Options for charitably inclined clients in 2020

Advisor Edition

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A time of giving

We are entering the season when many of your clients are planning to make gifts to families, friends, and charities they support. With the challenges many of us have faced in 2020, those charitable gifts are especially important this year as many people are looking to a variety of charitable organizations for help. In addition to the knowledge that their gifts are going to support causes important to them, clients can also sometimes take advantage of substantial tax benefits from making charitable gifts. So how does charitable giving work and what options do your clients have?

Changes under the CARES Act for upfront gifts

When donors make charitable gifts, they often take an income tax deduction. For donors who itemize these deductions, the maximum charitable deduction typically allowed under tax law, depending on the type of assets gifted and the organization the gift is made to, is 60% of adjusted gross income (AGI). However, under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, individual taxpayers may deduct up to 100% of their AGI for qualified charitable gifts of cash in 2020. This tax change is only available this year, and is a great reason to be discussing charitable gifts with your clients today. However, what if they want to support their favorite charity in other ways besides an upfront gift?

Charitable giving planning techniques

Options for clients who prefer other avenues of charitable giving range from simple to complex. For clients desiring a simple solution, an individually owned life insurance policy with the charity named as the beneficiary is perhaps the easiest way to ensure an identified amount ultimately passes to the charity. While this idea does not typically result in an upfront income tax deduction to the donor, it does produce an estate tax deduction once the donor passes away and the death benefit is paid. If the donor wants a current deduction, there are ways to structure the gift using a trust that can produce an immediate tax benefit.

Charities can also own life insurance on donors, who can make annual charitable gifts to help offset any premiums that might come due on the policies. The charity either purchases a policy on a donor (subject to the state's charitable ownership of life insurance laws) or the donor makes a gift of an existing policy to the charity. In addition to being relatively simple, this idea also benefits the charity in ways other than just the potential for a leveraged death benefit – the policy is accounted for as an asset of the charity and it can access the cash value of a permanent policy tax free.

For clients interested in an even greater level of sophistication, there are other techniques to consider, often using trusts to accomplish the donor's goals. Some of these ideas include:

- Charitable Remainder Trusts (CRTs): The donor makes a gift to a CRT and retains the right to an income stream from the trust for a term, then if there's anything leftover, the trust transfers it to the charity. The donor gets an income tax deduction based on the present value of the remainder gift to the charity.
- Charitable Lead Trusts (CLTs): The charity is able to use the assets transferred to the trust by the donor for a term and then the remainder is transferred to an individual, such as the donor's children. CLTs may result in an immediate income tax deduction depending on how they are set up for tax purposes and the value of the gift to the remainder beneficiary(ies) is discounted to present value, often resulting in a much smaller value of the gift for gift tax purposes.

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Charitable trusts can be complex and there are many design choices for both CRTs and CLTs. The choice of type and design depends on many factors so clients should work with attorneys and planners who are well-versed in the options and benefits relative to the specific goals of the clients. Often times, life insurance is used in conjunction with these trusts to replace the value to the client's beneficiaries of a gift made to the charity. Let's look at an example.

Success story

Sam and Nicole Ward would like to make a make a gift of highly appreciated stock to their religious institution. They prefer to have an income stream from the stock for several years, but they don't want to pay the large capital gains tax this year if the stock is liquidated. Additionally, they want to make sure their children benefit from the plan. What can they do?

The Wards could gift $1,000,000 of the stock to a charitable remainder annuity trust that will pay them an income stream for fifteen years. A CRT is a tax-exempt trust so the trustee could sell the stock and avoid the upfront capital gains tax in the year of the sale.

Assuming a 6.19% payout, the Wards would receive an annual income payment of $61,930, which would be subject to a deferred capital gains tax until all of the tax was realized. Assuming the November 2020 Applicable Federal Rate (AFR) of .40%, they would also be able to take an income tax deduction of $100,114 in the first year. Assuming a 5% growth rate on the trust assets, at the end of 15 years, their religious institution would receive $849,946 and the trust would terminate.

To replace the value of the assets transferred to the charity, they could then use some of their income stream to purchase a survivorship life insurance policy with a death benefit of $1,000,000, possibly owned inside of an irrevocable trust, that would pay out an income and estate tax free benefit for the beneficiaries.

- The Wards get 15 years of income with deferred taxation, an immediate income tax deduction, and the satisfaction of knowing their religious institution will receive a sizable legacy from them.
- The religious institution gets a large gift in 15 years.
- The children receive the $1,000,000 death benefit, free from income and estate taxes.
- The Wards accomplished their goals and everyone wins!

These are just a few of the ideas available for your clients who want to make large charitable gifts. Charitable giving is a noble and time-honored tradition in the United States, and this year as much as ever, clients are looking to their financial professionals to guide them through the options and benefits available. If you have any questions or would like assistance with how to have the charitable giving conversation with your clients, please contact your Business Development Specialist (BDS).

Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including the generation-skipping tax). Failure to do so could result in adverse treatment of trust proceeds. Truist Life Insurance Services does not render tax or legal advice nor does it prepare trusts.

Success stories and case studies are offered to show how Truist Life Insurance Services can provide insurance solutions in the advanced sales marketplace. Results may vary, and this example does not guarantee a similar result. When case studies are based on real life applications of the strategy presented, client names, specific circumstances, and financial information have been changed to protect privacy.

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