

**Diabetes Association of Greater Cleveland's  
*Planned Giving Guide***

**TABLE OF CONTENTS**

Life Insurance Gifts.....Page 2

Charitable Gifts of IRAs.....Page 3

Charitable Lead Trust.....Page 4

Charitable Gift Annuity.....Pages 5-6

Bequests.....Pages 7-8

Charitable Remainder Unitrust.....Pages 9-10

Charitable Remainder Annuity Trust.....Pages 11-12

## **LIFE INSURANCE GIFTS**

An often overlooked way of making a meaningful charitable gift is by designating a charity as the beneficiary of one or more of your **Life Insurance** policies. Very often, individuals who have had successful careers no longer have a need for life insurance purchased years ago. Rather than cash in an old policy, you may wish to consider transferring ownership of the policy to a charity who will also become the beneficiary. You will receive an income tax deduction equal to the policy's "interpolated terminal reserve" (generally, slightly above the cash surrender value of the policy) or your cost basis in the policy.

Assume that you have an old life insurance policy with a face value of \$100,000 and a current cash value of \$45,000. If you cash the policy in now, you will incur a taxable gain because your basis in the policy is less than the cash surrender value. Instead, by transferring the policy to the Diabetes Association of Greater Cleveland, you will receive a charitable income tax deduction based on the current cash value. In addition, you will receive additional income tax deductions on the future premiums that you pay. At death, the Diabetes Association of Greater Cleveland will receive the face value of the policy.

## CHARITABLE GIFTS OF IRAs

**IRAs** (and qualified retirement plans) are subject to both estate and income taxation. Since Charities are exempt from income taxes, naming a Charity as the beneficiary of an IRA is often the most tax efficient way to fund a gift for an individual who wishes to leave assets to Charity at death. When a Charity is named as the beneficiary of an IRA, the Charity will be able to collect the entire balance in the plan without having to pay any income taxes. In addition, the Decedent's estate will be able to claim an estate tax charitable deduction for any amounts passing to Charity thereby effectively eliminating both estate and income taxes on the charitable gift. On the other hand, if the Donor simply leaves a bequest in his Will to Charity and names his children as the beneficiaries of his IRA, the bequest to Charity will qualify for the estate tax charitable deduction; however, the children will have to pay income taxes when the IRA is distributed to them.

The following Example illustrates the benefits which can be achieved by funding a charitable gift at death through an IRA as opposed to a cash gift in the Donor's Will.

*Example:* John, a widower, dies in 2002 with an estate of \$2,000,000 comprised of cash in the amount of \$1,500,000 and an IRA holding assets valued at \$500,000. John named DAGC as the beneficiary of his \$500,000 IRA and left the balance of his estate to his two children. DAGC will receive the entire \$500,000 IRA without having to pay any income taxes attributable to the IRA. After the payment of the estate taxes on the balance of John's estate, each of his two children will receive approximately \$645,000. Alternatively, if John had provided a \$500,000 cash gift in his Will to DAGC and left the balance of his estate and his IRA to his two children, DAGC would receive \$500,000 from the decedent's estate tax free, and the children would receive approximately \$395,000 each and one-half of the IRA (\$250,000) after the payment of estate taxes.

However, the children will have to pay income taxes on the IRA proceeds upon distribution. Assuming that each child is subject to a combined federal and state income tax rate of 38%, \$190,000 of the \$500,000 IRA will be depleted by the income tax liability. This would leave each child with a total inheritance of \$550,000 rather than \$645,000. Note: This Example does not take into account the income tax deduction for income in respect of a decedent which each of the children **may** be able to utilize depending on their income levels and other deductions. The maximum IRD deduction per child in this Example is \$35,000.

## **CHARITABLE LEAD TRUST**

A **Charitable Lead Trust** provides payments to a charity for a period of years (or a term measure by one or more lives), upon the expiration of which the trust assets revert to the Donor or his or her family. In order to establish a Charitable Lead Trust, the Donor irrevocably transfers cash or other assets to the Trustee of the trust who then makes payments annually to the designated charity in the form of a guaranteed annuity or a specified unitrust amount to be recalculated each year.

