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MONTANA STATE UNIVERSITY EXTENSION

MontGuide

Save Montana Income Taxes with a Charitable Gift Annuity:

A Legacy qualifying for the Montana Endowment Tax Credit (METC)

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This MontGuide explains how charitable gift annuities could be used to meet both the altruistic and tax savings goals of Montanans.

MT201807HR Revised 8/18

IF YOU MADE A $10,000 GIFT TO YOUR FAVORITE charity and you received a **tax credit** that reduced your Montana income tax liability by over $3,000, would you be interested? Keep in mind a **tax credit** is a dollar-for-dollar reduction of the actual income tax you owe to the state Montana, while a **tax deduction** simply reduces your taxable income.

This MontGuide explains how **charitable gift annuities** could be used to meet both the altruistic and tax savings goals of Montanans. While other types of gifts are also eligible for the Montana Endowment Tax Credit (METC), the most common type is charitable gift annuities. Other types of gifts qualified for the Montana Endowment Tax Credit include: charitable remainder trusts; charitable lead trusts; pooled income funds; charitable life estates; and paid-up life insurance policies (see pages 5 and 6).

Montana Legislation

In 1997, the state legislature created a tax credit that could be used to reduce a taxpayer's Montana income tax liability. The legislature wanted to encourage gifts to endowments held by Montana tax-exempt charitable organizations. In its current form, the credit, commonly referred to as the Montana Endowment Tax Credit (METC), is effective through December 31, 2019.

Federal Legislation

With federal tax laws changing in 2018, taxpayers can claim larger standard deductions on their federal income taxes. The standard deduction for singles is $12,000; for married couples, $24,000. Therefore, many taxpayers will not claim any deductions for charitable contributions. For individuals who forgo a charitable deduction because they choose to claim the standard deduction, there will be no savings on federal taxes as a result of a charitable gift. The METC still applies however, resulting in substantial tax savings for Montanans. The example on page 5 assumes the fictitious donor(s) is claiming both a charitable federal deduction and the METC.

Who Can Make Gifts Qualifying for the Montana Endowment Tax Credit?

Individuals and Married Couples. The METC is ***40 percent*** of the allowable federal deduction for the charitable portion of a ***planned gift,*** up to $10,000 for an individual filing a Montana income tax return; $20,000 for a married couple. Gifts can be in the form of cash or securities (stocks, bonds, or mutual funds) or other assets qualifying for a federal income tax deduction. There are two criteria for a planned gift to qualify for the METC.

The *first* criterion is a gift by an individual or couple must be made by one of nine gift instruments to a qualified permanent endowment. The endowment must be held by a tax-exempt Montana 501(c)(3) organization or a Montana bank or a Montana trust company for the benefit of a 501(c)(3) organization. A 501(c)(3) is a United States organization operated exclusively for exempt purposes set forth in Section 501(c)(3) of the Internal Revenue Code. A ***qualified endowment*** is a permanent and irrevocable fund established for a specific charitable, religious, educational or philanthropic purpose.

A charity or non-profit endowment using gift principal for operating expenses, current construction, renovation of buildings, or purchasing equipment does NOT qualify as a permanent endowment. Therefore, a gift used for these purposes would not be eligible for the METC.

The *second* criterion for a gift by an individual or couple to be eligible for the METC, is the contribution must be irrevocable and in the form of a ***planned gift.*** The Montana Legislature has authorized nine techniques for planned gifts. Immediate or deferred payment charitable gift annuities are the two most frequently used.

Business Entities. Unlike an individual or a couple, a business entity is ***NOT*** required to make a planned gift. The METC may be claimed by Montana businesses making direct gifts to qualified permanent endowments held by tax-exempt Montana 501(c)(3) organizations. Eligible businesses include: S and C corporations, partnerships, and limited liability companies.

Businesses are entitled to a METC equal to ***20 percent*** of the amount of the allowable federal deduction, up to the maximum of their Montana income tax liability or $10,000, whichever is lower. Business gifts can be in the form of cash or securities (stocks, bonds, or mutual funds).

> **Example A:** Montana Bobcat, a C corporation, made a $50,000 cash gift to a local community foundation and restricted the gift to a permanent endowment. The METC for Montana Bobcat is equal to 20 percent of the $50,000 gift ($50,000 x 20% = $10,000). Montana Bobcat is eligible for a METC of $10,000, which is also the maximum credit the corporation can claim.

S corporations, partnerships, and limited liability companies pass METC qualifying contributions to their owners to be used on their individual income tax returns.

