are a defense, but who pays for these – the donor or the organization?

The second issue is gift liquidity. The ability to convert real property or personal property into cash that pays the organization's program expenses and expenses are a strong consideration before accepting such a gift. What happens when an organization receives a gift of ten percent of a large parcel of land, but the family members still control ninety percent of the interests? The exempt organization may be restricted in its ability to sell its interest, yet the organization remains liable for ten percent of the taxes and insurance for the property. The organization needs to play an active, but diplomatic role in the planning process with these donors or run several major risks with its donors.