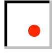

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Retiring With a Windfall? How to Give It Away

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By Jennifer Barrett
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In the mid-1990s, Barbara Harman and her husband, William Cain, enjoyed a spike in the value of some stocks they'd held for years. Longtime college professors, they'd already set aside enough money for their own retirement, so they decided to give away most of the unexpected windfall -- about $400,000. Then came the tough part: determining how best to donate their money.

It's an enviable challenge, and one a growing number of older Americans are facing. The average net worth of those 65 or older has increased nearly 80 percent in the past two decades, and those who reach the age of 65 can now expect to live another 19 years on average, according to a government report released this spring. "There is a lot more wealth out there, and more people are thinking about giving as part of a lifetime experience instead of just leaving everything to their estate," said Virginia Esposito, the founding president of the Washington-based National Center for Family Philanthropy. "People are leading longer, healthier lives, and they want to be active with the causes, institutions and people they really care about."

For Harman and her husband, who commute between Boston and Washington, the solution was to create a family foundation. It's an increasingly popular choice: In 2006, there were 35,693 family foundations registered -- nearly triple the number in 1990, according to the Foundation Center. But it's only one of several vehicles available today for those who want to make donations while they're alive, after they've passed, or both.

"People often aren't aware of all the options out there," said William Jordan, president of the Sentinel Group, a financial advisory firm. Picking the right one, though, can be critical in order to maximize the contributions, minimize the tax burden and make sure that the donor's financial goals are met.

After establishing that clients have more than enough money to meet their own needs, advisers like Jordan say the next step is figuring out what clients want to accomplish with their gift. Do they want to give cash to loved ones or direct money for a specific purpose -- like college tuition or a medical bill? Donate to one charity or give to many? Draw an income from the money they've set aside for charity or give it all away at once?

For Harman, forming a foundation was an obvious choice. She was already a board member of the Harman Family Foundation, which her father, Sidney, and stepmother, Rep. Jane Harman (D.-Calif.), had created about a dozen years earlier. Harman has since become executive director after retiring from Wellesley College, where she was an English professor. She liked the fact that any money they put into the Harman Cain Family Foundation is tax deductible. And they can draw from it at any time to make gifts to various causes -- as long as the annual donations equal at least 5 percent of the foundation's assets (now worth around $1 million). So far, they've given to groups ranging from the Boston-based Actors' Shakespeare Project to the National Gallery of Art in Washington. As director of the Harman Family Foundation, Harman has also helped oversee the construction of the Harman Center of the Arts and the publication of the annual Catalogue for Philanthropy: Greater Washington (http://www.cfp-dc.org).

The administrative costs and time required can be a turnoff for some. But for donors like Harman and her husband, who enjoy being actively involved, it was the right fit.

For those who want to see the effects of their gifts while they're still alive but prefer to keep administrative responsibilities and costs low, the donor-advised fund is a popular option, said Nancy Bryant, a financial adviser at Bryant Financial Advisory in Lutherville. These can be set up for as little as $5,000 (Schwab's or Fidelity's charitable gift funds) or $25,000 (Vanguard's Charitable Endowment Program). Donors can deduct the full value of the contribution from their taxes and typically have several choices on how the contribution will be invested. And donors usually can direct the money to various charities over several years.

Donors with a particular charity in mind might prefer a charitable lead trust. They can get a tax deduction (if they're listed as the trust owner). The designated charity draws a fixed annual income from the trust while the donor is alive; upon death, the remainder typically goes to the designated beneficiary or beneficiaries (like children) -- and any growth in the trust's assets passes on free of gift or estate taxes. "It's a chance to meet the goal of giving to charity while you're alive, but also provide something to your heirs," Bryant said.

The charitable remainder trust does the opposite: providing donors a steady stream of income while they're alive, and then giving the remainder to a named charity (or charities) upon their death. Gretchen Bolton, a Bethesda-based Certified Financial Planner with AXA Advisors, says even some of her clients who don't need the income prefer this because they can use all or most of the income to cover the premiums for a more substantial life insurance policy for their heirs. That way, both their heirs and their favorite cause benefit. "It is good for everybody," she said. (Some choose to designate a charity as the beneficiary of a life insurance policy, in order to increase the size of their gift.)

Many charities also offer pooled income funds, which consist of money or assets from various donors that are maintained by the charity itself. Donors receive a partial charitable deduction, and income from the fund is distributed among them proportionally each year based on their individual gifts. When a donor dies, the remainder of his portion is transferred to the charity. Mark Dickerson, a financial adviser with Wachovia Securities in Towson, said many of his clients like it because it's simple to arrange and can have a bigger impact than their single gift would. "It appeals to people who want to donate a little less," he said. "You get income, it lowers the potential estate taxes -- and all you have to do is sign a document."

Many charities also sponsor charitable gift annuities, with a fixed percent of income paid out regularly to the donor. Upon death, the remainder of the donor's annuities goes to the charity.

Having a foundation, a fund or a trust isn't required in order to enjoy the tax benefits of giving. Sometimes it really is as simple as writing a check. Under current tax laws, anyone can give an individual gift of up to $12,000 without either party being taxed on it (couples can donate up to $24,000). Financial advisers say many retirees take advantage of this gift exclusion to help their kids or grandkids come up with a down payment on a home or cover education expenses. Another option is to direct a gift for a specific purpose -- if a loved one is hit with an unexpected medical crisis, for example. Anyone can give unlimited amounts to pay for school tuition (but not books or supplies) or qualified medical expenses without owing gift taxes, as long as the money is given directly to the school or health care provider.

Jim Pearman, a financial adviser at Fee-Only Financial Planning in Roanoke, Va., said some clients combine a gift and loan. Grandparents could draw up a loan for any amount lent over $24,000 to help a family member cover the down payment or start a business, for example; then, each year, forgive (or "gift") up to $24,000 of the balance so neither party pays gift taxes. It's important to set up a formal agreement, however, using the applicable federal rate (a minimum required interest rate generally lower than those offered by lenders; see http://www.IRS.gov for current rates). Interest payments can be included in the amount forgiven. "We see this fairly often since it allows the client to give someone a lump sum, and then forgive the whole note over time," says Pearman.

Another way to help out with education costs is to set up a 529 plan, in which the principal grows tax-deferred and distributions used for the beneficiary's college costs are tax exempt. Some states also provide state income tax deductions for all or part of the donor's contributions. It's worth shopping around, as plans vary by state, and some have lower associated costs and fees than others.

A donor can always make a direct gift to a charity too. But financial adviser Pamela Shortal, managing director of the investment advising firm Harris SBSB in McLean, advises gifting securities that have appreciated instead. That way, the client can get a tax deduction for the full market value and avoid paying capital gains taxes (the charity can sell the stock without paying taxes). Direct gifts and 529 plans can be set up pretty easily without assistance; but for most other options, it's wise to seek out an adviser.

In the end, no matter the amount donated or the method, the example retirees set for their heirs can be almost as meaningful as the money they give away. Just ask Barbara Harman, who remembers how much of an influence her parents' generosity had on her. "Giving has become a valuable part of the culture of our family," she says, "and I definitely want to pass that on."

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