

AICPA Wealth Management Insider



A Solutions-Based Approach to Charitable Planning

A more effective and comprehensive approach to raising revenues in the world of increasingly scarce resources.

Igor Zey

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by Igor Zey, MSFS, CAP

Historically, charitable planning stems from either a donor's wish to make a specific size or type of gift to a certain organization or an organization soliciting a particular donor for a possible gift. Despite their relative success in the past, these approaches are not congruent with the trend toward comprehensive, integrated financial planning often practiced by affiliated advisors like CPAs, attorneys and other financial planning professionals. When gift planning starts with a particular result in mind it misses opportunities for larger gifts and gifts that are more satisfying for the donor, the donor's family and, ultimately, the charities themselves.

Despite recent business, economic and political upheavals, Americans are still the most charitable people on the planet. Those with assets not fully sheltered from estate taxation, are generally engaged in an ongoing process of financial, tax, asset and wealth management that has become increasingly complex, sophisticated and comprehensive. Advisors must address issues of philanthropy and charitable giving within the context of this ongoing planning discipline. Otherwise, if approached as a distinct, nonintegrated financial decision, success in fundraising and charitable planning will undoubtedly become a function of happenstance.

In particular, more than 95 percent of people with assets of \$1 million or more make significant annual financial contributions to a number of charitable organizations. It is also clear that most of that giving consists of cash contributions made on an annual, nonstrategic and unplanned basis. At best, for the traditional donor, charitable giving is an "expense" item in the annual budget. Such planning also most often fails to take into account the presence and manageability of "philanthropic capital" as a core component of an individual's financial wealth.

An alternative approach to philanthropic planning and wealth management will produce more consistent good results for all concerned. Philanthropy, not merely sustained annual giving, should be incorporated in the planning process from the outset. Advisors and fundraisers should understand the use and value of various charitable tools and techniques as integral components in an ongoing process of financial and wealth management by individuals and families. Charitable giving should be viewed as part of the whole wealth management and distribution process, not as isolated transactions that are somehow outside the primary planning process or that place unplanned for demands on a financial or estate plan that did not take the charitable proclivity of the client into account early on.

The first step in addressing philanthropy in the process of comprehensive wealth planning is to understand the various tools of charitable giving within the parameters of the traditional planning processes discussed earlier in this article. At a basic level, the objectives of traditional financial and estate planning can be distilled into the following strategies:

Production of Income

The following charitable giving tools can be used to produce income to the donor or to other designated beneficiaries: charitable remainder trusts (CRTs); pooled income fund gifts; charitable gift annuities; and

to a limited extent and in limited situations, gifts to private foundations and supporting organizations. The use of CRTs, pooled income gifts and charitable gift annuities to produce income is obvious.

The use of private foundations or supporting organizations to produce income is less obvious. Under current law and regulations, family members and other persons may receive income from the foundation or supporting organization in the form of reasonable salaries or other compensation for services performed for or on behalf of the charitable entity.

Reduction or Elimination of Income and Transfer Taxes

All of the gift tools and techniques, as well as outright current charitable gifts, result in possible income and transfer tax deductions that have the potential to reduce or eliminate current income or transfer taxes of the donor. The choice of a particular tool or strategy for the purpose of tax management will depend on a variety of factors, including the nature of the asset to be donated, the applicable deduction limitations and valuation issues:

- The level of taxable income accountable to the donor;
- The nature and extent of prior gifts and other contemplated current and future gifts and the impact of carry-forwards of charitable deductions from prior tax years;
- The public vs. private tax status of contemplated charitable donees;
- Other factors that will affect the size and usefulness of charitable deductions in a given tax period.

Some of the tools and strategies mentioned will generate both income as well as affording tax management benefits. For example, the creation and funding of a CRT will result both in income to the named income beneficiaries and an income tax charitable deduction to the donor.

Position or Reposition Assets for Either Growth or Income

CRTs, CLTs (charitable lead trusts), pooled income fund gifts and charitable gift annuities may all be used to reposition assets for future growth and/or income production. In most cases, the use of these tools to reposition assets will also protect the act of repositioning from taxation. For example, if a client/donor needs to reposition assets held for growth during earlier planning periods in order to produce higher levels of disposable income at the transition from working to retirement, the use of a CRT, a pooled income fund gift or a charitable gift annuity to produce the future income will also reduce or eliminate capital gains tax erosion of the principal value of the gift that will become the basis for income production in the future. Under current tax rules, this amounts to a savings of between 15 percent and 28 percent of principal in the repositioning of assets for income production. The resulting incremental addition to disposable income over the remaining lifetime of the donor is often substantial.

Protect Assets from Claims of Creditors, Family Members, Spouses, Litigants, etc.

All of the tools discussed above have the potential to protect gift assets from the claims of creditors, spouses, litigants and others: assets transferred irrevocably to charitable entities, whether those entities are public or private charities or charitable trusts, are no longer the property of the donor and are thus under most scenarios no longer subject to the claims of creditors against the original donor. The one exception to this general rule is a grantor CLT, which in most cases and under many state legal frameworks is not treated as an entity separate and apart from the donor although treated as a completed charitable gift for federal tax purposes. In those cases, the assets of the grantor CLT may be subject, under state and federal law, to claims of the donor's creditors or other claimants.

In general, use of these tools for the purpose of asset protection alone must be undertaken only after thorough analysis of local law. In many states, transfers to defeat the legitimate claims of creditors after

those claims have arisen may be set aside under various statutes designed to prevent fraud by obligors against those to whom they are legally obligated.

Use and Manage “Philanthropic Capital” Effectively and Efficiently

All of the strategies mentioned above are intrinsically tools that manage “philanthropic capital” more efficiently and effectively than “involuntary philanthropy” through tax payments in most situations. In the case of private family foundations, supporting organizations and donor-advised funds, these tools are specifically designed to allow direct individual or family management or control of philanthropic capital. In these cases, assets are captured in structures that allow direct input by the donor and others into the management and use of those assets for particular philanthropic purposes, often closely aligned with personal values, goals and interests of the donor.

Implementing the Strategies

Advisors, who engage individuals in comprehensive planning, will need to identify planning goals from among those goals listed above. While client/donors will not necessarily use the language expressed above, any articulated goal can be shown to primarily involve one or more of these objectives. In order to integrate charitable tools and strategies effectively into the process of wealth planning and management, it is necessary to understand which charitable tools and techniques are capable of use to accomplish each of the stated general planning objectives.

This article should be viewed as a primer on solutions-based charitable planning and a general overview of available tools. In a future issue, some of the practical investment and insurance-based strategies will be revealed.

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Igor Zey, MSFS, CAP, CLU, ChFC, AEP, CFP, is the president of [Zey Insurance Group](#). His practice focuses on uses of life insurance in the areas of estate and charitable planning, family law, wealth transfer in business and retirement.

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