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PLANNED GIVING FOR CHARITABLE ORGANIZATIONS

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<u>Caveat</u>: *The tax law includes numerous detailed rules and exceptions. In addition, some generally available tax benefits are unavailable (or limited) to certain taxpayers because of the specific facts of the taxpayer's situation. For purposes of this presentation, this outline focuses only on the general rules, and will not mention every exception and variation. Any person who wishes to utilize a technique discussed in this outline with the expectation of receiving a tax benefit should consult with his or her own tax adviser, and rely exclusively on that adviser who has direct knowledge of the specific facts, and of the donor's particular tax situation.*

1. The Challenges that Charities Face in this Economic Climate

Charities recently have experienced the trifecta of economic setbacks:

1. their portfolios have, in many cases, diminished in value;

2. the rate of annual return from their investments has reached historic low points; and

3. their donors feel much less well-off than they did in past years, and are more reluctant to part with their money.

But at the same time, the need for their services goes on, and the cost of providing those services has not gone down. This calls for more creative approaches to appeal to donors, both for current contributions and long-term contributions.

II. No Donor Ever Said, "This check is to pay your utilities and the salaries of your administrative staff."

Many donors need an incentive to contribute. Some will make gifts to the charity just because they support its general purposes and like what it does for the community. But more will respond when the charity can cite a specific project for which the contributions will be used.

A tangible short-term purpose for which money is needed will often produce an influx of donations if it appeals to the donor base.

For example, a humane league asks for donations for medical care for animals it has just rescued. A museum asks for donations because it needs a new sign that will be more visible from the highway. A hospital needs a new X-ray machine. These are just some of the examples we have seen recently, where the appeals for donations have been successful. The donors can easily understand these objectives, and can see the tangible results.

Yes, the charity still needs to pay its light bills and the salaries of its office staff. But a fund-raising appeal will be more successful if it offers the satisfaction of having contributed to the purchase of needed equipment, or the accomplishment of a specific charitable activity.

For larger gifts, "naming rights" provide an attractive inducement. Many of us enjoy public recognition while we are alive, and would like to leave a meaningful legacy after we are gone. A charitable gift coupled with a naming opportunity can provide both. In one respect, it confers a form of immortality, when one's name lives on in connection with a charitable activity that was especially important to the person when he or she was living.

Charities, when they acknowledge gifts, must disclose whether any goods or services were provided in exchange for the gift. But the IRS has acknowledged that consideration in the form of honorific recognition is an "incidental and tenuous" benefit that is not treated as economic consideration, and therefore does not affect the donor's tax deduction.

"Naming rights" can attach to assets that run the entire range of the spectrum of value -- from major assets such as a building or a new school at a university, to relatively inexpensive assets such as a new chair for the conference room, a new drinking fountain in the hallway, or a bench placed in the charity's courtyard. The availability of naming rights is limited only by the charity's imagination.

III. Creative Planned Giving

An immediate cash contribution is always a charity's first choice. But sometimes that is not possible, in which event a more creative approach is required. Or, perhaps, a much larger contribution can be obtained by suggesting options other than an immediate cash payment. Here are some examples:

(1) Donation of Appreciated Assets

For some donors, it is easier to part with a less-liquid asset than to part with cash of equal value. A donor who contributes an appreciated asset -- such as publicly-traded stock or real estate -- to a publicly-supported charity generally receives a two-fold tax benefit: he can deduct the full fair market value of the donated property, and he avoids paying the capital gains tax on the appreciation.

By deducting the full market value of the donated property, the donor effectively receives the benefit of the appreciation without paying the tax on it. (This assumes the donor has held the property for more than one year before donating it. The deductions available for other types of property vary, depending on the nature of the property and the purpose for which the charity uses it.)

Practical tip: If the gift consists of real estate, the charity will want to perform due diligence before accepting it, to assure that there are no environmental hazards or other conditions that could trigger economic liability. Some charities create LLCs to own real estate, as a means of liability protection.

(2) Multi-year Pledges

A donor who is only able to write a check for X dollars may be willing to make a much greater commitment if it can be spread over several years. Many charities have honorific named categories (sometimes called "societies" or "clubs") to recognize donors who have contributed a specific amount.

