Basic Taxation for Gift Planners

Date: June 28, 2018

Time: 1:00 – 2:30 Eastern

Presenter: Bill Laskin
Vice President,
Product Management
PG Calc

Taxation Basics for Gift Planners

- Income taxation basics
- Income tax charitable deduction rules
- Gifts of cash, capital gain property, IRD
- Transfer taxes: Gift / estate / generation skipping taxes
- What may lie ahead?

Federal Income Tax Basics

1) Gross Income
- Above-the-line Deductions
Adjusted Gross Income (AGI)

- Below-the-line Deductions
- Exemptions
Taxable Income

2) Compute tentative tax

3) Subtract tax credits to compute income tax owed

Federal Income Tax Basics

2018 Married Filing Jointly Rates

Taxable Income	Income Tax	% on Excess
$0	$0	10%
19,050	1,905	12%
77,400	8,907	22%
165,000	28,179	24%
315,000	64,179	32%
400,000	91,379	35%
600,000	161,379	37%

- Without 2017 Tax Act, 39.6% bracket would start at $480,050
- Brackets indexed for inflation

Federal Income Tax Basics

- Income tax schedule applies to ordinary income
  - ✓ Wages, salary, tips
  - ✓ Interest on investments (bonds, savings accounts, CDs)
  - ✓ Rents
  - ✓ Realized ordinary gain
  - ✓ Other sources

Federal Income Tax Basics

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

Federal Income Tax Basics

- Ted and Alice

Combined gross income:	$275,000
Above-the-line deductions:	- $25,000
Adjusted gross income (AGI) :	$250,000
Itemized deductions:	- $40,000
Taxable income:	$210,000

- 24% *marginal* income tax rate
- Tax on $210,000 = $28,179 + 24% x ($210,000 - $165,000)) = $38,979
- 14.2% *effective* tax rate ($38,979/$275,000 = 0.142)

Federal Income Tax Basics: Standard Deduction

2017 Tax Act

- Nearly doubled standard deduction
  - ✓ $24,000 for MFJ, $12,000 for single filer
  - ✓ Increases $1,300 if over 65, so $26,600 for typical PG donor couple
- Preserved deduction for charitable contributions, mortgage interest
- Placed $10,000 limit on SALT deduction
- Eliminated many other deductions and personal exemption

Federal Income Tax Basics: Standard Deduction

- 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
- 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

Itemize or Standard Deduction: Example 1

- Alan and June (both over 65, in 24% bracket)

Charitable gifts:	$10,000
SALT deduction:	+ $10,000
Total itemized deductions:	$20,000
Standard deduction:	$26,600

- Reduce taxable income $6,600 more by taking standard deduction
- Save $1,584 in tax by taking standard deduction

Itemize or Standard Deduction: Example 2

- Alan and June (both over 65, in 24% bracket)

Annual charitable gifts:	$10,000
Deduction for $50,000 CGA:	+ $25,000
SALT deduction:	+ $10,000
Total itemized deductions:	$45,000
Standard deduction:	$26,600

- Reduce taxable income $18,400 more by itemizing deductions
- Save $4,416 in tax by funding CGA and itemizing

Bunch Gifts to Take Advantage of Itemizing

- 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

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.)

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)

Capital Gains Tax

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

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%
77,200	38,600	15%
479,000	425,800	20%

- Brackets indexed for inflation
- 37% bracket is $600,000 for MFJ, $500,000 for single

Capital Gains Tax Example

- Mr. and Mrs. Albertson
  - ✓ $200K AGI, own P & G stock

FMV	$300,000
Cost basis	- $100,000
Long term gain	$200,000
Tax @ 15%	$30,000
Left to reinvest ($300,000 - $30,000)	$270,000

- When long term gain property donated outright: deduction based on FMV and capital gain not taxed

Gift of Cash vs. Gift of Appreciated Property

- Mr. and Mrs. Albertson give P & G stock or cash

	Give Stock	Give Cash
CG tax savings @ 15%	$30,000	$0
Income tax deduction	$300,000	$300,000
Income tax savings @ 24%	$72,000	$72,000
Total tax savings	$102,000	$72,000
Net cost of gift	$198,000	$228,000

- Albertsons can repurchase P & G stock; reset basis
- CG tax savings doesn't require itemizing

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

3.8% Medicare Surtax

- 3.8% surtax called the Net Investment Income Tax (NIIT or Medicare surtax). 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 ($250K for MFJ).
- Increases marginal rates for income tax and capital gains tax by 3.8%
- 3.8% surtax not reduced by charitable deductions

Impact of State and Local Taxes on Marginal Rate

- Deductible up to $10,000 for federal purposes
- When SALT < $10,000, marginal tax rate not the sum of separate rates
- Example: 24% Federal rate + 5% SALT
  - ✓ Blended rate = 24% + (1 - .24) x 5% = 27.8%
  - ✓ When SALT > $10,000, total tax is sum of separate rates: 24% + 5% = 29%

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

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

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 x $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 60% of AGI (i.e., $210,000) each year
  - ✓ Entire deduction can be used in four years (3 x $210,000 + 1 x $70,000 = $700,000)

