If you made a $10,000 gift to your favorite charity and could receive a tax credit that reduced your Montana income tax liability by over $3,600, would you be interested? A tax credit is a dollar-for-dollar reduction in the amount of actual income tax owed, while a tax deduction reduces your taxable income.

This MontGuide explains how charitable gift annuities can meet both the altruistic and tax savings goals of many Montanans. While other types of gifts are also eligible for the Montana Endowment Tax Credit (METC), the most common is through charitable gift annuities. Additional gifts qualifying for the METC include: charitable remainder trusts; charitable lead trusts; pooled income funds; charitable life estates; and paid-up life insurance policies.

Montana Legislation
In 1997, the state Legislature created a tax credit to reduce a taxpayer's Montana income tax liability. The Legislature wanted to encourage gifts to endowments held by Montana tax-exempt charitable organizations. The 2019 Legislature renewed the METC credit to be effective through December 31, 2025.

Federal Legislation
With the new federal tax law, taxpayers can claim larger standard deductions on their federal income taxes than in the past. The standard deduction in 2020 for singles is $12,400; for those filing jointly, $24,800. Thus, many taxpayers may not claim deductions for charitable contributions on their federal returns.

For individuals who forgo a charitable deduction because they claim the standard deduction, there are no savings on federal income taxes because of a charitable gift. The METC still applies however, resulting in substantial income tax savings for Montanans on their Montana income tax return.

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

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

The first criterion is an individual or couple making a gift must utilize one of the nine gift types listed in the law to a qualified permanent endowment. A qualified endowment is a permanent and irrevocable fund established for a specific charitable, religious, educational or philanthropic purpose, except as provided below. 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 must hold the endowment.

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 charity or non-profit endowment using the principal from a gift directly for construction, renovating, or purchasing operational assets, for example, buildings or equipment, do NOT meet the definition of a permanent endowment. Therefore, a gift to a fund used directly 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 filing jointly, a business entity does not make a planned gift. Montana businesses claim an METC by 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 have 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). S corporations, partnerships, and limited liability companies pass METC qualifying contributions to their owners who then list the amounts on their Montana individual income tax returns.

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

**Estates.** An estate can also make a gift to a qualified permanent endowment that is eligible for the METC. A personal representative or trustee can make gifts from an estate as directed by a deceased person’s 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, the estate can claim 20 percent. 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 wrote “$60,000 shall be donated to a local 501(c) (3) health care foundation in the form of a permanent endowment that would support Alzheimer’s disease training for certified nurse assistants working in an assisted living facility, nursing home, or similar facility in Bozeman, Montana.”

The calculation of the METC for Bill Moore’s estate gift is $12,000, which is 20 percent of the $60,000 gift ($60,000 x 20% = $12,000). However, the Moore estate has a limit of $10,000, the maximum METC an estate can claim.

To structure a qualifying METC estate charitable gift, seek the assistance from an attorney, who can work in conjunction with a certified public accountant or other financial professional, to effectuate, or put into force, your wishes.

**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.
- With a deferred payment, the charity begins the payments at a future date designated by the donor.

Immediate and deferred payment charitable gift annuities contain two components:
1. Lifetime income paid to the donor beginning immediately or at a designated date 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.

**How Does a Charity Determine the Interest Rate Paid 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). In establishing rate guidelines, factors include life expectancies, current interest rates on securities, and market assumptions.

Immediate payment gift annuity rates are available from the ACGA for one-life and two-lives. Rates for a one-life immediate payment annuity in five-year increments are in Table 1. Rates for Two Lives–Joint and Survivor immediate annuities are 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: Suggested Maximum Gift Annuity Rates, American Council on Gift Annuity Rates (ACGR) for One Life (Immediate Payment) effective July 1, 2020

<table>
<thead>
<tr>
<th>Age</th>
<th>Annuity Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>64-65</td>
<td>4.2%</td>
</tr>
<tr>
<td>70</td>
<td>4.7%</td>
</tr>
<tr>
<td>75</td>
<td>5.4%</td>
</tr>
<tr>
<td>80</td>
<td>6.5%</td>
</tr>
<tr>
<td>85</td>
<td>7.6%</td>
</tr>
</tbody>
</table>

Table 2: Suggested Maximum Gift Annuity Rates, American Council on Gift Annuity Rates (ACGR) Two Lives: Joint and Survivor (Immediate Payments) effective July 1, 2020

<table>
<thead>
<tr>
<th>Younger Age</th>
<th>Older Age</th>
<th>Annuity Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>65</td>
<td>65</td>
<td>3.8%</td>
</tr>
<tr>
<td>70</td>
<td>76-78</td>
<td>4.4%</td>
</tr>
<tr>
<td>75</td>
<td>77-78</td>
<td>4.8%</td>
</tr>
<tr>
<td>80</td>
<td>84</td>
<td>5.7%</td>
</tr>
<tr>
<td>85</td>
<td>89</td>
<td>7.0%</td>
</tr>
</tbody>
</table>

How Does a Charity Determine the METC on a Charitable Gift Annuity?

