ALAN CANTOR
CONSULTING

www.alancantorconsulting.com info@alancantorconsulting.com
Alan Cantor Consulting LLC | 88 Allison Street, Concord, NH 03301 | tel: 603.715.1791

Planned Giving Glossary

*Here follow short descriptions of various planned giving terms and vehicles. They are **not** meant to be comprehensive.*

Retirement Assets

End-of-Life Gifts of Qualified Retirement Assets. *An underutilized and very attractive source of planned gifts is the contribution at death of qualified retirement assets.* These assets include Individual Retirement Accounts (IRAs), 401(k)s, 403(b)s, and the like. The common denominator of all of these investments is that the owner of the assets has never paid income taxes on these funds – but would presumably pay those income taxes in retirement as the funds are withdrawn.

A life-end donation of qualified retirement assets to charity is simple and tax-smart. Why? Because if those assets were left to heirs, the heirs would be responsible for paying income taxes on those assets. Think of it as though there is an income tax obligation built into those retirement funds, because the original contributions were made "pre-tax." Those taxes need to be paid, one way or another, eventually. But if those funds are left to a charity, which does not pay income taxes, the full benefit goes to the charity – no taxes are paid. Or, to put it another way, if a donor has $1,000,000 in retirement assets, and $1,000,000 in regular assets (cash, stocks, bonds, real estate), and the donor wants to pass 50% of her assets to her family, and 50% to a charity, she should designate the charity as the beneficiary of her retirement assets, and her family members as the beneficiaries of her regular assets. This way, assuming she was not liable for estate taxes, there would be no taxes paid, and each entity would get the full $1,000,000. If she were to do the reverse, her heirs would be responsible for paying income taxes on the retirement assets.

Retirement assets (and the end beneficiaries) are governed by the instructions the donor makes with the retirement plan administrator. The donor can simply fill out a form designating that all or a percentage of the retirement assets should go to one or more charitable organizations. That's it! Though donors should of course check with their legal and financial advisors on all such matters, there is not a need to pay for a new will or a codicil on an existing will: making the charitable designation with the plan administrator is free and simple.

Qualified Charitable Distribution (QCD). *Another source of charitable giving stemming from retirement assets are **lifetime** distributions to charity from qualified*

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retirement funds. As retirees reach age 73, they are required to take what's called a "required minimum distribution" (RMD) from their qualified retirement funds – that is, IRAs, 401(k)s, or 403(b)s, for which no taxes have been paid. The retirees need to pay income taxes on whatever they withdraw.

Some people don't actually need that money to live on, and they are annoyed by having to take an annual withdrawal – and to then pay taxes on it. Moreover, taking the payments often pushes them into higher income tax brackets. There are other arcane aspects of tax accounting that make people of means reluctant to take their retirement distribution – unless, of course, they actually need the money.

The Qualified Charitable Distribution allows individuals to contribute retirement funds directly to one or more charitable organizations. When the funds in a QCD pass directly from an IRA to a charity, the funds don't count as income, and the donor is neither taxed nor receives a charitable tax deduction. At the same time, these Qualified Charitable Distributions count toward the Required Minimum Distribution from the retirement funds. So if, say, an individual is required to withdraw $150,000 from his retirement funds in a given year, but he makes $100,000 in Qualified Charitable Distributions, then he has met the RMD requirement but only has to pay taxes on $50,000. ($150,000 minus $100,000 equals $50,000.) Note: There is a limit of $100,000 per year on this sort of transfer.

One particularly attractive aspect of the QCD for donors is that if their "IRMAA" (Income-Related Monthly Adjustment Amount) is too high, they have to pay extra for their monthly Medicare Part B premium. The Required Minimum Distribution often pushes donors into higher Medicare premium brackets. But Qualified Charitable Distributions can provide a great benefit in this regard. Say, if a donor is required to take a Required Minimum Distribution that would put her $20,000 over the lower IRMAA bracket, she can direct that $20,000 of her RMD be distributed directly to charity. That would keep her in the less expensive Medicare premium bracket – and charity will get a $20,000 gift!

One last note: Qualified Charitable Distributions cannot go to donor-advised funds, at least at this point. That means that operating charities, which often compete for dollars with DAFs, have a great competitive advantage.

