

Aligning your Charitable Vision to an Appropriate Charitable Strategy

Strategic Charitable Gifting

Your charitable planning may be driven by multiple factors: a desire to support charitable pursuits about which you are passionate, a desire to provide a way for family and friends to remember you, or a desire to connect future generations to charitable gifting.

The tax benefit may not be the driving factor for a donor, but it does enable the charitably inclined to give more. In the current legislative environment, the path to tax-efficient charitable planning is complicated. There are many options to help accomplish your charitable objectives and preserve tax efficiency; however, pitfalls exist that may reduce or eliminate the tax benefit.

What is strategic gifting? Strategic gifting involves following a long-term giving plan, one that includes a budget, investment strategy, appropriate time horizon, and specific goals for charitable impact that allow for current and future success. Strategic donors must also determine how to most effectively use resources such as property, charitable vehicles, and input from experts and loved ones to reach their charitable goals. Among other considerations, this approach includes making contributions of tax-effective assets, such as appreciated securities, and selecting a gifting vehicle that most closely aligns with one's personal preferences and philosophies.

The following information provides insight on how strategic giving can help you meet your charitable goals.

There are many areas that require thoughtful consideration. Consider the following questions to help you develop your charitable giving plan:

- What type of assets do I have at my disposal?
- How much control do I want?
- What is the desired income stream for me, my family, and my charity?
- What amount of wealth am I willing or able to part with?
- What percentage of my income do I want to spend on philanthropy?
- Do I anticipate an income event that will benefit from a charitable donation/deduction?
- When does the charity need the funds to meet both my goals and its own?
- What is my desired timing for receiving an income tax deduction for the charitable gift?

It may be possible to maintain partial control over an asset being contributed to a charity or, in limited situations, to maintain a cash-flow stream from the asset. If control is your primary concern, then using a vehicle such as a donor advised fund or a private foundation may be appropriate. However, if a cash flow stream is desired, then a split-interest charitable trust may be more advisable.

Donor gives up more control as charitable organization moves away from center



Private foundation

A private foundation is a separate legal entity formed to administer the charitable interests of an individual or family by making grants to public charities. Income tax deductions are generally less favorable than those to public charities. Some donors prefer a private foundation because it allows them or their family more control over giving. A private foundation can be used to "pre-fund" several years of normal charitable giving. Private foundations can also be used to give assets that are not easily divided, such as real property, or provide a means to fund foreign charitable endeavors. There is a minimum annual asset distribution requirement. While a private foundation may be a significant part of the legacy you leave and the vehicle that brings your family together after your passing, you should consider the administrative complexities and the cost of maintaining a private foundation when you assess whether it is the right vehicle for you.

Donor-advised fund (DAF)

A DAF is easy to establish and maintain and does not require a custom drafted legal agreement. The donor's account is part of the charitable organization that holds the account that is managed as public charity. A donor would make a gift of property to the DAF and receive a tax deduction equal to the fair market value of the property in the year of the gift. Assets are deposited into an investment account where they grow tax free. Only one acknowledgment letter from the DAF is needed instead of a receipt from each separate charity receiving a gift from the DAF, which can significantly simplify recordkeeping for tax purposes. You retain the right to advise, but not to direct, the DAF in administering the affairs of the account you created. Advice may include naming the fund, managing investments, recommending grants, and selecting a replacement adviser at the death of the donor. In addition, a DAF offers flexibility in the amount, frequency, and timing of donations to charities. One key element of a DAF is the ability of the donor and/or his designees to name family members and friends as "account advisors," thereby promoting family philanthropy. Another key element of DAFs is the ability to make grants anonymously, there are few options other than a DAF that can assure the donors' anonymity.

The chart below summarizes the factors you should consider when evaluating where to contribute assets.

| Comparison | Public Charity | Donor Advised Fund | Private Foundation |
|-------------------------------------------------------------------|--------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Creating the vehicle | n/a | Established by agreement with community foundation or other charity. Easy to set up and administer. | Nonprofit corporation or trust organized as a private foundation. Can be costly including administration, accounting, and audit. |
| Start-up costs / Annual costs | n/a | No cost to donor or minimal, usually set by charity on a break-even basis. | Requires substantial legal, accounting, and operational costs like corporate startup. |
| Practical minimum size | n/a | Depends upon charity's policy, often \$5,000 to \$25,000. | Substantial assets required, \$1.0 million and up. |
| Contribution limit? Generally, exceptions apply | 60% of Adjusted Gross Income (AGI) for cash contributions, 30% of AGI for noncash | 60% of AGI for cash contributions, 30% of AGI for noncash | 30% of AGI for cash contributions, 20% of AGI for noncash |
| Donor controls grant making. | No | No, but donor can advise | Yes |
| Donor controls investment decisions? | No | No. Donor may choose investment plan, but sponsoring organization has control. | Yes |
| Donor manages operations and administers organization? | No | No. Donor pays a fee to sponsoring organization to provide administrative services. | Yes |
| Annual distribution requirements? | No | No | Yes - 5% of FMV of noncharitable use assets |
| Organization subject to income/excise tax? | No, unless there is unrelated business income | No, unless there is unrelated business income | Yes (1% or 2% excise tax on net investment income and an income tax on unrelated business income) |
| Organization subject to excise tax for prohibited actions? | Generally, no (potential excise tax on political activities) | Yes. Potential excise tax on excess business holdings, taxable distributions, and excess benefit transactions. | Yes. Potential excise tax due for engaging in acts of "self-dealing" having "excess business holdings and making "jeopardizing investments" or "taxable expenditures." |
| Organization required to file an annual tax return? | Yes (Form 990) | No. An annual filing by sponsoring organization, not each separate donor advised fund. | Yes (Form 990-PF) |

