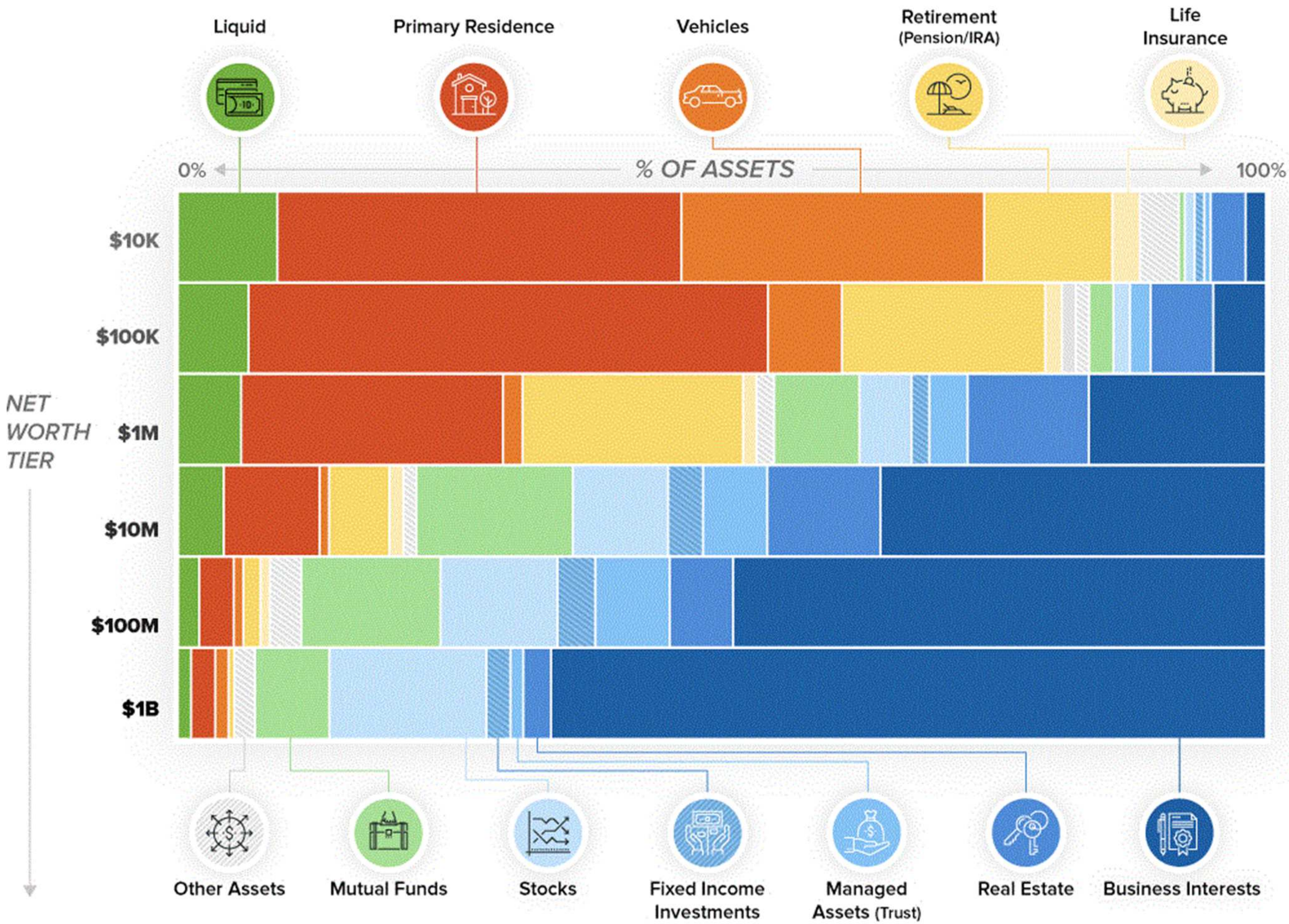
# Understanding Tax Issues That Can Lead to Bigger Gifts

| | |
|---|---|
| Date: | April 30, 2020 |
| Time: | 1:00 – 2:30 Eastern |
| Presenter: | Bill Laskin<br>Vice President,<br>Product Management<br>PG Calc |

