Reconfiguring Giving

Major changes in attitudes and tax laws may affect the philanthropic advice you give clients.

By Bruce W. Fraser

While the fourth quarter is usually when donors do most of their charitable giving, the last quarter of 2010 merits special attention. Several factors have changed the way donors and advisors have approached philanthropy in the last two years—the down economy, for one thing, as well as the estate tax debacle and government cutbacks at federal and state levels. Warren Buffett and Bill Gates have meanwhile launched a giving pledge that puts pressure on high-net-worth individuals to give more.

Amid the economic downturn, it’s probably not surprising that statistics from the Giving USA Foundation show a drop of 3.6% in charitable giving in 2009 from 2008. The Center on Wealth and Philanthropy at Boston College predicts that individual giving for 2010 will rise slightly to between $222 billion and $227 billion, from the $217.3 billion given in 2009 (an uptick that can be attributed to the outpouring of support for Haiti following its earthquake early in the year), but despite this increase, general giving is down from previous years, the center also affirms.

In response to reduced resources, donors are becoming more actively involved in “giving while living”—spending down their philanthropic dollars during their lifetimes rather than after, according to Betsy Brill, president and philanthropy advisor at Strategic Philanthropy Ltd. in Chicago.

Donors “are looking at it from a different perspective,” says Brill, whose clients are primarily advisors to high-net-worth individuals and families as well as closely held and family-owned businesses. “The question is: When do you have the greatest impact [with your giving]? Before you die or later?”

Several foundations are trying to turn donors’ attention to the philosophy of “giving while living.” The Atlantic Philanthropies, a multibillion dollar foundation, recently released a report that profiles 11 philanthropists giving generously during their lifetimes. The Aspen Institute has released a similar report, “Time Is of the Essence,” which advises philanthropists to be strategic when choosing how they give—whether it’s by spending down their endowments while alive or setting up a model that gives in perpetuity.

“What they found,” says Brill, “is that while the majority of foundations and trusts do not have any language in their bylaws regarding life span, the spend-out option is becoming increasingly attractive to donors who have become more concerned with their ability to exert control over the investing and spending of their foundation assets due to the economic crisis.”

Today, there are more vehicles available and different ways to use them for philanthropic investments, Brill notes. “You can change your entire vehicle. You can create a foundation that gives money in perpetuity, or you can adopt a charitable lead or charitable remainder trust, which tend to be time-limited vehicles.”

The Buffett-Gates Giving Pledge

Also spurring the wealthy to give while living is the Buffett-Gates Giving Pledge, in which 40 billionaires have pledged to give at least 50% of their assets to charity either during their lives or as part of their legacy. Many in the field are calling this pledge the game changer that will shape philanthropy in the U.S. for years to come.

The question is whether the campaign will encourage not only the wealthy but also ordinary people to step up.

“Certainly the pledge will contribute to people wanting to have more of an impact of their wealth distribution in their lifetimes, and demanding an accountability for it,” says Stacey Haefele, president and CEO of HNW Inc., a marketing firm in New York that focuses on wealth management for the high-net-worth sector.

Noting the potential impact, Jim Duggan, an estate and wealth planning attorney at Duggan, Bertsch LLC in Chicago says, “There is a real pressure point from very prominent figures, and other [high net worth] clients are looking at [the pledge] as an example.”

Duggan says that if the wealthy were already giving while living, the Buffett-Gates pledge has reinforced their philanthropic approach. “It is motivating more current action on the part of those who were on the fence or have not yet committed to their philanthropic structure,” he says.
He adds that there is also a political factor at work. Most of the giving of his clients, chiefly wealthy entrepreneurs and small business owners, is “motivated by disapproval of government spending in general and the desire to take [disbursement of their funds] into their own hands.”

Still, given the estate tax ambiguity, the pledge is “not necessarily going to result in people dashing off a check before year-end to a charity in any different way than they might or would do otherwise,” Haefele cautions.

Because of the changing estate tax rules, drafting estate plans has become more complicated, and Duggan, for one, finds himself drafting several different types of plans to cover various contingencies instead of just devising one conventional plan. Those lawyers who do rely on just the conventional plan are taking risks, he says.

“Drafting is a lot more complicated, but people are not thinking about that,” he says. “They’re thinking about what it is in the plan I need today. And lawyers are making the same mistake. You really need to draft plans that accommodate both possibilities: no tax or a lot of tax.”

