Special Financial Planning Opportunities in June 2020 with a Focus on Charitable Planning

Russell James, J.D., Ph.D., CFP®
Professor, Personal Financial Planning
Texas Tech University
There are special one-time opportunities for 2020 in the U.S.

- June/July § 7520 interest rates are the lowest in history
- Can eliminate 100% of income with charitable deductions
From simple to complex

1. The strategies
2. How things changed
1. Gifts of assets make sense because a drop doesn’t mean it isn’t still worth more than you paid for it
2. And not everything is lower than Jan 1, 2020

- Gold YTD return: 12.68%
- NCREIF Farmland property index 2020 Annual Total +3.98%
- WalMart, Amazon, Pharmaceuticals, Clorox are also big winners so far
Appreciated asset gifts are objectively cheaper

Tax deduction only

Tax deduction + Avoid capital gains tax
Asset gifts are cheaper for itemizers

**Donor**

$100k Cash

**Nonprofit**

Income tax deduction

($100,000 x 37%)

$37,000

Costs $63,000

**Donor**

$100k Stock

**Nonprofit**

$37,000

+$

Avoid capital gains

($90,000 x 23.8%)

$21,240

Costs $41,760
Asset gifts are cheaper for non-itemizers

Donor

$100k Cash

Nonprofit

Income tax deduction
($100,000 x 37%)

$37,000

Avoid capital gains
($90,000 x 23.8%)

$21,420

Costs $100,000

Donor

$100k Stock

Nonprofit

Costs $78,598
Asset gifts got EVEN cheaper for those in other states

**Donor**

- **$100k Cash**
  - Net cost $52,000 in ‘18 vs. $53,756 in ‘17

- **$100k Stock**
  - Net cost $20,680 in ‘18 vs. $26,356 in ‘17

**Nonprofit**

**2017**

- Income tax deduct. ($100,000 x 39.6%)
  - $39,600 fed
  - ($100,000 x 11%) = $11,000 state
  - $20,600 + $6,644 = Net cost $27,244

- Avoid capital gains ($90,000 x 23.8%)
  - $21,420 fed
  - ($90,000 x 11%) = $9,900 state
  - $11,520 + $6,644 = Net cost $18,164

**2018**

- Income tax deduct. ($100,000 x 37%)
  - $37,000 fed
  - ($100,000 x 11%) = $6,644 state
  - $30,356 + $6,644 = Net cost $37,000

- Avoid capital gains ($90,000 x 23.8%)
  - $21,420 fed
  - ($90,000 x 11%) = $9,900 state
  - $11,520 + $9,900 = Net cost $21,420
No need to change your portfolio!

The Charitable Swap

$100K new stock (high basis) → $100K old stock (low basis)

Donor

$100K cash → immediately buy identical stock (100% basis)

Nonprofit

No “wash sale” rule because this is gain property, not loss property.
The Charitable Swap with a DAF

$100K new stock (high basis)
$100K old stock (low basis)

Donor

$100K cash

immediately buy identical stock (100% basis)

Donor Advised Fund

$100K cash

immediately buy identical stock (100% basis)
What predicts who will donate noncash assets?

No significant differences for gender, other age distinctions, marriage, childlessness, African-American, Caucasian, Asian

1. High Income
2. High Education
3. Age 65+
1. Giving cash to education was 2x more responsive to tax price than giving cash to religion.

2. Giving stocks, bonds, or mutual funds to any charity was 10x more responsive to tax price than giving cash to education.

Tax incentives matter more.
How to talk about gifts of assets
Should you mention tax benefits?
Social Desirability Bias

People report socially-approved motivations

Other motivations must be tested, not self-reported
Avoid capital gains tax by making a gift of stocks or bonds to a charity.

Make a gift of stocks or bonds to charity.

