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Tax Information Every Gift Planner Should Know



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Time: 1:00 – 2:30 Eastern

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Starting With The Most Basic Stuff: Income Tax

Federal Income Tax Basics

Income tax schedule applies to ordinary income:

1. Wages, salary, tips
2. Interest on investments (bonds, savings accounts, CDs)
3. Rents
4. Realized ordinary gains
5. Other sources



Starting With The Most Basic Stuff: Income Tax

2019 Rates for Single Individuals

Taxable Income	Income Tax	% on Excess
\$0	\$0	10%
9,700	970	12%
39,475	4,543	22%
84,200	14,382.50	24%
160,725	32,748.50	32%
204,100	46,628.50	35%
510,300	153,798.50	37%

Brackets indexed for inflation



Starting With The Most Basic Stuff: Income Tax

2019 Rates for Married Filing Jointly

Taxable Income	Income Tax	% on Excess
\$0	\$0	10%
19,400	1,940	12%
78,950	9,086	22%
168,400	28,765	24%
321,450	65,497	32%
408,200	93,257	35%
612,350	164,709.50	37%

Brackets indexed for inflation



Starting With The Most Basic Stuff: Income Tax

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



Starting With The Most Basic Stuff: Income Tax

3.8% Medicare Surtax

- Official name: Net Investment Income Tax (NIIT).
- Surtax is imposed on lesser of:
 - ✓ net investment income (interest, dividends, annuities, royalties, rents, realized gain, planned gift payments), or
 - ✓ the amount by which a taxpayer's Modified AGI (MAGI) exceeds the applicable threshold (\$200K for Single, \$250K for MFJ, etc.)
- Increases marginal rates for income tax and capital gains tax by 3.8%
- 3.8% surtax not reduced by charitable deductions



Umm...The Charitable Deduction Is For The Charitable Gift

Substantiation of Charitable Gift

Varies depending on:

- Amount
- Type of property given
- Whether goods or services received
- Non-cash property > \$500
 - ✓ One portion or another of Form 8283 likely needs to be completed
 - ✓ 8282 tattletale form: charity files if sells property within 3 years of gift



Umm...The Charitable Deduction Is For The Charitable Gift

Deductibility by Type of Property

<u>Type of Property</u>	<u>Deductible Amount</u>
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



Umm...The Charitable Deduction Is For The Charitable Gift

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	60% of AGI
		Ordinary Income, non-appreciated 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

- 60% AGI limit on cash gifts is new in 2017 Tax Act



Umm...The Charitable Deduction Is For The Charitable Gift

Itemized Deductions vs. Standard Deductions

- Only makes sense to itemize when total deductions will exceed standard deduction
- Charitable deductions offer no tax benefit unless donor itemizes them
- JCT estimates itemizers will decline from 30% in 2017 to 12% in 2018 (no official 2018 stats yet)
- More than 12% of planned gift donors will itemize
 - ✓ Donors of large planned gifts will itemize
 - ✓ Donors of modest planned gifts may or may not itemize



Umm...The Charitable Deduction Is For The Charitable Gift

Example: Charitable Gift Annuity established by 72-year-old donor on August 24, 2019

Assumptions:

Annuitant Date of Birth	5/1/1947
Principal Cash Donated	\$10,000
Payout Rate - 2018 ACGA table	5.8%
IRS Discount Rate	2.8%
Payment Frequency	Quarterly, at end

Benefits:

Charitable Deduction	\$3,996.90
Annuity	\$580.00
Tax-free Portion	\$414.12
Ordinary Income	\$165.88

After 14.5 years, the entire annuity becomes ordinary income.



Umm...The Charitable Deduction Is For The Charitable Gift

- Bunch charitable gifts into single year so great enough to make itemizing beneficial
 - ✓ Give larger than typical gifts in one year, wait several years, then repeat
 - ✓ Give large gift to DAF, then recommend annual distributions as desired; repeat
 - ✓ Make a planned gift: gift annuity, charitable remainder trust, pooled income fund, retained life estate, grantor lead trust, bargain sale



Did You Hear About The IRS Discount Rate Election Statement?

Playing With The IRS Discount Rate

IRS Discount Rates in 2019

January	3.4%	June	2.8%
February	3.2%	July	2.6%
March	3.2%	August	2.2%
April	3.0%	September	2.2%
May	2.8%		



Did You Hear About The IRS Discount Rate Election Statement?

Playing With The IRS Discount Rate

Possible deductions and tax-free amounts for a 5.8% charitable gift annuity established for a 72-year-old in August 2019 with \$10,000 (total annuity = \$580).

