GIFT PLANNING AND THE NEW TAX LAW

PG CALC WEBINAR

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Introduction

Donors make charitable gifts for many reasons. Tax benefits are only one of them and donor surveys typically indicate that they are far from the most important motivation for most donors.

Nevertheless, the American Taxpayer Relief Act (ATRA) passed by Congress on January 1 to avoid the "fiscal cliff," along with the Affordable Care Act of 2010, have inaugurated a host of changes to U.S. federal tax rules that will alter the tax incentives for making charitable gifts, including planned gifts.

For the most part, there is good news to share.

- In the months leading up to the new law, a 28% limit on charitable deductions and a total dollar limit on all itemized deductions were both seriously considered, but in the end no new limits on the charitable deduction were introduced.
- There are opportunities for some taxpayers to save more in taxes by taking charitable deductions
- There's less uncertainty about the future of transfer tax rates and exemptions, making some donors more comfortable with making estate plans that include charity
- The charitable IRA rollover is back, at least for 2013

This paper reviews all of the tax changes that went into effect on January 1, 2013 with which we think gift planners should be familiar. Some will have a direct effect on specific types of gifts, while others are changes that may have an indirect influence on all giving. In each case, we explain the change and make our best assessment of its likely affect on planned gifts.

I. Income taxes

A. Increase in highest income tax bracket

The top federal income tax rate has increased from 35% to 39.6%. All other federal income tax brackets the same as they were in 2012.

The new top bracket applies to single taxpayers with taxable income over $400,000, married filing jointly and surviving spouses with taxable income over $450,000, and heads of households with taxable income of $425,000. The 2013 federal income tax schedule for a married filing jointly couple is below. The taxable income at which each tax rate starts is indexed for inflation, so the nice round income amounts at which the 39.6% rate kicks in will change in future years.

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2013 Federal Income Tax Schedule: Married Filing Jointly

Taxable Income*	Tax	% on Excess
$0	$0	10
17,850	1,785	15
72,500	9,983	25
146,400	28,458	28
223,050	49,920	33
398,350	107,768	35
450,000	125,846	39.6

* Taxable income is equal to gross income minus deductions and exemptions.

Impact on planned givers: To the extent that the greater tax savings from taking a deduction against a higher rate means an increased incentive to give, the new 39.6% bracket gives high income donors a little more incentive to make charitable gifts.

Example
James Jeffers is a single taxpayer who has taxable income of $500,000. If he decreases his taxable income to $450,000 by making a $50,000 charitable gift, he will decrease his income tax by 39.6% of $50,000 or $19,800. If the top rate were still 35%, he would save only $17,500 instead (35% of $50,000)

B. Increase in highest capital gain and qualified dividend tax rate

The top federal tax rate on most long term capital gain income and qualified dividends has increased from 15% to 20% for high income taxpayers. The taxable income thresholds for the 20% rate are the same as for new 39.6% income tax rate discussed above: single taxpayers with taxable income over $400,000, married filing jointly and surviving spouses with taxable income over $450,000, and head of households with taxable income of $425,000. Taxpayers who are in the 25% - 35% income tax brackets still pay 15% on this income, 0% if they are in the 10% or 15% income tax brackets. Long term capital gain from the sale of collectibles is still taxed at 28% and recaptured depreciation is still taxed at 25%.

Both taxes are progressive. For example, if a single taxpayer has taxable income of $360,000 plus another $100,000 of long term capital gain income, the first $40,000 of capital gain income will be taxed at 15% because it occurs below the $400,000 threshold. The remaining $60,000 will be taxed at 20% because it occurs above the $400,000 threshold.

Definition: Qualified dividends are dividends paid by stock in a U.S. corporation or by stock in a foreign corporation that is readily traded on an established U.S. stock market.

Impact on planned givers: The higher tax rate on long term capital gains will mean gifts of appreciated property will be more attractive to some high income donors because they are able to avoid a greater tax than in past years.

Example: Sam and Isabel Driver have taxable income of $750,000. They are considering funding a $250,000 Charitable Remainder Unitrust (CRU) with stock that they purchased for

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$50,000 many years ago. If they were to sell this stock themselves, they would owe capital gains tax of $40,000 (($250,000 - $50,000) x 20%), leaving only $210,000 to reinvest. By funding a CRU instead, the whole $250,000 can be reinvested. Under the former 15% top rate, the Drivers would have avoided only $30,000 in capital gains taxes by funding the CRU, rather than $40,000. So this year there are 10,000 more reasons for the Drivers to use their appreciated stock to fund their gift.

