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Giving Back

techniques for charitable giving

We all have personal reasons
for giving to **charity**,
but many of us give out of a
common desire to **share our
good fortune** with others.

By doing so, we strive to make
the world a better place for our
children to inherit. And we hope
that when they do, they will adopt
our beliefs about giving by helping
our most cherished causes
survive and prosper.

While our generosity can certainly
improve the communities in which we live
and work, it can also help us financially.

What follows is an introduction to
different charitable giving strategies,
including the significant financial and
estate planning issues associated with them.

Discuss them with your Financial Advisor,
who can help you make the most of
these strategies. After all, a well-structured
charitable plan can last more than a lifetime—
it can last for generations.

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DIRECT GIFTS

The most straightforward technique when making a charitable donation is an outright gift, which can be made during the donor's lifetime or upon his or her death (as a bequest). Various types of assets, including cash and securities, can be donated to charity as direct gifts.

A popular type of direct gift is a gift to a capital campaign. Charitable institutions regularly engage in capital campaigns to raise significant amounts of money within certain time frames, often for specific needs. A major reason behind the decision to contribute may be a commitment to the organization or the specific purpose of the campaign.

Direct lifetime gifts may entitle the donor to a charitable income tax deduction.¹ Deductions are allowed for up to 50% of the investor's adjusted gross income (AGI),

assuming the gift is cash and made to a public charity. Gifts of long-term appreciated property offer potential deductions of up to 30% of AGI.² Any part of the deduction that cannot be used in the year the gift is made can be carried forward for up to five years.

A large direct gift can also provide a gift-tax deduction equal to the fair market value of the gift. A direct gift can lower a donor's estate taxes by removing the asset and its appreciation from the estate. If the gift were made at death, there could be an estate tax deduction for the amount of the gift.

EXAMPLE OF INCOME TAX DEDUCTION

	AMOUNT OF GIFT	ADJUSTED GROSS INCOME (AGI)	ALLOWABLE DEDUCTION	CARRY FORWARD
Gift of cash	\$50,000	\$100,000	\$50,000	\$0
Gift of stock	\$50,000	\$100,000	\$30,000	\$20,000

¹ Individuals whose adjusted gross income exceeds \$145,950 (\$218,950 for married persons filing jointly) in 2005 and \$150,500 (\$225,750 for married persons filing jointly) in 2006 may be subject to an income tax deduction limitation. This adjusted gross income amount is indexed for inflation and may be increased in later years.

² Deduction limits may differ for gifts to private foundations.

GIFTS OF LIFE INSURANCE

Life insurance provides significant leverage when gifting it to charity, making it possible to gift a significant amount at a relatively small cost. A donor can either:

- purchase a life insurance policy and name a charity as the beneficiary
- give a charity an existing policy, or
- give the charity cash to purchase a life insurance policy on the donor in the charity's name³

Purchasing a life insurance policy and naming a charity as the beneficiary is appropriate for a donor who wants the right to revoke a gift. The donor can do so by simply changing the beneficiary on the policy's beneficiary designation form. The donor would receive an estate tax deduction for that portion of the death benefit going to the charity.

If a donor transfers ownership of a life insurance policy to a charity during lifetime, he or she would not retain the right to revoke the gift. However, the donor would receive a charitable income tax deduction, subject to AGI limits, equal to the policy's fair market value or the net premiums the donor has paid, whichever is less.

A third choice is to gift cash that a charity can use to pay premiums on a life insurance policy, on the life of the donor. The charity would own the policy and be entitled to receive the death benefit. The donor would receive a charitable income tax deduction for the gift of cash, subject to AGI limits.⁴

GIFTS OF TANGIBLE ASSETS

Many donors decide to give tangible assets, such as art and jewelry, to charity. If highly appreciated, the asset can be a substantial gift to charity while providing considerable tax benefits to the donor.

Charitable deductions for these assets are based on whether a gift is related to the purpose of the charity to which it is given. A donor is entitled to a charitable income tax deduction for the fair market value of the asset if the gift is related to the charity's mission. Giving an art museum a valuable painting, for example, could qualify for such a deduction. If the gift is unrelated to the charity's mission, however, the donor may be entitled to a charitable income tax deduction, limited to the donor's cost basis, plus any improvements the donor made

(having the painting mounted with an expensive frame, for example). In addition, donors who create the gifted artwork may also be entitled to a charitable income tax deduction limited to the donor's cost basis.

