Charitable Gift Financing

Amplifying Giving While Maximizing Tax Benefits

High-wage earners and profitable small business owners have the potential to amplify their charitable giving significantly by leveraging third-party financing. Capitalizing on tax laws and regulations established since 1978 enables these individuals to obtain substantial tax benefits while pursuing charitable giving on a scale previously unattainable.

Charitable donations have long been a meaningful and rewarding endeavor.

Through Charitable Gift Financing (CGF), these contributions can be greatly amplified, offering a powerful strategy that not only maximizes the impact of giving but also reduces tax liabilities.

What is Charitable Gift Financing?

Charitable Gift Financing is a strategic financial tool that benefits donors, charities, and lenders alike. It allows highearning, charitably inclined individuals to utilize third-party financing to make substantial, tax-deductible contributions to qualified 501(c)(3) organizations.

Consider a donor who wishes to contribute a significant amount but only has the funds available for a modest gift. By leveraging a third-party lender, the donor can make a much larger donation. The loan can be repaid in the future, often using proceeds from a life insurance policy. The Internal Revenue Code (IRC) Section 170(a) allows taxpayers to take a charitable deduction for the donation in the year it is made, regardless of when the loan is repaid (Rev. Rul. 78–38, 1978–1C.B.67, Granan v. Comm. 55 T.C. 753).

This approach not only empowers donors to make larger cash donations without straining their immediate cash flow, but it also helps minimize current income and capital gains tax liabilities. Moreover, if the donor wishes to continue charitable giving in subsequent years, they can continue to borrow, further benefiting from favorable tax treatment.

The Economic Substance Doctrine

The Economic Substance Doctrine is a principle in U.S. tax law that disallows transactions lacking genuine economic purpose beyond reducing tax liability. Its goal is to prevent taxpayers from engaging in transactions that technically comply with the tax code but have no substantial business or economic reasons apart from generating tax benefits.

The earliest mention of what later became the Economic Substance Doctrine can be traced back to the 1935 case of Gregory v. Helvering, 293 U.S. 465 (1935). In this landmark case, the U.S. Supreme Court established the precedent that tax-motivated transactions without real economic impact may be recharacterized by the IRS to deny tax benefits.

After Gregory, courts gradually refined the concept. Over time, it evolved into a more formal judicial doctrine that would evaluate whether a transaction has any economic substance beyond tax avoidance. Later cases, such as Knetsch v. United States (1960) and Frank Lyon Co. v. United States (1978), further developed the two-pronged test of the doctrine (business purpose and economic effect), which was finally codified under Internal Revenue Code Section 7701(o) as part of the Health Care and Education Affordability Reconciliation Act of 2010.

Under the two-prong test codified in 2010 through IRC Section 7701(o), a transaction must satisfy:

- **Objective Test:** Meaningfully change the taxpayer's economic position (outisde of tax benefits), and
- **Subjective Test:** Be driven by a substantial purpose beyond tax savings.

In the context of Charitable Gift Financing, the transaction passes the **Objective Test** because it creates a real financial obligation for the donor to repay the loan. It also changes the donor's economic position by enabling a substantial charitable contribution with real-life benefits like goodwill and improved reputation.

The **Subjective Test** is met as well because the transaction amplifies the donor's charitable giving beyond what would be feasible without the use of financing, aligning with the donor's philanthropic goals. Financing a charitable contribution allows the donor to make a more immediate and impactful contribution, further demonstrating the transaction's purpose beyond tax savings.

The Benefits of Charitable Gift Financing

Increased Charitable Impact:

Through third-party financing, donors can contribute significantly more to their matched causes. A donor can finance up to 90% of their charitable gift, giving them the ability to maximize their impact with only a fraction of the immediate cash outlay.

Preservation of Cash Flow:

By financing the donation, donors can preserve their current cash flow for other financial needs or investments, while still achieving their philanthropic goals.

Tax Savings:

Charitable cash donations made, using Charitable Gift Financing are fully tax-deductible (up to 60% of the taxpayer's Adjusted Gross Income ("AGI")) under IRC Section 170(a). As a result, donors can reduce their taxable income substantially in the year the donation is made, without having to pay off the loan first.

Legacy of Giving:

An additional and viable component of CGF is the creation of a lasting legacy. By structuring the loan repayment through life insurance proceeds, donors can ensure that their philanthropic efforts continue to make an impact even after they are gone.

Addressing Compliance and Economic Substance

To ensure full compliance with IRS regulations, particularly in regard to the Economic Substance Doctrine, it is essential to document the charitable intent and broader purpose of the gift. Taxpayers and their advisors must establish that the transaction serves the donor's economic interests and longterm charitable goals beyond just achieving tax savings. Proper documentation, including a written tax opinion and detailed records of the transaction's purpose, helps safeguard against IRS scrutiny.

Additionally, the financing itself must have a tangible impact. The taxpayer takes on a real debt obligation that, while it may be repaid through life insurance proceeds or future earnings, remains a bona fide liability. Thus, the CGF strategy passes both prongs of the economic substance test.

Conclusion

Charitable Gift Financing offers a unique and impactful solution for high-income individuals looking to maximize their philanthropic impact while benefiting from substantial tax savings. By strategically leveraging third-party financing, donors can make larger contributions to the causes they care about, preserve their financial security, and create a lasting legacy of giving.

However, it is crucial for taxpayers to work with knowledgeable advisors who understand the complexities of Charitable Gift Financing, the Economic Substance Doctrine, and all applicable tax regulations. With the right planning, documentation, and professional guidance, Charitable Gift Financing can be a highly effective strategy to amplify charitable giving and secure meaningful tax benefits.

About Wealth Excel LLC

Wealth Excel is a premier consulting firm based in Brea, California, specializing in wealth growth strategies for profitable small business owners and high-wage earner clients. Our services include innovative charitable gift financing, custom-designed private retirement plans, and comprehensive investment portfolios. With over 30 years of combined experience, our expert team is dedicated to meeting the sophisticated financial goals of our clients.

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