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Taxation Basics for Gift Planners



Date: April 28, 2016

Time: 1:00 – 2:30 Eastern Time

Presenter: Gary Pforzheimer
President
PG Calc



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Agenda

- Income taxation basics
- Income tax charitable deduction rules
- When is a gift complete / substantiation
- Gift / estate / generation skipping taxes / IRD
- What may lie ahead?

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It All Started in 1913

TO BE FILED IN BY COLLECTOR. Form 1040 (Revised). TO BE FILED IN BY INTERNAL REVENUE BUREAU.

Assessment List 22-B (1913) **INCOME TAX.** File No.

Folio Line **THE PENALTY** Examined by

FOR FAILURE TO HAVE THIS RETURN IN THE HANDS OF THE COLLECTOR OF INTERNAL REVENUE ON OR BEFORE MARCH 1 IS \$20 TO \$1,000. (See instructions on page 4.)

UNITED STATES INTERNAL REVENUE.

RETURN OF ANNUAL NET INCOME OF INDIVIDUALS.
(As provided by Act of Congress, approved October 3, 1917.)

INCOME RECEIVED OR ACCRUED DURING THE YEAR ENDED DECEMBER 31, 1913...

Filed by (or for) *Franklin D. Roosevelt* of *Hyde Park, Dutchess County, New York* (When not available) *John G. ...*

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Some People's Taxes Aren't Basic



Donald J. Trump
@realDonaldTrump

Signing my tax return...
1:13 PM - 15 Oct 2015

6,619 Retweets 10,750 Likes






Some Are Straightforward



Some Are Straightforward: Bernie's 1040 - Status and Exemptions

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Bernie's 1040: Income




Loss number or exemption claimed		Lines above ▶		Line #	
Income		7	Wages, salaries, tips, etc. Attach Form(s) W-2		356,441.
7a Taxable interest. Attach Schedule B if required		7a			11.
b Tax-exempt interest. Do not include on line 7a		7b			
8a Ordinary dividends. Attach Schedule B if required		8a			2.
b Qualified dividends		8b			
10 Taxable refunds, credits, or offsets of state and local income taxes		10			
11 Alimony received		11			
12 Business income or (loss). Attach Schedule C or C-EZ		12			4,900.
13 Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶		13			
14 Other gains or (losses). Attach Form 4797		14			
15a IRA distributions		15a	b Taxable amount		
15b Pensions and annuities		15b	b Taxable amount		4,982.
17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E		17			
18 Farm income or (loss). Attach Schedule F		18			
19 Unemployment compensation		19			
20a Social security benefits		20a	b Taxable amount		39,281.
21 Other income. List type and amount		21			4,213.
22 Combine the amounts in the far right column for lines 7 through 21. This is your total income ▶		22			205,617.
23 Exclusion of investment income		23			

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Bernie's 1040: Deductions, Exemptions, Credits




Appendix 1

38 Amount from line 37 (adjusted gross income)	38				205,271.
Tax and Credits					
39a Check <input type="checkbox"/> SO You were born before January 2, 1965. <input type="checkbox"/> Blind <input type="checkbox"/> Blind <input checked="" type="checkbox"/> checked ▶ 39a <input type="checkbox"/> 1					
b If your spouse itemizes on a separate return or you were a dual-status alien, check here ▶ 39b <input type="checkbox"/>					
40 Standard Deductions	40				
41 Subtract line 40 from line 38	41				56,377.
42 Exemptions. If line 38 is \$152,225 or less, multiply \$3,000 by the number on line 41. Otherwise, see instructions	42				7,900.
43 Taxable income. Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-	43				160,994.
44 Tax. See instructions. Check if any from: a <input type="checkbox"/> Form(s) 8814 b <input type="checkbox"/> Form 4972 c <input type="checkbox"/>	44				26,961.
45 Alternative minimum tax. See instructions. Attach Form 6251	45				
46 Excess advance premium tax credit repayment. Attach Form 8992	46				
47 Add lines 44, 45, and 46	47				26,961.
All others:					
48 Foreign tax credits. Attach Form 1116 if required	48				
49 Check for child and dependent care expense. Attach Form 2441	49				
50 Education credits from Form 8863, line 19	50				
51 Retirement savings contributions credit. Attach Form 8860	51				
52 Child tax credit, except for eligible 1892s, if required	52				
53 Residential energy credits. Attach Form 5695	53				
54 Other credits from Form: a <input type="checkbox"/> 8802 b <input type="checkbox"/> 8801 c <input type="checkbox"/>	54				
55 Add lines 48 through 54. These are your total credits	55				
56 Subtract line 55 from line 47. If line 55 is more than line 47, enter -0-	56				26,961.

