Indiana Association of
Public Education Foundations

Planned Giving Demystified

You Don't Need to be an Expert

But You Do Need to Ask

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I. Introduction

Let's face it, sophisticated planned giving can be intimidating for everyone involved. It involves complex terms and calculations, complicated tax rules and sometimes serious penalties if mistakes are made. Yet this fear, or a mindset that you are not qualified to talk about planned giving, or request that one of your loyal supporters consider making a planned gift to your organization, can lead to lost opportunities not only for your organization, but also for your supporters and the students that benefit from your mission.

It is not necessary for you or anyone on your staff to master the vast complexity possible in planned giving. Rather, all you need understand is the underlying simplicity common to almost all planned giving. Generally, planned gifts lower taxes for your donor and allow your donor to make a larger gift than they thought possible due to that tax savings and/or expanding the donor's imagination about possible donations other than cash. More complicated "split interest" planned gifts also involve a sort of "trading" of a gift for income. You don't need to know all the rules; you just need to be able to understand some basic concepts, recognize opportunities, determine your prospects, cultivate your loyal supporters and initiate the conversation. Then listen. If technical expertise is necessary, call your local community foundation, especially if you have an endowment fund with the community foundation. There are many other resources as well. Even if you don't understand anything else, keep in mind that despite the seemingly vast array of planned gift types, 80% of all planned gifts are, and are likely to remain, bequests—gifts in a will. Most everyone understands that!

II. Opportunity Recognition

Would you know a planned gift if it hit you in the face? Do you know how, where and when to look for one?

A. Definition of Gift Planning

There are a variety of definitions of planned giving. Two of my favorite gift planning experts offer the following definitions: Laura Hansen Dean defines gift planning as, "Helping a donor make a gift to charity s/he wants to make but never thought was possible by creatively and legally structuring a charitable gift so that a donor can give at times and in ways that honor his/her values and help meet his/her personal, financial, and estate planning goals." Bryan Clontz defines gift planning as a process using tax and financial planning methods allowing the donor to efficiently achieve his or her personal and charitable objectives. It offers solutions to the questions, "How should I give or what is the best way to give?" and helps to lower the donor's real cost of giving if possible.

Another definition I have heard is "a stop and think gift." Often planned gifts are included in a donor's estate plans, but with increased income and capital gains taxes and the elimination of estate taxes for all but one fourth of one percent of the population (see discussion of ATRA in section IV herein), it may be more tax efficient/ result in better tax savings for estate gift donors to try to accelerate their gift during their lifetime.

B. Who Are Likely Planned Gift Prospects?

·**Those who believe in your mission.** Those who provide annual or routine support through time, talent or treasure. Those whom your organization has benefited—beneficiaries of your mission.

·**Those with whom you have a relationship**. Part of any "planned giving program" is cultivation. A good donor cultivation practice will lead to relationships which will lead to additional gifts and planned gifts. Practice cultivation, including thanking donors, telling donors how their gifts have been used to support the critical work of the foundation, providing ongoing education about your mission, articulation of why you need planned gifts.

·**Think linkage--** who are your loyal supporters? Who has given to the foundation regularly, even if perhaps not every year?

·**Think capacity--** but this is not as important as linkage. (Donald Trump has capacity, but is not likely to make a planned gift to your foundation.)

III. "The Conversation"

You have to ask. One of the most important and simplest things to understand about planned giving is you need to ask for the planned gift! Yes, we all hear about amazing bequests left to organizations by people they least suspected would even have that kind of money let alone leave it to that organization. That is the exception!

People give to people. Your role is to identify your planned gift prospects and figure out the best person at your organization to initiate "the conversation." Is the right individual at your foundation a board member who is a friend of the prospect (and who can talk a bit about why they have made a planned gift to the foundation)? Is it a combination of people? Make sure whoever it is that they can passionately articulate your organization's need for the planned gift. Newsletters and direct mail serve a role in educating your prospects and alerting them that your organization is indeed a worthy planned gift recipient, but rarely result in action on the part of your prospect. Stories of actual planned gift donors are great, but not a substitute for face to face asks.