It is less clear what effect the increased tax rate on qualified dividends will have on charitable giving. On the one hand, affected taxpayers get to keep a little less of their qualified dividends than before. Consequently, donating assets that produce qualified dividends to charity will mean the sacrifice of a little less after-tax income than previously. On the other hand, these donors will have less total after-tax income from qualified dividends and so may be inclined to give less to charity and keep more for themselves.

C. 3.8% net investment income tax (Medicare surtax)

This new tax went into effect on January 1, 2013 and is part of the Affordable Care Act of 2010 rather than ATRA 2012. 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 thresholds for the new 39.6% income tax rate and 20% tax rate on long term capital gain. We'll come back to this fact in the example below.

MAGI equals AGI plus any foreign earned income exclusion. Taxpayers below the MAGI thresholds do not pay any Medicare surtax. The rest of this discussion applies to donors who are above the applicable MAGI threshold.

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.

We will focus on the second part, which 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.

Net investment income includes income or realized capital gain from stock, bonds, certificates of deposit and other passive sources, but not qualified retirement plan distributions or gains from sales of an active business, S corporation, or partnership interest.

Example: George and Ann McNeil are married filing jointly with $100,000 in wage income and $200,000 of long-term gain on the sale of appreciated stock. They 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 the 3.8% surtax on $50,000, the lesser of $200,000 in net investment income and $50,000 excess MAGI over the threshold ($300,000 - $250,000). This effectively raises their marginal capital gains tax rate from 15% to 18.8%. If the McNeils had taxable income exclusive of their capital gain in excess of $450,000, then the

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tax rate on their capital gain would increase from 20% to 23.8%. In each case, the surtax makes giving appreciated property to charity more attractive.

There is no charitable deduction against the surtax. Only properly allocable deductions paid or incurred to produce the net investment income being taxed can be deducted for purposes of the surtax.

Payments from life income vehicles subject to surtax
Planned gift beneficiaries who have a MAGI above their applicable threshold will owe the 3.8% surtax on their payments.

Gift annuities: Gift annuity payments are surtaxed on their ordinary income and capital gain portion. The capital gain portion 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 should apply: if the reportable capital gain can be spread over the donor's life expectancy, the surtax on this capital gain may be spread over the donor's life expectancy, too. The tax-free portion is not subject to surtax.

Charitable remainder trusts: While a charitable remainder trust (CRT) itself is exempt from the surtax, its income 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 good news is that the beneficiary is never surtaxed on more than her 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: Pooled income fund (PIF) income is surtaxed. 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 $11,950 for 2013. Long-term gains retained by the pooled income fund and set aside for charity are excludable, as they are for the regular income tax. The IRS did invite further comments by March 5, 2013 on whether pooled income funds should be granted an exemption from the surtax for administrative reasons, which would be very sensible, as under most PIF trust agreements both short-term and long-term gains are typically set aside for ultimate distribution to charity and any short-term gains are typically small amounts.

Charitable lead trusts: Nongrantor 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 income 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 $11,950 for 2013. That could hit capital gains realized from portfolio rebalancing, as the capital gains tax does already, if those gains plus other income exceed what the CLT distributed to charity in the same year.

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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 there is already no charitable deduction for the regular income tax imposed on the donor for grantor CLT income and capital gains.

Impact on planned givers: In summary, the Medicare surtax introduces additional complexity that gift planners will have to learn and adapt to in working with donors who may be subject to it. However, it strengthens incentives for charitable giving, particularly of appreciated property.

D. Two payroll taxes increased on 1/1/2013

Unrelated to ATRA, wage earners will have more in payroll taxes subtracted from their take-home pay as of January 1, 2013.

1. **Additional .9% Medicare tax for high income wage earners**
   As mentioned earlier, there is a second element to the new Medicare surtax. Taxpayers with MAGI 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 will pay an additional 0.9% in Medicare payroll tax on wages and self-employment income above the applicable threshold.
2. **Payroll tax relief expired 12/31/12**
   For 2011 and 2012, the social security payroll tax was reduced from 6.2% to 4.2% for all taxpayers as an economic stimulus measure. Although there was some effort to include an extension of this temporary tax relief in ATRA, it was not part of the final bill, so it expired on 12/31/2012. This means that wage earners will take home 2% less of their first $113,700 in wages in 2013 than they did in 2012.