The first step is to calculate the charitable portion of the gift. 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.

The second step is to discount the present value by the Applicable Federal Rate (AFR) at the time of the gift. The Internal Revenue Service publishes the rate monthly. For the monthly rate go to: https://apps.irs.gov/app/picklist/list/federalRates.html. The AFR rate is typically found in Table 5 of the monthly ruling document. The AFR in July 2020 was 1.17 percent.

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

What is the METC on an Immediate Payment Charitable Gift Annuity?

With an immediate payment charitable gift annuity, an annuitant 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 5.1 percent (See Table 1). Claude will receive $765 annually for the rest of his life from the local community foundation ($15,000 gift x 5.1% gift annuity rate = $765). The tax-free portion of the $765 payment is $575.28. The rest ($189.72) is as ordinary income.

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 15.9 years (based on actuarial tables), the current ACGA rate (5.1 percent), the value of the asset funding the contract ($15,000), discounted by the AFR rate (2.0% in this example).

To calculate the charitable portion of Claude’s gift, subtract the present value of his income payments from the amount of the gift ($15,000 gift - $9,148.65 present value = $5,851.35). The charitable portion of Claude’s gift annuity is $5,851.35.

Table 3: Montana Income Tax Savings with an Immediate Payment Charitable Gift Annuity for Claude (Example C)

<table>
<thead>
<tr>
<th>Tax Treatment</th>
<th>Immediate Payment Gift Annuity (Rounded)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original Gift Amount</td>
<td>$15,000.00</td>
</tr>
<tr>
<td>Charitable Portion of the Gift</td>
<td>$5,851.35</td>
</tr>
<tr>
<td>METC (40% of charitable portion) tax savings</td>
<td>$2,340.54</td>
</tr>
</tbody>
</table>

To determine Claude’s METC, multiply the charitable value of his gift ($5,851.35) by 40 percent, resulting in an METC of $2,340.54 ($5,851.35 x 40% METC = $2,340.54). Claude’s income tax liability is $1,726, down from the almost $4,000 he would have owed without the METC ($4,000 Montana tax owed - $2,340.54 METC = $1,726) after the application of the METC. The METC saved Claude $2,340.54 in Montana income taxes. All this information is available in a printed format provided by the non-profit.

METC rules stipulate the donor cannot gift the remaining annuity payments back to the charity within five years of
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.

What is the METC on a Deferred Payment Charitable Gift Annuity?

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 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. The result is the donor's eligibility for a larger METC.

The annuity rate for a deferred payment charitable gift annuity must be at least five percent 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: Marie and Bill 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 Marie and Bill with an illustration for a $10,000 gift in exchange for income payments beginning when Bill reaches age 90.

Based on their current ages (Marie, 65 and Bill, 70) and a deferral period of 20 years for the payments to begin, the illustration revealed Bill and Marie qualified for an annuity interest rate of 14.2 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 that the charitable portion of their gift is $9,133.70. Marie and Bill are eligible for a METC of $3,653.48 ($9,133.70 charitable portion of gift x 40% METC = $3,653.48).

What are the Montana Income Tax Savings if a Donor Prefers to Make an Outright Gift?

What if Marie and Bill 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 taxable income and NOT qualify for the METC, their income tax benefits would have been substantially lower.

Example E: Marie and Bill receive $690 in savings on their Montana income taxes for their $10,000 cash gift [$10,000 x 6.9% (the top Montana income tax rate) = $690]. While Marie and Bill have a 24 percent federal income tax rate, they will not save any taxes because they took the marital standard deduction of $24,800. This is an amount larger than their total itemized deductions.

By utilizing the deferred payment charitable gift annuity, Marie and Bill received a METC of $3,653. A comparison of their income tax savings with the deferred payment gift annuity and an outright gift is in Table 4.

<table>
<thead>
<tr>
<th>Tax Treatment</th>
<th>Deferred Payment Gift Annuity</th>
<th>Outright Gift</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Original Gift Amount</td>
<td>$10,000.00</td>
<td>$10,000.00</td>
</tr>
<tr>
<td>B. Charitable Portion of the Gift</td>
<td>$9,133.70</td>
<td>$10,000.00</td>
</tr>
<tr>
<td>C. METC (40 percent of charitable portion)</td>
<td>$3,653.48</td>
<td>N/A</td>
</tr>
<tr>
<td>D. Montana Income Tax Savings (6.9% tax rate)</td>
<td>$3,653.48</td>
<td>$690.00</td>
</tr>
</tbody>
</table>

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) (Form 260) for the year of the gift. Form QEC is available on the Department of Revenue's website: https://app.mt.gov/myrevenue/Endpoint/Form/QEC?from=Directory

A charity should provide a taxpayer with information indicating what amount of the donation qualifies for the METC. The charity should also provide supporting
documentation to back up the taxpayer’s claim for the METC on their Montana tax return. Filers must attach a receipt for their contribution issued by the charity or institution holding the endowment or planned gift.