One technique is to offer a donor immediate recognition at the higher category if he or she will make a pledge to contribute that amount in equal installments over two, three or five years. For example, an immediate gift of $1,000 combined with a pledge of $1,000 per year for four years will result in the donor being recognized in the category of $5,000 donors. This requires the charity to prepare a pledge

agreement, and to see that someone on its staff will be responsible for sending annual "invoices" for the remaining installments.

Are the pledge agreements legally binding? This depends in part on state law, and in part on the language of the agreement. As a general rule, an agreement to make a gift in the future is not binding. But, when the donor makes a promise with the knowledge that it will induce the charity (and other donors) to take actions such that the donor's failure to honor his pledge will cause an economic detriment, the agreement is more likely to be enforceable. The legal theory is called "detrimental reliance". An example would be a donor's promise to contribute the cost of adding a new wing onto a school, knowing that the school will enter into construction agreements and incur other financial obligations in reliance on the donor's promise to honor his pledge. In this situation, the charity can probably demonstrate (1) that economic harm would result from the donor's failure to keep his commitments, and (2) that the donor knew this fact when he entered into his pledge agreement.

Many charities -- especially when a single donor's performance under his pledge agreement is not financially critical -- take the view that they will not sue their donors who fail to honor their pledge agreements, because of the adverse publicity that often results. But even then, the rate of compliance with pledge agreements is usually very high.

Practical tip: Whenever a donor signs a written instrument that will result in a future benefit to the charity, the charity should make sure that the donor's own lawyer reviews the agreement before the donor signs it. The charity should insist on this, even if the donor claims he does not need independent advice. Otherwise, a disgruntled donor or his heirs may have a basis to claim that the donor did not understand the significance of the agreement he or she was signing, or that he or she was pressured into signing it. (This may not be essential if the pledge is relatively small, and if the charity has no intention of taking legal action to enforce it.)

(3) Charitable Bequests

Many donors have considerable net worths, but cannot afford to make large charitable gifts for a simple reason: they need their money, and the income from their investments, to pay their bills and maintain their lifestyles.

Charitable bequests can provide a major long-term source of funding. A bequest often produces a larger infusion of cash than the donor could have afforded to contribute during his lifetime. A donor has no further need for his property when he is dead. If there is no surviving spouse or children, or alternatively, if the family is very well provided for, the donor can make a much more generous gift to his favorite charity at this point.

A bequest to charity may take various forms, such as --

(a) a gift of a specified amount of money,

(b) a gift of a specified percentage of the donor's estate (either a percentage of the whole estate, or a percentage of the "residual" estate after certain specific bequests are satisfied), or

(c) a designation of charity as the beneficiary of the donor's life insurance policy, IRA, 401(k) plan, or other qualified retirement plan.

There are income tax benefits associated with selecting an IRA or a qualified retirement plan to be the vehicle for making charitable gifts at one's death. Generally, the distributions from those accounts will be subject to income tax when paid to a non-charitable beneficiary, such as a child or grandchild. (Surviving spouses may "roll over" such distributions to defer the income tax, but the income tax will be due eventually when the money is withdrawn.) But, of course, a charity is tax exempt, and will not have to pay income tax when it receives those distributions as a named beneficiary.

For example, suppose a donor wants to make a $50,000 bequest to charity at his death. If he has at least that much in his IRA, 401(k) or other qualified retirement account, it is more advantageous to make the gift to charity by naming it as the beneficiary of the retirement plan to the extent of $50,000, rather than making a bequest in that amount. That way, no income tax will be due on the $50,000 that goes to charity from the retirement plan, and no income tax will be due on the additional $50,000 that the family will receive from the estate. If the donor likes that idea, but is concerned that the retirement plan may be depleted by the time of his death, he can resolve this uncertainty by making a bequest to the charity equal to $50,000 reduced (but not below zero) by the amount that the charity receives from his IRA or other retirement plan as a result of his death.