Impact on planned givers: These payroll taxes are unavoidable. No deductions can be taken against them, including charitable contribution deductions, should one of your donors ask. It seems unlikely these payroll tax increases will have a measurable impact on planned gifts.

E. AMT thresholds increased

The alternative minimum tax (AMT) is a parallel income tax system designed to ensure that high income taxpayers with certain deductions that lower their taxable income "too much" pay at least a minimum amount of tax. It is a very flat tax system with only two rates: 26% and 28%. Charitable contributions are deductible from alternative minimum taxable income, but only against the 26% or 28% bracket. For a taxpayer who would otherwise be in the 33% income tax bracket or higher, the AMT reduces the value of her itemized charitable contributions. For example, a donor who gives $10,000 to charity and pays AMT, saves $2,800 in tax, but if this same donor would otherwise pay regular income tax in the 33% income tax bracket, she would save $3,300 in tax.

When originally enacted in the 1969, the AMT exemption amount was sufficient to keep all but a relatively few high income taxpayers out of the AMT. However, the exemption amount did not have an automatic inflation adjustment. Nineteen times Congress passed a temporary "patch" that increased the exemption amount so that the AMT would not affect millions of middle class taxpayers Congress never intended it to affect. Nevertheless, the lack of an

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inflation adjustment made tax planning difficult for taxpayers who had enough income and deductions to possibly pay AMT.

The good news is that ATRA has permanently patched the AMT exemption amount and has incorporated an annual inflation adjustment so that the AMT will not apply to middle income taxpayers for the foreseeable future. This change will make it easier for middle income donors to plan their charitable contributions.

Impact on planned givers: Many taxpayers will no longer have to rely on temporary patches from Congress in order to stay out of AMT. This change will encourage donors who were relying on periodic patches to keep them out of the AMT to make more charitable contributions, including planned gifts.

II. IRA Rollover

A. Charitable IRA Rollover Extended Through 12/31/2013.

The charitable IRA rollover was first included in the Pension Protection Act of 2006, with an expiration date of 12/31/2007. It was subsequently extended several times, covering all years through the end of 2011. It expired at the beginning of 2012, but the good news is that it has been extended again by ATRA through 12/31/2013 and retroactive to 1/1/2012, with some special provisions thrown in because 2012 was over by the time ATRA became law.

The IRA Charitable Rollover has proven to be a popular way for donors to support their favorite causes. The main reason is that it enables a donor to make a gift to charity from his IRA and not include the amount distributed in his taxable income. In addition:

- Charitable IRA rollovers count toward a donor's required minimum distribution from an IRA.
- Funds transferred per the charitable IRA rollover can fulfill a pledge to charity.
- Charitable IRA rollovers typically are easy to do. The donor just contacts the administrator of his IRA and instructs him to issue a check made out to the recipient charity.

The terms of the latest extension are identical to the previous ones, namely:

- The donor is age 70½ or older.
- The rollover must be from a traditional IRA or Roth IRA.
- The total of all qualifying IRA charitable rollover gifts made during the year is $100,000 or less.

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- The gift is made to a public charity and not to a private foundation or supporting organization, nor to a donor advised fund maintained by a charity.
- The donor receives no benefit in exchange for the gift. (This requirement rules out gifts for life income arrangements.)
- The donor has documentation from the charity that the distribution was received and that he or she received no benefits. See the Appendix for sample letters.
- Rollovers from 401(k) and 403(b) plans and other qualified retirement plans that are not IRAs, do not qualify for charitable IRA rollover treatment. Contributions from non-IRA plans will be treated as taxable distributions followed by a charitable contribution. Donors often take advantage of the charitable IRA rollover by rolling assets from one of these plans into an IRA and subsequently authorizing a distribution to charity from the IRA.

Beyond making it easier to make gifts from their IRA, the charitable IRA rollover can be advantageous from a tax standpoint to donors who:

- Do not itemize their charitable deductions. More of these donors live in the nine states that do not have a state income tax.
- Do itemize but would lose tax deductions due to the Pease limitation if they increase their adjusted gross income by taking an IRA distribution.
- Regularly contribute 50 percent of their adjusted gross income to charity or are maxed out on their carry forward of charitable deductions from previous years, in which case they cannot deduct any of the amount they withdraw from an IRA and then contribute.
- Live in a state that with a state income tax that does not permit charitable deductions.

