# Gift Planning Now

A Newsletter for Berkeley's Donor Advisors

Spring 2016

## Annual Wait Over for IRA Charitable Rollovers

The *Protecting Americans from Tax Hikes Act of 2015*, signed by President Obama on December 18, 2015, makes permanent the qualified charitable distribution (QCD) for donors ages 70½ and older. Since 2006, Internal Revenue Code §408(d)(8) allowed owners of traditional and Roth IRAs to make direct gifts to charity and avoid the income tax that would otherwise be owed on an IRA withdrawal. The IRA charitable rollover had expired and been renewed several times during those years – often at the end of the year – leaving donors little time to plan their IRA gifts.

There are some restrictions to keep in mind when planning with clients for distributions from their IRA:

- Donors must be age 70½ or older on the date of the gift.
- No charitable deduction is allowed, but because the donor avoids income tax that would otherwise be due, the effect is similar.
- The transfer can count toward the account owner's required minimum distribution for the year, so QCD gifts should be planned prior to taking required distributions.
- Up to $100,000 may be given annually.

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## New Endowed Scholarship Will See Donors' Impact Doubled

Thanks to a generous bequest from Berkeley honors student Ruth (Janke) Johnson '38, C.Mult. '39, your clients have a special opportunity to partner with the University to provide significant support to Berkeley students – and to have their support matched dollar-for-dollar. ***The Ruth Johnson Undergraduate Scholarship Match Program*** will allow Berkeley to match 50 new endowed scholarship funds of $100,000.

Ruth Johnson taught French and Spanish in public high schools for 30 years, and she treasured her Berkeley education throughout her life. Learning of the increasing difficulty many students have paying for their undergraduate education, she was motivated to make a gift that would help make the Berkeley experience possible for many others. If you have a client who might be interested in creating an endowed scholarship fund, please call our office at 800.200.0575 to learn more about this program that will double the impact of their gift.

## Annual Wait . . . *(continued from page 1)*

• Transfers must be made directly from the IRA custodian to charity. Donors should not take withdrawals and then contribute the funds to charity.

• Only funds in traditional and Roth IRAs are eligible. QCDs are not allowed from 401(k)s, 403(b)s or other qualified retirement plans.

• Transfers must be made to public charities, not to donor advised funds, private foundations or supporting organizations.

• Funds cannot be transferred to establish charitable remainder trusts or charitable gift annuities. No donor benefits are permitted in return. However, pledge commitments may be satisfied with QCDs.

Philanthropic clients who do qualify to make QCDs should be encouraged to make their annual gifts – or major gifts – from their IRAs. Who can benefit?

• Warren, age 85, is required to take mandatory distributions from his IRA of approximately $25,000 this year, even though he has no need for the funds. He pays tax at a 28% rate, meaning he will keep only $18,000. He makes gifts to charity each year totaling about $20,000, but because he does not itemize on his income tax return, he receives no tax benefit from his generosity. Warren could instead have his IRA custodian transfer the full $25,000 to the charities he supports. Not only does he increase his giving significantly, but he avoids the tax he would otherwise pay on the withdrawal.

• Maureen, age 82, has several IRAs, including a rollover IRA from her late husband, totaling nearly $1.5 million. As a result, her required minimum distribution for 2016 will be about $93,750. By directing the custodian to transfer $100,000 this year to her favorite charities, Maureen avoids income tax on the distribution and reduces her adjusted gross income, helping her avoid reductions in her personal exemption and itemized deductions. Making the full $100,000 distribution over several years will also help reduce the size of her IRAs and required minimum distributions in future years.

UC Berkeley Planning Pointer:

## Donor Advised Funds and Donor Designated Funds Provide Flexibility for Your Clients' Giving

Donor advised funds (DAFs) offered through numerous financial institutions have become well known in recent years, but not everyone is aware that the UC Berkeley Foundation (UCBF) offers DAFs as well as donor designated funds (DDFs). Both vehicles provide important flexibility that most other gift types do not. DAFs and DDFs at UCBF can be funded with gifts of cash, securities and real estate.

Contributions to a DAF or a DDF at UCB can be made at times that are most effective for your clients from a tax or financial planning perspective, while grant recommendations to UCBF (and in the case of DAFs, to other IRS-qualified public charities as well) may be made on a separate timetable to support a client's charitable interests. The assets of both DAFs and DDFs established at UCBF are professionally invested and administered by Kaspick and Company, UCBF's planned gift asset investment manager, using institutional quality, no-load mutual funds. Current annual fees for investment and administration are 63 basis points, which in many instances will be significantly lower than commercial institution fees.

Key features of DAFs and DDFs:

• Charitable contributions are irrevocable;

• Donor takes an immediate income tax charitable deduction to the fullest extent of the law;

• Donor avoids capital gains tax on donated appreciated assets;

• Donor recommends annual grants to UCBF (and in the case of DAFs, to other IRS-qualified public charities as well) on a timeline that matches the donor's giving objectives;

• Potentially increases charitable giving through professional investment management;

• Estate gifts qualify for 100% charitable deduction; and

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# Best Assets for Funding Testamentary Charitable Remainder Trusts


A client planning to create a testamentary charitable remainder trust should give careful thought to what kind of property to leave to the trust. For charitable remainder trusts created during life, highly appreciated, long-term capital gain property is most appealing because there is no capital gains tax when the trust is funded or when the trustee sells and reinvests. But that advantage disappears at death, since capital assets receive a stepped-up basis at death.