Charities often create honored categories (e.g., "clubs" or "legacy societies") for donors who represent that they are making a bequest to the charity. They keep these donors up-to-date on the charity's activities through newsletters, e-mails and other communications. Some host periodic meetings for these donors, and/or send them birthday cards and holiday cards. All of these communications provide a subtle reminder of the promise to provide for the charity upon the donor's death.

There is, of course, one inherent shortcoming with a statement of intent to leave money to a charity upon one's death: it is usually completely unenforceable. (The concept of "detrimental reliance", discussed above, is very unlikely to apply to a gift that is promised at an indefinite, unpredictable time in the future.)

How, then, may a charity "lock in" a donor's promise to make a gift at death?

(a) Gift of a remainder interest in a residence or a farm.

Generally, income tax deductions are not available for the gift of a partial interest in property. An exception, however, applies to gifts of a remainder interest in a personal residence or a farm.

For example, a donor may deed his personal residence to a charity, but retain the right to live there for his lifetime (or for the joint lifetimes of himself and his spouse), or for a specific duration of years. The residence in question can be the donor's principal residence or a vacation home, so long as it is occupied by the donor. The donor may take an income tax deduction based on the present value of the charity's remainder interest, which (as a percentage of total value) depends on the ages of the persons who retain the lifetime right to occupy the property, or on the length of the term for which the donor has retained the right to occupy the property.

While the charity's economic benefit will be deferred from a gift of this type, it will at least be reasonably certain. After the property is deeded to the charity, the donor will not be able to change his mind or have second thoughts -- assuming, of course, that the donor is of sound mind and is not under any duress at the time of making the conveyance. (See note above regarding the importance of the donor's own lawyer reviewing any documents to be signed.)

(b) Charitable gift annuity.

A charitable gift annuity is a contract by which a donor pays a lump sum of cash (or other marketable asset) either to the charity or to a financial institution acting on behalf of the charity, and is provided with a stream of fixed payments in exchange for that gift. Depending on the donor's age, the fixed payments may substantially exceed the amount of income he is able to obtain from investing the cash, and he receives the assurance that he cannot outlive his income.

Upon the death of the donor (or the donor and his spouse, if both are named as lifetime beneficiaries), the charity receives the remaining funds. The amount remaining will, of course, depend on many factors, including the amount of the periodic payments to the donor, the success of the investments made with the gifted assets, and the longevity of the donor (and/or his spouse).

Charitable gift annuities are intended to provide a benefit to the remainder beneficiary, but it is always conceivable that in certain cases, a donor's longevity may so far exceed his actuarial life expectancy so as to skew this result. Similarly, a sharp decline in the stock or bond market could cause the invested assets to fall far below expectations. Unless a charity is both sufficiently staffed to administer such annuities, and financially capable of weathering possible declines in investments and the unexpected longevity of beneficiaries, charities often work with financial institutions to create these opportunities for donors.

(c) Gift of a Life Insurance Policy.

A donor may give a life insurance policy insuring his life to a charity. The charity would then become the owner of the policy, and designate itself as the beneficiary. Typically, the charity will ask the donor to promise to make continuing gifts to the charity to cover the future premiums. If the donor makes such a promise, but fails to make the future gifts, the charity can make an economic decision whether to continue to pay the premiums, sell the policy, or surrender it.

(4) Charitable Bequests In Trust

Some donors prefer to make their charitable bequests by leaving gifts in trust for exclusively charitable purposes. Examples are (1) a trust that pays all of the income to a named charity, but if it ceases to exist, then the income will be distributed to another named charity or charities; and (2) a trust that divides the

income between three charities for a specified period of time, and at the end of that period, the principal is divided among those charities and the trust terminates.

Why would a donor leave money in trust, rather than directly to the charity? Perhaps the donor is concerned that the charity may cease to exist, and if that happens, the donor wants to direct where the money goes next, rather than leaving that decision to the charity's Board of Directors. Or, perhaps the donor wants the charity to use the trust distributions for a specific purpose, and gives his trustee the responsibility for assuring that it happens. Or, perhaps the donor is concerned about protecting the assets he leaves from potential creditors of the charity.