1,006 Respondents
Groups X/Y

Mentioning tax deductions increases charitable interest

Interested Now: 20%
Interested Will Never Be Interested: 17%

14% 23%

Random assignment

Mentioning tax deductions increases charitable interest

<table>
<thead>
<tr>
<th>Interested Now</th>
<th>Will Never Be Interested</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>50%</strong></td>
<td><strong>8%</strong></td>
</tr>
<tr>
<td><strong>33%</strong></td>
<td><strong>14%</strong></td>
</tr>
<tr>
<td><strong>31%</strong></td>
<td><strong>20%</strong></td>
</tr>
</tbody>
</table>

1,904 Respondents Groups D/E/F

Receive a tax deduction and make a gift that pays you income for life.

Make a gift that pays you income for life and receive a tax deduction.

Make a gift that pays you income for life.


Random rotating assignment
Mentioning tax deductions increases charitable interest

<table>
<thead>
<tr>
<th>Interested Now</th>
<th>Will Never Be Interested</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>26%</strong></td>
<td><strong>23%</strong></td>
</tr>
</tbody>
</table>

*Immediately receive a tax deduction for 70% of the value of a house or land by making a charitable gift of the property, but keeping the RIGHT TO USE it for the rest of your life.*

<table>
<thead>
<tr>
<th>12%</th>
<th><strong>33%</strong></th>
</tr>
</thead>
</table>

*Make a charitable gift of either a house or land, but keep the RIGHT TO USE for the rest of your life and immediately receive a tax deduction for 70% of the value of the property.*

<table>
<thead>
<tr>
<th>11%</th>
<th><strong>42%</strong></th>
</tr>
</thead>
</table>

*Make a charitable gift of either a house or land, but keep the RIGHT TO USE it for the rest of your life.*

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1,826 Respondents, Groups F/B/D
1,782 Respondents, Groups E/A/C

**Random rotating assignment**

<table>
<thead>
<tr>
<th>Interested Now</th>
<th>Will Never Be Interested</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>28%</strong></td>
<td><strong>17%</strong></td>
</tr>
</tbody>
</table>

- Get an **immediate tax deduction** by making a gift where you still control the investment of the assets, and receive income from the investments for the rest of your life with anything left over going to charity at your death.

- Make a gift where you get an **immediate tax deduction**, still control the investment of the assets and receive income from the investments for the rest of your life with anything left over going to charity at your death.

- Make a gift where you still control the investment of the assets, and receive income from the investments for the rest of your life with anything left over going to charity at your death.


Mentioning tax deductions increases charitable interest
Best phrasing to describe tax benefits
Avoid taxes by giving stocks

How to avoid taxes by giving stocks

Save taxes by giving stocks

Tax tips when giving stocks

Avoiding capital gains taxes by giving stocks

Giving stocks

Please rate your level of interest in clicking on the button to read the corresponding information.
Avoid taxes by giving stocks

How to avoid taxes by giving stocks

Save taxes by giving stocks

Tax tips when giving stocks

Avoiding capital gains taxes by giving stocks

Giving stocks

I might be/am definitely interested

28% Avoid taxes by giving stocks

27% How to avoid taxes by giving stocks

25% Save taxes by giving stocks

24% Tax tips when giving stocks

24% Avoiding capital gains taxes by giving stocks

16% Giving stocks

Accepting noncash gifts is safer today

- Using DAFs that accept any asset type
- Using new instruments like the single-asset LLC
No Required Minimum Distributions for 2020, but you can still give up to $100,000 with QCDs!

- IRAs or IRA rollovers only; no 401(k), 403(b), SEP, SIMPLE, pension or profit sharing plans
- Participant 70 ½ or older
- $0 income
- $0 deduction
- $100,000 per person maximum
- No private foundations, donor advised funds, charitable trusts, or charitable gift annuities

$10,000
The SECURE Act’s “above-the-line” charitable deduction

A donor couple has earned income, but doesn’t want to add to combined IRA balance

RESULT:
An unusable itemized deduction

RESULT:
An above-the-line $7,000 deduction for Wife’s IRA contribution regardless of her age. No change in combined IRA balance: $7,000 shift from Husband’s IRA to Wife’s IRA. A $7,000 reduction in Husband’s Required Minimum Distribution with no income recognition.
Retirement plan assets inherited by non-charitable beneficiaries are reduced by income tax.
A client with a $1MM IRA and a $1MM house wants to leave one to her child and one to charity. Does it matter which goes where?
IRA(child); House(charity)

