National Capital Gift Planning Council

Nuts and Bolts Session

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Income Tax and Tax Brackets

Calculating Income Tax

Gross Income

- Everything earned or received as taxable income during the year

Minus Adjustments

- Such as self-employed health insurance, alimony payments, IRA contributions

Equals Adjusted Gross Income

Minus Personal Exemptions

- $4,000 per dependent for 2015

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Income Tax and Tax Brackets (Continued)

Minus Deductions

- Standard deduction of $6,300 for single, $12,600 for married filing joint, or itemized deductions (including charitable), if greater than standard deduction

Equals Taxable Income

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Tax Brackets for 2015

- *Married Individuals Filing Joint Returns and Surviving Spouses as an example*

Taxable Income	*Tax Due*
• *$0-$18,450*	*10%*
• *$18,451-$74,900*	*$1845 plus 15% over $18,450*
• *$74,901 - $151,200*	*$10,312 plus 25% over $ 74,900*

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Tax Brackets (Continued)

- $151,201- $230,450 — $29,387 plus 28% over $ 151,200
- $230,451-$411,500 — $51,577 plus 33% over $230,450
- $411,501-$464,850 — $111,324 plus 35% over $411,500
- $464,850 plus — $129,996 plus 39.6% over $464,850

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Charitable Deductions

- A deductible charitable gift occurs when the donor delivers money or valuable property to a charity or agent of the charity
- Gift is not completed until actually given, so, for example, a pledge is not deductible
- Generally, a retained interest of some sort is not a completed gift, with some specific exceptions

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Charitable Deductions (Continued)

- There are specific rules about how charitable gifts are valued (Fair Market Value vs. Cost Basis) depending on: the type of property given, the donor's holding period for the asset, and the tax status of the charity receiving the gift
- There are very specific rules about what a donor needs to do to substantiate a gift, to meet IRS rules

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Charitable Deductions (Continued)

- Introducing the concept of the capital gains tax as it affects the charitable deduction
- A Capital Asset is distinguished from ordinary income property in that it is generally an investment such as stocks, bonds or real estate
- A capital gain is the sales price of an asset over its cost basis (reduced by depreciation, if applicable)

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Charitable Deductions (Continued)

- The capital gains tax rate applied to qualified dividends and gain from the sale of capital assets held more than one year is lower than the rate on ordinary income such as wages. Gain from short-term capital gain (held less than a year) is taxed at ordinary income rates.
- The long-term capital gains rate is also graduated, topping out at 20% if a taxpayer is in the top 39.6% ordinary income tax bracket

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Charitable Deductions (Continued)

- In addition to the ordinary income tax and the capital gains tax, there is now a net investment income ("NII") tax of 3.8%, which is applied to NII – including capital gains, for filers with NII above certain income thresholds ($250,000 for married filing joint)
- Therefore, you may see the top capital gains rate referred to as 23.8%

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Charitable Deductions (Continued)

- Why are we talking about capital gains in relation to charitable deductions?
- The distinction between long-term and short-term capital assets can affect the value of the deduction between fair value and cost basis
- In general, the deduction for short-term capital gain property, or donor-created artwork, or "ordinary income property" – is limited to cost basis.

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Charitable Deductions (Continued)

- The deduction for long-term capital gain property is generally the fair market value of the property
- Great planning tip – donation of long-term capital gain property can achieve a double benefit: (1) a tax deduction at fair value, and (2) no capital gains tax.

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Charitable Deductions (Continued)

- Another limit on charitable deduction: the % of adjusted gross income, which may be 20%, 30%, or 50%
- Relevant % depends on the type of property given (cash and ordinary income property vs. long-term capital gain property) and the type of charity receiving the donation (public charity vs. private foundation)
- For example, the limit for donations of cash or ordinary income property is 50% of AGI limit if given to a public charity, and 30% for gifts to a private foundation

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Charitable Deductions (Continued)

- The limit for gifts of long-term capital gain property is 30% of AGI for gifts to a public charity, and 20% for gifts to a private foundation
- If the gifts exceed these limits, the excess can be be carried forward 5 years

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Income Tax Benefit of a Charitable Deduction

- A donor’s cost in making a gift is reduced by the tax savings
- For example, a gift of $10,000 for a donor in a 40% tax bracket would be $6,000 – ($10,000, less tax savings of $4,000)
- Cost of a gift of a long term appreciated stock may be lower than the cost if the donor sells the stock and contributes the after-tax sales proceeds

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Income Tax Benefit of a Charitable Deduction (Continued)

- For example, a gift of Apple stock worth $10,000 with a tax basis of $2,000 would cost a 40% bracket donor $6,000 ($10,000 value, less $4,000 tax savings). If the stock was sold by the donor, with the donor gifting $10,000 of cash, the cost of the gift would be increased by the capital gains tax: $8,000 x 30% = $2,400