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Income Tax Basics



- **Marginal** tax rate
 - Tax rate on last dollar earned
- **Effective** tax rate
 - Average tax rate on income


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Income Tax Basics: 2016 Married Filing Jointly Rates

Taxable Income	Income Tax	% on Excess	Cap Gain Tax
\$ 0	\$ 0	10%	0%
18,550	1,855	15%	0%
75,300	10,368	25%	15%
151,900	29,518	28%	15%
231,450	51,792	33%	15%
413,350	111,819	35%	15%
466,950	130,579	39.6%	20%

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Income Tax Basics: A Simple Example

- Ted and Alice

Adjusted gross income (AGI):	\$200,000
Itemized deductions:	- \$40,000
Personal exemptions	<u>- \$16,200</u>
Taxable income	\$143,800
Tentative income tax	\$27,492
Tax credits	<u>- \$1,000</u>
Income tax due	\$26,492

 - 25% *marginal rate*
 - 13.2% *effective tax rate* (\$26.4K / \$200K)

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Income Tax Basics: Capital Gains

- Capital assets (e.g. investments)
- Capital gains tax on sale when fair market value (FMV) exceeds cost basis
- Rate of tax on long-term capital gain
 - 15% rate for most
 - Other rates: 0%, 25%, 28%
- Short-term capital gain taxed as ordinary income

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Income Tax Basics: Cost Basis

- Cost basis usually what was paid for a capital asset
- Can be different if asset was inherited or received as a gift
- Can be adjusted upward (for money paid to protect/enhance) or downward (due to depreciation)



Income Tax Basics: Capital Gains Tax Rates

Taxable Income	Income Tax Rate	Capital Gains Tax Rate
\$ 0	10%	0%
18,550	15%	0%
75,300	25%	15%
151,900	28%	15%
231,450	33%	15%
413,350	35%	15%
466,950	39.6%	20%



Income Tax Basics: Capital Gains Tax Example

- Mr. and Mrs. Albertson
Own P & G stock
 - FMV \$328,000
 - Basis - \$116,000
 - Long term gain \$212,000
 - Tax @ 15% (AGI is \$200K) \$31,800
 - Only \$296,200 would be left for reinvestment
($\$328,000 - \$31,800$)



Income Tax Basics: Impact of Capital Gain on Charitable Gifts

- Outright gift:
 - All capital gain is forgiven
- Gift annuity:
 - Capital gain associated with gift is forgiven
 - Capital gain associated with income interest is reportable, usually ratably
- Charitable remainder trust
 - Tiers of income
 - Capital gain taxed as capital gain is paid
- Capital loss assets should be sold instead



Income Tax Basics: Medicare Surcharge

- The first part is an extra .9% tax on wages and self-employment income above the thresholds.
- The second part is a 3.8% surtax called the Net Investment Income Tax or NIIT. This surtax is imposed on the lesser of:
 - net investment income or
 - the amount by which a taxpayer's MAGI exceeds the applicable threshold (\$250K for MFJ).
- The 3.8% surtax cannot be reduced by charitable deductions and applies to life income gift payments



Income Tax Basics: Impact of State and Local Taxes

- Generally deductible for federal purposes
- Total tax rate not the sum of separate rates
- 28% Federal rate + 5% state taxes
- Blended rate = $28\% + (1 - .28) \times 5\% = 31.6\%$



Income Tax Charitable Deduction: Clearing the Standard Deduction Hurdle

- Many types of itemized deductions, with charitable deduction being just one
- Itemizing not worth it unless all eligible deductions total more than standard deduction



Income Tax Charitable Deduction

- Must be to an IRC Sec. 170 charity
- Not all charitable gifts produce charitable deductions
- Deduction for split-benefit gift is a fraction of what it would be for outright gift



Income Tax Charitable Deduction: Value of the Income Tax Charitable Deduction

- \$10,000 taxable income
- At 28% marginal rate, \$2,800 tax due
- \$10,000 gift to charity: \$2,800 tax savings
- Cost of gift is only $\$10,000 - \$2,800 = \$7,200$
- Sometimes deduction straddles two marginal rates

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Deductibility by Type of Property

Type of Property	Deductible Amount
Cash	Face amount
Securities and real estate - owned over one year	Fair market value
Securities and real estate - owned one year or less	Cost basis or fair market value (whichever is less)
Tangible personal property:	
"Related Use" owned over one year	Fair market value
"Related Use" owned one year or less	Cost basis or fair market value (whichever is less)
"Unrelated Use" regardless of how long owned	Cost basis or fair market value (whichever is less)
Inventory (excluding inventory contributed for research and other special cases)	Cost basis or fair market value (whichever is less)

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Deductibility by Type of Organization

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

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Carly's Deductions Worksheet

CASH CONTRIBUTIONS (CONT'D)		\$1,939,929 * 30% = PLENTY!

