Take It to the Next Level

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People will give despite, maybe even because of an economic downturn. But you have to know how to help them do it. In this article from Trusts & Estates' Charitable Supplement, Robert F. Sharpe, Jr. discusses how recessions don't necessarily cause people to give less but causes them to give more creatively.

By Robert F. Sharpe, Jr.

What a difference a year can make. Last fall, stock markets were hitting record highs and optimism for the future was widespread. But as we near the end of 2008, the picture is decidedly different. Fluctuating equity markets, a relatively weak dollar, increased energy prices, falling housing prices, and the subprime debt crisis all weigh heavily.

In such an environment, it's more important than ever that advisors assist clients in making charitable gifts effectively. Certainly, the funding needs for many charities, particularly social service agencies, is great, running counter-cyclical to the economy.

It may seem self-evident that charitable giving—particularly larger gifts—would wane under economic pressure. But history tells us otherwise. American philanthropy is resilient: forging nearly continuous growth every year for the past four decades through every economic climate.

Take, for example, the particularly challenging time of the 1980 to 1981 economic crisis. The country had just entered its second recessionary period in as many years. The prime rate was 20 percent, inflation hit 10 percent, mortgage rates were 15 percent, and the unemployment rate was over 9 percent. To many, the economy had not looked as bad since the Great Depression and there were dire predictions that fundraising would suffer dramatic setbacks. Surprisingly, in that year giving in America grew 13 percent over 1980, some 3 percent when adjusted for inflation.

Since that time, fundraising has weathered two more recessions: in 1990 and 2001. Yet, according to the 2008 edition of Giving USA, giving in America has survived economic storms, dipping only 1 percent on average (when adjusted for inflation) during recessionary periods going back at least as far as 1955.

That said, recessions do have an impact on which organizations receive money. During the past 30 years we've observed that some types of groups experience declines, while others show robust growth. Newspaper reports at the end of the Great Depression announced that a number of educational institutions actually raised more funds during the Depression than they had during the boom years of the 1920s. Meanwhile, the arts suffered.

Perhaps surprisingly, reports at the time indicated that much of the giving was done in the form of bequests and through other sophisticated planning tools. This was in part due to active efforts to promote bequests, gift annuities and other planned gifts from the late 1800s through the 1920s.

So, in light of today's economic challenges, advisors shouldn't be surprised to see their clients increasingly seeking assistance in making larger gifts. And expect them to want to do so in such a way that meets multiple planning goals.

Charities are certainly increasing the opportunities for those clients to give. Hundreds, if not thousands, of capital and endowment funding campaigns are either in the planning stages or already well underway. And in many cases organizations

are asking for larger gifts—to offset the drop in giving by those who are more directly affected by the economic downturn.

Such gifts, however, will likely take forms other than traditional pledges of cash over a three- to five-year period.

American Generosity

Rather than stop giving, many of your clients may, however, pay more attention to the form and timing of their gifts. For example, some have seen the value of securities fall in recent months but still enjoy significant gains when viewed from a longer-term perspective. They may be wise to give those securities and use the cash they might have otherwise donated to instead diversify their holdings through the purchase of a broader group of stocks at lower current market prices.

Older clients of means who are no longer working may be among those least affected by the current economic conditions. Those already retired obviously can't lose their jobs. Many seniors have long ago retired their mortgages and were not caught up in the subprime lending excesses of recent years. Retired persons also may be less affected by increased fuel costs because they are no longer commuting and may drive little, if at all. Others have relocated to warmer climes, so home heating costs may not be as big a factor for them.

According to IRS reports, people over 65 account for over 50 percent of total giving of appreciated securities. So it's important for advisors to keep information about giving non-cash property in front of them. Some may find this to be an excellent time to use securities that have increased in value but yield little income to fund charitable trusts and other gifts that provide additional income to help pay for higher medical expenses and other costs.

It's a vital service to help clients make larger gifts in ways that also enable them to provide for a more secure retirement, lend financial support to dependent loved ones, transfer wealth to future generations or meet any number of other financial objectives. Now may be a good time to revisit the charitable planning toolbox and determine which techniques are best suited for the economic picture that appears to be unfolding.

Assuaging Concerns

People make charitable gifts for any number of reasons—including the desire to help others, gain peer acceptance, satisfy a need for recognition, support their religious beliefs, express gratitude for services received, and save on taxes.

Yet some motivated people who possess the means to give ultimately decide against making a gift, especially larger ones. Why? We have found that most impediments to giving can be boiled down to one or more of these reasons:

(1) concerns over unfulfilled obligations to provide support for children, parents and others;

(2) fear of outliving one's resources during retirement years and/or not providing adequately for a spouse and/or other dependents;

(3) worry about business or other financial losses that could occur in the future; and

(4) concerns about catastrophic health problems or long-term mental and/or physical disabilities that could necessitate expensive care over an extended period of time.

