INTEGRATED WEALTH MANAGEMENT
BROOKE CRANE-ACRE
44444 Mound Rd
Suite 200
Sterling Heights, MI 48314
888-434-7791
advisor@integratedfg.com

Charitable Gifting

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What constitutes a gift to charity?

A gift to charity is simply a gratuitous transfer of property to a charitable organization. The key is that your gift must be some kind of property--your time or personal services do not count. There are several different types of property that can be donated to charity , and a gift is limited only by your imagination. Are you the type who wants to donate cash, stock, or your lunch box collection from a 1960s sitcom?

How do you decide whether to donate to charity?

The decision to donate to charity is a personal one. Although the IRS does not require that you have any charitable motivation when you donate to charity--you can do it strictly for the tax benefits--most people who decide to donate to charity have a charitable intent.

There are an infinite number of charities from which to choose. Most people have a particular charity in mind when they decide to make a contribution.

What are the tax benefits of donating to charity?

Through tax legislation, Congress has attempted to encourage charitable giving because it is good social policy. Most every charity depends on individual contributions to remain financially solvent, especially in this era of fewer direct government dollars. As a result, charitable giving has become interconnected with the tax laws, which have grown more and more complex.

Congress has sweetened the pot for taxpayers who donate to qualified charities . First, you generally receive an income tax deduction in the year you make the gift. Second, you do not have to worry about gift tax because federal gift tax does not apply to charitable gifts. Third, charitable gifts serve to reduce your taxable estate, thus reducing your potential estate tax liability. For more information, see Charitable Deduction . It is this last area--estate tax--where charitable giving may produce the greatest tax benefits. Over the next 30 years, an estimated $8 trillion of assets will pass from one generation to the next, resulting in the assessment of significant estate taxes. One solution to minimize these estate taxes is charitable giving.

What options do you have for donating to charity?

An outright gift

In the typical situation, your gift will be for the charity's benefit only, and the charity will take possession of the gift immediately. This type of gift is called an outright gift . This arrangement satisfies the general rule that a gift to charity must be paid to the charity in the form of money or property before the end of the tax year to be deductible for income tax purposes.

Split interest gift in trust

Another option is for your gift to be split between a charity and a noncharitable beneficiary. Here, one party (usually the noncharitable beneficiary) receives the use of the donated property for a specific period of time, which means he or she is paid a certain sum every year out of the donated property. Then, after this time period is up, the remaining property passes to the charity. Such gifts can be used to provide for a dependent child or a surviving spouse. In this arrangement, the charity's right to enjoyment and possession of the gift is delayed because the noncharitable beneficiary has the first interest in the donated property. Ordinarily, this delay would mean no tax deductibility for your gift. However, Congress has voiced its approval of such arrangements as long as the gift is set up as one of a number of special trusts expressly created for this purpose. If your split interest gift is set up as one of these trusts, you receive federal income, gift, and estate tax deductions.

CRAT (charitable remainder annuity trust)

A CRAT is a split interest gift between a noncharitable beneficiary and a charitable beneficiary. The noncharitable beneficiary has the first interest, and the charity has the remainder interest or second-in-line interest. The trust pays out a fixed amount of income every year (an annuity) to the noncharitable beneficiary for the term of the trust, and the remaining assets pass to the charity at the end of the term.

CRUT (charitable remainder unitrust)

A CRUT is a split interest gift between a noncharitable beneficiary and a charitable beneficiary. As with a CRAT, the noncharitable beneficiary has the first interest, and the charity has the remainder interest. However, instead of paying out a fixed amount each year, a CRUT pays the noncharitable beneficiary a fluctuating amount each year, depending on the value of the trust assets for that year. This amount is calculated as a percentage of the assets in the trust on a specified date each year. At the end of the trust term, the remaining assets pass to the charity.

Tip: *There are several varieties of CRUTs (* NI-CRUT *,* NIMCRUT *, or* Flip CRUT *), each with slightly different rules regarding how the noncharitable beneficiary is paid.*

Pooled income fund

A pooled income fund is a split interest gift between a noncharitable beneficiary and a charitable beneficiary. Like the CRAT and CRUT, the noncharitable beneficiary has the first interest and the charity has the remainder interest. A pooled income fund is managed by the charity (much like a mutual fund) and is made up of donations from several donors. The charity pays the noncharitable beneficiary a fluctuating amount each year, depending on the value of the fund in that year. These income distributions are made to the noncharitable beneficiary for his or her lifetime, after which the portion of the fund assets attributable to the noncharitable beneficiary is severed from the fund and used by the charity for its charitable purposes.

Charitable lead trust

A charitable lead trust is a split interest gift between a noncharitable beneficiary and a charitable beneficiary. Here, the charity has the first or lead interest and the noncharitable beneficiary has the remainder interest. The charity is paid a certain amount every year for the term of the trust, and then the remaining assets pass to the noncharitable beneficiary at the end of the trust term.

Bargain sale

A bargain sale in the context of charitable giving is a sale to charity at a bargain price (i.e., a price below the fair market value of the item sold, fair market value being the price a willing buyer would pay a willing seller in an arm's length transaction). The difference between the sale price and the actual fair market value of the asset equals your donation to charity. A bargain sale involves two separate transactions for tax purposes: a sale and a charitable gift. The IRS treats each event as a separate transaction. Consequently, each is reported separately on your income tax return.

Private foundation

Donors with sufficient resources may want to create a private foundation . A private foundation is a separate legal entity (often named for the donor) than can endure for many generations after the original donor's death. The donor creates the foundation, then transfers assets (typically appreciated assets) to the foundation, which in turn makes grants to public charities. The donor and his or her descendants retain complete control over which charities receive grants.

Community foundation

A type of organization related to a private foundation is called a community foundation . A community foundation concentrates its activities within a defined geographic area and is typically controlled by a representative group of community members, which may include the donor. In practice, a community foundation is a public charity, though it appears to share some of the characteristics of a private foundation.

Donor-advised fund

Similar in some respects to a private foundation, a donor-advised fund (DAF) offers an easier way for a donor to make significant charitable gifts over a long period of time. A DAF actually refers to an account that is held within a charitable organization. The charitable organization is a separate legal entity, but the donor's account is not--it is merely a component of the charitable organization that holds the account. Once the donor has transferred assets to the account, the charitable organization becomes the legal owner of the assets and has ultimate control over them. The donor can only advise--not direct--the charitable organization on how the donor's contributions will be distributed to other charities.

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