

Give & Take

News and Ideas for Development Executives of Nonprofit Organizations

Will Planned Giving Die With the Estate Tax?

by Robert F. Sharpe, Jr.

On January 1, 2006, ongoing changes in federal estate tax laws will usher in a new era in charitable gift planning. Whether donors are considering a gift in the form of a bequest through a will, the remainder of a retirement plan, a gift of life insurance proceeds, or other means, estate tax considerations will play less of a role in motivating donors to make gifts that are completed through their estates at death.

That's because the amount that individuals can leave through their estates free of federal estate tax will rise to \$2 million on January 1. This will result in the elimination of estate tax for over 99% of Americans. In fact, the Congressional Budget Office (CBO)¹ has estimated that just 16,700 decedents will be subject to estate tax in 2005. If 22% of those persons leave bequests to charity (the average based on 2004 IRS figures), the number of those affected by the estate tax who leave funds to charity will shrink to just under 3,700. Surveys have found that 8% or more of Americans plan to leave funds to charity. If that is the case, then there are upwards of 200,000 charitable estates each year, with less than 2% of them subject to taxes in 2005.

While it will be some time before we know the full impact of the elimination of the estate tax on charitable bequests, organizations and institutions that have long encouraged donors to leave funds to charity to avoid estate tax may have to rethink their approach. Complex plans driven by state-of-the-art software that rely on charitable gifts to eliminate estate taxes will simply be irrelevant to the vast majority of donors. While it is true that a small number of donors are still concerned about estate taxes, they are among the very wealthiest individuals, are typically well advised when it comes



Washington, D.C., is the site of two upcoming Sharpe seminars this March. Register now for "An Introduction to Planned Giving" and "Managing Planned Giving Relationships."

to these matters, and do not normally look to their charitable interests for guidance in estate planning.

The death of planned giving?

Does this mean the end of planned giving? Of course not. In fact, approached in the right vein, we believe the elimination of estate taxes can represent a tremendous opportunity to encourage charitably inclined persons to make larger bequests for charitable purposes than they might have previously considered.

Experienced development executives know that a large percentage of charitable bequests have traditionally come from older, childless persons, often widowed or never married. These persons typically leave relatively small amounts to nieces, nephews, siblings, or other friends and relatives, with the bulk of their estates left as residuary bequests to charitable interests—often four, five, six or more in number. The typical amount left to charity in the form of residuary estate gifts has been in the range of \$150,000, with each of a number of charities receiving an average of \$35,000 to \$50,000. The vast majority of these estates have long fallen below the taxable threshold. These bequest donors typically gave smaller amounts during lifetime from incomes that were as modest as the value of their estates. In the case of these donors, their heirs would receive their entire estate were it not for charitable dispositions. The cost of the charitable bequests to the heirs is thus 100% of the dollars given in this way.

Inside:

- What you—and your donors—should know about deduction limits p.2
- New ideas for communicating with donors p.7

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Knowing
your limit(s)

Planning Matters

One of the major lessons learned from KETRA legislation last fall is the importance of the 30% and 50% limitations on charitable deductions for federal income tax purposes. Every year, hundreds of thousands of individual taxpayers reach these limits and report many billions of dollars in carry-forward deductions. For instance, IRS reports for the 2003 tax year, the most recent year for which data are published, reveal that carry-forward charitable contribution deductions were reported by more than 500,000 taxpayers. These income tax returns include almost \$26 billion of charitable gifts carried forward from one or more prior years when percentage limitations for charitable deductions were reached.

The IRS figures also provide important information about the adjusted gross income levels of those who encountered deduction limits. A simplified breakdown may be seen at right.

It may come as a surprise to many that the vast majority of taxpayers reporting carry-forward contributions after exceeding AGI limits in prior years have moderate income levels. Many assume that only wealthy, high-income individuals encounter these limits. While it is true that those with the highest incomes report the largest dollar amount in carry-forward deductions, those with more modest AGI levels were more likely to encounter the percentage limitations for charitable contributions.

