



JOHNSON
TRUST COMPANY

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A NEW PARADIGM:
Charitable Tax Planning Ideas to
Meet Your Client's Income Tax
and Financial Planning Goals



The Bridge Builder...

An old man, going a lone highway,
Came at the evening, cold and gray,
To a chasm, vast and deep and wide,
Through which was flowing a sullen tide.
The old man crossed in the twilight dim—
That sullen stream had no fears for him;
But he turned, when he reached the other side,
And built a bridge to span the tide.

“Old man,” said a fellow pilgrim near,
“You are wasting strength in building here.
Your journey will end with the ending day;
You never again must pass this way.
You have crossed the chasm, deep and wide,
Why build you the bridge at the eventide?”

The builder lifted his old grey head.
“Good friend, in the path I have come,” he said,
“There followeth after me today
A youth whose feet must pass this way.
This chasm that has been naught to me
To that fair-haired youth may a pitfall be.
He, too, must cross in the twilight dim;
Good friend, I am building the bridge for him.”

WILL ALLEN DROMGOOLE



THREE KEY QUESTIONS FOR CLIENTS:

1. Quantify Your Financial Independence

“How much wealth do you need to hold during your lifetime to feel financially secure?”

2. Identify An Appropriate Family Legacy

“How much wealth do you feel is appropriate to transfer to family, and how, and when, should the wealth be transferred, given their special circumstances?”

3. Maximize Your Contribution to Society

“Do you wish to make charitable gifts with assets that remain, or will likely go to the government in taxes?

“If yes, how, and when do you wish to make the charitable gifts (e.g. during lifetime, at death, next generation, etc.)?”



CHARITABLE GIFTS FROM INCOME VS. NET WORTH

Gifts from Income:

- » Controlled by “cash flow” concerns

Gifts from Net Worth

- » Controlled by financial security and tax concerns



CHARITABLE GIFTS FROM INCOME VS. NET WORTH

Tax-Wise Charitable Gifts from Net Worth Often Can:

- » Increase cash flow to the donor or their family.
- » Preserve the donor's financial security.
- » Make gifts to charity of funds that would otherwise pass to the government as taxes.



TAX-WISE CHARITABLE GIVING

Maximize Income Tax Savings

- » Charitable deduction for gifts to a public charity can be applied annually up to:
 - 60% of AGI, for cash gift
(note: limited to 50% of AGI if make gifts of cash and appreciated property, or have carryover deductions for gifts of appreciated property).
 - 30% of AGI for gifts of long-term appreciated property (securities, real estate, etc.)
- » Unused charitable deduction can be carried forward for up to five years