**Estate Tax Ramifications**

In an economy that is teetering, it’s been tough for the rich to expand their wealth. But donating it to their heirs has become much easier, at least in 2010. By most accounts, the Bush tax cuts of 2001 helped estate planners, heirs and givers. Interest rates have hit rock bottom and the estate tax has disappeared (for this year alone, at least). If this is nirvana, however, it could rapidly change. The tax breaks expire at the end of the year, and Congress has not decided whether to come up with new ones (at least not as of this writing).

Regardless, there is still time for affluent individuals to consider or reconsider how they might help both their heirs and their favorite charities.

Those clients who transfer wealth before the end of 2010 can avoid the negative consequences of 2011: Next year, the maximum gift tax rate will increase to 55% from 35%; the maximum marginal estate tax rate will go back up to 60% (after going all over the map, from 45% in 2009, to 0% in 2010); and the applicable exclusion amount will decrease in 2011 to $1 million from its 2009 level of $3.5 million.

“As the law stands now, and assuming Congress does nothing, anyone who has $1 million or more will be affected by the estate tax starting next year, and will owe 55% of any assets over $1 million to the federal government at their death,” says Haefele. (Spouses are still excluded, so it is essentially a $2 million exemption, or $1 million per spouse.)

All the changes in the tax rules, such as changes in cost basis calculations and gift tax exemptions, will likely affect wealth transfers. And those changes don’t even take into account the possible income tax increase in 2011. Though income taxes have little to do with estate taxes, they can’t be dismissed entirely. The issue has become a political football, and if legislation stalls, taxes could rise across the board at all income levels. But it’s the wealthy in particular that have been targeted for heftier increases by the Obama administration.

Tina Davis Milligan, a partner at Baker Tilly Virchow Krause LP, an accounting firm in Chicago, believes there are tax advantages to giving now rather than later. But she has some clients who want to accelerate their deductions this year since they realize their charitable deductions won’t be reduced.

“This would not normally be the intuitive thing to do,” says Milligan. “You would have thought they’d see a larger tax benefit in tax deduction next year when tax rates are higher, but because their deductions would be limited next year, they’re going to give more this year instead of next year.”

This year, next year. It all depends, of course, on each client’s individual time table.

Mary Ann Mancini, a partner at the law firm Bryan Cave in Washington, D.C., and leader of the firm’s private client group, says most of her clients do their charitable giving during their lifetime to reduce the income tax burden.

“If they feel income tax rates are going to rise next year,” says Mancini, “they are likely to do their charitable giving next year and not this year when rates are low.

“Obama is talking about keeping rates low but not for the wealthy, and it’s the wealthy who do so much charitable giving, so there’s no reason for them to make charitable gifts this year because for them, even if Congress does something, it’s likely their income taxes are going to go up.”

All these shifts provide plenty of opportunity for advisors to step up to the plate. The Merrill Lynch Cap Gemini *World Wealth Report*
2010 shows a rising demand for philanthropy-related advisor services among high-net-worth individuals because they increasingly view philanthropic choices as inextricably linked to their broader financial planning initiatives.

As a result of this changing landscape, many donors are reconfiguring their giving and asking their advisors to join with estate planners, tax advisors and accountants in client-centered teams to facilitate the process. The murkiness is affecting not only the very wealthy but a much broader swath of the less affluent that need advice from planners.

“This isn’t something that just affects billionaires,” says Haefele. “There is opportunity here to help a level of client—someone with $1 million to $5 million in assets who perhaps thought they would not have to worry about these things. They will need an advisor to navigate the confusion and shed some light on the best route forward.”

**Top Considerations**

So what should be at the top of people’s minds in 2011 when giving as part of their estate planning?

Haefele says the most important thing is the choice of vehicle, whether it’s a donor-advised fund, a foundation or a charitable lead or remainder trust. Donors want to pick the best vehicle, not just to remove their assets from their taxable estate for their heirs, but also to protect and best channel assets to causes that matter to them, either right away or in the future.

“The impending increase in the estate tax, coupled with the higher income tax rates next year, makes this year-end particularly important for planning,” says Milligan.

Milligan adds that the more pressing thing this year is to minimize gift and income taxes, as higher rates loom and donors must take advantage of today’s lower rates by year’s end. These are things that can be planned for, whereas the estate tax repeal cannot be—unless a client is terminal and expected to die by January 1.

“Clients and their advisors need to craft estate plans that contemplate an unknown and ever-changing estate tax landscape,” says Duggan. “Conventional drafting does not cut it anymore. One’s estate plan needs to accommodate a circumstance where on the one hand there is no estate tax whatsoever and on the other virtually all of the estate is subject to a very high estate tax.”

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