$1,000,000 House
$1,000,000 to charity

$1,000,000 IRA
-$370,000 (37% federal income tax)
-$133,000 (13.3% California state income tax)

$497,000 to child

SECURE now requires faster withdraw (10 years)

IRA(charity); House(child)

$1,000,000 IRA
$1,000,000 to charity

$1,000,000 House
-$0 (no income tax)

$1,000,000 to child
Retirement plan charitable beneficiaries

- A public charity
- A private family foundation
- A charitable remainder trust
Bad retirement plan death beneficiaries

• Not Charitable Lead Trusts (because they aren’t tax exempt)
• Avoid naming estate as beneficiary with instructions in estate documents (estate itself may have to pay income taxes)
Charities are not “designated beneficiaries”, so could accelerate RMD’s for other beneficiaries. Solutions:

• Separate IRAs into a 100% charitable and 100% non-charitable account before death (+ RMDs can be taken from either to match desired plans)

• Beneficiaries can separate accounts by end of year following participant death\(^1\)

• Payout charity share before September 30 of year following participant death.\(^2\)

• If spouse is beneficiary, simply roll that share into spouse’s IRA

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1. Treas. Reg. sec. 1.401(a)(9)-8 Q&A 2(a)
2. Treas. Reg. sec. 1.401(a)(9)-4 Q&A 4(a)
Charitable Gift Annuities

Initial Gift

Lifetime Payments

The hot new item?
Payments are a fixed obligation of the charity, regardless of market events.
<table>
<thead>
<tr>
<th>Age</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>30</td>
<td>2.8%</td>
</tr>
<tr>
<td>40</td>
<td>3.3%</td>
</tr>
<tr>
<td>45</td>
<td>3.5%</td>
</tr>
<tr>
<td>50</td>
<td>3.7%</td>
</tr>
<tr>
<td>55</td>
<td>4.0%</td>
</tr>
<tr>
<td>60</td>
<td>4.3%</td>
</tr>
<tr>
<td>65</td>
<td>4.7%</td>
</tr>
<tr>
<td>70</td>
<td>5.1%</td>
</tr>
<tr>
<td>75</td>
<td>5.8%</td>
</tr>
<tr>
<td>80</td>
<td>6.9%</td>
</tr>
<tr>
<td>85</td>
<td>8.0%</td>
</tr>
<tr>
<td>90+</td>
<td>9.0%</td>
</tr>
</tbody>
</table>

Example donor ages & rates

April 2020, American Council on Gift Annuities

Rates will drop on July 1. Motivate donors to act now!
I want income that won't change (CRUT or PIF) or run out (CRAT)
Large charitable gift annuity use increased following market volatility

A charitable remainder annuity trust backed by donor’s initial investment

A charitable gift annuity backed by all assets of a large charitable institution
Taxation of Charitable Gift Annuities
Charitable Deduction

Ordinary Income

Tax Free Return of Investment

Capital Gain

Gift Taxes

Annuity $4,000

Charitable Deduction
Charitable deduction is the value of what you give less the value of what you get back.
$100,000 Cash – Value of Annuity
Charitable Deduction

Donor gives $100,000
Charity pays age 55 donor $4,000 per year for life
Deduction is falling as annuity value is increasing. Bad if you want to use the deduction.
7520 Rates
February Rate: 2.2%
March Rate: 1.8%
April Rate: 1.2%
May Rate: 0.8%
June/July Rate: 0.6%

Suppose a donor, age 55, donates $100,000 for a charitable gift annuity paying $4,000 per year. (This matches the current ACGA rate of 4%.) The charitable deduction for that gift using the April rate is $14,340. Using the February rate it is $25,277.
New attraction to CGAs

If funded with cash, the income tax deduction can eliminate 100% of income in 2020. (Connect with me on LinkedIn for the full paper on this.)