During Lifetime, Give Capital Gain Assets

- » Usually better to give from appreciated assets than from income

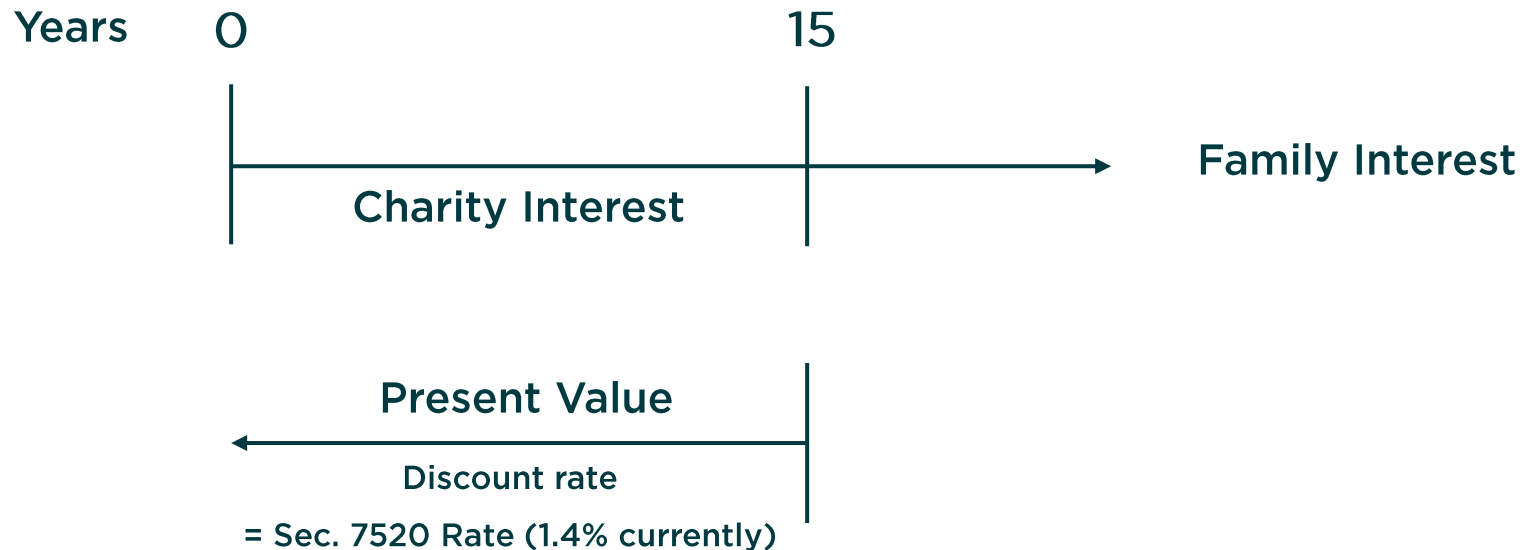
At Death, Give Ordinary Income Assets

- » IRA, Stock Options, Deferred Compensation, etc.



INVESTMENT-ENHANCED CHARITABLE PLANNING

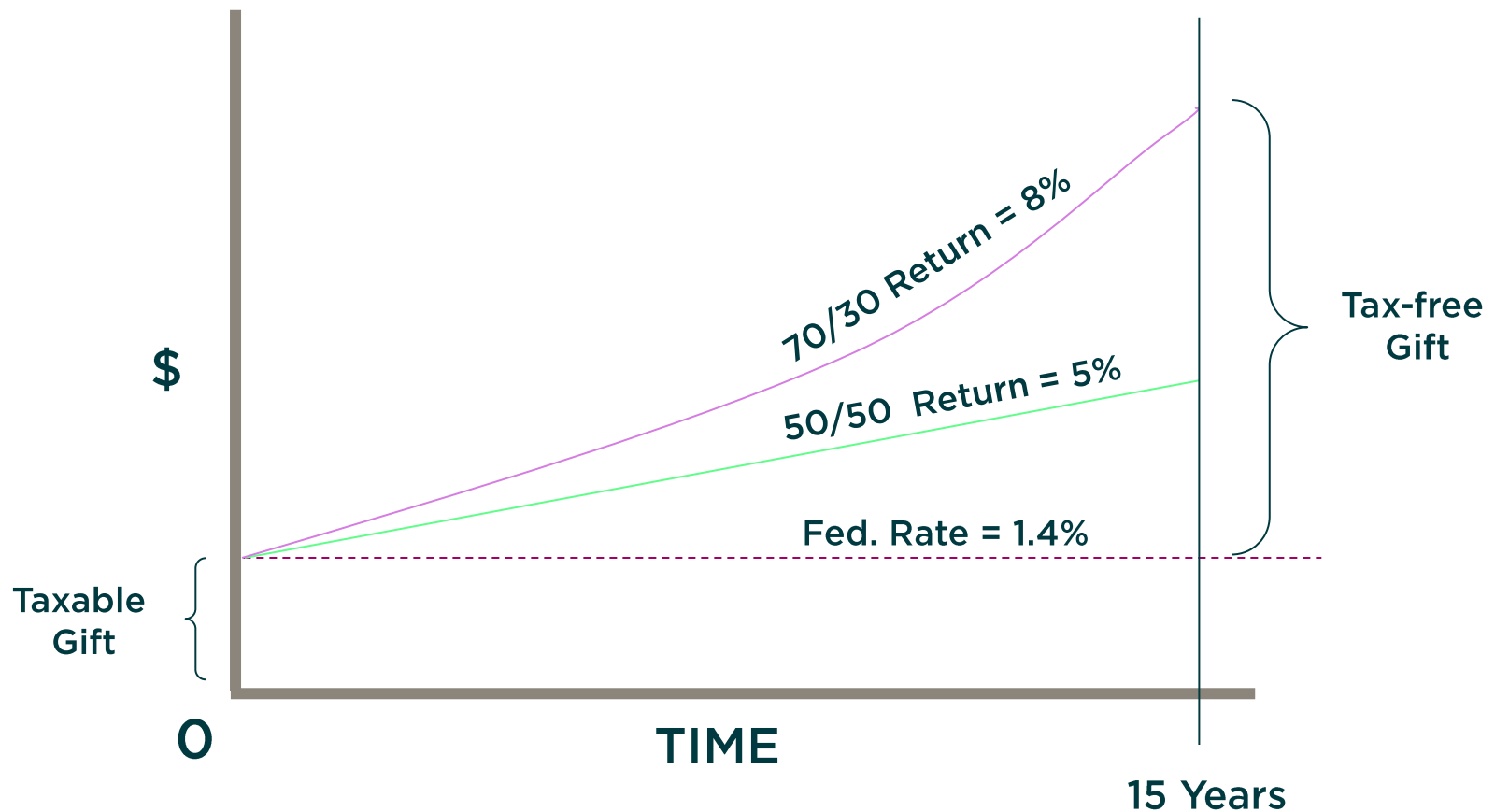
EXAMPLE: CHARITABLE LEAD TRUST



$$\text{Taxable Gift to Family} = \text{Trust Assets} - \text{PV of Charity Interest}$$