Estate tax deductions are allowed for the fair market value of the asset, regardless of whether the gift is related to the charity's mission. The estate tax deduction is allowed if a donor makes a gift of tangible assets through a will or revocable trust.

³ Some states require the charity to have an "insurable interest" in the donor's life. Please consult your tax or legal advisor to evaluate your state's law.

⁴ Individuals whose adjusted gross income exceeds \$145,950 (\$218,950 for married persons filing jointly) in 2005 and \$150,500 (\$225,750 for married persons filing jointly) in 2006 may be subject to an income tax deduction limitation. This adjusted gross income amount is indexed for inflation and may be increased in later years.

GIFTS OF REAL ESTATE

When considering gifting real estate to charity, a donor should think about the following issues:

- Is the donor currently using this property?
- Does the property meet the donor's investment objectives?
- Would a large capital gains tax be due if the donor sells this property?

At the time of the gift, a donor may be eligible for a charitable income tax deduction equal to the fair market value of the real estate, subject to AGI limits. However, if the property has been owned less than one year, the charitable income tax deduction is equal to the donor's cost basis, plus any improvements the donor made.

If a donor is living in the real estate property, it can still be gifted to charity during the owner's life, with the donor retaining the right to use the property until death. A current deed can be created that transfers ownership of the property to a charity when the donor dies. When the deed is recorded (according to the laws of the state in which the donor resides), the donor is entitled to a charitable income tax deduction for the fair market value of the property, less the value of the donor's right to use the property for the rest of his or her life. The fair market value of the property at the donor's death is excluded from his or her estate.

"SPLIT INTEREST" VEHICLES

Split interest vehicles are used to designate two beneficiaries—a current beneficiary and a remainder beneficiary. The current beneficiary receives an annual payout stream from the trust, typically during the donor's lifetime. The remainder beneficiary receives the assets left in the trust at the conclusion of its term. The four major types of "split-interest" vehicles are: the charitable gift annuity, the charitable remainder trust, the charitable lead trust and the pooled income fund.

CHARITABLE GIFT ANNUITIES

A charitable gift annuity is a special type of agreement designed to provide a donor with the benefits of a traditional annuity while giving to charity. In exchange for a gift of cash or securities (some states allow the gift of closely held stock or property), the donor receives annuity payments from a charity for life. In the case of a deferred annuity, the lifetime annuity payments start at some future time of the donor's choosing.

Typically, the donor receives an income tax deduction equal to the gift given to charity, less the present value of the lifetime annuity payouts. Each annuity payment to the donor is generally partially income tax-free. If the gift is a long-term capital gain asset, such as publicly traded stock, the annuity payouts the donor receives may be partially income tax-free, partially taxed as ordinary income and partially taxed as long-term capital gain. Many charitable gift annuity programs permit contributions as low as \$10,000.

CHARITABLE REMAINDER TRUSTS

A charitable remainder trust (CRT) is a tax-exempt trust that enables a donor to give to charity, diversify assets and receive annual payouts. If a donor has been holding onto appreciated assets for fear of paying high capital gains, he or she could transfer the assets to a CRT and possibly avoid immediate capital gains on the transfer. In addition, the trust would provide the donor with an annual payout stream. At the end of the payout term, the remainder of the assets would be left to charity.

Creating a CRT could provide a donor with an income tax deduction. The deduction would be based on the fair market value of the gift, less the present value of the donor's payout stream. It would also be determined by the nature of the gift, the type of charity receiving the gift and the donor's AGI. There may be income tax due on the annual payouts to the donor.

The donor determines the term of the trust, which can last for the life of the donor, or for a fixed term of up to 20 years. The donor can also choose the level of annual payouts to be paid by the trust. Typically, the maximum payout rate depends on the length of the trust or the life expectancies of the income recipients, but it cannot exceed 50%. The minimum payout is 5%. When the donor's payout term ends (often at death), whatever is left in the trust is distributed to the charity (or charities) of the donor's choice.

CHARITABLE LEAD TRUSTS

Charitable lead trusts (CLTs) are more attractive in periods of low interest rates. A CLT works as follows: a donor funds the trust with an asset (preferably assets expected to appreciate); the charity receives a fixed annual payout from the trust, and the remainder goes to the donor's beneficiaries at the end of the charity's payout term.

