



Stupid Charitable Tricks: Planning Mistakes I Have Seen

October 25, 2016



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Dear Advisor,

Charitable gift planning is a broad topic that can have significant benefits for your charitable clients. At this year's workshop, we draw on the wealth of experience that our presenter, Ramsay Slugg, has from his life-long career in charitable giving. We hope the main takeaway today for each of you an understanding that there are many different ways to structure gifts to meet your client's needs. As you continue your client interactions, Ramsay's examples are likely to help you identify opportunities to help your clients achieve their charitable goals.

The Community Foundation's staff is available to be a part of your team whenever charitable planning is on the list of topics for your clients. This is true even in situations where we are not going to be a part of the solution. Of course, we are proud of the fact that our mission and purpose offers the flexibility to accomplish a wide spectrum of charitable goals. Whether we are helping a client to structure a planned gift for the benefit of our community, or simplifying their current giving through a donor-advised fund, we will partner with you to leave your clients feeling happy with the outcome of their planning process.

The best way to find out if the Community Foundation can support you in accomplishing your clients' goals is to ask. We are available when needed to help find the right giving option for your client's particular situation – be it legal, financial or other. We hope that you will come to think of us as your 'charitable back office', freeing you to focus on your area of core competency.

We have a wealth of written materials that you can use when working with clients. Additionally, we are also available to meet face-to-face with you individually or including your client. Please contact Tom Griffith, Director of Gift Planning, at 315-883-5544 or tgriffith@cnycf.org with questions or to schedule a meeting.

Thank you for joining us this morning. I hope we have an opportunity to work together in the future.

Sincerely,

Peter A. Dunn
President & CEO



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Agenda

7:30 am: Registration

8:00 am: Welcome and Introductions

8:10 am: Presentation by Ramsay H. Slugg

9:50 am: Questions & Answers



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Ramsay H. Slugg

Ramsay H. Slugg is a Managing Director and member of the National Wealth Planning Strategies Group at U.S. Trust. Previously, he was the National Practice Director of Bank of America's Philanthropic Management group. He has also served as the Central Region Director of the Bank's Charitable Management Services Group, and the Central Region Director of the Wealth Management Consulting Group.

Mr. Slugg has also served as an adjunct professor at Texas Christian University and Texas A&M College of Law. He is a frequent speaker on tax and financial planning topics, especially as they relate to art and collectibles, and is frequently quoted in the Wall Street Journal, New York Times, Forbes, Barron's and other business publications. He is the author of the Handbook of Practical Planning for Art Collectors and Their Advisors, published by the American Bar Association's Section of Real Property, Trust and Estate Law.

Mr. Slugg is admitted to practice law in Texas, is a member of the State Bar of Texas, the American, and Tarrant County Bar Associations, the Tax and Estate Planning Section of the Tarrant County Bar (Chair, 1999-2000), the Lone Star Chapter of the Partnership for Philanthropic Planning, and the College of the State Bar of Texas. He currently serves as Co-chair of the American Bar Association's Real Property Trust and Estate Law Art and Collectibles Committee, as well as several other leadership positions. Mr. Slugg received his J.D. degree from the Ohio State University College of Law, and his undergraduate degree from Wittenberg University.



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5^{for} CNY

The difference you can make for your clients by partnering with the Community Foundation to support the organizations they care about is crucial. We invite you to think about what's next, and how you can make sure the things that matter to your clients today have a secure future, long after their gone.

Why now?

About 40% of our region's wealth, totaling approximately \$22 billion, will change hands from one generation to the next in our community in the next decade. This impending transfer offers a great opportunity to accelerate the realization of our hopes and dreams for a better Central New York. All it takes is people like you and your clients to consider charity as a part of the plan for their estate.

Learn more
about the study,
see helpful
infographics, and
watch our video at
www.5forcny.org

When your clients set aside at least a portion of their estate for Central New York - the home of their heritage, their livelihood, their roots – they can help move our community in the right direction. Even something small, like 5%, could make an extraordinary difference.

Where to begin?

Incorporating charitable giving into your client's estate plans can sound complex at first, but philanthropic planning can be as simple as including a bequest in their will.

This type of planning can also encompass much more than a simple bequest. With the goals of providing for their loved ones, reducing taxes and remembering worthy causes, there are a variety of techniques available that have mutual benefit to them, their community and their favorite charitable organizations, both now and into the future.

How Can the Community Foundation Help?

Community foundations are tax-exempt public charities that help people accomplish their philanthropic goals. Donor funds are managed professionally and endowed assets are designed to grow over time.

The long-term goal of a community foundation is to build permanent funds that will support community needs in perpetuity. By responsibly stewarding those funds and making grants to various causes, your local community foundation is making a difference in this region.

Remember: Our staff is available to help you navigate your planning and provide custom giving suggestions for your clients based on their interests. Contact us to request a private meeting or to set up an information session with you and your clients. **(315) 422-9538 or email Tom Griffith at tgriffith@cnycf.org.**

Smart Giving for Tomorrow



Lee Gatta, CLU®, ChFC®, AEP®, visited the headquarters of Home Aides of CNY, one of the organizations that will benefit from her and her husband's legacy giving plan.