Nuts and bolts

Understanding these limitations can help maximize both the tax savings and the satisfaction of donors making larger gifts. Gift development executives and marketing materials that imply that charitable gifts are fully deductible for federal income purposes may mislead an unsuspecting donor about the potential effect that a gift may have for tax purposes. Even guarded claims that "gifts are fully deductible up to the allowable limits" provide little guidance to donors who might be affected.

Therefore, it may be beneficial to review the 30% and 50% limits and carry-forward provisions. The amount allowed as a charitable deduction by

individuals in any tax year is limited to a percentage of an individual's contribution base, which is basically adjusted gross income computed without regard to any net operation loss carry-back. For most persons, this will be the same as their adjusted gross income, or AGI.

AFFECTED TAXPAYERS

AGI	Number of Returns	Percentage of Total
<\$50,000	296,000	59%
\$50,000-\$199,000	167,300	33%
>\$200,000	37,420	8%
Total	500,720	100%

The percentage limit depends upon the type of donee organization and the donated property. For charitable organizations described in section 170 (b)(1)(A) (public charities, private operating foundations, and certain governmental entities), the maximum percentage limit is 50% of the individual contribution base. A 30% limit applies to contributions to non-operating foundations and certain other organizations. While gifts of cash may be deductible up to a 50% limit, gifts of long-term appreciated capital gain property are generally deductible up to 30% of the individual taxpayer's contribution base (usually AGI). A taxpayer may elect to have all gifts of appreciated property deducted against the 50% limit by reducing the claimed contribution by the amount of the appreciation. Gifts subject to the 50% limit are considered first, followed by any gift falling into the 30% limitation. The combined deduction for contributions may not exceed the overall 50% limitation. Any contribution subject to either of these limits shall be carried forward for use in the next year. The maximum carry-forward period is five years, so it is possible for some gifts to provide income tax savings in as many as six years. Contributions of appreciated capital gain property to charities described in section 170(b)(1)(B) are deductible up to 20% of the individual's contribution base.

While the basic tax rules are relatively straightforward, the application of the same rules can be very complex. Is the gift to a 50% charity or a 30% charity? Is the donor subject to a 50%, 30%, or 20% limit? Do the gifts include cash, capital gain property, or some combination? What is the individual's contribution base this year? Does it fluctuate significantly?

Give & Take:

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Sharpe Seminar Series

Featured Seminar: *Philanthropy in Times of Change*

This seminar was presented for the first time in October to rave reviews. Of special interest to past Sharpe seminar attendees, the content is focused on how to respond to current conditions that some have described as the “perfect storm.”

The decline in persons in the age range for making bequests and many other planned gifts is now unfolding as predicted. At the same time, uncertainty surrounding the economy and estate tax law continues to present challenges to otherwise motivated donors and their advisors.

What, then, is the appropriate response for those who manage planned and major gift development efforts and are now setting goals and expectations for their staff and volunteer leadership? Robert Sharpe and Jonathan Tidd team up again to provide practical solutions for those who are expected to succeed in spite of what may seem to be debilitating obstacles.

Attendees will leave with renewed confidence in the steps that they can take today to succeed in an era of increased emphasis on helping donors make current and deferred gifts in light of their age, wealth, and other circumstances. [G&T](#)



Upcoming Seminar Training Dates

Philanthropy in Times of Change

Chicago/Oak Brook
February 6-7
Washington, D.C.
February 23-24

An Introduction to Planned Giving

Washington, D.C.
March 20-21

Managing Planned Giving Relationships

Washington, D.C.
March 22-23

Multiple registration discounts are available. For more information or to register, please contact The Sharpe Group.
Phone 1-800-238-3253, ext. 5360
Fax 901-761-4268
Web site: www.sharpenet.com
E-mail: seminars@sharpenet.com

On the Agenda for ‘Philanthropy in Times of Change’

Day One

- Navigating Seas of Change
- Tax Incentives for Charitable Gifts – What’s Left?
- Managing the Gift Planning Matrix
- The Best Planned Gifts in Today’s Environment
- How Will the Baby Boomers Boom?
- Making Gifts Using Pre-Existing Estate and Financial Planning Tools

Day Two

- Meeting the Needs of the Silent Generation
- Gift Planning for the G. I. Generation
- Estate Planning After Estate Taxes
- Communicating Gift Planning Opportunities
- Terminating a Planned Gift
- Working With the Donor’s Advisors – Are They Friends or Foes?