# Agenda

- What assets do donors own?
- SECURE Act and CARES Act have created planned gift opportunities
- Lowest IRS discount rate ever and depressed stock values have created planned gift opportunities
- Irrevocable gift ideas
- Revocable gift ideas



Liquid
Primary Residence
Vehicles
Retirement
(Pension/IRA)
Life
Insurance
0%
% OF ASSETS
100%
NET
WORTH
TIER
$10K
$100K
$1M
$10M
$100M
$1B
Other Assets
Mutual Funds
Stocks
Fixed Income
Investments
Managed
Assets (Trust)
Real Estate
Business Interests

# SECURE Act and CARES Act Changes

- SECURE Act – ended "stretch" inherited IRA
  - ✓ Effective January 1, 2020: in most cases where heir is non-spouse or more than 10 years younger than deceased, inherited IRA must be emptied within 10 years.
- CARES Act – waives 60% of AGI limit on cash gifts made in 2020
  - ✓ Donor can deduct up to 100% of AGI cash gifts made in 2020 to public charities (except DAFs, SOs, or PFs)
- These changes create new gift opportunities

# Lowest IRS Discount Rate EVER

- IRS discount rate in May 2020 = 0.8%
  - ✓ Will result in record high deductions for CLTs and RLEs
- Recent plunge in stock values
  - ✓ Creates opportunity to transfer stock to heirs at lower transfer tax cost
  - ✓ Can shelter future growth in value from all transfer tax

# Don’t Forget the QCD!

- Qualified charitable distribution from an IRA still a great gift!
  - ✓ Same rules as before SECURE Act and CARES Act
    - Must be 70 ½
    - Gift must be to public charity (no DAFs, SOs, PFs)
    - Donor must not receive a benefit (no LIPs)
    - $100,000/year limit
    - Must be from Traditional IRA, Roth IRA, or inactive SEP or SIMPLE IRA - almost all from Traditional IRA

# Don’t Forget the QCD!

- CARES Act suspends RMD for 2020, but QCD still a great tax-efficient gift.
  - ✓ Transfer to charity not reported as income
  - ✓ No deduction (because donor never taxed on IRA assets)
- Appeals especially to donors who:
  - ✓ Don’t itemize
  - ✓ Contribute up to their AGI limits
  - ✓ Live in a state without a charitable deduction (e.g. MA)
  - ✓ Want to reduce Medicare premiums

# Leveraging the Temporary 100% Limit

- CARES Act – donor can deduct up to 100% of AGI cash gifts made in 2020 to public charities (except DAFs, SOs, or PFs)
- 100% limit reduced dollar-for-dollar by gifts subject to other AGI limits
  - ✓ If LTCG gifts = 30% of AGI, then cash limit = 70% of AGI
  - ✓ Carryforward of 100% limit deductions subject to usual 60% limit

# Leveraging the Temporary 100% Limit

- Can withdraw any amount from retirement plan (IRA, 401(k), 403(b), etc.) and deduct whole amount by electing waiver
  1. Withdrawal increases income by amount of withdrawal
  2. 100% deduction on outright gift of same amount offsets income from withdrawal
- Unlike QCD, not limited to IRA or to $100,000, minimum age is 59 ½ (avoid 10% excise tax)
- Caveat: increasing AGI could increase Medicare premiums or have other negative effects

# Leveraging the Temporary 100% Limit

- Donor wants to give collectible to charity, which will sell it and use proceeds
  - ✓ Capital gain subject to special 28% tax rate
  - ✓ Deduction limited to donor's cost basis
- Donor can increase tax benefit by selling collectible, then giving cash proceeds

# Leveraging the Temporary 100% Limit

Mr. Jackson, age 78, owns a valuable painting worth $500,000 that he inherited when it was worth $200,000.