My husband Joe and I have been blessed by the support we have received from the local community. We decided to pay that forward by establishing a charitable giving plan through the Community Foundation. We had our sights set on a charitable gift larger than we were comfortable contributing now, so we decided to use a life insurance policy to achieve our goal.

We chose a policy with terms that fit our goals, and the Community Foundation agreed to be the policy's owner and beneficiary. While the Community Foundation owns the policy, we receive a tax deduction for our donation to them of the annual premium payments. When I pass away, the policy will fund the *Lee M. Gatta and Joe Reddick Family Fund*, which will provide continued support for issues that are of importance to us: the support of women and girls through the Women's Fund of CNY and eldercare coordination and support.

The Community Foundation was ideally suited to help us identify and carry out our charitable vision. We are pleased to make this gift as a way to give back to the community that has given us so much. We are confident that the Community Foundation will honor our wishes in perpetuity.



Read more of the Lee's story at Gatta.5forCNY.org.



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Professional Advisors

The Community Foundation recognizes the key role that you, as your clients' professional advisor and confidant, play in structuring a plan to address the needs and desires of clients with charitable interest. We work hard to make the charitable giving process easy and rewarding for all involved. To do that, we have dedicated ourselves to meeting your needs, ensuring that you have the technical information and tools at your fingertips to help your clients achieve their charitable goals.

What can the Community Foundation do for you?

- 1) The Community Foundation provides an extremely flexible, accountable, dynamic charitable platform for long-term giving. Donors can create funds for multiple charitable beneficiaries or allow the Foundation to direct the funds to charitable organizations that can most effectively achieve the donor's goals. Also, the Community Foundation will steward the donor's intent and act as a hedge against nonprofit uncertainty.
- 2) The Community Foundation can create funds around a specific area of interest – for example, education, arts, or the environment. This fund can serve as a catalyst to bring other donors in the community to the table with similar interests, leveraging your client's contributions.
- 3) The Community Foundation can work with you and your client to identify the most effective type of life income gift to meet their needs and to maximize the benefits of those gifts through the use of the most effective assets and distribution rate.
- 4) The Community Foundation can serve as trustee of split interest vehicles like charitable remainder trusts or can arrange for third party trust administration if the donor prefers to self-trustee.
- 5) The Community Foundation can prepare charitable deduction calculations for your clients.
- 6) The Community Foundation accepts donations of complex, non-cash assets including real estate, closely held stock, art, collections and life insurance.
- 7) The Community Foundation can work with your clients who want to create a platform for family philanthropy.



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Professional Advisors (cont.)

Most of your clients may not know how to achieve their charitable goals or what they can accomplish through effective charitable planning. Some may not even know to raise the issue unless their advisor first presents the topic for conversation. Discussing philanthropy with your clients can be good for your clients and good for your business.

What can you do to support the Community Foundation?

- 1) Ask your clients about their charitable goals in the financial and estate planning process. This will increase charitable giving across the community. **Begin with these three questions:**
 - Do you have charities that you support on an annual basis?
 - Do you want to include any of these charities in your financial or estate plans?
 - If I could show you how to shift tax dollars to charitable dollars in your planning, would you be interested in exploring that?
- 2) Involve us during the planning process if you are creating a perpetual charitable gift through the Community Foundation. We will be happy to brainstorm with you about how that gift might be structured to best achieve your client's charitable goals.
- 3) Help educate your clients and the community about the unique role of the Community Foundation in building a permanent pool of resources for the community.
- 4) Serve as our ambassadors and advocates in the community. Encourage your friends, colleagues, or clients to call us or visit our website at www.cnycf.org if they have questions, concerns, or see opportunities.

If you have questions or would like to discuss a specific situation for a particular client, please feel free to contact Tom Griffith, Director of Gift Planning, at 315-883-5544 or tgriffith@cnycf.org.




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Ten Reasons

To Partner with the Community Foundation


- ONE We enable you to **broaden your practice** by building on our philanthropic expertise.
- TWO We provide highly **personalized service** tailored to each individual's charitable and financial interests.
- THREE We are a **local** organization with deep roots in the community.
- FOUR Our professional program staff's **knowledge on community issues** and needs is available to donors on request.
- FIVE Our **donor-advised funds** help people invest in the charities they already care about, and learn about new causes to invest in.
- SIX We accept a wide **variety of assets**, and can facilitate even the most complex forms of giving.
- SEVEN We offer maximum **tax advantage** under state and federal law.
- EIGHT We **multiply the impact** of gift dollars by pooling them with other gifts and grants.
- NINE We offer **permanence** to donors, through endowment funds and multi-generational involvement.
- TEN We are **community leaders**, convening agencies and coordinating resources to create positive change.




Stupid Charitable Tricks: Charitable Planning Mistakes I Have Seen

Professional Advisor Continuing Education Seminar
for the Central New York Community Foundation

Ramsay Slugg
October 25, 2016






Disclosure

IMPORTANT: This presentation is designed to provide general information about ideas and strategies. It is for discussion purposes only since the availability and effectiveness of any strategy are dependent upon your individual facts and circumstances. Clients should always consult with their independent attorney, tax advisor, investment manager, and insurance agent for final recommendations and before changing or implementing any financial, tax, or estate planning strategy.