Estates. An estate can also make a gift to a qualified permanent endowment eligible for the METC. A Personal Representative or Trustee may make gifts from an estate as directed by a written will or trust document.

The METC an estate would receive depends upon the form of contribution made. If the contribution is a planned gift, the estate may claim 40 percent of the value of the qualifying gift. If the estate makes a direct contribution, 20 percent can be claimed. The maximum METC for an estate is $10,000.

> **Example B:** The Personal Representative of the Moore estate followed Bill Moore's will in which he stated *"$60,000 shall be donated to my local 501(c)(3) health care foundation in the form of a permanent endowment that would support Alzheimer's dementia training for certified nurse assistants working in an assisted living facility, nursing home, or similar facility in Billings, Montana."*
>
> The METC for Bill Moore's estate gift is calculated as 20 percent of the $60,000 gift ($60,000 x 20% = $12,000). However, the Moore estate is limited to a METC of $10,000, the maximum credit an estate can claim.

To structure a qualifying METC estate charitable gift, seek the assistance of an attorney, certified public accountant or other financial professional.

What is the difference between an Immediate Payment and a Deferred Payment Charitable Gift Annuity?

A charitable gift annuity is a contract between a donor and a charity. A donor gives cash or other property (such as stocks, bonds, mutual funds or real estate) to a charity in exchange for the charity's promise to pay the donor (annuitant) a lifetime annuity.

- With an ***immediate payment,*** the charity begins the payments within the year after the gift is made.
- With a ***deferred payment,*** the charity begins the payments at a future time designated by the donor.

Immediate and deferred payment charitable gift annuities contain two components:

1. Lifetime income paid to the donor (annuitant) beginning immediately or at a designated time in the future.
2. A gift to the charity upon the donor's death or when the donor decides to cancel the gift annuity and gift future payments to the charity.

The Income Portion: How does a charity determine the rate the organization will pay to the annuitant for a charitable gift annuity?

Most charities offer income payments based on annuity rate guidelines established by the American Council on Gift Annuities (ACGA). Factors such as life expectancies, current interest rates on securities, and market assumptions are included in the establishment of the rate guidelines.

Immediate payment gift annuity rates are available from the ACGA for one-life and two-lives (typically for a married couple). Rates for a one-life immediate payment annuity in five-year increments are shown in Table 1. Rates for Two Lives–Joint and Survivor immediate annuities are listed in Table 2. Rates for all ages can be found at: www.acga-web.org/gift-annuity-rates or by contacting your favorite charity.

TABLE 1. American Council on Gift Annuity Rates (ACGR) for One Life (2018) (Immediate Payment)

Age	Annuity Rate
65	5.1%
70	5.6%
75	6.2%
80	7.3%
85	8.3%

TABLE 2. American Council on Gift Annuity Rates (ACGR) Two Lives: Joint and Survivor (2018) (Immediate Payments)

Younger Age	Older Age	Annuity Rate
65	69 – 71	4.7%
70	75 – 77	5.2%
75	79 – 80	5.7%
80	83 – 84	6.5%
85	88	7.7%

The Charitable Portion: How does a charity determine the METC on a charitable gift annuity?

The *charitable portion* is the original gift amount minus the present value of the annuity payments made by the charity to the donor.

The *present value* is the total value of the annuity payments over the annuitant's life expectancy, discounted by the Applicable Federal Rate (AFR) at the time of the gift. The AFR in March, 2018 was 3.0 percent. The rate is published monthly by the Internal Revenue Service (IRS). For more information go here: www.irs.gov/pub/irs-drop/rr-18-06.pdf. Scroll to Rev. Rul. 2018-06 Table 5.

The gift officer of many larger Montana charities can provide a potential donor with amounts of the charitable portion and present value of an immediate or deferred payment charitable gift annuity. Local community foundations in Montana can provide the figures for smaller charities who do not have their own gift annuity programs.

How does an Immediate Payment Charitable Gift Annuity qualify for the METC?

With an immediate payment charitable gift annuity, an annuitant (the donor) elects to receive income for a single or joint lives. Under a typical agreement, income payments to the annuitant begin within a few months after the date of the gift.

Example C: Claude, age 70, established an ***immediate payment charitable gift annuity*** with a $15,000 gift to his local community foundation. The foundation's gift officer informed Claude he qualified for an annuity rate of 5.6 percent (See Table 1). He will receive $840 annually for the rest of his life from the local community foundation ($15,000 gift x 5.6% gift annuity rate = $840).

The foundation also calculated the ***present value*** of Claude's future income payments. The present value is based on Claude's remaining life expectancy of 19½ years (based on actuarial tables), the current ACGA rate (5.6 percent), and the value of the asset funding the contract ($15,000). The present value of Claude's annuity payment is $8,863.60.