If the donor can’t use charitable tax deductions, lower interest rates are better for CGAs because a larger share of the annual payments will be considered as tax-free return of the original investment.
What is a “qualified contribution”? First, the taxpayer must elect this treatment for the gift. Also, the gift can’t go to a donor advised fund or a supporting organization. Finally, a “qualified contribution” requires

(i) such contribution is paid in cash during calendar year 2020 to an organization described in section 170(b)(1)(A)

To break it down, a “qualified contribution” is a deductible “contribution,”
1. “paid in cash”
2. “during calendar year 2020”
3. “to an organization described in section 170(b)(1)(A)”
   (i.e., a public charity).
If the donor can’t use charitable tax deductions, then the situation reverses

• The lower §7520 rates are actually better
• because a larger share of the annual payments will be considered as tax-free return of the original investment.
• The original investment is the amount paid for the CGA less the charitable deduction.
• As the deduction gets smaller, the original investment gets larger.
Part of each annuity check just gives you back some of the money you paid.

- **Initial Gift**: Charity $100,000 (1/31/2015)
- **Annual Payments**
  - 1/31/2016: Donor $4,000
  - 1/31/2017
  - 1/31/2018

+ Return of Investment

Earnings
The rest is earnings (taxable)
There is NO tax on getting back your own money
\[ \text{Annual return of investment} = \frac{\text{Original life expectancy}}{\text{Earnings}} \]

\$ used to buy annuity

\text{Original life expectancy} = \text{Annual return of investment}

\text{NOT the deductible gift part of the transaction}
Deduction is falling as annuity value is increasing. Good if you DON’T want to use the deduction.
Testing Charitable Gift Annuity Ad Messages

People like me do things like this

What “you” would do or what another donor has done?

You make a gift and receive a tax deduction and yearly income for life. Any unused gift amount will go to the charity at the end of your life.

Interested Now
Definitely/somewhat/slightly
All: _____%
55+: _____%

Sara made a gift and received a tax deduction and yearly income for life. Any unused gift amount will go to the charity at the end of her life.

Gift Annuity

All: _____%
55+: _____%

Please rate your interest in pursuing the above described charitable giving arrangement
What “you” would do or what another donor has done?

- **Gift Annuity**
  - You make a gift and receive a tax deduction and yearly income for life. Any unused gift amount will go to the charity at the end of your life.
  - **Interested Now**
    - **All:** 33.5%
    - **55+:** 23.2%

- **Gift Annuity**
  - Sara made a gift and received a tax deduction and yearly income for life. Any unused gift amount will go to the charity at the end of her life.
  - **Interested Now**
    - **All:** 38.6%
    - **55+:** 38.6%
Sara made a gift and received a tax deduction and yearly income for life. Any unused gift amount will go to the charity at the end of her life.

Gift Annuity

Please rate your interest in pursuing the above described charitable giving arrangement: % Interested now (definitely/somewhat /slightly)

All: ____%  
55+: ____%  

All: ____%  
55+: ____%
Sara made a gift and received a tax deduction and yearly income for life. Any unused gift amount will go to the charity at the end of her life.

Please rate your interest in pursuing the above described charitable giving arrangement: % Interested now (definitely/somewhat /slightly)

All: 38.6%
55+: 38.6%

All: 31.1%
55+: 29.8%
What’s the problem with the donor picture? Is it just this photo? This donor age? Is it photos in general or what?
Sara made a gift and received a tax deduction and yearly income for life. Any unused gift amount goes to the charity at the end of her life.

<table>
<thead>
<tr>
<th>Age Group</th>
<th>Interest Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>55+</td>
<td></td>
</tr>
<tr>
<td>35-54</td>
<td></td>
</tr>
<tr>
<td>U-35</td>
<td></td>
</tr>
</tbody>
</table>
People like me do things like this
How do these compare with text only or a non-donor photo?
Similar [dissimilar] age donor photos did better [worse] than text only or non-donor photo

Why?
The association was completely explained (mediated) by the answer to one question...
How much do you identify with Sara?

