Minimizing Income Taxes in an Estate-Tax Free Environment

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American Institute for Cancer Research

Major Gifts, Trusts and Bequests to the American Institute for Cancer Research

The American Institute for Cancer Research is devoted to the task of conquering our nation's most dreaded illness. Today, scientists funded by AICR are closer than ever to uncovering the root causes of cancer. That means all of us are closer to living in a world in which every cancer that can be prevented is prevented.

Here at AICR, that's the rallying cry of a mission we take very seriously. Right now, more than 1.7 million cases of cancer occur in the United States every year. But AICR researchers estimate that we could cut that number by around 40%, simply by eating better, moving more and staying as lean as we can.

AICR has provided more than $107 million in research grants to leading scientists at clinics, universities and cancer centers throughout the United States. AICR's research is revealing how and why cancer happens, and, more importantly, what we can do to bolster our bodies' natural defenses and stop cancer in its tracks.

Millions of Americans provide financial support to our programs – often through tax-planned gifts, trusts and bequests. To encourage, facilitate and recognize this very important financial support, the Institute has created the League of Willful Cancer Fighters. We will be pleased to enroll in the League any client who has made or intends to make a bequest to the Institute or to name the Institute as the beneficiary of a trust, a life insurance policy, a retirement death benefit or other form of estate gift. We invite you or your client to call us at your convenience.

To encourage generous gifts to the Institute and other charities, we have prepared this booklet to help attorneys and other financial advisors understand all the important tax and financial rewards Congress has provided. Our staff can provide the exact tax and financial consequences of any gift, trust or bequest your clients may want to consider. And because we are so active in this specialized field, we can provide whatever technical and practical information you may request for planning and drafting a charitable gift arrangement that will provide your clients both the greatest personal satisfaction and the greatest tax and financial rewards.

Please feel free to call the Office of Gift Planning at any time. Our toll-free telephone number is 1-800-843-8114. And please . . . if the opportunity presents itself, inform your clients about how a gift, trust or bequest to the American Institute for Cancer Research can further the fight against cancer and also enhance their personal tax, investment, retirement and estate plans.

MINIMIZING INCOME TAXES IN AN ESTATE-TAX FREE ENVIRONMENT

Between increases in the applicable exclusion amounts for gift, estate and generation-skipping transfer taxes, and the introduction of portability, allowing a surviving spouse to inherit the unused portion of a deceased spouse's estate tax exclusion, the focus on minimizing taxes through estate planning has taken on less urgency. Individuals are relying less on wills to pass assets, turning instead to trusts and beneficiary designations.

Clients with philanthropic interests may find that accelerating their giving accomplishes several goals:

- enabling donors to itemize expenses on their income tax returns;
- providing assistance to loved ones while reducing transfer tax costs;
- increasing gifts to favorite charities through gifts that provide the donor with payments for life;
- allowing donors to see the good their generosity can achieve during their lifetimes.

Billions of dollars are given to charity each year, much of it from donors who receive no tax benefit from their generosity. It's estimated that only about 12% of taxpayers will itemize each year. But Americans give to support the missions of their favorite organizations, not simply for the tax deduction. Even those who don't itemize should nevertheless look for tax-smart ways to give. One of the easiest is to contribute assets that the donor has owned more than one year and that have appreciated in value. A charitable deduction is available for the full, fair market value of the property, but even without a deduction, the donor saves by avoiding the capital gains tax that he or she would otherwise owe if the property were sold. For example, Tina gives $2,500 annually to the AICR, but does not itemize on her income tax returns. She could instead give stock worth $2,500. If she originally purchased the shares for $1,000, she avoids the capital gains tax on her $1,500 paper profit. That's a savings of at least $225, even without a charitable deduction. When AICR sells the shares, we pay no capital gains tax because we are a tax-exempt organization. Every dollar of Tina's gift can be put to use working to conquer cancer.

The AICR Office of Gift Planning would be pleased to provide more information about any of the ideas offered in this booklet or to discuss how charitable techniques can fit into a client's planning.