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Today's Agenda

- Introductory Thoughts
- Federal Tax Rules
- Charitable Planning Mistakes – Donor Perspective
 - Direct Giving
 - Split Interest Giving
 - Indirect Giving
- Charitable Planning Mistakes – Donee Perspective
- Q & A



Charitable Planning Mistakes – Preliminary Thoughts



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"These Americans are the most peculiar people in the world...In a local community, in their country a citizen may conceive of some need, which is not being met. What does he do? He goes across the street and discusses it with his neighbor. Then what happens? A committee comes into existence and then the committee begins functioning on behalf of that need...All of this is done by private citizens of their own initiative."

Alexis de Tocqueville, *Democracy In America* (1835)

"For most people, giving money to charity is no better tax wise than losing money in the stock market...and since nobody does that on purpose, why give money to charity for the tax break? The simple answer is, nobody should."

Ramsay H. Slugg, *Everyday* (2016)



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Charitable Planning Mistakes



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Federal Tax Rules

Income Tax Rules

- 2 Types of Charities
- 4 Types of Property
- Amount of the Federal income tax charitable deduction is dependent upon a combination of the type of property donated and the type of charity to which it is donated



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Federal Tax Rules (cont.)

Type of Property	Type of Charity	
	50%	30%
Cash	50%	30%
Ordinary Income Property	50%*	20%*
Long Term Capital Gain	30%	20%**
Tangible – Unrelated	50%*	20%*

* Limited to lesser of fair market value (FMV) or cost basis

** Limited to cost basis unless publicly traded stock



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Charitable Planning Mistakes



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Federal Tax Rules (cont.)

Income Tax Rules (cont.)

- Must itemize to deduct
- 5 Year Carry forward
- Itemized Deduction Phase-out Rules
- Strict Appraisal and Substantiation Requirements
- Other specialized rules
 - Partial Interest Rule for all donations
 - Related Use Rule for donations of tangible personal property
 - Fractional Interest Rule for donations of art
- The more rules we have, the more opportunities for mistakes



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Charitable Planning Mistakes



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Federal Tax Rules (cont.)

Partial Interest Rule

- Donations of Partial Interests do not qualify for an income tax charitable deduction
 - 4 exceptions to the rule:
 - Undivided portion (fractional interest)
 - Irrevocable remainder interest
 - Qualified conservation or façade easement
 - Qualified split interest trusts and pooled income funds



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Federal Tax Rules (cont.)

Partial Interest Rule (cont.)

- Consequences:
 - Lack of income tax charitable deduction
 - Possible taxable gift



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Federal Tax Rules (cont.)

Partial Interest Rule (cont.)

- Example: donor who contributes artwork but retains copyright (no deduction)
- Example: donor contributes fractional interest in artwork, and fractional interest in the copyright (deductible)
- Example: Oil & Gas Interests are often fractional interests, so must be careful



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Federal Tax Rules (cont.)

Related Use Rule

- Donations of tangible personal property will be limited to a cost basis deduction unless, at the time of donation, the recipient charity certifies that it intends to use the donated property to further its charitable, tax exempt mission
- Otherwise, donor is limited to a cost basis deduction
- Sale within 3 years of donation requires filing of amended Form 8283
- Common mistake is to think that the charity must hold the property for 3 years



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Charitable Planning Mistakes



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Federal Tax Rules (cont.)

Fractional Interest Rule

- If a donation of a fractional interest in art is made, then the donor:
 - Must complete the donation of the entire work within the earlier of death or 10 years
 - Must use the same appraised value of the initial fractional gift for all subsequent fractional gifts (for income tax only, not gift or estate tax)
 - Must relinquish possession for actual ownership periods



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Federal Tax Rules (cont.)

Estate and Gift Tax Rules

- 100% Fair Market Value Deduction



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Charitable Planning Mistakes



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Donor Perspective

- Direct Donations
- Split-Interest Donations
 - Charitable Gift Annuities
 - Qualified Split-interest Trusts (CRTs and CLTs)
 - Remainder Interests
 - Conservation/Façade Easements
 - Pooled Income Funds
- Indirect Gifts
 - Private Foundations
 - Donor Advised Funds (Community Foundations)
 - Supporting Organizations



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Charitable Planning Mistakes



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Donor Perspective – Direct Giving

- Mistake #1 – Failure to Substantiate
 - General Substantiation Rules
 - For cash:
 - < \$250 – 3rd party record is sufficient
 - > \$250 – contemporaneous written acknowledgement (“CWA”), with statement that no goods or services received; keep for 3 years
 - For property
 - > \$500 < \$5,000 – CWA, plus Form 8283
 - > \$5,000 – CWA, Form 8283, and qualified appraisal (unless publicly traded stock, or closely-held stock under \$10,000)
 - Qualified appraisal requires a qualified appraiser
 - Applies to private foundations as well as public charities



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Charitable Planning Mistakes



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Donor Perspective – Direct Giving (cont.)