The ***charitable portion*** of Claude's gift is calculated by subtracting the present value of his income payments from the amount of the gift ($15,000 gift - $8,863.60 present value = $6,136.40). The charitable value of Claude's gift annuity is $6,136.40.

TABLE 3. Montana Tax savings with an Immediate Payment Charitable Gift Annuity (Example C: Claude)

Tax Treatment	Immediate Payment Gift Annuity
Original Gift Amount	$15,000
Present Value of the Annuity Payments (rounded)	$8,864
Charitable Portion of the Gift (rounded)	$6,136
METC (40% of charitable portion) tax savings (rounded)	$2,455

Claude's METC is calculated by multiplying the charitable value of gift ($6,136.40) by 40 percent, resulting in an METC of $2,455. If Claude owes $4,000 in Montana income tax, after the METC is applied his income tax liability is $1,545 ($4,000 - $2,455 = $1,545). The METC saved Claude $2,455 in Montana income taxes.

METC rules stipulate the donor cannot gift his/her remaining annuity payments back to the charity within five years of the date of making his/her gift. An exception to the rule applies, however, if the donor passes away within those five years.

Donors who gift their future annuity payments to the charity before the end of their lives are typically eligible for additional federal and Montana income tax deductions. Such gifts, however, do not qualify for the METC.

How does a Deferred Payment Charitable Gift Annuity qualify for the METC?

The most cost effective gift used by donors to qualify for the METC is the **deferred payment charitable gift annuity**. This annuity has similar characteristics to the immediate gift annuity, except annuity payments begin at a future date selected by the donor. Payments typically begin when the donor (annuitant) is older, and therefore, the METC is higher.

With a deferred payment charitable gift annuity, the present value of the income payments is usually lower than with an immediate payment charitable gift annuity because of the length of time before payments begin. This leads to a larger charitable portion of the gift. Therefore, the donor is eligible for a larger METC.

The annuity rate for a deferred payment charitable gift annuity must be at least five percent for the gift to qualify for the METC. As with the immediate payment charitable gift annuity, the donor cannot gift his interest in the contract to the charity within five years of the date of the gift.

Example D: Bill and Marie contacted a Montana university foundation because they wanted to support a scholarship fund. The gift officer suggested a ***deferred payment charitable gift annuity*** because of its eligibility for the METC. The gift officer provided them with an illustration for a $10,000 gift in exchange for income payments beginning when Bill reaches age 90.

Based on their current ages (*Bill, 70 and Marie, 65*) and a deferral period of 20 years for the payments to begin, the illustration revealed Bill and Marie qualified for an annuity rate of 16.7 percent. The gift officer indicated if they wanted to maximize their tax benefits, however, they could reduce the value of their gift annuity income payments simply by electing a lower annuity rate of five percent. Under this arrangement, when Bill reaches age 90, they will begin receiving an annual annuity payment of $500 for the rest of their lives ($10,000 gift x 5% annuity rate = $500).

The charity's gift officer further explained the illustration shows the ***present value*** of Bill and Marie's annuity income payments is $752. The resulting ***charitable portion*** and federal deduction is $9,248 ($10,000 gift - $752 present value of Bill and Marie's annuity payments = $9,248 charitable portion).

They are eligible for a METC of $3,699 ($9,248 charitable portion of gift x 40% = $3,699). Because Bill and Marie's income is taxed at a 24% federal rate, they will save $2,220 on their federal income taxes ($9,248 charitable portion x 24% federal tax rate = $2,220). The total state and federal income tax savings generated by their deferred payment charitable gift annuity is $5,919 ($3,699 METC savings + $2,220 federal tax savings = $5,919).

What are the tax savings if a donor prefers to make an outright gift?

What if Bill and Marie had decided to make an outright gift of $10,000 to the university foundation for immediate use, rather than making their gift through a deferred payment charitable gift annuity?

Because the $10,000 gift would only count as a reduction of state and federal taxable income and NOT qualify for the METC, their income tax benefits would have been substantially lower.

Example E: Bill and Marie would receive $690 in savings on their Montana income taxes for their cash gift [$10,000 x 6.9% (the top Montana income tax rate) = $690]. Because Bill and Marie have a 24 percent federal income tax rate, they would save $2,400 on their federal income taxes ($10,000 x 24% tax rate = $2,400). Their total state and federal income tax savings from an outright gift would have been $3,090 compared to $5,919 with the deferred payment charitable gift annuity ($690 Montana + $2,400 federal = $3,090).

