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## Intermediate Taxation for Gift Planners




Date: November 16, 2017  
 Time: 1:00 – 2:30 Eastern Time  
 Presenter: Bill Laskin,  
 Vice President, Product Management  
 Jeffrey Frye  
 Senior Client Services Advisor  
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## Agenda

- Provisions related to the charitable deduction
- Provisions related to income tax
- Provisions related to transfer tax
- Provisions in House and Senate tax bills

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## Charitable Deduction: Pease Limitation

- Reduces itemized deductions by 3% of amount by which donor's AGI exceeds threshold amount
- Cannot reduce deductions more than 80%
- Threshold in 2017: \$313,800 for MFJ, \$261,500 for SF
- Most taxpayers subject to Pease limitation itemize enough non-charitable deductions that their charitable deductions are fully deductible

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## Charitable Deduction: Pease Limitation

Example: Harold and Jane

- \$400,000 AGI
- Deductions: \$20,000 charitable gifts, \$25,000 state and local taxes, \$10,000 mortgage interest
- Pease reduction:  $3\% \times \$86,200 = \$2,586$
- Giving \$20,000 still saves  $33\% \times \$20,000 = \$6,667$
- Pease limitation has no effect on tax savings from H and J gifts

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## Charitable Deduction: Deduction Carryforward Rules

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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## Charitable Deduction: Deduction Carryforward Rules

Example 1: Ben and Sarah

- AGI = \$125,000
- Charitable contributions = \$75,000 cash
- Can use \$62,500 of deduction in year of gift ( $\$125,000 \times 50\%$ )
- Carry forward \$12,500 of deduction, will be subject to 50% limit

Example 2: Ben and Sarah

- AGI = \$125,000
- Charitable contributions = \$75,000 in appreciated securities
- Can use \$37,500 of deduction in year of gift ( $\$125,000 \times 30\%$ )
- Carry forward \$37,500 of deduction, will be subject to 30% limit

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## Charitable Deduction: Deduction Carryforward Rules

Order of Priority of Deductions from IRS publication 526:

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."

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## Charitable Deduction: 50% Special Election

Deduction limitations:

- Gifts of cash to public charity: 50% of AGI
- Gifts of long term gain property to public charity: 30% of AGI
- 30% limit applied within 50% limit
- Can carry forward deduction up to 5 additional years
- Donor can elect to treat ALL current and carried forward long term gain property gifts as 50% gifts

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## Charitable Deduction: 50% Special Election

May make sense for donor to make 50% election when:

- Cost basis of gift property is high relative to its FMV
- Can't use all of deduction if limited to 30% of AGI
- Expects to be in higher income tax bracket in year of gift than in subsequent years

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## Charitable Deduction: 50% Special Election

Example: Sam

- \$100,000 AGI
- Gives \$250,000 stock he inherited with \$240,000 basis
- If 30% limit: deduct \$30,000/yr x 6 yrs = \$180,000
- If 50% limit: deduct (\$50,000/yr x 4 yrs) + \$40,000 = \$240,000

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## Charitable Deduction: IRS Discount Rate Election

**Summary of Benefits for 5.4% Charitable Gift Annuity**  
**Date of Gift: 6/15/2017 Cash Donated: \$10,000.00**  
**Annuitant age 72**

CHOICE OF BENEFITS:	April 2017 IRS Discount Rate 2.6%	May 2017 IRS Discount Rate 2.4%	June 2017 IRS Discount Rate 2.4%
Charitable Deduction:	\$4,326	\$4,240	\$4,240
Annual Payout	\$540	\$540	\$540
Tax-free Portion (for 14.5 yrs)	\$391	\$397	\$397
Ordinary Income Portion*	\$149	\$143	\$143

\*Once all tax-free portions have been distributed, the entire annuity will become ordinary income.

