

# INVESTMENTS & WEALTH REVIEW

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Elevating the Practice of the Advice Professional

## Beyond the Portfolio: Navigating the Philanthropic Adjacency with Charitable Gift Planning

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INVESTMENTS & WEALTH INSTITUTE®

# Beyond the Portfolio

## NAVIGATING THE PHILANTHROPIC ADJACENCY WITH CHARITABLE GIFT PLANNING

BY GARY PFORZHEIMER

FOR ULTRA-HIGH-NET-WORTH (UHNW) families, wealth is rarely just a number on a balance sheet. It is a tool for impact, a vehicle for legacy, and a complex puzzle of tax and estate considerations.

This issue of the *Investments & Wealth Review* focuses on adjacencies—those critical areas of support that exist just outside traditional financial advice and portfolio management but are essential to a client’s holistic financial health. And perhaps no adjacency offers more strategic value—or more opportunity for advisor differentiation—than planned giving.

Although many advisors are comfortable discussing checkbook philanthropy, the true opportunities lie in structured charitable contributions that align a client’s altruistic goals with their financial needs. By mastering tools such as charitable trusts, you can help clients solve for tax alpha, create sustainable income streams, and deepen multigenerational bonds within their families.

### The Advisor’s Toolkit: Beyond the Basics

Donor-advised funds (DAFs) and private foundations are popular giving vehicles, but UHNW clients often require more robust planned giving to meet complex goals. Among the charitable tools available to the advisor are the following.

#### *Charitable Remainder Trust*

A charitable remainder trust (CRT) is the workhorse of planned giving. It is a “split-interest” vehicle: The donor (or other beneficiaries) receives income for a term of years or

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for life, and the remainder goes to charity. The donor picks a percentage (5 percent or greater, maximum of 50 percent based on age), which is applied to the market value of the trust each year to determine the payout.

**TAX ADVANTAGE.** The donor receives a current income-tax charitable deduction for the present value of the charity’s remainder. There is no capital-gains tax on the transfer of appreciated assets to a CRT and, as a tax-exempt entity, a CRT pays no capital-gains tax when it sells appreciated assets, allowing the full proceeds to be reinvested to produce income.

**SUITABILITY.** A CRT is ideal for clients needing to diversify out of a concentrated position without triggering capital gains while maintaining or increasing cash flow.

See the sidebar, “The Versatile Charitable Remainder Unitrust,” for additional details about a particularly useful CRT, the charitable remainder unitrust (CRUT).

#### *Charitable Gift Annuity*

A charitable gift annuity (CGA) is an annuity contract issued by a charity in exchange

for a contribution. The annuity payments are backed by the financial resources of the charity. Gift annuities are subject to state regulation, and most charities adhere to annuity rates provided by the American Council on Gift Annuities.

**TAX ADVANTAGE.** The donor receives a current income-tax charitable deduction for the difference between the amount contributed and the value of the annuity. A portion of the annuity payments can be tax-free.

**SUITABILITY.** A CGA is good for clients wishing to make modest-sized contributions and secure a source of tax-favorable income for life.

#### *Charitable Lead Trust*

A charitable lead trust (CLT) essentially is the inverse of a CRT. The charity receives the “lead” income stream for a set period, and the “remainder” passes back to the donor or the donor’s heirs.

**TAX ADVANTAGE.** CLTs are premier estate-tax planning tools. They can be structured to provide significant gift-tax deductions, allowing assets to pass to heirs with significantly reduced gift and estate-tax cost.

**SUITABILITY.** A CLT is best for high-income clients with taxable estates who do not need current income but want to pass wealth to the next generation efficiently.

#### **How It Works: Mechanics and Financial Illustrations**

For the financial advisor, the “how” is as important as the “why.” Every planned gift involves a calculation of the charitable deduction, which is based on the present value of the interest that passes to charity.

## THE VERSATILE CHARITABLE REMAINDER UNITRUST

A charitable remainder unitrust (CRUT) is an irrevocable trust that provides an annual income stream to beneficiaries, with the remainder passing to charity. The trust pays a fixed percentage (5 percent or greater, with a maximum of 50 percent based on age), which is applied to the market value of the trust each year to determine the maximum annual payout amount. There are four primary variations based on how payouts are calculated:

**STANDARD CRUT (SCRUT).** Pays a fixed percentage of the trust's value, revalued annually. If the trust lacks sufficient investment income, principal may be distributed to make the payout.

**NET INCOME CRUT (NICRUT).** Pays the lesser of the fixed percentage or the trust's actual annual net income. This protects the principal value if earnings are low.

**NET INCOME WITH MAKEUP CRUT (NIMCRUT).** Similar to a NICRUT, but tracks deficiencies. If the trust earns more than the fixed percentage in later years, it can make up for previous years' shortfalls.

**FLIP CRUT.** Starts as either a net income type (often while holding illiquid assets such as real

estate) and "flips" to a standard CRUT after a triggering event, such as the sale of the asset.