DISTRESSED MANAGERS IV LP (P)		

OTHER CASH CONTRIBUTIONS		

50% ORGANIZATION(S)		
AMERICAN HEART	1,000.	
CHURCH	500.	
LORTON COMMUNITY ACTION CENTER	10,000.	
TOTAL CASH CONTRIBUTIONS BEFORE LIMITATION	11,500.	

CASH CONTRIBUTION LIMITATION		

TOTAL TO SCHEDULE A, LINE 16		11,500.

NONCASH CHARITABLE CONTRIBUTIONS		

NONCASH CONTRIBUTIONS FROM FORM 8283		

TOTAL NONCASH CONTRIBUTIONS BEFORE LIMITATION	249,855.	

NONCASH CONTRIBUTION LIMITATION		

TOTAL TO SCHEDULE A, LINE 17		249,855.

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Income Tax Charitable Deduction

- Bob and Carol
 - \$350,000 AGI
 - Donate \$700,000 appreciated stock to art museum (public charity)
 - Deduction can be used up to 30% of AGI (i.e., \$105,000) each year
 - Year of gift plus five carryover years
 - Deduction used: $6 \times \$105,000 = \$630,000$
 - Deduction lost: $\$700,000 - \$630,000 = \$70,000$



Income Tax Charitable Deduction

- Bob and Carol
 - Same as before, but \$700,000 cash gift
 - Deduction can be used up to 50% of AGI (i.e., \$175,000) each year
 - Entire deduction can be used in four years ($4 \times \$175,000 = \$700,000$)



Income Tax Charitable Deduction

- Order of priority of deductions
 - Pub. 526 describes how to prioritize current and carryover year deductions
- Special Election
 - Elect to deduct LTCG property at cost basis so that 50%-of-AGI limit will apply



When is a Charitable Gift Complete?

- Depends upon whether it's:
 - Check
 - Credit Card
 - Stock
 - Real Estate
 - Tangible Person Property
 - IRA Rollover




Valuation of Securities

- Mean market value
- Not the the closing price
- Not the proceeds received
- Other rules may apply for non publicly traded securities



Gift Substantiation


- Varies depending on:
 - Amount
 - Type of property given
 - Whether goods or services received
- Non-cash property
 - One portion or another of Form 8283 likely needs to be completed

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Gift Substantiation and 8283s

- 8283 Section A
- 8283 Section B and appraisals
- 8282 Tattleale form


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Transfer Taxation Basics

- Gift tax
- Estate tax
- Generation-skipping transfer (GST) tax
- At least for 2016, all 3 feature \$5.45 million exemption (derived from a tax credit) and tax rate of 40% on the excess

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Transfer Taxation Basics

Estate tax

- Assessed on estate at death
- Takes into account certain gifts made during (and any gift tax paid on those gifts)
- Unlimited marital deduction
- Unlimited charitable deduction
- Deduction for state "death taxes"

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Transfer Taxation Basics: Gift Tax

- Unlimited charitable deduction (but gift tax return may still need to be filed)
- Unlimited marital deduction (if spouse U.S. citizen)
- Annual exclusion per donor: \$14,000
- Each spouse can give \$14,000 to any person each year, so parents of a family of three children can transfer \$84,000 (2 x 3 x \$14,000) to the next generation each year free of tax



Transfer Taxation Basics: Generation Skipping Transfer tax

- A tax on a tax
- Applies to certain transfers to "skip persons"
- Skip person: relative two or more generations younger or non-relative 37.5+ years younger
- Marital and charitable deductions
- As with estate and gift taxes, can be relevant in connection with some split-benefit gifts



Transfer Taxation Basics: Income in Respect of a Decedent (IRD)

- Actually an income tax issue, but arises in connection with transfers upon death
- If income associated with an asset would have been taxed in hands of decedent had he/she remained alive, new owner/beneficiary of asset will be taxed on income as it is paid
- Traditional IRAs and certain other assets feature IRD; when distributed to charity, no tax is owed



Transfer Taxation Basics: Example of Gift Tax

- Mr. Soto makes first taxable gift to son of \$700,000 in 2000. He pays no gift tax.
- He makes a \$5,430,000 gift in 2015 and, although this is the limit at the time, his prior gift means this transfer makes him pay tax.