- Mistake #2 – International Giving
 - If U.S. citizen, or U.S. resident, donates to a non-U.S. charity, no federal income tax charitable deduction is allowed
 - Work arounds:
 - “Friends of” organizations
 - Use of private foundation to make grants

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Charitable Planning Mistakes



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Donor Perspective – Direct Giving (cont.)

- Mistake #3 – Nature of Asset Donated, Part 1
 - No federal income tax charitable deduction for the untaxed appreciation component of “Ordinary Income Property,” resulting in cost basis deduction
 - Short-term capital gain stock or other capital asset
 - Non-qualified stock options (if you can even give them away)
 - Accrued interest on a bond
 - Inventory
 - Commercial annuities
 - Others

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Charitable Planning Mistakes



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Donor Perspective – Direct Giving (cont.)

- Mistake #3 – Nature of Asset Donated, Part 2
 - “Section 1256” Contract (certain options, such as index options)
 - Marked to market at year-end, meaning gain accrual (and tax) each year
 - Gain is deemed to be 60% LTCG, 40% STCG
 - Donation is a termination, meaning have to reduce donation amount by the STCG
 - Uncertainty here

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Charitable Planning Mistakes



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Donor Perspective – Direct Giving (cont.)

- Mistake #3 – Nature of Asset Donated, Part 3
 - Donating an asset subject to debt (whether apparent or not)
 - Real estate
 - Master Limited Partnerships, Private Equity, Hedge Funds, other partnerships
 - A reduction in the donor's share of Partnership debt s treated as a cash distribution, perhaps causing some gain recognition and/or limitation of deduction to basis

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Charitable Planning Mistakes



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Donor Perspective – Direct Giving (cont.)

- Mistake #3 – Nature of Asset Donated, Part 4
 - Donating an asset that you cannot donate
 - Incentive stock options
 - Non-vested stock options
 - Restricted stock units
 - Stock appreciation rights
 - Collared stock
 - Other contractually restricted assets (shareholders' agreement, contractual lock up)

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Charitable Planning Mistakes



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Donor Perspective – Direct Giving (cont.)

- Mistake #4 – Assignment of Income
 - Donating an asset, but income attributable to that asset is still the obligation of the donor
 - Compensatory stock options (deduction of \$ 0, and when the donee charity exercises, the income is attributed back to the donor)
 - Pre-arranged Sale
 - More common issue with split-interest giving, especially CRTs, and indirect giving, with private foundations and donor advised funds

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Charitable Planning Mistakes



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Donor Perspective – Direct Giving (cont)

- Mistake #5 – Related Use Rule for Tangible Personal Property
 - Income tax charitable deduction for a donation of tangible personal property will be limited to cost basis unless, at the time of donation, there was a bona fide intent on the part of the donee charitable organization to use the donated property in furtherance of its tax exempt mission
 - Best practice is to obtain a self-serving letter or other documentation from the donee charity attesting as to intended use
 - Selling a donation and putting proceeds into endowment is not a related use...ever
 - Remember substantiation rules
 - A real surprise – Gold ETFs are often “grantor trusts,” meaning the grantor is treated as owning the underlying asset, in this case gold bullion, which is tangible personal property
 - Question – how could gold bullion ever be used to further a charity’s mission?

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Donor Perspective – Direct Giving (cont.)

- Mistake #6 – Other Interesting Issues
 - Effect of SEC Rules
 - Rule 144 may limit amount of permitted sales, which must further be aggregated with sales by donee charity. Be aware and coordinate
 - Market discount rules for bonds
 - If donor purchased a bond below par, that market discount is ordinary income at disposition, which means it falls under Mistake #3

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Charitable Planning Mistakes



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Donor Perspective – Direct Giving (cont.)

- Specific Assets
 - Commercial annuities – Ordinary Income Property, so whether a donation is a disposition, causing ordinary income recognition (which adds to basis), or deduction is reduced by unrealized gain, the effect is a cost basis deduction
 - Master Limited Partnerships – possible issues:
 - Treated as partnerships for tax purposes, a donation could relieve the owner of liability, same as a cash distribution – accounting nightmares
 - Multi-state issues – accounting nightmares
 - Possible recapture, which reduces deduction to basis – accounting nightmares
 - Unrelated Business Taxable Income (UBTI) to the donee – accounting nightmares
 - S Corporation Stock – charities may own S Corp stock, but all income is UBTI (even investment type income that would normally be excluded from UBTI)

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Donor Perspective – Split-interest Giving

- **Charitable Gift Annuities** – contract between a donor and a donee charity, whereby the donor contributes cash or other assets, receives a promise (unsecured) from the donee charity to pay the donor, donor's surviving spouse, and/or other beneficiary a certain amount of money for a certain period of time, with the residuum retained by the charity
- No real mistakes to consider, but donor should realize this is an unsecured obligation of the donee charity, and charities do sometimes go bankrupt

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Donor Perspective – Split-interest Giving (Cont.)

- Charitable Remainder Trusts (CRTs)
 - Irrevocable trust
 - Inter vivos or testamentary
 - Non-charitable beneficiary receives the “income” interest, either an annuity or unitrust amount
 - “Income” interest is payable for a life, joint lives, or term of years not to exceed 20
 - Charitable beneficiary receives the remainder interest

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Donor Perspective – Split-interest Giving cont.)