Regardless of the reason, one consequence is that such a trust must apply to the IRS for recognition of tax-exempt status as a charitable organization -- either as a private foundation or as a supporting organization, depending on the circumstances, and depending on the details of its relationship with the public charity or charities to which it will make distributions. Assuming it is approved as a charitable trust, it will be required to file IRS Form 990 (or 990-PF) for each year of its existence.

Practical tips: Traditionally, such trusts were often written to provide that the net income is distributed to charity each year. But in this investment climate, the net investment income of a trust -- after being reduced by administrative expenses -- may result in a very small distribution to charity.

In order to qualify as charitable, the trust must provide that if it is a private foundation, it is empowered to make the distributions required by Code section 4942 (generally speaking, 5% of the value of its net investment assets during the prior year), even if that amount exceeds its income. The requirements of section 4942, however, allow some administrative costs to be included for purpose of the 5% distribution requirement. This may still result in considerably less than 5% of the asset value each year actually passing to charity.

In light of recent experience, when drafting such trusts, I generally recommend a requirement that the trust actually distribute to charity each year an amount that is based on its net asset value, rather than its net income. Under this language, the full 5% (if that is the percentage selected) will go to charity, regardless of the amount of the administrative expenses.

(5) So-Called "Split Interest Trusts" -- Trusts that Benefit both the Charity and the Donor or a Family Member

What about a trust that provides benefits for a charity, but also for a non-charitable beneficiary, such as the donor himself, or a family member? This is called a "split interest trust", because it is split between charitable and non-charitable beneficiaries.

In general, a charitable tax deduction is not permitted for gift to a "split interest" gift , unless that trust is created as a **charitable remainder trust** or a **charitable lead** trust that meets criteria prescribed by the tax law.

(a) Charitable Remainder Trust

A charitable remainder trust ("CRT") provides that a charity will receive the “remainder interest” after the deaths of one or more beneficiaries who are to receive regular payments from the trust, either for their lifetimes or for a period of years (not to exceed 20 years). The donor may be one such beneficiary. Therefore, a donor who wishes to commit a gift to charity, but needs all of his investment income to pay living expenses, may create a charitable remainder trust that provides distributions to him for the rest of his life, with the remainder to charity after his death. The donor may also provide for other non-charitable beneficiaries to receive distributions -- a common variation is to provide income to the donor and his spouse for their lives, and after the survivor of them dies, the balance goes to charity.

In order to qualify as a charitable remainder trust, the actuarial value of the gift to charity when the trust is created must be at least 10% of the value of the principal. This limits to some extent the "generosity" that can be extended to the non-charitable beneficiaries, especially if the donor is thinking of giving a lifetime income interest to someone who is now quite young.

The charitable contribution income tax deduction is based on the actuarial value of the interest passing to charity. The shorter the time that the charity’s interest is deferred, the greater is the charitable contribution deduction available to the donor.

The annual payout to non-charitable beneficiaries may be calculated in one of two ways:

(1) As a fixed amount, in which case the trust will be called a "charitable remainder annuity trust" (or "CRAT"), or

(2) As a percentage of the annual value of the trust assets, in which case the trust will be called a “charitable remainder unitrust” (or "CRUT").

The annual payout must be at least 5% of the trust assets, but may not exceed 50%.

There is also a variation of the CRUT known as the "net income make-up" CRUT, or "NIMCRUT", which is especially useful when the trust will initially own assets that produce little or no income. A “NIMCRUT” provides that if the trust income falls below the fixed payout percentage in a given year, the shortfall can be made up in later years. This flexibility enables the trust to avoid having to sell off assets prematurely in order to make the required annual distribution.

Tax saving technique: A donor to a CRT may deduct, as a charitable contribution, the actuarial value of the remainder interest passing to charity. But a CRT may be especially attractive to a donor who owns highly appreciated, low-basis assets that he is otherwise planning to sell. If the appreciated asset is contributed to the trust at a time when there is no binding contract of sale, the trust (because it does not pay tax on investment income) may make the sale without paying any capital gains tax on the proceeds. This will leave a greater sum of money that can be used to pay income to the donor for the rest of his lifetime.

