

The Ripple Effect

How charitable lifetime income vehicles can help you build a lasting legacy and receive an income stream.

BY ANITA SLOMSKI AND AMY BARRY

An investment banker and his wife became so enamored with the bucolic Wyoming town to which they retired that they decided to make substantial gifts to the local hospital and library. They decided the highly appreciated company stock they owned was the perfect asset to donate, since it would allow them to diversify their portfolio without incurring capital gains tax.

Rather than donating the stock outright, however, Nathan E. Arnell, a trust and estate attorney in Millburn, N.J., suggested they set up a charitable remainder trust (CRT) to benefit local nonprofit organizations.

"My client had assets in the high eight figures, but he liked the idea of getting an automatic stream of income from the trust, which would give his wife added financial security should he die first," says Arnell. "In addition to the up-front tax deduction they received when they established the CRT, they were able to defer paying capital gains taxes, so those investments continued to grow for the life of the trust." CRTs, however, are just one type of charitable income vehicle that philanthropically minded individuals can choose in order to meet multiple long-term needs. There are two additional vehicles—charitable gift annuities (CGAs) and pooled income funds (PIFs)—that can help provide a solution for managing both philanthropic and personal financial goals. "While you have to have philanthropic intentions to choose a charitable income vehicle, many people like getting income back in return for their gift," Arnell says.

A Savvy Way to Plan for Multiple Goals

Similar to annuities that can be purchased from commercial insurance companies, charitable income vehicles are designed to provide an income stream for the life of the designated beneficiaries. However, unlike commercial annuities, charitable income vehicles are philanthropic in nature, meaning the asset you donate is not subject to capital gains taxation,

because the sponsoring charity takes ownership of the asset and is exempt from paying this tax.

Furthermore, donors may take a tax deduction for a portion of their gift for the year it was made. Because of the capital gains treatment, charitable income vehicles can offer significant benefits when you donate a highly appreciated asset.

"If you're financially secure but desire additional income, charitable income vehicles can help you maximize the use of appreciated assets," says Mike Murphy, vice president of estate planning at Fidelity Investments. "They are a great estate-planning tool to remove assets from your taxable estate, and they allow people to fulfill their charitable goals. In the end, charitable income vehicles can serve both your needs and those of the charity very well."

Richard A. Feigenbaum, director of estate planning and wealth management at Copeland Capital Management LLC, in Wellesley, Mass., offers this example: "Say you have \$1 million in stock with a \$200,000 cost basis. You'll pay \$120,000 in federal capital gains taxes (plus possible state tax) if you sell it outright. But if you put it in a charitable income vehicle, you get an immediate income tax deduction on the portion of your gift that will pass to charity, you pay

no capital gains tax when the stock is liquidated, and the asset is out of your estate for estate tax purposes."

"If your income payout is seven percent," Feigenbaum continues, "you'll receive \$70,000 in income each year, whereas when you held the stock, you may have received only \$15,000 in annual dividends. You've just converted an illiquid asset that produced little or no income for you into one that is both highly productive and diversified."

If the tax rate on long-term capital gains increases, charitable income vehicles may become even more attractive as a way to manage the tax liability on the sale of highly appreciated assets. There is a tradeoff, however, with charitable income vehicles. By making a gift to charity and taking the charitable tax deduction, you give up some of the income potential that you might get from other investments. A fixed annuity, offered by an insurance company, for example, will pay a higher income rate than a charitable gift annuity. Thus, charitable income vehicles should not be considered a primary source of retirement income.

Compare Your Options

The three types of charitable income vehicles—CRTs, CGAs, and PIFs—share a few similarities. All three are irrevocable gifts, a necessary requirement for removing the assets from

your estate and exempting them from estate taxes. With each, you are also allowed a one-time charitable tax deduction for the expected remainder that will eventually go to charity. The amount of that deduction is based on the life expectancies of the income beneficiaries (or the term of the trust for a CRT), the value of the assets you contribute, and the payouts you are expected to receive. The lower the income payout and the more a charity is slated to receive, the greater your up-front deduction.

But, as described in the chart on the next page, there are some key differences as well. Also, depending on the vehicle, the income payouts can be varied or fixed, and may be calculated differently. With a CRT, you elect the payout rate, which could result in fixed or variable payouts. For a CGA, the fixed annuity payout rate is set by the charity. And for a PIF, payouts will vary, as they are based on the underlying investment and the fund's rate of return. Remember: some or all of the income that comes from a charitable income vehicle is subject to ordinary income tax, and when you make other people the income beneficiaries, there may be gift tax implications.

Let's take a closer look at each of these vehicles.

1 Charitable Remainder Trusts for overall flexibility CRTs are an excellent vehicle for individuals who want to provide substantial future gifts to charities, while maintaining the greatest overall flexibility.

A CRT is an irrevocable trust that can be customized to meet the needs of the individual donor. For example, similar to a gift annuity, a CRT could be established to pay a fixed amount of income each period. Alternatively, a CRT can pay an amount that varies each year based on performance of the trust similar to a PIF, or the trust could specify that the payment calculation may be switched at a defined point in the future.

