Year-End Planning Alert

2013 Year-End Charitable Giving Tips

The "giving season" is in full swing! Mailboxes are beginning to overflow with heart-tugging appeals from passionate charities that seek our financial support before year end. It is not by accident that this is called the "giving season." Charities know that as the year comes to a close, many individuals talk with their advisors to find ways to minimize projected income tax bills, and charitable giving may provide this needed relief.

Savvy donors consider different ways to accomplish their charitable giving that meet their personal, financial and tax objectives when making charitable gifts. Here are some tips to consider:

Sell loss assets and give cash to charities.

Use the loss deduction on your income tax return as an offset to gains you may have realized from other investments. Gifts of cash to a public charity are subject to a higher (50%) Adjusted Gross Income (AGI) limitation. That means it is more likely that you will be able to use all of the charitable income tax deduction in the year the gift is made.

Make gifts of appreciated assets.

In contrast to selling loss assets and giving the cash proceeds, consider gifting your appreciated assets (such as stocks and bonds) instead of cash. Gifting appreciated assets allows the donor to obtain two tax benefits. First, the donor receives a charitable gift and income tax deduction based on the fair market value of the appreciated assets on the date of the gift.[1] Second, the unrealized appreciation will not be taxed to the donor of the asset. For example: Assume that Mr. Generous makes a gift of XYZ stock worth $30,000 on the date of gift. Mr. Generous purchased such stock for $10,000 five years ago. Mr. Generous gives the stock to Best Public Charity. Mr. Generous will receive a charitable deduction of $30,000 and will not have to recognize gain on the difference between the purchase price ("basis") of $10,000 and the fair market value of $30,000 ($20,000). If Mr. Generous sold the stock for $30,000 and then gave the sales proceeds to Best Public Charity, Mr. Generous would have realized the gain of $20,000 and be subject to the capital gains tax in the year of the sale. By gifting the stock instead of cash from the sale, Mr. Generous obtains the charitable income tax deduction and avoids the imposition of the capital gains tax on the appreciation that is inherent in the stock.

Start early to transfer certain assets.

One of the requirements for obtaining a charitable income tax deduction in a given year is that the gift be "delivered" to the charity on or before December 31st. For gifts of mutual fund assets, it takes a few weeks or more to complete the transfer of the asset for effective "delivery." Don't wait until December 28th to begin the transfer of a mutual fund to the charity. The gift must be made on or before December 31, 2013 if the donor wants the benefit of the tax deduction in 2013.

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[1] The deduction is based upon the asset's fair market value if the asset is a long-term capital asset (held longer than one year) and is donated to a public charity.

Calculate your projected tax deduction before making your gift.

After a hiatus of 2 years, the American Taxpayer Relief Act of 2012 ("ATRA 2012") reinstated the "Pease" limitation on itemized deductions. Named after the member of Congress who proposed the law years ago, the "Pease" limitation reduces itemized deductions by 3% of the amount by which AGI exceeds certain levels (the "thresholds"), up to a maximum reduction of 80% of all affected itemized deductions, including charitable deductions.

The AGI thresholds above which the "Pease" limitation applies under ATRA 2012 are $300,000 (married filing jointly), $275,000 (head of household), $250,000 (single), and $150,000 (married filing separately). Don't find out too late that the charitable deduction you are relying on is not what you expected due to the "Pease" limitation!

Consider a Charitable Gift Annuity (CGA) for a secured, fixed payout.

If you are older and worried about your assets losing value or having a reduced income due to the fluctuating markets, a CGA with fixed payouts can provide some security. In fact, age is a positive attribute when it comes to CGAs: the older you are, the higher the payout rate becomes. CGAs may provide much higher payouts than Certificate of Deposit (CD) interest rates and dividend-paying stocks can yield today. And unlike CD interest and stock dividends, which may be taxed at ordinary income tax rates, portions of each CGA payment are characterized as long-term capital gain, ordinary income and return of principal. The lower tax payments, combined with the charitable income tax deduction generated when the CGA is created, often provide an even higher effective rate of return. And finally, because the underlying obligation to make the payment is secured by all of the assets of the charity issuing the annuity, CGAs can be especially attractive in today's volatile environment.

Make matching gifts.

To increase your level of giving, check to see whether you can bolster your gift with a matching gift from your employer.

Consider a Charitable Remainder Trust (CRT).