NOT YOUR FATHER'S ESTATE TAX

As recently as 2008, the federal applicable exclusion sheltered estates up to only $2 million. Anyone with a home, a qualified retirement plan, life insurance and savings risked losing part of the estate to taxes. Married couples were able to postpone taxes at the death of the first spouse but, without proper planning, faced the prospect of higher taxes at the survivor's death. In recent years, the advent of higher sheltered amounts and portability for a deceased spouse's unused exclusion mean relatively few estates are subject to federal estate tax. Some states also impose estate or inheritance taxes, often at amounts lower than the federal level. With less emphasis on estate taxes, the focus may shift to inter vivos charitable gifts as a way to reduce income taxes. Vehicles such as charitable gift annuities and charitable remainder trusts allow donors to achieve several objectives:

- establish a current charitable gift, while retaining payments for life;
- reduce capital gains taxes when gifts are funded with appreciated assets;
- increase spendable income;
- be entitled to a larger charitable deduction that may enable the donor to itemize in the year of the gift;

■ provide for a charity at death, similar to including a bequest in a will or living trust.

Clarence has been a supporter of the American Institute for Cancer Research since losing his wife to ovarian cancer several years ago. He has included a $50,000 bequest to AICR in his living trust and makes annual gifts of $5,000. With limits on itemized deductions and higher standard deductions, Clarence no longer receives any tax advantage from his annual gifts. He also knows that his estate will not be subject to tax at his death. Instead, Clarence has decided to accelerate his bequest by establishing a $50,000 charitable gift annuity. By funding the gift annuity with appreciated securities, he avoids some of the capital gains tax he would owe if he sold the shares and can spread the remainder of the gains over his life expectancy. A portion of the payments he receives each year will be favorably taxed capital gains tax. At Clarence's death, AICR will use the remaining portion of his gift annuity to help fund research into ovarian cancer in his wife's name.

CREATIVE GIVING TO BOOST INCOME TAX DEDUCTIONS

Charitable gift annuities – A charitable gift annuity is simply an agreement between AICR and a donor. In exchange for an irrevocable gift of cash or appreciated assets, AICR promises to make fixed payments for life for one or two annuitants. The amount of the payment depends on the age or ages of the annuitants, but generally ranges from 4.7% to 9.5% for one-life, as shown in the chart. AICR uses the recommended rates established by the American Council on Gift Annuities. Donors are entitled to income tax charitable deductions for a portion of the value of the gift amount – generally 40% or more.

A gift annuity can be established to begin payments in the year of the gift or payments can be postponed to some future year – a deferred payment charitable gift annuity. With a deferred gift annuity, both the eventual payment and the charitable deduction are increased.

A gift annuity may enable a donor to lock in gains on appreciated securities and receive payments based on the full fair market value of the shares. A portion of the capital gain is avoided, with the balance spread over the donor's life expectancy. If the gift annuity is funded with cash, a large portion of the annual payment will be tax-free for the annuitant's life expectancy. The table on the next page shows examples of the tax-free portion. At the end of the annuitant's life expectancy, all payments are taxed as ordinary income.

Single-Life Gift Annuity Rates

Age	Rate	Age	Rate
60	4.7%	75	6.2
61	4.7	76	6.4
62	4.8	77	6.6
63	4.9	78	6.8
64	5.0	79	7.1
65	5.1	80	7.3
66	5.2	81	7.5
67	5.3	82	7.7
68	5.4	83	7.9
69	5.5	84	8.1
70	5.6	85	8.3
71	5.7	86	8.5
72	5.8	87	8.7
73	5.9	88	8.9
74	6.1	89	9.2
		90 or older	9.5

Benefits of a Charitable Gift Annuity for $10,000*

Age	Recipient's Annual Payment	Tax-Free Portion	Taxable Income	Charitable Deduction	Effective Payout Rate**
60	$470	$295	$175	$2,904	5.9%
65	510	336	174	3,325	6.5
70	560	388	172	3,826	7.3
75	620	449	171	4,432	8.3
80	730	550	180	4,827	9.9
85	830	662	168	5,501	11.6
90	950	782	168	6,168	13.5

* The $10,000 figure is merely a convenient multiple. We will be glad to provide you with tax and financial results for any size gift.

** The "effective" rate takes into account the donor's charitable deduction tax savings and the benefits of the tax-free income in a 22% federal income tax bracket. Deductions vary according to current interest rates.