- Charitable Remainder Trusts (cont.)
 - “Income” interest must be either:
 - Annuity – fixed sum or fixed percentage of the initial contribution (CRAT)
 - Unitrust – fixed percentage of the net fair market value of the trust, revalued annually (CRUT)
 - “Income” interest must be:
 - At least 5% of the initial value of the trust
 - No more than 50% of the initial value of the trust
 - Remainder interest:
 - Present value must be at least 10% of the initial value
 - For CRATs, must meet 5% “probability exhaustion test”

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Donor Perspective – Split-interest Giving (cont.)

- Charitable Remainder Trusts (cont.)
 - Types of CRTs
 - Charitable Remainder Annuity Trust (CRAT) – pays a fixed amount or fixed percentage of initial trust principal
 - Charitable Remainder Unitrust (CRUT) or Standard Charitable Remainder Unitrust (STANCRUT) – pays a fixed percentage of the net fair market value of the trust principal, revalued annually
 - Net Income Charitable Remainder Unitrust (NICRUT) – pays the lesser of
 - Unitrust amount
 - Net income actually earned by the trust

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Donor Perspective – Split-interest Giving (cont.)

- Charitable Remainder Trusts (cont.)
 - Types of CRTs (cont.)
 - Net Income With Make-up Charitable Remainder Unitrust (NIMCRUT) – pays the same as a NICRUT, but with accrual of shortfall when net income is less than the unitrust amount, paid when net income exceeds the unitrust amount
 - FLIP Charitable Remainder Unitrust (FLIP-CRUT) – allows for a NICRUT or a NIMCRUT to become a STANCRUT upon a “triggering event”
 - “Triggering event” must be something beyond the control of the donor, the unitrust beneficiary, the trustee, or any other person
 - Can only “flip” once, and only one way (no “backflips”)

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Donor Perspective – Split-interest Giving (cont.)

- Charitable Remainder Trusts (cont.)
 - Income Taxes
 - CRTs do not pay income taxes...unless they have Unrelated Business Taxable Income (UBTI)
 - Non-charitable “income” beneficiaries do pay income tax according to “WIFO” (worst in, first out)
 - Ordinary Income, current and accrued
 - Capital Gain, current and accrued
 - Other Income, such as tax exempt, current and accrued
 - Return of principal
 - Key word – deferral...not avoidance!

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Donor Perspective – Split-interest Giving (cont.)

• Charitable Remainder Trusts (cont.)

- Donor qualifies for an income tax charitable deduction equal to the present value of the remainder interest (subject to adjusted gross income (AGI) and phase-out limitations)
- Diversify a concentrated asset position with deferred capital gains tax consequences
- Almost always achieve a higher current after tax yield than what was earned on the contributed asset
- Estate tax savings
- Benefit charity or charities of choice

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Charitable Planning Mistakes



CENTRAL NEW YORK
COMMUNITY
FOUNDATION, INC.

Donor Perspective – Split-interest Giving (cont.)

• Charitable Remainder Trusts (cont.)

- CRTs are primarily an income tax planning tool with estate tax benefits
- CRTs are subject to private foundation rules, so must avoid self-dealing
- If "income" interest is payable to other than the donor or donor's spouse, gift and/or estate tax consequences
- CRATs work "better" in high interest rate environment

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Charitable Planning Mistakes



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FOUNDATION, INC.

Donor Perspective – Split-interest Giving (cont.)

• Charitable Remainder Trusts Planning Mistakes

- Drafting Errors and Reformation
- Investment Performance
- Donor/Income Beneficiary Changed Circumstances
- Other Problems I Have Seen

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Charitable Planning Mistakes



CENTRAL NEW YORK
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FOUNDATION, INC.

Donor Perspective – Split-interest Giving (cont.)

• Charitable Remainder Trusts Planning Mistakes (cont.)

- Drafting Errors and Reformation
 - The potential consequence of a drafting error is the loss of (income, gift or estate tax) deduction and perhaps the loss of the income tax exemption for the CRT; the trust will continue, but will not be a valid CRT for federal tax purposes
 - Inter vivos errors
 - IRS has issued forms which, if followed, will be valid CRTs
 - Allowed to make modifications to those forms so long as they comply with all of the applicable Internal Revenue Code Sections and Treasury Regulations

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Charitable Planning Mistakes



CENTRAL NEW YORK
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Donor Perspective – Split-interest Giving (cont.)

• Charitable Remainder Trusts Planning Mistakes (cont.)

- Drafting Errors and Reformation (cont.)
 - Inter vivos errors (cont.)
 - Permitted reformations – a CRT that fails the minimum value test for the remainder interest may be void ab initio, or it may be reformed by reducing the payout percentage or reducing the non-charitable term, to meet the ten percent minimum present value test [IRC Sec. 2055(e)(3)(J)]
 - Requires a judicial proceeding that commences within 90 days after the due date (including extensions) for the CRT's first income tax return (or estate tax return in case of testamentary CRTs)
 - Cannot increase the income tax charitable deduction that would have been otherwise allowable

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Charitable Planning Mistakes



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FOUNDATION, INC.