A few cautions: clients should not bequeath property that (i) will cause the trust to have unrelated business taxable income, or (ii) could result in a private foundation excise tax being imposed. Transfers of debt-encumbered real estate will disqualify a charitable remainder trust (Ltr. Rul. 9015049). Transfer of S corporation stock to a charitable remainder trust will terminate the company's S status. The following assets can make better funding ideas for testamentary remainder trusts:

*Income in respect of a decedent* – U.S. savings bonds, retirement accounts and other items subject to income tax in an estate may be ideal for funding testamentary remainder trusts. Trustees can liquidate and reinvest such assets without loss to income taxes faced by taxable beneficiaries. Other items of IRD include accounts receivable, unpaid bonuses and commissions, accrued royalties under a patent license, last salary checks and payments on installment obligations.

*Ordinary income property* – For inter vivos charitable remainder trusts, income tax charitable deductions for gifts of tangible personal property must be calculated using the donor's cost basis (or fair market value, if less) and deductions are postponed until the item is sold from the trust. No such rules apply to the estate tax charitable deduction. Other items better left to testamentary trusts include works created by a deceased artist, inventory items and depreciated business property.

*Life insurance* – Life insurance policies contributed to a charitable remainder trust during life produce income tax deductions calculated on the lesser of the policies' fair market value or the donor's cost basis (total premiums paid). When life insurance is paid at death to a charitable remainder trust, however, the estate tax charitable deduction will be calculated on the full value of the proceeds passing to the trust.

UC Berkeley Planning Pointer:

## Donor Advised Funds . . .

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• Existing DAFs and DDFs can be named as a beneficiary in a will or other testamentary instrument, or as a beneficiary of a retirement plan assets (401(k), 403(b), IRA) or life insurance policy.

The two key differences between DAFs and DDFs established with UCBF are the minimum gift amounts and the amount of grant distributions that must support UC Berkeley. The minimum gift amount for a DAF is $500,000 and for a DDF is $100,000. A minimum of 51% of the grant distributions out of a DAF must be designated to UCBF, other qualified charitable organizations can be recipients of the grants not designated to Berkeley. With a DDF, 100% of the grant distributions must support UC Berkeley.

## Trust's Deduction Not Limited to Basis

The Green Dynasty Trust (Trust) was established in 1993, allowing the settlors, David and Barbara Green, and the trustee, Mart Green, to distribute amounts from gross income to charity. The Trust was a limited partner in Hob-Lob (HL) (which owned and operated many Hobby Lobby stores) and received substantial distributions from this partnership.

In 2004, G, a single-member LLC wholly owned by the Trust, contributed several parcels of land held more than one year to various charities. All of the properties were purchased using distributions from HL to the Trust. On its Form 1041 for 2004, the Trust initially claimed charitable deductions totaling about $20.5 million. The deduction was increased to more than $29.6 million on an amended return, on which the Trust sought a refund of nearly $3.2 million. The IRS disallowed the refund, saying that the charitable deduction for the real property was limited to basis, not fair market value.

The IRS argued that Code §642(c) limits a trust's deduction to the amount of gross income it contributes to charity and that gross income does not include unrealized appreciation.

The court found that limiting the deduction to basis would require the court to read into Section 642(c) a limitation that did not exist in the statute. Rather, the court concluded that "fair market value" is the generalized valuation tax standard in the Code and Congress did not insert a different standard in section 642(c). In addition, the court noted that the fact that the properties were given in a year subsequent to their purchase does not prevent them from "being considered as charitable donations derived from gross income," (*Green*, DC – Okla, November 4, 2015).

## Restricted Gifts Require Careful Planning

Philanthropic clients often have an interest in making gifts or bequests earmarked for specific projects or programs at Berkeley, rather than for the general purposes of the University.

Gift restrictions have practical implications for the donee organization, and may present tax issues for the donor's estate, as well. Several questions typically arise:

• How will the restriction be enforced?

• Does a bequest restriction risk disqualification from the estate tax charitable deduction?

• Is the restriction of such a nature as to cause us to reject or disclaim the gift or bequest?

As to enforcement, a bequest can be drafted as a conditional bequest that would fail upon the occurrence or nonoccurrence of some event. A conditional bequest to charity is still deductible for estate tax purposes if, at the time of the decedent's death, the possibility that the bequest will fail is so remote as to be negligible [Reg. §20.2055-2(b)(1)].

Will we be willing and/or able to accept a gift or bequest that is restricted? Lifetime gifts involving restrictions typically occur in the context of consultation and negotiation between us, the donor and their advisors. Restricted bequests, however, are often made without charity's input, sometimes with unfortunate results (e.g., a bequest to support a favorite program no longer in existence). Conclusion: Donors and their advisers should always consult with us before attaching restrictions to testamentary transfers.

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