☐ She is not at all like me
☐ She is not really like me
☐ She is a little bit like me
☐ She is somewhat like me
☐ She is a lot like me

People __me__ do things like this
Non-Grantor Charitable Lead Trust

Donor gives money from which charity receives payments, with remaining amount going to family members.
Using non-grantor Charitable Lead Trusts to cut gift and estate taxes
Gift taxes are not paid on the **ACTUAL** remainder that eventually goes to the heirs.

Gift taxes are paid on the present value of the **PROJECTED** remainder going to the heirs.
If the **ACTUAL** amount is higher than the **PROJECTED** amount, this part goes to heirs tax free.
The **PROJECTED** remainder assumes investment growth at the **INITIAL** §7520 rate.

If actual growth is greater than the §7520 rate, the **ACTUAL** remainder will be greater than projected.
The **PROJECTED** remainder of $10MM at 0.8% §7520 with $543,060/year charitable payments for 20 years is $0, resulting in $0 gift taxation.

If actual growth is 8%, the **ACTUAL** remainder will be $21,758,079.
If the charitable gift (or bequest) was already planned, the zeroed-out CLAT (or zeroed-out testamentary CLAT) provides a no cost chance at tax-free transfers to family.
Non-Grantor CLT pays income taxes but deducts charitable distributions usually without income limitations

(Non-Grantor) CLT taxed on income

Donor

Initial Transfer

Payments for Life/Years

Charitable deductions to CLT with no income limitations

Anything Left Over

Donor’s heirs

CLT can also pay out any income in excess of annuity or unitrust amount

Charity

Donor (Non-Grantor) CLT taxed on income

Payments for Life/Years

Charitable deductions to CLT with no income limitations

IRS
Grantor CLT
Donor immediately deducts present value of all future projected payments to charity
Funding $10,000/year gifts through a 20-year grantor CLAT (returning remainder to donor) creates an immediate deduction of

• **$184,142 at 0.8%** §7520 rate

• **$98,181 at 8%** §7520 rate

See iclat.net
Charitable Remainder Trusts

1. Avoid capital gains tax
2. Get a tax deduction

Donor ➔ Initial Transfer ➔ CRT ➔ Anything Left at Death ➔ Charity

Payments During Life

Professor Russell James
Texas Tech University
What is a “qualified contribution”? First, the taxpayer must elect this treatment for the gift. Also, the gift can’t go to a donor advised fund or a supporting organization. Finally, a “qualified contribution” requires

(i) such contribution is paid in cash during calendar year 2020 to an organization described in section 170(b)(1)(A)

To break it down, a “qualified contribution” is a deductible “contribution,”
1. “paid in cash”
2. “during calendar year 2020”
3. “to an organization described in section 170(b)(1)(A)” (i.e., a public charity).
Benefit of Charitable Remainder Trust

- Income with no upfront capital gains tax (less gain now)
- Tax deduction (CRUT no change, CRAT down)
CRAT disqualified if >5% chance of exhaustion due to annuitant longevity

STEP 1: Using §7520 rate, at what age will the CRAT exhaust?

Using a financial calculator solve for n (number of time periods) after entering present value (initial CRAT assets), rate (§7520 rate), payments, and setting future value to 0. The underlying formula is

\[ n_{PV} = \frac{\ln \left( \frac{1 - \frac{PV(r)}{P}}{1 + r} \right)}{\ln(1 + r)} \]

- \( n \): number of periods
- \( PV \): Present Value (of Annuity)
- \( r \): rate
- \( P \): Payment/Cash Flows

STEP 2. Is there >5% chance the donor will live that long?