Donor Perspective – Split-interest Giving (cont.)

• Charitable Remainder Trusts Planning Mistakes (cont.)

- Drafting Errors and Reformation (cont.)
 - Inter vivos errors (cont.)
 - Requirements for all reformations, including non-judicial reformations
 - Difference between the value of interest at date of death and reformed interest cannot exceed five percent of the reformed interest
 - The length of time of the noncharitable interest cannot be extended
 - The change is effective as of the date of death (for estate tax purposes) or date of initial gift (for income and gift tax purposes)

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Charitable Planning Mistakes



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Donor Perspective – Split-interest Giving (cont.)

- Charitable Remainder Trusts Planning Mistakes (cont.)
 - Drafting Errors and Reformation (cont.)
 - Testamentary errors
 - Permitted reformation rules are the same for testamentary reformations, that is, CRTs that are formed at the death of the grantor
 - The reformation rules for any violation of the requirements of IRC Sec. 664 are set forth in
 - IRC Section 2055(e)(3) – estate tax charitable deduction
 - IRC Section 2522(c)(4) – gift tax charitable deduction

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Charitable Planning Mistakes



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FOUNDATION, INC.

Donor Perspective – Split-interest Giving (cont.)

- Charitable Remainder Trusts Planning Mistakes (cont.)
 - Investment Performance
 - At time of formation, we are assuming that the CRT will earn the applicable rate on a linear basis
 - If it earns more
 - CRAT – all excess benefits the remainder beneficiary
 - CRUT – the “income” and remainder beneficiaries share in the excess to the extent of their respective interests
 - If it earns less
 - CRAT – runs the risk of running out of money
 - CRUT – theoretically, will never run out of money, but both “income” and remainder beneficiaries will receive less than anticipated

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Charitable Planning Mistakes



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Donor Perspective – Split-interest Giving (cont.)

- Charitable Remainder Trusts Planning Mistakes (cont.)
 - Investment Performance (cont.)
 - Can you reduce the percentage payout if you find that mandated distributions exceed earnings?
 - Example: client sets up 8% CRAT, and market is underperforming so that the CRAT principal is declining more rapidly than anticipated, from market decline and continuing annuity payments. Client wants to reduce the 8% payout to 5%

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Charitable Planning Mistakes



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Donor Perspective – Split-interest Giving (cont.)

- Charitable Remainder Trusts Planning Mistakes (cont.)
 - Investment Performance (cont.)
 - Too bad!

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Charitable Planning Mistakes



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Donor Perspective – Split-interest Giving (cont.)

- Charitable Remainder Trusts Planning Mistakes (cont.)
 - Investment Performance (cont.)
 - The client could do a termination, discussed below, including giving the income interest to the remainder charity so that market declines do not matter to the CRAT because the charity will receive whatever is left over
 - Or, the client could give 3% (or more or less) of the 8% to the charity. This does not solve the problem of underperformance, but it would get more money to the charity sooner, before the CRAT runs out of money

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Charitable Planning Mistakes



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Donor Perspective – Split-interest Giving (cont.)

- Charitable Remainder Trusts Planning Mistakes (cont.)
 - Donor/Income Beneficiary Changed Circumstances
 - Donor/"income" Beneficiary
 - Wants/needs the value of his interest now
 - No longer wants/needs the interest
 - Either could be prompted by lower than expected investment performance
 - Gets divorced

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Charitable Planning Mistakes



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FOUNDATION, INC.

Donor Perspective – Split-interest Giving (cont.)

- Charitable Remainder Trusts Planning Mistakes (cont.)
 - Donor/Income Beneficiary Changed Circumstances (cont.)
 - An option – especially attractive today – is to terminate the CRT
 - Low Section 7520 rate (currently 1.6% compared to an average historical rate of 6% or more) gives a higher value to the “income” interest, especially for annuity trusts
 - Lower remainder value = lower income tax deduction
 - Low capital gains rate means less incentive to defer
 - Prospect of higher capital gains rate in the future means that the use of a CRT would defer capital gains to a higher rate environment

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Charitable Planning Mistakes



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Donor Perspective – Split-interest Giving (cont.)

- Charitable Remainder Trusts Planning Mistakes (cont.)
 - Donor/Income Beneficiary Changed Circumstances (cont.)
 - If the reasons to establish CRTs are “upside down,” then it stands to reason that terminating existing CRTs may make sense
 - Who Do You Represent?
 - Generous Donor/“Income” Beneficiary
 - Needy Donor/“Income” Beneficiary
 - Divided Donor/“Income” Beneficiary
 - Charitable Remainderman

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Charitable Planning Mistakes



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Donor Perspective – Split-interest Giving (cont.)

- Charitable Remainder Trusts Planning Mistakes (cont.)
 - Donor/Income Beneficiary Changed Circumstances (cont.)
 - Generous Donor/“Income” Beneficiary
 - “Income” beneficiary who no longer needs the “income” from the CRT, and simply donates that interest to the charitable remainderman
 - Low 7520 rate = higher valuation of that interest = better deduction
 - “Income” interest is a capital asset, with deemed basis of zero, so 50/20% AGI limitation if short term (unlikely) or 30/20% AGI limit if long term
 - Cost basis limitation (which is zero) if the remainderman is a private foundation (or donor has right to change to private foundation)
 - This only works well if the remainder beneficiary is a public charity

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Charitable Planning Mistakes



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Donor Perspective – Split-interest Giving (cont.)