Openers. Thank a planned giving prospect for his or her loyal support and ask for a meeting to explore their interest in

·Perpetuating/ endowing their annual support to your organization;

·Helping to secure/ ensure the financial future of your organization;

·Becoming a member of your planned giving society (or the founding member); and/or

·Having their name or a family or business name perpetually associated with your organization.

Ask your prospect about their motivation. What is it about the education foundation that attracts their support? Listen to the answer!

One possible question: Would you consider making a planned gift (or a gift of your farm, your home, your company, some of your investment portfolio, etc.) if we could show you how?

IV. How Taxes Affect Planned Giving

If we as gift planners and development professionals can help save people money as they are planning to benefit our cause, that is part of our job. With recent tax law changes, opportunities abound to explore opportunities for your donors to make a legacy gif,t not only as part of their estate plans, but also, or alternatively, while they are still living.

The American Taxpayer Relief Act of 2012 (enacted January 1, 2013) (ATRA), set the federal estate and gift tax exemption at $5 million, adjusted for inflation, so that the 2015 exemption is currently $5,430,000 million. In addition, ATRA made permanent the right of a surviving spouse to use any portion of his or her deceased spouse's unused exemption, effectively allowing a married couple to give away to non-charitable beneficiaries as much as $10,860,000 and not incur any federal estate taxes. Recent studies estimate that less than one quarter of one percent of all estates will wind up paying any federal estate or gift tax post ATRA. ATRA also added a new income tax rate of 39.6% for individuals with taxable income over $400,000 and married couples over $450,000. These amounts also have been adjusted for inflation after 2013. The silver lining for taxpayers falling into this new top bracket is that it makes charitable giving "more affordable" during life. The value of the charitable deduction is equal to a taxpayer's marginal tax rate. E.g., a taxpayer in the 35% tax bracket will reduce his or her tax liability by 35 cents for every one dollar of charitable contribution, for a net cost of 65 cents per dollar contributed. In the 39.6 % new top bracket, tax liability is reduced by 39.6 cents for every dollar contributed, for a net cost of 60.4 cents per dollar contributed. The higher marginal tax rate results in a 7 percent decrease in the after-tax cost of giving for taxpayers in the top bracket over that for taxpayers in the 35 percent bracket (and so forth).

Finally, ATRA also substantially increased the top capital gains tax rate. First, the basic tax was increased from 15 to 20% for taxpayers in the new top income tax bracket. Next, since capital gains are included in adjusted gross income, capital gains realization also would generate additional tax liability through ATRA's modified reinstatement of the Pease limitation –resulting in a top rate of 21.2%. Finally, although not a result of ATRA, the 3.8% Medicare investment surcharge beginning after 2012 results in increasing the highest marginal rate on capital gains to 25%.

V. Planned Gifts During Lifetime

As a result of ATRA, with estate tax charitable deductions almost nonexistent and income and capital gains taxes through the roof, it may be advisable for donors with charitable bequests in their estate plans to consider accelerating all or a portion of such gifts and make them NOW during their lifetimes in order to obtain income tax benefits and capital gains tax savings that no longer are available to their estates. If a donor is in an effective 25% income tax bracket, making a $50,000 charitable donation during life could result in a $12,500 income tax savings, whereas leaving that gift in his or her estate would result in no tax benefit whatsoever if the estate totals less than $5.43 million for an individual or $10.86 million for a couple. Some of the most common lifetime charitable gift options are as follows:

Gifts of Appreciated Assets

With investment markets hitting record levels (even though we've had a few rocky days lately), it may be more important than ever for donors and their advisors to pay special attention to the benefits of non-cash gifts DURING LIFE. A higher capital gains tax rate increases the incentive to donate appreciated property. Not only does the donor get a charitable deduction (in most cases) for the current fair market value of the gift, but also avoids paying capital gains tax on the unrealized gain. Charitable gifts of appreciated property, including stock, business interests, investments, real estate, etc., are more attractive than ever.

Only 31% of all donors in the high net worth category, many of whom we know have stock portfolios, make gifts of publically traded securities rather than cash. Even if you don't know how to accept stock gifts, your community foundation does!

