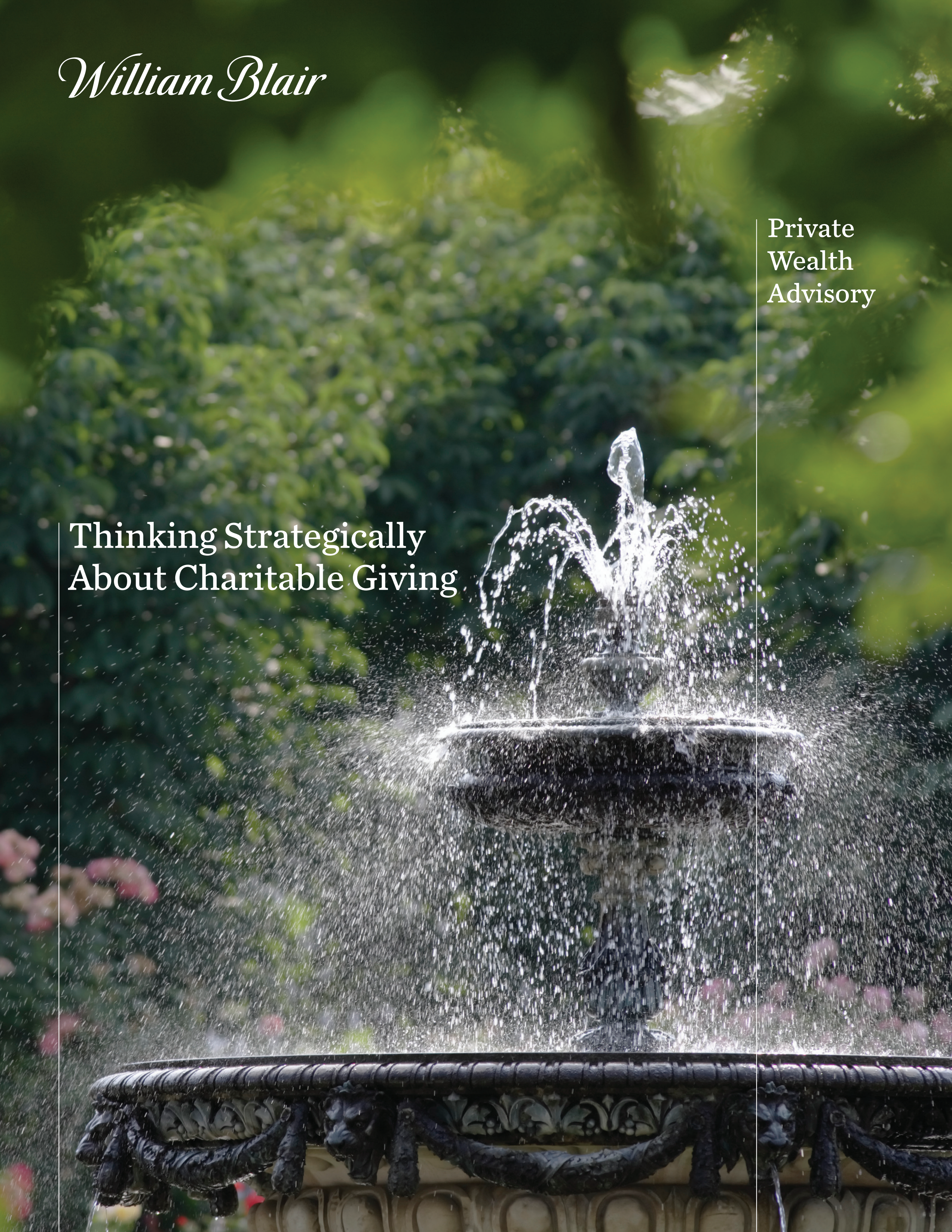