The primary benefit of a CLT lies in its gift tax consequences. The value of the donor's initial gift to the trust is determined by a government-set rate, the term of the trust and the payout to charity. When the government-set rate is low, the value of the donor's gift is reduced for gift-tax purposes.

Unlike charitable remainder trusts, CLTs are not tax-exempt entities. Depending on the type of CLT:

- the donor may be able to take a charitable income tax deduction at the time he or she makes the gift.
- either the donor or the trust must pay capital gains tax when the charity sells the trust assets.
- the donor or the trust must pay income tax on any income generated in the trust.

EXAMPLE:

When \$1 million is transferred to a charitable lead annuity trust, with a payout rate of about 8% per year, the annual payout to charity would be about \$80,000 for 20 years, and the value of the gift is zero. At the end of the trust's term, the heirs receive about \$250,000 free of gift and estate tax, and the charity would receive about \$1.6 million in total payouts during the 20-year term.⁵

POOLED-INCOME FUNDS

A pooled-income fund allows donors to "pool" together cash or securities to create one large gift for charity. The charity then reinvests these assets as a pool, similar to traditional mutual funds. The fund's annual income is paid to the donors or their beneficiaries, based on each donor's share of the pool. Upon the death of a donor or the donor's beneficiary, the remaining share of the pool is transferred to the charity. Pooled-income funds generally are beneficial for investors who wish to make small gifts to charity (subject to the charity's own minimum requirements) while still receiving income from the gifts.

A donor to a pooled-income fund is generally entitled to a charitable income tax deduction for the amount the charity is expected to receive at the donor's death. Donors are not required to pay gift tax on contributions to the pooled-income fund, unless the income is received by someone other than the donor or spouse

(assuming the spouse is a U.S. citizen). If the donor contributes to the fund at his or her death, the estate will receive an estate tax charitable deduction for the projected value of the trust at the end of its term. If the fund is set up this way, the donor would designate a lifetime income beneficiary.

⁵ For illustrative purposes only. This example assumes a government-set rate of 5%, a 6% growth rate of assets in the trust, and a trust term of 20 years. If the trust had a growth rate of 8%, the heirs would receive almost \$1 million and the charity would still receive \$1.6 million. Performance may vary.

CONSIDERING A PROFESSIONAL TRUSTEE

It may be possible for you or a family member to act as trustee of a trust that you establish. However, many individuals may not have the time or expertise to effectively perform the duties and responsibilities of a trustee. Charitable trusts and foundations often have additional administrative and investment management requirements that, if not performed correctly, may jeopardize their charitable and financial benefits.

There are many advantages of appointing a professional trustee or co-trustee, such as one of the Citigroup Trust⁶ affiliated trust companies.

- An experienced and knowledgeable Trust Officer
- A virtually unparalleled range of investment styles and managers
- Complete fiduciary administration and tax preparation
- Internet access to a list of holdings and the activity in the trust
- The continuing involvement of your Financial Advisor

⁶ Trust services are provided by one of the following entities: Citibank, N.A.; Citicorp Trust, N.A. (California); Citicorp Trust, N.A. (Florida); Citicorp Trust South Dakota; Citicorp Trust Bank, fsb; or Smith Barney Corporate Trust Company. The service providers listed above are collectively referred to as "Citigroup Trust" and the entities as the "affiliated trust companies."

BENEFITING FAMILY AND CHARITY

One concern that many donors have in gifting significant assets to charity is that the asset will no longer be available for the family. Following is a technique that helps to ensure the family will be left with an inheritance, too.

Using the savings from a donor's charitable income tax deduction and any payouts received from one or a combination of the charitable vehicles discussed, a donor can gift an annual amount to an irrevocable life insurance trust. The trust would purchase a life insurance policy on the life of the donor. At the donor's death, the life insurance proceeds could be distributed to the trust's beneficiaries—presumably family members. Assuming the trust is established correctly, the proceeds are not taxed for income or estate tax purposes. This strategy allows donors to create a substantial benefit for heirs in exchange for gifting a relatively small amount.