Caveat: If a CRT has any unrelated business taxable income ("UBTI"), that income will be taxed at a rate of 100%. UBTI includes not only income from an active trade or business, but also "debt-financed income", so anyone proposing to utilize a CRT should first examine the anticipated sources of trust income to determine whether any of it will be UBTI. For example, property encumbered by debt should not generally be transferred to a CRT.

(b) Charitable Lead Trust

As discussed above, the CRT provides a stream of payments to non-charitable beneficiaries first, and then gives the remainder to charity.

A charitable lead trust ("CLT") reverses the order of the split-interest benefits. Under a CLT, the charity receives its interest first for a specified number of years,

then the property typically reverts to the donor’s beneficiaries, such as children or grandchildren.

The annual payment to the charitable beneficiary under a CLT may be a fixed amount (“charitable lead annuity trust”, or "CLAT"), or may be based on a percentage of the annual value of the trust assets (“charitable lead unitrust”, or "CLUT").

Charitable lead trusts are well suited to accomplish significant transfer tax (gift and estate tax) savings. For example, the value of an asset worth X dollars becomes greatly diminished when the transferee's enjoyment is delayed for a period of time, during which another party (the charity) is receiving a regular stream of income.

The income tax deduction available for a donation to a charitable lead trust depends on whether the trust is a grantor trust or a non-grantor trust, a discussion that is beyond the scope of this outline. As noted above, the principal benefit to the donor is usually the opportunity to transfer assets to children or grandchildren -- either during his lifetime or at his death -- with a considerable discount in the gift or estate tax. In addition to the discount based on the family members' deferred receipt of the assets, there will be no transfer tax imposed on any appreciation that occurs in the trust assets from the time they are transferred to the CLT to the time the family members receive the assets.

IV. "Qualified Charitable Distributions" from a Donor's IRA -- A Valuable Technique With an Early Expiration Date.

Some donors with IRA accounts may make direct gifts from their IRAs to qualified charities, without causing the distribution to be included in income for federal income tax purposes. These direct gifts are called "qualified charitable distributions", or "QCDs". But this provision is now scheduled to expire on December 31, 2013, so it must be utilized quickly.

In past years, this provision has expired several times and has been renewed, but always for temporary periods of time. And, sometimes the renewal does not occur until many months after the provision expired. It is anyone's guess whether it will be renewed again.

The impending expiration date is the bad news, but the good news is that the expiration date can be used to convey a sense of urgency to donors who are in a position to take advantage of this provision.

Here are the parameters:

(1) The donor must be at least 70 1/2 years old on the date of distribution.

(2) The distribution to charity must come from a traditional IRA or a Roth IRA, and must consist of funds that would be included in the donor's income if distributed to him under the usual tax rules. (Because the distribution must consist of funds that would be includible in gross income if distributed, in most cases the transfer should come from a traditional IRA. Only in certain limited situations will a distribution from a Roth IRA qualify.)

(3) The limit that can be transferred under this provision is $100,000 per donor per tax year. The distributions may come from multiple IRAs owned by the same donor, so long as the total does not exceed $100,000. The distribution may be made from an inherited IRA, so long as the current beneficiary meets the age requirement. If a husband and wife have separate IRA accounts, each may give up to $100,000.

(4) The gift must be one that would qualify in full for the charitable deduction under the usual tax rules, without regard to the percentage limitation (that is, the limit based on the percentage of adjusted gross income). Thus, for example, a distribution can't be used to buy a table at a fund-raising event or to pay for items at a charity auction, since neither of those payments is 100% deductible. Further, the distribution may not be used to fund a charitable remainder trust or charitable lead trust, a pooled income fund, or a charitable gift annuity.

(5) Only certain charities may be recipients of QCDs -- generally these are publicly supported charities, excluding all supporting organizations, regardless of type. The distribution may not be made to a donor advised fund (as defined in Code section 4966(d)(2)), even though the sponsoring organization otherwise qualifies as a publicly supported charity. It may not be made to a private foundation, unless it is a private operating foundation (as defined in Code section 4942(j)(3)) or a so-called "conduit foundation" (as defined in Code section 170(b)(1)(F)(ii)).

