INTERMEDIATE TAXATION FOR GIFT PLANNERS

PG CALC WEBINAR

NOVEMBER 16, 2017

© All rights reserved

Presented by:

Bill Laskin, Vice President, Product Management
Jeffrey Frye, Senior Client Services Advisor
PG Calc
129 Mt. Auburn St.
Cambridge, MA 02138
617-497-4997
blaskin@pgcalc.com
jfrye@pgcalc.com

Introduction

The U.S. tax code is complex, including as it applies to charitable contributions. In this paper, we focus on some of the elements of the code with implications for charitable giving that are less well known or less well understood among gift planners. We have organized these topics into three sections:

1. provisions related to the charitable deduction
2. provisions related to income tax
3. provisions related to transfer tax

In addition to reviewing provisions of the existing tax code, we consider in the last section of the paper proposed provisions in the House and Senate tax reform bills that are racing through Congress as we write. Although, these provisions are a moving target – some may be dropped or revised as Congress works to reconcile differences between the two bills – several would represent a dramatic change in current tax law and could have a substantial effect on the tax benefits of charitable gifts.

Provisions Related to the Charitable Deduction

I. Pease Limitation

Reintroduced in 2013, the so-called "Pease limitation," which was originally introduced by Congressman Donald Pease in 1991, reduces itemized deductions by 3% of the amount by which a donor's adjusted gross income (AGI) exceeds a threshold amount. The threshold amount depends on the donor's filing status and is indexed annually for inflation. The threshold amounts in 2017 are shown below.

$313,800 for married couples who file jointly
$287,650 for heads of household
$261,500 for single filers
$156,900 for a married person filing separately

Although the Pease limitation is typically described as a reduction in deduction, for most taxpayers affected by it at all, it actually acts as a surtax on income. An example will clarify what I mean.

Harold and Jane are married and file jointly. They have adjusted gross income this year of $400,000, $86,200 over the threshold for applying the Pease limitation. This means they must reduce their total itemized deductions by 3% x $86,200 = $2,586. In addition to $20,000 in charitable deductions, they have also itemized $25,000 in state and local taxes and $10,000 mortgage interest, a total of $55,000 in itemized deductions.

If there were no Pease limitation, Harold and Jane would have taxable income of $400,000 - $55,000 = $345,000. This amount of taxable income puts them in the 33% federal income tax bracket and they would owe taxes of $89,067.

 © 2017 PG Calc Incorporated

With the Pease limitation, Harold and Jane's allowable itemized deductions would be $55,000 - $2,586 = $52,414, so they would have taxable income of $400,000 - $52,414 = $347,586. As a result, they would owe taxes of $89,920. The Pease limitation added $853, 33% of $2,586, to their tax bill.

Now, what would happen if Harold and Jane contributed an additional $1,000 this year, increasing their total itemized charitable deductions to $21,000? They're AGI is unchanged, so they must reduce their total itemized deductions by the same $2,586. However, they're allowable total itemized deductions are $56,000 - $2,586 = $53,414, they're taxable income is $400,000 - $53,414 = $346,586, and they will owe taxes of $89,590. In other words, giving away an additional $1,000 saved them $330, 33% of $1,000, in taxes. This means that the existence of the Pease limitation had no effect on the taxes they saved by giving more to charity.

On the other hand, what if Harold and Jane had an additional $1,000 of AGI instead. Now, their AGI would be $401,000, so their deduction reduction would be $2,616, their allowable itemized deductions would be $52,384, and their taxable income would be $348,616, so they would owe taxes of $90,260. Without the Pease limitation, their taxes would have been $90,250. In sum, the Pease limitation added $10, or 1% x $1,000, to their total tax. In effect, the Pease limitation increase Harold and Jane's tax bracket from 33% to 34%.

Most taxpayers who have an AGI above the Pease limitation threshold itemize enough deductions other than charitable deductions that every dollar of charitable deduction they itemize is fully deductible. Any deduction reduction is absorbed by other itemized deductions, such as those for state and local taxes and mortgage interest.

The Pease limitation cannot reduce a taxpayer's itemized deductions by more than 80% of their total deductions. As a practical matter, however, it is exceedingly rare for this limitation to the limitation to take effect. A taxpayer in a state with an income tax of 3% or more will increase her total deductions by 3% or more of every additional taxable dollar. This means her total itemized deductions, which include state and local taxes, will increase faster than the amount they must be reduced due to the Pease limitation.

It is also worth noting that the Pease limitation does not apply when computing the alternative minimum tax (AMT). This means that in an edge case, the Pease limitation could prevent a donor from paying AMT instead of regular income tax. Since the AMT top bracket is 28%, keeping a donor out of paying AMT likely would make her charitable deductions more valuable, since they would likely reduce income being taxed in a 33% or higher bracket.

II. Deduction Carryforward Rules

Charitable Deduction Limitations

We work in planned giving with the assumption that donors are looking to make complex charitable gifts which result in a combination of benefits – a certain level of financial support to the charity, a charitable income tax deduction for the donor, and some other benefit (such as income for life). The amount of the charitable tax deduction that a donor can actually use in any one year, however, depends on a number of variables. The easiest to understand is the limitation

© 2017 PG Calc Incorporated

based on the level of the donor's income, specifically, his or her adjusted gross income (AGI). The IRS rules ensure that a taxpayer cannot offset all of his or her taxable income with an equal amount of charitable deductions.

Amount of the Deduction a Donor May Claim Each Year

Generally speaking, the amount of charitable deductions that a donor can use in a single calendar year – deductions from *gifts of cash or other non-appreciated property* – may not exceed 50% of the donor's AGI. Further, the amount of charitable deductions that can be claimed in one year – deductions *from gifts of appreciated property* – may not exceed 30% of the donor's AGI. These are commonly referred to as the 50%/30% limitations.

Please note, however, that these limitations are for gifts made to the most common types of charitable organizations – *public charities and private operating foundations*. If the charitable deductions are based on gifts made to other types of charitable organizations – specifically, *private non-operating foundations* – the limits are lower. With gifts to these other types of organizations, the limits are 30% for cash gifts and 20% for gifts of appreciated property.

We should also point out that there is one exception based on the specific gift vehicle – the *grantor lead trust is subject to 20%/30% AGI limitations*, regardless of the type of charitable organization receiving the payments.

Options for Claiming Charitable Deductions in Future Years

Based on the application of these criteria, if the donor's deductions cannot be completely reported in the years in which the gifts are made, the donor has as many as five additional "carryforward" years in which to use the deductions. Carryforwards (also referred to as "carryovers") apply in connection with gifts to private non-operating foundations as well as to public charities and operating foundations. Charitable deductions used in subsequent years are subject to the same limitations that apply to deductions used in the years of the gifts, i.e. 50%/30% or 30%/20%.

Important point: the donor may not *choose* to divide up and apply his or her charitable deductions over more than one year if he or she is not bumping up against the percentage limitations for the first year (or for any subsequent year). The IRS rules require the donor to use the charitable deductions as soon as possible within the limitations of the tax code.

Here is a table illustrating the different limitations on using charitable deductions in any given year.

© 2017 PG Calc Incorporated

Type of Organization	Examples	Type of Property	Deductibility
Public charities and private operating foundations. Sometimes called "50% Charities."	Educational institutions, churches, tax-exempt hospitals, governmental units, publicly supported organizations such as the American Red Cross or a symphony orchestra, along with private operating foundations.	Cash and Ordinary Income Property	50% of AGI
		Long-term Capital Gain Property	30% of AGI
Private non-operating foundations. Sometimes called "30% Charities."	Strictly "grant making" foundations.	Cash and Ordinary Income Property	30% of AGI
		Long-term Capital Gain Property	20% of AGI

Example: *Bob and Carol have an AGI of $350,000. They are considering donating to an art museum publicly-traded stock worth $700,000. They bought the stock several years ago for $400,000. Since these shares of stock are appreciated publicly-traded securities held for more than one year, Bob and Carol would be entitled to a deduction for the full fair market value of the stock (and would completely avoid being taxed on any of the $300,000 of long-term capital gain).*

Nevertheless, precisely because the securities are an appreciated capital asset held long term, Bob and Carol would be able to claim in the year of the gift only $105,000 (i.e., 30% of their $350,000 AGI) of the $700,000 deduction. Assuming their AGI remained at $350,000 in each of the following five years and that they make no other charitable gifts during this period, they would be able to deduct at most only $630,000 (i.e., 6 x $105,000) in the year of the gift plus the five carryover years. This means they will not be able to use $70,000 of their $700,000 deduction.