For example, if a married couple owned \$1 million of stock that did not pay dividends and they transferred the stock to a CRT, the CRT could create a payout stream for them. The couple could use a portion of these payouts to pay life insurance premiums. This CRT pays out between \$50,000 and \$70,000 per year,⁷ and the donors could decide to use \$48,000 of this amount each year to fund an irrevocable life insurance trust.⁸ At the end of the payout term, about \$739,000 could go to the charity,⁹ and the heirs could receive a death benefit of about \$3,561,632 from the insurance trust.¹⁰ With this strategy, donors can fulfill their commitment to charity while providing leveraged gifts to heirs.

⁷ For illustrative purposes only. This illustration assumes a charitable remainder unitrust with a 6% growth rate and a 7% payout rate. Performance may vary.

⁸ For illustrative purposes only. This amount would fully leverage the couple's combined annual gift tax exclusion. Example assumes the couple has two children.

⁹ For illustrative purposes only. Assumes a 26-year payout stream and a government-set rate of 5%. Performance may vary.

¹⁰ For illustrative purposes only. Based on an illustration of second-to-die universal life insurance with a guaranteed death benefit. The illustration is for a married couple, ages 64 and 65, who are non-smokers. Life insurance is medically underwritten. Performance may vary.

DONOR-ADVISED FUNDS

A donor-advised fund provides a flexible way to give donations to nonprofit organizations. The donor makes an irrevocable, nonrefundable contribution of cash or securities to the fund. He or she can direct the fund's administrator as to which qualified organizations grants should be made, the amount of the grants and when grants should be paid. A donor can also appoint a family member or friend to continue making grants from a donor-advised fund after the donor's death.

Assets in a donor-advised fund are typically managed by a professional investment advisory firm. This provides donors with the opportunity to increase the value of their contributions to the fund, resulting in potentially larger grants to nonprofit organizations. Donors are often entitled to a charitable income tax deduction for the amount contributed to a donor-advised fund, subject to AGI limits. Any unused portion may be carried forward for up to five years.

SMITH BARNEY CHARITABLE INVESTMENT FUND

A donor-advised fund:

- Establishes a long-term charitable giving strategy
- Offers a potential charitable income tax deduction
- No capital gains tax on contributions of appreciated securities
- Helps reduce estate tax liability
- Investors select grant recipients, grant amounts¹¹ and timeline
- Assets are professionally managed
- Contributions may grow if market values appreciate
- Family members can continue grants after the donor's death

¹¹ Minimum \$250.

PRIVATE FAMILY FOUNDATIONS

A private family foundation is a tax-exempt charitable entity created by a corporation, person or family to direct gifting. Private foundations are usually set up by individuals or families wishing to make substantial gifts to charity, while maintaining ultimate control of how grants are made.

When an individual sets up a private family foundation (it can be established during life or at death), he or she contributes assets to the foundation and chooses the trustees or directors who will make the grants to worthy charities. Donors may desire to be actively engaged in managing the foundation or have family members join or succeed them in that management.

Donors might enjoy significant income, gift and estate tax deductions for making substantial contributions to a private family foundation. Some lifetime gifts offer matching income and gift tax deductions. Testamentary gifts offer a dollar-for-dollar estate tax deduction. For these potential benefits, however, donors must be willing to bear the legal and accounting costs associated with the creation and maintenance of a foundation.

A natural complement to a private family foundation is the irrevocable life insurance trust, which allows donors to give the same amount to children as they are giving to a private foundation. Here is an example of how this strategy could work: A donor funds a private family foundation at death with \$6 million. Using a portion of the \$1 million applicable exclusion amount, during the donor's lifetime he or she could pay a one-time premium to an irrevocable life insurance trust of about \$849,000 to receive a \$6 million death benefit for heirs.¹² That way, both charity and family can benefit equally. The life insurance strategy could be used when gifting assets to other charitable vehicles as well.

¹² For illustrative purposes only. Based on an illustration of second-to-die universal life insurance, with a guaranteed death benefit for 44 years. The illustration is for a married couple, both age 55 and non-smokers. Life insurance is medically underwritten. Performance may vary.

Implementing Your Charitable Plan

We hope this discussion of charitable giving techniques has provided you with some ideas for your own wealth management program. Keep in mind, however, that it is only the first step in the planning process. Talk with your Financial Advisor about your overall wealth planning objectives—your goals for transferring wealth to family and charity, how much you'd like each to have and how much control you wish to exercise over your gifting.

Together with the
philanthropic and planning

professionals of Smith Barney,
your Financial Advisor can help
you structure a **giving program**
designed to fulfill both your charitable
and wealth planning objectives.

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