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## Charitable Deduction: IRS Discount Rate Election

**Requirements** (see Reg. Sec. 301.9100-8(a)(1)):

- A statement that an election under section 7520(a) is being made
- The transferor's name and taxpayer identification number as they appear on the return
- A description of the interest being valued
- The recipients, beneficiaries, or donees of the transferred interest
- The date of the transfer
- The Applicable Federal Midterm rate that is used to value the transferred interest and the month to which the rate pertains

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## Charitable Deduction: IRS Discount Rate Election

**Example of IRS Discount Rate Election Statement:**

Applicable Mid-Term Rate Election  
Charitable Gift Annuity

Donor Name: John Smith  
Taxpayer ID: 999-88-7777

According to Reg. Sec. 301.9100-8(a)(1), I, John Smith, 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 THE CHARITY made on June 15, 2017. The payout rate of the gift is 5.4%, payable for the lifetime benefit of an individual, age 72.

To value the transferred interest, I elect to use the 2.6% rate under Section 7520 for April, 2017 (120% of the Applicable Mid-Term Federal Interest Rate compounded annually and rounded to the nearest two-tenths of one percent).

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## Charitable Deduction: Form 8283

Form 8283:

- Must be filed by donor when total non-cash donations for year exceed \$500 (deductible amount without respect to % AGI limits)
- Complete Section A for each item or group of similar items (e.g. coin collection) that produces deduction  $\leq$  \$5,000 and for publicly-traded securities of any value
- Complete Section B for each item or group of items that yields deduction  $>$  \$5,000 (other than publicly-traded securities)
- Attach 8283 to 1040. Attach multiple 8283s, as needed
- Make donor aware when Form 8283 must be filed!

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## Charitable Deduction: Form 8283

Section A: deduction  $\leq$  \$5,000

- Part I: describe items / groups of items
  - Donee organization, date of contribution, FMV
  - If securities, company name and # of shares; if  $>$  \$500, also date acquired, how acquired, cost basis
- Part II: complete if gift of partial interest or restricted use
  - Most planned gifts are gifts of a partial interest
  - Enter amount or deduction being claimed
  - If tangible property, identify where it is
  - Indicate if use is restricted

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## Charitable Deduction: Form 8283

Section B: deduction > \$5,000

- Part I: describe items / groups of items
  - Date of gift, deduction claimed
  - Appraised FMV, date acquired, how acquired, cost basis
- Part II: identify items in Part 1 valued at \$500 or less
  - Donor attests to value of items in Part 1 with signature

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## Charitable Deduction: Form 8283

Section B: deduction > \$5,000

- Part III: filled in by qualified appraiser
  - Attests to value of items in Part 1
  - Includes items in Part 1 with deduction > \$5,000, > \$10,000 if closely-held stock
  - Require written signed appraisal: art worth > \$20,000, clothing / household items not in good used condition, easement on buildings in historic districts, deduction > \$500,000
- Part IV: Authorized officer of charity signs acknowledging receipt of property described in Part 1, then returns form to donor

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## Income Tax Provisions: Medicare Surtax

- 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 modified 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

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## Income Tax Provisions: Medicare Surtax

Example: Mark and Helen

- Wage income = \$100,000 (puts them in 25% bracket)
- Capital gain income (stock sale) = \$200,000 (taxed at 15%)
- Excess MAGI = \$50,000 (\$300,000 - \$250,000); NIIT = \$200,000
- Pay NIIT on \$50,000, the lesser of excess MAGI and NIIT.

Surtax effectively raises their marginal capital gains tax rate from 15% to 18.8% on last \$50,000 of capital gain, which makes giving appreciated property to charity more attractive.

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## Income Tax Provisions: Alternative Minimum Tax

- Alternative Minimum Tax (AMT) is computed in parallel with standard federal income tax
- Taxpayer pays whichever tax is greater
- Most deductions disallowed under AMT
- AMT meant to assure that taxpayers with a lot of deductions pay at least a minimum amount of tax
- About 5.2 million taxpayers expected to pay AMT in 2017

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## Income Tax Provisions: Alternative Minimum Tax

- Two rates
  - 26% on income below applicable threshold (\$187,800 for MFJ)
  - 28% on income above applicable threshold
- Exemption (\$84,500 for MFJ)
- Exemption phase-out above applicable threshold (\$160,900 for MFJ)
- Effective AMT rate during most of phase-out is 35% (\$187,800 - \$525,800 for MFJ)
- Deduction allowed for charitable contributions (and mortgage interest)
- For donor with income in AMT phase-out range, tax savings from gifts could be higher under AMT; otherwise likely to be lower

