

Please Give Generously

High-net-worth charitable giving can be more than a random act of kindness.

By James C. Quinn, CFP



PEOPLE ARE MOTIVATED TO GIVE TO charity for all kinds of reasons, from connections to a specific cause to a major life change—or, as we have witnessed, in response to a national tragedy. The motivation may be personal, but independent registered investment advisers have a big opportunity—and a responsibility—to help clients maximize the financial impact of their giving.

Contrary to popular belief, high-net-

worth individuals consider charitable giving a natural part of their wealth planning discussions. What's more, a recent study by Giving USA and the Spectrem Group revealed that interest in charitable planning increases as clients achieve greater wealth. In fact, households with \$5 million or more in assets accounted for more than half of the \$248 billion donated to charities last year. More than half (52%) of these wealthy investors

were likely to have had charitable planning conversations with their advisers.

That's a strong call to action for RIAs: If you want to retain or attract these high-net-worth clients, be prepared to discuss charitable planning. Otherwise, they may end up talking to someone else.

For high-net-worth individuals, giving can be more than a random act of kindness. In addition to achieving altruistic

objectives, giving can also involve financial decision making. There are many benefits to clients when giving is incorporated into their overall financial plan, from reducing current income and estate taxes to helping to provide for retirement income. In some cases, advisers can help their clients create more dollars for charity.

CHOOSING THE RIGHT VEHICLE

The way to take maximum advantage of these benefits is with a planned giving strategy, which can begin with a structured giving vehicle. Depending on the specific needs of a client, there are several options. Understanding each is important to help a client choose which are most appropriate.

Donor-advised funds. DAFs allow individuals to make contributions, take an immediate tax deduction and then recommend grants to qualified public charities of their choice on a client's preferred timetable. Donor-advised funds can be a particularly effective way to generate current-year income tax deductions for clients who have experienced a particularly high-income year. Some donor-advised funds can also accept closely held stock or a large position of concentrated stock. The donor can then recommend grants to multiple charities from the single block of stock.

Private foundations. These tax-exempt organizations are generally set up by an individual, family or organization to facilitate charitable giving goals. Donors receive a charitable deduction upon funding them, retain total control over grant making and can choose between appointing an investment adviser and self-directing the foundation's investments, while adhering to extensive administrative and compliance requirements.

Pooled-income funds. Under these agreements, donors contribute assets to charity and receive an immediate, partial tax deduction; the charity then pays a lifetime income stream to designated beneficiaries (pursuant to a formula). At the death of the last surviving income beneficiary, the remainder is distributed to the charity.

Charitable remainder trusts. These irrevocable trusts generate an income stream

Deducting the Donation

Gifts of appreciated stock can only be deducted to a certain point. Here's a summary of the tax treatment of appreciated securities when donated through various charitable giving vehicles:

- Donor-Advised Fund: 30% of adjustable gross income (AGI)
- Private Foundation: 20% of AGI
- Pooled-Income Fund: Tax deduction based on a calculation that incorporates life expectancy and the anticipated income stream
- Charitable Remainder Trust: Tax deduction based on value of the eventual gift to charity
- Charitable Lead Trust: Tax benefits vary but deduction is based on value of interest passing to charity
- Charitable Gift Annuity: Tax deduction based on life expectancy and anticipated income stream

All of these vehicles reduce or eliminate capital gains tax liability for gifts of appreciated securities.

for one or more individuals or other non-charitable beneficiaries for a set number of years. The principal of the donated assets eventually goes to one or more designated charities.

Charitable lead trusts. The opposite of charitable remainder trusts, these irrevocable trusts provide a fixed amount or a percentage of the trust assets paid to a charity for a term of years or the lifetime of the donor. The principal of the trust is either retained by the donor or given to a non-charitable beneficiary, usually the donor's heirs, at the donor's death.

Charitable gift annuities. These are contracts with a nonprofit organization. In exchange for a gift, the nonprofit guarantees the donor an income stream for life.

Charitable giving vehicles vary considerably in structure, design, complexity and tax treatment. What all planned giving programs do have in common, however, is that they offer donors some or all of the following advantages:

- Reduced tax liability through current charitable tax deductions;
- Lower or no estate tax liabilities, accomplished by strategically shrinking estate size;
- Elimination of capital gains on contributions of appreciated assets;
- Creation of tax-efficient charitable gifts flowing to charitable beneficiaries that are designated or recommended by the donor;

- Opportunity to create and/or pass on a legacy of charitable giving to children and grandchildren; and

- Opportunity to redirect social capital that otherwise might have gone to tax liabilities.