Given all these potential worries, it's surprising that many people ever come to the conclusion that it's possible to make a large gift at all. These concerns are the reason that many donors and their advisors so often default to including a charity in their wills after death when these fears are no longer a factor.

But there are ways that advisors can assuage these concerns. Much is written about "planned giving," "deferred giving," "charitable 'gifting' techniques," "social capital planning," etc., but in the final analysis all these tools fall into four primary categories:

Category 1—Outright gifts with no strings attached. Planning these gifts primarily revolves around timing for tax and other purposes as well as choosing the best property to use to fund the gift.

Category 2—Gifts made in such a way as to assure the future economic security of a loved one; for example charitable lead trusts, charitable remainder trusts (CRTs) coupled with wealth replacement, life income gifts for elderly parents and other options.

Category 3—Gifts funded during life that provide income for the donor and/or another loved one for life or other period of

time but not devoted for charitable purposes until death or expiration of another time period (CRTs, gift annuities and other split-interest gifts.)

Category 4—Testamentary gifts that allow the donor to keep full access to income and corpus of funds for the remainder of his lifetime; examples include bequests via wills, remainder distributions from revocable living trusts, life insurance and retirement plan designations, pay on death provisions for investment accounts, and others.

Many donors, advisors and representatives of charities are fairly well-versed in the options. Obviously, charities prefer category 1 because they receive the donations relatively quickly. For less experienced fundraisers and advisors, it's easiest to default to category 4, because categories 2 and 3 can be more complex.

Some charities are finding that category 1 is less of an option these days. This includes organizations and institutions that are increasingly dependent on gifts from the leading edge of baby boomers who now are entering their sixties in staggering numbers. But these donors are finding it increasingly difficult to complete larger outright gifts in today's economic climate. Yet it's unrealistic to automatically turn to bequests and other "death gifts," given donor life expectancies of several decades or longer.

All roads now seem to lead to gift plans in categories 2 and 3. And these gifts should be structured so as to possess as many of the following attributes as possible:

- enables a client to make a large gift in relation to his means in a way that addresses a personal financial or economic challenge that would otherwise preclude the gift;
- provides maximum benefits to the charitable recipient within a reasonable period of time;
- places no undue investment risk on either the donor or the charitable recipient; and
- affords the donor with maximum tax savings and other economic benefits.

The not-for-profits and advisors who master the incredible flexibility and power of these planning tools, as well as the tax savings, asset management, predictability and other advantages they bring, will find no shortage of eager donors and clients.

Worried About Eldercare

One of the concerns for middle-aged donors that can interfere with the desire to make a relatively large gift is the need to provide financial support for dependent loved ones, whether children, siblings or parents. Many are unaware of the options available using common charitable gift planning tools.

Take the case of John, age 58. He is currently helping support his widowed mother, age 89. Her income has been steadily shrinking during the past few years due to lower interest rates. He is providing her about $800 per month from his after-tax income. In his tax bracket, he must earn nearly $1,200 per month to make these gifts.

John's father died of heart disease at age 63. Now, John worries about how his mother will survive should he also die prematurely and predecease her. John has been asked to make a gift in the range of $75,000 to one of his charitable interests, but doesn't see how he can afford to do so.

One of his advisors suggests he consider a charitable gift annuity as a way to help his mother while making a significant gift in her honor.

Is this a good solution?

John is currently earning a total income on his investments of about 6 percent. At that rate, it requires approximately $240,000 to yield the pre-tax income required to give his mother $800 per month after tax. He is concerned about recent fluctuations in investment markets and worried that he may not be able to sustain earnings at this level in coming years.

Enter the charitable gift annuity: If John uses $100,000 to fund a gift annuity for the benefit of his mother, a number of attractive benefits would result. At age 89, John's mother would receive quarterly payments totaling 10.1 percent of the amount transferred. Her income from a $100,000 annuity would thus be $10,100 per year, or about $840 per month. Of this amount, just under 80 percent of her annual payments, some $8,000 would be received as a tax-free return on her investment in the contract over a period of time equal to her life expectancy of five years. After tax, in her lower income bracket, his mother would net slightly more than the $800 per month he is currently providing her. If she outlives her life expectancy, her entire payments would be taxed as ordinary income, still at much lower rates than John currently pays.

Because of the ultimate charitable disposition of the funds involved, John will be entitled to an income tax deduction of $58,000, saving him more than $19,000.

The balance of $42,000 ($100,000 less $58,000 charitable deduction) is considered a gift to his mother for gift tax purposes. He might choose to utilize a portion of his lifetime exemption amount to offset any tax due, or use his income tax savings to help pay the gift taxes.