What if instead of donating publicly traded securities, Bob and Carol donated $700,000 cash to the museum? Because of the increased ability to claim a deduction associated with a gift of cash (50% of AGI) versus long-term appreciated property (30% of AGI), they will be able to enjoy the full benefit of their income tax charitable deduction. They will be able to deduct $175,000 dollars a year (50% of $350,000) and use their entire $700,000 deduction in four years ($175,000 x 4 = $700,000), again assuming their AGI remained at least $350,000 in each of the following three years and that they make no other charitable gifts during this period.

Let's now assume that instead of contributing publicly traded securities, Bob and Carol donated to the museum $700,000 in artwork with a cost basis of $250,000. In this case, the rules governing gifts of tangible personal property apply. If the museum displays the artwork in its galleries or otherwise uses it to further the museum's charitable mission, the gift will be deemed

 © 2017 PG Calc Incorporated

to be for a "related use" and the donors will be entitled to a deduction for the full fair market value of their artwork, $700,000, and the deduction can be claimed up to a limit of 30% of AGI. If the museum instead sells the artwork upon receipt, the gift will be deemed to be for an "unrelated use" and the deduction Bob and Carol receive will be limited to their cost basis of $250,000, although this deduction could be claimed up to a limit of 50% of AGI.

Order of Priority of Deductions

The deductibility projections in the example above do not account for the fact that Bob and Carol may have made prior charitable gifts that produced deductions that they are carrying over. They may well also make additional charitable contributions – either in the year of their gift to the museum or in future years – that will affect their ability to claim the deduction associated with whatever gift to the museum they actually make.

There are ordering rules provided by the IRS that guide a taxpayer as to which charitable deductions to take when. These rules are laid out in IRS Publication 526 and are summarized below:

1. Current contributions of cash and non-appreciated property to “50% charities.”
2. Carryover contributions of cash and non-appreciated property to “50% charities.”
3. Current contributions of long-term capital gain property to “50% charities.”
4. Carryover contributions of long-term capital gain property to “50% charities.”
5. Current contributions of cash and non-appreciated property to “30% charities” as well as contributions of such property “for the use of” “50% charities.”
6. Carryover contributions of cash and non-appreciated property to “30% charities” as well as contributions of such property “for the use of” “50% charities.”
7. Current contributions of long-term capital gain property to “30% charities” as well as contributions of such property “for the use of” “50% charities.”
8. Carryover contributions of long-term capital gain property to “30% charities” as well as contributions of such property “for the use of” “50% charities.”

III. 50% Special Election

The deduction for gifts of cash to a public charity is based on the amount of cash donated. Similarly, the deduction for gifts of long term appreciated property to a public charity is based on the fair market value of the property. However, the deduction for a gift of cash to a public charity is limited to 50% of the donor’s adjusted gross income, while the deduction for a gift of long term appreciated property to a public charity is limited to 30% of the donor’s adjusted gross income. In either case, deduction amounts that cannot be used in the year of the gift can be carried forward up to an additional five years.

Often overlooked by donors of long term appreciated property is the option to elect to have their contribution limited to 50% of their AGI, rather than 30%. By making this election, their deduction must be based their cost basis in the property rather than its fair market value (Sec. 170(b)(1)(C)(iii)). When a donor makes the 50% election, the donor’s cost basis must be used to determine the deduction for (1) all long-term property gifts for the current year, and (2) all long-term property gifts in prior years for which a deduction is being carried over, whether or not a similar election was made in the year of those gifts.

© 2017 PG Calc Incorporated

It may make sense for a donor to make the 50% election when (1) the donor's cost basis is high relative to the property's current fair market value, (2) the donor probably would not be able to use the deduction over the course of as many as six years if limited to 30% of AGI, or (3) the donor expects to be in a higher income tax bracket in the year of the gift than in subsequent years.

Example:

Sam has an adjusted gross income of $100,000. He gives 1,000 shares of XYZ Corporation stock that he inherited recently to the museum where has spent his career. The stock was worth $240,000 when he inherited it and is now worth $250,000. He has never made a stock gift before.

If Sam doesn't make the 50% election, he will be able to deduct just $30,000 of his donation in the year of his gift. Assuming his AGI remains at $100,000 over the next 5 years, he'll be able to deduct $30,000/year in each of those years, for a total of $180,000. The other $70,000 will be wasted.

If Sam makes the 50% election, on the other hand, he will be able to deduct his entire cost basis of $240,000 over six tax returns: $50,000 in the year of his gift and in each of the next 4 years, and then the last $40,000 on his sixth return.

In this very simple example, Sam would be able to deduct $60,000 more in total by making the 50% election.

IV. IRS Discount Rate Election Statement

Also known as the AFR or Applicable Federal Rate, the *IRS Discount Rate* is used to determine the charitable deduction for many types of planned gifts, such as charitable remainder trusts and gift annuities. The IRS requires the rate to be used as an estimate of the annual rate of return on the assets in which the gift proceeds are invested.

The discount rate is published monthly, announced on or about the 20th of the month that precedes the month to which the rate will apply. It equals 120% of the annual mid-term rate, rounded to the nearest 0.2%. The annual mid-term rate is the annualized average yield of U.S. Treasury instruments over the past 30 days that have remaining maturities of 3-9 years.

Although there is a specific discount rate for each month, the IRS allows the donor *to choose among the three most recently published discount rates for computing the charitable deduction*. Typically, the donor will want to use the highest of the last three discount rates in order to get the highest deduction available for funding a charitable gift annuity or charitable remainder trust. There is an exception, however, in the case of gift annuities. If the donor does not itemize deductions on his or her tax return, or if the donor is unable to use the charitable deduction for some other reason, using the *lowest* IRS discount rate of the last three months will give the donor a *slightly higher proportion of tax-free income.*

As you can see, there are several good reasons why a donor would choose to compute his or her deduction using the IRS discount rate for one of the two months prior to the month of gift.

 © 2017 PG Calc Incorporated

However, the donor cannot just make this decision silently without jeopardizing the deduction. Rather, the IRS requires a donor to make an explicit election in order to claim a charitable deduction that was computed using the IRS discount rate for either of the two months prior to the month of gift. The election must state that a prior-month election under section 7520(a) of the Internal Revenue Code is being made and identify the elected month (1.7520-2(b)). The election must be attached to the taxpayer's federal income tax return on which the deduction is claimed.

The IRS Discount Rate Election Statement in PG Calc's *Planned Giving Manager* and *PGM Anywhere* contains all of the information that the IRS requires to be included. See Appendix 1 for an example.

V. Form 8283

A taxpayer who itemizes her deductions on Schedule A of her 1040 must provide additional information about certain itemized charitable donations on Form 8283 and attach this form, as well as Schedule A, to the 1040. An example of the form is in Appendix 2.

A taxpayer must complete Form 8283 when her total non-cash donations for the year exceed $500. For this purpose, "total non-cash donations" means total deductions after applying any fair market value reductions (such as for a gift of short term gain property) and before applying any income limits that could result in a carryover.

The IRS provides detailed instructions on when and how to fill out Form 8283. This paper covers the basics, not every detail.

Completing Form 8283
Form 8283 is divided into Section A and Section B. Depending on the type and size of a charitable gift, the donor may have to complete Section A, Section B, or both sections.
A donor completes Section A to report donations of property for which the donor is claiming a deduction of $5,000 or less per item or group of similar items (such as a stamp collection or set of books). A donor also completes Section A to report donations of publicly traded securities, regardless of their value.

