

# CHARITABLE PLANNING STRATEGIES FOR US-CONNECTED TAXPAYERS

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# Pure Gifting Strategies

**Contributions to Charity provide both:**

- Income Tax Benefit and
  - Estate Tax Benefit



# US INCOME TAX BENEFITS

- **US taxpayer entitled federal income tax deduction (mostly) for gifts to US tax exempt organizations**
  - Individual donors – 100% deduction against income (but limited to income levels no greater than 50%)
  - Corporate donors – 100% deduction no greater than 10% of income
  - Treaty exceptions - Canada, Mexico, Israel
- **Limitations based on type of charity**
- **Limitations based on type of property contributed**
- **Non-resident alien US charitable income tax deduction also available**



# Limitation Based upon Donee Status

- **US public charities**
- **US private foundations**
- **Foreign charity exempt from US income tax**
  - IRS Determination Letter classifying as an exempt public charity
- **“American Friends of” structure**
- **Treaty-based Charities – Canada, Mexico & Israel**



# **“American Friends of” Organizations**

- **Used by individual donors giving globally and by private foundations making grants globally**
- **Gift to the US charity, an “American Friends of” organization, which exercises discretion and control over further gifts to foreign charities**
- **Doctors Without Borders USA/Médecins Sans Frontières USA is one example**



# US GIFT AND ESTATE TAX BENEFITS

- **US person** may be entitled an unlimited gift and estate tax deduction for gifts to charity - US or foreign
- **Non US citizen, non US domiciliary** may also be entitled unlimited gift and estate tax deduction for gifts to charity - US only
- *Note – there is no requirement that charity be a US charity*



# Eligibility for Gift/Estate Tax Deduction for non-US Gifts?

- **Generally, gift and estate tax charitable deductions not permitted if the entity (US or non-US) has not notified the IRS that it is applying for recognition as a Section 501(c)(3) organization.**
- **Exceptions exist –**
  - **Substantially-all non-US donors** – If non-US charity has, from the date of its creation, received at least 85% of its support from non-US sources, contributions by US donors will qualify for the estate and gift tax charitable deductions, even if the organization has not applied for Section 501(c)(3).
  - **Exclusively Charitable Trust** - Where the non-US charity is a trust that is not exempt from taxation under Code Section 501(a), all of the interests in the trust are devoted to one or more charitable purposes, the trust will be treated as a 501(c)(3) organization for purposes of the estate and gift tax charitable deductions for US donor contributions and is not required to apply for 501(c)(3) status



# “Split” Gifting Strategies

**Make use of a “split interest” trust to make a gift to charity, in part, and provide benefit to self or family:**

- Charitable Remainder Trust
  - Charitable Lead Trust





# Charitable Remainder Trust

- A “split-interest trust”, a charitable remainder trust (a “CRT”) offers those taxpayers with charitable intent the advantage of making “split gifts” – a gift in part to charity and a gift in part either to others or to be retained for themselves during their lifetimes.
- Through careful choice of jurisdiction, planning and drafting, taxpayers may enhance the after-tax benefits of a CRT – so much so that the after-tax benefits outweigh the charitable cost.



# Charitable Remainder Trusts: Benefits

- Deferral of income tax “within” CRT permitting tax-free diversification of portfolio
- Contributions of unencumbered assets = tax-free
- Contributions give rise to tax (charitable) deduction
- Tax-deferred income stream retained by beneficiary and family members



# Charitable Lead Annuity Trust

A “split interest” trust – like a CRT with the roles reversed:

- Trust makes an annual payment per a fixed schedule to charity – i.e., charity “leads”.
- After trust terminates, remaining assets are distributed to non-charitable beneficiaries or a trust for their benefit



# Charitable Lead Trust Benefits

Allows taxpayers to make a future gift to family at a reduced “gift” tax cost:

- The present value of the remainder interest is a taxable gift
  - The present value of the income stream to charity is available as a **gift-tax** charitable deduction, as well as having potential income tax savings benefits
- Why?
- Investment hurdle rate for CLAT 4% (§7520 rate)
  - Depressed asset values reduce the gift tax cost of transfer to non-charitable beneficiaries
  - Appreciation in excess of assumed growth rate transfers free of gift tax to heirs



# Charitable Remainder Trust v. Charitable Lead Trust

- **Charitable remainder trust or gift annuity – these allow you:**
  - To cash in on highly appreciated stocks with no tax loss in principal
  - To create income for term or life, which may include significant % of tax-free income
  - To receive a partial upfront income tax deduction
- **Charitable lead trust – these allow you:**
  - To affect a significant wealth transfer to your heirs with reduced gift tax valuation
  - To create a fixed payment stream to charity
  - To receive an upfront income tax deduction and possible delay in capital gains tax



# **Focus on Charitable Remainder Trusts**



# CRT Tax Treatment Generally

- CRT itself s tax-exempt unless unrelated business taxable income present – i.e., no “mining” allowed, staking questionable but likely permissible
- Unitrust payments are taxed to non-charitable beneficiaries under tiered system, as follows:
  - Ordinary income
  - Short term capital gains
  - Long term capital gains
  - Tax exempt income
  - Corpus
- In-kind distributions may trigger capital gains

# More Specific Requirements

- Trust = irrevocable with completed transfer of assets
- “Unitrust amount” payable to non-charitable beneficiaries at least annually (except in case of NIMCRT or NICRT) – “implied yield” set by statute
- Actuarial value of remainder interest to charity must be at least 10% of transfer at time of funding, based upon implied yield, trust term, pay-out percentage
- Unitrust annual pay-out not less than 5% nor more than 50% of CRT fair market value
- No ability to leverage (no margin, no borrowing)
- No “personal use” of assets within CRT.