See www.sharpenet.com/seminars for a complete agenda and dates for this and other Sharpe seminars.

What Attendees Are Saying About ‘Philanthropy in Times of Change’

“Excellent presentation of complex material offering practical suggestions and tools!”

“Excellent resource—wholeheartedly recommend.”

“Very complete seminar. I’m understanding more and more! Thank you.”

“The professionalism of Sharpe Group seminars amazes me.”

Die With the Estate Tax? ...Continued from page 1

A larger universe?

Ironically, the elimination of the estate tax may expand the group of persons who make charitable gifts through their estate to include more wealthy persons with children. Consider that persons of wealth who wish to leave assets to their children must now pay estate taxes on many billions of dollars per year for the privilege of doing so. Elimination of the estate tax will put those tax dollars “in play.” The CBO has estimated that an immediate elimination of the estate tax would reduce estate tax revenues by \$150 billion between 2006 and 2010, an average of \$30 billion per year. Given these figures, there could be an extra \$30 billion available each year for persons planning their estates to devote to any number of other uses.

Those who no longer owe estate taxes will have a choice to make. Should they allow their families to enjoy the entire windfall brought about by the elimination of estate taxes, or should they split it between their families and their charitable interests? The decision they make may to some extent depend on how the nation’s nonprofit community addresses the issue. Those who believe that wealthy persons will not leave funds to charity without an estate tax incentive may choose to lobby for the continuation of the estate tax so that charities will not be hurt. However, few boards can be expected to endorse that position given the fact that many trustees are themselves persons of significant wealth!

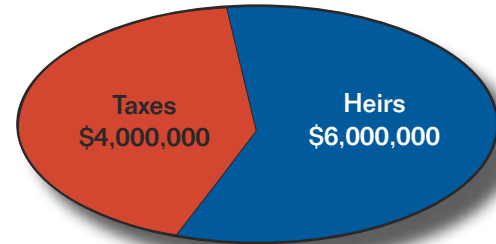
A better approach may be to inform wealthy donors of the increased control they may enjoy over their assets so they may carefully consider how to distribute those assets wisely. Keep in mind that many donors now decide how much they wish their loved ones to receive, pay the tax on that amount, and then leave what remains to charitable interests. As a result, charities may begin to receive all or a portion of the share formerly allotted to the government.

Lower tax can mean larger gifts

For those who now have taxable estates and must split assets between charitable recipients, taxes, and their families, elimination of estate taxes can actually mean they can leave more to their families and their charitable interests.

Let’s consider the case of a wealthy individual with a \$10 million estate who would like to leave it all to her children. Here is the way her assets would be split at death under current law (taxes are approximate):

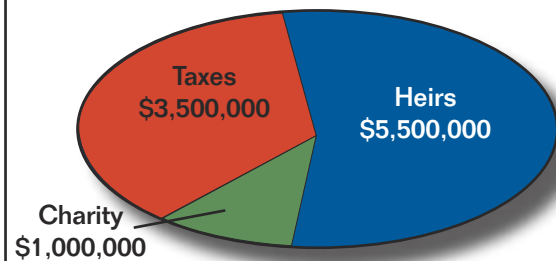
Result if Taxable Estate With No Charitable Bequests



Suppose, like many others, she decided to leave bequests (in this case 10% of her estate) to charity.

Here is how the distribution would break out under current estate tax law:

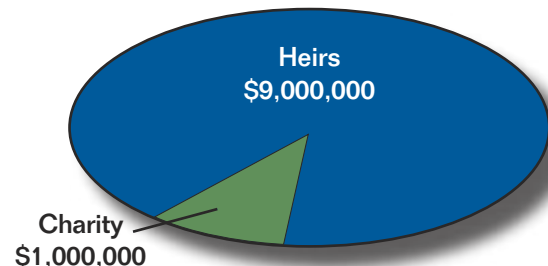
Result if Taxable Estate With Charitable Bequests



Note that the family would receive \$5.5 million and the “cost” of the charitable bequest to them would be \$500,000.

