

LIFETIME CHARITABLE GIFTS

*Choosing the Assets to Donate***The Wealth Strategies Group**

at Atlantic Trust integrates estate, financial and investment planning through sophisticated assessment of goals with the objective of multigenerational capital preservation, family business continuity and strategic philanthropic objectives.

You do not have to be Warren Buffet to benefit from making lifetime gifts to charity. The announcement, in 2006, that the legendary investor and philanthropist would accelerate his philanthropy with a \$31 billion pledge to the Bill & Melinda Gates Foundation, reminded other donors that lifetime gifts have significant advantages over charitable bequests.

Part of the appeal is “the legacy effect—the chance to see all the good works that may result from your generosity,” says Lisa M. Garcia, managing director at Atlantic Trust. Whether you choose to give anonymously, or prefer to be recognized for your donation, you can witness the charity use it productively.

Another attraction is the prospect of achieving an income tax deduction and a gift-tax deduction, in addition to estate tax savings. For gifts to a public charity, donors are entitled to an income tax deduction for up to 50% of adjusted gross income (AGI) for cash contributions and up to 30% of AGI for donations of other appreciated assets held at least 12 months. Any deduction that cannot be taken in the year of the donation can be carried forward up to five years.

A donation that is deductible for income tax purposes is also eligible for a gift tax deduction. If you are otherwise required to file a gift tax return (for example, if you made gifts to an individual for more than \$13,000), you should report your gifts to charity on this return, but can take an unlimited deduction for those gifts. By reducing the size of your taxable estate, lifetime gifts may also decrease or eliminate estate taxes.

“Even clients who are not very charitably inclined at first sometimes become more philanthropic when they realize that at least some of the funds would otherwise have gone to taxes,” says Judith A. Saxe, managing director at Atlantic Trust. “With a charitable donation, you can control where the assets go, as opposed to having the money generally go to taxes.” A key aspect of any gifting plan is choosing the best assets to donate, and various wealth management strategies may inform those decisions. You will want to consider the pros and cons, from a tax perspective, of donating various types of property, as well as the opportunities and impediments posed by the Pension Protection Act of 2006 (PPA 2006). That law, one of the most

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sweeping pieces of charitable legislation in more than three decades, added new incentives for lifetime donations, and various restrictions aimed at past abuses.

Benefits of Donating Appreciated Property

“If you are charitably inclined, there are significant benefits to giving away appreciated property,” says Garcia. With long-term marketable securities, for example, your deduction, which is subject to AGI limitations, is generally based on the full market value of the securities. Since you are not selling the property—but instead donating it—you do not have to pay capital gains taxes. Therefore, by donating these assets, rather than selling them and donating the after-tax proceeds, you can, in effect, make the dollars earmarked for charity go much further.

“Still, the value of your deduction will depend on both the nature of the asset and the charity that receives it,” Garcia notes. For example, when you donate long-term marketable securities to a public charity, you will be allowed a current deduction of up to 30% of your AGI, but if you donate those same assets to a private foundation, a current deduction will be available of up to 20% of your AGI. Amounts not currently deductible due to percentage limitations may be carried forward for five years.

Many of our clients appreciate the ease and convenience of giving through a donor-advised fund, which is one type of public charity. These funds, which avoid the administrative headaches of a private foundation, enable donors to open an account by making an irrevocable contribution, and to take an immediate income tax deduction for that contribution. However, they can postpone recommendations about which qualified nonprofit organizations should receive distributions from the fund account until some time in the future. A growing number of donor-advised funds accept donations not only of cash and marketable securities, but also of real estate or tangible personal property. Typically, they would sell these assets to raise cash for the organization.

One restriction to keep in mind with donations of assets other than marketable securities is the prearranged sale rule. In cases where a donor has already committed to sell an asset before giving it to charity, the rule forces the donor to pay tax on the gain, effectively negating any deduction.

Donations of Real Estate

Although real estate is a popular type of noncash gift, these donations carry certain complications. Most charities prefer that the property not be mortgaged because, depending on the nature of the real estate, the term of the note and the charitable vehicle used, it can run afoul of various tax law restrictions. In addition, just as if it were purchasing the property, the nonprofit must check for liens and be sure there are no environmental hazards that would carry cleanup obligations under federal law. And since the property will generally be converted to cash, the value must be high enough that the charity is willing to devote the effort and resources to selling it.

Assuming the charity would like to receive the real estate, there are a variety of ways to contribute it. You can donate it outright—as one of our clients did—by giving land to a New England conservation group. Another possibility, typically used when the charity plans to keep the property, is to enter into a bargain sale: sell the asset to charity for less than the fair market value, and take a charitable income tax deduction for the difference. Some landowners have reaped substantial income tax benefits by donating conservation easements—permanent restrictions that prevent certain uses of their real estate. By making such a donation, you give up some liquidity: the restrictions are perpetual and apply to future owners, and may make the property harder to sell. However, the income and estate tax savings can be impressive.

