SCHUBERT & COMPANY
FAMILY WEALTH ADVISORS

CPT Planning

Using Forward Gifts to Charity for CPTs to Gain Additional Deductions

While CPTs are usually established to continue for the donors' lifetimes, the donors have the option to make a "forward gift" of the principle to the remainder charity (Donor Advised Fund), while they are still living. This "forward gift" captures an additional charitable deduction because the donor is gifting a lifetime income stream to the charity. Given the current interest rate environment, the rules for how to calculate this second deduction (first deduction was at original funding) are strongly in the taxpayers favor and can result in a total charitable deduction in excess of the original value contributed when the two deductions (initial funding and forward gift) are combined.

The best way to illustrate this point is to walk through a quick case study:

> Husband (H) and Wife (W) both age 55 in 2023, already plan to leave some money to charity in their wills, so in order to capture an additional tax benefit for something they are already planning to do, they decide to contribute $500K into a CPT in 2023. Using the IRS promulgated 2.2% discount rate for "young funds" under the CPT rules, their initial charitable deduction at the time of funding is approximately 51%, or $255,000.
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> H&W feel great about their decision and receive a 9% distribution[i] of income from their CPT in 2024, 2025, and 2026. At the beginning of 2027, H&W decide they don't need the additional income from the CPT and they like the idea of making a "forward gift" into their donor advised fund, from which they do all their charitable giving. Because their CPT is no longer a "young fund" the IRS uses the actual historical distribution rate (9%) for the variable in calculating the value of the income stream that is being donated to charity via the forward gift. Using 9%, the donor's retained portion of income for their remaining lifetimes at the time of the forward gift equals 87.8% of the principal value in the CPT, or $438,975. This is the FMV of the income stream being gifted to charity, and thus, is the amount of the second charitable gift.

In summary

H&W received the same income from their $500K as if they had simply kept the funds in their name, however, by flowing the funds through the CPT structure and using the forward gift concept, they captured a charitable deduction of 51% in the year of contribution and then another 87.8% in the year of forward gift for a total charitable deduction of 138% of the original amount contributed.

H&W are under no compulsion to use the forward gift to charity concept. It is simply planning flexibility that is built into every CPT. The logic for why H&W might want to do a forward gift could also be different than simply the fact that they don't need the income from the CPT any longer. Let's assume their financial picture had become tighter than originally expected at the time of contribution to the CPT. The use of the forward gift into their donor advised fund allows them to use the principal amount in the CPT to subsidize their desired giving over several years when their annual income might not be sufficient to continue their desired level of giving.

In other words, the two reasons to make a forward gift are the exact inverse of each other. The first reason might be because finances have become more flexible, and the donors do not need income from their CPT any longer. Conversely, it could be that their finances have become less flexible, thus the ability to supplement their current charitable giving from funds outside their income is a good thing. There is LOTS of planning flexibility in using a CPT. The lowest amount needed to fund a CPT is $100,000, but because CPTs do generate annual K-1s and have higher tax compliance needs relating to reporting the annual income, higher amounts work much better.

This sounds too good to be true. Where is the logic?

This beneficial situation regarding the IRS code and its rules on the interest rates used to calculate the deduction happen to fall in the donor's favor given the rapid rise in interest rates during 2022. However, the circumstances could easily be reversed. If the interest rate used to discount the initial contribution happened to be lower than the actual returns experienced by the donors in the first three years of investing, under the same contribution scenario as above, the donors would walk away with a charitable deduction of less than 100% of the value contributed. The interest rate environment for investing and the IRS code's assumptions built into the rules for CPTs (also known as pooled income funds) happen to fall in the donor's favor for the remainder of the calendar year 2023. Beginning Jan 1, 2024, the cradle to grave 138% charitable deduction will become lower; however, it is likely still above 100% given the high interest rate returns that can be earned across a well-diversified investment portfolio using alternative investments in the private debt space.[ii]

Schubert & Co – contact us about CPTs

Schubert & Company currently manages an aggregate value in excess of $22 million in CPT structures[iii]. For more information about how a CPT might be beneficial for you or your family, please call us at 972-422-1010, or e-mail Kelley Schubert kelley@schubertandcompany.com or Cole McClellan cole@schubertandcompany.com. We have a practice focused on helping generous Christian-minded families make bold commitments in funding the Kingdom with their resources. CPTs are just one tool in the toolbox.

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Past performance is not a guarantee of future results. Values change frequently and past performance may not be repeated. There is always the risk that an investor may lose money.

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[i] The 9% return is for illustrative purposes only and is not an actual return on an investment. It represents the distribution amount (dividend paid) and not the total return. This illustrative performance is for a specific investment portfolio with a specific investment purpose.

[ii] The 9% return is for illustrative purposes only and is not an actual return on an investment. It is an estimate of the total return including dividends that gets a total deduction of 138% when including the forward gift deduction. If interest rates remain at the current level (March 2023) and the initial discount rate on the initial donation to the CPT increases a small amount in future years, it is still reasonable to expect including the forward gift will get a total deduction of 100% or more based on the current illustration. This illustrative performance is for a specific investment portfolio with a specific investment purpose.

[iii] Data is as of 12/31/2022.