Taxpayers who file electronically do not mail the QEC form, unless contacted by the Montana Department of Revenue to do so. Subchapter S corporations, partnerships and limited liability corporations do not submit the Qualified Endowment Credit (QEC) form with their Montana income tax return. Charitable income tax deductions for these types of businesses pass through to shareholders, partners, or members in the same way as income and losses. The amount of the charitable contribution proportional to each taxpayer appears on the federal schedule K-1 statement.

Additional Types of Gifts Qualifying for the METC

There are additional types of gifts that qualify for the METC including: charitable remainder trusts; charitable lead trusts; pooled income funds; charitable life estates; and paid-up life insurance policies.

Charitable Remainder Trusts

Donors typically contribute cash or property to charitable remainder trusts for three reasons:
1. To avoid a capital gain on appreciated assets;
2. To generate income; and
3. To leave gifts to favorite charities.

The trustee manages and invests the assets within the charitable remainder trust 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 life or the end of the trust term.

Trustees of a remainder trust can be charitable organizations, banks, trust companies, or even the donor. Trustees control the property in a trust. They have a legal obligation to administer the trust solely for the purpose(s) specified in the trust document.

Generally, attorneys representing the charity and the 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. After the establishment of a charitable remainder trust, donors can make additional contributions to it during future years.

Income beneficiaries of a charitable remainder trust can be one or more individuals of the donor’s choosing, including the donor. The trust’s beneficiaries receive income annually during their lives. At the end of the trust’s term, the assets pass 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. The statement must appear in the governing document of the trust. The donor generally cannot change his/her mind and remove the assets from the charitable remainder trust or redirect the ultimate gift to a non-endowment purpose absent compliance with the Montana Uniform Trust Code.

The donor should decide which of the two primary types of charitable remainder trusts would work best for his/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 assets in the trust to income beneficiaries after the annual re-evaluation of the assets.

Charitable Lead Trusts

Another form of a charitable trust is the charitable lead trust. A donor contributes to 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, the remaining assets return 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 an annual fixed dollar amount to charity.

Pooled Income Funds

Donors can make contributions to pooled income funds. The donor’s funds and gifts from other donors become commingled 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/her units of participation. Net investment income distributes to the pooled income fund donor annually during his/her lifetime.

When a donor passes away, the portion of fund assets attributable to him/her passes to the charity to fulfill the donor’s stated charitable purpose. The charitable deduction available for a pooled income fund gift is the present value
Charitable Life Estate

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

After the donor’s death, the charity sells the home and uses the proceeds to fund a charitable permanent endowment. By entering into an irrevocable agreement for a charitable life estate, the donor received a 40 percent METC (up to the maximum of $10,000 annually).

Paid-Up Life Insurance Policy

Life insurance policies with all premium payments paid qualify for the METC when gifted to a charity. 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 up to a maximum of $10,000 annually. The replacement value is available from the life insurance company.

Summary

The METC encourages Montanans to donate to 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 officer how to structure the gift.

The METC provides Montanans with incentives for philanthropy by significantly increasing the tax benefits for giving. For individual and joint filing 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 those filing jointly. 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 with a limit of $10,000 annually.

Online Resources

- Montana Department of Revenue Qualified Endowment Credit form: https://app.mt.gov/myrevenue/Endpoint/Form/QEC?from=Directory
- Applicable Montana Code Annotated 2019, Montana Endowment Tax Credit, Title 15, Chapter 30, Specific Tax Credits and Tax Checkoffs, 15-30-2326 though 15-30-2329
- 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

Representatives of the following organizations reviewed this Montguide and recommend its reading by Montanans who are interested in learning about the METC.

- Business, Estates, Trusts, Tax and Real Property Section: State Bar of Montana
- The Catholic Foundation for the Diocese of Helena
- Montana Community Foundation
- Montana State University Alumni Foundation

The authors also wish to extend appreciation to Montana residents who also reviewed the publication and made many worthwhile suggestions.

Disclaimer

The information in this MontGuide is for educational purposes only. No endorsement of any charity is implied. Furthermore, there is no discrimination against other charities or nonprofits not mentioned as examples.

Software Calculations

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