If you are a donor with highly appreciated assets (such as commercial real estate or appreciated stock), you may find that a CRT provides a tax-savvy giving strategy. These irrevocable trusts can be used to generate an income stream for you or your beneficiaries for a set period of time (20-year maximum), or for life, at which point the remainder of the donated assets is transferred to one or more charitable organizations you select. CRTs are often funded with highly appreciated securities due to the potential capital gains tax benefits—the trust is tax-exempt and can sell the trust assets tax-free. By committing the remaining proceeds of a donation to a CRT to charity at the end of the CRT term, you can earn an income stream from all of the proceeds of sale, not just the amount that you would have left if you had not used a CRT and had paid the capital gains tax. The payment to the non-charitable beneficiary of a CRT (typically you and/or your spouse) can be a fixed amount payable over the term of the trust (a Charitable Remainder Annuity Trust, CRAT) or an amount based on a set percentage of the value of the CRT assets as revalued every year (a Charitable Remainder Unitrust, CRUT). The CRAT provides the beneficiary with stability in payments while the CRUT provides the beneficiary with the opportunity to receive higher payments if the trust assets increase in value over the term of the trust, but also lower payments if the assets decrease in value.

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Use a Charitable Lead Trust (CLT) to make inter-generational transfers for lower transfer tax costs.

If you can part with assets without jeopardizing your financial security and you want to transfer them to the next generation in a tax-advantaged way, now is the time. Unlike a CRT, which won't benefit your favorite charity until the trust terminates, a CLT makes payments to the charity throughout the term of the trust. What's more, the non-charitable beneficiaries (typically your children and/or grandchildren) receive the remaining trust assets—generally appreciated—at the termination of the trust. And when interest rates are low, as they are now, the present value of the remainder interest (calculated when a CLT is created) is generally lower, which means the amount of the gift you make to the next generation is also lower. Lower remainder interest values mean lower transfer tax costs.

In the end, CLTs can create precisely the win-win situation that estate planners look for when advising their clients: immediate payments to your favorite cause and lower transfer taxes when you pass the assets on to the next generation.

Create a Donor-Advised Fund account (DAF).

As the year-end approaches, many individuals find that the time for considered and strategic charitable giving is limited. Rather than being rushed to give money to charities without having time to undertake a thoughtful process as to which organizations should receive such funds, more and more individuals are creating DAFs to lock in their public charity charitable gift and income tax deduction and then have the time to make grant recommendations to the charities they wish to support. Charitable organizations that sponsor DAFs ("sponsoring organizations") can generally accept a wide variety of assets from donors, including cash, appreciated stock, bonds, mutual funds, restricted and closely held or non-publicly traded securities, real estate, limited partnerships, and other illiquid assets. They don't require extensive financial resources to set-up (most can be established with an initial contribution of $10,000 or less). Additionally, donors are not burdened with the administration, operational or compliance aspects of managing the fund. Donors have the joy of giving without the administrative activities required to create and maintain a private foundation. Although the sponsoring organization is the legal owner of the DAF assets and has final authority regarding the investment and distribution of the assets, individuals who create DAFs have grant recommendation and investment advisory privileges which are generally followed by the sponsoring organization if allowable by their grant and investment policies. To learn more about donor-advised funds, please go to bmocharitablefund.com.

Create a Private Foundation.

For individuals of greater wealth, charitable giving goes hand-in-hand with creating legacy for the family. One way to define and leave a legacy is through a family private foundation. Private foundations offer families opportunities to focus their collective efforts on charitable issues that matter to the family. They can provide a vehicle to educate new generations of wealth-holders on the responsibilities of wealth as well as the skills needed to manage the foundation's assets effectively—skills that will be useful to the "pupil" in managing his or her individual wealth. Families who want to control the grant-making process and the investment of assets, generally lean toward the creation of a private foundation as the vehicle of choice for practicing their philanthropy. Asset selection is very important when an individual wants to fund a private foundation. Only gifts of

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cash and marketable securities can be transferred to a private foundation if the donor needs to obtain the maximum income tax deduction in the year the assets are transferred. For charitable income tax deduction purposes, cash and marketable securities are deductible at fair market value. An asset other than cash or a marketable security is deductible only to the extent of the asset's basis which is generally much lower than the fair market value.

Make an IRA Charitable Rollover.

For 2013, taking advantage of the IRA Charitable Rollover can make great sense for individuals with sizable balances within their IRA accounts, sufficient resources to meet their financial needs from other resources and charitable aspirations. IRA owners who have attained age 70½ can make outright charitable gifts from their IRA directly to qualifying charities in an amount of up to $100,000, which meets the IRA owner's minimum distribution requirement without such distribution being included in his or her income in the year of the rollover.[2] In addition to meeting charitable goals, this tactic eliminates the increase in AGI that would occur from receiving a minimum IRA distribution and presumably lessens the impact upon various deduction phase-outs, including the "Pease" limitation mentioned above.

Charitable giving is a time-honored tradition that brings great satisfaction if done in a manner that matches an individual's or family's passion to a strategy (that meets the family, financial, tax and philanthropic goals) and to worthy charities that will make a difference in our world.

To learn more about the most advantageous options for making meaningful and financially efficient gifts to charity, please contact your CTC Consulting | Harris myCFO advisor.

[2] "Qualifying charities" does not include private foundations, donor-advised fund sponsoring organizations and supporting organizations.The IRA owner is not entitled to a charitable income tax deduction for the funds that are transferred from the IRA to the qualifying charitable organization.