A donor completes Section B to report donations of property for which the donor is claiming a deduction of more than $5,000 per item or group of similar items.

Section A: Value of Items of $5,000 or Less
Section A of Form 8283 is divided into two parts: Part I and Part II.

Part I requests a description of the assets donated and to which charities. The donor must complete Section A, Part I for any non-cash donations for which she claimed a deduction of $5,000 of less, with the exception of publicly traded securities. The $5,000 limit applies specifically each item or group of similar items.

The IRS defines publicly traded securities for this purpose as:

a. Securities listed on an exchange in which quotations are published daily,

 © 2017 PG Calc Incorporated

b. Securities regularly traded in national or regional over-the-counter markets for which published quotations are available, or
c. Securities that are shares of a mutual fund for which quotations are published on a daily basis in a newspaper of general circulation throughout the United States.

The IRS instructions provide the following helpful example on how to decide whether a donation must be reported in Section A (vs. Section B, which we will review shortly):

You claimed a deduction of $2,000 for books you gave to College A, $2,500 for books you gave to College B, and $900 for books you gave to College C. You must report these donations in Section B because the total deduction was more than $5,000. You must file a separate Form 8283, Section B, for the donation to each of the three colleges.

Part II asks the donor to identify assets listed in Part I in which the donor gave only a partial interest or to which the donor has attached any restrictions, such as requiring the charity to hang a donated artwork in its headquarters. The donor of a gift annuity, a charitable remainder trust, or other "split interest" planned gift has made a gift of a partial interest and therefore must complete Section A, Part II when the gift is funded with non-cash assets and the donor claims a deduction of $500 to $5,000.

Section B: Value of Items More Than $5,000
A donor must complete one or more parts of Section B of Form 8283 for one item (or one group of similar items) for which she is claiming a deduction of more than $5,000 per item or group of items (except for contributions of publicly traded securities reported in Section A). The donor must provide a separate form for each property donated unless it is part of a group of similar items.

Section B of Form 8283 is divided into Parts I – IV. Part I and, if necessary, Part II are completed by the donor. Part III, if necessary, is completed by a qualified appraiser. Part IV is completed by the charity. The donor must file a separate Form 8283, Section B, for each donee organization and each item of property (or group of similar items).

Part I asks the donor to describe the property donated, including appraised fair market value, date acquired, and how acquired. It also asks for the date of gift and the deduction being claimed.

Part II asks the donor to identify all property listed in Section B, Part I that has an appraised value of $500 or less. The donor attests to these valuations with a signature.

Part III is a signed declaration from a qualified appraiser confirming that he or she is qualified to appraise the property in Section B, Part I.

Donations listed in Section B, Part I that don't require a qualified appraisal:

1. Non-publicly traded stock of $10,000 or less,
2. A vehicle (including a car, boat, or airplane) if the deduction for the vehicle is limited to the gross proceeds from its sale,
3. Intellectual property,

© 2017 PG Calc Incorporated

4. Certain securities considered to have market quotations readily available (see Regulations section 1.170A-13(c)(7)(xi)(B)),
5. Inventory and other property donated by a corporation that are "qualified contributions" for the care of the ill, the needy, or infants, within the meaning of section 170(e)(3)(A), or
6. Stock in trade, inventory, or property held primarily for sale to customers in the ordinary course of a trade or business.

Property listed in Section B, Part I that requires a written and signed appraisal to be attached to Form 8283:

1. Art valued at $20,000 or more. For individual objects valued at $20,000 or more, a photograph must be provided upon request.
2. Clothing and household items not in good used condition.
3. Easements on buildings in historic districts.
4. Deduction of more than $500,000.

Part IV requests the signature of an official at the charity acknowledging receipt of the property described in Section B, Part I. The person acknowledging the gift must be an official authorized to sign the tax returns of the organization, or a person specifically designated to sign Form 8283. After completing Part IV, the organization must return Form 8283 to the donor. The donor must give a copy of Section B to the organization. The donor may then complete any remaining information required in Part I and the qualified appraiser can complete Part III.

Interestingly, the IRS instructions note that if the donor finds it impossible to get the donee's signature, the IRS will not disallow the deduction for that reason if the donor attaches a detailed explanation of why it was impossible.

Make your donor aware of Form 8283
When a donor makes a gift to your organization that will require the donor to file a Form 8283 with her tax return, you should make sure the donor is aware of this requirement. Here's some sample language you could include in the materials sent to the donor to acknowledge the gift.

If gift included publicly-traded securities and the deduction is more than $500:

Because you have transferred publicly-traded securities and the amount of the deduction is more than $500, you will need to complete Section A of IRS Form 8283 (Noncash Charitable Contributions) to be filed with your [*gift year*] return. You should seek your tax advisor's assistance in completing this form.

If gift included real estate or tangible property (art works, coin or stamp collections, gems/jewelry, books, etc.) and the deduction is more than $5,000, or closely-held stock and the deduction is more than $10,000:

Because you have transferred [*type of property*] and the amount of your deduction is more than [*$5,000/$10,000*] you will need to complete Section B of IRS Form 8283 (Noncash Charitable Contributions) and have the appraiser of the property sign Part III, Certification of Appraiser. You should seek your tax advisor's assistance in completing this form.

 © 2017 PG Calc Incorporated

Provisions Related to Income Tax

VI. Medicare Surtax

This tax went into effect on January 1, 2013 and is part of the Affordable Care Act of 2010. It is imposed on top of other income taxes.

The surtax kicks in when modified adjusted gross income (MAGI) is above $250,000 for joint returns and surviving spouses, $200,000 for heads of households and single taxpayers, and $125,000 for married filing separately. Notice that these thresholds are substantially lower than the threshold for the 39.6% income tax rate and 20% tax rate on long term capital gain.

MAGI equals AGI plus any foreign earned income exclusion. Taxpayers below the applicable MAGI threshold do not pay a Medicare surtax.

The Medicare surtax has two parts. The first part is an extra .9% tax on wages and self-employment income above the thresholds. Just as there is no charitable planning against the current Medicare payroll tax, this extra .9% will have little effect on gift planning.

Net Investment Income Tax

The second part of the Medicare Surtax is a 3.8% surtax called the Net Investment Income Tax or NIIT. This surtax is imposed on the lesser of (1) net investment income or (2) the amount by which a taxpayer's MAGI exceeds the applicable threshold.

There are 3 categories of income subject to NIIT:

Category 1: Gross income from interest, dividends, rents, royalties, and nonqualified annuities, other than such income derived in the ordinary course of a trade or business not described in Category 2.

Category 2: Other gross income from businesses that trade financial instruments or commodities, and businesses that are passive activities within the meaning of Sec. 469.

Category 3: Net gain (to the extent taken into account in computing taxable income) attributable to the disposition of property, other than property held in a trade or business that is not described in Category 2. Gains and losses from dispositions of trade or business property used in passive activities are included in calculating the net investment income tax.

Net investment income from these categories may be reduced by investment expenses such as early-withdrawal penalties, interest expense, adviser fees, directly related rental and royalty expenses, and state and local taxes allocable to items included in investment income.

Wages, self-employment income, unemployment compensation, business income from non-passive sources, Social Security benefits, tax-exempt interest, and qualified pension, annuity, and individual retirement account distributions are excluded when calculating the net investment income tax.

© 2017 PG Calc Incorporated

The surtax crosses regular tax brackets. For example, a couple who are married filing jointly with $100,000 in wage income and $200,000 of long-term gain on the sale of appreciated stock will be in the 25% income tax bracket, with capital gains taxed at a lower rate of 15%. However, since their MAGI is $300,000, they are subject to NIIT on $50,000, which is the lesser of $200,000 in net investment income and $50,000 of excess MAGI over the threshold ($300,000 - $250,000). This effectively raises their marginal capital gains tax rate from 15% to 18.8% and makes giving appreciated property to charity more attractive.