<u>Month</u>	<u>Rate</u>	<u>Deduction</u>	<u>Tax-Free Portion</u>
June	2.8%	\$3,997	\$414
July	2.6%	\$3,906	\$421
August	2.2%	\$3,718	\$433



Did You Hear About The IRS Discount Rate Election Statement?

Election Statement from Planned Giving Manager

Applicable Mid-Term Rate Election

Charitable Gift Annuity

Donor Name: Joe Donor

Taxpayer ID: 12-3456789

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

The interest being valued is a charitable gift annuity agreement with THE CHARITY made on August 29, 2019. The payout rate of the gift is 5.8%, payable for the lifetime benefit of an individual, age 72.

To value the transferred interest, I elect to use the 2.8% rate under Section 7520 for June 2019 (120% of the Applicable Mid-Term Federal Interest Rate compounded annually and rounded to the nearest two-tenths of one percent).



Yes, You *MAY* Carryover, But Only if You *MUST*

- Limitations on using charitable deductions
- Tax Cuts and Jobs Act of 2017: cash charitable contribution limitation increased from 50% to 60% of AGI
- But deductible amount may be further limited to 50%, 30%, or 20% of AGI, depending on type of property donated and type of organization receiving the gift



Yes, You *MAY* Carryover, But Only if You *MUST*

Deduction Carryover (Carry Forward) Rules

- If donor unable to use all of charitable deduction in one year, may carry unused portion forward into the next year.
- Donor may carry forward unused deductions and portions thereof for up to 5 additional calendar years.
- Donor may not pick and choose which year or years to use deductions; all deductions must be used to the maximum extent possible in the first calendar year.



Those Pesky Capital Gains: You Can Run, But You Cannot Hide

Capital Gains Tax

- Applied when a capital asset is sold for more than the seller's cost basis
- What is a capital asset?
 - ✓ Securities
 - ✓ Real estate
 - ✓ Collectibles (art, antiques, coins, stamps, etc.)
 - ✓ Other tangible personal property (cars, furniture, etc.)



Those Pesky Capital Gains: You Can Run, But You Cannot Hide

Impact of Capital Gain on Planned Gifts

- Gift annuity:
 - ✓ Capital gain associated with gift is forgiven
 - ✓ Capital gain associated with annuity interest is reportable, ratably over life expectancy if donor is also annuitant
- Charitable remainder trust
 - ✓ Tiers of income
 - ✓ Capital gain taxed as it is distributed
- Capital loss assets should be sold and proceeds given



Those Pesky Capital Gains: You Can Run, But You Cannot Hide

Determining Cost Basis

- Cost basis usually what was paid for a capital asset
- When received as a gift: cost basis is donor's basis
- When inherited: cost basis is FMV at time of donor's death
- Can be adjusted upward (for money paid to protect/enhance) or downward (depreciation)



Those Pesky Capital Gains: You Can Run, But You Cannot Hide

Capital Gains Tax

- Tax when held more than one year (long term)
 - ✓ Low income taxpayers: 0%
 - ✓ Most taxpayers: 15%
 - ✓ High income taxpayers: 20%
 - ✓ Same for qualified dividends
 - ✓ Other rates: 25% (depreciation recapture), 28% (collectibles)
- Tax when held one year or less (short term)
 - ✓ Same as ordinary income (up to 37%)



Those Pesky Capital Gains: You Can Run, But You Cannot Hide

Capital Gains Tax Rates

- With 2017 Tax Act, capital gains tax brackets no longer match income tax brackets

Taxable Income (MFJ)	Taxable Income (Single)	Capital Gains Tax Rate
\$ 0	\$ 0	0%
78,750	39,375	15%
488,850	434,550	20%

- Brackets indexed for inflation
- 37% bracket is \$612,350 for MFJ, \$510,300 for Single



Those Pesky Capital Gains: You Can Run, But You Cannot Hide

Example: Charitable Gift Annuity established by 72-year-old donor on August 24, 2019

Assumptions:

Annuitant Date of Birth	5/1/1947
Principal Donated	\$10,000
Cost Basis	\$3,000
Payout Rate - 2018 ACGA table	5.8%
IRS Discount Rate	2.8%
Payment Frequency	Quarterly, at end

Benefits:

Charitable Deduction	\$3,996.90
Annuity	\$580.00
Tax-free Portion	\$124.23
Capital Gain Income	\$289.89
Ordinary Income	\$165.88

Total Reportable Capital Gain of \$4,202.17 must be reported over 14.5 years (donor age 72 is primary annuitant).

After 14.5 years, the entire annuity becomes ordinary income.