(\( l_x @ \text{age-of-exhaustion} / l_x @ \text{current-age} \), using Table 2000CM at www.irs.gov/Retirement-Plans/Actuarial-Tables )

Can draft around with Rev Proc 2016-42. Pays out when hits 10% PV
<table>
<thead>
<tr>
<th><strong>Sale</strong></th>
<th><strong>CRUT</strong></th>
<th><strong>ILIT</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>$1,000,000 asset</td>
<td>$1,000,000 asset</td>
<td>$1,000,000 asset</td>
</tr>
<tr>
<td>-$238,000 capital gains tax</td>
<td>$0 capital gains tax</td>
<td>$0 capital gains tax</td>
</tr>
<tr>
<td>$1,000,000 in 5% unitrust</td>
<td>$1,000,000 in 5% unitrust</td>
<td>$1,000,000 in 5% unitrust</td>
</tr>
<tr>
<td>pays $50,000 annually + a charitable tax deduction of $300,000 worth $120,000</td>
<td>pays $50,000 annually + a charitable tax deduction of $300,000 worth $120,000</td>
<td>pays $50,000 annually + a charitable tax deduction of $300,000 worth $120,000</td>
</tr>
<tr>
<td>+ ILIT</td>
<td>+ ILIT</td>
<td>+ ILIT</td>
</tr>
<tr>
<td>Client pays $120,000 initially and $10,000 annually for a $400,000 ILIT-owned policy (including post-crummey gift taxes)</td>
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<td>Client pays $120,000 initially and $10,000 annually for a $400,000 ILIT-owned policy (including post-crummey gift taxes)</td>
</tr>
<tr>
<td>Client uses $40,000/year</td>
<td>Charity receives $1,000,000 remainder</td>
<td>Heirs receive $400,000 (tax free from ILIT)</td>
</tr>
<tr>
<td>Heirs receive $457,000 ($762,000-$304,800 est. tax)</td>
<td>Heirs receive $400,000 (tax free from ILIT)</td>
<td>Heirs receive $400,000 (tax free from ILIT)</td>
</tr>
<tr>
<td>Heirs receive $457,000 ($762,000-$304,800 est. tax)</td>
<td>Heirs receive $400,000 (tax free from ILIT)</td>
<td>Heirs receive $400,000 (tax free from ILIT)</td>
</tr>
</tbody>
</table>
A CRT increases AUM

- No upfront capital gains tax at sale
- Tax deferred growth (only distributions taxed)
- Immediate tax deduction
- Post-mortem management with DAF/PF beneficiary
Retained Life Estates & Remainder Interests in Homes and Farms
A remainder interest gives the right to own the property after a set time or after the death of a person.

OK, you can have my stuff now.

Charles A. Donor
Unlike a will, a remainder interest is not revocable, and can even be sold.
A deductible remainder interest in farmland or a personal residence must be transferred by deed, not by trust or contract.
Charitable deduction for remainder interest deed with retained life estate in $1,000,000 of farmland by age 55 donor

- $122,350 (11.6% (May 89))
- $859,830 (0.6% (June 20))

You can use the tax savings to buy life insurance for heirs who weren’t going to farm anyway.
Leaving land to charity by will

• Revocable
• $0 tax deduction
• Impacts charity after death

Leaving land to charity by remainder deed

• Irrevocable
• Immediate income tax deduction
• Impacts charity after death or immediately if charity sells remainder interest
• Immediately increases cash assets available for income producing investments
Gifts of a remainder interest with retained life estate in the donor’s personal residences can also be deducted.
Includes second homes, vacation homes, even a boat with bathroom, cooking, and sleeping facilities, if used by the donor as a residence.
Cash giving up to 100% deduction + 2018 benefit bump

1. Federal rates went up (33% to 35%) for singles earning $200,000 to $416,700

2. 2017 charitable tax deductions reduced by 3% of income over $261,500 [Pease limitation]

3. Higher state tax benefits with SALT caps

4. Income limits raised to 60%
1. The new 20% deduction for business income phases out at higher *taxable income* levels.

2. But, charitable deductions reduce *taxable income*, and can thereby “bring back” the business income deduction from the dead.

3. Double benefit: Charitable deduction + bringing back the phased out business income deduction.
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Please connect with me on LinkedIn for more slides and videos!