Life-Income Gifts

Charitable Gift Annuity (CGA): *A contractual agreement between a donor and a charitable organization, whereby the donor irrevocably transfers an asset to the organization, and the organization promises to send the donor (or the donor and one other person, or up to two beneficiaries other than the donor) payments for life.* After the death of the final surviving beneficiary, the charitable organization stops making payments, and the charitable organization gets to keep what remains of the gift.

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Charitable Gift Annuities are always for a fixed dollar amount, typically based on a percentage of the value of the original gift. For instance, a donor and charity may agree to a 7% charitable gift annuity (payable to the donor) for a $100,000 gift. Each year until the donor's death, the charity pays $7,000 to the donor (typically in quarterly installments, in this case, of $1,750).

Note that the charitable organization is responsible for the payments, regardless of how the investment of the charitable gift annuity assets performs.

Charitable gift annuities are generally thought to be the simplest form of life-income gift in that they do not require the establishment of a separate trust. Typical minimal gift size: $10,000.

Rates are generally based upon the age of the beneficiaries. The older the beneficiary (and, hence, the shorter the life expectancy), then the higher the rate. The rates for two beneficiaries is lower than for one. (This is because two people have a longer joint life expectancy than one.) A national board – the American Council on Gift Annuities (ACGA) – adjusts the recommended rates each year, if necessary, based on market conditions. Note that CGA regulations vary from state to state. New Hampshire law (which governs the administration of gift annuities from NH *donors*, whether the organization is based in NH or not) prohibits offering New Hampshire residents rates any higher than those recommended by the ACGA. New Hampshire law also has guidelines for the type of organization that can offer Charitable Gift Annuities (the organization needs to adequate assets and a long-enough track record as a nonprofit) to satisfy the Attorney General's office, and the organization needs to note on its annual report to the AG's office that it does, indeed, offer CGAs.

Charitable Gift Annuities offer the following benefits to donors:

1. Guaranteed income for life, usually at an attractive rate;
2. Avoidance of the capital gains tax, in cases where the gift is made with an appreciated asset;
3. A charitable income tax deduction for a portion of the gift (usually between 40% and 60%, depending on the rate and age of the beneficiary, and the IRS discount rate – see below), which can be taken in the year of the gift, and, if necessary, spread over the subsequent five years;
4. Annual income that can be partially tax free or priced at the capital gains rate; and
5. Avoidance of estate tax.

Deferred Charitable Gift Annuity: *A charitable gift annuity that does not start making payments to beneficiaries until a date designated by the donor.* For example, a 55-year-old earning a steady income might create a deferred charitable gift annuity that would not start paying until she reaches age 65 – the date of her presumed retirement.

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Charitable Remainder Trust (CRT): A trust established that will pay a donor, donors, or their designated beneficiaries an income stream for their lifetimes, with the remainder then passing to charity or charities upon the death of the final beneficiary. CRTs can also be established for a term of years.

Charitable Remainder Trusts come in many sizes and shapes and types. They require the involvement of attorneys and advisors to create and/or approve the documents, and thus involve some start-up costs. Because of these costs, ongoing reporting, investment expenses, and the complexity of administration, Charitable Remainder Trusts are rarely established for less than $250,000.

Charitable Remainder Trusts give donors similar financial benefits to those provided by Charitable Gift Annuities: increased income, deferral of capital gains taxes, partial income tax deduction, removal of assets from the estate, and (often) a favorable tax treatment of the income stream. Unlike Charitable Gift Annuities, donors can reserve the right to adjust the eventually charitable beneficiary. That means that a CRT can be established, for example, to benefit a particular university. But the donor can replace the university at some point with a local art gallery or a youth program, or even a multiple of charities at various percentages. (The eventual benefit must, however, go to some sort of charity or charities; it cannot revert to the donor's family or another noncharitable entity.) This is illustrative of the flexibility of CRTs: they're more expensive to create and maintain, and they require a large initial gift, but they can be tailored to meet the donors' interests and priorities.