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If you are holding appreciated property that you are prepared to sell—perhaps you invested in land that has since been developed—donating the property to a charitable remainder trust offers a way to avoid capital gains tax and diversify. With this trust, individual beneficiaries receive income for whatever period of time you specify—their lifetimes or a term of years (20 years is the maximum). When this interest ends, the charity receives whatever is left, known as the remainder interest. Since the trust is a tax-exempt entity, it is not required to pay capital gains tax when it sells the real estate. Meanwhile, you can take an income tax deduction based on the current value of the charity’s remainder interest. As mentioned above, there should not be a mortgage on the property donated to the CRT and there should not be any prior agreements to sell the property before it is placed in trust.

Gifts of Tangible Personal Property

In addition to real estate, charities are receptive to a wide range of other donations, including collectibles and art. Such gifts may be transferred outright, through a bargain sale or by using a split interest vehicle such as a charitable remainder trust.

Deduction Limits For Lifetime Charitable Gifts

Tax regulations limit the deductible amount of a charitable gift depending on the asset contributed, the charitable purpose of the organization receiving the gift, and limits on the donor’s adjusted gross income (AGI).

Any deduction that cannot be taken in the year of the gift can be carried forward up to five years.

After calculating the limits on deductions for charitable gifts, it may be necessary to reduce your overall deductions based on other limitations imposed by federal tax law.

	Direct gift to public charity	Gift to donor-advised fund	Gift to private foundation
Cash	Up to 50% of AGI	Up to 50% of AGI	Up to 30% of AGI
Publicly-traded stock (unrestricted)	Up to 30% of AGI	Up to 30% of AGI	Up to 20% of AGI
Restricted stock*	Up to 30% of AGI	Up to 30% of AGI	Up to 20% of AGI (deductible at cost basis)

FMV=fair market value

*Must meet the Internal Revenue Code definition of ‘qualified appreciated stock.’

These funds, which avoid the administrative headaches of a private foundation, enable donors to open an account by making an irrevocable contribution, and to take an immediate income tax deduction for that contribution.

One caveat: in order for donations of tangible personal property to qualify for a full fair-market value deduction, the charity must use the asset in a manner related to its exempt purpose (see box).

In one sense, gifts of art and collectibles are especially beneficial. While the capital gains rate is 15% for sales of appreciated stocks, bonds and real estate, the rate for tangible personal property is 28%. By donating valuable assets like art, you can avoid paying this tax and can take a charitable income tax deduction.

However, PPA 2006 greatly restricted the common practice of donating a partial interest in a piece of art—known as a fractional gift, with the possibility of making additional such gifts over time. “Now, whenever you donate a fractional interest, you must donate the residual (remaining) interest in the property within 10 years (or at death, if that happens sooner),” says Linda S. Beerman, managing director at Atlantic Trust. When you make this subsequent donation, your deduction is limited to the fair market value of the property either at that time, or when you made the initial donation—whichever is less. “So if it increases in value, you don’t get the benefit of

SPECIAL RESTRICTION FOR GIFTS OF TANGIBLE PERSONAL PROPERTY

The Related Use Rule

When considering a gift of tangible personal property, you need to keep in mind a limitation that applies to these types of gifts: In order for your donation to qualify for a full fair-market value deduction, the charity must use the asset in a manner related to its exempt purpose. If the item donated does not satisfy this related use rule, your income tax deduction is limited to your basis in the asset or its fair market value, whichever is less. For example, a donor who gives violins to a symphony orchestra can deduct the fair-market value, but when giving the same instruments to an animal rights group, would be limited to cash basis.

Some donations, such as gifts of art to a museum with similar works in its collection, easily pass the test. “However, if the property has no relationship to the charity’s purpose and the institution will merely sell it to raise cash, your deduction will probably be limited to cost basis,” Saxe says.

PPA 2006 gave teeth to the related use rule when deductions of more than \$5,000 are involved. Now, if the charity sells the asset within three years, part of the deduction is recaptured. If the sale was in the year of your donation, your deduction will be reduced to basis. For sales in subsequent years, you must include as income the difference, if any, between your basis and the fair market value deduction you took. Various penalties apply, including a \$10,000 fine for someone who identifies property as having a related use knowing that it is not intended for it. ■

a larger deduction when you give the remaining interest. But if it decreases in value, you don’t get the benefit of the higher value that you used originally,” Beerman notes. Donors who do not contribute the residual interest will lose the initial deduction for the fractional gift and also must pay a 10% penalty.