(6) As with all tax benefit provisions, the correct procedure must be followed. The distribution must be made by the IRA trustee directly to the charity. If the IRA trustee makes the distribution to the account owner, the tax benefit is lost. If the donor wishes to make an in-person presentation, it will be acceptable if the IRA trustee makes the check payable to the charity and delivers it to the donor, who in turn delivers it to the charity. In this scenario, the IRA owner has no opportunity to receive the funds personally. However, if the end of the year is approaching, the donor should make sure the gift is delivered to the charity by year-end.

Practical tip: The distribution may not be made from a 403(b) plan, a 401(k) plan, or other qualified retirement plan, or from an ongoing SEP or SIMPLE IRA. But in some cases, a donor who has money in a qualified retirement plan such as a 401(k) plan may have the ability to transfer funds into an IRA in his name. If so, that donor can first transfer funds into an IRA, and then utilize this provision to make a direct transfer to charity.

Caveat: The donor who makes a direct gift from his IRA to charity will not be entitled to a chartable tax deduction. This, however, is a reasonable trade-off because the money is not included in the donor's gross income. As discussed below, this is often a very beneficial trade-off.

(a) Advantages of the "direct gift" to charity

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One may ask, what is the advantage of a direct gift? After all, anyone may withdraw funds from his or her IRA and contribute those funds to charity. The withdrawal is taxable income, but the charitable contribution is deductible. At first glance, this appears to be a "wash", but it isn't necessarily so. There is a wide variety of circumstances in which a charitable deduction does not offset the income resulting from an IRA withdrawal, and in which the QCD rules will provide significant benefit.

Some taxpayers use the standard deduction, and do not itemize. Within the age group of eligible QCD donors, it is not unusual to find higher income persons who do not itemize, especially those who live in states that do not impose an income tax.

Other taxpayers itemize, but receive only a limited tax benefit from itemized deductions. When an IRA withdrawal is added to a taxpayer's other income, his

adjusted gross income ("AGI") is increased, which may in turn may cause the loss or reduction of other tax benefits. For example, the increased AGI reduces the ability to deduct medical expenses and certain other itemized deductions, which are allowed only to the extent they exceed a percentage of AGI. In this situation, a higher AGI means a lower deduction. Taxpayers with a higher AGI may also pay more tax on their social security income. In addition, some state income tax laws don't allow deductions for charitable contributions.

For numerous reasons, the standard tax rules create "slippage" that reduces the tax benefit of using funds withdrawn from IRAs to make lifetime gifts to charity. The QCD provisions avoid this "slippage".

A QCD is counted toward satisfying the account owner's required minimum distribution ("RMD"). This is the amount that an IRA owner over age 70-1/2 is required to withdraw from his IRA each year in order to avoid penalties. When a QCD is made, the amount paid directly to the charity offsets the amount that otherwise would have to be distributed to the account owner.

As discussed above, no tax deduction is allowed for a QCD, but this is logical because the payment that would otherwise be included in the donor's income goes directly to the charity without affecting the donor's income. It is a benefit -- and an exception to the usual tax rules -- when one has the ability to direct a sum of money to a beneficiary of his choice without first taking that money into income.

Similarly, because the distributions are neither included in income nor deducted as charitable contributions, they are not subject to the charitable contribution percentage limits. Effectively, they increase the limit of a donor's tax-favored gifts to charity.

Donors should check with their tax advisers as to the effect of a QCD for state income tax purposes. Many states define "income" on the basis of federal adjusted gross income, and if so, a QCD should be excluded from income for state law purposes as well as federal.

(b) <u>Special Appeal to Affluent Donors</u>

QCDs provide benefits to donors in almost every income range, but the technique should have added appeal to the more affluent donors. They, typically, would not withdraw from their IRAs in the absence of the RMD rules. They do not need those withdrawals to pay living expenses, and would rather not have the added

taxable income. The affluent donor may view the QCD rules as a tax-advantaged way to make charitable gifts that he would otherwise make from other assets. The very limited window of time may actually encourage him to be more generous, in order to take maximum advantage of the opportunity while it is available.