For upper-income taxpayers, income from planned gifts is subject to the 3.8% Medicare surtax as described below:

Gift annuities
The ordinary income portion of the annuity is surtaxed as Category 1 income. The capital gain portion is subject to surtax as Category 3 income, but can be spread over life expectancy under the same rules as for the regular income tax. This is the treatment afforded installment sales. Although IRS guidance does not directly address gift annuities funded with appreciated property, it seems to us the same principle applies. The tax-free portion is not subject to surtax.

Charitable remainder trusts
The charitable remainder trust itself is exempt from the surtax. However, the beneficiary is surtaxed on the lesser of (1) the total amount of distributions for the year or (2) the current and accumulated net investment income for the CRT, with the accumulation starting after December 31, 2012. This means that the amount subject to surtax is not necessarily the same as the amount subject to the regular income tax. That's because the CRT tiers of income approach takes into account income for all years of the trust, not just years after December 31, 2012. The beneficiary is never surtaxed on more than their total distribution for the year, even if the CRT earns more than was distributed that year, such as a big capital gain on the sale of the donated property.

Pooled income funds
The beneficiary will be surtaxed on taxable distributions from a pooled income fund. The PIF itself is not exempt, and as a trust it may be surtaxed on short-term gains not distributed by the trust, if the trust's undistributed net investment income exceeds $12,500 for 2017. Long-term gains retained by the pooled income fund and set aside for charity are excludable, as they are for the regular income tax.

Non-grantor and testamentary charitable lead trusts
Non-grantor and testamentary CLTs are surtaxed on undistributed net investment income. Amounts distributed by a charitable lead trust to meet the charitable payout would escape the surtax. However, any excess would be subject to surtax at the trust level. The surtax threshold for trusts is the amount of income where the highest income tax bracket begins, only $12,500 for 2017. That could hit capital gains realized from portfolio rebalancing, as the capital gains tax does already, if those gains plus other income exceed what was distributed to charity.

Grantor charitable lead trusts
Grantor CLTs are surtaxed on the donor. Grantor charitable lead trusts are exempt at the trust level but any net investment income passes through to the donor's tax return, with no deduction for the charitable payout, in the same way as there is already no charitable deduction for the regular income tax imposed on the donor for grantor CLT income and capital gains.

 © 2017 PG Calc Incorporated

Retained life estates
RLEs are surtaxed on rental income. Typically, a retained life estate is for a home in which the donor continues to live and for which the donor receives no income, so there would be no surtax. But, in the case where the home or farm is rented, that rent would be subject to surtax, unless the income comes from an active trade or business such as farming.

VII. Alternative Minimum Tax

The alternative minimum tax, or AMT, is an income tax regime designed to make sure that taxpayers with high income and significant deductions pay their fair share of federal income taxes. The AMT allows fewer exemptions and deductions than the standard tax system, and certain taxpayers must calculate their taxes both ways and pay the higher amount. About 5.2 million taxpayers are expected to pay the AMT in 2017.

Determining AMT income
Taxable income for AMT purposes is often much greater than for standard income tax purposes. To determine AMT income, you start with your adjusted gross income (AGI) minus itemized deductions from your 1040, and then add back in deductions and tax breaks that are not allowed under the AMT.

Among the deductions that must be added back in:

- State and local income taxes
- Real estate and personal property taxes
- Miscellaneous itemized deductions, such as employee business expenses
- Interest on home equity loans
- Deduction for a net operating loss
- The standard deduction, if taken instead of itemizing

Two important deductions are not added back in when computing AMT: the mortgage interest deduction and the charitable deduction.

Determining the AMT
The AMT system has just two tax brackets: 26% and 28%. The 26% rate applies to AMT income below the applicable amount shown in the table below. The 28% rate applies to all AMT income over that amount.

Filing Status	2017 Threshold for 28% Rate
Single	$187,800
Married filing jointly	$187,800
Head of household	$93,900
Married filing separately	$187,800

In order to determine your taxable AMT income, you reduce your total AMT income by the AMT exemption amount for which you are eligible, and then compute the AMT on that amount.

 © 2017 PG Calc Incorporated

The table below shows the AMT exemption available in 2017 for the different taxpayer statuses. These exemptions are indexed annually for inflation.

Filing Status	2017 Exemption
Single	$54,300
Married filing jointly	$84,500
Head of household	$54,300
Married filing separately	$42,250

Not all donors who pay the AMT can just subtract the exemption amount listed above for their filing status, however. These exemptions phase out for donors with AMT income above the prescribed level for their filing status. The table below lists these thresholds. The donor loses $0.25 of exemption for every dollar her AMT income exceeds the applicable threshold. This means that a donor's AMT exemption becomes completely phased out once the donor's AMT income exceeds five times the threshold amount.

Filing Status	2017 Phase-out Threshold
Single	$120,700
Married filing jointly	$160,900
Head of household	$120,700
Married filing separately	$80,450

For example, a donor who files singly and pays the AMT will receive no AMT exemption at all if her AMT income equals or exceeds (4 x $54,300) + $120,700 = $337,900. This also means that her effective AMT rate for AMT income above $120,700 and less than $187,800 would be 26% + .25 x 26% = 32.5% and for AMT income above $187,800 and less than $337,900 would be 28% + .25 x 28% = 35%. Her AMT rate for AMT income above $337,900 would be 28% again.

Effect on tax savings from a gift

Recall that charitable gifts may be deducted from AMT income. This means that for a donor who pays the AMT, each dollar of charitable deduction will reduce the donor's tax by the amount deducted multiplied by the donor's marginal AMT bracket. As we just saw above, that bracket effectively could be 26%, 28%, 32.5%, or 35%. Depending on the donor's amount of taxable income under the standard and AMT regimes, he may be in a higher or lower bracket under the AMT and therefore in a position to save more or less tax as a result of making charitable gifts.

For example, a donor filing singly who itemized $25,000 in charitable gifts, thereby reducing his AMT income from $325,000 to $300,000, would save 35% x $25,000 or $8,750 in AMT. If this same donor were paying the standard income tax instead, he would very likely be in the 33% bracket and the same $25,000 in charitable gifts would save him $500 less in income tax: 33% x $25,000 or $8,250.

On the other hand, a donor filing singly whose $25,000 in charitable gifts reduces his AMT income from $750,000 to $725,000, would save 28% x $25,000 or $7,000 in AMT. If this same donor were paying the standard income tax instead, he would very likely be in the 39.6% bracket and the same $25,000 in charitable gifts would save him $2,900 more in income tax: 39.6% x $25,000 or $9,900.

 © 2017 PG Calc Incorporated

VIII. The 8 Tiers of Trust Taxation

Periodic distributions made to beneficiaries of Charitable Remainder Unitrusts and Charitable Remainder Annuity Trusts are subject to taxation under the so-called 4-tier tax system. Historically, those 4 tiers have been defined as follows:

Ordinary Income – dividends, interest, rents and royalties
Capital Gains – distributions of both short-term and long-term gains
Tax-free Income – interest earned from municipal bonds and other tax-free investments
Return of Principal – non-taxable distributions of trust corpus

Changes to tax laws in recent years, however, have complicated the 4-tier system, resulting in what some now describe as the 8-tier tax system. The basic categories are still the same 4 original "tiers," but the first two tiers are essentially divided into multiple sub-tiers.

1. **Ordinary income** consists of interest, dividends, rents, and royalties, but dividends are not all taxed at the same rate. Qualified dividends are taxed at a lower tax rate (15 or 20%), whereas non-qualified dividends ("ordinary dividends") are taxed at the beneficiary's marginal income tax bracket (currently up to 39.6%). This tier, therefore, can be broken down into 2 separate categories, and in classic WIFO-accounting style ("Worst In, First Out"), the income that will be more heavily taxed must be completely distributed before the income that will be less heavily taxed can be distributed:

    a. Interest, rents, royalties, and ordinary dividends (taxable up to 39.6%).
    b. Qualified dividends (taxed at 15 or 20%).