There are several general types of CRTs. These include:

> **Charitable Remainder Annuity Trust (CRAT):** *A CRAT pays a fixed dollar amount (based upon a percentage of the original value of the gift) for life.* A 6% CRAT on an asset valued at $1,000,000 would pay $60,000 a year, regardless of the market value of the trust from year to year.
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> **Charitable Remainder Unitrust (CRUT):** *A CRUT pays a fixed percentage of the value of the trust each year, based on market value.* For example, a 6% CRUT on an asset valued at $1,000,000 would pay $60,000 in the first year. If, on December 31 of that first year, the value of the trust rises to $1,100,000, then the trust will pay $66,000 in the second year – 6% of the revalued trust.
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> **FLIP Charitable Remainder Unitrusts:** *A type of CRT that is used primarily when gifts of real estate is donated to create the trust.* Because real estate is illiquid, it generally cannot produce the cash needed to make payments to beneficiaries. Most gifts of real estate are therefore made into a FLIP CRUT. So long as the real estate is unsold, it pays the beneficiaries only what the trust earns – in most cases, nothing. Once the real estate is sold, and the resulting assets are invested in stocks and bonds and other liquid instruments, then the trust "flips" and begins paying beneficiaries as a standard CRUT would.

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Pooled Income Fund (PIF): *Another form of life-income gift – rarely used today.* In a Pooled Income Fund, gifts from donors are pooled with those from other donors, and they then share the annual income on a *pro rata* basis. Pooled Income Funds gained popularity during the high interest rates of the early 1980s, but they grew much less popular when interest rates plummeted in the 2010s. Unlike Charitable Remainder Trusts, where the annual distributions can be drawn from interest, dividends, capital gains, and principal, or Charitable Gift Annuities, where the annual payments are pledged by the institution, regardless of the investment returns, *the annual payments of Pooled Income Funds are entirely market driven and are literally the income* – that is, the interest and dividends – earned by the pool. Those organizations with old Pooled Income Funds generally have satisfied donors: their funds have appreciated significantly, so the annual distributions have continued to rise. New donors, however, are far less interested in Pooled Income Funds, as the annual payments tend to be very low compared with other vehicles.

Charitable Lead Trusts (CLT): *Primarily a vehicle for transferring wealth from one generation to another at deeply reduced estate or gift taxes.* The donor places an asset in the lead trust, and for a period of years (or a lifetime), the trust makes an annual distribution to charity. At the end of that period (typically, 20 or 25 years) the assets of the trust pass on to the next generation. Because the transfer to the next generation takes place many years after the date of the transfer into the Lead Trust, and because of the intervening years of contributions to charity, the "present value" of the gift is a fraction of its original value. This means that a transfer of, say, $1,000,000 to the next generation might be considered a taxable gift of only $200,000 or so – or even zero. CLTs are expensive to create and to maintain, and typically are very large -- $500,000 or more. They are most attractive to donors when IRS discount rates (see below) are low, and who are so wealthy that they are liable to estate taxes – that is, a net worth for a couple of over $30 million or so. They are typically managed by the donors' investment firm, attorneys, bank, or other advisors. Charities that benefit are usually passive participants – simply receiving the check when it arrives. And Charitable Lead Trusts are very rare relative to other giving vehicles.

IRS Discount Rate. *The rate, adjusted monthly by the Internal Revenue Service, by which the government presumes planned gift assets will grow in the future.* For example, if the discount rate is 5%, the IRS is projecting that the assets contributed in a planned gift to charity will grow at 5% annually for the length of the gift. This means that with a life-income gift (a charitable gift annuity, a charitable remainder trust, or a pooled income fund contribution), the amount that charity is likely to receive at some future date if the IRS discount rate is 5% is less than if the IRS discount rate were 8%. This, in turn, means that a donor making a life-income gift with an 8% discount rate will receive a somewhat higher income tax deduction than the person making the gift with a 5% rate.

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Conversely, a lower IRS discount rate provides *added* tax benefits to donors creating a *charitable lead trust*. This is because with a charitable lead trust, the charity is the beneficiary for a certain time period, and then the property reverts to the donor's family. A lower IRS discount rate means that the government presumes that the assets will grow slowly – which means that, as projected at the time the trust is established, *less will go back to the family* than if there were a high rate, and consequently (for gift tax purposes) the trust represents less of a gift to family members. That's good, from a tax standpoint.

One thing to keep in mind is that the IRS Discount Rate in no way affects the actual income stream received by the donor – only the calculations (at the time of the gift) for income tax and gift/estate tax purposes. Another thing to keep in mind is that the donor and the donor's advisors may choose any of three monthly rates to govern their gift: the rate in the month of the gift, or the rate in either of the two previous months, whichever is most advantageous.

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