INVESTMENT-ENHANCED CHARITABLE PLANNING





THE CHARITABLE PLANNED GIFT MENU

You Can Make A Charitable Gift, but Keep the Assets During Lifetime:

- Will Bequests
- Revocable Trust Provisions
- Retirement Plan/IRA Beneficiary Designation to Charity
- Gifts of Remainder Interest in a Residence or Farm
- Life Insurance

You Can Make A Charitable Gift, but Keep the Income

- Charitable Remainder Trusts
- Charitable Gift Annuities
- Pooled Income Fund

You Can Give the Income to Charity, but Keep the Assets for Family

- Charitable Lead Trust

You Can Make a Charitable Gift When You Need the Deduction, but Distribute the Gifts Later or Over Multiple Generations

- Private Foundations
- Donor Advised Funds



LIFETIME IRA GIFTS

1. A Qualified Charitable Distribution (“QCD”) from an IRA is permitted, with limitations.
2. The IRA owner must be at least age 70 ½. [Note: New IRA RMD age is 72].
3. The QCD should only be made from a traditional IRA.
4. The QCD cannot exceed \$100,000, annually.
5. The QCD counts towards the IRA owner’s Required Minimum Distribution, but is not counted as taxable income.
6. The QCD must be made directly to a public, tax-exempt charity.
 - QCDs cannot be made to a donor advised account, a grant-making foundation, or to fund a life-income charitable trust or gift annuity.
 - However, QCDs can be made to an endowment fund or a field of interest fund at a public charity.



IRA GIFTS AT DEATH: BENEFICIARY DESIGNATION TO CHARITY

GIFT PLAN:

- » Charity designated as Primary or Contingent Beneficiary to receive part or all of an IRA or Retirement Account, upon donor's death.
- » Charity must be named in the Designation of Beneficiary Form for the account.

DONOR BENEFITS:

- » IRA assets distributed to charity avoid income tax and estate tax.
- » Substantial gift to charity, using asset that would otherwise be "double-taxed" when passing to family.
- » Preserves other assets to pass to family that will not be subject to both income tax and estate tax.



IRA BENEFICIARY DESIGNATION TO CHARITY

EXAMPLE:

Mrs. Warren's likely taxable estate includes a \$1,000,000 IRA and a \$1,000,000 investment portfolio. Since her daughter is an anesthesiologist, Mrs. Warren feels she can afford to split her estate between her daughter and charity. She plans to use her Lifetime Gift Tax Exclusion to fund a trust for grandchildren during her lifetime, which will cause all of her estate to be subject to federal estate taxes.

If Mrs. Warren makes a \$1,000,000 bequest to charity from her Will, and leaves the IRA to her daughter, her daughter will receive the following:

BEGINNING IRA BALANCE	\$1,000,000
LESS: ESTATE TAX	(\$400,000)
LESS: INCOME TAX INCURRED TO PAY ESTATE TAX	(\$180,000)
NET IRA BALANCE (TAXABLE INCOME)	\$420,000

If, instead, Mrs. Warren gives the \$1,000,000 IRA to charity, and transfers the \$1,000,000 balance of non-IRA assets to her daughter, the estate will save \$180,000 in income taxes, leaving \$600,000 to her daughter after estate taxes.



GIFT OF A REMAINDER INTEREST IN A RESIDENCE OR FARM:

GIFT PLAN:

- » Donor signs and records a new Deed that names a charity as the remainder interest owner of the personal residence or farm after the donor's lifetime.
- » Donor continues to retain a lifetime interest in the property with full rights and enjoyment, including the right to lease the property.
- » Donor and Charity typically enter into a Life Estate Agreement that confirms:
 - » donor's responsibility for maintenance, repairs, and taxes during the donor's lifetime;
 - » donor's responsibility to insure the property, and the agreed division of any proceeds if a catastrophic loss occurs;
 - » All major improvements must be jointly approved by the donor and charity;
 - » charity's right to reasonably enter upon and inspect the property, after notice to the donor;
 - » donor's obligation to indemnify and hold harmless the charity for any liabilities arising from the property during the donor's lifetime.