| | Give Painting | Sell Painting, Give Proceeds |
|---|---|---|
| Painting FMV | $500,000 | $500,000 |
| Painting cost basis | $200,000 | $200,000 |
| Realized gain | $0 | $300,000 |
| Capital gain tax (@ 28%) | $0 | $84,000 |
| | | |
| Charitable deduction | $200,000 | $500,000 |
| Income tax savings (@ 35%) | $70,000 | $175,000 |
| Capital gain tax | - $0 | - $84,000 |
| Net tax savings | $70,000 | $91,000 |

# Leveraging the Temporary 100% Limit

If Mr. Jackson funds a 5% flip CRUT instead, better to give painting to CRUT than sell and give proceeds

| | Give Painting | Sell Painting, Give Proceeds |
|---|---|---|
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| Painting cost basis | $200,000 | $200,000 |
| Realized gain | $0 | $300,000 |
| Capital gain tax (@ 28%) | $0 | $84,000 |
| | | |
| Charitable deduction (64.7%) | $129,496 | $323,540 |
| Income tax savings (@ 35%) | $45,324 | $113,239 |
| Capital gain tax | - $0 | $84,000 |
| Net income tax savings | $45,324 | $29,239 |

# Leveraging the Temporary 100% Limit

- 100% election also attractive for donor with unusually high income in 2020 (bonus, sell business)
- Example: $200,000 AGI + $1 million windfall
  - ✓ Waive limit: save $363,412 in year of gift
  - ✓ Don’t waive limit: save $296,404 over 4 years ($220,617 + $63,251 x 2 + $12,536)

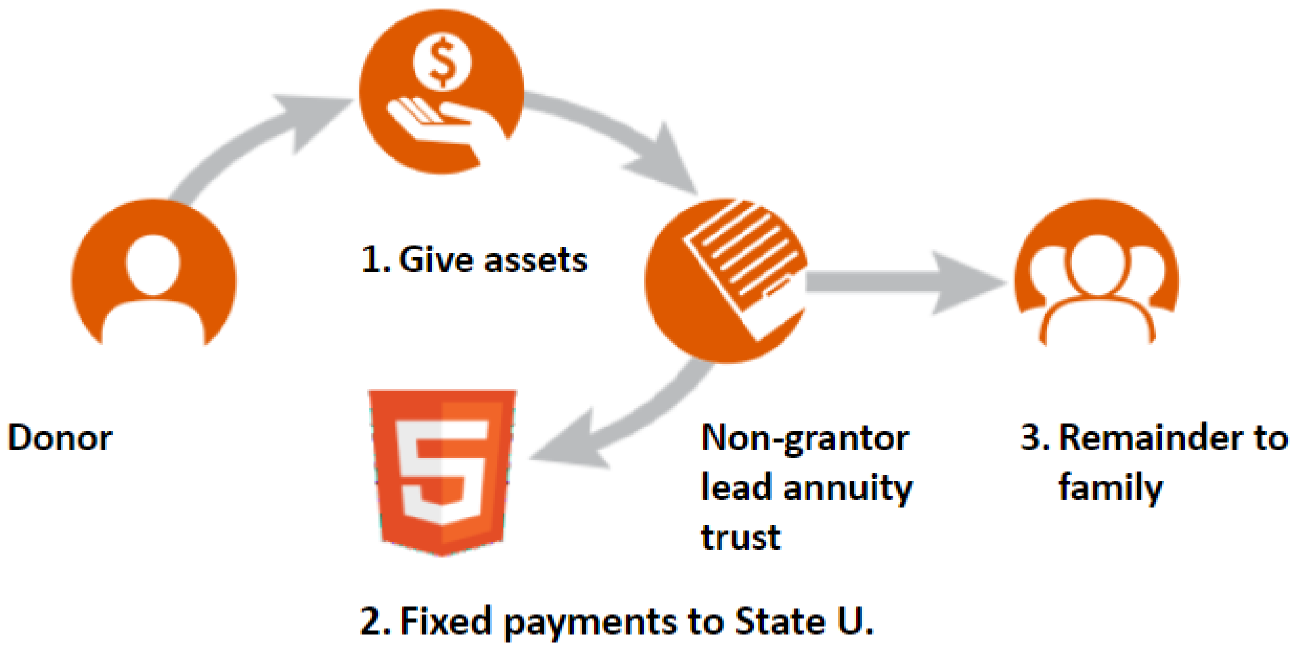
# Leveraging the Temporary 100% Limit

- BUT, 100% election not always the tax-wise choice
  - ✓ Depends on where donor is on income tax schedule