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## Income Tax Provisions: The 8 Tiers of Trust Taxation

Ordinary Income		Capital Gain				Tax-free Income	Return of Principal
Interest, rents, royalties, and ordinary dividends	Qualified dividends	Short-term capital gain	Long-term capital gain from sale of collectibles	Long-term capital gain from sale of assets involving depreciation recapture	Long-term capital gain from sale of other investments	Interest earned on tax-exempt securities	Distributions of trust corpus
Taxed up to 39.6%	Taxed at 15% or 20%	Taxed up to 39.6%	Taxed from 10% to 28%	Taxed from 10% to 25%	Taxed from 0% to 20%	Not taxed	Not taxed

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## Income Tax Provisions: The 8 Tiers of Trust Taxation

### IRS Form 5227 for 2017

**Schedule A—Distributions, Assets, and Donor Information**

**Part I.A. Accumulation Schedule (Section 664 trust only) (See the instructions).**

Ordinary income	Qualified dividends	Short-term capital gain	Long-term capital gain from sale of collectibles	Long-term capital gain from sale of assets involving depreciation recapture	Long-term capital gain from sale of other investments	Interest earned on tax-exempt securities	Distributions of trust corpus
1	2	3	4	5	6	7	8

**Part I.B. Simplified Net Investment Income Calculation**

Accumulation trust	Current trust	Distributions	Trading net
9	10	11	12

**Part II.A. Current Distributions Schedule (Section 664 trust only) (See the instructions).**

Ordinary income	Short-term capital gain	Long-term capital gain	Marketable income	Dividend	Total paid (1) through (5)	Net investment income
13	14	15	16	17	18	19

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## Transfer Tax Provisions: 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

\* Annual exclusion goes up to \$15,000 in 2018

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# Transfer Tax Provisions: Gift Tax

Example: Mabel gives \$50,000 to each of her 5 nieces and nephews in 2017. She has given \$100,000 to each of her 3 siblings in previous years. The resulting gift tax would be computed as follows:

Prior years' potentially taxable transfers:	\$300,000
Current year's potentially taxable transfers:	+ \$250,000
Lifetime cumulative potentially taxable transfers:	\$550,000
Tentative gift tax on first \$500,000:	\$155,800
Tentative gift tax on next \$50,000:	+ \$18,500
Total tentative gift tax:	\$174,300
Lifetime gift tax credit : (equivalent to transfers of \$5,490,000)	\$2,141,800
Net gift tax due for 2017:	\$0

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# Transfer Tax Provisions: Generation Skipping Transfer Tax

- Assessed on transfers to "skip" person made during life or at death
- Devised to assure that each generation of a family pays transfer tax on substantial transfers
- Lifetime exemption of \$5,490,000 in 2017 (\$5,600,000 in 2018); no portability
- A skip person is:
  - Lineal descendant 2 or more generations below transferor
  - Non-lineal descendant 37.5+ years younger than transferor
- GSTT assessed at highest gift / estate tax rate (currently 40%)

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# Transfer Tax Provisions: Generation Skipping Transfer Tax

- Direct skip (e.g. bequest in will): transferor (donor or donor's estate) pays tax
- Taxable distribution (e.g. CRT payment): recipient pays tax
- Taxable termination (e.g. CLT distribution to heirs): trust pays tax
  - CLAT: fraction of distribution subject to GST (inclusion ratio) determined at end of trust; CAN'T allocate exemption exactly
  - CLUT: fraction of distribution subject to GST (inclusion ratio) determined when trust funded; CAN allocate exemption exactly

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## Tax Reform: Where Are We in the Process?