By utilizing the deferred payment charitable gift annuity, Bill and Marie receive an additional $2,829 in tax savings. A comparison of Bill and Marie's income tax benefits with the deferred payment gift annuity and an outright gift is illustrated in Table 4, below.

Substantiating the METC

To claim the METC for charitable gift annuities (immediate and deferred), taxpayers must submit, along with their tax returns, the Montana Department of Revenue form, Qualified Endowment Credit (QEC) for the year in which the gift was made. The METC form (QEC) is available on the Department of Revenue's website: https://app.mt.gov/myrevenue/Endpoint/Form/260.

The charity should provide the taxpayer with information indicating what amount of the contribution qualifies for the METC. The charity should also provide sufficient supporting documentation to back up the taxpayer's claim for the METC on their Montana tax return.

Taxpayers filing electronically are not required to mail the QEC form, unless contacted by the Montana Department of Revenue. Additionally, filers must attach a receipt for their contribution issued by the charity or institution holding the endowment or planned gift.

Subchapter S corporations, partnerships and limited liability corporations are not required to submit the Qualified Endowment Credit (QEC) form with their Montana income tax return because charitable income tax deductions are passed through to shareholders, partners, or members in the same way income and losses are reported. The amount of the charitable contribution proportional to each taxpayer is reported on a federal schedule K-1 statement.

Charitable Remainder Trusts

Donors typically contribute cash or property to charitable remainder trusts for three reasons:

1. To avoid a capital gain on their appreciated assets;
2. To generate income; and
3. To leave gifts to their favorite charities.

Assets are managed and invested within the charitable remainder trust by the trustee for the benefit of:

- Beneficiaries (donor, donor's children or grandchildren, or others designated by the donor) who receive income generated by assets in the trust; and
- Charities who will ultimately receive the balance of the trust at end of the donor's lives or the end of the trust term.

Trustees of a remainder trust can be charitable organizations, banks, trust companies, or even the donor. Trustees are given control of property in a trust with a legal obligation to administer it solely for the purposes specified in the trust document.

TABLE 4. Comparison of State and Federal Income Tax Benefits Between an Outright Gift and a Deferred Payment Charitable Gift Annuity Qualifying for the METC

Tax Treatment	Deferred Payment Gift Annuity	Outright Gift
A. Original Gift Amount	$10,000	$10,000
B. Present Value of the Annuity Payments	$752	N/A
C. Charitable Portion of the Gift	$9,248	$10,000
D. Federal Income Tax Deduction	$9,248	$10,000
E. Federal Tax Savings (24 percent tax rate)	$2,220	$2,400
F. METC (40 percent of charitable portion)	$3,699	N/A
G. Montana Income Tax Deduction Savings (6.9% tax rate)	N/A	$690
Total State and Federal Income Tax Savings (E + F + G)	**$5,919**	**$3,090**

Generally, attorneys representing the charity and donor are involved to develop the trust document containing specific directions to the trustee. Many charities have minimum gift requirements ranging from $50,000 to $100,000 to establish a charitable remainder trust. Once a charitable remainder trust is established, donors may make additional contributions to the charitable remainder trust in future years.

Income beneficiaries of a charitable remainder trust can be one or more individuals of the donor's choosing, including the donor. Income is typically distributed to the trust's beneficiaries during their lives. At the end of the trust's term, the assets are distributed to the remainder beneficiaries, which could be one or more charities listed in the trust document.

For a charitable remainder trust gift to qualify for the METC, the remainder gift to a Montana charity must support a permanent endowment. This must be irrevocably stated in the governing document of the trust – meaning the donor cannot change his or her mind and remove the assets from the charitable remainder trust or redirect the ultimate gift to a non-endowment purpose.

The donor decides which of the two primary types of charitable remainder trusts would work best for his or her situation:

- A **charitable remainder annuity trust** (CRAT) pays a fixed dollar amount annually to income beneficiaries based on a stated percentage of the trust's original assets.
- A **charitable remainder unitrust** (CRUT) pays a fixed percentage of the trust's assets to income beneficiaries. The assets are revalued annually.

Charitable Lead Trusts

Another form of a charitable trust is the **charitable lead trust** in which a donor makes a contribution into a trust managed by a trustee. The trustee makes payments to the donor's qualified charity for a certain period of years chosen by the donor.

At the end of the term the trust terminates and remaining assets are returned to the donor or to a remainder beneficiary of the donor's choosing. A charitable lead trust can be a unitrust that pays a fixed percentage of trust assets to a charity annually or an annuity trust that pays a fixed dollar amount annually to charity.