- Charitable Remainder Trusts Planning Mistakes (cont.)
 - Donor/Income Beneficiary Changed Circumstances (cont.)
 - Needy Donor/“Income” Beneficiary
 - “Income” beneficiary who either needs or wants their money now rather than over the defined payment period (life or term)
 - Several ways to sell the “income” interest, to the charity or to a third party, or the charitable and non-charitable beneficiaries agree to a termination
 - State law must allow
 - “Income” beneficiary cannot be terminally ill
 - Avoid self-dealing issues
 - Each interest receives its actuarially computed present value

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Charitable Planning Mistakes



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Donor Perspective – Split-interest Giving (cont.)

- Charitable Remainder Trusts Planning Mistakes (cont.)
 - Donor/Income Beneficiary Changed Circumstances (cont.)
 - Needy Donor/“Income” Beneficiary
 - “Income” beneficiary receives a lump sum equal to the present value of their interest
 - Treated as the sale of a capital asset, with deemed basis of zero, to the remainderman
 - Rev.Proc. 2008-3, 2008-1 I.R.B. 110 – this is so common, that IRS will no longer issue advance rulings on whether early termination, when all parties receive their actuarial share of the CRT, will cause disqualification, termination of private foundation status, self-dealing or taxable expenditure

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Charitable Planning Mistakes



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Donor Perspective – Split-interest Giving (cont.)

- Charitable Remainder Trusts Planning Mistakes (cont.)
 - Donor/Income Beneficiary Changed Circumstances (cont.)
 - Divided Beneficiary
 - Division, not a termination
 - Usually, but not necessarily, a divorce
 - Number of PLRs and Revenue Rulings that approve this, so long as the economic interests are not changing

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Charitable Planning Mistakes



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Donor Perspective – Split-interest Giving (cont.)

- Charitable Remainder Trusts Planning Mistakes (cont.)
 - Donor/Income Beneficiary Changed Circumstances (cont.)
 - Charitable Remainderman
 - How can you object to the Generous Donor?
 - Unaffected by the Divided Donor
 - What about the Needy Donor?
 - If a CRAT, with significant asset declines, the annuity will likely exhaust the trust, so the charity gets nothing – so something now is better than nothing later
 - If a CRUT, theoretically unaffected by asset decline, but perhaps better to get something now to invest in own funds
 - In short, charity should not object

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Charitable Planning Mistakes



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Donor Perspective – Split-interest Giving (cont.)

- Charitable Remainder Trusts Planning Mistakes (cont.)
 - Other Problems I Have Seen
 - “Mixed-Use” CRT – testamentary CRT that pays education expenses of grandchildren so long as they maintain a B average and don’t abuse drugs. Education assistance terminates at age 35, and if they graduate by then, then they get a stated dollar amount. CRT terminates when last grandchild attains age 35, remainder to 3 named charities
 - CRT distributes appreciated securities in payment of the annuity/unitrust amount
 - CRT pays a portion of the annuity/unitrust to charity
 - CRT formed by S Corporation
 - CRT pays annuity/unitrust payment to another trust

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Charitable Planning Mistakes



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Donor Perspective – Split-interest Giving (cont.)

- Charitable Remainder Trusts Planning Mistakes (cont.)
 - Other Problems I Have Seen
 - CRT includes power to invade corpus
 - CRT pays the income tax of the “income” beneficiary
 - CRT allows donor to change charities
 - CRT allows donor to change charities, including to a private foundation
 - CRT pays to someone for life, then for 20 years to someone else
 - CRT funded with art or collectibles
 - CRT funded with partnership interests
 - CRT funded with deferred annuities
 - CRT with the charity serving as trustee

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Charitable Planning Mistakes



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FOUNDATION, INC.

Donor Perspective – Split-interest Giving (cont.)

- Charitable Lead Trusts
 - Irrevocable trust
 - Inter vivos or testamentary
 - Charitable beneficiary receives the “income” interest, either an annuity or unitrust amount
 - “Income” interest is payable for life, lives, or term of years (notice, no limitation on term of years), or even for a life plus term of years
 - Non-charitable beneficiary receives the remainder interest

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Charitable Planning Mistakes



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Donor Perspective – Split-interest Giving (cont.)

- Charitable Lead Trusts (cont.)
 - “Income” interest must be either:
 - Guaranteed Annuity Interest, which is a sum certain at least annually (CLAT)
 - Unitrust Interest, which is a fixed percentage of trust assets, revalued annually (CLUT)
 - CLT must also be either
 - Grantor Trust – donor entitled to income tax charitable deduction when funded, but must also report income of trust in future years
 - Non-grantor Trust – no up-front income tax deduction, but the trust itself is responsible for any income tax consequences

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Charitable Planning Mistakes



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Donor Perspective – Split-interest Giving (cont.)

