The 23rd Annual

Planned Giving CONFERENCE

presented by the Northern California Planned Giving Council

in association with Colonial Consulting, LLC

MASTERS TRACK

Session 4: 3:45 pm – 5:00 pm

Topic:

Now For Something Different

Presented by:

Erik Dryburgh, Esq.

Workshop Summary:

This session will focus on some new, and some not so new, ideas centered upon (a) revocable gifts (from bequests to revocable CRTs to revocable endowments), (b) gift planning when estate taxes are not an issue (from planning for income tax benefits to blowing the partial interest rule), and (c) a few interesting gift assets (from stock options to VC partnership interests to single member LLCs).

Workshop Presenter

Erik Dryburgh, Esq., is a principal in the law firm of Adler & Colvin, a law firm specializing in representing nonprofit organizations and their donors. He has an undergraduate business degree from the University of Wisconsin at Madison, and earned his J.D. at the University of California at Berkeley, Boalt Hall. He is also a Certified Public Accountant (inactive). Erik's areas of expertise include charitable gift planning, endowments, and not-for-profit organizations.

Erik has authored the chapter "Charitable Remainder Trusts," in California Estate Planning, Continuing Education of the Bar (2002) and published numerous articles on charitable gift planning.

Erik is a past Board member of the Partnership for Philanthropic Planning (formerly NCPG), the San Francisco Estate Planning Council, and the Northern California Planned Giving Council. He is the Chair of the Charitable Planning and Exempt Organizations Committee of the American College of Trust and Estate Counsel (ACTEC), and a member of the American Bar Association's Real Property, Trust and Estate Section. Erik received the 2005 Phil Hoffmire Service Award from the Northern California Planned Giving Council.

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NOW FOR SOMETHING DIFFERENT..........

Northern California Planned Giving Council

April 29, 2015

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Revocable Gifts

Some long-term planned giving folks see an increase in revocable gifts, perhaps due to donors' still-significant anxiety regarding their financial situation.

Bequests

Typically the largest component of a planned giving program.

Questions of the Day: Will the increased unified credit amount reduce the number or size of decrease bequests? How do you motivate people to leave bequests (or other revocable gifts) when they realize no tax savings by doing so?

Caution - donors may now avoid the federal estate tax due to the increased unified credit amount, but many states (but not California) still have an estate or inheritance tax.

Regardless, a key issue remains: How to ensure donors use your correct legal name. The legal name is that which appears on the organization's Articles of Incorporation (sometimes called a Certificate of Incorporation) or on the organization's founding trust instrument. For organizations incorporated in California, you can search for their legal names on the California Secretary of State website with the "Business Search" function found at http://kepler.sos.ca.gov.

Some donors list the organization's address too, but of course the address can also change. The safest approach is to list the legal name, along with the organization's EIN.

IRA beneficiary designation

Because IRAs are "IRD" assets, they are perhaps the most attractive asset to leave to charity at death:

- IRAs are subject to estate tax when left to heirs;
- IRAs are subject to income tax when distributed to heirs;
- Combined tax rate can exceed 70%.

Leaving the IRA to charity will result in it receiving 100% of the proceeds.

This remains true even if estate taxes are not an issue for the donor.

Longer life and economic downturns will increase the risk that a donor's retirement funds may be depleted at death, in which case the bequest of the IRA may be less than expected. Consider backing up a testamentary IRA gift with formula clause in the will.

Deferred annuities

A lifetime gift of an annuity contract will cause the owner/donor to realize the deferred income - rendering it a poor inter vivos gift asset.

A bequest will be treated similarly to a bequest of an IRA. The bequest will qualify for the estate tax contribution deduction. Also, deferred annuity contracts are generally taxed similarly to IRA accounts upon death of the owner, which means that the excess of the annuity death benefit above the amount invested is treated as taxable income to the recipient (IRD).

Pay on Death Accounts

Make sure donor gives you a list of the accounts - so you can locate them.

Life insurance policies

If the charity is named as a beneficiary of a policy, there is no income tax deduction for the donor.

If the donor transfers a fully paid-up policy to the charity, he/she gets a deduction equal to the replacement cost (limited to cost basis). The deduction for a not-yet-fully paid policy is (approximately) cash surrender value (limited to cost basis). To get a deduction, the gift must be complete – i.e., donor must transfer ownership of the policy, not just name the charity as a beneficiary.

Revocable CRT

For the donor - a second RLT with one asset, income to donor, remainder to charity.

What does this accomplish?

Pledges

The key (and never-ending) question is "Is this pledge binding or not?