In addition, these undivided owner-ships can no longer be structured so that both you and the charity (for example, a museum) have access to the property—such as the right to display a painting for equal parts of the year. PPA 2006 requires that the charity have “significant possession” of the property.

Using Life Insurance to Enhance Charitable Giving

Life insurance offers a way to benefit a charity without reducing your family’s inheritance. Sometimes donors use it to back up a large pledge—for instance, designed to name a building, an endowment, or a school within a university. That way, if the donor dies before the pledge is fulfilled, the life insurance proceeds can be used to carry out the donor’s intentions. Although state insurable interest laws generally prohibit investors from owning insurance on the lives of strangers, most states make an exception for charities so they can insure key donors and continue their endowments.

How the charitable income tax deduction is calculated will depend on whether you donate a new or existing policy, and whether or not it is paid up, meaning no further premiums remain to be paid. If the policy is in premium-paying mode, the best way to structure the arrangement is for you to gift funds to the charity, so that it can pay the premiums, rather than your paying future premiums directly to the insurer. If instead you paid the premiums directly to the insurer, it might be construed as a gift for the use of charity, and your deduction would be limited to 20% of adjusted gross income, with a five-year carry-over. In contrast, when you make a cash gift directly to the charity, so that it can use the funds for any purpose, the deduction is 50% of adjusted gross income with a five-year carryover.

As the named insured, it is important that you not retain any ownership rights in the donated policy, including the right to change the beneficiary or to borrow against it. Otherwise you would not be eligible for a charitable income tax deduction and the policy proceeds would be included in your estate.

Substantiation Requirements

To support any deduction for cash, you must not only be able to produce a bank record but have a written acknowledgement from the charity including its name, the date and the amount of the contribution. Previously these requirements applied only to donations of \$250 or more.

When claiming deductions for more than \$500 of anything other than cash or publicly traded securities, you must file a Form 8283 with your income tax return. This form calls for an acknowledgement by the charity that it has received the donated property.

For all gifts other than cash and marketable securities it is also necessary to get a qualified appraisal before taking a deduction for more than \$5,000—more than \$10,000 for gifts of stock in a closely held company. Under federal regulations, the appraisal cannot be made more than 60 days before the donation, and must be complete by the time the income tax return is due.

If the charity sells the asset within two years of the donation, another requirement applies: the charity must file Form 8282, which enables the IRS to match the sale with the Form 8283 reporting the donation. Based on this process, the IRS can identify



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taxpayers who deducted more than the charity eventually received for the asset. These are also the forms the IRS uses to flag donations that do not meet the related use test.

Policies of Individual Charities

No matter how tax-efficient a particular strategy seems on paper, your ability to implement it will depend in part on the policies of the charity that you wish to benefit. “One client, who wanted to use a charitable lead trust to endow a chair, could not fund it that way because the university needed to receive the assets over a shorter time frame,” says Saxe. This client wound up making the donation with cash and marketable securities instead.

In other cases we have worked with charities that were willing to accommodate both a variety of giving tools and complex assets, such as shares in a closely held company, partnership interests, and real estate. Atlantic Trust advisors can help you identify your charitable goals and find ways to achieve them in the context of your overall financial and estate planning. ■

CHOOSING A GIVING VEHICLE

“Often when we discuss charitable planning with clients, their first question is, ‘What is the best way to give?’” says Lisa M. Garcia, managing director at Atlantic Trust. Those who are accustomed to simply writing a check might be interested in the additional benefits that can be achieved with a structured giving vehicle, such as: the anonymity or convenience of a donor-advised fund, the control that can be achieved with a private foundation, the income tax efficiency of a charitable remainder trust, or the estate tax savings associated with a charitable lead trust. (See “Charitable Giving Alternatives Matrix.”) Some clients have more than one giving vehicle—for example, both a private foundation and a donor-advised fund. For clients who are concerned about the paperwork burden of running a private foundation, we can assist with management and advisory services.

Timing is also important in choosing a charitable vehicle. Your financial profile and tax picture might influence your decision to make your gift in a single year or to initiate a multiyear gifting program. “For one generous client, who was in poor health and already had tax carryovers from previous years that he might never be able to use, advisors at Atlantic Trust recommended using a charitable lead trust to satisfy a pledge, rather than making additional yearly gifts,” says Linda S. Beerman. The trust, funded with marketable securities, was designed to pay income for five years to the charity, after which the client’s children would receive the remaining assets. (Many charitable lead trusts are designed to last for considerably longer, achieving even greater tax benefits.) Since this was a nongrantor trust—one in which the client did not reserve any powers—he would not need to report any trust income on his personal income tax return. The trust would receive a charitable income tax deduction each year for the money that went to charity. ■

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