TAX-EFFICIENT STRATEGIES

Structured giving vehicles can allow for more efficient and effective charitable planning for clients. Many planned giving vehicles facilitate the contribution of appreciated securities in kind. These contributions allow donors to avoid capital gains tax on long-term appreciated securities while potentially increasing the amount the charity receives.

If a client likes a certain stock or mutual fund but is concerned about its low cost basis, recommend donating the position to charity. With the cash the client would have donated, he or she can buy new shares of the same security, thus raising the cost basis.

THE CASE OF MR. SMITH

Clients with significant net unrealized appreciation (NUA) within their retirement accounts can also benefit from using a structured giving vehicle to manage wealth in a tax-efficient manner while supporting charitable causes. For example, distributions can be recharacterized to capital gains from income by facilitating an in-kind, lump-sum distri-

The Benefit of Planned Giving

The hypothetical Mr. Smith is in an enviable position: He has highly appreciated stock in ABC Co. in his 401(k), part of a \$5 million estate held jointly with his spouse. By creating a donor-advised fund, he can slowly transfer in appreciated stock and significantly reduce his tax liability.

Current market value of the client's ABC stock:

Held in the 401(k) plan:	\$1,000,000
Plan basis in shares:	\$100,000
Net unrealized appreciation:	\$900,000

Mr. Smith's adviser came up with this planned giving strategy:

- Distribute \$1,000,000 from the 401(k) to a taxable brokerage account, creating an income tax liability for the original \$100,000 cost basis for ABC stock.
- The \$100,000 cost basis increases Mr. Smith's AGI from \$250,000 to \$350,000. This enables Mr. Smith to make a deductible gift to his donor-advised fund of \$105,000 (30% of AGI). Total tax savings: \$47,250.
- Over the next several years, Mr. Smith can diversify his remaining \$900,000 of ABC stock while using contributions to his donor-advised to offset capital gains.

Tax Advantage, Year One	Estimated Tax Savings
Avoidance of Capital Gains (\$94,500 at 15%)	\$14,175
Income Tax Savings this Year (35% tax bracket)	\$33,075
Estimated Total Tax Savings	\$47,250

tribution from a 401(k) to a taxable brokerage account, and then contributing the shares to charity. This enables a client to avoid possible future tax bills for income in respect to the decedent (IRD), in which retirement assets can be taxed significantly when left to beneficiaries.

A donor-advised fund is an optimal structured giving vehicle to use in this situation. To illustrate, consider the hypothetical example of Mr. Smith, who

is 65 years old and plans to retire from ABC Co. next month. In his 401(k) plan, he holds \$1 million of ABC stock. The cost basis for the stock is \$100,000, leaving Mr. Smith with an NUA of \$900,000. Mr. and Mrs. Smith have a total estate of \$5 million and an adjusted gross income (AGI) of \$250,000. He is very concerned about the impact of IRD on his 401(k) assets. He and his wife also have a strong philanthropic intent.

Mr. Smith's adviser came up with the following strategy:

- Mr. Smith distributes \$1 million from his 401(k) to a taxable brokerage account; he is required to pay income tax on the cost basis of the stock—\$100,000.
- The \$100,000 cost basis is considered ordinary income, increasing his AGI from \$250,000 to \$350,000.
- Mr. Smith transfers \$105,000 (30% of his AGI) of ABC stock into a donor-advised fund to maximize his charitable deduction and avoid capital gains tax on the sale of the stock. Total tax savings: \$47,250.
- Over the next few years, he diversifies his remaining \$900,000 of company stock while using contributions to his DAF to offset capital gains incurred.

Incorporating charitable planning services into a wealth management practice can build client loyalty, distinguish an adviser from competitors, and potentially generate referrals from other affluent donors. Now is a great time—between quarterly tax planning for wealthy clients and the holiday giving rush when many charitable planning decisions are made—to raise the subject of charitable giving with clients. Year-end reviews of financial plans can include giving strategies that can help clients reduce their tax burden and potentially make more dollars available for future gifts to charity. **FP**

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