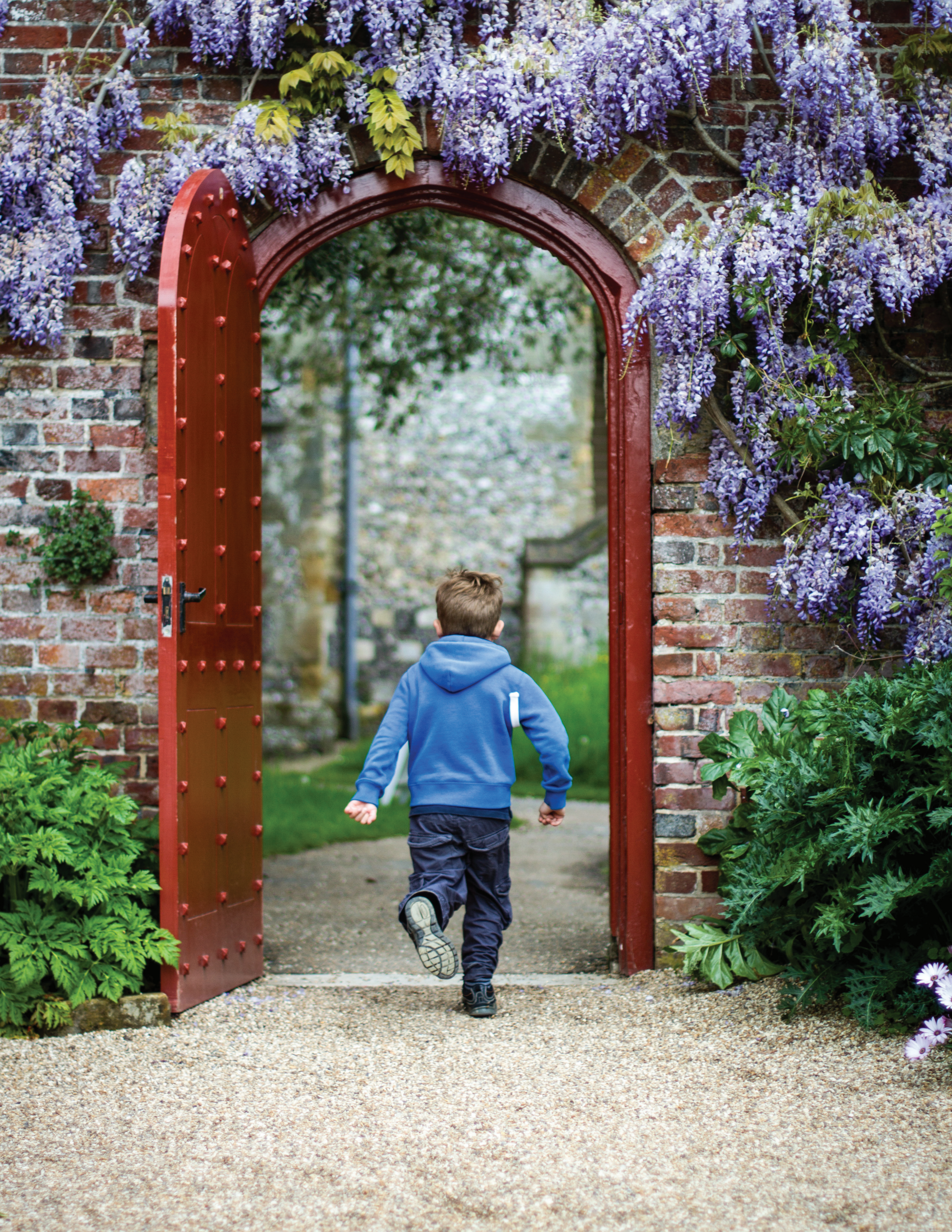
William Blair