The variety of assets that can be contributed to and/or held by a CRT is normally broader than with a PIF or CGA, so the CRT's trustee has more flexibility in management of the investments. This greater investment choice and increased control for the trustee may translate into higher returns and, consequently, greater income or ultimate benefit to the charity. In addition, many investors reserve the option of changing the charitable beneficiary during their lifetime. "We all know that circumstances in life may change, so why not keep the flexibility to support the causes you value in the future?"

asks Kevin Bartlett, senior vice president of Fidelity Personal Trust Company. As with the PIF, Bartlett notes, "You may also name a charity with a donor-advised fund (DAF) program as the beneficiary of your CRT, so that your family members may become successor advisors of the account and continue the tradition of charitable giving."

However, because it is a legal entity, a CRT requires an attorney to draft the trust document and a trustee to administer it, and it must file annual tax returns. "It's not an armchair quarterback approach. You have to be involved on an annual basis and not everyone wants that kind of nuisance," says Feigenbaum. To answer those concerns, many financial services companies offer charitable trust administration services. For example, Fidelity provides trust administration for CRTs and may serve as trustee or cotrustee with another individual for charitable trusts starting at \$250,000. The payouts can be for a term of up to 20 years or over the lifetimes of up to two income beneficiaries (typically you and your spouse).

"CRTs are definitely more flexible compared to the other charitable income vehicles, but the price of that flexibility is the high contribution, cost of administration, and maintenance burden," observes Steven Perlmutter, vice president of Program Development at Fidelity Charitable Services. Depending on the individual situation, he says, "You may be able to achieve more complex goals using a PIF and a CGA in tandem instead of a CRT, reducing both the cost and additional administration of a trust."

Charitable Giving During Your Lifetime

While charitable income vehicles such as pooled income funds are a terrific way to support charity in the future, many individuals want to provide support to charity now. Oftentimes, people donate cash or write checks when they make a donation, but there may be a more effective alternative.

A Giving Account® at the Fidelity® Charitable Gift Fund, an independent public charity with a donor-advised fund (DAF) program, is a simple way to support your favorite charities at any time. What's more, you can extend your charitable legacy by naming a loved one to succeed you as the Account Holder of your Giving Account, thereby involving your family in the future of philanthropy.

To learn more visit the Gift Fund's Web site at CharitableGift.org.

2 Charitable Gift Annuities for the lowest minimum, and guaranteed income The low minimum requirements for a CGA, which typically range from \$5,000 to \$10,000, make it the most accessible of all the charitable income vehicles. A CGA is a contract offered by a charity or nonprofit organization that—in exchange for a donation of assets—pays a fixed amount of annual

Comparing Charitable Lifetime Income Vehicles

| | Charitable Remainder Trust | Charitable Gift Annuities | Pooled Income Fund |
|----------------------------------|---|---|--|
| Minimum Contribution | <ul style="list-style-type: none"> Typically \$200K or more | <ul style="list-style-type: none"> Typically \$5K–\$10K | <ul style="list-style-type: none"> Typically \$10K–\$20K |
| Income Beneficiaries | <ul style="list-style-type: none"> Unlimited | <ul style="list-style-type: none"> Limited to 2 | <ul style="list-style-type: none"> Limited to 2 |
| Assets Accepted | <ul style="list-style-type: none"> Most types of securities and property, including real estate, art, and collectibles, provided the donated asset can produce income | <ul style="list-style-type: none"> Ultimately at the charity's discretion; most types of securities and property can be donated, including real estate, art, and collectibles | <ul style="list-style-type: none"> Generally at the charity's discretion; most types of securities and property can be donated, including real estate, art, and collectibles Cannot accept tax-exempt securities or mutual funds that hold tax-exempt securities |
| Investment Management | <ul style="list-style-type: none"> Flexible; Trustee or delegate controls, depending on trust setup | <ul style="list-style-type: none"> Charity controls how the contributed assets are invested | <ul style="list-style-type: none"> Specific to program chosen; the sponsoring charity controls |
| Tax Treatment | <ul style="list-style-type: none"> On Donated Asset <ul style="list-style-type: none"> Partial income tax deduction based on IRS-designated rate tables (based on life expectancy) and payout structure Capital Gains <ul style="list-style-type: none"> Avoided or deferred On Income Payments Received <ul style="list-style-type: none"> Tiered tax treatment | <ul style="list-style-type: none"> Partial income tax deduction based on CGA yield set by charity and beneficiary life expectancy <ul style="list-style-type: none"> Avoided or deferred Tiered tax treatment | <ul style="list-style-type: none"> Partial income tax deduction based on beneficiary life expectancy and PIF's historic rate of return <ul style="list-style-type: none"> Avoided Taxed as ordinary income |
| Charitable Beneficiaries | <ul style="list-style-type: none"> Number of Beneficiaries <ul style="list-style-type: none"> Unlimited Option to Change? <ul style="list-style-type: none"> Yes, if in trust documents | <ul style="list-style-type: none"> One <ul style="list-style-type: none"> No—must be sponsor charity | <ul style="list-style-type: none"> Flexible if sponsor has a donor-advised fund (DAF) program—otherwise only one* Only if sponsor has a DAF program* |
| Setup and Administration | <ul style="list-style-type: none"> Required legal setup; annual maintenance costs and tax filing; costs may be paid by trust | <ul style="list-style-type: none"> Generally no setup cost to donor; charity administers; may not deduct fee from income to donor | <ul style="list-style-type: none"> Generally no setup cost to donor; charity administers and may deduct administration fees from PIF assets |
| Key Advantages | <ul style="list-style-type: none"> Overall flexibility (if established correctly) | <ul style="list-style-type: none"> Easy to establish Guaranteed income payout | <ul style="list-style-type: none"> Easy to establish and maintain Avoids all capital gains Potential income payout increase |
| Key Disadvantages | <ul style="list-style-type: none"> Complex and expensive | <ul style="list-style-type: none"> Inflation risk; locked-in charitable recipient; private contract with charitable recipient | <ul style="list-style-type: none"> Fewer asset types accepted; income-yield risk |
| Future Family Involvement | <ul style="list-style-type: none"> Yes, if CRT names a charity with a DAF program as one of the remainder beneficiary charities | <ul style="list-style-type: none"> No | <ul style="list-style-type: none"> Yes, if PIF is sponsored by a charity with DAF program |