Each type offers unique advantages for balancing immediate tax deductions, long-term asset growth, and flexible income timing. The four CRUT types are summarized in the table below.

### Income Beneficiary Taxation

Because the trust itself is tax-exempt, it accumulates various types of income: dividends, interest, realized capital gains, and tax-exempt. The payments to the income beneficiary of a CRT are taxed depending upon the trust's source of funds for the payment. The trustee must make payments to the income beneficiary according to a "worst-in, first-out" approach known as the four-tier payout rule, which requires that the most heavily taxed income be distributed before any tax-favored layers are reached.

Distributions are categorized and taxed in the following specific order:

**TIER 1: ORDINARY INCOME.** This includes interest, non-qualified dividends, and business

income. All current and accumulated (undistributed from prior years) ordinary income must be exhausted first.

**TIER 2: CAPITAL GAINS.** Once the ordinary-income tier is empty, the trust distributes realized capital gains. Short-term gains are distributed before long-term gains, and those subject to higher rates (such as collectibles) are distributed before those at lower rates.

**TIER 3: OTHER INCOME.** This consists primarily of tax-exempt income, such as interest from municipal bonds.

**TIER 4: TRUST CORPUS (PRINCIPAL).** If the first three tiers are exhausted, the distribution is treated as a tax-free return of the original principal.

Note that net income types (NICRUT, NIMCRUT) or a flip type before the triggering event will distribute only ordinary (tier 1) income. Essentially, the income beneficiary cannot receive the tax-favored income available in the higher tiers until the trust has distributed every dollar of the higher taxed income from the previous tiers.

### Four Types of CRUTs

TYPE	PAYOUT	IF NET INCOME IS LOW	BEST USE CASE
Standard (SCRUT)	Fixed percentage of annual trust value.	Assets must be sold to meet the full payout requirement.	Liquid assets (cash/stocks) where consistent income is the priority.
Net Income (NICRUT)	Lesser of fixed percentage or trust's net income.	Payout is limited to available net income with no catch-up later.	Illiquid assets or when preserving the trust principal is critical.
Net Income with Makeup (NIMCRUT)	Lesser of fixed percentage or net income, with makeup provision.	Shortfalls are tracked and paid out in future years if net income exceeds the percentage.	Supplementing retirement; allows deferred income while assets grow.
Flip CRUT	Starts as net income type then flips to SCRUT upon a specific event.	Limited to income until the flip, e.g., sale of a house, then pays a fixed percent regardless of net income.	Unmarketable or illiquid assets (real estate/private stock) intended for eventual sale.

When funding a CRT or a CGA, the client receives an immediate income-tax charitable deduction. For a CLT the client may claim an income-tax charitable deduction, but it usually is more advantageous to elect a gift-tax deduction to reduce or eliminate

taxes on the gift of the remainder to heirs. The deduction is calculated, as set forth in U.S. Treasury regulations, using three primary variables:

**THE VALUE OF THE ASSETS CONTRIBUTED:** The fair market value at the time of transfer.

**THE ESTIMATED TERM:** This is either the life expectancy of the beneficiaries based on Internal Revenue Service (IRS) mortality tables, a set number of years (up to 20), or a combination of the two.

**THE SECTION 7520 RATE:** This is the IRS’s discount rate, set monthly at 120 percent of the applicable federal mid-term rate.

Although not especially volatile, the Section 7520 rate has varied over the years from a high of 11.6 percent in the spring of 1989 to a low of just 0.4 percent during the summer of 2020. The rate has averaged 5 percent and is currently near that level.

### Selection of the Discount Rate

The IRS sets a new discount rate each month, and the client may choose from the discount rate in effect for the month in which the gift is made or either of the previous two months. Because the new discount rate is announced approximately two weeks before the beginning of each month, a savvy planner can arrange the timing of the gift to elect from among four rates: the current month; either of the previous two months; or, by postponing the gift, the coming month (see table 1).

The highest available discount rate results in a larger income-tax deduction for CRTs and CGAs. For example, a CRUT paying 5 percent for the lifetime of a 70-year-old would produce an income-tax charitable deduction of about 50.0 percent of the value contributed when the discount rate is 5 percent, but the deduction would be about 49.6 percent if the rate is 3 percent. A CGA paying 6.3 percent for the lifetime of a 70-year-old would produce an income-tax charitable deduction of about 36.6 percent of the value contributed when the discount rate is 5 percent, but the deduction would be about 25.8 percent if the rate is 3 percent.

The effect of the discount rate on the gift-tax deduction for a CLT is the opposite: The lowest available discount rate results in the

largest gift-tax deduction. For example, a charitable lead annuity trust (CLAT) paying an annuity to charity equivalent to 8.0 percent would produce a 100-percent gift-tax deduction when the discount rate is 5 percent. It could set the annuity to charity to 6.7 percent to zero out gift taxes if the rate is 3 percent.