Another reason the affluent donor may wish to make the maximum QCD in 2011 is to remove the gifted amount from his taxable estate. An IRA account is, of course, fully included in the owner's estate for estate tax purposes. While the estate tax exemption is now quite generous ($5 million), there is no assurance that it will remain at that level.

If the donor has already designated a charity as a beneficiary of his IRA upon death, this provision may encourage him to accelerate the gift. The gift may now be made during his lifetime without the income tax consequence that would ordinarily serve as a deterrent. The gift will still reduce his taxable estate, and it may provide a great deal of added satisfaction to witness the benefits his gift will provide to his favorite charity. Naming opportunities and other means by which charities honor significant donors will be more meaningful to a donor who is alive to enjoy the recognition.

As discussed, a taxpayer who uses the QCD technique realizes two income tax benefits: (a) the IRA funds that he uses to donate to charity are not included in his AGI, and (b) by having the QCD satisfy his minimum distribution requirement for 2013, he avoids an item of income that would otherwise increase his AGI.

(c) New Medicare Tax Provides Added Incentive to Use a QCD

The new additional 3.8% Medicare tax on high-income persons creates yet a further incentive to use a QCD. For 2013, the added tax will now apply to investment income as well as wages, and it impacts single taxpayers with adjusted gross income above $200,000 and married taxpayers filing jointly with adjusted gross income above $250,000. For donors whose income exceeds this limit, or who are on the cusp of reaching the limit, the QCD will prove especially beneficial.

Although the Medicare tax does not apply to income received from retirement accounts, that income is considered in determining whether the taxpayer's AGI reaches the level at which the tax will apply to his investment income. By using the QCD, the donor's AGI will not be increased by the amount required to make a

gift to his favorite charity. And, if the QCD also satisfies the donor's minimum distribution requirement for 2013, the amount of that minimum distribution is another item that would have increased the donor's AGI, but now will not do so.

(d) Using a QCD to Pay Off the Donor's Pledge

The QCD rules may be especially attractive to a donor who has made a pledge to a charity. IRS Notice 2007-7 indicates that a qualifying charitable distribution may be used to satisfy a pledge that the IRA owner had made to the recipient charity. This is in direct contrast to the rules relating to a private foundation or a donor advised fund -- neither one of them may make a distribution to charity that satisfies a legally binding pledge of the donor, who is typically a "disqualified person".

The distinction is that the donor is treated as the owner of his IRA funds, while in the case of the private foundation or the donor advised fund, a charitable organization owns the funds. (In the case of the donor advised fund, the sponsoring organization is the owner.) Because the donor is deemed to own his IRA account, a QCD from the donor's IRA that is used to pay off the donor's pledge is not a prohibited transaction.

(e) Some Other "Nuts and Bolts"

An IRA owner who requests a qualified charitable distribution is deemed to have elected out of the withholding requirements, so the IRA trustee need not withhold taxes. The IRA trustee may rely on a reasonable representation made by the IRA owner that the distribution qualifies under Code section 408(d)(8). If for any reason taxes are withheld, those taxes will not be considered as part of the QCD.

Suppose the transaction fails to qualify, in part or in full, as a QCD. Among the reasons a gift might not qualify as a QCD are: if it is not completed by December 31, 2013, if the donor was not age 70-1/2 or older on the date the distribution was made, if the IRA trustee issues the check in the name of the donor, or if the distribution is made to a disqualified charity such as a supporting organization or donor advised fund. If the distribution meets all the requirements but exceeds the $100,000 limit, the excess portion of the distribution would fail to qualify. If all or part of the distribution fails to qualify, the donor must include the non-qualifying distribution in gross income, under the usual rules. Then, assuming the recipient was a charity, the gift would be deductible as a charitable contribution if the donor itemizes, subject to the usual percentage limitations.

The IRA trustee is required to report all distributions from an IRA on Form 1099-R, including a distribution that is a QCD. The distribution will be reported for the year in which it was made, because the IRA trustee is not responsible for determining whether the account owner is treating the distribution as a QCD, or whether it qualifies. The burden is on the account owner to determine whether the distribution qualifies as a QCD, and to report it accordingly.