GIFT OF A REMAINDER INTEREST IN A RESIDENCE OR FARM:

DONOR BENEFITS:

- » Charitable income tax deduction equal to the present value of the appraised value of the property, discounted over the donor's actuarial life expectancy.
- » At the donor's death, the charity becomes the owner of the property and takes all responsibility for management and sale of the property, relieving family or an executor of responsibility for the property.
- » If the donor wants to move from the property during the donor's lifetime, the donor can choose two options:
 - » Donor and charity can work together to sell the property, and divide the sale proceeds according to their proportional interests based on the selling price of the property and the donor's then current actuarial life expectancy; or,
 - » Donor can gift the donor's remaining life interest to the charity, based on the property's current appraised value and the donor's current actuarial life expectancy, and take an additional charitable income tax deduction. Charity then becomes the sole owner of the property and takes all responsibility for management and sale of the property.



GIFT OF REMAINDER INTEREST IN RESIDENCE

EXAMPLE:

Mr. and Mrs. Lowry, both age 75, own a large home in an appealing neighborhood that is currently appraised for \$2 million. They raised their 4 children in the home, and now host regular family gatherings. They foresee moving to an assisted living community in the future when one or both of them become unable to manage the household. All of their children live outside of the town where the Lowrys live.

The Lowrys did well building a commercial building supply company, and sold the business at the right time to a much larger supplier who wanted to enter their market, netting the Lowrys over \$10 million. They now live on the income from their portfolio, but their financial and tax advisors are encouraging them to generate income tax deductions to offset the large amount of taxable income from their portfolio.

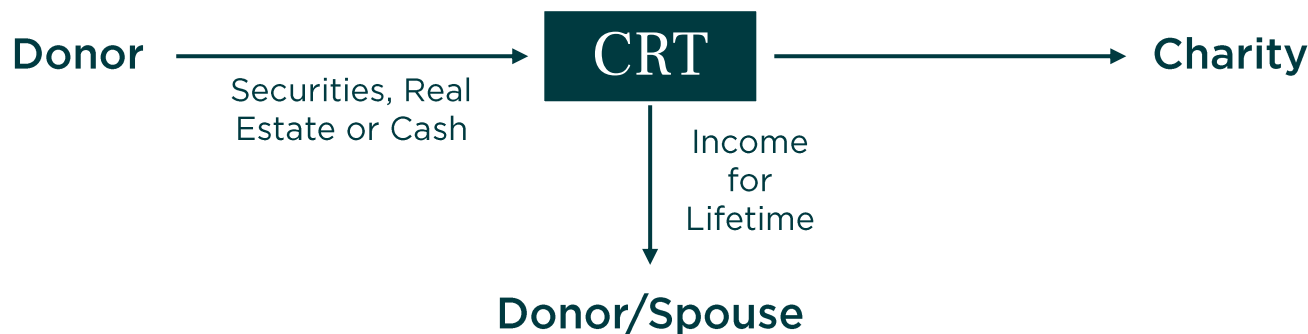
The Lowrys have implemented several estate planning strategies to move wealth during lifetime and at death to their children and grandchildren, funded primarily from their liquid portfolio. The Lowrys have always known they want to give back to the community where they built their business and raised their children, and want to make a gift to the local college from which some of their family have graduated, and they've hired several of their employees.

The Lowrys sign a new Deed that gives a remainder interest in their home to the college, while retaining a life interest in the home. The Lowrys generate a \$1,135,000 charitable income tax deduction from the gift.

Ten years later, when the Lowrys wish to move to an assisted living community, they ask the college to assist them in selling their home. The home sells for \$2,250,000, which the Lowrys and college split proportionally, with \$629,224 (28%) going to the Lowrys, and \$1,620,776 (72%) going to the college.

CHARITABLE REMAINDER TRUST (CRT)

GIFT PLAN:



DONOR BENEFITS:

- » Charitable income tax deduction equals the value of assets transferred to the CRT minus the present value of the expected CRT payments.
- » Capital gains tax savings.
 - CRT is tax-exempt.
- » Estate tax savings.
 - Charitable remainder interest is not taxed in donor's estate.
- » Income to donor is taxable, but may be taxed at favorable capital gains tax rates (currently 0%/15%/20%)
- » Payments may be either fixed (Charitable Remainder Annuity Trust) or variable (Charitable Remainder Unitrust).
- » Life insurance can be used to replace the assets transferred to the CRT.



CRUT – Lifetime gift

EXAMPLE:

Mr. and Mrs. Burns owned a large block of Procter & Gamble stock, acquired from inheritance and from Mr. Burns' career at P&G. When he passed away, part of the P&G stock was used to fund a Family Trust that will pass to Mrs. Burns' children after her lifetime, outside of her estate. Mrs. Burns continues to own the balance of the P&G stock, and a substantial stock portfolio, which she holds with a very low cost basis.