- Example: donor with $200,000 taxable income makes $200,000 in qualified cash contributions
  - ✓ Makes 100% election: pays no income in 2020; saves $45,016
  - ✓ Doesn't make 100% election: saves $31,625 in 2020 and $22,136 in 2021; total savings is $53,761

# Lead Trust Offers Double Leverage

- Charitable lead trust
  - ✓ Reverse of charitable remainder trust



# Lead Trust Offers Double Leverage

- Non-grantor charitable lead trust
  - ✓ Like CRT, payments can be fixed amount (annuity trust) or fixed % of trust value as revalued annually (unitrust)
  - ✓ Growth within CLT escapes all transfer tax
  - ✓ CLT is a taxable trust
  - ✓ CLT gets unlimited income tax deduction for payments to charity
  - ✓ Donor receives gift tax deduction; no estate tax when trust ends (GSTT does apply)

# Lead Trust Offers Double Leverage

Deduction for $1,000,000 7% CLAT with 15-year term

| IRS Discount Rate | Amount of Contribution Deductible |
| --- | --- |
| 0.6% | $1,000,000 * |
| **0.8%** | **$985,740** |
| 1.0% | $970,550 |
| 2.0% | $899,450 |
| 3.0% | $835,660 |
| 4.0% | $778,290 |
| 5.0% | $726,580 |

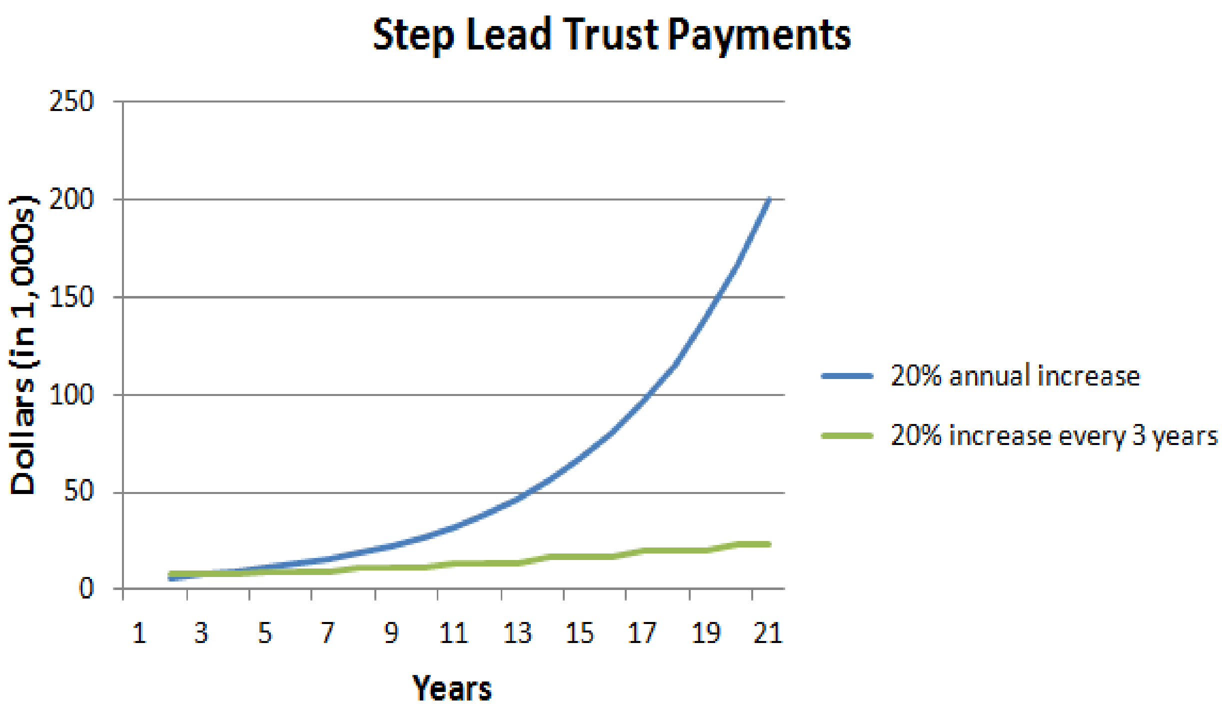
* $69,911 payout sufficient to earn $1,000,000 deduction