Private Wealth Advisory

Thinking Strategically About Charitable Giving





Using charitable giving strategies to enhance the tax-efficiency of your donations plays a vital role in maximizing the impact of your gifts.

Maximizing the impact that you and your family can have in supporting causes that are near to your hearts requires more than just generosity and good intentions. It takes careful planning and an in-depth understanding of the various vehicles that can be used to facilitate your charitable gifts and the tax laws related to those gifts.

Just as no two families' philanthropic legacies are identical, the strategies used to achieve these legacies should be carefully crafted to each family's unique set of goals, resources, time frame, and tax considerations. These strategies must also be crafted as an integrated piece of the family's comprehensive wealth-management plan.

Developing your philanthropic strategy requires answering three primary questions:

1. *How much do you want to give?*
2. *Which assets do you want to contribute?*
3. *Which charitable giving vehicle(s) will be the most effective and tax-efficient in achieving your goals?*

Deciding How Much to Give

The first, and in many ways the most important, decision in developing a philanthropic strategy is to determine how much you will contribute to charities. At William Blair, we help our clients answer this question by thinking about "core" vs. "excess" assets. Core assets represent the amount needed to support your lifetime spending needs. The amount remaining beyond that, or excess assets, becomes what is available to fund your wealth-transfer or philanthropic goals.

Deciding how to prioritize between philanthropic and wealth-transfer goals is a deeply personal decision, and there is no one right way to make this decision. It is important to realize, however, that these decisions shouldn't be made in a vacuum. In a carefully crafted wealth-management strategy, the lifestyle, philanthropic, and wealth-transfer goals are all working in concert and executed in a tax-efficient manner.

Deciding Which Assets to Contribute

After quantifying how much you want to give, the next step is determining which assets to use in funding those gifts. This requires understanding the potential benefits tied to donating different types of assets.

Cash
Writing a check is the simplest way to make a charitable contribution. You don't have to transfer stock certificates, titles, or other ownership documents, or worry about your basis or valuations for tax purposes. Your deduction simply equals the amount you donate less the value of any goods and services you receive in return. But, in some cases, contributing cash may not maximize the potential tax benefits of your gift.

Appreciated assets
If you own assets that have appreciated significantly since you acquired them and you have owned them for more than one year, donating these assets, rather than cash, may help you maximize the tax benefits of your gift. When you donate long-term capital gain property, such as publicly traded stock, shares in a private company, and, in some situations, real estate, you can deduct the asset's full fair market value (FMV) at the time of the gift. In addition to enjoying the deduction, you will avoid having to pay capital gains tax on the appreciation. The charity can either hold the stock as an investment or, because of its tax-exempt status, sell the stock immediately without any tax impact. When contributing less-marketable assets, such as shares of a privately-owned company or real estate, you may need to obtain a qualified appraisal from a valuation professional.

"Loss" assets
If you would like to dispose of assets that are worth less than your basis, it is not advisable to donate them to charity. Rather, sell the assets so that you can recognize the loss on your income tax return and then donate the sale proceeds to charity.

Case Study: Quantifying Benefits of Giving Appreciated Stock

Susan is planning on making a sizable donation to a charity that supports cancer research. To fund the donation, she plans on using stock that she purchased 10 years ago for $40,000 that today has a fair market value of $75,000. Rather than selling the stock and then writing a check to the charity, she instead choses to gift the stock directly to the charity. This approach, which allows Susan to avoid paying the 23.8% capital gains and Medicare tax on the stock's $35,000 of appreciation, is a double-win because it allows her to donate $8,330 more to the charity and generates an additional $11,412 in net tax savings.

Current value of securities

$75,000

Original cost of securities	$ 40,000
Susan's federal long-terrn capital gains rate on appreciation of $35,000 = 23.8% or	$ 8,330

CHOICE 1	**CHOICE 2**
Sell the securities and donate cash to the charity	Donate appreciated securities directly to the charity
RESULT:	RESULT:
$75,000 sale minus long-term capital gains tax of $8,330 owed by Susan =	Susan pays no long-term capital gains tax. Asset value of
$66,670	**$75,000**
cash available to donate to charity	donated to charity,
	$8,330 more than she had available from choice 1.

By donating appreciated securities to the charity rather than cash generated by selling the securities and paying tax

- Charitable deduction and contribution = $75,000
- Susan saved $11,412 in taxes calculated by a larger deduction for the donation and paid no capital gains tax.
- The charity received $8,830 more as a donation.