As noted above, if a donor would like to take advantage of the QCD rules, but is unable to do so because his retirement funds are in a 401(k) plan or other employer-sponsored qualified retirement plan, he may be able to roll over some or all of his balance in the employer-sponsored plan to an IRA. After the donor has established and funded his IRA, he may then use the IRA to make a qualified charitable distribution.

Observation: The Tax Reform Act of 1969 drew sharp distinctions between private foundations and publicly-supported charities. It subjected private foundations to additional restrictions, and effectively made them a less favored form of charity. The Pension Protection Act of 2006, which was the first law to create the QCD rules, created new distinctions between categories of publicly-supported charities and effectively made two of them into less-favored types -- supporting organizations (especially Type III non-functionally-integrated supporting organizations) and donor advised funds. The QCD rules discussed here follow those distinctions by excluding donor advised funds and supporting organizations, as well as most private foundations, from the class of permitted recipients. Note that the exclusion applies to all supporting organizations, regardless of type, and regardless of the degree of functional integration with the supported organization.

(f) Note to Charity: Don't Forget the Acknowledgment Letter!

As discussed above, a distribution to charity is a QCD only if it would qualify for the charitable deduction if made by the account owner to the charity under the usual tax rules, without regard to the percentage of adjusted gross income ("AGI") limitations. One of the prerequisites of deducting a charitable contribution is the substantiation requirement that generally applies to charitable gifts.

The charity must furnish a “contemporaneous written acknowledgement” to the donor. The IRA trustee should notify the charity receiving the transfer as to the

name and address of the donor from whose account the funds are coming, so the charity can provide the required acknowledgment.

The charity will want its acknowledgment letter for QCDs to be different from the letter it uses to acknowledge regular tax-deductible contributions, which may come from the same persons who also provide QCDs. To accomplish this purpose, as well as satisfying the IRS rules, the charity may wish to include the following information in its acknowledgment letter:

1. the date and amount of the gift;

2. the name and address of the donor from whose IRA the gift was made;

3. a statement that the transfer to charity was made directly by the IRA trustee;

4. a statement that the recipient charity is an organization described in Code sections 501(c)(3) and 170(b)(1)(A), that it is not a private foundation or a supporting organization, that the transfer is not a split interest gift, and that the transfer was not made to a donor advised fund;

5. a statement than no goods or services were, or will be, transferred to the donor in connection with the gift;

6. a statement that the donor intends the gift to qualify under Code section 408(d)(8); and

7. a statement that the gift would qualify as a charitable contribution if made by the account owner directly to the charity.

The consequences of failing to provide an acknowledgment letter are serious: it will cause the IRA distribution to be taxable to the account owner. And, since the lack of an acknowledgment letter means the transfer doesn't qualify as a deductible charitable contribution, the owner may not deduct the gift as an itemized deduction.

(g) Time is of the Essence to Benefit from QCD Rules

A charity's development officers will find the QCD rules to be a valuable aid to fund-raising at a time when it is greatly needed. There is no assurance that it will

survive past the end of 2013, and the federal deficit portends an uncertain future for any provision that reduces taxes for the well-to-do.

The QCD rules help both charities and their donors. The expiration date of December 31, 2013 creates some urgency for charities to spread the word, and for donors to act quickly before the window of opportunity closes.

V. Seeking Grants from Private Foundations.

Private foundations are required by law to make annual distributions to publicly supported charities. Databases exist that identify private foundations on the basis of where they are located, and what purposes or causes they support. Each private foundation must file annually an IRS Form 990-PF -- and like the 990s, the 990-PFs are available to the public. A foundation's 990-PF explains (in Part XV, page 10) the procedure for applying for grants from the private foundation (or alternatively, states that no applications are accepted because the foundation's support is pre-committed). Publicly supported charities looking for funding should not overlook this potential source.

* * *

When funds are scarce, charities should leave no stone unturned in an effort to seek contributions. Understanding the creative techniques for planned giving is a "must" for any development officer of a charity.