Example: Donor owns stock purchased in 2011 for $250. S/he contributes it to your org more than a year and a day later (required term for long term capital gain property) when it is worth $750. Donor avoids capital gain on the $500 growth, which would be $100 at 20% cap gains tax rate. Charitable deduction of $750 fair value saves income tax:

*in 25% income tax bracket=$750 X 25%=$187.50 saved

*PLUS $100 capital gains tax avoided + $287.50 total savings.

Net cost to give $750 to charity in this case is $462.50.

Life Income Planned Gifts: Charitable Gift Annuities and Charitable Remainder Trusts

These irrevocable, life income gifts are more attractive in this era of appreciated assets and high capital gains rates, as they offer the donor the ability to realize gains in a tax-free environment, obtain a charitable income tax deduction and enjoy income based on the total value of donated assets. Under current investment market conditions and given higher income and capital gains taxes, the use of both CRTs and CGAs is growing. A CGA may be especially useful for a donation of low dividend producing, appreciated stock in exchange for a CGA. The donor can convert that stock into an income stream and save capital gains taxes that otherwise would be incurred if the appreciated stock was sold and reinvested for higher income producing assets.

Charitable Gift Annuity is a contact between the donor and your organization (or your community foundation for the benefit of your community foundation fund) that provides a fixed income for life to one or two "annuitant" named by the donor. Part of the amount given is a charitable gift and qualifies for the charitable income tax deduction. Part of the annitu received each year by the donor (or other named annuitant(s)) is tax-free income for the rest of the annuitant's average life expectancy when funded. After that all the annuity is taxable income. For donors (annuitants) age 70 years or older, immediate payment charitable gift annuities payout at 5.1% (higher for older annuitants) as determined by the American Council of Gift Annuities. It is not possible in the current interest rate environment for your supporters to receive 5.1% on a CD at their local bank.

Charitable Remainder Trust is an actual trust created under Section 664 of the Internal Revenue Code. It is a bit more complicated than a gift annuity and generally should be considered if the appreciated asset to be contributed have a value of at least $250,000 to $500,00 or more. The trust is created between the donor and a trustee. It pays the donor (or person/s named by the donor) either a fixed(CRAT) or variable (CRUT) income interest of 5 or 6% or more for life or a term of years not greater than 20, with the assets in the trust following the income interest going to charity (the remainder interest). The donor receives a charitable income tax deduction for the present value of the charitable remainder interest…and again avoids capital gains tax on the donated appreciated assets (can be publically traded stock, privately held business interests, real estate,

Gifts of Grain or Livestock

Needless to say, there are a lot of farms in Indiana! For cash basis farmers, charitable gifts of grain or livestock can result in significant federal and state income tax savings, as well as self-employment taxes. This is because the farmer will not need to realize income from the donation, but can still deduct the cost of production. Many Community Foundations accept gifts of grain or livestock.

Gifts of Remainder Interest in Personal Residence or Farms (Life Estate Agreements)

There is a specific statutory exception to the general rule that no deduction is allowed for federal income tax purposes for any contribution of a partial interest in property to charity for gifts of a remainder interest in a personal residence or farm. The transaction must involve an irrevocable transfer of title with a retained right to use the property for a fixed term of years or for the life of one or more individuals. Gifts of this type most frequently are established to last for the life or lives of the residents of the contributed property and therefore are often referred to as "life estate agreements."

For donors desiring to make a significant gift and who might be considering a testamentary gift of their home, vacation home or farm, a life estate agreement offers the donor a current, potentially substantial charitable income tax deduction, and offers the charity the opportunity to "lock in" an otherwise revocable intention. It allows donors to "leave everything else to their kids"…and if no kids, this might be a gift that is especially appealing to would be donors. The continuing relatively low interest rate environment causes the present value of the charitable gift to be larger than when interest rates are higher.

The term "personal residence" includes any property used by the donor as a personal residence, even though it is not used as THE principal residence. Vacation homes are therefore included.

A "farm" includes "any land used by the taxpayer or his tenant for the production of crops, fruits, or other agricultural products or for the sustenance of livestock." With the current value of farmland, this might be an especially attractive lifetime gift opportunity—offering great tax benefits and lowering the net cost of the gift for the donor.

Irrevocable Transfer of Life Insurance Policy

Many people find they do not need all the insurance they did when they were younger. Over 80% of life insurance policies do not stay in force until the death of the policy owner. Over $12 million is sold on the secondary market and experts recommend charities become more aware of what life insurance is as a tangible asset.