- House Bill
  - Out of committee and being debate on floor
  - Amendments still being considered
  - Expect vote before Thanksgiving
- Senate Bill
  - Chairman's mark reported out of committee
  - Amendments still being considered be Finance Committee
  - A little behind House in the process; vote may be after Thanksgiving
- Goal is to send tax bill to President to sign before Christmas

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## Tax Reform: Income Tax Rates

House Bill

- Reduces current 7 brackets to 4; rate lower at most income levels
- Top rate still 39.6%, but starts at \$1 million vs. \$480,000 for MFJ
- Effective rate of 45.6% while 12% bracket phased out (\$1.2 million threshold for MFJ, otherwise \$1 million threshold); takes \$1.1 million excess to fully phase out
- MFJ with \$260,000 - \$425,000 taxable income go from 33% to 35%
- 30% of pass-through income taxable can count as business income taxable at 25%
- Eliminates AMT

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## Tax Reform: Income Tax Rates

Senate Bill

- Maintains 7 brackets; rate lower at most income levels
- Highest bracket is 38.5%, which starts at \$1 million vs. \$480,000 for 39.6% MFJ
- 17.4% deduction for non-wage pass-through income taxable
- Eliminates AMT

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## Tax Reform: Income Tax Rates

Effect on charitable giving

- Donors will generally pay less tax on last dollar of income, so donors who itemize will save less taxes than now
- Modestly reduced tax incentive to give: modest negative effect, if any

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## Tax Reform: Itemized Deductions

- Both Bills eliminate most itemized deductions
- No deduction for state and local taxes, except House Bill allows up to \$10,000 deduction for property taxes
- Mortgage interest deduction preserved: House Bill limits to interest on \$500,000 loan, \$1 million limit in Senate Bill (which is current limit)

The good news in both bills:

- Charitable deduction preserved without a cap
- 50% AGI limit on deductions for cash gifts increased to 60%
- Pease limitation repealed

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## Tax Reform: Standard Deduction

Taxpayers can take standard deduction when total itemized deductions are less than standard deduction.

- House Bill and Senate Bill would roughly double standard deduction
- Both bills increase SD to \$24,000 for MFJ, \$12,000 for SF
- Under current law, SD in 2018 will be \$13,000 for MFJ, \$6,500 for SF

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## Tax Reform: Standard Deduction

Effect on charitable giving

- 69% of taxpayers expected to take SD in 2017
- 5% of taxpayers estimated to take SD if increased as proposed
- Donors who take SD (don't itemize) will get **NO** tax benefit from charitable deduction
- Likely to have significant negative impact on giving: IU Lilly Family School of Philanthropy Study predicts 1.7% - 4.6% decrease.

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## Tax Reform: Standard Deduction

CGP pushing for Universal Charitable Deduction

- Above-the-line deduction that would benefit all donors
- H.R. 3988 introduced, limits deduction to 1/3 standard deduction
- Amendment #9 to Senate Bill, 60% MAGI limit, Pease-like reductions
- Same IU Study estimates up to \$4.7 billion increase in giving in context of changes to SD, itemized deductions, and income tax rates

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## Tax Reform: Transfer Taxes

House Bill

- Double exemption from gift, estate, and GST tax to \$11.2 million (\$22.4 million per couple) in 2018
- Eliminate estate and GST taxes starting in 2024
- Reduce top gift tax rate from 40% to 35% in 2024

Senate Bill

- Like House Bill, double exemption from gift, estate, and GST tax to \$11.2 million (\$22.4 million per couple) in 2018
- Does not eliminate transfer taxes in future
- Does not change transfer tax rates in future

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## Tax Reform: Transfer Taxes

Effect of changes on charitable giving

- 99.8% of estates won't pay any federal estate tax (FET) in 2017
- Even tinier slice wouldn't pay FET in 2018 and after, but these are the largest estates which can make the largest gifts
- If FET eliminated, no incentive to give to avoid FET
- Fewer CLTs
- Maybe fewer bequests from large estates, too, but maybe just as many since no tax to reduce estate size

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## Summary

- Charitable deduction appears here to stay
- Context for charitable deduction could change dramatically
- Unless universal charitable deduction makes it into final bill – a long shot – changes will reduce tax benefits of giving
- Between now and end of 2017 is an opportunity to receive known tax benefits, and likely greater ones
- Donors give because they believe in your mission; tax benefits are nice, but usually not essential. Focus on mission and other non-tax benefits and donors will continue to give and generously.

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## Questions and Answers



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## Still Have a Question?

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