### Solving for Common Client Goals

Perhaps one of the greatest advantages that charitable planning can bring to your practice is its ability to solve multiple problems simultaneously.

**GOAL: SUPPORTING A CAUSE WHILE PROTECTING THE FAMILY.** A client wants to give \$1 million to an alma mater but is worried about leaving enough for the heirs. By using a life insurance replacement strategy, the client can fund a CRT to support the school and use the tax savings and excess income from the CRT to pay premiums on a life insurance policy held in an irrevocable life insurance trust. This effectively replaces the wealth for the heirs with a tax-free death benefit.

**GOAL: TAKING MAXIMUM ADVANTAGE OF LUMPY INCOME YEARS.** In one-time-bonus or high-income years, a deferred CGA allows the clients to take the tax deduction now (when their bracket is highest) but delay the income payments until retirement (when their bracket may be lower).

### When a Charitable Gift Makes Sense: Identifying the Windows of Opportunity

A charitable gift is rarely a standalone decision. Often it is a response to a specific financial inflection point, particularly when combined with a client’s desire to support one or more charities. Understanding when

to introduce planned giving—particularly around liquidity events, retirement transitions, or estate planning—can position you as a trusted strategist.

### Scenario 1: The Liquidity Event (Concentrated Stock or Business Sale)

Consider a client, Sarah, who owns a highly appreciated private business she is preparing to sell for \$10 million. Her cost basis is negligible. A straight sale would trigger a massive capital-gains tax hit, potentially eroding 20–30 percent of her proceeds, depending on her jurisdiction. Transferring a portion of her business interest to a DAF, although an excellent idea in some cases, would solve only the capital-gains problem but not provide her with additional income for her lifetime.

**THE CHARITABLE GIFTS SOLUTION.** By transferring a portion of her business interest to a CRUT before the sale, Sarah avoids capital-gains tax on that portion, because the trust is a tax-exempt entity and creates an income stream for life.

**THE OUTCOME.** Sarah receives a significant income-tax charitable deduction in the year of the gift, establishes a variable lifetime income stream for herself (and/or others) based on the full pretax value of the assets, and eventually makes a transformative gift to the charities of her choice. These charities don’t need to be irrevocably named at the onset and, except when created in direct combination with a charity that will serve as trustee, usually are changeable.

### Scenario 2: The Retirement-Income Gap

Robert and Elena are retiring. Their portfolio includes \$2 million of low-dividend, highly appreciated growth stocks. They need more cash flow to maintain their lifestyle but

TABLE 1 Comparative Performance

VEHICLE	PRIMARY SOLUTION	INCOME STRUCTURE	TYPICAL TAX IMPACT
CRT	Conversion of appreciated assets	Fixed percent of annual value or a fixed dollar amount	Capital-gains tax deferred; immediate income-tax charitable deduction
CGA	High-yield fixed income alternative	Fixed dollar amount for life	Partially tax-free income, income-tax deduction; simple contract with charity
CLT	Estate-tax reduction	Payment to charity, then assets to heirs	Gift-tax deduction reduces or eliminates tax on transfer to heirs

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don't want to sacrifice a significant portion of their principal to capital-gains tax upon liquidation.

**THE CHARITABLE GIFT SOLUTION.** A CGA allows them to exchange volatile or low-yield assets for a fixed, predictable payment for life.

**THE OUTCOME.** This exchange can provide a higher payout rate than they could achieve through traditional fixed-income markets, and an income-tax charitable deduction can offset other retirement income. CGAs can be set to start at future dates, and creating a ladder of CGAs allows for contributions alongside traditional retirement vehicles and a large income stream when they choose to start their income payments.

### **Scenario 3: The Multigenerational Wealth Transfer**

The Miller family has a taxable estate valued at \$50 million. They are concerned about the 40-percent federal estate tax that will apply

to any assets passing to their children above the federal estate-tax exclusion. They also have a strong desire to support a local medical research center during the next 20 years.

**THE CHARITABLE GIFT SOLUTION.** A CLAT is established with a contribution of \$10 million in assets. The trust pays a fixed amount to the research center for 20 years and then distributes its remainder to the Miller's children.

**THE OUTCOME.** Although the Millers have made a taxable gift to their children of the trust remainder at the end of 20 years, the contribution to the CLAT generates a gift-tax deduction that can allow the trust assets to pass to their children without gift and estate taxes.

### **Conclusion: The Advisor as Architect**

Charitable gift planning is not merely a nice-to-have service. It is a sophisticated tool that bridges the gap between financial engineering and personal legacy. For the UHNW

advisor, moving beyond the portfolio into these structures demonstrates a level of care and expertise that standard wealth platforms cannot replicate.

By identifying the right scenarios—whether it's a business sale, a retirement transition, or a complex estate transfer—and applying the correct structural solutions, you can help clients do good in the world while optimizing their financial outcomes, deepening relationships, and building trust for years to come. ●

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