Interaction of 60% and 30% Limits

- Our interpretation of 2017 Tax Act: 30% limit functions within 50% limit, not 60% limit
- Manuela has $100,000 AGI
  - ✓ Gives $40,000 cash and $20,000 long term gain property
  - ✓ Deducts $40,000 cash, which reduces 50% limit of $50,000 to $10,000
  - ✓ Deduct $10,000 of long term gain property and carry forward remaining $10,000

Income Tax Charitable Deduction

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

Charitable IRA Rollover

- Traditional and Roth IRA only (can rollover other qualified plan to IRA, then make rollover gift)
- Minimum age – 70 ½
- Maximum annual amount – $100,000
- Payment must be directly to charity
- Outright gifts to public charities only; not to private foundation, supporting organization, donor advised fund, or life income plan
- Can fulfill a pledge
- Counts toward required minimum distribution (RMD)
- Beneficiary of inherited IRA can do rollover

Charitable IRA Rollover: Who Benefits Most?

- Tax benefit
  - ✓ Donor doesn't declare rollover amount as income
  - ✓ No deduction
- Donors who benefit most
  - ✓ Do not itemize deductions
  - ✓ Already contribute 50% - 60% of income
  - ✓ Live in a state with an income tax that does not permit itemized deductions (e.g., MA)
  - ✓ Like the simplicity of making gift directly from an IRA

When is a Charitable Gift Complete?

Depends upon whether it's:

- Check
- Credit Card
- Stock
- Real Estate
- Tangible Person Property
- IRA Rollover

Relevance:

- Year-end gifts
- Valuation

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

Transfer Taxation Basics

- Gift tax
- Estate tax
- Generation-skipping transfer (GST) tax
- 2017 Tax Act doubled lifetime exemptions for all three taxes (expires on 12/31/2025)
- In 2018, all three feature $11.18 million exemption and tax rate of 40% on the excess

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”

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)

Transfer Taxation Basics: State Taxes at Death

- 12 states have an estate tax
- Details vary greatly between states
  - ✓ Exemptions range from $1 million to $5.49 million (much lower than federal $11.18 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

Transfer Taxation Basics: Federal Gift Tax

- Unified with federal estate 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 x 3 x $15,000) to the next generation each year free of tax

Transfer Taxation Basics: Generation Skipping Transfer tax

- Assessed in addition to gift or estate tax; prevents tax avoidance by skipping generations
- Applies to certain transfers to “skip persons”
- Skip person: relative two or more generations younger or non-relative 37.5^{+} years younger
- As with estate and gift taxes, can be relevant in connection with a planned gift that benefits a skip person

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

- Actually an income tax issue, but arises with transfers at death
- If income associated with an asset would have been taxed in hands of decedent, new owner of asset will be taxed on income as it is paid
- Qualified retirement plans (e.g., traditional IRAs, 401(k)s, 403(b)s, etc.) and certain other assets feature IRD; when distributed to charity, no tax is owed

Transfer Taxation Basics: Example Factoring in IRD

- Mr. Soto dies in 2018 with an estate worth $12,730,000. He made no taxable gifts during life.
- Assume that $1,000,000 of Mr. Soto's estate is from the balance in his qualified retirement plan.
- He can save $210,000 in total taxes by making charitable gifts first from his qualified plan and then from other assets, rather than all from other assets.

Transfer Taxation Basics: Example Factoring in IRD

	Give IRD to Charity	Give IRD to Son
Estate tax		
Estate tax owed	$620,000	$620,000
Income tax		
Balance in qualified plan	$1,000,000	$1,000,000
Income tax deduction	- $1,000,000	- $0
Estate tax attributable to IRD	- $0	- $400,000
Taxable income	$0	$600,000
Income tax owed (son's rate=35%)	$0	$210,000
Total tax on estate and IRD	$620,000	$830,000

Taxes saved by making gifts from IRD = $830,000 - $620,000 = $210,000

Transfer Taxation Basics: Always Give IRD First

- Use IRD assets to fund charitable gifts regardless of estate size
- When estate owes no estate tax, giving IRD to charity saves even more income tax

Income tax	Give IRD to Charity	Give IRD to Son
Balance in qualified plan	$1,000,000	$1,000,000
Less qualified plan assets donated	- $1,000,000	- $0
Taxable income	$0	$1,000,000
Income tax owed (son's rate=35%)	$0	$350,000

What May Lie Ahead?

Extend Charitable IRA Rollover?

- Charitable IRA Rollover now “permanent”
- Add donor advised funds and foundations?
- Add some life income gifts?

What May Lie Ahead?

Universal charitable deduction?

- Above-the-line charitable deduction
  - ✓ Smith-Cuellar (HR 5771): allow without limit
  - ✓ Lankford-Walker (S. 2123, HR 3998) : allow up to 1/3 of standard deduction
- Non-itemizers would get tax benefit from charitable contributions

Questions?

Still Have a Question?

Contact: Bill Laskin

Email: bill@pgcalc.com

Phone: 888-474-2252