Now suppose the estate tax is repealed:

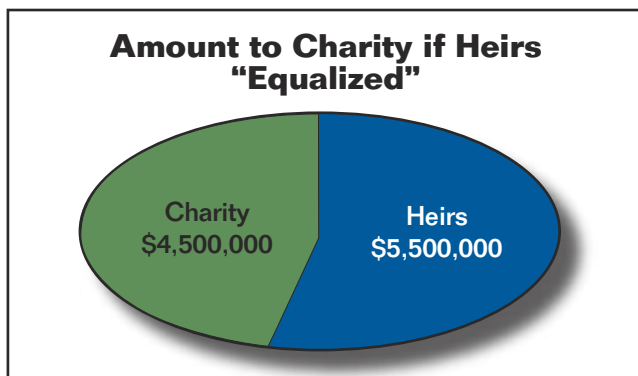
Result if No Taxes With Bequests



In this case, the heirs would receive \$9 million, which is \$3.5 million more than they would enjoy under the current tax regime, while the charity would still receive \$1 million. Under these circumstances, the donor may choose to increase her charitable bequests to as much as \$4.5 million, leaving \$5.5 million for the children—the same amount they would receive if her estate were taxable.

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Die With the Estate Tax? ...Continued from page 4



The elimination of the estate tax would give this donor greater flexibility and more choices. She can increase her charitable bequest by any amount between \$1 million and \$4.5 million without depriving her children of the inheritance they would have received under current law when she decided to leave the \$1 million to charity despite the cost to the children. Cases like this reveal that elimination of the estate tax would not necessarily lead to fewer funds for charity but might, in fact, result in greater amounts left to charity.

Individuals with inherited wealth may also begin to give more to charity. It is not uncommon for those who have inherited assets to feel that they were entrusted with the funds for the benefit of their family and thus do not have the right to give away "family money" at their death. With no estate tax, these persons may reconsider that position and leave all or a portion of what would have been expended in tax dollars for purposes that the family can agree will further commonly held objectives.

The desire to give remains

Given these circumstances, why would anyone argue that repeal of the estate tax would result in less to charity? Some may mistakenly argue that bequests under current law do not "cost" heirs anything as they simply take funds that would have been directed to pay estate taxes and given them to charity instead. However, making a charitable bequest has always had a cost, with or without an estate tax. Persons who accumulate \$10 million normally know that their heirs receive less if they leave a bequest to charity. This at least partially explains why 80% or more of taxable estates have traditionally not included charitable dispositions even though 70% or more Americans contribute to charity during their lifetimes.

Every time a donor with children or other dependents makes a gift during his lifetime, he is deciding to deprive himself—and by extension his family—of the amount he would have had available to spend if he had kept the money and paid tax on it. Americans choose to deprive themselves and their families of close to \$200

billion each year in this way. Should it be any surprise, then, that they choose to leave close to \$20 billion per year to charity through their estates?

Would Americans stop making current gifts if there were no income tax? There is ample evidence that Americans supported non-profit endeavors well before the arrival of the income tax in 1913 and the estate tax in 1917. The bequests that provided initial funding for Harvard University, Johns Hopkins University, and the Smithsonian Institution in the seventeenth and nineteenth centuries are just three of many possible examples.

Scholarly studies have revealed that many among the ranks of the wealthy have indicated that they will, in fact, leave more to charity if the estate tax is eliminated. See "The Mind of the Millionaire: Findings from a National Survey on Wealth with Responsibility" by Paul Schervisch and John Havens, available at <http://www.bc.edu/research/swri/meta-elements/pdf/mompub1.pdf>.²

Communication is key

Elimination of the estate tax presents a wonderful opportunity for nonprofits to dispel common misconceptions. For example, donors have been told for so long and so often about the estate tax savings of charitable gifts that they may believe the reason to give is vanishing with the estate tax.