Mrs. Burns, age 75, is told by her advisors she should avoid taking distributions from the Family Trust, since the trust will pass estate tax-free to her family, and she should reduce her remaining estate, to avoid estate taxes, by making annual gifts to her children and grandchildren. However, Mrs. Burns is concerned she needs all the dividend income she is receiving from her stock portfolio for her needs. Mrs. Burns is also concerned with holding so much of her wealth in P&G stock. In addition to benefiting her family from her estate, Mrs. Burns is also interested in funding an endowed scholarship at the college from which she and Mr. Burns graduated

The P&G stock is currently worth \$1,000,000, but never pays a dividend over 1%, resulting in annual income of \$10,000. However, with a cost basis of \$100,000, after paying capital gains taxes, Mrs. Burns will only have \$820,000 to reinvest, which, at a 5% return from reinvesting in a conservative portfolio, will yield \$41,000 the first year.

To increase her income and diversify her investment in P&G, Mrs. Burns transfers the P&G stock to a Charitable Remainder Trust that will pay her \$60,000 each year for her lifetime ($6\% \times \$1,000,000$). The gift generates a charitable income tax deduction of \$550,000, resulting in tax savings of \$203,500 (37% tax rate).

By increasing the income she receives from the P&G stock, Mrs. Burns feels she can start making annual gifts to her family from the remainder of her portfolio.



CRUT – IRA Beneficiary after death

EXAMPLE:

Mrs. Burns is the owner and beneficiary of a \$1 million IRA that she rolled-over from her husband's estate.

Mrs. Burns, age 75, is told by her advisors that if she leaves her IRA to her only son, Jack, age 45, the IRA will be taxed in her estate, and Jack must withdraw the balance of the IRA over a 10-year period after her death.

If Mrs. Burns names Jack as the Primary Beneficiary of her IRA, and Jack withdraws the \$1 million IRA ratably over 10 years after her death, he will receive \$1,076,000 after-tax (assuming 7% annual investment return; 28% annual income tax rate). The present value of the annual IRA distributions (after-tax) if Mrs. Burns died today is \$984,000 (assuming 3% inflation rate).

In addition, the \$1 million IRA will generate \$400,000 of estate taxes in Mrs. Burns' estate, that can be paid from non-IRA assets.

Alternatively, if Mrs. Burns names a 5% CRUT benefiting Jack as the Primary Beneficiary of her IRA, Jack will receive \$2,100,000 total after-tax distributions during his 37-year expected lifetime (assuming 7% annual investment return; 28% annual income tax rate). The present value of the annual CRUT distributions (after-tax) if Mrs. Burns died today is \$1,200,000 (assuming 3% inflation rate).

In addition, Mrs. Burns' estate will be reduced by a \$215,000 charitable deduction for the CRUT charitable remainder interest, potentially saving estate taxes of \$86,000.

And, at the end of Jack's expected lifetime, the CRUT will distribute approximately \$2 million to charity.



CHARITABLE GIFT ANNUITY

GIFT PLAN:

- » Gift to charity, in exchange for fixed payments to the donor for life, or for the lives of the donor and another beneficiary.
- » Most charities follow the annuity rates set by the American Council on Gift Annuities, for example:

AGE	PAYOUT RATE
60	3.9%
65	4.2%
70	4.7%
75	5.4%
80	6.5%
85	7.6%
90	8.6%



CHARITABLE GIFT ANNUITY

DONOR BENEFITS:

- » Charitable income tax deduction equals value of assets transferred for annuity minus present value of expected annuity payments.
- » Secure, annuity payments for life, that may be substantially greater than income from stocks, bonds or CDs.
- » Annuity payments may be partially tax-free.



CHARITABLE GIFT ANNUITY

EXAMPLE:

Dr. and Mrs. Basinger, both 70, have reached the stage in their life when they are making plans for the future. They've completed their estate plans to provide for their children and finalized the required distributions from their IRAs.

The latest step was to sell their home, which they lived in for 35 years, and move to a smaller patio home. The Basingers were fortunate to sell their home for \$300,000 without paying capital gains taxes, using the \$500,000 per couple capital gains exclusion for the sale of the residence.

Now that the Basingers have taken care of their children and themselves, they are considering making a gift to charity.