To achieve immediate tax benefits, the owner of a policy can irrevocably transfer the policy to charity by obtaining a change of ownership form and making the charity both the owner and the beneficiary.   The value of the income tax charitable deduction is equal to the lesser of the policy's replacement value or the cost (in terms of net premiums paid.)

Watch for the Potential Return of the IRA Charitable Rollover

Although this "tax extender" expired at year end 2014, it is possible (likely?) that Congress will extend this and other tax extenders once again before the end of 2015 and make them retroactive for at least the entire year of 2015. Beginning with the Pension Protection Act of 2006 for a two year period, and extended by Congress from time to time through 2014, individuals age 70 ½ or older can distribute up to $100,000 tax-free annually directly from their IRA to charity without taking including the distribution in their gross income (and without taking a charitable income tax deduction). Like gifts of grain and livestock, the tax advantage of this type of gift is not the income tax charitable deduction, but rather avoidance of additional tax liability on the amount rolled over (and avoiding the potential of being bumped into a higher tax bracket by receipt of the mandatory distribution).

To qualify (*assuming this now expired legislation is once again extended*), the distribution must be made directly by the IRA administrator or trustee to a public charity (not including donor advised funds or supporting organizations), and the entire distribution must be deductible under normal charitable deduction rules (i.e., not a quid pro quo contribution such as a charity dinner.) A rollover contribution to your foundation, with the donor receiving nothing in return would have qualified under all previous applications of the charitable rollover.

How does this save your donor taxes if there is no charitable contribution deduction?

Assume Donor has adjusted gross income from non IRA sources of $50,000 in the year in which he instructs his IRA administrator to distribute $100,000 directly to your foundation.

Result with no IRA rollover extended legislation: The transfer from the IRA would be treated as a distribution to Donor, increasing his adjusted gross income to $150,000, followed by his charitable contribution to your foundation, which would be deductible as a charitable contribution up to 50% of Donor's AGI, or $75,000. This leaves $25,000 additional AGI subject to income tax, even though the entire $100,000 IRA distribution went to charity.

Result if IRA Rollover is extended: Under the special charitable IRA rollover provision, the distribution from Donor's IRA to the foundation would not increase Donor's AGI (nor would it entitle Donor to take a charitable contribution deduction). With the result that Donor makes a gift in the same amount but owes income tax on only $50,000 AGI rather than on $75,000 AGI if no extender.

Planning tip: whether or not the extension comes late in the year: For donors who would make a charitable gift anyway and who must take a mandatory distribution from their IRA, they should consider making charitable gifts directly from their IRAs to charity in 2015 even before the law is extended, but only up to their required minimum distribution amount (RMD). This strategy would have worked in previous years when the rollover temporarily expired and was extended retroactively. It is perhaps even more appealing post ATRA when taking RMD into income might bump individuals into scary high income tax brackets.

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VI. Bequest Giving Remains King

Regardless of ATRA and the consequent unavailability of estate tax charitable deductions for the vast majority of charitable bequests, 80% of all planned gifts are, and are likely to remain, bequests. Bequests are the most common and primary source of planned giving revenue. Interesting and instructive facts about bequest giving in America include:

*This bears repeating: 80% of all planned gifts are bequests. So far, the substantial decrease in potential estate liability has not adversely affected this percentage. According the Giving USA 2015, giving by bequest totaled $28.13 billion in 2014, an increase over 2013 or 15.5%.

*About 10% of the population over age 55 now has a provision for a charitable bequest in their will. However, since33% of Americans are willing to consider a charitable bequest there is room for growth.

*Bequests are the major gift of the middle class. Asking for 5% of your donors' estate may give your donors the opportunity to leave a significant legacy without pain. There are a lot of folks out there who are willing to consider a bequest but who have not been asked to!

*Once donors name a charity in their will, they almost never remove it. Stewardship is nevertheless important to minimize the defection rate.

*Even if someone has left your organization a gift in their will, they might not know that what they have left you is a "bequest." Be careful about the complicated, foreign terminology of "planned giving." Donors are more likely to understand leaving you a *gift in their will* or leaving you *a gift of their retirement plan*.