# Lead Trust Offers Double Leverage

- Married couple want to transfer $5 million each to two daughters and make leadership gift to campaign
- Fund 7% CRAT with $7 million in stock worth $10 million 3 months ago
  - ✓ Stock rebounds over next 3 years and returns 7% thereafter
  - ✓ $10 million to daughters 15 years later
  - ✓ $142,600 taxable gift – 70:1 leverage of gift tax exemption
  - ✓ Charity receives $10.5 million over 15 years

# Step Lead Trust Options

- CLAT payments can increase over time – “step” lead trust (see Rev. Proc. 2007-45)

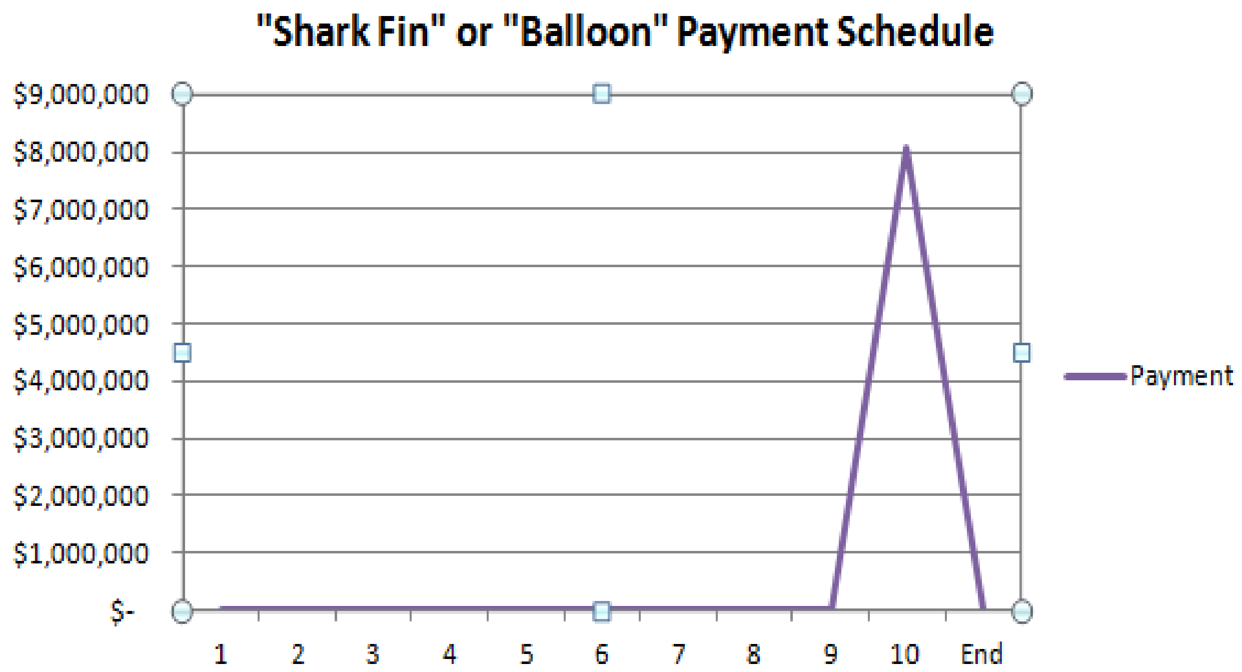


# Step Lead Trust Options

- Step lead trust protects trust value in early years.
  - ✓ Appealing to donors worried about investment performance in near term
  - ✓ In some situations, can be used to pass value of closely-held business to heirs