Pooled Income Funds

Donors can make contributions to **pooled income funds** that are comingled with gifts from other donors for investment purposes. Each donor's contribution is a fraction of the total value of the fund (called a donor's "units of participation"). Each donor receives a fractional share of the income of the fund, based on his or her units of participation. Net investment income of the fund is distributed to pooled income fund donors annually for their lifetimes.

When a donor passes away, the portion of fund assets attributable to him or her is distributed to the charity to fulfill the donor's stated charitable purpose. The charitable deduction available for a pooled income fund gift is calculated as the present value of the remainder gift to charity. The METC is calculated as 40 percent of this value.

Charitable Life Estate

A charitable life estate is typically a gift of a personal residence, farm, ranch, cabin, or condo to a qualified charity with the donor reserving a life estate. Under a charitable life estate agreement, property ownership is gifted to the charity, but the donor continues to live in the home for the rest of his or her life. The donor agrees to pay property taxes, household insurance, and maintenance costs.

After the donor's death, the charity sells the home to fund a charitable permanent endowment. By entering into this irrevocable agreement for a charitable life estate, the donor is entitled to a 40 percent METC in the year the life estate was created.

Paid-Up Life Insurance Policy

Life insurance policies with all premium payments paid, can be gifted to charity and qualify for the Montana Endowment Tax Credit.

These policies include single premium, whole life, universal life, and variable life. Term policies do not qualify. The METC is 40 percent of the replacement value of the paid-up policy, a figure that can be obtained from the life insurance company.

Summary

The Montana Endowment Tax Credit (METC) encourages Montanans to build endowments to support Montana charities and nonprofits. Such endowments will ultimately help assure sustainability for charities in our state. Individual taxpayers can qualify their gifts for the METC by making a planned gift held by or for the benefit of a 501(c)(3) Montana charity. Businesses can qualify for the METC through an outright gift to an endowment. Estates can qualify with a planned gift or outright gift. If you are considering making a gift eligible for the METC, ask the charity how the gift should be structured.

The METC provides Montanans with incentives for philanthropy by significantly increasing the tax benefits for giving. For individual and married taxpayers, the credit is equal to 40 percent of the charitable portion of the planned gift. For individual taxpayers, there is a $10,000 limit on the METC; $20,000 limit for married taxpayers. The METC for businesses is calculated as 20 percent of the gift, with a limit of $10,000. The METC for estates can be either 40 percent for a planned gift or 20 percent for an outright gift.

Online Resources

- Montana Department of Revenue Qualified Endowment Credit form: https://app.mt.gov/myrevenue/Endpoint/Form/260
- Applicable Montana Code Annotated sections:
  - Qualified Endowment Definition: 15-30-2327(1)(c) MCA
  - Planned Gift Definition: 15-30-2327(1)(b) MCA
  - METC for Individuals: 15-30-2328 MCA
  - METC for Businesses: 15-31-161, 15-31-162 MCA
- Administrative Rules of Montana:
  - Tax Credit and Deduction Limitations 42.4.2704 www.mtrules.org/gateway/ruleno.asp?RN=42.4.2704
  - Eligibility Requirements to Hold a Qualified Endowment 42.4.2703 www.mtrules.org/gateway/ruleno.asp?RN=42%2E4%2E2703
  - Creating a Permanent Irrevocable Fund 42.4.2705 www.mtrules.org/gateway/ruleno.asp?RN=42%2E4%2E2705

Acknowledgements

This MontGuide has been reviewed by representatives of the following organizations who recommend its reading by Montanans who are interested in learning how the METC could meet their charitable giving and tax savings goals:

- Billings Clinic Foundation
- Business, Estates, Trusts, Tax and Real Property Section: State Bar of Montana
- Catholic Foundation of Eastern Montana
- The Catholic Foundation for the Diocese of Helena
- Montana Community Foundation
- Montana Society of Certified Public Accountants
- Montana Nonprofit Association
- Montana State University Alumni Foundation
- National Association of Insurance and Financial Advisors: Montana Chapter
- Rocky Mountain College
- Yellowstone Boys and Girls Ranch Foundation

The authors also wish to extend appreciation to members of the general public who also reviewed the publication and made many worthwhile suggestions.

Disclaimer

The information in this MontGuide is for educational purposes only. References to charities or nonprofits are made with the understanding no endorsement is implied and no discrimination against other charities or nonprofits is intended.

Software Calculations

Calculations for the charitable portion and present value of annuities examples were provided by the Crescendo software program. Other software programs may have different results because of the assumptions made within.

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Revised August 2018