### **ADVANTAGES OF A CHARITABLE LEAD TRUST**

- If the Donor will receive the trust property back after the term, the Donor receives an income tax charitable deduction for the year that the trust is established. However, the Donor will be taxed on all income paid to the charity. The up-front deduction may be beneficial to the Donor particularly if he transfers tax-exempt securities to the trust.
- If the trust property is payable to someone other than the Donor after the term of the trust, the Donor can make before tax dollars available to charity, i.e., neither the Donor nor the charity will be taxed on the payments.
- If the Donor designates that at the termination of the trust the trust property passes to a family member, the Donor will receive a gift tax deduction based on the charity's right to receive payments for the term of the trust. Depending on the vacation of the charity's interest in the trust, there may be no taxable gift with respect to the property left to the family member at the end of the trust term.
- A Donor's estate plan may provide for the establishment of a Charitable Lead Trust at the time of the donor's death. The value of the charity's right to receive payments for the term of the trust will qualify for an estate tax deduction thereby reducing estate taxes.

### **HOW A CHARITABLE LEAD TRUST MAY BENEFIT YOU AND THE DIABETES ASSOCIATION OF GREATER CLEVELAND**

Donald had \$1 million in securities which are appreciating at a rate of more than 10% annually. Donald would like to gift the stock to his children, but he realized that by doing so he will incur a substantial gift tax. He decides to establish a Charitable Lead Trust, naming Diabetes Association of Greater Cleveland (DAGC) as the charitable beneficiary of the trust for a term of twenty years. During that period, DAGC receives \$100,000 annually (assuming that Charitable Lead Trust is set up as a 10% annuity trust). After the expiration of the twenty year period, the securities will be transferred to Donald's children. Donald receives a charitable gift tax deduction at the time of the gift which zeroes out the gift of the remainder interest to the children. By opting for a Charitable Lead Trust, Donald has not only accomplished his wish to gift a large asset to his children without being subject to a substantial gift tax, but he has also benefited a worthwhile cause.

## **CHARITABLE GIFT ANNUITY**

A **Charitable Gift Annuity** is a legal contract between one or more Donors and a charitable organization. In exchange for a gift of assets to a charity, the annuitant, the Donor, or other designated individual, receives a guaranteed fixed income stream. Upon the death of the annuitant, the charity receives any unused portion of the gift. There are two types of annuities. With an immediate annuity, the annuitant begins receiving income upon the establishment of the annuity. With a deferred annuity, the annuitant defers the start of payments to a specified date in the future. The annuity interest rate will be computed based upon the age of the annuitant, the number of annuitants (single or joint), and current interest rates. If there are two annuitants, the interest rate will be determined based upon the annuitants' combined life expectancy. (Applicable current rates will be provided upon request.)

### **ADVANTAGES OF A CHARITABLE GIFT ANNUITY**

- The satisfaction of making a meaningful gift to a worthy charity.
- The security of a lifetime income stream.
- A Donor who established an annuity will receive a charitable deduction, based on the age of the annuitant and the time at which the payments will begin. The older the annuitant, the larger the deduction.
- A charitable gift annuity funded with appreciated property will reduce the capital gains tax consequences to the Donor. Additionally, the capital gain will be reported ratably over the Donor's life expectancy provided the Donor is one of the annuitants and the annuity is not assignable.
- A portion of an annuitant's income payments will be tax-free for his or her lifetime.
- A Charitable Gift Annuity may provide a higher income stream for the donor.
- Potential savings on estate taxes and estate administration expenses.
- Relief from managing the investment since the charity assumes this responsibility, including payment of any fees which may be associated with the annuity.

**HOW A CHARITABLE GIFT ANNUITY MAY BENEFIT YOU  
AND THE DIABETES ASSOCIATION OF GREATER CLEVELAND**

John and Ann are nearing retirement and seek security for the future and a greater yield on their investments. They hold stock totaling \$100,000 which pays an average dividend yield of 3%. To increase their yield and gain the security of a guaranteed annual income, they enter into an annuity contract with the Diabetes Association of Greater Cleveland. Based on an interest rate of 6%, John and Ann immediately begin receiving an annual income of \$6,000. They also receive an immediate charitable income tax deduction.<sup>1</sup> John and Ann have established security for the future through their charitable gift annuity.

---

<sup>1</sup>The charitable income tax deduction will vary upon the annuitants' ages and the Donor's income. A gift of cash is deductible by the Donor to the extent it does not exceed 50% of the Donor's adjusted gross income. A gift of appreciated property is generally deductible by the Donor to the extent the fair market value of the gifted property does not exceed 30% of the Donor's adjusted gross income. Any portion of the gift which exceeds the adjusted gross income limitations may be deducted over the following five years.

## **BEQUESTS**

A **bequest** is a gift provided for in an individual's Last Will and Testament of cash, securities, and/or real property to another individual or charitable institution, e.g., Diabetes Association of Greater Cleveland ("DAGC"). There are five types of bequests which you may wish to consider when planning your estate.