Example: Mary Chen does not itemize her deductions and is in the 28% income tax bracket. If she makes a $5,000 rollover gift to your charity from her IRA, her income tax will be unaffected. If there were no charitable IRA rollover, however, she would have to include the $5,000 withdrawal in her income. Since she does not itemize, Mary wouldn't get an offsetting deduction, so she would pay an additional $1,400 of income tax (28% x $5,000).

If Mary were to itemize, any of the other circumstances listed above could limit her deduction so that it does not completely offset her $5,000 increase in AGI, creating more income tax for her. Even if she would be able to use her entire deduction, the availability of the charitable IRA rollover eliminates the possibility that her gift will increase her income tax and simplifies her tax return a little bit.

The rollover is not as appealing to donors who:

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- Live in a state that exempts all or a portion of retirement distributions from state income tax and which allows a deduction for charitable gifts on the state income tax return. These donors will benefit more from taking a taxable distribution, then contributing it to charity and claiming a deduction on both the federal and state income tax returns (as long as their charitable deduction isn't limited in some way on their federal return). In this case, donors will pay less in state income tax and the same in federal income tax than if they made an IRA rollover gift.

- Have highly appreciated securities which could be contributed instead.

- Have an uncooperative IRA administrator, which does happen unfortunately.

The new law includes IRA rollover gifts made in 2012, as well as 2013. This helps donors that took a chance by making qualifying IRA distributions in 2012 in the hope that the provision would be extended. Make sure that these donors get a receipt from your organization that has the required information for IRA Charitable Rollover gifts.

Two special provisions are available in January 2013 only (and will be effectively expired by the time we give our Webinar on January 31). If a donor did not make a qualifying gift in 2012 but wants to, they can do so in one of two time-limited ways:

1. Make a 2012 IRA Rollover in January 2013. Your donor can do a rollover gift in January and "elect" to have this gift be considered made in 2012. How the election is to be made will be specified by the Secretary of the Treasury later this year (presumably before April 15!).
2. Convert a December 2012 IRA distribution into a 2012 charitable IRA rollover gift. Some donors waited to take their required minimum distributions until December, hoping that the charitable IRA rollover would be extended for 2012. If that is the case, and the distribution meets all of the rollover criteria except for the direct transfer to charity requirement, your donors can claim it as a charitable IRA rollover gift in 2012, to the extent that they now transfer the distribution in cash to your organization.

   This transfer from their bank account to your organization must occur by January 31, 2013. If your donor took a distribution in December and made a gift to your organization in December these two can be tied together, as long as the charitable distribution occurred AFTER the withdrawal from the IRA.

The IRS provides useful guidance on how to document these special IRA rollover gifts on its website: http://www.irs.gov/Retirement-Plans/Charitable-Donations-from-IRAs-for-2012-and-2013

Impact on planned givers: The revival of the charitable IRA rollover is great news for gift planners, at least through the end of 2013. According to the Investment Company Institute, IRA assets totaled $5.13 trillion as of June 30, 2012. The combination of an appealing giving opportunity and the huge reservoir of funds eligible to take advantage of it represents an excellent fundraising opportunity for gift planners. Make sure you use all of your marketing channels to let your charity's supporters know about the benefits of the charitable IRA rollover.

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The Partnership for Philanthropic Planning and other trade groups will continue to promote making the charitable IRA rollover permanent law rather than dependent on extensions from Congress. In the meantime, take advantage of the 11 months you know it has left.

III. Deductions

A. 3% deduction reduction rule

ATRA resurrects the “Pease” limitation on itemized deductions that was in effect from the late 1990s until it was completely phased out in 2010.

This limitation requires taxpayers with adjusted gross income (AGI) above a specified threshold to reduce their itemized deductions by 3% of the amount by which their AGI exceeds the threshold. The reduction also has its own limit: it cannot reduce total itemized deductions by more than 80%. In addition, it does not apply to deductions for medical expenses, investment interest, casualty and theft losses, and gambling losses. The thresholds are as follows (they will be indexed for inflation after 2013):

Filing Status	AGI Threshold
Married filing jointly/Surviving spouse	$300,000
Head of household	$275,000
Single	$250,000
Married filing separately	$150,000

These thresholds are substantially higher than the ones in force before 2010. For example, CCH estimates that under the old rules the threshold for married filing jointly taxpayers would have been $178,150 for 2013, far lower than the new $300,000. As a result, the limitation will apply to fewer donors than in the past, and when it does apply, it will reduce itemized deductions less than if the old indexed thresholds were back. For instance, the reduction will be about $3,550 less for a married filing jointly couple with an AGI over $300,000 than if a $178,150 threshold applied.