    - Dividends in early years can accumulate and be used to make payments to charity in later years
    - Can minimize taxes by reducing closely-held stock gradually
    - Pass growth in value tax-free
    - Beware of rule against excess business holdings

# Step Lead Trust Options

- "Shark fin" trust - extreme form of step lead trust
  - ✓ Makes minimal payments until final year, then one very large payment



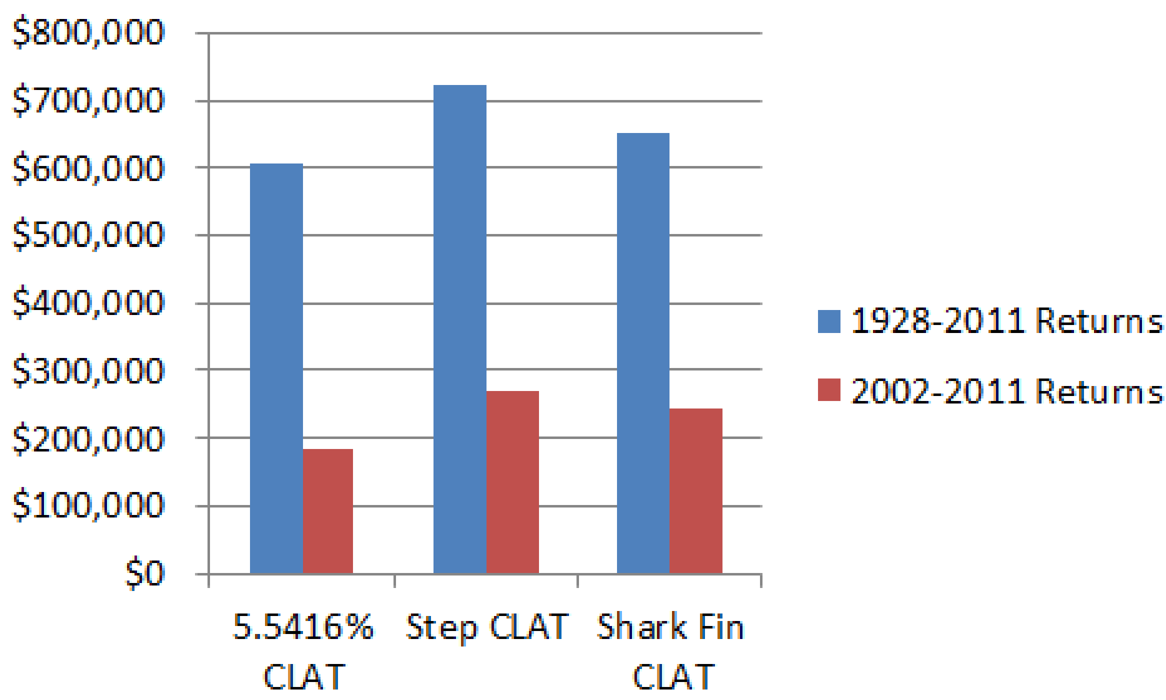
# Step Lead Trust Options

- "Shark fin" trust can be used in same situations as step lead trust
  - ✓ Give assets maximum time to grow before make significant payment to charity
  - ✓ Can time sale of closely-held stock to coincide with year of balloon payment – shelter large capital gain

# Step Lead Trust Options

Monte Carlo Simulation: three $1 million 20-year CLATs that earn 100% deduction (1.0% IRS discount rate)

