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Understanding Tax Issues That Can Lead to Bigger Gifts



Date: April 30, 2020
 Time: 1:00 – 2:30 Eastern
 Presenter: Bill Laskin
 Vice President,
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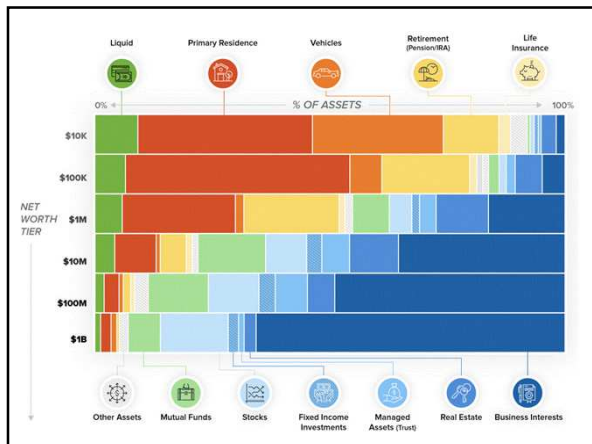
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Agenda

- 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

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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

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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

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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

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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

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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

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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

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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

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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

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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
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 (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

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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)

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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

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Lead Trust Offers Double Leverage

- Charitable lead trust
 - ✓ Reverse of charitable remainder trust

1. Give assets

2. Fixed payments to State U.

3. Remainder to family

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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)

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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

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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

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Step Lead Trust Options

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

Years	20% annual increase (Dollars in 1,000s)	20% increase every 3 years (Dollars in 1,000s)
1	10	10
3	12	12
5	15	15
7	18	18
9	22	20
11	28	22
13	35	25
15	45	30
17	58	35
19	75	40
21	100	45

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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

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Step Lead Trust Options

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

Years	Payment (Dollars)
1	\$0
2	\$0
3	\$0
4	\$0
5	\$0
6	\$0
7	\$0
8	\$0
9	\$0
10	\$8,000,000
End	\$0

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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

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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

CLAT Structure	1928-2011 Returns	2002-2011 Returns
5.5416% CLAT	~\$600,000	~\$200,000
Step CLAT	~\$750,000	~\$250,000
Shark Fin CLAT	~\$650,000	~\$250,000

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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

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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

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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



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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

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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

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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

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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

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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

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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

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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

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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)


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Donate S Corporation Stock or Assets

- Give S corp stock 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



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Donate S Corporation Stock or Assets

- Give S corp assets 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))


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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



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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

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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

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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

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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

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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

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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!

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Questions?



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Still Have a Question?

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