2. **Capital gains** distributions result from capital gains being realized inside the trust. Short-term capital gains are taxed at a higher rate than long-term capital gains, and there are currently 3 different levels of possible taxation on long-term capital gains. As with the ordinary income tier, these types of gains must be distributed in WIFO fashion, so the most heavily taxed gains are distributed first, and so on.

    a. Short-term capital gains (10 to 39.6% maximum tax rate).
    b. Long-term capital gains from collectibles (10 to 28% maximum tax rate).
    c. Long-term capital gains from depreciation recapture (10 to 25% maximum tax rate).
    d. Long-term capital gains from other investments (0 to 20% maximum tax rate).

3. **Tax-free income** results from the interest earned on tax-exempt securities that the trust has invested in; charitable remainder trusts rarely invest tax-exempt securities.

4. **Tax-free return of principal** – any distributions of trust corpus are not taxed. To the extent first-, second-, or third-tier income received by the trust in a given year is not distributed to income beneficiaries in that year, the excess is carried forward in its given tier for potential distribution in subsequent years.

 © 2017 PG Calc Incorporated

Example
A 6% charitable remainder unitrust valued at exactly $500,000 on January 1, 2017, will pay $30,000 to the income beneficiaries in 2017. Where is that money going to come from and how is it going to be taxed?

Here is the total of income and capital gains for the entire year, as of December 31, 2017:

1. **Ordinary Income:** The trust earned income for the year of $15,000. More specifically, the trust earned:

   a. $8,000 interest
   b. $7,000 in qualified dividends

2. **Capital Gain:** The trustee sold investments that resulted in $32,000 in capital gains. The capital gains broke down as follows:

   - $2,000 associated with the sale of securities held less than a year (short term gains)
   - $3,000 associated with a sale of collectibles
   - $5,000 associated with depreciation recapture on a sale of real estate
   - $22,000 associated with the sale of securities ("regular" long term capital gains)

3. **Tax-free income:** The trust is invested in fully taxable investments, so there is no tax-free income.

4. **Return of principal:** The combination of ordinary income and capital gains earned in 2017 exceed the 5% beneficiary distribution, so there will be no tax-free return of principal in 2017.

The federal tax reporting rules require income to be distributed and reported from the trust in the "worst in, first out" order within each tier, so the tax reporting for distributions made to beneficiaries in 2017 would look as follows:

Total beneficiary distributions in 2017: $30,000

Tax reporting for 2017:

$8,000 **Ordinary income from interest** (taxable at beneficiaries' marginal income tax bracket of up to 39.6%)
$7,000 **Ordinary income from qualified dividends** (taxable at 15 or 20% depending on beneficiaries' income tax bracket)

$2,000 **Short term capital gain** (taxable at beneficiaries' marginal income tax bracket of up to 39.6%)
$3,000 **Long-term capital gain from sale of collectibles** (taxable at 28%)
$5,000 **Long-term capital gain from depreciation recapture** (taxable at 25%)
$5,000 **Long-term capital gains from "other" investments** (taxable at 15 or 20% depending on beneficiaries' income tax bracket)

© 2017 PG Calc Incorporated

$0 **Tax-free income**
$0 **Return of principal**
$17,000 **Long-term capital gains from "other" investments carried over to 2018** (taxable at 15 or 20% depending on beneficiaries' income tax bracket)

The federal tax rules require that any earned income or realized capital gains in charitable remainder trusts that are not distributed in any given calendar year are carried over to the next calendar year. In our example, all of the ordinary income was distributed, all of the short-term capital gains were distributed, and all of the long-term capital gains associated with collectibles and depreciation recapture were distributed, but only $5,000 of the $22,000 "regular" long-term capital gains was distributed. That means $17,000 of this long-term capital gains will be carried over to 2018. The long-term capital gains tier at the beginning of 2018 will consist of $17,000 of gains from a prior year.

If all of the other numbers are the same for 2018, but no additional "regular" long-term capital gains are realized, the tax reporting for 2018 would *still be exactly the same as the reporting for 2017*. It would include another $5,000 of the accumulated and carried-over regular long-term capital gains. The long-term capital gains tier would be reduced to $12,000, and that amount would carry over to the next calendar year.

In any given year, all current ordinary income plus all amounts carried over from prior years must be completely distributed before any capital gain income can be distributed. Likewise, all current realized capital gain income plus realized capital gain carried over from prior years must be completely distributed before any tax-free income can be distributed. This is why tax-free income (and non-taxable distributions of principal) are the exception in charitable remainder trusts, and typically occur only when the trusts are initially funded with cash or assets with little or no appreciation.

Provisions Related to Transfer Tax

IX. Gift Tax

Federal gift tax is assessed on the transfer of property from one individual to another during life. As one of the three types of federal transfer taxes – the other two being the estate tax and the generation skipping transfer tax – it is not based on either of the persons involved in the transfer, but rather, it is based on the dollar value of the property being transferred. It is payable by the party transferring the property, not the party receiving the property.

The gift tax is based on a progressive schedule – it's the same schedule the estate tax is based on, as detailed in the table below:

 © 2017 PG Calc Incorporated

Gift and Estate Tax Rate Schedule in 2013 - 2017

Taxable Transfer	Tax	% on Excess
0	0	18
10,000	1,800	20
20,000	3,800	22
40,000	8,200	24
60,000	13,000	26
80,000	18,200	28
100,000	23,800	30
150,000	38,800	32
250,000	70,800	34
500,000	155,800	37
750,000	248,300	39
1,000,000	345,800	40

If the federal gift tax were calculated strictly according to this table, the gift tax on a lifetime transfer of $1,000,000 would be $345,800. Every dollar transferred over $1,000,000 would be taxed at 40%. Fortunately, the federal tax code also allows each taxpayer a lifetime gift tax credit, which is indexed each year for inflation. You can see how the credit has increased over the last 16 years in the table below:

Gift Tax Credit Schedule

Year	Amount of Credit	Amount of Exemption Equivalent
2001	220,550	675,000
2002-2010	345,800	1,000,000
2011	1,730,800	5,000,000
2012	1,772,800	5,120,000
2013	2,045,800	5,250,000
2014	2,081,800	5,340,000
2015	2,117,800	5,430,000
2016	2,125,800	5,450,000
2017	2,141,800	5,490,000

Here is how it works in reality: If a person gives $5,490,000 to another individual – let's say a friend – in 2017, the *tentative gift tax* would be $2,141,800, according to the Gift Tax Rate Schedule above ($345,800 on the first $1,000,000 plus 40% on the excess, or $1,796,000, on the additional $4,490,000). But the transferor would be entitled to use his or her lifetime gift tax credit, which equals $2,141,800 for 2017, so there would be no net gift tax due. If the transferor decided to give the friend another $1,000,000, however, the federal gift tax would be $400,000. Please note that any potentially taxable transfers of wealth must be reported on the annual Gift

© 2017 PG Calc Incorporated

Tax Return, IRS Form 709; even if there is no actual gift tax due, the transferor is required to file a gift tax return to substantiate the use of the gift tax credit.

In addition to using the Gift Tax Credit, the donor may end up not owing any tax on a potentially taxable transfer for a number of other reasons.

Annual Gift Tax Exclusion - An individual may give another individual up to $14,000 in cash or property *each year* without having to report the gift or incurring a gift tax. There is no limit to the number of individuals to whom such gifts may be made. Husbands and wives may join together (gift-splitting) and give up to $28,000 to any individual without making a taxable gift. To qualify for the annual exclusion, the gifts must be present-interest gifts. That is, the donee must have a right to benefit from the property now.

The annual exclusion is adjusted for inflation in increments of $1,000. Because inflation has been relatively low in recent years, the exclusion amount has increased only every three to four years. It will be $15,000 in 2018, the first increase since 2013.

Gift tax marital deduction - With the exception of certain gifts of future interests, gifts between spouses are not subject to gift tax, whatever the amount. This includes spouses in same-gender marriages. If the donee spouse is not a U.S. citizen, however, there is an annual exclusion that is indexed for inflation each year. In 2017, the annual gift tax exclusion for transfers to spouses who are not U.S. citizens is $149,000 ($152,000 in 2018).