* If the sponsor charity offers a donor-advised fund program, as the *Fidelity*® Charitable Gift Fund does, additional successor flexibility may be available, including multiple charitable beneficiaries—otherwise only one charitable beneficiary may be named.

income for the lifetimes of one or two individuals. The older you and your spouse are—and the shorter your life expectancies—the greater the income payout. “If I’m 65, I might get six and a half percent from a CGA for the rest of my life, but if I’m 85, I may get eleven percent,” Perlmutter says. “A gift annuity won’t keep up with inflation, but you know what your income will be every year.” CGAs generally are most attractive to older individuals because of their higher guaranteed income.

You can establish a CGA with as little as \$5,000 in assets, which can be as diverse as those you contribute to a CRT. But be certain you want a particular charity to receive the remainder, since you can’t change the charitable beneficiary with a CGA.

3 Pooled Income Funds for simplicity Operated as an irrevocable trust by a charitable organization, a pooled income fund allows charitably inclined individuals to contribute cash or marketable securities to a collective fund, often called a “charitable mutual fund,” that pays income to the donors for their lifetimes, before distributing the remainder to charity. There are approximately 1,600 pooled income funds, including the *Fidelity*® Pooled Income Fund.

People who choose pooled income funds typically do so because they are very similar to CRTs, but are easier to establish, with much lower minimum contribution requirements and typi-

cally very low administrative fees. In addition, among the three charitable income vehicles, a PIF is the only one that avoids all capital gains tax on contributed assets. By definition, a PIF pays only income to the income beneficiaries and retains all capital gains and principal for the charitable organization. CGAs and CRTs, on the other hand, can return some portion of principal and gains to the donor, who may incur capital gains tax. So for those individuals who believe the capital gains rate will increase, a PIF can offer a considerable tax advantage.

Pooled income funds sponsored by a charity with a donor-advised fund also can be ideal for passing on charitable values to younger family members. In addition to being distributed to individual charities, the remainder of a PIF can be used to establish a donor-advised fund, for individual successors (e.g., children or grandchildren) to advise (see sidebar on previous spread). The children won’t receive an income stream from the amounts in the donor-advised fund, but they will be able to recommend which charities should be supported during their lifetimes and in the future. “Many parents want their children to be philanthropically involved, and having them participate in the giving process is a great way to instill the family’s philanthropic values,” says Sarah C. Libbey, president of the *Fidelity* Charitable Gift Fund.

A PIF pays a variable income rate based on the actual performance

of the fund’s investments, which the donor cannot change. The *Fidelity*® Pooled Income Fund, for example, is designed to balance income and capital appreciation. “The portfolio is designed to grow with the market and provide a good level of current income,” says Perlmutter. But unlike a gift annuity, individuals can take advantage of potential capital appreciation within a pooled income fund, which may enhance future income payments.

Like the Wyoming couple who supported their favorite charitable causes while also assuring a future income stream, you too may want to consider a charitable lifetime income vehicle to help you meet multiple goals. If you are looking for a way to support your favorite causes, pass on your philanthropic values to loved ones, and supplement your income, a charitable lifetime income program may be right for you. ■

Learn More

To help you decide which charitable income vehicle may be right for you, talk to your *Fidelity* Private Client Group Account Executive, call a Charitable Planning Specialist at **800.682.4438**, or visit the *Fidelity* Charitable Gift Fund’s Web site at CharitableGift.org/income.



Fidelity® Charitable Gift Fund
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