Deciding Which Charitable Giving Vehicles to Use

There are five primary vehicles, or methods, for making charitable gifts. These methods vary considerably in terms of how simple or complex they are to execute and administer, how much control and flexibility the donor has, the timing of when the gifts are made, and the nature of the tax benefits. As a result, each vehicle has its own unique set of pros and cons. Determining which vehicle is best-suited for your philanthropic goals requires a careful assessment of your philanthropic goals, your balance sheet, and your tax exposure.

Direct gifts

The most straightforward form of charitable giving is making gifts directly to a public charity during your lifetime. Whether the gift is of cash, stock, or another asset, the charity is able to benefit from the resources immediately and you, as the donor, are able to claim the full tax deduction, within adjusted gross income (AGI) deductibility limits (discussed in detail below), in the year that the gift is made. Direct gifts often work well for individuals who aren't focused on estate-planning concerns and who are looking to make an immediate impact for a specific charity. In addition to being the simplest and fastest way to make a charitable impact, direct gifts are also the least expensive, as they do not involve any administrative fees or excise taxes.

Charitable Remainder Trusts

With a charitable remainder trust (CRT), the donor makes an irrevocable gift of assets—usually highly appreciated assets—to the trust and designates 1) beneficiaries to receive an income stream during the term of the trust and 2) one or more charities to receive the assets that remain in the trust after the trust term expires. The donor, who can also be one of the beneficiaries, receives an income tax deduction in the year of the contribution based on the expected value of the assets remaining in the trust at the end of the trust term. Because the trust doesn't have to pay capital gains tax on the contributed assets, CRTs can be especially appealing to business owners or others who have low-basis, highly appreciated assets. CRTs allow donors to diversify their assets in a tax-efficient manner and generate an income stream. Because the gift to the trust needs to be irrevocable, however, these vehicles require careful planning. These vehicles also involve set-up and administrative costs.

Charitable Lead Trusts

In many ways, charitable lead trusts (CLTs) are the inverse of CRTs. With a CLT, one or more charities receive an income stream during the life of the trust, and the value of the assets remaining at the end of the trust term pass to one or more named beneficiaries, often children or grandchildren. If structured properly, CLTs can be an effective tool for passing wealth to younger generations in a tax-efficient manner while supporting charities in the meantime. If the trust is structured as a grantor trust, meaning that the income earned by the assets in the trust is taxable to the donor, the donor receives an income tax deduction in the year of the contribution equal to the present value of the income stream to the charity. As with CRTs, CLTs involve set-up and administrative costs.

Donor-Advised Funds

For individuals or families who want to establish a sizeable charitable giving vehicle now but want flexibility to determine when and to which charities those funds are distributed, donor-advised funds (DAFs) can be an attractive option. A DAF is a charitable account set up in the donor's name but held by an organization that manages the investments, administers the funds, and makes the qualifying grants at the donor's request. With a DAF, the donor gets to deduct the full value of the assets contributed to the DAF, within AGI contribution limits, in the year of the contribution, but the decisions about when and how to distribute the funds can be made in subsequent years. The donor also gets to decide how the funds are invested within the DAF, and those funds grow tax-free. In terms of AGI deductibility limits, gifts to DAFs are treated as gifts to a public charity.

Private foundations

For donors who are looking to foster continued family involvement in the management of the family's philanthropic legacy, establishing a private foundation can be an appealing option. Private foundations provide the highest levels of control over the administration, investment management, and distribution decisions. These vehicles can also provide opportunities for younger generations to be actively involved in carrying out their family's philanthropic mission. Private foundations require annual administration expenses, and the investment income may be subject to excise tax. Plus, the deductibility limitations for donations to private foundations are more restrictive than gifts to public charities.

Comparing Charitable Giving Strategies

Here is a look at the relative pros and cons of five of the most common methods used for making charitable gifts.