Charities need to act now to tell donors that the elimination of the estate tax gives them new freedom and responsibility when it comes to the distribution of their assets. In addition, charities must make the case why their particular cause should receive a portion of the donor's newfound wealth.

Emphasize other ways to give

The elimination of the estate tax will also bring into sharper focus the importance of making planned gifts during lifetime. Such gifts can serve to maximize the remaining tax and financial benefits and make it easier for motivated donors to give larger amounts. The income tax will not soon be eliminated, and the current plan to eliminate estate tax in 2010 leaves the gift tax intact with a maximum rate of 35%.

Gift planning tools that result in welcome income tax savings, asset management, and more stable sources of income will have greater appeal than ever after the elimination of the estate tax. Persons who



Robert F. Sharpe, Jr., is president of The Sharpe Group. He advises a number of the nation's leading nonprofits in the design and implementation of their gift planning initiatives.

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would be inclined to leave a gift at their death may be more likely to give during their lifetimes in ways that result in current tax savings and other benefits. Gift annuities, charitable remainder trusts, and gifts of remainder interests in homes and certain other real estate are examples.

Gifts in the form of charitable lead trusts that result in significant gifts over a period of years, while ultimately transferring unlimited amounts free of gift tax, will also continue to hold great appeal for wealthy donors in the wake of an elimination of the estate tax.

Charitable gifts of retirement plan assets during lifetime and at death will remain a wise option. These assets are now potentially subject to both income and estate tax. If the estate tax is eliminated, income tax will continue to be due on the amounts left to heirs from retirement accounts. For that reason, it will still be prudent to direct amounts remaining in retirement accounts to charitable use and leave nontaxable assets to other heirs.

There are untold billions of dollars outstanding in life insurance policies in America. Many of these policies are maintained for the purpose of paying estate taxes on real estate, businesses, art collections, and other illiquid assets. If no estate tax is due, the windfall in many estates will come in the form of life insurance policies that are no longer needed for their original purposes. With the jury still out on whether estate taxes will be eliminated for everyone, a wealthy individual would be ill advised to allow insurance policies to lapse. These persons might leave all or a portion of the insurance policies to their charitable

interests if they are no longer needed to pay estate taxes on the amounts left to their heirs.

Conclusion

No one knows what will eventually happen to the estate tax liability that remains in place for the wealthiest Americans. We do know that for now the estate tax is gone for the vast majority who pass away in 2006 and in coming years. With proper perspective, nonprofits can encourage their donors to take advantage of this newfound wealth to make an even greater impact on their charitable interests. Funds previously redistributed involuntarily by the government through estate taxes can now be thoughtfully divided on a voluntary basis between family and charity. Now more than ever, the mission of your nonprofit organization or institution matters most as donors decide how to vote with dollars they have inherited or accumulated themselves. G&T

¹ This reference and others references to Congressional Budget Office statistics refer to Revenue Option 41, which may be accessed through the CBO Web site at www.cbo.gov.

² Schervish, Paul G. and John J. Havens. "The Mind of the Millionaire: Findings from a National Survey on Wealth with Responsibility." *New Directions for Philanthropic Fundraising*. 32 (Summer 2001): 98.

Planning Matters ...Continued from page 2

Are there carry-forward contributions to consider from prior years, or will this year's gift create a carry-forward situation? In many cases, the donor's accountant or other tax advisors will be the only ones capable of determining the answers to these questions with any degree of certainty.

However, it might be beneficial to consider a variety of donors that may encounter these limits. Many retirees are property rich, but their incomes may have fallen dramatically after they stopped earning a salary. Donors in this category could include those making large outright or split interest gifts. For example, a widow wishing to make a commemorative gift in memory of her spouse may hit the limit at a relatively low gift level regardless of whether it is funded with cash or appreciated property. Or consider a retired schoolteacher who funds a gift annuity or other life income arrangement with cash or appreciated property. Depending on her age and payment rates, the charitable deduction is often in the 25% to 66% range and likewise may approach either applicable limit.