Charitable gift annuities can be arranged to begin payments in the year of the gift or can be postponed until some later year. Deferred gift annuities offer larger payouts and charitable deductions, as the chart below shows.

Deferred Gift Annuity Rates – Number of Years from the Date of Issue of Agreement to Annuity Starting Date

Present Age of Donor	5 years	10 years	15 years	20 years
55	5.6%	7.3%	9.6%	12.8%
60	6.1	8.0	10.7	15.1
65	6.7	8.9	12.6	17.2

The ability to postpone when gift annuity payments begins offers several planning opportunities. A donor could arrange a series of gift annuities to begin at retirement, for example, thereby qualifying for income tax deductions while boosting retirement income. The chart shows how annual gifts of $10,000 to fund charitable gift annuities could increase income starting at retirement.

Year of Gift	Charitable Contribution	Payout Deduction	Rate	Payout at Age 65
Year 1	$10,000	$4,211	7.2%	$720
Year 2	10,000	4,142	7.0	700
Year 3	10,000	4,160	6.7	670
Year 4	10,000	4,094	6.5	650
Year 5	10,000	4,123	6.2	620
Year 6	10,000	4,062	6.0	600
Year 7	10,000	4,003	5.8	580
Year 8	10,000	3,944	5.6	560
Year 9	10,000	3,885	5.4	540
Year 10	10,000	3,827	5.2	520
TOTAL	**$100,000**	**$40,451**	**6.16%**	**$6,160**

It's not even necessary for the client to know exactly when payments on a deferred payment charitable gift annuity will begin. The IRS has approved a gift annuity arrangement in which the donor selects an expected starting date (Ltr. Rul. 9743054). The charitable deduction is determined on the date of the gift, but the arrangement permits payments to begin either earlier or later, within an agreed range. If the donor chooses to have payments begin earlier, a lower payout rate will apply, while delaying payments beyond the expected starting date will result in larger payments. The chart below shows how payments could be increased for a 55-year-old donor who estimates that payments will begin at age 68. If payments begin before age 68, payout rates would be reduced. The charitable deduction is not affected by the choice of when payments start.

Starting Age	Payout Rate	Annual Payments
68	8.4%	$ 840
69	8.9	890
70	9.6	960
71	10.1	1,010
72	10.6	1,060
73	11.2	1,120
74	12.2	1,220
75	12.7	1,270
76	13.6	1,360
77	14.6	1,460

Trusts – Charitable remainder trusts also enable donors to accelerate testamentary gifts to inter vivos gifts, while retaining payments for life or a term of years. The charitable remainder annuity trust pays a fixed sum annually, equal to at least 5% but no more than 50%, of the amount contributed to the trust [Code §664(d)(1)(A)]. The charitable remainder unitrust pays a fluctuating amount, equal to at least 5% but no more than 50%, of the annual value of the trust's assets [Code §664(d)(2)(A)]. There are several similarities between the charitable remainder annuity and unitrust:

- the remainder interest must be irrevocably contributed to or for the use of a charity;
- a trust can last for the life or lives of the income beneficiaries, all of whom are living when the trust is created, or for a term of up to 20 years;
- the value of the charitable remainder must be at least 10% of the net fair market value of the assets transferred to the trust on the date of the gift [Code §§664(D)(1)(D), 664(d)(2)(D)];
- the trust is exempt from income taxes; and
- income and corpus are allocated to the annuity or unitrust amounts according to a "four-tier" system as current and accumulated ordinary income, capital gains, other (tax-exempt) income and return of corpus [Reg. §1.664-1(d)(1)].

Although the annuity trust and unitrust have many similarities, they are different in several respects:

- The governing instrument of a charitable remainder annuity trust must expressly prohibit additional contributions to the trust. The governing instrument of a unitrust may permit additional contributions.
- A unitrust may provide for the payment of all trust income in lieu of the specified unitrust amount for a taxable year when trust income is less than the specified amount. In addition, a unitrust instrument may provide for the payment of "catch-up" amounts in years when trust income exceeds the specified unitrust amount. Such provisions are not permitted in an annuity trust.

The tables below contain examples of the charitable deductions for $100,000 annuity trusts and unitrusts, assuming the use of a 3% §7520 rate and quarterly payments.