*Moving beyond bequest giving for a moment, it may be instructive that charitable giving by individuals and bequests comprised 80% of total charitable giving in 2014, whereas corporate charitable giving amounted to just 5% of total charitable giving. People more than corporations are your charitable targets in terms of time and resource allocation.

*Despite very good reasons to make a gift during life in order to take advantage of charitable income tax deductions, there is a tendency to defer gifts of assets until death—especially by the Great Generation (WW) and Millennials.

VII. Beneficiary Designations and POD/ TOD Directives

People are inclined to make beneficiary designations for the same reason they are attracted to bequests. The gift can be revoked and if less remains than expected, the charitable beneficiary gets less too.

Retirement Plan Assets

Retirement plan assets constitute the largest asset holding of many Americans. These assets do not pass via will or trust, but rather through beneficiary designation on the beneficial form of the Plan Custodian. Beneficiary designations are revocable until death, can be made and changed easily and can be split between individuals and charity or among charities. Retirement plan assets left to individuals are heavily taxed and consequently "expensive" to inherit. Therefore, retirement plan assets are great assets to donate to charity.

A dramatic increase is predicted in the number of individuals who choose to leave IRAs to charity outright or in charitable remainder trusts.

IRA beneficiary designations could potentially affect the transfer of several trillion dollars worth of assets in pension plans.

Contingent Beneficiary and Disclaimer Planning

On retirement plan beneficiary designation forms, there is often space for a contingent beneficiary (and if not, this can be requested). For individuals with charitable inclinations but who are unsure about whether love ones will be sufficiently provided for, the IRA owner could select spouse and/or child as the designated beneficiary/ies and select your foundation as the contingent beneficiary. Depending upon income and estate tax rules in effect at the time the IRA owner dies, the designated beneficiary/ies may determine that there would be substantial tax savings—and that the amount remaining after tax is not needed by them or better suited to meeting the needs of the community-- by "disclaiming" and allowing the distribution to be made to the contingent charitable recipient.

Disclaiming also works for contingent bequests. The testator (will maker) can allow the beneficiary to decide whether to accept a specific or residuary bequest or, if it is not needed, to pass to a specifically identified charitable contingent beneficiary—your organization.

Beneficiary designations and disclaimers must follow specifically prescribed rules to be valid.

Guiding Heirs

As a twist on the theme of obtaining income tax charitable deductions in the absence of any available estate tax charitable deduction-- individuals may want to leave a NON CHARITABLE bequest to their spouses or children with a *non-legally binding request* that the recipient consider making a charitable donation in memory of the deceased spouse or parent, thus enabling the spouse or child beneficiary to take a personal charitable income tax deduction for the charitable donation made with that portion of their inheritance.

Pay on Death and Transfer on Death Directives

Although bequests are growing in number and dollar amount, there are still countless prospects out there who may not ever have a will or a retirement account. But they have a bank account and/or perhaps an investment account. I read a 2014 article in *Planned Giving Tomorrow* that urged the promotion of these under-utilized, SIMPLE ways to secure legacy gifts. A POD is a simple agreement telling the bank who will inherit a bank account. A TOD is similar but applies to investment accounts. POD and TOD forms are available from the bank or brokerage firm and can be completed by the donor right there on the spot. No lawyer needed. Easy to market along with bequests and beneficiary designations—leaving a gift in one's will or retirement plan.

VIII. Conclusion

Trillions of Dollars will be transferred over the next several decades. Myriad studies have forecast that trillions of dollars will be transferred in the next thirty five to forty years to heirs, taxes or charity. According to Paul Schervish of Boston University, an estimated $41 to $136 trillion will be transferred. Assets under management among SEC-registered investment advisors increased 12.6% in 2014 to $61.7 trillion.

IRA Transfers. There is an estimated $10 plus trillion and climbing invested in IRAs, 401Ks and other income in respect of a decedent. Intergenerational transfers will include IRA beneficiary designations, which could potentially affect the transfer of several trillion dollars.

Key Question: Will this wealth be invested philanthropically? Certainly not if we don't ask! We would do well to have our hand out with respect to the millions of dollars that will be changing hands in your respective communities alone.