Qualified transfers - Payments made directly to service providers for tuition or medical care are not considered taxable transfers for purposes of gift taxes. These payments must be made directly to an educational institution or medical provider to be considered qualified transfers.

There are other considerations that may also affect the applicability of federal gift taxes. In some cases, the legal means by which the transfer is made may include language or conditions that allow for some limited control in the future by the transferor. The limited retention of control may result in the gift being considered "incomplete" according to federal tax laws; if the gift is considered incomplete, there is likely to be no federal gift tax due at the time of the transfer.

Unified Gift and Estate Tax and Portability

As mentioned above, the federal gift tax is closely related to the federal estate tax: both are cumulative and share the same exemption amount, which is $5,490,000 in 2017. Federal estate tax is structured such that it builds on lifetime transfers of wealth. If a person dies in 2017, and has used his or her entire lifetime gift tax exemption of $5,490,000, there is no federal estate tax credit available for the estate. The gift tax credit and estate tax credit can be divided and used partly for lifetime transfers and partly for transfers at death, but the *total available credit is for all transfers combined.*

The lifetime gift and estate tax exemption is portable between spouses. If the first spouse to die does not use up all of his or her lifetime gift and estate tax exemption, his or her executor can make the unused portion of the exemption available to the surviving spouse by making an explicit election on the deceased's estate tax return. For the election to be valid:

 © 2017 PG Calc Incorporated

1. The portability election must be made by timely filing an estate tax return for the deceased spouse's estate (including extensions). The estate tax return must be filed even if not otherwise required.
2. The election must be made by the executor of the deceased spouse's estate.
3. The estate tax return must be complete and properly prepared.
4. The estate tax return must include a computation of the deceased spouse's unused exemption amount.

X. Generation Skipping Transfer Tax

The federal estate tax is levied on the right to transfer property at death. Using IRS Form 706, the amount of tax depends on the size of the estate the deceased leaves (as augmented by any taxable gifts made by the person during life and decreased by various deductions and exemptions), adjusted for any gift tax paid by the person during life.

The generation-skipping transfer tax (GST tax) tax is assessed on certain transfers of assets from an individual to one or more "skip persons," regardless of whether such transfers occur during the individual's life or upon his or her death. This tax is assessed *in addition to* gift or estate tax. Its purpose is to prevent skip persons from receiving assets free of gift or estate tax that otherwise would be subject to one of those two taxes.

The GST tax lifetime exemption is the same as the exemption for gift and estate tax: $5,490,000 in 2017 and indexed for inflation (it will be 5,600,000 in 2018). So, a taxpayer can transfer up to $5,490,000 in total to skip persons before the taxpayer needs to pay any GST tax.

The GST tax is a separate exemption from the unified exemption for gift and estate tax. Unlike those two transfer taxes, portability does not apply to the GST tax. Spouses each get their own lifetime GST tax exemption and cannot assume the unused portion of a deceased spouse's exemption.

The GST tax is assessed at the highest estate tax rate in place at the time of the transfer. In 2017, that rate is 40%. This means that a taxpayer, or the taxpayer's estate if the estate is making the transfer, will pay $0.40 in GST tax on every dollar to which the GST tax applies.

Who is a "skip" person?
A skip person is an individual beneficiary who is a lineal descendant of the transferor belonging to a generation two or more generations below the transferor, or anyone else who is 37.5 years or younger than the transferor. There is an exception in the case of a lineal descendant skip person when all members of the intervening generation(s) have died prior to the transfer. For example, a charitable lead trust that terminates in favor of a donor's grandchild is not subject to GST tax if it was funded after the donor's child who parented the grandchild has died (although the grandchild won't receive a distribution until the lead trust terminates, the transfer occurs when the lead trust is funded).

 © 2017 PG Calc Incorporated

Significance of the GST Tax with Respect to Charitable Giving
Because the GST tax applies only to certain types of transfers to *individuals*, there is no need for a GST tax charitable deduction as such. Nevertheless, it is important for gift planners to keep in mind that some gifts can have GST tax consequences for donors.

There are three kinds of generation skips:

Direct Skip
A direct skip occurs when a transfer subject to GST tax is made directly from the donor to the skip person during the donor's life or by will. The donor pays GST tax if the transfer is made during the donor's life, and the donor's estate pays the tax if the transfer is by will.

Taxable Distribution
A taxable distribution occurs when a transfer subject to GST tax is made to the skip person by means of a distribution from a trust (other than a distribution made in connection with a taxable termination – see below). A charitable remainder trust makes taxable distributions when it makes unitrust or annuity payments to a skip person, for example. The recipient of the distribution pays the tax.

Taxable Termination
A taxable termination occurs when a transfer subject to GST tax is made to the skip person at the termination of a trust. A charitable lead trust makes a taxable termination when it distributes its remaining corpus to a skip person, for example. The trust pays the tax.

Special rules for charitable lead trusts
To determine the fraction of the final distribution of a lead trust subject to GST tax, you multiply the amount of the distribution by a factor called the "inclusion ratio." If the amount of the transfer is $1 million and the inclusion ratio is 0.3, for example, the amount of the transfer subject to GST tax would be 0.3 x $1 million, or $300,000.

The inclusion ratio for a charitable lead unitrust (CLUT) is computed at the time the CLUT is created. The inclusion ratio for charitable lead annuity trust (CLAT) is computed at the time the CLAT terminates and is based, in part, on the value of the CLAT assets at that time. As a consequence, it is easy to determine exactly how much GST tax exemption a donor must allocate in order to make the inclusion ratio for a CLUT zero, in which case there will be no GST tax to worry about when the CLUT terminates. In contrast, we can't know what the exact value of a CLAT's assets will be when it terminates, so a donor of a CLAT can't determine precisely how much GST exemption to allocate in order to make the inclusion ratio zero. The donor is pretty much guaranteed either to over-allocate exemption, thereby wasting exemption that could have been used to reduce or eliminate the GST tax on other transfers to skip persons, or to under-allocate exemption, thereby potentially causing the CLAT to pay GST tax unnecessarily when it terminates.

The above planning challenge leads many financial and legal advisors to recommend a CLUT rather than a CLAT when the remainder beneficiaries are skip persons in relation to the donor.

© 2017 PG Calc Incorporated

XI. Tax Reform Provisions That Could Affect Charitable Giving

Under Republican leadership, Congress is working feverishly to complete the details of sprawling tax reform legislation, the "Tax Cuts and Jobs Act," and have it on President Trump's desk for his signature by the end of this year. As of this writing, we have seen the specifics of the House bill and the Chairman's Mark of the Senate bill. The two bills differ in some important ways and so a reconciliation process will be required before a final bill can be passed and signed by the President. The final form of the bill, and even whether it will pass the House and Senate, is unknowable. The discussion that follows is based on provisions found in the House bill and the Senate bill as they currently stand. It seems likely that these provisions will look substantially similar in the final bill.

The list below summarizes provisions in the bills that would affect charitable giving. The provisions would be effective January 1, 2018 unless otherwise noted.

- Both bills would roughly double the standard deduction to $24,000 for married taxpayers filing jointly, and $12,000 for single filers.
- Both bills would eliminate most itemized deductions. The mortgage interest and charitable deductions would be preserved, however. The House bill would allow the mortgage interest deduction on up to a $500,000 loan. The Senate bill limit would be $1 million. The House bill would eliminate the deduction for state and local income taxes, but allow a property tax deduction with a cap of $10,000. The Senate bill would eliminate the deduction for all state and local taxes, including property taxes.
- Both bills would eliminate the Pease limitation and increase the limit on deductions for gifts of cash from 50% of AGI to 60% of AGI.
- Both bills would eliminate the personal exemption.
- The House bill would reduce the current seven federal income tax brackets to four - 12%, 25%, 35%, and 39.6%. The top bracket would kick in at a much higher level of taxable income than it does now. The Senate bill would maintain seven brackets. Several brackets would be at a modestly lower rate than now and the top bracket, 38.5%, would start at the same much higher income level as the top bracket proposed in the House bill.
- The House bill would allow qualified pass-through business owners either to count 30 percent of their income as business income (rather than wage income), taxable at 25%, or set the ratio of their wage income to business income based on their capital investment. The Senate bill would provide a 17.4% deduction for non-wage income, with certain limitations for many types of service businesses.
- Both bills would eliminate the alternative minimum tax.
- Both bills would double the lifetime exemption from gift, estate, and generation skipping taxes to $11.2 million per person, $22.4 million per couple and index these amounts for inflation. Only the House bill would eliminate estate and GST taxes altogether in 2024; the Senate bill would not eliminate these taxes. Neither bill would revise the current step-up in cost basis for transfers through an estate.