- Charitable Lead Trusts (cont.)
 - Types of CLTs
 - Charitable Lead Annuity Trust (CLAT)
 - Charitable Lead Unitrust (CLUT)
 - Benefits of CLTs/Planning Thoughts
 - Non-grantor CLT is a leveraged gifting technique, similar in structure and purpose to a Grantor Retained Annuity Trust (GRAT)
 - Non-grantor CLT has incidental income tax benefit of not being subject to AGI limits or itemized deduction phase-outs

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Charitable Planning Mistakes



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Donor Perspective – Split-interest Giving (cont.)

- Charitable Lead Trusts (cont.)
 - Benefits of CLTs/Planning Thoughts (cont.)
 - All CLTs allow funding charitable gifts without permanently giving away an asset
 - Grantor CLT provides current income tax charitable deduction for present value of the income stream going to charity in future years, which may be useful against income spike
 - CLTs are not tax exempt, so either grantor (of grantor CLT) or the trust itself are subject to income tax
 - CLTs are subject to private foundation rules



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Charitable Planning Mistakes



CENTRAL NEW YORK
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Donor Perspective – Split-interest Giving (cont.)

- Charitable Lead Trusts Planning Mistakes
 - CLTs are not “charitable” trusts, so not subject to the stringent rules as are CRTs
 - Mitigates the number of drafting and trust administration errors
 - CLTs, as split-interest trusts, are subject to some of the private foundation excise tax rules such as self-dealing, excess business holdings
 - Monitor funding with closely-held stock or Family Limited Partnership (FLP) interests because of excess business holding rules
 - Monitor distributions if to a private foundation to avoid Section 2036 inclusion if CLT grantor is also a disqualified person of the foundation
 - Avoid contributing encumbered property, because of possible gain recognition



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Charitable Planning Mistakes



CENTRAL NEW YORK
COMMUNITY
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Donor Perspective – Indirect Giving

- Private Foundations
- Donor Advised Funds (including Community Foundations)
- Supporting Organizations



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Charitable Planning Mistakes



CENTRAL NEW YORK
COMMUNITY
FOUNDATION, INC.

Donor Perspective – Indirect Giving (cont.)

- Private Foundations
 - A charitable entity formed by an individual or family to carry out charitable activities
 - Private non-operating foundation – makes grants to other charities
 - Private operating foundation – conducts its own charitable activities
 - Since the creator maintains significant control over investments, operations and future grants, private foundations have:
 - Least favorable tax status
 - Exposure to excise (penalty) taxes for errant behavior (We have a WSR)
 - Possible loss of exemption for errant behavior

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Charitable Planning Mistakes



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FOUNDATION, INC.

Donor Perspective – Indirect Giving (cont.)

- Private Foundations (cont.)
 - Tax on Net Investment Income (different definition than for 3.8% surtax)
 - Qualifying Distributions – non-operating foundations must pay out “income,” defined to be 5% of non-charitable use assets, each year, within 12 months of end of year, or face 30% tax on shortfall
 - Calculated and self-reported on Form 990-PF
 - Self-Dealing – no direct or indirect financial transactions between the foundation and its “disqualified persons”
 - Self-dealing is the most common excise tax violation; loans from foundations is most common form of self dealing, followed by compensation issues
 - Taxable Expenditures – prohibition on political activities (with exceptions) or payments to individuals (with exceptions)

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Charitable Planning Mistakes



CENTRAL NEW YORK
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FOUNDATION, INC.

Donor Perspective – Indirect Giving (cont.)

- Private Foundations (cont.)
 - Excess Business Holdings – basically, cannot own more than 20% of voting shares of a business, aggregated with ownership of disqualified persons
 - Jeopardy Investments – though not defined, focus is on investment process, not specific investments
 - Termination
 - Can be subject to 100% tax
 - Unrelated Business Taxable Income (“UBTI” or “UBIT”)

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Charitable Planning Mistakes



CENTRAL NEW YORK
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FOUNDATION, INC.

Donor Perspective – Indirect Giving (cont.)

• Donor Advised Funds

- An account maintained by a public charity where the donor has retained the right to advise (but not direct) where future distributions will be made
- May be maintained by a community foundation, a financial services company, or even an operating charity such as a university
- Less expensive (on the low end), easier to administer, version of a private foundation, without the same level of continuing donor control
- Funding – refer back to Direct giving
- Operation – mistakes are unlikely since DAF is operated by sponsoring organization, not donor

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Charitable Planning Mistakes



CENTRAL NEW YORK
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FOUNDATION, INC.

Donor Perspective – Indirect Giving (cont.)

• Supporting Organizations

- Pension Protection Act of 2006 made significant changes to qualification requirements for Supporting Organizations, especially “Non-functionally integrated Type III Supporting Organizations”
- Proposed Regs issued, with only 1 last area of concern, which is required payout by a Type III supporting organization

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Charitable Planning Mistakes



CENTRAL NEW YORK
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Donee Perspective

• Substantiation • Gift Acceptance

- For donations other than cash and marketable securities, does the charity have the ability, internally or through outside service providers:
 - Sell the asset
 - Manage the asset
 - Recognize assets that produce UBTI
- Reputational risk

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