Another possibility would be to use his tax savings amount to purchase a life insurance policy on his life payable to his grandchildren. At age 58, he can use his income tax savings of $19,000 to purchase a significant amount of insurance that will pay his grandchildren upon the death of the survivor of him and his wife.

Finally, his disposable income increases as it was requiring the income from $240,000 to support his mother instead of the $100,000 needed to fund a gift annuity providing her the same benefits. The result is that he can now invest the remaining $140,000 to help fund his own retirement.

Let’s look at what John would accomplish with a charitable gift annuity. He will have:

- arranged for a predictable source of income for his mother backed by the endowment and other resources of the gift annuity issuer;

- honored his mother with a gift which will amount to about $75,000 at the end of his mother’s life expectancy of five years, assuming the underlying gift annuity reserve fund can earn 5 percent to 6 percent on the funds;

- freed more of his assets to build his own retirement; and

- made a provision for his grandchildren that might not have otherwise been possible.

A Second Home

Let’s look at another dilemma, this one created by a second home, and solving it with a charitable remainder unitrust (CRUT).

George and Mary, age 66 and 64, have recently retired and are planning to sell their primary residence and move to a more temperate climate. They anticipate that it will require all of their exemption from capital gains tax to shelter the amount of gain from the sale of their primary residence. They also own a vacation home valued at $750,000 for which they paid $100,000 25 years ago. They would like to sell the second home but are reluctant to do so because of the $100,000 or more in capital gains tax that would be due on a sale.

They have planned to include one of their charitable interests for a significant gift as part of their estate plan, but have not yet done so. Their advisors have told them, though, that it is unlikely either will be subject to estate tax at the death of the survivor. Therefore, their advisors say, it would be wise to accelerate gifts where possible to take advantage of tax savings from charitable gifts during their lifetimes.

One effective way to meet their objectives would be through the use of a CRUT. It’s suggested they use the vacation home to fund a CRUT that would make payments to them of 5 percent of the value of the trust each year. This option allows them to enjoy increased income over time with the growth of the assets inside the trust.

Many variations exist in the way the income from a CRUT can be determined. In this case, because the trust is funded with real estate that may not sell immediately, it is decided to structure the trust in the form of a net income unitrust with a so-called “flip” provision.

The Internal Revenue Service has provided that a unitrust can pay the specified amount each year (in this case 5 percent of the value of the trust assets) or the net income of the trust, whichever is less. This is a very helpful provision during the time that the real estate is unsold and there is no income being produced. The trust document can provide that the trust “flip” to a straight unitrust following a predetermined event, in this case the sale of the home. From that point forward George and Mary would begin to receive 5 percent of the value of the trust as valued each year.

Making their gift in this way provides a number of financial benefits:

- The entire net proceeds of the sale of the vacation home will remain in the trust as no capital gains tax will be due because of the tax-exempt nature of the trust.

- The corpus of the trust can grow on a tax-free basis over time.

- The couple continues to enjoy the investment management expertise of the advisors who currently manage their other investments.

- Because the balance remaining in the trust ultimately will be distributed for charitable purposes, George and Mary will be entitled to a charitable income tax deduction of some $262,500. Recall they anticipate no estate tax savings if a bequest of a

similar size were made at death.

- They can use this deduction, subject to the 30 percent of adjusted gross income limit for gifts of appreciated property, to reduce income taxes for the year of the gift and up to five future tax years.

- The amount in the trust will be effectively removed from their estate for federal estate tax purposes.

- Finally, George and Mary enjoy the knowledge that at the death of the survivor a significant gift will serve to fund the causes they wish to benefit.

A final thought. If they wanted to keep the use of the home for their lifetime and still enjoy the right to use the home as desired, they could make a gift of the home to a charitable interest with a retained life estate. In that case they would enjoy an immediate income tax deduction of $242,500.

Note that in both cases, the donors were able to make significant charitable gifts on a scale they may not have initially thought possible using widely utilized gift planning tools in fairly standard ways. These are generous gifts made for multiple reasons but with no gimmicks and without pushing the envelope.

There is no shortage of people equipped to help their clients make what are commonly referred to as “planned gifts” in fairly straightforward ways. But creative gift planning requires planners graduate to another level of sophistication.

In Other Words . . .

The more things change the more they stay the same. Our gift planning toolbox is full of time-tested, reliable methods of helping donors of various age ranges and wealth levels, who are motivated in different ways, make gifts for current, capital and endowment purposes.

Advisors who work with clients planning for retirement, long-term disability, transfer of wealth to heirs and other important priorities can add a valuable dimension to their practice as they help those persons who want to “vote with their dollars” do so in the most effective ways possible.

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