

Charitable Giving

1. Charitable Giving, Generally. A bequest to a charity in your Will is deductible for estate tax purposes. If you make charitable gifts during your lifetime, however, you receive a double benefit in that you obtain a current income tax deduction and the property gifted to the charity will be removed from your estate for estate tax purposes. If you give appreciated property in which you have a low cost basis to charity, you also may be able to avoid the capital gains tax that you would be required to recognize if you were to sell such property.

The amount of the income tax deduction available for the year in which a charitable contribution is made may depend on a number of factors, including: (1) the type of property contributed; (2) the fair market value of the property contributed at the time of the contribution; (3) the donor's basis in the contributed property at the time of the contribution; (4) the type of charitable organization or charitable giving vehicle that receives the contributed property; and (5) whether the contributed property is related to the recipient organization's charitable purposes. There are a number of ways to contribute to a charity, including outright gifts or bequests to existing publicly supported charities, establishing a "private foundation" and creating a "charitable remainder trust."

2. Private Foundations. Generally, there are two types of tax exempt charitable organizations, contributions to which are deductible by the donor for income tax purposes. These two types of organizations are (1) publicly supported charities and (2) private foundations. Publicly supported charities typically receive financial support from a broad section of the general public and actively engage in charitable activities or function in a close supporting relationship to publicly supported active charitable organizations. In contrast, private foundations are typically funded and controlled by one individual, family or corporation, and are engaged primarily in making grants to active publicly supported charitable organizations.

Charitable giving through a private foundation permits a donor to establish a long term charitable giving program in which the donor may actively participate during his lifetime and in which his family members may continue to participate after his death. Private foundations typically are established as nonprofit corporations managed by a Board of Trustees. The Trustees make decisions as to the foundation's grant-making policies and grant recipients. The foundation may be established with broad charitable purposes so that its grant-making policies may always reflect your charitable interests, even if such interests change from time to time.

The disadvantages associated with private foundation status include certain limits on charitable deductions, special taxes, reporting requirements and start-up and ongoing management costs. The deductibility of contributions to private foundations is more limited than the deductibility of contributions

to publicly supported charities. For example, a contribution of cash to a publicly supported charity would be deductible in the year of the gift to the extent that the amount contributed did not exceed fifty percent (50%) of the donor's adjusted gross income. A contribution of cash to a private foundation, however, is deductible to the extent that the amount contributed does not exceed thirty percent (30%) of the donor's adjusted gross income.

Furthermore, a donor who contributes long-term capital gain property to a publicly supported organization is entitled to a charitable deduction equal to the fair market value of the contributed property, to the extent that that value does not exceed 30% of the donor's adjusted gross income in the year of the gift. The deduction for a contribution of most types of long-term capital gain property to a private foundation, however, is limited to the donor's basis in the contributed property and may be deducted only to the extent that that amount does not exceed twenty percent (20%) of the donor's adjusted gross income. Excess contributions may, however, be carried over and deducted in the five taxable years following the year of the gift.

Private foundations also are subject to certain taxes that are not imposed on public charities. For example, a private foundation must pay an annual two percent tax on its net investment income. Generally, a private foundation must make charitable distributions each year equal, in the aggregate, to at least five percent of the fair market value of its assets. In years in which a private foundation increases its average charitable grants payout over the preceding five years by at least one percent (1%) of its net investment income for the year in question, the tax on its net investment income is reduced to 1%.

Furthermore, a series of complex regulations and taxes designed as penalties restrict private foundations from engaging in certain prohibited activities. For example a private foundation may not engage in "self-dealing" transactions. Self-dealing transactions are transactions between a private foundation and its "disqualified persons" (i.e., the persons who make substantial contributions to and/or control the private foundation). In addition, generally, a private foundation and its disqualified persons together may not own more than 20% of the voting shares in any business corporation.

Private foundations also must comply with certain reporting and public disclosure requirements. Private foundations must make their annual information returns available for public inspection and must obtain prior approval from the Internal Revenue Service (the "IRS") for procedures for making certain types of grants, especially scholarship and fellowship grants to individuals or grants to organizations that have not been recognized by the IRS as tax exempt charitable organizations. A private foundation must exercise ongoing "expenditure responsibility" (i.e., verify and document the use for charitable purposes) with respect to grants made to individuals and to organizations that are not recognized as

qualified charitable organizations. For this reason, I generally recommend that our foundation clients restrict their grant-making activities to qualified charitable organizations.

Finally, the procedures associated with the establishment of a private foundation may be fairly extensive, as you know. These procedures include incorporation under state law and applying to the IRS for recognition of the foundation's tax exempt status. Ongoing management of the foundation's assets and operations also must be provided for.

Despite the restrictions and inconveniences described above, many donors prefer to establish a private foundation rather than to make outright gifts to public charities because the donor and members of the donor's family can enjoy being actively involved in managing the activities of the foundation during the donor's lifetime, and because the foundation established by the donor will continue after the donor's death as a philanthropic entity.

Another alternative to outright giving is the establishment of a new (or contribution to an existing) charitable endowment fund through a community foundation. Typically, the community foundation manages the fund and makes the final decisions as to grant recipients, but allows the donor to specify an area of charitable interest and/or to provide suggestions with respect to particular grant recipients. Community foundations are considered to be publicly supported organizations. Note that the organization that administers a community foundation normally charges for its services.

3. Charitable Remainder Trusts. A charitable remainder trust allows a donor to transfer property to a trust, reserve an income interest in that property for life, for the lifetime of both spouses or for a term of years and, in the year the trust is funded, to deduct for income tax purposes the present value of the remainder interest in that property that eventually will pass to one or more charitable organization(s). To qualify the contribution of the remainder interest for the charitable deduction, the trust must meet the following requirements:

- (1) The trust must pay an annuity equal to at least 5% of the initial fair market value of the contributed property, or a "unitrust" amount equal to at least 5% of the value of the trust's assets, calculated annually, to at least one individual who must be living at the time the trust is created.
- (2) The annuity or unitrust amount must be payable at least annually, and for a term of years or for the life or lives of the individual beneficiary or beneficiaries.
- (3) The trust may pay no other amounts to or for the use of any person other than a qualified charitable organization.

- (4) When the trust terminates, the remainder interest must be transferred to or for the use of a qualified charitable organization.

The amount of the income tax charitable deduction that results from a transfer to a charitable remainder trust (i.e., the present value of the charitable remainder interest) is calculated in accordance with actuarial tables and interest rates published by the IRS. Essentially, that value is the excess of the fair market value of the property placed in trust over the present value of the annuity or unitrust interest reserved for the donor and/or others.

4. Gift of Stock to Charity and Subsequent Purchase or Redemption. In certain situations, it may be permissible for a donor to make a gift of appreciated property, such as stock, to a charitable organization, and for the donor's corporation later to redeem such stock. Such transactions must be carefully structured to avoid the donor being deemed to have sold the stock and then given the proceeds to charity. In that event, the donor would be required to recognize capital gain on the presumed sale of the stock.

The general requirements for such a transaction are as follows: (1) the plan to redeem the stock should not be formally adopted or proposed by the charity or the corporation before the gift is made; (2) the charity may not be legally bound to later sell the stock at the time of the gift or as a result of conditions placed on the gift; and (3) the redemption must be for the full fair market value of the stock. I would recommend that at least two months elapse between the gift and any decision or formal offer with respect to a purchase or redemption of the stock.