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Bestowing Gifts

By Peter Lynch

Most of us spend more time building up our net worth than we do in figuring out how to give it away for maximum benefit. Nobody argues with the fact that you can't take it with you, but a lot of people try to delay letting go of it right up to their date of departure. Consequently, charity begins not at home, but at the reading of the will.

The retentive impulse can be very unfortunate for the people and organizations we'd most like to support. When charity begins at the reading of the will, the bulk of the money falls into the hands of the nation's biggest profligate: the federal government.

Uncle Sam's is the unkindest cut of all, the 55% federal tax on inheritance for the deceased in the top bracket. Many states also take their cut, which has caused a great migration of the elderly to places like Florida, which in addition to sunshine offers the warmth and comfort of no estate taxes. But moving to Florida for the postmortem tax break is hardly worth the effort. Most of what the state doesn't get, the feds will.

A 55% tax on inheritance makes death the equivalent of a 2,000-point drop in the current Dow Jones average, and this after all the years the deceased has paid taxes on capital gains and "unearned income." (While the government encourages us to save and invest, it persists in using this insulting term, which makes it sound as if we don't deserve the proceeds from the saving and investing we've managed to do. Here's a suggestion for President Clinton: Order the IRS to drop the phrase "unearned income" from all tax forms immediately.)

I'm straying away from my main point, which is that there are ways to insure that a greater percentage of any good fortune can be handed down to our children or to the worthy causes that we'd most like to support. A giveaway plan ought to be part of any investment strategy, for what's the use of struggling to accumulate net worth, and then allowing it to be carted off to Washington by strangers?

The government offers us various ways to avoid the ultimate tax, beginning with the onetime contribution of up to \$600,000 that each person (\$1.2 million per married couple) is permitted to make to the recipient of his or her choice, free of the gift tax. We can bestow this \$600,000 on anyone we like, or even someone we don't like--wife, husband, uncle, mother-in-law, Mike Milken, or General Motors, to help make up for that company's recent losses.

Meanwhile, every adult couple can give up to \$20,000 annually to each of their children, also free of any gift tax. This opportunity is well-known, but many couples fail to take advantage of it, either because: (1) they worry that their children aren't mature enough to use the money wisely, or (2) they imagine they will go on living for a long time, and see no need to rush to sign over any of their assets.

Since it's simple enough to set up a trust fund for the children to delay their receipt of the money, thereby eliminating worry number one, my guess is that number two is the more likely cause of procrastination over making the \$20,000 transfers by people who could easily afford them. This failure to act is very rewarding for the government, but unfortunate for the heirs.

This brings us to charitable contributions. Although corporations get most of the publicity for being charitable, individuals do most of the giving. In 1991, 89% of the \$125 billion collected by churches, foundations, hospitals, schools, and the like came from individuals. According to Nathan Weber of the Giving USA digest, we Americans spend more money every year on charity than we spend on gas and oil.

Our collective generosity is a wonderful thing, and continues to set us apart from certain societies of Scrooges in other parts of the world. Nevertheless, our charitable giving often comes in dribs and drabs out of the checkbook, with the major contributions left to the will. But there are more effective methods to consider.

Before you write the next sizable check to your favorite charity, you might want to review your portfolio to see if there are any securities that you could donate instead. Stock certificates can be signed over to any qualified tax-exempt organization, which in turn can sell the shares and pay no taxes on your gains. If you sold the shares yourself, you would owe the 28% capital gains tax, but by giving away the shares, you get their full value as a tax deduction. The advantages are even greater in states that have their own capital gains taxes.

Consider the following two scenarios. If you donate \$5,000 to a worthy cause, and you happen to be in the highest tax bracket, you can save \$1,550 on this year's income tax, so the donation ends up costing you \$3,450. However, if you donate 1,000 shares of stock for which you paid \$2,000 five years ago, but which are now worth \$5,000, you avoid the \$840 tax on the capital gain and you still get the \$1,550 write-off against your taxable income. This way, the same \$5,000 donation has cost you only \$2,610.

I'm not a tax expert, but I'm told there are also advantages to donating artwork, jewelry, houses, used cars, and the like. Several national charities accept used cars in their "vehicle donation" programs. If you're giving away shares of stock, you must have owned them for a least a year and a day to get the full benefit of the tax breaks.

Before you give anything away, you ought to consult with your tax advisor. If you are subject to the alternative minimum tax, you'll have to make an adjustment for the size of the gift.