### **General Bequest**

The most common type of bequest is the general bequest by which an individual designates specific dollars (e.g., \$10,000) to be left DAGC.

### **Specific Bequest**

With a specific bequest, you can designate that specific property (e.g., real estate or securities) to be left to DAGC. It is important to understand that a specific bequest can only be satisfied with the property stipulated in one's Will. Should that property be gifted or sold prior to death, DAGC cannot receive anything in its place.

### **Residuary Bequest**

A residuary bequest provides that DAGC will receive all or a portion of the estate's assets remaining after all debts, taxes, expenses, and all other bequests have been paid.

### **Percentage Bequest**

A percentage bequest is a gift to DAGC which is based on a percentage of your estate. If the size of your estate changes, the amount of the bequest changed in direct proportion. By using a percentage gift, inflation will not reduce the value of your intended gift to DAGC.

### **Conditional Bequest**

A conditional bequest is a bequest which is contingent on the occurrence of a particular event. For example, you may wish to make a gift in your Will to a relative with the proviso that in the event that the relative does not survive you, the gift will pass to DAGC. Conditional bequests are often included in Wills to provide for a gift to be made if an individual's spouse does not survive.

## **ADVANTAGES OF THE BEQUEST FORM OF GIFT**

- A bequest is the simplest vehicle by which you can provide for DAGC in your estate plan. A simple clause in your Will, or a Codicil to an existing Will, is all that is required to make a bequest.
- A bequest gives you full use of the property to be gifted during your lifetime.
- Your estate will be entitled to a charitable deduction for estate tax purposes for the full, fair-market value of your gift.

## WHY A BEQUEST?

Bequests are the ideal ways to make a meaningful gift:

- You are young and just starting out. You might intend to do more philanthropically in the future, but right now a substantial gift is out of the question.
- Your assets are tied up in real estate which you do not want to liquidate in order to make a gift.
- You are at retirement age and uncertain of future financial security and, therefore, more comfortable monitoring your current investments and postponing your gift to DAGC until death.
- You want to make a substantial gift, but are uncertain as to how much you can afford. A percentage bequest is an excellent alternative.
- Through your Will, you want to secure the future to other beneficiaries before a portion of your estate passes to DAGC. In such a case, a contingent bequest may be the appropriate solution.

## **CHARITABLE REMAINDER UNITRUST**

A Charitable Remainder Unitrust involves an irrevocable transfer of cash or property by a donor to a trustee who in turn makes payments to one or more non-charitable beneficiaries over the lifetime of the beneficiaries or for a fixed term not to exceed 20 years. The non-charitable beneficiary is entitled to receive payments each year determined by multiplying a fixed percentage (no lower than 5%) by the net fair value of the trust assets, as revalued annually. In the event that the trust income exceeds the required payout amount for a particular year, the excess is added to principal. Upon the termination of the trust, the remaining trust assets are transferred to one or more charities.

### **ADVANTAGES OF A CHARITABLE REMAINDER UNITRUST**

- You may use a Charitable Remainder Unitrust to provide payments for yourself or your designated beneficiary for life or a period not to exceed 20 years.
- By designating a charity as the remainder beneficiary, you receive an income tax charitable deduction when the trust is created based upon the present value of the charity's remainder interest and your income.
- You incur no capital gains tax on the transfer to and subsequent sale by the trust of highly appreciated assets.
- The Charitable Remainder Unitrust may provide a hedge against inflation if the value of the trust assets appreciates at a rate proportional to the annual rate of inflation.
- Your estate benefits because there are no estate taxes on assets transferred to the trust. In addition, your estate may also benefit from reduced estate settlement costs.
- Unlike a Charitable Remainder Annuity Trust, additional property may be added to a Charitable Remainder Unitrust. Additional contributions to a Charitable Remainder Unitrust will also be eligible for an income tax charitable deduction.
- The trustee can invest in tax-free assets which in turn may yield tax-free income to you depending on the nature of the other trust assets and whether the trust has any undistributed capital gains.