Transfer Taxation Basics: Example of Gift Tax

Taxable gift made in 2015	\$5,430,000
Prior taxable gifts	+ \$700,000
Cumulative lifetime taxable gifts	\$6,130,000
Tentative tax on \$6,130,000	\$2,397,800
Less prior gift taxes paid	- \$0
Less tax on 2015 exemption of \$5,430,000	- \$2,117,800
Gift tax owed	\$280,000



Transfer Taxation Basics: Example of Estate Tax

- Mrs. Soto dies in 2015 and leaves all of her assets to Mr. Soto.
- Mrs. Soto made no taxable gifts during her lifetime and there is no estate tax because of the unlimited marital deduction.
- In addition, Mrs. Soto's estate elects to port her \$5,430,000 lifetime exemption to Mr. Soto.
- Mr. Soto dies in 2016 with an estate worth \$6,000,000. He made taxable transfers (to his son) during his lifetime totaling \$6,130,000 on which he paid \$280,000 in gift tax.

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Transfer Taxation Basics: Example of Estate Tax

Estate in 2016	\$6,000,000
Prior taxable gifts during life	+ <u>\$6,130,000</u>
Taxable estate	\$12,130,000
Tentative tax	\$4,797,800
Less gift tax paid during life	- \$280,000
Less tax on 2016 exemption of \$10,880,000 (\$5,450,000 + 5,430,000)	- <u>\$4,297,800</u>
Estate tax owed	\$220,000

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Transfer Taxation Basics: Example Including a Bequest

- Mr. Soto could have eliminated his estate tax by making charitable gifts in his estate of \$550,000 or more.

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Transfer Taxation Basics: Example Including a Bequest

Estate in 2016	\$6,000,000
Less charitable gifts	- \$550,000
Prior taxable gifts during life	+ <u>\$6,130,000</u>
Taxable estate	\$11,580,000
Tentative tax	\$4,577,800
Less gift tax paid during life	- \$280,000
Less tax on 2016 exemption of \$10,880,000 (\$5,450,000 + 5,430,000)	- <u>\$4,297,800</u>
Estate tax owed	\$0

- Cost of gift = \$550,000 – \$220,000 = \$330,000

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Transfer Taxation Basics: Example Factoring in IRD

- Assume that \$500,000 of Mr. Soto's \$6,000,000 estate is from the balance in his qualified retirement plan.
- He can save \$175,000 in total taxes on his estate's assets by making his charitable gifts first from the \$500,000 in his qualified plan and then from other assets as needed.



Transfer Taxation Basics: Example Factoring in IRD

- Estate tax is the same, regardless of assets used to fund gift

Estate tax	Give IRD to Charity	Give IRD to Son
Estate in 2016	\$6,000,000	\$6,000,000
Less charitable gifts	- \$550,000	- \$550,000
Prior taxable gifts during life	+ \$6,130,000	+ \$6,130,000
Taxable estate	\$11,580,000	\$11,580,000
Tentative tax	\$4,577,800	\$4,577,800
Less gift tax paid during life	- \$280,000	- \$280,000
Less tax on 2016 exemption of (\$5,450,000 + 5,430,000)	- \$4,297,800	- \$4,297,800
Estate tax owed	\$0	\$0



Transfer Taxation Basics: IRD Example

- Save income taxes by funding gift with IRD assets

Income tax	Give IRD to Charity	Give IRD to Son
Balance in qualified plan	\$500,000	\$500,000
Less qualified plan assets donated	- \$500,000	- \$0
Taxable income	\$0	\$500,000
Income tax owed (son's rate=35%)	\$0	\$175,000
Total tax	\$0	\$175,000
Tax savings with \$550,000 gift:		
Estate taxes saved	\$220,000	\$220,000
Income taxes saved	+ \$175,000	+ \$0
Total taxes saved	\$395,000	\$220,000



What May Lie Ahead: Income Taxation

- Changes in tax rates: higher? lower?
- "Simplification" of tax rules: flat tax? fewer deductions/credits?
- Postcard 1040s?



What May Lie Ahead: The Permanent IRA Rollover?

- 2016 and beyond is now known
- Donor Advised Funds and Foundations?
- Adding in some life income gifts?



What May Lie Ahead: Income Tax Charitable Deduction

- Helps charities, at least to some extent
- Viewed by some as a "tax expenditure"
- Could be subject to limitations on all itemized deductions
- Could be singled out for special treatment
- Could be replaced by a tax credit



What May Lie Ahead

Transfer taxation

- Complete elimination of one or more of the types of taxes
- Increased impact of taxes: higher rates, lower exemptions
- Possible reactions by states



Questions and Answers





Still Have a Question?

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