What makes a pledge binding? A promise to pay, where the charity provides consideration (naming opportunity, for example) or the charity (or others) relies on the pledge to its detriment.

Why do we care?

Sometimes the donor says he/she can't pay:

- Directors have a fiduciary duty to protect (and secure) charitable assets, and act in the best interests of the charity. This means that they (or the development staff) can't "just" write-off a binding pledge. Note that a binding pledge is booked as an asset on the charity's financial statements.

Sometimes the donor wants to pay his/her pledge from a private foundation or donor-advised fund:

- Private foundations and self-dealing under IRC section 4941
- DAFs and the incidental benefits rules of IRC section 4967

Gifts Which are Irrevocable to the Donor, Revocable as to the Charity

Private Foundation

The transfer of assets is irrevocable to the donor, but revocable to any given charitable grantee. The corollary to the individual pledge question is the foundation's grant commitment - is it binding or not? Another question is whether the donor can ensure/direct that the foundation assets go to his/her desired charity upon termination of the foundation. This is easier with a charitable trust entity than a nonprofit corporation.

Donor-Advised Fund

Again, this is irrevocable to the donor, but revocable to any given charitable grantee. Can you secure a binding grant commitment from a donor who has a DAF? What if the donor promises (via a binding pledge) to advise a grant to your charity, and the sponsoring organization agrees to make the advised grant if it gets such advice and the DAF has sufficient assets?

"Revocable" Endowments

The Virtual Endowment

Attractive to a donor who wants to make an endowed gift now, has high current income, but doesn't have the necessary principal amount. Essentially a pledge for the desired endowment principal amount (payable in a specified number of years or even at death) coupled with a pledge to pay (for example) 5% of the principal amount every year until the principal is paid. Key question - is the pledge binding or not?

The Mortgage Endowment

The donor essentially pays his endowment amount over time. Using the endowment principal amount, a payment term, and an interest rate, you can calculate the required annual payment using a mortgage amortization program. Again, is the pledge binding pledge or not?

Revocable Endowment

Essentially, a grantor reversionary term-of-years CLT. Donor gets an upfront income tax deduction, charity gets an annual annuity payment for the term-of-years, and at the end – the donor can either roll the gift over into a new CLT or take the funds back.

(with thanks/credit to Steven Meyers and Bill Samers)

Gifts That Fail IRC Section 2055

If donor will avoid paying estate taxes due to the increased unified credit amount, they can make bequests that would otherwise fail IRC section 2055.

Life estate remainder gift

With real estate that is not a residence or farm/ranch - e.g., commercial property.

Gift of a partial interest

Some interest in the property to an heir, the balance of the property to charity (e.g., gift of closely-held stock to charity, coupled with a transfer of the voting rights to another key shareholder).

Earmarking

Gift to charity which is "earmarked" for certain beneficiaries.

Non-Qualified CRT

For an heir - many donors won't need an estate tax deduction going forward, therefore they don't need a *qualified* testamentary CRT. A non-qualified CRT set up at death can be very flexible: pay a unitrust amount or income if greater, allow the invasion of principal pursuant to some standard, skip payments altogether, flip from net income to a unitrust amount at the beneficiary's request, etc. A donor can also establish a non-qualified CRAT that would fail the 5% probability test.

Note that the trust will be taxable on its undistributed income.

Income tax Planning

Income tax contribution deductions may be more important going forward than estate tax contribution deductions (due to the increased unified credit amount). Many planners are advising clients to delete the charitable bequest from their estate plan, leave the assets to the children, and "request" that they make the charitable gift with their bequest. This is an opportunity to teach family values, connect the children with parents' charitable interests, and provides the children with an income tax deduction.

A Few Notes on Gifts of Other Assets

Silicon Valley and the Start-Ups

Pre-IPO - the donor's big issue is the deduction, which will drive the choice of charitable gift vehicle. Appraisals are a key issue as well. Donors also worry about voting control. Charity-side issues are often manageable, as the gift asset is C-Corp stock.

Post-IPO - often, there are still lots of restrictions on the shares, intended to stop insiders from dumping too many shares just as the stock goes public, guard against real or perceived insider-trading, etc. This can create deduction and choice of charitable vehicle issues. Similarly, there can still appraisal issues.

Donors often want the charity to retain shares - which creates a tension with the charity, due to its duty to diversify and the prudent investor rule.

Hedge and Venture Capital Funds

These are (for tax purposes) usually gifts of limited partnership interests. This can carry more risk for the charity - capital calls, and phantom income (UBI).

Stock Options

Not a good lifetime gift asset.

Virtual Currency

IRS has ruled it is "property", not "currency". Appraisals are (again) a big issue.