## HOW A CHARITABLE REMAINDER UNITRUST MAY BENEFIT YOU AND THE DIABETES ASSOCIATION OF GREATER CLEVELAND

Robert and Lisa are nearing retirement age. They have substantial investments in highly appreciated securities. They are concerned that if they liquidate the securities to provide for their retirement, they will incur a significant capital gains tax. In addition, Robert and Lisa would like to reduce their current income tax liability, as well as estate taxes payable at death. A Charitable Remainder Unitrust is a vehicle that will address Robert and Lisa's tax concerns, provide them with a guaranteed income for life, take advantage of the built-in capital gains of the securities, and give them the satisfaction of knowing they have made a significant charitable gift. Accordingly, Robert and Lisa transfer their securities with a fair market value of \$500,000 to a Charitable Remainder Unitrust. Assuming they have an adjusted gross income of \$225,000, they will receive an income tax deduction of \$67,500<sup>1</sup>, and the balance may be used over the next five years. They will also begin receiving an annual income of \$25,000 (5% of fair market value of initial contribution). Additionally, since Robert and Lisa have chosen a Charitable Remainder Unitrust, their income will increase as the trust principal grows assuming that the securities Robert and Lisa have gifted at an average annual rate greater than 5%.

---

<sup>1</sup>The charitable income tax deduction for the year of the gift is limited by 30% of Robert and Lisa's adjusted gross income.

## **CHARITABLE REMAINDER ANNUITY TRUST**

A **Charitable Remainder Annuity Trust** involves an irrevocable transfer of cash or other property by the Donor to a trustee, who in turn makes payments to one or more non-charitable beneficiaries over the lifetime of the beneficiaries or for a fixed term not to exceed 20 years. Upon the death of the last non-charitable beneficiary, the remaining trust property passes to one or more designated charities. The distinguishing feature of a Charitable Remainder Annuity Trust is that the annual payout to the non-charitable beneficiary or beneficiaries is fixed at the inception of the trust. Unlike a Charitable Remainder Unitrust, which provides for a variable payout, a Charitable Remainder Annuity Trust provides the non-charitable beneficiary with a fixed annual income. In the event the trust generates more income than is necessary to pay the annuity, the additional income will be added to principal. If the trust income is insufficient to meet the annuity payment provided for in the trust instrument, the balance will be made up from trust principal.

### **ADVANTAGES OF A CHARITABLE REMAINDER ANNUITY TRUST**

- You may use a Charitable Remainder Annuity Trust to provide payments for yourself or your designated beneficiary for life or a period not to exceed 20 years.
- By designating a charity as the remainder beneficiary, you will receive an income tax charitable deduction when the trust is created based upon the present value of the charity's remainder interest. By contrast, a bequest under an individual's Will, while generating an estate tax deduction, does not provide the benefit of current income tax savings.
- You incur no capital gains tax on the transfer to and subsequent sale by the trust of highly appreciated assets.
- The trustee can invest in tax-free assets which in turn may provide tax-free income to you depending on the nature of the other trust assets and whether the trust has any undistributed capital gains.
- The assets remaining in the trust at the time of death may be required to be reported on the Donor's estate tax return, however, there is a corresponding charitable deduction resulting in no estate tax being assessed on the trust assets.
- Because the income to be paid by the trust is based on a fixed percentage of the initial gift, you know what the payment will be regardless of the actual rate of return on the investments held by the trust.

## HOW A CHARITABLE REMAINDER ANNUITY TRUST MAY BENEFIT YOU AND THE DIABETES ASSOCIATION OF GREATER CLEVELAND

*Example 1:* John and Joanne are both 72. They have planned well for their retirement and are not in need of additional income. What they do need, however, is an income tax deduction. They decide to transfer securities with a fair market value of \$50,000 and a cost basis of \$5,000 to a Charitable Remainder Annuity Trust with a term of twenty years, naming their three children as the current beneficiaries of the Trust. John and Joanne will receive an immediate income tax deduction.<sup>1</sup> Additionally, they will not be subject to any capital gains tax for transferring appreciated securities to the trust. In return, their children receive an annual income of \$3,500 based on a 7% annuity factor. At the end of twenty years, DAGC will receive the remainder of the trust assets.

*Example 2:* Martha is 70 and has her assets invested in certificates of deposit which are yielding a three to four percent return. Martha would like a stable, higher annual return. She decides to transfer her assets (totaling \$100,000) for a Charitable Remainder Annuity Trust. She not only receives an income tax deduction<sup>2</sup>, but she also receives an annual income of \$7,000 (based on a 7% return) for the rest of her life. At Martha's death, DAGC will receive the remaining assets held in the trust.

---

<sup>1</sup>The charitable income tax deduction will be limited to 30% of John and Joanne's adjusted gross income because they have gifted appreciated assets of the trust. Of course, any unused portion of the deduction may be carried over to the next five years.

<sup>2</sup>The charitable income tax deduction will be limited to 50% of Martha's adjusted gross income. As was the case in Example 1, any unused portion of the deduction may be carried over to the next five years.