The Donor Must Be The Owner

Example: Alice and George, married couple

- Best tax treatment (most favorable): Alice and George are Joint Owners, Joint Donors and Joint Annuitants
- Less favorable tax treatment: One Owner (either Alice or George), One Donor, Concurrent Annuitants, Donor is Named 1st Annuitant
- Least favorable tax treatment: One Owner (either Alice or George), One Donor, Joint Annuitants; 50% of the reportable capital gains must be reported in the year of the gift



The Donor Must Be The Owner

Example: Charitable Gift Annuity established f/b/o 72-year-old annuitant on August 24, 2019
 Donor is NOT the annuitant

Assumptions:

Annuitant Date of Birth	5/1/1947
Principal Donated	\$10,000
Cost Basis	\$3,000
Payout Rate - 2018 ACGA table	5.8%
IRS Discount Rate	2.8%
Payment Frequency	Quarterly, at end

Benefits:

Charitable Deduction	\$3,996.90
Annuity	\$580.00
Tax-free Portion	\$414.12
Ordinary Income	\$165.88

Total Reportable Capital Gain of \$4,202.17 must be reported in the year of the gift.
 After 14.5 years, the entire annuity becomes ordinary income.



The Long-Term Automatic DRIP: A Tax Accounting Nightmare

Example:

- Donor purchases 100 shs of ABC Fund on 5/5/2017 for \$10/share
- \$.10/share dividend paid quarterly; dividend is automatically reinvested
- Assume the price/share and dividend/share stay the same for 2 years
- Tax accounting: we now have 9 tax lots, each with its own cost basis and acquisition date



The Long-Term Automatic DRIP: A Tax Accounting Nightmare

Example: Automatic Quarterly Dividend Reinvestment for 2 Years

Date	Transaction	Price per share	Inc per share	New shares	Net Amount	Cumulative Total Shares
5/5/2017	Original purchase	\$10.00		100.000	\$1,000.00	100.000
7/15/2017	Dividend paid		\$0.10		\$10.00	
7/15/2017	Div Reinvest	\$10.00		1.000	\$10.00	101.000
10/15/2017	Dividend paid		\$0.10		\$10.10	
10/15/2017	Div Reinvest	\$10.00		1.010	\$10.10	102.010
1/15/2018	Dividend paid		\$0.10		\$10.20	
1/15/2018	Div Reinvest	\$10.00		1.020	\$10.20	103.030
4/15/2018	Dividend paid		\$0.10		\$10.30	
4/15/2018	Div Reinvest	\$10.00		1.030	\$10.30	104.060
7/15/2018	Dividend paid		\$0.10		\$10.41	
7/15/2018	Div Reinvest	\$10.00		1.041	\$10.41	105.101
10/15/2018	Dividend paid		\$0.10		\$10.51	
10/15/2018	Div Reinvest	\$10.00		1.051	\$10.51	106.152
1/15/2019	Dividend paid		\$0.10		\$10.62	
1/15/2019	Div Reinvest	\$10.00		1.062	\$10.62	107.214
4/15/2019	Dividend paid		\$0.10		\$10.72	
4/15/2019	Div Reinvest	\$10.00		1.072	\$10.72	108.286



No Good Deed Goes Unpunished: Donor is Not the Beneficiary

Example: Charitable Gift Annuity established f/b/o 72-year-old on 8/24/2019
 Donor is NOT the annuitant

Assumptions:

Annuitant Date of Birth	5/1/1947
Principal Donated	\$10,000
Cost Basis	\$3,000
Payout Rate - 2018 ACGA table	5.8%
IRS Discount Rate	2.8%
Payment Frequency	Quarterly, at end

Benefits:

Charitable Deduction	\$3,996.90
Investment in Contract (Value of Life Interest)	\$6,003.10
Potentially Taxable Transfer	\$6,003.10
Annual Gift Tax Exclusion:	\$15,000.00
Taxable Gift (If Annual Gift Tax Exclusion is Available)	\$0.00
Taxable gift (If Annual Gift Tax Exclusion is NOT Available)	\$6,003.10



No Good Deed Goes Unpunished: Donor is Not the Beneficiary

Transfer Tax: Federal Gift Tax

- Assessed on taxable transfers during life
- 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: \$15,000
 - ✓ Each spouse can give \$15,000 to any person each year, so parents of a family of three children can transfer \$90,000 ($2 \times 3 \times \$15,000$) to the next generation each year free of tax



No Good Deed Goes Unpunished: Donor is Not the Beneficiary

Gift and Estate Tax Rate Schedule in 2013 - 2019

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

Top estate tax bracket = 40%

Gift tax credit schedule

Year	Amount of Credit	Amount of Exemption Equivalent
2017	2,141,800	5,490,000
2018	4,417,800	11,180,000
2019	4,505,800	11,400,000