 © 2017 PG Calc Incorporated

- The House bill would lower the top gift tax bracket from 40% to 35%. The Senate bill is silent on the top gift tax rate.

Income tax rates
The current federal income tax schedule for a married couple, filing jointly is:

Taxable Income	Tax Rate
$0 - $19,050	10%
$19,051 - $77,400	15%
$77,401 - $156,150	25%
$156,151 - $237,950	28%
$237,951 - $424,950	33%
$424,951 - $480,050	35%
$480,051 & above	39.6%

The proposed federal income tax schedule for a married couple, filing jointly in the House bill is:

Taxable Income	Tax Rate
$0 - $24,000	0%
$24,001 - $90,000	12%
$90,001 - $260,000	25%
$260,001 - $1,000,000	35%
$1,000,001 & above	39.6%

There is a complicated phase-out provision of the 12% bracket for taxpayers with adjusted gross income (AGI) over $1 million, $1.2 million if married filing jointly. Those taxpayers with AGI over the applicable threshold could face an effective marginal tax rate of up to 45.6%.

The proposed federal income tax schedule for a married couple, filing jointly in the Senate Bill is:

Taxable Income	Tax Rate
$0 - $19,050	10%
$19,051 - $77,400	12%
$77,401 - $120,000	22.5%
$120,001 - $290,000	25%
$290,001 - $390,000	32.5%
$390,001 - $1,000,000	35%
$1,000,001 & above	38.5%

Under the House bill, most taxpayers will be in the same or a lower tax bracket under the proposed schedule, although taxpayers with $260,000 - $425,000 of taxable income will see their

© 2017 PG Calc Incorporated

tax bracket increase from 33% to 35%. Under the Senate Bill, all taxpayers will be in the same or a lower bracket, including those with over $1 million in taxable income (38.5% vs. the current 39.6%). Many taxpayers who receive income from pass-through entities such as partnerships and S Corporations would pay lower rates on some or all of that income than on their wage income. In general, donors who itemize their deductions would save the same amount or a little less in taxes under both of the proposed income tax schedules than they do under the current schedule. Exceptions would include donors who would have otherwise paid tax at the lower rates of the now repealed alternative minimum tax.

The standard deduction

About 69% of taxpayers currently take the standard deduction. It has been estimated that the combination of a much higher standard deduction amount and the elimination of most itemized deductions would increase this percentage to about 95%. This would mean that despite the retention of the charitable deduction in the House and Senate bills, about 95% of potential donors would derive no tax benefit from the charitable deduction because they wouldn't itemize their deductions.

An Indiana University Lilly Family School of Philanthropy Study (http://independentsector.org/wp-content/uploads/2017/05/tax-policy-charitable-giving-finalmay2017-1.pdf) conducted in May 2017 found that the reduced tax benefit that would result from an increase in the standard deduction and the reduction in income tax rates would reduce charitable giving by 1.7% - 4.6%. The study assumed a slightly smaller increase in the standard deduction than is proposed in the Framework ($11,000/$22,000 vs. $12,000/$24,000), so it may have predicted a slightly greater negative effect using the more current proposed figures.

Deduction limitations

Some apparent good news for charities is that both bills would increase the limit on charitable deductions for gifts of cash from 50% of adjusted gross income (AGI) to 60% of AGI. They would also eliminate the Pease limitation. These changes, of course, would affect only the estimated 5% of donors who actually itemize their deductions, and of those, likely only a small fraction would have bumped up against the 50% AGI limitation or have lost charitable deductions due to the Pease limitation.

CGP proposes a universal charitable deduction

The National Association of Charitable Gift Planners (CGP), along with other advocates for the charitable sector, is encouraging Senators and Representatives to support the addition of a universal charitable deduction to their tax reform bills. This would be an "above the line" deduction, meaning that all taxpayers would be able to reduce their taxable income by making gifts to charity, not just the small fraction who itemize their deductions.

Rep. Mark Walker (R-NC) introduced H.R. 3988 in October of this year, which would allow exactly this treatment for taxpayers who take the standard deduction, albeit only up to one-third of their standard deduction. Senators Stabenow and Wyden have introduced Amendment #9 to the Chairman's Mark, which would allow an above the line charitable deduction up to 60% of modified AGI and reduced the deduction allowed in a way similar to the current Pease limitation. As we write this, CGP is marshalling support for this amendment. If successful, and this provision is preserved in the final bill, it would encourage all donors to make charitable gifts, including the 69% today who take the standard deduction.

© 2017 PG Calc Incorporated

Possible effect on testamentary charitable giving

The reality is that even without tax reform, very few donors are affected by federal estate tax (FET). In 2018, a single person will be able to give $5.6 million away over her lifetime (indexed for inflation) without paying FET. A married couple will be able to give twice that much: $11.2 million. The Joint Committee on Taxation estimates that only 0.2% of taxpayers who die in 2017 will owe any estate tax. So, for 99.8% of taxpayers, doubling of the federal estate tax exemption in 2018 would have no effect, nor would eliminating it in 2024 as the House bill proposes.

As a result of the doubling of the estate tax exemption in 2018, the slice of the 0.2% sliver of taxpayers whose estates are over $5.6 million but under $11.2 million (or over $11.2 million but under $22.4 million for married couples) would no longer save 40% of every dollar they give away to charity. Under the House bill (but not the Senate bill), the estates that are even larger would see the same loss of tax benefits starting in 2024. The very largest charitable bequests naturally come from the very largest estates, so it is possible that the number and size of these bequests will decline as a result of these changes. The counter-argument is that as a result of the reduction, and then elimination, of the estate tax, these large estates will have more assets available to transfer to charity and therefore will tend to give more to them.

Summary

In general, these developments will reduce the tax benefits of making a charitable gift. For the many more taxpayers who will take the standard deduction rather than itemize, the charitable deduction will be of no value. Most of those who still itemize will save less from deductions because their tax rate will be lower. The doubling of the gift and estate tax deductions will remove federal estate tax savings as an incentive for all but the wealthiest donors (although state estate taxes will remain a consideration). Even the wealthiest donors will lose this incentive if the House bill's proposed elimination of the estate tax is adopted.

While lower taxes will translate into donors keeping more of their wealth and income, research suggests the many reductions in tax incentives will discourage charitable giving of all kinds, including planned gifts. There is a very short-term opportunity between now and the end of the year to encourage donors to give while the tax benefits are greater. In the longer term, gift planners will be wise to put less focus on the tax benefits of a planned gift and more focus on the other ways it will benefit the donor and the charity.

 © 2017 PG Calc Incorporated

Appendix 1

Election Statement from Planned Giving Manager

Applicable Mid-Term Rate Election
Charitable Gift Annuity

Donor Name: Joe Donor
Taxpayer ID: 12-3456789

According to Reg. Sec. 301.9100-8(a)(1), I, Joe Donor, am making an election as provided under Section 7520(a) of the Internal Revenue Code.

The interest being valued is a charitable gift annuity agreement with State University made on November 30, 2017. The payout rate of the gift is 4.5%, payable for the lifetime benefit of an individual, age 62.

To value the transferred interest, I elect to use the 2.2% rate under Section 7520 for October, 2017 (120% of the Applicable Mid-Term Federal Interest Rate compounded annually and rounded to the nearest two-tenths of one percent).

Instructions to Donor

You are receiving the above election statement because the IRS discount rate used to compute the value of your charitable contribution was based on a rate for one of the two months prior to the month of your gift.