For those still working, both affected gifts and incomes tend to be larger still. Relatively few persons with an AGI of \$100,000 can afford to make gifts that are going to hit the limit because most of that income will be spent on living expenses, or needs to be saved for retirement or other purposes. Yet those with incomes four to five times that amount, or more, may have accumulated enough wealth that they can consider six- or seven-figure gifts. Donors that are key prospects for capital campaigns often fall into this

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Footnotes

Tax law changes bring new opportunities

On January 1 of this year, we hit another benchmark in the scheduled estate tax phaseout process. The amount that can now be left to heirs free of estate taxes is \$2 million—up from \$1.5 million the previous two years. This limit will be in place until 2009, when it is scheduled to rise to \$3.5 million.

Now that we are at the midway point in scheduled elimination of the estate tax, it may be a good time to remind donors of the impact Congress's laws may have on their estate and long-range plans. Consider sending your donors the informative Sharpe brochure "Has Congress Changed Your Will?"

This newly designed, six-panel brochure explains in understandable terms how the current tax law changes may affect donors. For example, readers will learn that:

- Estate tax phaseout is making estate taxes a thing of the past for almost all Americans (see page 1).
- Because they may no longer need to plan for payment of estate taxes, donors may have more assets available to distribute among their heirs as well as their charitable interests.
- Now may be the time to review current estate plans and bring them up to date, taking into account estate tax changes and the continuation of the unlimited marital deduction.

The brochure also includes helpful information about the giving opportunities available through retirement plans, life insurance, and other planning options in light of the tax law changes.



You may want to send "Has Congress Changed Your Will?" to all or a portion of your donors, staff members, and volunteers, as well as advisors who may have only a basic knowledge of how the tax law changes could affect gifts their clients may be considering. Sending this brochure, a short cover letter, and a response device to your constituents this winter may be one of the most cost-effective ways to educate them about the positive gift planning opportunities that took effect January 1.

Ensure that your organization is one of the first to communicate the benefits and important planning possibilities coming about as a result of tax law changes. A copy of "Has Congress Changed Your Will?" is enclosed with this issue of *Give & Take*. To place an order, call The Sharpe Group at 1-800-238-3253 or visit www.sharpenet.com/pubs.

Start the new year off right

Sharpe is proud to offer a number of training opportunities in 2006, including two presentations of the popular new seminar "Philanthropy in Times of Change" in February. See page 8 or www.sharpenet.com/seminars for a complete training schedule for 2006. **G&T**



News and ideas about The Sharpe Group's services.

Planning Matters

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category. A multimillionaire may have an income of \$250,000-\$500,000 and can easily have the ability to make a gift of \$500,000 or \$1 million from assets, not income. If the gift is given outright (instead of being broken into pledge installments), it may easily hit the limits.

The key to dealing with these limits is to understand them and to make sure that donors are fully informed before they make the gift. To learn more about these and other important issues, attend one of Sharpe's popular seminars. See page 3 for more information. **G&T**



THE SHARPE SEMINAR SERIES

Plan Your 2006 Calendar



Training Schedule 2006

January

An Introduction to Planned Giving	New York	Jan. 9-10
Managing Planned Giving Relationships	New York	Jan. 11-12

February

Philanthropy in Times of Change	Chicago/Oak Brook	Feb. 6-7
Philanthropy in Times of Change	Washington, D.C.	Feb. 23-24

March

An Introduction to Planned Giving	Washington, D.C.	Mar. 20-21
Managing Planned Giving Relationships	Washington, D.C.	Mar. 22-23

April

An Introduction to Planned Giving	Chicago/Oak Brook	April 18-19
Managing Planned Giving Relationships	Chicago/Oak Brook	April 20-21

May

Major Gift Planning	Orlando, FL	May 11-12
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June

An Introduction to Planned Giving	Boston, MA	June 12-13
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August

An Introduction to Planned Giving	New York	Aug. 21-22
Managing Planned Giving Relationships	New York	Aug. 23-24

September

Major Gift Planning	New York	Sept. 6-7
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November

Major Gift Planning	Washington, D.C.	Nov. 6-7
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