CRTs and Taxation: What You Really Need To Know

- If CRT is funded with appreciated property, capital gains will be realized inside the trust when property is sold
- Trust is tax-exempt and will not be taxed on the gains
- However -
- Trust has tax reporting requirements – Trustee must file annual tax return(s)



CRTs and Taxation: What You Really Need To Know

Example:

- CRT funded with \$500,000 in long-term gain property; cost basis is \$100,000.
- Trust realizes \$400,000 in capital gains when property is sold.
- CRT must pay beneficiary \$25,000 in 2019.
- Investments only earn \$11,000 in dividends and interest in 2019.
- Where does Trustee come up with the other \$14,000?



CRTs and Taxation: What You Really Need To Know

Example continued . . .

- Trustee sells assets to raise additional \$14,000 for beneficiary distribution.
- Beneficiary K-1 (tax reporting form) shows the following breakdown for the year:
- Total amount paid to beneficiary: \$25,000
- Amount of ordinary income paid: \$11,000
- Amount of capital gains distributed: \$14,000



CRTs and Taxation: What You Really Need To Know

- Each year, the beneficiary will receive a K-1 showing a combination of ordinary income and capitals gains.
- As long as there are realized but undistributed capital gains inside the trust, the beneficiary will not receive tax-free income from the trust.
- The only way the CRT can pay tax-free income is to have little or no realized capital gains occurring inside the trust.
- If the Trustee invests in tax-free bonds, the interest of the income beneficiary is being favored over the interest of the remainder charity.



Seriously, She Has Too Much Money!

Transfer Taxation Basics: Federal Estate Tax

- Assessed on estate at death
- Takes into account taxable gifts made during life (and any gift tax paid on those gifts)
- Unlimited marital deduction & charitable deduction
- Transfers through estate get step-up in cost basis
- Exemption portable between spouses
- Deduction for state “death taxes”



Seriously, She Has Too Much Money!

Transfer Taxation Basics: Federal Estate Tax

- One in a thousand estates (0.1%) settled in 2018 expected to pay federal estate tax
- For the few that owe federal estate tax, charitable bequests save \$0.40 for every \$1 given (i.e., gift costs only \$0.60 per \$1 given)
- Let's use the example of Mrs. O'Brien, who has a \$25 million estate and is in the midst of some serious estate planning.



Seriously, She Has Too Much Money!

Gift and Estate Tax Rate Schedule in 2013 - 2019

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

Estate tax credit schedule

Year	Amount of Credit	Amount of Exemption Equivalent
2017	2,141,800	5,490,000
2018	4,417,800	11,180,000
2019	4,505,800	11,400,000

Top estate tax bracket = 40%



Seriously, She Has Too Much Money!

If Mrs. O'Brien dies in 2019, and her total estate is valued at \$25 million, here is how her actual estate tax would be computed:

Estate in 2019	\$25,000,000
Prior taxable gifts	+0
Taxable estate	\$25,000,000
Tentative estate tax	\$9,945,800
Less 2019 estate tax credit	(4,505,800)
Estate Tax Due in 2019	\$5,440,000
Net estate distributable to Mrs. O'Brien's heirs:	\$19,560,000
Effective Estate Tax Rate	21.8%



Seriously, She Has Too Much Money!

What if Mrs. O'Brien wants to leave a significant amount of her estate to one or more non-profit organizations? That money comes off the top in the estate – any gifts to charity earn charitable estate tax deductions. Here's what it would look like if Mrs. O'Brien gave \$10,000,000 of her estate to charities.

Estate in 2019	\$25,000,000
Prior taxable gifts	+0
Less charitable bequests	(\$10,000,000)
Net Taxable estate	\$15,000,000
Tentative tax	\$5,945,800
Less 2019 estate tax credit	- \$4,505,800
Estate Tax Due in 2019	\$1,440,000
Net estate distributable to Mrs. O'Brien's heirs:	\$13,560,000
Effective Estate Tax Rate	5.8%



Seriously, She Has Too Much Money!

ASSUMPTIONS:

Projection begins in 2019 and runs for 20 years.

Lead trust makes annual, end of period payments to THE CHARITY.

Original principal of \$10,000,000 has a cost basis of \$4,000,000.

Donor income tax bracket is 40.8%, 23.8% for capital gains.

Beneficiary income tax bracket is 40.8%, 23.8% for capital gains.

Value of donor's estate is \$25,000,000. Prior taxable gifts are \$11,400,000.

Basic exclusion is \$11,400,000.

Income is 2.5%, capital appreciation is 4.5%.