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Income Tax Benefit of a Charitable Deduction (Continued)

- A charitable deduction may be reduced by the so-called phase-out of itemized deductions
- Itemized deductions generally including charitable deductions, are reduced for high income taxpayers by 3% of AGI above a threshold (incomes above $309,000 for married filing joint)
- Exemptions are also phased-out above certain income levels

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Income Tax Benefit of a Charitable Deduction (Continued)

- Some individuals are subject to an alternative minimum tax (AMT) which is a parallel tax system
- You literally calculate your income tax twice under regular and AMT and pay the higher amount
- Although very complicated, taxpayers most likely subject to AMT are those with high state and local income taxes

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Income Tax Benefit of a Charitable Deduction (Continued)

- The highest marginal rate for AMT is currently 28% which could affect the tax benefit of a deduction for that year

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Transfer Taxes

- For transfer taxes (i.e. estate and a gift taxes) there is an unlimited charitable deduction
- Several basic concepts – 40% tax rate (Federal) annual exclusion for gifts of $14,000 per year ($28,000 for a married couple); Lifetime exemption of $5.43 million for 2015 which could therefore mean $10.8 million exemption for a married couple
- Spousal marital deduction of an unlimited amount and unlimited deduction for charitable contributions

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Charitable Remainder (or Lead) Trusts

- Gifts direct to charity mean the gifted assets will no longer be available to a donor’s family members
- For this reason many individuals are wary of making large gifts to charity
- Methods to address this concern include gifts in trust, where family members have an interest in the trust

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Charitable Remainder (or Lead) Trusts (Continued)

- For example – Charitable Remainder Trust (“CRT”) - family members retain an interest in the trust for life or for a term of years (up to 20) that pays a fixed percentage of the value of the trust assets each year. Thereafter, the trust remainder goes to charity. A charitable deduction is available for the “present value” of the remainder interest.
- There is also a “Charitable Lead” Trust – charity gets the current trust interest and family members get the remainder interest – (much less used vs the CRT).

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IRS Discount Rates

- The Section 7520 rate is used to discount the value of annuities, life estates and remainders to present value and is revised monthly
- Used to value deductions for charitable gift annuities, charitable remainder and lead trusts and retained life estates

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IRS Discount Rates (Continued)

- Another complicated topic, but for example the lower 7520 rates in recent years have affected CRATS by lowering the charitable contribution deduction and increasing the annuity interest to the non-charitable beneficiary
- The effect on CLAT's has been the opposite by increasing the contribution deduction and reducing the value of the remainder interest

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Gifts of Tangible Personal Property and Substantiation

- Tangible personal property – art, antiques, and jewelry are examples.
- Gifts of tangible personal property generally are limited to the cost of the property.
- Gifts to a charity where the property will be used by the charity in performing its "exempt function" – art given to an art museum – would be deductible at the fair market value.

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Tangible Personal Property (Continued)

- Special charitable donation rules apply to clothing or household items, cars, boats and airplanes, taxidermy, inventory from the donor's business, a patent or other intellectual property

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Substantiation

- To get a charitable deduction for income tax purposes, gifts over $250 must be documented in writing from the charity as to - who made the gift?, what was the gift?, when was the gift made?, and to whom was the gift given?
- The written documentation must also state that the donor did not received any goods or services in return for the gift (or alternatively, the value of such goods or services)
- Certain large property gifts require appraisals to show how the gift was valued

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Substantiation (Continued)

- Demarcations exist for gifts of cash whether below $250 or above $250
- Gifts of property over $500 requires a separate IRS form with the donor’s tax return
- Gifts of property above $5,000 require a qualified appraisal of the property and a summary included with the return
- Gifts of property over $500,000 and gifts of art over $20,000 require the entire qualified appraisal with the return

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IRA Qualified Charitable Rollover

- Been around since 2006 but is not a permanent part of the law
- It was renewed for 2014; not sure for 2015
- For tax years before 2015, individuals age 70 ½ or older could distribute up to $100,000 from their IRA's to qualified charities without having to include the distribution in their gross income

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IRA Qualified Charitable Rollover (Continued)

- The amount distributed is not included in the AGI of the donor thereby not impacting deductions that are affected by AGI limits
- Donations must go directly from IRA custodian to a public charity
- The amount so distributed to charity qualified as "required minimum distributions" under the IRA rules

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Income in Respect of a Decedent (IRD)

- IRD is income the deceased was entitled to, but had not yet received at the time of his or her death
- It is included in the decedent's estate for estate tax purposes but not reported on final income tax return which only includes income received before death
- This income is taxed when it is received by the decedents beneficiaries

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IRD (Continued)

- Distributions from traditional IRA's and employer provided retirement plans are considered IRD, making them poor assets to transfer to heirs if the estate is taxable

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