Split Interest Charitable Trust

If a cash flow stream is desired, then a split-interest gift may be a tax-efficient alternative to transfer the asset. The financial interest from these trusts is split between the charitable and noncharitable beneficiaries (including the donor). The two most common kinds of split-interest charitable trusts are a charitable lead trust (CLT) and a charitable remainder trust (CRT).

Charitable Lead Trust (CLT)

A CLT is a lifetime or testamentary transfer of cash or property in trust for the benefit of charity. The CLT will make distributions to a charity or charities for a specific amount of time (term of the trust) with the remaining assets (remainder interest), passing to the named noncharitable beneficiaries at the end of the trust term. There could be a taxable gift based on the present value of the remainder interest at the time of trust creation if the non-charitable beneficiary is someone other than the grantor. However, the value of the gift for gift tax purposes is reduced by the present value of the income interest received by the charity. A CLT can be designed to pay in two different ways: as a fixed annuity payment (a fixed dollar amount) annually or a unitrust amount (fixed percentage) to the charity. A CLT may be useful when the asset being contributed has a high potential for future appreciation. In addition, it may also be appropriate strategy if your heirs are still young and not capable of assuming control of a substantial amount of assets. When assets do eventually pass to the non-charitable beneficiary or beneficiaries, they are not subject to federal gift or estate tax.

CLTs are suitable for donors (or heirs) who have sufficient other income-producing assets to provide for their cash needs during the charitable term and do not need the income from the property selected for transfer to the CLT. The CLT is suitable for donors with charitable intent, and the CLT can potentially substitute for donor's annual gifts to charity. This technique is most beneficial for donors with rapidly appreciating assets with significant estate tax exposure seeking estate tax-reduction techniques to increase the value of the future transfer to heirs.

Charitable Remainder Trust (CRT)

Alternatively, a CRT is a lifetime transfer of cash or property in trust in exchange for an income stream for a fixed period or for the lives of the noncharitable beneficiary / beneficiaries (typically the donor), with the remaining assets (remainder interest) passing to the charity at the end of the trust term. The trust can pay out a fixed amount of income every year (annuity trust) or a fixed percentage of the FMV of the assets in the trust (unitrust) to noncharitable beneficiary. The amount distributed each year to the noncharitable beneficiary must be at least five percent of the initial FMV of the trust assets. A CRT may be a good planning option if you have an appreciated asset that you would like to sell and diversify but desire to be able to defer the gain over time. Income is taxed only when distributions are made from the trust. You would receive a charitable deduction in the year of transfer equal to the remainder value for the charity, which must be at least 10 percent of the amount contributed. CRTs are suitable for donors who anticipate having a need for income during the trust term, particularly if the donor uses appreciated property to fund the trust and has a desire for portfolio diversification.

The chart below summarizes some of the factors you should consider when evaluating where to contribute assets.

| Comparison | Advantages | Disadvantages |
|-----------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Outright Gift | Deductible for income taxes | No retained interest |
| Charitable Lead Trust | Income stream transferred to charity satisfies donor's charitable objectives (A current gift to charity) Current income tax deduction for Grantor CLAT. Deduction can offset income in high-tax year Charitable deduction greater with lower \$7520 rate. Future interest in property transferred to heirs at a significant wealth transfer tax discount | Transfer of assets is irrevocable. Donor gives up use of income for life of the trust. Legal and administrative fees If current income tax deduction is taken, future income is taxable to donor Requires charitable payment each year regardless of income CLAT may not be ideal for GST planning Certain private foundation rules apply |
| Charitable Remainder Trust (CRT) | Fixed-income stream retained by donor and/or family members Current charitable deduction is allowed for the present value of the remainder interest of the trust. Charitable deduction greater with higher \$7520 rate. Deferral of capital gains taxes on sale of appreciated property transferred to the trust Allows diversification inside CRT with sales proceeds undiminished by taxes are reinvested by trustee for growth and income Reduce future estate taxes | Transfer of assets is irrevocable Qualified appraisal generally required Legal and administrative fees Distributions to noncharitable beneficiaries are generally subject to income tax Limited on types of assets in which to invest Subject to some private foundation rules |

Charitable contributions are often the largest controllable deduction for an individual. For those seeking tax efficiency, there are many areas that require thoughtful consideration. It is critical to work with an adviser specializing in this area to navigate your way through these decision points effectively to achieve both your philanthropic goals and your tax planning goals. Being a strategic donor is an ongoing process that involves consistent monitoring, evaluation, and, if necessary, adjustment.

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