Seriously, She Has Too Much Money!

6.2344% Non-Grantor Lead Annuity Trust

Principal Placed in Plan	\$10,000,000
Annuity to THE CHARITY	\$623,440
Gift Tax Deduction	\$10,000,000
Taxable Gift	\$0
Gift Tax (paid 2019 by donor)	\$0
Principal and Tax to Establish Plan	\$10,000,000
Total Income Tax Paid Over Term by Trust	\$0
Principal after 20 Years	\$13,138,615
Benefit to Family	\$13,138,615
(ending principal less taxes in 2039)	
Total Distributed to THE CHARITY	\$12,468,800
Total Benefit	\$25,607,415



Maybe It's Not The Federal Estate Tax We Should Worry About

Transfer Taxation Basics: State Taxes at Death

12 states have an estate tax

- Details vary greatly between states
 - ✓ Exemptions range from \$1 million to \$5.749 million (much lower than federal \$11.4 million)
 - ✓ Tax rates range from 0.8% to 16% (much lower than federal 40%)
- 6 states impose inheritance tax (2 impose both taxes)
 - ✓ Rates range from 4.5% to 18%
 - ✓ Spouses, children, grandchildren often exempt from tax



Maybe It's Not The Federal Estate Tax We Should Worry About

States with an Estate or Inheritance Tax in 2019

Connecticut: The top estate tax rate is 12 percent and is capped at \$15 million (*exemption threshold: \$3.6 million; the exemption amount will rise to \$5.1 million in 2020, \$7.1 million in 2021, \$9.1 million in 2022, and is scheduled to match the federal amount in 2023.*)

District of Columbia: The top estate tax rate is 16 percent (*exemption threshold: \$5.6 million*)

Hawaii: The top estate tax rate is 16 percent (*exemption threshold: \$5.49 million*)

Illinois: The top estate tax rate is 16 percent (*exemption threshold: \$4 million*)

Iowa: The top inheritance tax rate is 15 percent (*no exemption threshold*)

Kentucky: The top inheritance tax rate is 16 percent (*exemption threshold for [Class C beneficiaries](#): \$500; exemption threshold for Class B beneficiaries: \$1,000; Class A beneficiaries, which is the majority, pay no inheritance tax*)

Maine: The top estate tax rate is 12 percent (*exemption threshold: \$5.6 million*)

Maryland: The top estate tax rate is 16 percent (*exemption threshold: \$5 million*); The top inheritance tax rate is 10 percent (*no exemption threshold*)

Sources: TheBalance.com, Everplans.com, Kiplinger.com, TaxFoundation.org.



Maybe It's Not The Federal Estate Tax We Should Worry About

States with an Estate or Inheritance Tax in 2019 (continued)

Massachusetts: The top estate tax rate is 16 percent (*exemption threshold: \$1 million*)

Minnesota: The top estate tax rate is 16 percent (*exemption threshold: \$2.7 million; this increases to \$3 million in 2020*)

Nebraska: The top inheritance tax rate is 18 percent (*exemption threshold: \$10,000*)

New Jersey: The top inheritance tax rate is 16 percent (*no exemption threshold*)

New York: The top estate tax rate is 16 percent (*exemption threshold: \$5.749 million*)

Oregon: The top estate tax rate is 16 percent (*exemption threshold: \$1 million*)

Pennsylvania: The top inheritance tax rate is 15 percent (*no exemption threshold*)

Rhode Island: The top estate tax rate is 16 percent (*exemption threshold: \$1,561,719*)

Vermont: The top estate tax rate is 16 percent (*exemption threshold: \$2.75 million*)

Washington: The top estate tax rate is 20 percent (*exemption threshold: \$2.193 million*)

Sources: TheBalance.com, Everplans.com, Kiplinger.com, TaxFoundation.org.



Does She Or Doesn't She? Only Her Advisor Knows For Sure...

- Most difficult tax-related challenge for gift planners: not knowing enough about the donor's personal tax situation
- Donor may be less-than-forthcoming about sources of income and levels of wealth
- Potential gift arrangements may not benefit a particular donor because of tax information not being disclosed
- Conversations around transfer taxes are especially difficult: so much depends on whether there is any lifetime exclusion amount remaining



Does She Or Doesn't She? Only Her Advisor Knows For Sure...

- Gift planners also should be careful about assuming income tax brackets.
- Discussions about after-tax benefits can be risky if the donor has not disclosed her marginal income tax bracket.
- For gift plans involving potential gift taxes, use the term “potentially taxable transfer.”
- It's generally a good idea to encourage the donor's advisors to be part of the discussion process.



Questions?





Still Have a Question?

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