Gift Planning Under the New Tax Law

PG CALC WEBINAR

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I. INTRODUCTION

On December 22, 2017, the President signed into law an "Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018." That's quite a mouthful, so this article will refer to the law as the "Tax Reform Act" for convenience.

There has been some alarm in the charitable community about the impact of this law on charitable giving. The intention of the analysis that follows is twofold. First, it explains which laws affecting planned giving have changed and which laws remain intact. Second, it offers five suggestions on the best ways donors can continue to make tax-efficient planned gifts.

I. WHAT IS IN THE TAX REFORM ACT THAT AFFECTS THE CHARITABLE SECTOR?

- **Reduced individual income tax rates.** The Tax Reform Act retains seven brackets, as under previous law, but reduces rates, including a top marginal rate of 37 percent, down from 39.6%. Individual income tax brackets will be indexed using the Chained Consumer Price Index measure of inflation, so brackets are expected to rise slightly less quickly than they would have using the prior indexing formula. The net effect of reduced income tax rates will be to reduce the tax savings for an income tax charitable deduction.

- **The income tax charitable deduction.** The income tax charitable deduction is retained in the Tax Reform Act. Other itemized deductions are eliminated or subject to limitations. State and local taxes will be deductible only up to a combined annual limit of $10,000. Deductions for mortgage interest will be limited to interest on up to $750,000 of debt for those married filing jointly, down from $1 million. See below for tax law changes that will affect the number of taxpayers who will continue to itemize under the new law.

- **Increase in the standard deduction.** The law eliminates the personal exemption and increases the standard deduction to $12,000 for singles, $24,000 for married couples filing jointly, and $18,000 for heads of households. Itemized deductions (including charitable deductions) will not reduce a taxpayer's income tax unless their total exceeds their applicable standard deduction amount.

  The Tax Policy Center estimates changes to the standard deduction will reduce the number of taxpayers who itemize their deductions from 46 million to 13 million, with an estimated loss of giving between $12 and $20 billion in 2018. There is debate about the size of the loss in charitable giving. Lower tax rates and a robust increase in economic activity could at least partially offset the impact of the reduced income tax benefit from charitable deductions because more donors take the standard deduction.

- **Increase in the adjusted gross income limitation on cash gifts.** There is an increase in the adjusted gross income (AGI) limitation on charitable gifts of cash to public charities from 50% of AGI to 60% of AGI. The AGI limitation on charitable gifts of appreciated property to public charities remains 30% of AGI. The interplay of these AGI limits continues to be complicated, and in some ways have changed with the new law. Itemizers will continue to be able to carry forward deductions subject to either limitation for up to five years.

- **Gift tax, estate tax, and generation skipping taxes.** The law retains the gift tax, estate tax and generation skipping taxes at a top tax rate of 40%. Estates will still be entitled to an unlimited estate tax deduction for charitable gifts. The Tax Reform Act doubles the "basic exclusion amount" for federal gift, estate, and generation skipping from $5 million to $10 million. The $10 million is then adjusted for inflation for the years since the basic exclusion amount was established in 2011. The new tax law also adopts a new cost-of-living adjustment for this purpose called the "Chained Consumer Price Index for All Urban Consumers." Pending release of IRS regulations clarifying the cost-of-living adjustment, the exemption amount could be 11.2 million or $11.18 million. (See our blog post for more details on the exemption.)

  The increased exemption amount could reduce the incentive to make charitable bequests for those estates no longer subject to the estate tax. Some have speculated, on the other hand, that large estates not subject to estate tax could increase charitable estate gifts if relieved of the estate tax burden. While the volume of bequests is unpredictable and does not correspond exactly with tax policy changes, it is interesting to look at the correlation between estate tax policy and bequest giving. In 2001, the estate tax exemption was a mere $675,000 and the top tax rate was 55%. In 2016, the estate tax exemption was $5.45 million, and the top rate was 40%. Nonetheless, bequest giving increased, adjusted for inflation, from $20.15 billion in 2001 to $30.36 billion in 2016.

- **Excise tax on net investment income of certain colleges and private universities.** The Tax Reform Act imposes a 1.4% excise tax on investment income of private colleges with assets valued at $500,000 or more per full-time student, and with at least 500 total students. Endowment funds used to carry out a college's tax-exempt purpose are excluded from the asset threshold, but the IRS has not released regulations as to which funds are subject to this exclusion. The impact of this provision is to target large endowments at private colleges and universities. It is unclear how such a provision might affect the willingness of donors to make endowment gifts to the private colleges and universities that are affected.

- **Excise tax on executive compensation for highly compensated non-profit employees.** An employee who is one of the five highest-paid employees of a non-profit organization is subject to a new 21% excise tax on compensation paid by most non-profits in excess of $1 million. The threat to philanthropy of this provision is primarily one of reputation. Increased scrutiny of high non-profit salaries could discourage some donors from making gifts.

- **Repeal of charitable deduction for college athletic event seating rights.** The law repeals the 80% charitable deduction for gifts made in exchange for college athletic event seating rights. Powerhouse college athletic programs are likely to revamp their seat licensing arrangements as a result. It remains to be seen if this change in the law will have a material impact on support for athletics programs.