Past experience suggests that the Pease limitation had no more than a mild effect on charitable contributions. Now, that effect should be even milder because of the higher thresholds.

An example will demonstrate that the Pease limitation reduces the amount of charitable deductions only for donors either with very high income or with high income but few or no itemized deductions other than charitable contribution deductions.

Example

Mr. and Mrs. Smith file a joint tax return. Between them, they have a total AGI of $500,000. They have taken itemized deductions for $20,000 real estate taxes and $10,000 in mortgage interest, as well as $50,000 in charitable deductions, for a total of $80,000 in itemized deductions. Because of the Pease limitation, their itemized deductions will be reduced to $74,000 as follows:

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\$500,000 - \$300,000 = \$200,000	*Amount subject to 3% deduction reduction*
\$200,000 x 3% = \$6,000	*Amount of deduction reduction*
\$80,000 - \$6,000 = \$74,000	*Amount of itemized deductions after reduction*

Notice that the Smiths' real estate taxes and mortgage interest deductions far exceed their \$6,000 Pease limitation. The \$6,000 reduction can be thought of as affecting the value of only these deductions. Consequently, the Smiths' charitable deductions will reduce their total income tax due by the same amount, with or without the \$6,000 reduction. The Smiths would need a combined AGI of over \$1.2 million before the reduction in their total itemized deductions started eating into their itemized charitable deductions. If they lived in a state with a state income tax, and most people do, they would itemize a state income tax deduction and need an even greater combined AGI before their charitable deductions were reduced!

The tax benefit of the Smiths' charitable deductions would most likely be affected if they not only lived in a state without an income tax, but also did not own real estate on which to pay tax, and did not hold a mortgage on which to pay interest. In this case, they might have few or no itemized deductions subject to the Pease limitation apart from their charitable contributions. As a result, the \$6,000 reduction would come right out of their \$50,000 in contribution deductions.

When does the 80% limitation come into play? Suppose the Smiths had an impressive combined AGI of \$2.5 million. In this case, their tentative reduction would be 3% of (\$2,500,000 - \$300,000), or \$66,000. But 80% of their \$80,000 in itemized deductions is only \$64,000, which is less than \$66,000. Obeying the 80% limit, their deductions would be reduced to \$16,000 (\$80,000 - \$64,000), not \$14,000 (\$80,000 - \$66,000).

Impact on planned givers: The Pease limitation adds a layer of complexity for high income donors, which could discourage some donors from making as many charitable gifts. In most cases, however, even for many donors with an AGI above the applicable threshold, the limitation will not constrain the amount by which their charitable deductions can reduce their income tax. From the viewpoint of tax incentives, the limitation should affect the charitable giving of only a tiny fraction of all donors.

B. Personal exemption phase-out revived

All taxpayers can take a personal exemption on their tax return for themselves, their spouse (if filing jointly), and each dependent. In 2012, the personal exemption was \$3,800. Until 2010, there was a phase-out of the personal exemption for taxpayers with an AGI over the applicable threshold. In 2010-2012, this phase-out of the personal exemption was itself completely phased out. During those years, taxpayers could take all of their personal exemptions, regardless of their AGI. As with the Pease limitation, ATRA has revived the phase-out of the personal exemption for 2013 and beyond. The AGI thresholds for the personal exemption phase-out are exactly the same as they are for the Pease limitation:

Filing Status	AGI Threshold	AGI w/100% phase-out
Married filing jointly/Surviving spouse	\$300,000	\$422,500
Head of household	\$275,000	\$397,500
Single	\$250,000	\$372,500
Married filing separately	\$150,000	\$211,250

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Here's how the phase-out works: for each $2,500 or fraction thereof by which a taxpayer's AGI exceeds the applicable threshold amount, the personal exemption available is reduced by 2%. The personal exemption is $3,900 in 2013. It is indexed for inflation.

For example, a married filing jointly taxpayer with an AGI of $400,000 who has claimed $7,800 in personal exemptions (2 x $3,900 each) would have to reduce his personal exemption by 80% or $6,240 (($400,000 - $300,000)/2,500 x 2%) x $7,800). Instead of being able to deduct $7,800 from his taxable income, he would be able to deduct only $1,560. If the taxpayer is in the 35% income tax bracket, he will pay $2,184 more in income tax because of the reduced personal exemption (35% x $6,240).

As shown in the table above, married filing jointly taxpayers with an AGI of $425,000 or greater lose all of their personal exemptions.