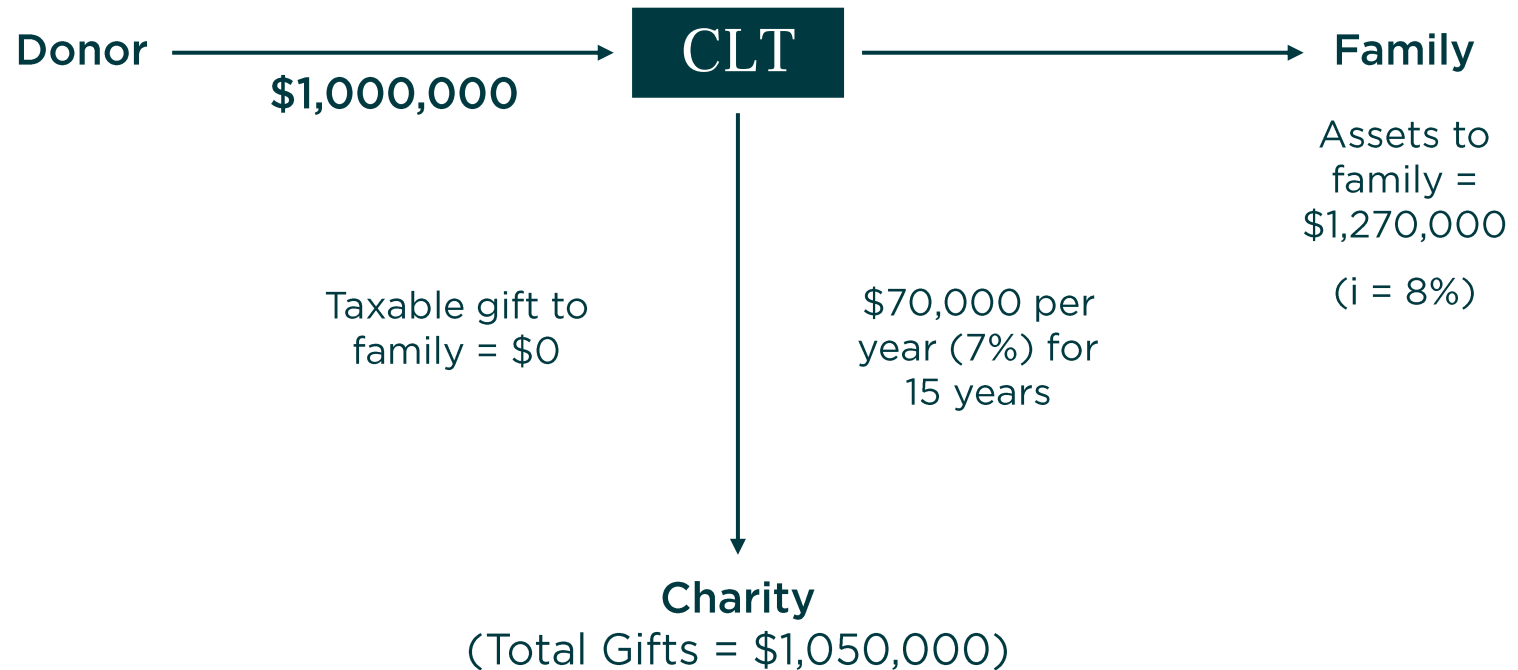
Dr. Basinger is uneasy about investing the \$300,000 sale proceeds in the stock market. They have seen stock markets decline and, at their age, can't afford to see their investments fall in value for an extended period of time, particularly since they have substantial stock investments inside their IRAs. However, the alternatives among safer investments are not very appealing – CDs and money market funds are paying around 1% and U.S. Treasury bonds are paying 2.5%.

Instead, the Basingers give the \$300,000 to the University in exchange for a Charitable Gift Annuity that will pay them \$15,000 (5%) annually for their joint lifetimes. \$10,200 of each annual payment will be tax-free. The Basingers are pleased that whatever happens in the stock market, they can count on this income stream. Also, the gift generates a charitable income tax deduction of \$91,000 that will help offset the taxable income from their IRAs.



CHARITABLE LEAD TRUST (CLT)

GIFT PLAN:





CHARITABLE LEAD TRUST (CLT)