- **Repeal of 3% deduction reduction rule ("Pease" limitation).** The law repeals the "Pease" limitation, which reduced a donor's itemized deductions by 3% of the amount by which a donor's adjusted gross income exceeded the applicable threshold. This limitation could reduce itemized deductions up to 80%. For high income donors who still itemize their deductions, and most high-income donors will, the benefit of their charitable deductions will be more assured without the Pease limitation to worry about.

The provisions relating to individuals will expire at the end of 2025. That means that unless Congress acts before then to extend the provisions or make them permanent, in 2026 the law will revert to the law in effect in 2017. Provisions related to business taxes do not have an expiration date.

II. Are There Still Tax-Efficient Ways to Make Gifts Post-Tax Reform?

Significantly fewer donors will be able to enjoy the tax benefit of itemizing their income tax charitable deductions beginning in 2018. While tax benefits can influence the size and timing of a gift, the primary impetus for charitable giving will continue to be the donor’s affinity for the work of the non-profits they support. Market the reasons for giving using specific examples of how philanthropy has strengthened your charity. Feature the demonstrable, measurable impact that giving has had to advance its charitable mission. Show and tell how your charity is an expression of your donor’s values and life story. Your donors will respond by giving as they always have.

And, there are still tax-advantaged ways to make gifts to charity. Market these opportunities to all donors, not just planned gift donors. The benefit of these tax advantages can increase the amount of the gifts you receive and encourage donors to make gifts sooner than they might otherwise:

- **Encourage gifts of appreciated property, such as publicly-traded securities and real estate.** Prior law provided a double tax benefit for gifts of appreciated property to charity held at least one year. The donor enjoyed a fair market value income tax charitable deduction -plus the gift avoided all the capital gain income on the appreciated property.

  Donors who itemize after the Tax Reform Act can still have that double tax benefit. Even donors who won’t normally itemize might enjoy this double tax benefit if their gift is sufficiently large to allow them to itemize. Even donors making modest gifts who don’t itemize will still enjoy the complete avoidance of capital gain income on contributions of appreciated property.

- **Talk-up making gifts to charity using the charitable IRA rollover.** Donors over 70½ can make a direct transfer from a traditional IRA or Roth IRA to charity of up to $100,000. The rollover to charity counts toward satisfying the donor’s required minimum distribution and is not included as income to the donor. The donor avoids all income tax on the withdrawal, even if the donor doesn't itemize after the new law. The net effect of making a charitable IRA rollover gift is to keep at least the same tax benefit as donors who still itemize their deductions.

Remember the donor must strictly follow the rules to make a qualified charitable distribution from their IRA. Here is a checklist to follow:

- Donor must have attained the age of 70½ at the time of the gift. It is not enough to have attained 70½ in the year the rollover is made.
- The total amount that an individual taxpayer can make in charitable IRA rollover gifts in any year is limited to $100,000.
- The IRA administrator must make the rollover distribution directly to the charity. If the donor takes a distribution and then makes a gift, that does not qualify.
- The donor can receive no benefit in exchange for the rollover gift, so only outright gifts to public charities qualify. No life income gifts. The gift also cannot go to a donor advised fund or supporting organization. It can be used to fulfill a pledge, however.
- The donor is not entitled to an income tax charitable deduction for a charitable IRA rollover. The donor never paid tax on the IRA money and it will not be included as income on the donor's tax return, so there is no offsetting tax deduction.

- **Urge larger gifts to charity.** Some donors, especially those who live in high tax states, may find their total deductions put them close to the threshold where itemizing deductions offers greater tax benefits than taking the standard deduction. In such cases, donors might consider making larger charitable gifts to increase their itemized deductions so that they can enjoy the additional tax savings that itemizing would offer. As wealthier donors see their taxes going down, they could feel more generous.

- **Suggest including a gift for charity from your donors' estates.** Donors in retirement are often concerned about outliving their resources. These fears discourage them from considering large outright gifts to charity during life. Encourage these donors to consider bequests from their estates. This leaves them with the flexibility to maintain their assets during life in case of the unexpected and still make a generous gift to charity. For those donors with estates large enough to pay estate taxes, charitable gifts remain an excellent way to reduce estate taxes $0.40 for every $1 given.

- **Recommend that donors make gifts to charity from all or a portion of what's left in their retirement plans.** Assets in qualified retirement plans, such as IRAs, 401(k)s, and 403(b)s, are subject to income tax when distributed to heirs. There are non-charitable strategies to delay and stretch out the income tax, but when retirement plan assets are eventually distributed to heirs they will be taxed as ordinary income. Naming a charity as beneficiary of a portion or all of a qualified retirement plan will avoid the income tax that might otherwise be due on these assets. This is an extremely tax efficient way for donors to make gifts to charity that cost their heirs less than giving other kinds of assets.

III. CONCLUSION

It is difficult to predict with precision how the Tax Reform Act will affect philanthropy and planned giving. The doubling of the standard deduction and the exemption from gift, estate, and generation skipping taxes will most directly impact tax policy of concern to philanthropy. Philanthropy is driven by the emotional connection that a donor has with a charity and how the charity expresses the donor's values and concerns. Tax policy can influence philanthropic behavior, but taxes don't drive the philanthropic impulse. Lead donor discussions with your charity's mission, how philanthropy strengthens your organization, and that the need for donor support continues.

Donors should always contact their accountant or financial planner to understand how the new tax law will affect their individual tax situation.