**90% Confidence Interval for Principal at End of Term**



# Grantor CLT to Pay Pledge

- Grantor lead trust
  - ✓ Donor earns income tax deduction for present value of lead trust payments
  - ✓ Deduction limited to 20%/30% of donor's AGI
  - ✓ All income earned during trust term is taxable to donor
  - ✓ Remaining assets returned to donor at end of trust term
  - ✓ Tax-efficient way to make pledge payments or offset a portion of windfall income

# Grantor CLT to Pay Pledge

Donor fulfills $500,000 pledge with 5-year grantor 20% CLAT funded with $500,000 cash:

| | |
|---|---|
| Funding amount in May 2020 | $500,000 |
| Income tax charitable deduction (0.8% IRS rate) | $488,220 |
| Income tax savings (37% tax rate) | $180,641 |
| Income tax paid during term by donor | $22,765 |
| Amount returned to donor(1) | $126,202 |

(1) Assumes an investment return of 2% income and 5% appreciation.

If donor invested $500,000 and made same contributions:

- ✓ Similar income tax savings
- ✓ But $85,947 left after last pledge payment vs. $126,202 in GCLAT

# Opportune Time for a Retained Life Estate

- Retained life estate
  - ✓ Give personal residence or farm
  - ✓ Retain right to live in/use property for life and/or term of years
  - ✓ Receive income tax deduction for value of charity's remainder interest
  - ✓ Donor remains responsible for upkeep and taxes while holding life estate
    - Agreement should make donor's responsibilities clear
- As with CLATs, low IRS discount rate = high deduction

# Opportune Time for a Retained Life Estate

- RLE for 74-year-old, $500,000 property, land worth $200,000, house worth $300,000 with $75,000 salvage value and 45-year useful life

| IRS Discount Rate | Amount of Contribution Deductible |
|---|---|
| **0.8%** | **$404,365** |
| 1.0% | $395,815 |
| 2.0% | $356,852 |
| 3.0% | $323,384 |
| 4.0% | $294,485 |

# Opportune Time for a Retained Life Estate

- If donor decides to move out because of failing health or some other reason, donor can:
  - ✓ Rent the property and be entitled to the income
  - ✓ By agreement with the charity, sell the property and divide the proceeds proportionally
  - ✓ Contribute life interest and receive another charitable deduction

# Opportune Time for a Retained Life Estate

- Can issue gift annuity in exchange for RLE
  - ✓ Base annuity on remainder value of RLE
  - ✓ Deduction is deduction computed for the CGA
  - ✓ Advisable for charity to offer reduced annuity rate
  - ✓ Consider deferring payments to reduce charity's risk
- Charity needs sufficient funds to cover annuity and reserve requirements
- Charity needs to be willing to accept risk

# Bargain Sale

- Sell property to charity for less than FMV
- Deduction = FMV - sale price
- Must have charitable intent!
  - ✓ Some charities have donor sign statement of charitable intent

# Bargain Sale

- Donor reports gain allocable to sale portion
- Way to reduce capital gain tax when donor wants to give portion of property and doesn't want income
- Can be great way for charity to acquire real estate it wants to use

# Bargain Sale of Real Estate

Example:

- Nancy purchased home for $100,000; home now worth $500,000
- College wants home to house admin offices
- Nancy ready to downsize
- Nancy enthusiastic supporter of college

# Bargain Sale of Real Estate

- Sell and give $250,000 vs. Bargain sale for $250,000

| | Sell and Give | Bargain Sale |
|---|---|---|
| Sale proceeds | $500,000 | $250,000 |
| Deduction | $250,000 | $250,000 |
| Reportable gain | $400,000 | $200,000 |
| Taxable gain | $150,000 | $0 |
| Capital gain tax | $22,500 | $0 |

# Donate S Corporation Stock or Assets

- 4 million Subchapter S corporations in U.S. with nearly $4 trillion in assets (2014)
- Must be domestic
- Limited to 100 shareholders
- Net income flows proportionally to tax returns of shareholders
- One level of taxation (individual level)