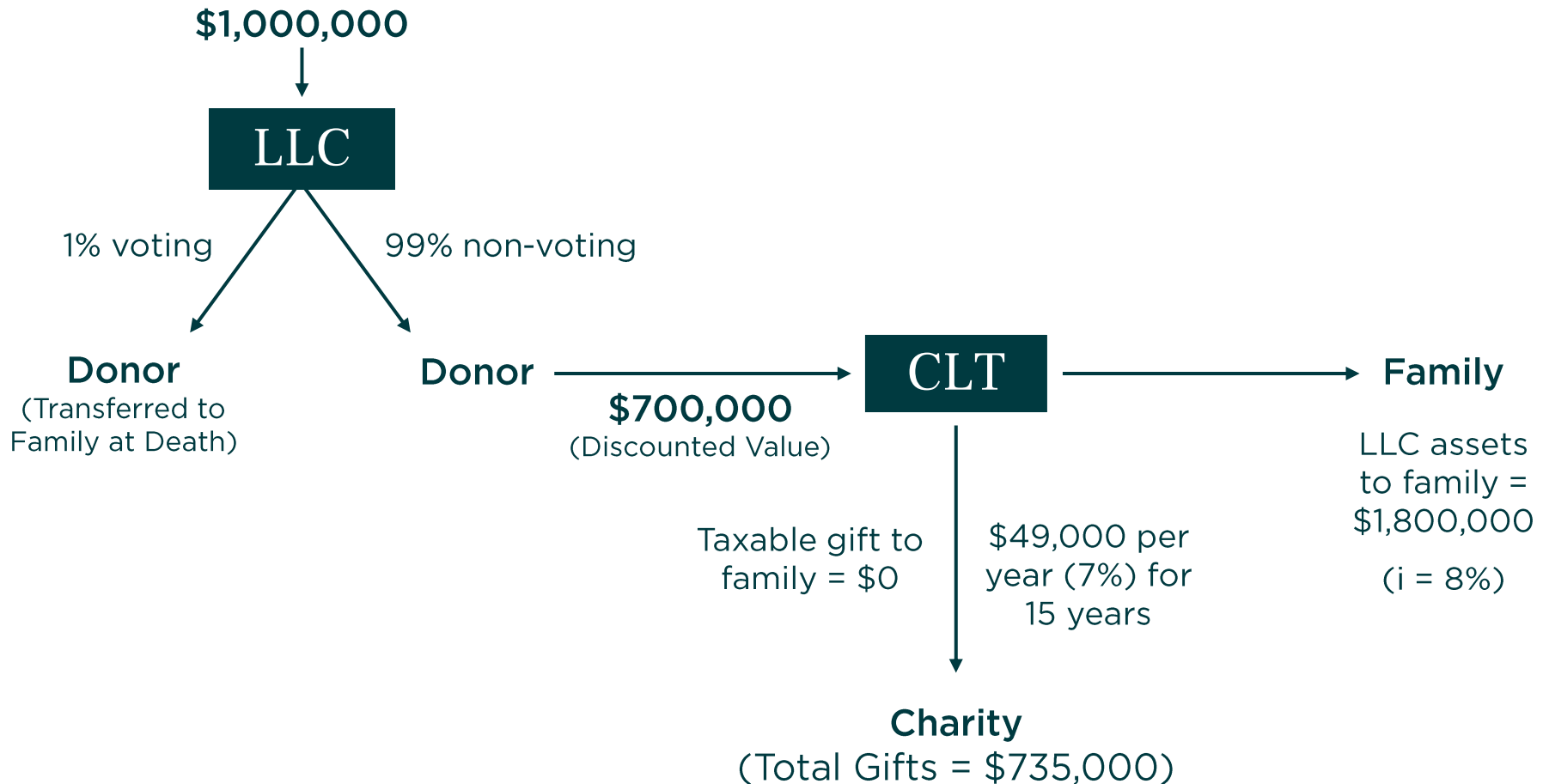
DONOR BENEFITS:

- » Transfer significant assets to family at reduced gift tax value.
- » Donor can choose to either:
 - » Avoid income taxes on investment of CLT assets (a non-grantor CLT); or,
 - » Benefit from income tax deduction, but pay income taxes for the CLT, allowing the CLT assets to grow tax-free (a grantor CLT).



CHARITABLE LEAD TRUST - FUNDED WITH LLC UNITS

GIFT PLAN:





CHARITABLE LEAD TRUST (CLT)

Good Technique in These Situations:

- » Donors who are focused on reducing their taxable estates.
- » Donors who want to delay when their family receives assets (e.g., when children retire, when grandchildren start a career, etc.).
- » Donors who wish to “freeze” assets passing to family at current value, passing future appreciation to family without estate taxes.
- » Donors who wish to make a capital campaign gift, but have already made gifts that equal/exceed their AGI limits. A non-grantor CLAT with a short term, and structured to return the asset to the donor, can make the campaign gifts and apply annual charitable income tax deductions against the CLAT’s taxable income.