Sally and Rick are both age 70. They contribute $7,500 annually to AICR, but their only other itemized expenses are their state income tax and real estate taxes, limited to $10,000. They receive no additional tax benefit from their generosity. The couple could use $100,000 of appreciated securities that are currently paying a 3% dividend to establish a charitable remainder unitrust that will pay them 6% of the annual value of the trust assets every year. In the year the trust is funded, they will be entitled to a charitable deduction of $34,852, assuming quarterly payments and the use of a 3% §7520 rate. In addition to allowing them to itemize, there are other advantages they will enjoy:

- Payments equal to 6% of the trust's value ($6,000 the first year), which is more than they were receiving in dividends.
- A hedge against inflation. If the value of the stock increases, so too will their annual payments.
- No loss to capital gains tax or the net-investment income tax. Because the unitrust is tax-exempt, no capital gains tax is owed when the trustee sells the appreciated securities.
- Continued income for their joint lives. Trust payments will continue for the survivor's lifetime at the death of the first spouse.

Gift of $100,000 to Annuity Trust for Life of Beneficiary (Fixed Payout)

	Deduction if Beneficiary Receives:		
Age of Beneficiary	$5,000 Annually	$5,500 Annually	$6,000 Annually
70	$44,874*	$39,361*	$33,849*
75	55,095	50,604	46,114
80	64,568	61,024	57,481
85	72,897	70,187	67,477
90	79,831	77,814	75,797

**Special trust language required.*
Deductions fluctuate with interest rate changes.

Gift of $100,000 to Unitrust for Life of Beneficiary (Variable Payout)

	Deduction if Beneficiary Receives:		
Age of Beneficiary	5% Payout Annually	6% Payout Annually	7% Payout Annually
60	$38,267	$32,362	$27,593
65	45,057	39,135	34,196
70	52,478	46,756	41,835
75	60,281	54,992	50,314
80	67,893	63,222	58,983

Deductions fluctuate with interest rate changes.

■ The satisfaction of knowing that when the trust ends, the funds will pass to AICR to establish a fund in the names of Rick's parents.

Remainder interests in homes and farms – Donors can deed homes or farms to charity while reserving the right to use the property for life [Code §170(f)(3)(B)(i)]. Perhaps one of the most attractive features of this type of gift is that, while carrying out the donors' charitable intentions and reducing income taxes, donors need not change their lifestyle.

The term "personal residence" is defined broadly to include any property used by the donor as a personal residence, even if it is not used as the principal residence. It includes, for example, the donor's vacation home or stock owned by the donor as a tenant-stockholder in a cooperative housing corporation [Reg. §1.170A-7(b)(3)]. Personal residence does not include the proceeds from the sale of a residence or the furnishings or other personal property included in the home. A "farm" is any land used by the donor or a tenant for the production of crops, fruits or other agricultural products or for the sustenance of livestock, including cattle, hogs, horses, mules, donkeys, sheep, goats, captive fur-bearing animals, chickens, turkeys, pigeons and other poultry. It is not necessary to place the farm or residence in a trust.

Dennis and Marlene own a vacation home that they plan to leave to AICR at their deaths. Because their estates won't be subject to tax, their adviser suggested that the couple consider making a gift now, while reserving the right to use the home. They will continue to be responsible for the maintenance, insurance and taxes on the property. Assuming the property is worth $400,000, of which $100,000 represents the value of the land, and that Dennis and Marlene are ages 71 and 69, their deduction would be more than $160,000. They retain the right to live in or rent out the home for income for their lifetimes.

SAVING INCOME TAXES WITHOUT A DEDUCTION

With higher standard deductions, it's estimated that only about 12% of taxpayers will itemize each year. Taxpayers ages 65 and older may find it even more difficult to itemize. Single individuals have an additional $1,600 standard deduction; joint filers an added $2,600. This comes at a point when many taxpayers in that age category are finally able to make larger charitable gifts – they've paid off mortgages, no longer have children to put through college and are turning attention to the legacy they'd like to leave behind.

Clients in this situation might find it beneficial to arrange life-income gifts that provide payments for life along with larger charitable deductions that enable them to exceed the standard deduction, but there are also ways to assist AICR that save taxes, even if no deduction is available.