The IRS requires a planned gift donor to make an explicit election in the event that the value of the donor's charitable contribution was computed using the IRS discount rate for either of the two months prior to the month of gift. The month of your gift is November, 2017 and the IRS discount rate used to compute the value of your charitable contribution is for October, 2017.

You must attach the election statement to your federal income tax return for the tax year in which you claim your income tax charitable deduction for this gift. You should provide your tax preparer with a copy of this election statement.

If you are filing your federal income tax return electronically and are also filing a Form 8283, Noncash Charitable Contributions, you can submit this election statement separately on paper as an attachment to the Form 8283 by using a Form 8453, U.S. Individual Income Tax Transmittal for an IRS *e-file* Return. Otherwise, you will have to file your entire tax return on paper in order to attach this election statement. Please consult your tax preparer for guidance.

© 2017 PG Calc Incorporated

Appendix 2

Form **8283** (Rev. December 2014) Department of the Treasury Internal Revenue Service

Noncash Charitable Contributions

▶ Attach to your tax return if you claimed a total deduction of over $500 for all contributed property.

▶ Information about Form 8283 and its separate instructions is at *www.irs.gov/form8283.*

OMB No. 1545-0908

Attachment Sequence No. **155**

Name(s) shown on your income tax return | **Identifying number**

Note. Figure the amount of your contribution deduction before completing this form. See your tax return instructions.

Section A. Donated Property of $5,000 or Less and Publicly Traded Securities—List in this section **only** items (or groups of similar items) for which you claimed a deduction of $5,000 or less. Also list publicly traded securities even if the deduction is more than $5,000 (see instructions).

Part I **Information on Donated Property**—If you need more space, attach a statement.

1	(a) Name and address of the donee organization	(b) If donated property is a vehicle (see instructions), check the box. Also enter the vehicle identification number (unless Form 1098-C is attached).	(c) Description of donated property (For a vehicle, enter the year, make, model, and mileage. For securities, enter the company name and the number of shares.)
A		☐	
B		☐	
C		☐	
D		☐	
E		☐	

Note. If the amount you claimed as a deduction for an item is $500 or less, you do not have to complete columns (e), (f), and (g).

	(d) Date of the contribution	(e) Date acquired by donor (mo., yr.)	(f) How acquired by donor	(g) Donor's cost or adjusted basis	(h) Fair market value (see instructions)	(i) Method used to determine the fair market value
A						
B						
C						
D						
E						

Part II **Partial Interests and Restricted Use Property**—Complete lines 2a through 2e if you gave less than an entire interest in a property listed in Part I. Complete lines 3a through 3c if conditions were placed on a contribution listed in Part I; also attach the required statement (see instructions).

2a Enter the letter from Part I that identifies the property for which you gave less than an entire interest ▶
If Part II applies to more than one property, attach a separate statement.

b Total amount claimed as a deduction for the property listed in Part I: **(1)** For this tax year ▶
(2) For any prior tax years ▶

c Name and address of each organization to which any such contribution was made in a prior year (complete only if different from the donee organization above):

Name of charitable organization (donee)

Address (number, street, and room or suite no.)

City or town, state, and ZIP code

d For tangible property, enter the place where the property is located or kept ▶

e Name of any person, other than the donee organization, having actual possession of the property ▶

		Yes	No
3a	Is there a restriction, either temporary or permanent, on the donee's right to use or dispose of the donated property?		
b	Did you give to anyone (other than the donee organization or another organization participating with the donee organization in cooperative fundraising) the right to the income from the donated property or to the possession of the property, including the right to vote donated securities, to acquire the property by purchase or otherwise, or to designate the person having such income, possession, or right to acquire?		
c	Is there a restriction limiting the donated property for a particular use?		

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 62299J Form **8283** (Rev. 12-2014)

 © 2017 PG Calc Incorporated

Form 8283 (Rev. 12-2014) Page **2**

Name(s) shown on your income tax return	**Identifying number**

Section B. Donated Property Over $5,000 (Except Publicly Traded Securities)—Complete this section for one item (or one group of similar items) for which you claimed a deduction of more than $5,000 per item or group (except contributions of publicly traded securities reported in Section A). Provide a separate form for each property donated unless it is part of a group of similar items. An appraisal is generally required for property listed in Section B. See instructions.

Part I **Information on Donated Property**—To be completed by the taxpayer and/or the appraiser.

4 Check the box that describes the type of property donated:

a ☐ Art* (contribution of $20,000 or more)
b ☐ Qualified Conservation Contribution
c ☐ Equipment
d ☐ Art* (contribution of less than $20,000)
e ☐ Other Real Estate
f ☐ Securities
g ☐ Collectibles**
h ☐ Intellectual Property
i ☐ Vehicles
j ☐ Other

*Art includes paintings, sculptures, watercolors, prints, drawings, ceramics, antiques, decorative arts, textiles, carpets, silver, rare manuscripts, historical memorabilia, and other similar objects.

**Collectibles include coins, stamps, books, gems, jewelry, sports memorabilia, dolls, etc., but not art as defined above.

Note. In certain cases, you must attach a qualified appraisal of the property. See instructions.

5	(a) Description of donated property (if you need more space, attach a separate statement)	(b) If tangible property was donated, give a brief summary of the overall physical condition of the property at the time of the gift	(c) Appraised fair market value
A			
B			
C			
D			

	(d) Date acquired by donor (mo., yr.)	(e) How acquired by donor	(f) Donor's cost or adjusted basis	(g) For bargain sales, enter amount received	See instructions (h) Amount claimed as a deduction	See instructions (i) Date of contribution
A						
B						
C						
D						

Part II **Taxpayer (Donor) Statement**—List each item included in Part I above that the appraisal identifies as having a value of $500 or less. See instructions.

I declare that the following item(s) included in Part I above has to the best of my knowledge and belief an appraised value of not more than $500 (per item). Enter identifying letter from Part I and describe the specific item. See instructions. ▶

Signature of taxpayer (donor) ▶ Date ▶

Part III **Declaration of Appraiser**

I declare that I am not the donor, the donee, a party to the transaction in which the donor acquired the property, employed by, or related to any of the foregoing persons, or married to any person who is related to any of the foregoing persons. And, if regularly used by the donor, donee, or party to the transaction, I performed the majority of my appraisals during my tax year for other persons.

Also, I declare that I perform appraisals on a regular basis; and that because of my qualifications as described in the appraisal, I am qualified to make appraisals of the type of property being valued. I certify that the appraisal fees were not based on a percentage of the appraised property value. Furthermore, I understand that a false or fraudulent overstatement of the property value as described in the qualified appraisal or this Form 8283 may subject me to the penalty under section 6701(a) (aiding and abetting the understatement of tax liability). In addition, I understand that I may be subject to a penalty under section 6695A if I know, or reasonably should know, that my appraisal is to be used in connection with a return or claim for refund and a substantial or gross valuation misstatement results from my appraisal. I affirm that I have not been barred from presenting evidence or testimony by the Office of Professional Responsibility.

Sign Here Signature ▶ Title ▶ Date ▶

Business address (including room or suite no.)	**Identifying number**

City or town, state, and ZIP code

Part IV **Donee Acknowledgment**—To be completed by the charitable organization.

This charitable organization acknowledges that it is a qualified organization under section 170(c) and that it received the donated property as described in Section B, Part I, above on the following date ▶

Furthermore, this organization affirms that in the event it sells, exchanges, or otherwise disposes of the property described in Section B, Part I (or any portion thereof) within 3 years after the date of receipt, it will file **Form 8282**, Donee Information Return, with the IRS and give the donor a copy of that form. This acknowledgment does not represent agreement with the claimed fair market value.

Does the organization intend to use the property for an unrelated use? . . . . ▶ ☐ Yes ☐ No

Name of charitable organization (donee)	**Employer identification number**	
Address (number, street, and room or suite no.)	City or town, state, and ZIP code	
Authorized signature	Title	Date

Form **8283** (Rev. 12-2014)

 © 2017 PG Calc Incorporated