Impact on planned givers: The return of the personal exemption phase-out will increase income taxes for high income taxpayers. While taking charitable deductions can reduce total income tax for these taxpayers, it cannot reduce the effect of the personal exemption phase-out. On the whole, then, the personal exemption phase-out will reduce after-tax income for high income taxpayers and therefore their disposable income from which to make charitable gifts. Since planned gifts tend to be made out of wealth rather than current income, this decrease in disposable income will have a negative affect on annual gifts more than on planned gifts.

IV. Transfer taxes

A. Gift, estate, and GST tax exemption amounts are the same as in 2012 (with indexing for inflation), but permanent

Without ATRA, federal gift tax and estate tax exemption amounts would have plunged from $5,120,000 to $1,000,000 per individual on January 1. That didn't happen, of course. ATRA keeps the gift tax, estate tax, and generation skipping tax exemptions substantially the same as they were in 2012. In 2013, these exemptions, which have become permanently unified under ATRA, are $5.25 million per individual, $10.5 million for married couples.

This means that an individual can give up to $5.25 million during life before owing any gift tax. If the individual doesn't use up all of his gift tax exemption during life, then whatever remains can be used as an exemption from estate tax.

ATRA also makes permanent the portability of unused spousal gift tax and estate tax exemptions. This portability allows a surviving spouse to elect to use any unused exclusion remaining from his or her last deceased spouse. If a surviving spouse remarries and the new spouse subsequently dies, the surviving spouse then has access to the unused estate tax exclusion of the second spouse only. Portability is available only if an election is made on the deceased spouse's estate tax return.

Example: Karen McNeil dies in 2013, having made $1 million in lifetime taxable gifts. She leaves her entire $10 million estate to her husband so no estate tax is due at her death. If an

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election is made her estate tax return to allow her husband to use her $4.25 million unused estate tax exclusion, his available exclusion amount will increase to $9.5 million — his own $5.25 million plus his wife Karen's unused $4.25 million. He can use his $9.5 million exclusion for lifetime taxable gifts and any unused amount for taxable gifts made at death.

Portability is not available for the GST tax exemption.

Impact on planned givers: ATRA's permanent adoption of high transfer tax exemptions that will continue to be adjusted for inflation, and portability of gift and estate tax exemptions between spouses, very few donors will have estates large enough to owe estate tax. For these donors, saving estate tax will not be a motivation for making bequests or other planned gifts. Gift planners will do well to focus on promoting to this group their organization's mission and the importance of leaving a legacy.

A big plus of the new law is that it lays to rest, at least for now, donor (and advisor) uncertainty over the future of transfer tax exemptions. Donors who were delaying their estate planning until this uncertainty was resolved can now proceed with their planning, including their charitable planning. This benefit applies to all donors no matter the size of their estate.

B. Increase in top gift and estate tax bracket and in GST bracket from 35% to 40%

ATRA has increased the top federal gift tax and estate tax brackets from last year's 35% to 40%. Consequently, the generation skipping tax (GST) rate has also increased from 35% to 40%. This increase is permanent.

Here is the unified federal gift tax and estate tax schedule for 2013:

Taxable	Tax	% on
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

You'll notice that the 40% rate kicks in at a taxable gift/estate of just $1 million, far below the $5,250,000 exemption available against gift/estate tax. What this means is that any donor who needs to pay transfer tax will pay it at the 40% rate.

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Example: Sarah Shulman, who never married, dies in 2013 with an estate worth $8 million. She made $2 million in taxable gifts during her lifetime. If she includes no bequests to charity in her estate plan, her estate tax will be computed as follows:

Estate value	*$8,000,000*
Prior taxable gifts	*+ $2,000,000*
Charitable bequests	*- $0*
Taxable estate	*$10,000,000*
Estate Tax Exemption	*- $5,250,000*
Taxable Estate	*$4,750,000*
Tax owed ($4,750,000 x 40%)	*$1,900,000*

If Sarah includes a $1 million charitable bequest in her will, her estate tax will decline by $400,000, 40% of her $1 million gift, as shown below.

Estate value	*$8,000,000*
Prior taxable gifts	*+ $2,000,000*
Charitable bequests	*- $1,000,000*
Taxable estate	*$9,000,000*
Estate Tax Exemption	*- $5,250,000*
Taxable Estate	*$3,750,000*
Tax owed ($3,750,000 x 40%)	*$1,500,000*

The combination of a higher top income tax bracket and higher top estate tax bracket means that for donors who are in both, there's an even greater incentive for them to designate qualified retirement plan assets for charity. Since retirement plan assets and other income in respect of a decedent (IRD) are subject to both of these taxes, the potential combined tax rate on these assets if not given to charity has risen from about 58% to over 63%. (You don't just add 39.6% and 40% together because the income tax attributable to IRD assets is deductible from the estate taxable amount.)