Qualified charitable distributions (QCDs) – Code §408(d)(8) permits IRA owners who have reached age 70½ to direct account custodians to make payments directly to charity. These gifts are not deductible, but because they can take the place of the required minimum distributions that are fully taxed, donors can nevertheless save taxes. For example, Linda is required to take a distribution of $48,000 this year, even though she doesn't need the funds and doesn't want to pay tax on the withdrawal. She could, instead, tell her IRA custodian to send part or all of the distribution to AICR, thereby avoiding the income tax that she would ordinarily owe. If Linda tells the custodian of her IRA to send $20,000 to AICR, she reduces her income tax by $4,400 in a 22% income tax bracket.

IRA owners can give up to $100,000 annually tax free. QCDs can be made only to public charities, such as AICR, and cannot be used to establish life-income gifts such as charitable gift annuities or charitable remainder trusts. They can, however, satisfy charitable pledges and are not subject to the 60%-of-AGI deduction limit for cash gifts to charity (Notice 2007-7).

Interest-free loans – Non-itemizers might consider substituting interest-free loans of up to $250,000 per charity, repayable on demand, for their annual gifts to a charity [Temp. Reg. §1.7872-5T(9)]. Such an arrangement has benefits for both the donor and charity. An interest-free loan sufficient to generate income to charity equal to the donor's annual gift, could:

■ lock in a donor's annual contributions, avoiding the risk that he or she might forget to send a check some year;

■ provide income tax savings to annual givers who do not itemize deductions;

■ result in substantial testamentary gifts if the donor/lender provides that the loan will be forgiven at death.

Consider a non-itemizing retired couple, Jean and Roger, who give $15,000 annually to AICR, for which they cannot claim a deduction. Suppose the $15,000 is generated by an interest-bearing account of $500,000 that pays 3% interest. Jean and Roger must pay tax on the interest, even though they give it to AICR. What they could do instead is bypass the IRS by lending $500,000 to AICR, interest-free and repayable on demand.

We would keep the interest produced by the $500,000, saving Jean and Roger the trouble of writing a check and of reporting the $15,000 of interest on their tax return. They reduce their taxable income just as if they had used a $15,000 charitable deduction. And they can always get their money back if they need it. At their deaths, they could make a fine bequest to AICR – without having to make or change a will – by simply forgiving the loan.

TAX SAVINGS: NOT THE ONLY REASON FOR CHARITABLE BEQUESTS

The use of outright charitable bequests and testamentary life-income arrangements may no longer be as important in estate planning, but clients may want to use charitable vehicles to address other planning concerns.

Generation-skipping transfers – The GST – just like the estate tax – is a concern for only a few estates per year. But just because a grandparent can leave more does not mean the recipients are necessarily old enough to handle the windfall responsibly.

Peter and Lisa want to leave a significant portion of their $8 million estate to their five grandchildren, currently ages 12 to 18. A charitable lead trust would allow the couple to postpone the age at which the grandchildren receive the funds. They could direct that $2 million pass to a lead trust at the survivor's death. The trust would make payments to AICR for a term of years before the assets are distributed to the grandchildren outright or pass to noncharitable trusts in the grandchildren's names.

Peter and Lisa could instead fund a lead trust during their lifetimes. The transfer would be shielded from gift and GST taxes, thanks to their credits. Assets passing to the lead trust would be removed from the couple's estates, which could reduce their income taxes. In addition, they could see the good their gifts to AICR accomplish during their lifetimes.

Avoiding tax on income in respect of a decedent – Wayne's $4 million estate includes a $1.5 million IRA. He'd like the IRA to benefit his two nephews, but he'd also like to leave something for AICR in his late wife's name. Wayne could simply name the nephews as the designated beneficiaries of the IRA and allow them to take withdrawals over their life expectancies, but he's not sure they could resist the temptation to withdraw all the funds immediately.

Wayne could name AICR as beneficiary of the IRA, conditioned on our issuing a charitable gift annuity for each nephew (Ltr. Rul. 200230018). The gift annuities would be directed to pay the rate equal to the rate paid to other annuitants the same ages as the nephews at

Wayne's death. The nephews would receive payments based on the full value of the IRA, without depletion from income tax. He also has the satisfaction of knowing that the nephews will have a steady source of income for their lives. If either of the nephews is younger than AICR's minimum gift annuity age at Wayne's death, we could issue a deferred annuity, resulting in higher payments to the nephews.