Until recently, the most effective way for an individual to contribute to charity has been through a foundation. But as I've discovered for myself, you pay a lot of legal fees to establish a foundation, and after that, you continue to pay the accountants for doing a great amount of paperwork. If Fidelity Investments had launched its Charitable Gift Fund a few years earlier, my wife and I could have avoided the bother.

This is my fifth column for Worth, and I haven't yet recommended a Fidelity product, so perhaps I can be allowed one plug for a Fidelity fund that permits small and large investors alike to

funnel money into worthy causes. At present, Fidelity is the only for-profit company that the IRS has approved to run a public charity, but various community foundations have set up similar operations.

You invest in the Charitable Gift Fund much in the same way you'd invest in a regular mutual fund. You make an initial contribution that is fully tax-deductible. A fund manager puts your money to work, and your assets grow tax-free. In the case of Fidelity's gift fund, you have the option of investing in a growth pool, an equity-income pool, or an interest-income pool, depending on your tolerance for the ups and downs of the stock market. You may also split investment of that gift between any of the funds. You can draw on your share of the assets by having the Gift Fund send checks (in amounts of \$250 or more) to your favorite charities at any time.

Imagine that someday you'd like to do something special for the American Heart Association. So, you invest \$10,000 in an equity mutual fund that grows at 10% a year, for 20 years. Assuming you deduct the amount needed to pay yearly taxes on the dividends, and then pay the capital gains tax on the profits when you get out of the fund, you will have turned your \$10,000 into a \$43,000 gift.

On the other hand, if you invest the same \$10,000 in a Gift Fund account where it grows at 10% a year, but tax-free, your original \$10,000 will produce a gift of more than \$67,000. You see the advantage of tax-free compounding.

A technique I often use to inspire a charity to which I've contributed is the challenge grant. You offer them a donation of a specific amount, but only if they can match it by raising a similar amount from other sources. I've never met an organization that failed to match a challenge grant.

What begins with a donation may result in a larger involvement: a seat on the board, or a place on an ad hoc committee, or some similar opportunity to serve a worthy cause. In my own experience of working with charities, I've found that there's no job that's more rewarding.

CHARITABLE TRUSTS: SMART WAYS TO GIVE IT AWAY There are a few additional newfangled methods by which people can avoid estate taxes and maximize their charitable contributions.

Charitable remainder trust. You give a major asset (e.g., a portfolio of stocks) to a qualified charity. The stocks are sold, and the proceeds are put into a trust account that you've set up in advance. The trust is managed by the charity or an outside investment manager. You and your spouse continue to receive the income from the trust account for as long as you live. After you both die, the charity gets your trust account. This doesn't do your heirs any good, but if you don't have children, or if your children are richer than you are and don't need to inherit your money, there are tax advantages.

Pooled income fund. This is similar to the charitable remainder trust described above, except that your assets are put into a pooled fund run by the charity or an outside manager. Well-run funds

of this type can deliver the same returns as regular mutual funds. you can deduct about 25% to 50% of your donation, depending on your age and the fund's earnings history.

Charitable lead trust. This is a charitable remainder trust in reverse. You donate assets to a trust, the charity gets the income as long as you're alive, and when you die, the assets are handed over to your heirs. The more years the charity has use of the income, the bigger the tax break for your heirs.

Life estate agreement. You and your spouse sign over your house to charity and get a tax deduction for the present value of the remainder interest of the property. You can stay in the house for as long as you live. Then the charity takes possession.

Charity insurance. You take out a life insurance policy and name the charity of your choice as beneficiary. This enables you to give much more away than you could otherwise.

Charitable trust with insurance. Set up a charitable remainder trust and take out a life insurance policy that is equal to the value of the assets you've given to the trust. When you die, the assets in the trust become the property of the charity, but the life insurance pays off to the insurance trust, which in turn is distributed to your heirs. They pay less in taxes than they would if you simply willed your estate to them.

Gift annuity. These are offered by several financial services companies, colleges, and universities. You make a donation. The charity pays you a fixed return on your money, say 8% a year. You can arrange for payments to start immediately or later. The longer you delay, the greater your tax deduction may be. A 40-year-old who buys a fixed annuity that will start paying him income at age 65 can write off 90% of the value of the gift.

Peter Lynch retired in 1990 from managing the Magellan Fund, the best-performing of all mutual funds over a 15-year period. He is a trustee of the Fidelity Group of Funds and his new book, *Beating the Street*, was published in March by Simon & Schuster.

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