Impact on planned givers: For most planned gift donors, the increase in gift/estate tax rate will make no difference, as the generous gift/estate tax exemptions will be sufficient to eliminate all gift/estate tax. For donors whose estates are large enough to owe estate tax, the higher top rate for taxable transfers will increase moderately the incentive to make outright bequests or fund a planned gift during life or at death. For some in this group, the estate planning benefits of the charitable lead trust will be especially attractive.

C. Increase in annual gift tax exclusion to $14,000

The annual gift tax exclusion allows each taxpayer to make gifts of present interests up to the exclusion amount to any number of individuals without making a taxable gift. The exclusion amount is indexed for inflation and after several years at $13,000 per individual, in 2013 it has increased to $14,000 ($28,000 for married couples who do gift splitting). This change is unrelated to ATRA.

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Example: Harold and Julie Remington have three children. They can give each of them $28,000 in 2013, a total of $84,000, without making a taxable gift (and that doesn't count against your lifetime exclusion).

Impact on planned givers: The increase in the annual gift tax exclusion should have little effect on planned gifts.

D. State death tax deduction made permanent

Once upon a time, before 2002, each dollar of state death tax paid could be taken as a dollar-for-dollar credit against the federal estate tax up to limits established in a federal state death tax credit schedule. The credit was then phased out over several years in favor of a state death tax deduction. Although not limited by a federal schedule like the credit was, the deduction is generally less valuable to a taxpayer than the credit. Since 2005, there has been only a state death tax deduction.

Without ATRA, the state death tax credit would have returned. ATRA, however, has made the state death tax deduction permanent.

Impact on planned givers: Given that the state death tax deduction has been in place for years and ATRA simply made it permanent, we don't expect it to affect planned gift donations one way or the other.

V. Other

A. Conservation contribution provisions extended

To encourage qualified conservation contributions, the Pension Protection Act of 2006 (PPA) increased the donor's deduction limit, even if the property has appreciated, to 50 percent of AGI, and the carryover period for the unusable portion of the deduction to 15 years. It increased the deduction limit to 100 percent of AGI when the donor is a qualified farmer or rancher (which can include certain corporate farmers and ranchers) and the property will be used in agriculture or livestock production. ATRA extends these provisions through 12/31/2013.

B. Sub S corp gift provisions extended

Sometimes, a Subchapter S corporation owns appreciated stock or real estate, and the corporation makes a gift of that property to a charity. Each shareholder then claims his or her pro rata share of the contribution when determining personal income tax liability. Under the law prior to the PPA, the shareholder had to reduce the basis of his or her stock by the amount of the contribution claimed. This effectively negated the benefit of such gifts, for the shareholder's tax liability would be increased in the future. The PPA included a provision that eased this problem by making the basis reduction equal to the shareholder's pro rata share of the basis of the contributed property, rather than the shareholder's pro rata share of the market value of the contributed property. ATRA extends this provision through 12/31/2013.

Impact on planned givers: The extension of the conservation contribution and Subchapter S corporation provisions encourage gifts of types rarely received by most charities. However, the extension of the conservation contribution provisions represents an important fundraising and marketing opportunity for charities whose mission includes protection of the environment. While the extension of the Subchapter S provision doesn't favor a particular type of charity in this way,

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keep it in mind whenever working with a supporter who owns Subchapter S stock. You might also consider including an article about this opportunity in a newsletter early in the year.

VI. Conclusion

On balance, we expect the tax changes ushered in by ATRA, the Affordable Care Act, and indexed tax schedules to be favorable to charitable giving, including planned giving. The resurrection of the charitable IRA rollover, in particular, gives gift planners a great opportunity to tap into a huge potential source of outright gifts for the remainder of 2013. Although the expiration date of the rollover will create a sense of urgency that will encourage more rollover gifts in 2013, gift planners should continue to work toward convincing Congress to make the charitable IRA rollover permanent and to make it apply to life income gifts.

Higher top income tax and estate tax brackets will affect relatively few donors, but for those donors who are affected, the higher brackets will provide additional incentive for them to make charitable gifts of all kinds. Donors who are in the highest income tax bracket and subject to the 3.8% net investment income tax will be able to avoid substantially more capital gains tax by funding charitable gifts such as charitable remainder trusts with long term appreciated property.