Giving Strategy	Advantages	Disadvantages	Suitable for
Direct Gift	Simplicity and immediate benefit to the charity	No involvement in grant-making decisions	Individuals who have identified a charity they want to support and want to make an immediate impact
Charitable Remainder Trust	Donor receives current or deferred cash flow and is able to diversify concentrated holdings without incurring immediate recognition of capital gains	Requires annual administration	Individuals who own low-basis, highly appreciated securities and would like to increase cash flow and diversify assets in a tax-efficient manner
Charitable Lead Trust	Charity receives current cash flow; donor or designated heirs receive assets at trust termination; allows for significant tax deduction or tax-efficient wealth transfer	Requires annual administration; must be established as a grantor trust to qualify for income tax deduction	Financially secure individuals who wish to transfer wealth to heirs in a tax-efficient manner and provide current cash flow to a charity
Donor-Advised Fund	Easy to establish and maintain; donors are able to participate in distribution decisions; fund can be named after the donors; treated as a public charity for deductibility purposes	Limited control over fund management and administration; annual administrative expenses	Individuals who don't require income from donated assets and would like to avoid the cost and administration of a private foundation
Private Foundation	Fosters continued family involvement and control; creates a public entity that can be named after the family	Requires annual administration; investment income may be subject to excise tax; deductibility limitations are more restrictive than with gifts to public charities	Individuals who don't require income from donated assets and are interested in fostering family involvement with greater control

Donor-Advised Funds vs. Private Foundations

Many high-net-worth individuals and families assume that private foundations are the most appropriate tools for creating an enduring philanthropic legacy. While foundations certainly have features that help families achieve these goals in a tax-efficient manner, donor-advised funds (DAFs) can deliver many of these benefits, but with lower expenses and less administrative burden.

	Donor-Advised Fund	Private Foundation
Deductibility of Cash Gifts	60% of AGI	30% of AGI
Deductibility of Long-Term Capital Gain Property	30% of AGI	20% of AGI
Excise Tax	None	1% - 2% annually of investment income
Valuation of Gifts	Fair market value	Fair market value for publicly traded stocks; cost basis for certain other gifts, including closely held stock and real estate
Control	Donor may advise but organization makes final decision	Donor family has authority for distribution and investment decisions, subject to IRS rules
Annual Payout Requirements	None	Must distribute 5% of net assets, valued annually, regardless of how much assets earn
Privacy	Individual donors may be anonymous	Donors must file public tax returns
Perpetuity	Can exist in perpetuity	Can exist in perpetuity

Understanding Deductibility Limits

As you decide which assets to give and which types of giving vehicles to use, you will want to consider the annual deductibility limits. These limits are based on AGI, as well as the type of property donated and whether it is given directly or through a planned giving vehicle. Any amounts beyond the limit can be carried forward for up to five years.

If your income fluctuates significantly from year to year, or if you anticipate having a one-time event, such as selling a business, that may cause your income to surge one year, concentrating charitable gifts in the year(s) of higher income can help to maximize the tax benefits of those gifts.

Maximum Percentage of AGI that Can Be Deducted Annually for Charitable Gifts

Giving Strategy	Cash	Long-Term Capital Gain Property	Tangible Personal Property
Direct Gift	60%	30%	50%
Charitable Remainder Trust	60%	30%	50%
Charitable Lead Trust	30%	30%	30%
Donor-Advised Fund	60%	30%	50%
Private Foundation	30%	20%	20%

Contributing RMDs to Charity Tax-Free

Starting in the year when you turn 70½, you must start taking required minimum distributions (RMDs) from your non-Roth IRAs and 401(k)s. You can contribute up to $100,000 a year from your IRAs, but not from your 401(k)s, directly to a charity and have the contribution count toward your RMDs. Making such gifts directly from your IRA to the charity, as opposed to having the distribution go to you and then you making a gift to a charity, means that the money won't be included in your taxable adjusted gross income (AGI).

William Blair's Approach to Philanthropic Planning

At William Blair, we believe that a family's true philanthropic legacy is measured, not by the amount of money contributed, but by the impact that the family has on the lives of those around them. Strengthening this impact across multiple generations requires vision and careful planning that effectively uses the various charitable giving vehicles.

For more than 80 years, we have been committed to helping clients and their families navigate the many decisions that go into building philanthropic legacies. To learn more about how to get started in developing a tax-efficient plan for your charitable giving, please don't hesitate to contact us.