GIFTS OF S-CORPORATION STOCK

GIFT PLAN:

- » Donor holds S-Corporation stock which will be liquidated by a sale to a 3rd party, or by a redemption of the stock by the company; often resulting from a sale of the company, or from implementation of an ownership succession plan.
- » Donor wishes to make a charitable gift of some of the proceeds from selling the S-Corporation stock
(ie. “unlock the charitable capital in the value of the S-Corporation stock”).
- » Before the sale or redemption is finalized, the donor transfers some of the S-Corporation shares to a public charity.
- » The donor and charity sell their respective shares of S-Corporation stock to the 3rd party buyer or the company.



GIFTS OF S-CORPORATION STOCK

DONOR BENEFITS:

- » Charitable income tax deduction equal to the appraised value of the S-Corporation shares transferred to the charity.
- » Capital gains tax savings – the donor will avoid the capital gains income on the sale of the shares, but the charity will be taxed on some of the capital gains from selling the shares, as Unrelated Business Taxable Income (“UBTI”)
 - » NOTE: UBTI only arises when the charity holds or sells S-Corporation stock – the sale of C-Corporation stock, LLC units or other business interests usually do not generate UBTI).
- » Estate tax savings – S-Corporation shares transferred to charity will not be taxed in the donor’s estate.



GIFTS OF S-CORPORATION STOCK

TWO KEY ISSUES:

» **Avoid a Step-Transaction:**

» If a donor has a binding commitment to sell an appreciated asset, and prior to closing the sale, gifts the asset to charity, the IRS will likely tax the realized capital gain to the donor by applying the Step-Transaction Doctrine.

» However, if the donor transfers the appreciated asset to charity before there is a binding commitment to sell the asset, the capital gain income will be taxed to the charity, which is tax-exempt.

(Palmer v. Commissioner, 62 T.C. 684 (1974); IRS Rev. Rul. 78-197, 1978-1 CB 83)

» A binding obligation would generally arise when a binding Letter of Intent, or a Purchase/Sale Agreement has been signed, or, possibly after a shareholder vote to approve the sale.

» Solution: The donor should make the charitable gift of stock as far in advance of negotiations and signing of a binding agreement as possible.



GIFTS OF S-CORPORATION STOCK

TWO KEY ISSUES:

» **Reduce Unrelated Business Income Tax to the Charity:**

- » When a public charity holds S-Corporation stock, the business income attributable to the stock is taxed to the charity as UBTI.
- » When a public charity sells S-Corporation stock, the capital gains from the sale of the stock is taxed to the charity as UBTI.
- » The UBTI is taxed to the charity based on what kind of entity the charity is:
 - » if the charity is a non-profit corporation (a “Corporation Charity”), the UBTI is subject to a corporate tax rate of 21%.
 - » If the charity is a trust (a “Trust Charity”), the UBTI is subject to trust tax rates, which are similar to individual income tax rates and includes capital gains rates of 0-20%. Trusts can apply a charitable income tax deduction for income distributed to charity during the trust’s tax year, applicable for UBTI up to 60% of the trust’s UBTI.

NOTE: Typically, the charity pays the tax on UBTI from the gift proceeds, which reduces the remaining gift from the donor.



GIFTS OF S-CORPORATION STOCK

GIFT PLAN - to reduce tax on UBTI:

- » Donor gifts the S-Corporation stock to a Trust Charity that has been recognized by the IRS as an IRC Sec. 501(c)(3) tax-exempt public charity. The gift should occur before there is a binding obligation on the Trust Charity to complete a sale of the stock.
- » The Trust Charity sells the S-Corporation stock to the 3rd party buyer, or redeems the shares to the company. Upon the sale, the Trust Charity will incur UBTI equal to the realized capital gains from the sale of the stock, typically taxed at 21%.
- » In the Trust Charity's same tax year (could be a fiscal year), the Trust Charity transfers the sale proceeds to a Corporation Charity that has been recognized by the IRS as a 501(c)(3) tax-exempt public charity.
- » When the Trust Charity transfers the sale proceeds to the Corporation Charity, the Trust Charity can take a charitable deduction against the UBTI, applicable up to 60% of the UBTI, which reduces the taxable UBTI by 60%, effectively reducing the tax rate on the UBTI to 8.4%.



GIFTS OF S-CORPORATION STOCK

Where can you find a Trust Charity?

- » Many Community Foundations were initially formed as Trust Charities, for which only banks could manage the gift funds.
- » Later, many Community Foundations also formed non-profit corporations to allow for gift funds to be managed by non-bank investment managers.
- » Some Gift Funds sponsored by investment companies have formed affiliated Trust Charities to facilitate gifts of S-Corporation stock and gifts of illiquid, non-publicly traded assets (e.g. LLC units, partnership interests, real estate, art, collectibles, etc.)

THANK YOU!

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