Too much of a good thing – Some parents or grandparents just don't feel the need to leave everything to family members. Clark has a $6 million estate, and while he wants the bulk to go to his children and grandchildren, he also wants to provide continuing support for AICR programs. Clark could determine the amount he'd like each family member to receive, with the remainder passing to AICR through his will, living trust or beneficiary designation.

NON-QUALIFIED OPTIONS THAT MEET CHARITABLE GOALS

Most donors and their advisers are interested in making sure that a charitable remainder trust satisfies all the requirements of Code §664 in order to qualify for a charitable deduction. Generally, split-interest gifts must be in the form of a charitable remainder annuity trust [Code §664(d)(1)], charitable remainder unitrust [Code §664(d)(2) and (3)] or a pooled income fund [Code §642(c)(5)] to entitle the donor to an income tax or estate tax charitable deduction. A trust that fails to qualify not only means a lost tax deduction, but the IRS could impose gift taxes on the charitable interest, and the trust will not be tax exempt.

But is an estate tax charitable deduction always necessary? Possibly not, particularly if the client's estate is completely sheltered by the estate tax credit. Consider Ben, who has an estate of $4 million and wants to benefit his only sister, Paula, and then have the assets pass to AICR. But Ben doesn't want Paula's interest to be limited to a specified dollar amount or percentage as it would be with either an annuity trust or unitrust. He would like her to have all the income generated by the trust assets and even permit the trustee to make distributions of corpus to Paula. If Ben were establishing gift for a spouse, he could fund a qualified terminable interest trust that would allow distributions of principal and still qualify for the marital deduction [Code §2056(b)(7)]. At the spouse's death, the value of the assets passing to charity would qualify for a charitable deduction in her estate. But there is no such comparable vehicle for gifts to non-spouses.

Ben could, however, create a testamentary trust for Paula's benefit and have the assets pass at her death to AICR. The result? Ben's estate is not entitled to a charitable deduction, but it is more than sheltered by the estate tax credit. Paula is subject to tax on distributions from the trust, just as she would be with a qualified charitable remainder trust. At her death, no part of the trust is included in her gross estate, unless she held a general power of appointment. AICR is entitled to as much or as little as is left in the trust at Paula's death. Because the trust is not a qualified charitable remainder trust, it is not subject to the private foundation rules [Code §4941, 4943, 4944, 4945].

The drawback to a non-qualified trust? The trust is not a tax-exempt entity. Therefore, the sale of assets within the trust will not avoid capital gains tax. This may not be as much of a concern with a testamentary trust, where the assets funding the trust receive a stepped-up basis at Ben's death. Taxes may be a problem, however, if the trust is funded with U.S. savings bonds or other income in respect of a decedent. In addition, a trust itself may potentially be subject to income tax – at steep rates. However, a trust is not taxed on income distributed in a particular year. Non-qualified trusts may be worth investigating for clients who want to benefit AICR but would like more flexibility than what is offered by charitable remainder trusts.

The War Against Cancer

When you have the occasion to draft a trust or a bequest for a client who wants part of his or her estate to support the war against cancer, our correct legal name is:

"The American Institute for Cancer Research, a not-for-profit corporation incorporated in the District of Columbia."

Please feel free to contact our Office of Gift Planning for additional information about the mission and the future plans of the American Institute for Cancer Research.

Our Office of Gift Planning will be pleased to help you plan a trust or bequest that will accomplish the specific objectives of your client. We can also provide the exact tax consequences of any trust arrangement a client may want to consider. There is no other obligation for this service.

Information for the Attorney or Advisor

- AICR's official name:
  American Institute for Cancer Research
- AICR's mailing address:
  1560 Wilson Boulevard, Suite 1000
  Arlington, VA 22209
- AICR's phone number:
  800-843-8114
- AICR's identification:
  A not-for-profit organization under Section 501(c)(3)
  of the Internal Revenue Service Code
- AICR's tax-exempt IRS number:
  52-1238026

The information and examples provided in this booklet are for information and discussion purposes only. The examples are hypothetical, and the facts and tax consequences of individual transactions may vary from person to person. Each estate planning professional must independently determine and evaluate the tax and financial consequences of each individual situation.

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