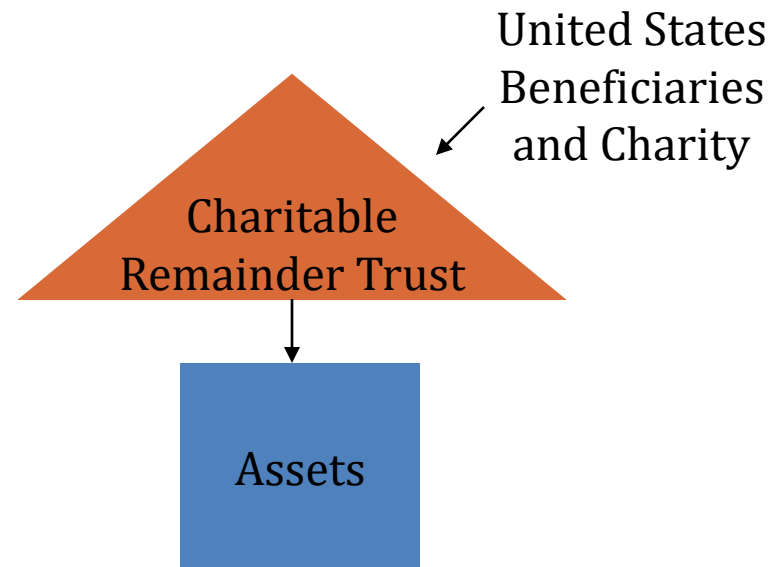




# Sale of Assets = Tax-Free

## CRT is exempt from income tax

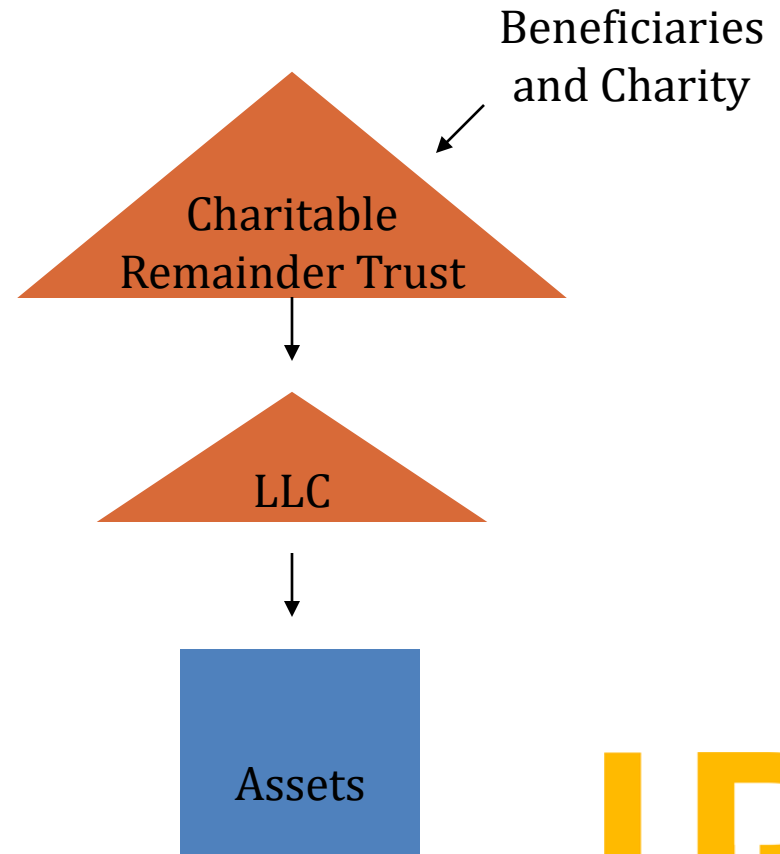
1. Contribution of appreciated asset gives rise to charitable contribution deduction with taxpayer entitled to annual distributions equal to (e.g., 10%) of FMV of assets (measured annually)
2. CRT selling assets exempt from tax
3. Reinvestment in assets is tax-free
4. Taxable income realized only when taxable taxpayer receives a distribution of gains
5. Gains taxable as long-term gains or short-term or interest or ...
6. At end of term (e.g., 20 years), balance goes to charity



# Enhancing the Solution

## Interposing an LLC can defer (and time) income realization to US Taxpayer

1. CRT has no requirement to “distribute” until there is “income”
2. Taxpayer realizes no tax until CRT “distribution”
3. No “income” to CRT until LLC distribution to CRT
4. Thus, taxable income deferred within LLC – i.e., CRT is tax exempt and beneficiary only taxable on CRT distribution



# Taxpayer Tax Status Matters

- If CRT payee is a US person, such person is taxed on all income realized at rates applicable to character of CRT income
- Likewise, if CRT payee is a non-US person, such person is taxed on rules applicable to him/her, including:
  - No tax on short term or long term non-real-estate gains
  - No tax on most interest realized