# Donate S Corporation Stock or Assets

- Give S corp <u>stock</u> outright
  - ✓ Donor gets income tax deduction for FMV (30% of AGI limit)
  - ✓ Net income is UBTI to charity; so is gain on sale; charity likely will want to sell quickly


- Give S corp stock for gift annuity
  - Donor gets income tax deduction for charitable interest (30% of AGI limit)
  - Donor preserves cash flow from donated shares
- Give S corp stock for CRT – destroys S status

# Donate S Corporation Stock or Assets

- Give S corp <u>assets</u> outright
  - ✓ Shareholders share FMV deduction according to shares owned
  - ✓ Shareholder basis reduced by basis in donated assets according to shares owned
- Can fund gift annuity or CRT with S corp assets and preserve S status
- Caveats:
  - ✓ Requires agreement of all shareholders
  - ✓ If gift is substantially all assets of S corp, shareholders will recognize gain on transfer (Sec. 337(d))

# Designate Retirement Plan Assets for Charity

- Retirement assets are IRD
- Subject to income tax at owner's death
- Best to use retirement assets for testamentary charitable gifts and transfer other assets to heirs


  - ✓ Offers tax benefit even for 99.9% of estates that don't pay estate tax
  - ✓ To avoid income tax, make gift directly to charity, not to estate which then makes gift

# Designate Retirement Plan Assets for Charity

- Alvin's estate worth $6 million: $500,000 in IRA, rest in stock, cash, home, and personal property

| | **Give from IRA** | **Give from other assets** |
|---|---|---|
| Gift to charity | $500,000 | $500,000 |
| Estate tax savings * | $0 | $0 |
| Income tax savings (@ 35%) | $175,000 | $0 |
| Net cost of gift | $325,000 | $500,000 |

* Federal estate tax exemption is $11.58 million in 2020

# Designate Retirement Plan Assets for CRT

- SECURE Act limits availability of “stretch” IRA
- Formerly, heir could stretch RMDs over life expectancy (e.g., 34 years for a 50-year-old)
- Under SECURE Act:
  - ✓ Heir must withdraw all funds within 10 years unless heir is:
    - Spouse
    - Less than 10 years younger
    - A minor, disabled, or chronically ill
  - ✓ No RMD when funds must be withdrawn within 10 years

# Designate Retirement Plan Assets for CRT

- Donor wishes to provide income to children for life and make sizeable charitable gift
- Testamentary CRUT funded with retirement plan assets a solution to consider
  - ✓ No income tax on transfer to CRUT (see multiple PLRs)
  - ✓ Children receive payments for life (or term of years)
  - ✓ Payments taxed as ordinary income at least until funding amount distributed
  - ✓ Save estate tax if estate large enough to owe it

## Designate Retirement Plan Assets for CRT

John funds 6% CRUT with $500,000 from IRA for twin sons, age 55, vs. sons receive IRA, withdraw over 10 years, and spend same amounts as CRUT will provide

| | 6% CRUT | Inherited IRA |
|---|---|---|
| Principal | $500,000 | $500,000 |
| Charitable deduction | $82,390 | $0 |
| After 39 years (3% inc., 5% apprec.): | | |
| Total after-tax payments | $1,210,338 | $1,210,338 |
| Remaining principal | $1,082,372 | $4,448 |
| Total benefit | $2,292,710 | $1,214,786 |

# Designate Retirement Plan Assets for CRT

- Results depend on many factors:
  - ✓ Payout rate of CRUT
  - ✓ Investment performance
  - ✓ Son's marginal tax rate
  - ✓ How long sons live (if they live 34 years, nearly $200,000 left from inherited IRA instead of $4,448)
- Considerations:
  - ✓ Sons have no access to principal
  - ✓ Costs associated with creating CRUT

## Conclusion

- Recent changes in tax law (SECURE Act, CARES Act) have created new gift opportunities
- Extremely low IRS discount rate has enhanced several gift options
- QCDs remain an excellent source of tax-efficient gifts
- We've covered some ideas and assets; there are many others
- Keep an open mind!

# Questions?

# Still Have a Question?

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