Although ATRA makes many changes permanent, that only means they're permanent until Congress passes legislation that alters them. Congress is not done grappling with the U.S.'s long term budget woes and further revisions to the tax code are likely. At minimum, it will take many months for the details of a broad tax reform package to be hammered out and passed, and it's anyone's guess what specific changes will be made that are relevant to gift planning.

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Appendix: Sample Charitable IRA Rollover Letters

Sample Request from IRA Owner to IRA Administrator
for Qualified Charitable Distribution from IRA

[Date]

TO: [IRA Administrator]
[Address]
[City, State, ZIP Code]

RE: Request for Charitable Distribution from Individual Retirement Account
Account # ______________

Dear Sir or Madam:

Please accept this letter as my request to make a direct charitable distribution from the account referenced above, as provided by Section 208 of the American Taxpayer Relief Act of 2012 and Section 408(d)(8) of the Internal Revenue Code of 1986, as amended.

Please issue a check in the amount of $___________ [not to exceed $100,000] payable to [Legal Name of Charity]. Please mail the check directly to this organization at the following address:

[Legal Name of Charity]
[Address]
[City, State, ZIP Code]
[Attn: Name]

In your transmittal to [Charity], please give my name and address as the donor of record in connection with this transfer. Please copy me on your transmittal.

Optional paragraph for January 2013 distributions that the donor wants to count as an IRA Charitable Rollover gift made in 2012: It is my intention to have this transfer qualify for exclusion from taxable income during the 2012 tax year. **Therefore, it is imperative this distribution be postmarked no later than January 31, 2013.**

Optional paragraph for requests occurring close to year-end: It is my intention to have this transfer qualify for exclusion from taxable income during the 2013 tax year. **Therefore, it is imperative this distribution be postmarked no later than December 31, 2013.**

If you have any questions or need to contact me, I can be reached at [telephone].

Thank you for your assistance in this matter.

Sincerely,

[Plan Owner]
[Plan Owner Address]

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Sample Letter from Donor Informing Charity of Forthcoming Qualified Charitable Distribution from IRA

[Date]

[Charity Name]
[Charity Address]

Attention: [Name]

Dear Mr./Ms. [Name]:

It is my pleasure to inform you that I have requested that a qualified charitable distribution from my Individual Retirement Account in the amount of $____________ be made to [Charity] by my plan administrator, [name of administrator]. This gift is to be used for the general purposes of [Charity] [please substitute more specific language if applicable].

It is my intent to comply with the requirements of Section 208 of the American Taxpayer Relief Act of 2012 and Section 408(d)(8) of the Internal Revenue Code of 1986, as amended, in connection with this gift. *Optional sentence, if applicable to the situation: It is my further intention that this gift qualify as a 2012 IRA Rollover gift and I will make the required election in the manner to be prescribed by the IRS.*

Accordingly, upon your receipt of payment from my plan administrator, please send me a contemporaneous written acknowledgement that states the amount of my gift, that no goods or services were provided to me by your organization as consideration for this gift, and that my gift will not be placed in a donor advised fund or supporting organization.

If you have any questions or need to contact me, I can be reached at [telephone].

Sincerely,

[Donor Name]
[Donor Address]

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Sample Contemporaneous Written Acknowledgement from Charity to Donor

[Date]

[Donor Name]
[Donor Address]

Dear [Donor]:

Thank you for your gift in the amount of $___________ from your Individual Retirement Account. We are writing to acknowledge that we received your gift directly from your plan administrator and that it is your intention for all or a portion of your gift to qualify as a qualified charitable distribution from your IRA, as provided Section 208 of the American Taxpayer Relief Act of 2012 and Section 408(d)(8) of the Internal Revenue Code of 1986, as amended. *Optional sentence, if applicable: It is our further understanding that you plan to elect to have this gift be deemed to be a 2012 charitable rollover gift.*

In that connection, we warrant to you that our organization is qualified under Section 170(b)(1)(A) of the Internal Revenue Code and that your gift was not transferred to either a donor advised fund or a supporting organization as described in Section 509(a)(3).

We further warrant that no goods or services of any value were or will be provided to you in connection with this gift.

Please retain this letter with your important tax documents and provide a copy to your tax preparer.

Thank you again for your generous contribution to our organization.

Sincerely,

[Charity]

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