BUDROS RUHLIN ROE

Building money towards meaning.

Philanthropic Gifting Under the New Tax Act

- Key Changes of the Tax Cuts & Jobs Act of 2017 (TCJA) Impacting Charitable Gifting Strategies
- Gifting Strategies under the New Act
- Impact of Higher Interest Rates
- Impact on Charitable Giving and Offsets

2018 Tax Brackets

Ordinary Income Brackets

	S	MFJ/QW	MFS	HOH	T&E
10%	$ 9,525	$ 19,050	$ 9,525	$ 13,600	$ 2,550
12%	$ 38,700	$ 77,400	$ 38,700	$ 51,800	-
22%	$ 82,500	$ 165,000	$ 82,500	$ 82,500	-
24%	$ 157,500	$ 315,000	$ 157,500	$ 157,500	$ 9,150
32%	$ 200,000	$ 400,000	$ 200,000	$ 200,000	-
35%	$ 500,000	$ 600,000	$ 300,000	$ 500,000	$ 12,500
37%					

Capital Gain & Qualified Dividend Brackets on Taxable Income

	S	MFJ/QW	MFS	HOH	T&E
0%	$ 45,000	$ 77,200	$ 38,600	$ 51,700	$ 2,600
15%	$ 425,800	$ 479,000	$ 239,500	$ 452,400	$ 12,700
20%					

Retained the 3.8% Medicare surtax on net investment income on income above $250,000 (MFJ)

Comparative Brackets

Income Range	Scheduled 2018 rate	TCJA
$1 to $19,050	10%	10%
$19,051 to $77,400	15%	12%
$77,401 to $156,150	25%	22%
$156,150 to $165,000	28%	22%
$165,001 to $237,950	28%	24%
$237,951 to $315,000	**33%**	**24%**
$315,001 to $400,000	33%	32%
$400,001 to $424,950	**33%**	**35%**
$424,950 to $480,050	35%	35%
$480,051 to $600,000	39.6%	35%
Over $600,000	39.6%	37%

Tax on Comparable Taxable Income

Standard Deduction & Personal Exemption

Change in Standard Deduction

Tax Year	S	MFJ/QW	MFS	HOH
2017	$6,350	$12,700	$6,350	$9,350
2018	$12,000	$24,000	$12,000	$18,000
65+	$13,600	$26,600	$13,300	$19,600

- Personal Exemptions are repealed:
  for MFJ under age 65:
  New Standard Deduction: $24,000
  Old Standard Deduction plus Exemption: $20,800

Summary of Itemized & Other Deductions/Exclusion

Deduction	2018
State/Local/Real Estate Taxes	Limited to $10,000 (not indexed for inflation)
Mortgage Interest	Limited to interest on $750,000 acquisition debt for primary and secondary residences; HELOC interest deduction repealed; Existing mortgages grandfathered at $1M.
Charitable Contributions	AGI limit **increased** from 50% of AGI to 60%; No deduction for college athletic ticket payments
Medical Expenses	Deductible after exceeding 7.5% of AGI for ’17 and ’18, then increases to 10% of AGI
Miscellaneous itemized	Repealed; also repealed for trusts
Personal Casualty Loss	Repealed, unless in a federally declared disaster
Pease Limitations	Repealed
Moving Expenses	Repealed as well as exclusion for reimbursements
Alimony	After 12/2018, repealed alimony deduction; not taxable
Gambling Losses/Expenses	Both are limited to gambling winnings

Estate, Gift & GST

- Everything stays the same except the Basic Exclusion Amount and the GST exemption doubles to $11.2M

- Step-up Basis is retained

- Exemption returns to $5.5M in 2026

Individual Planning under TCJA
Comparison of Prior vs. Current Law

	Prior Law	Current Law	Difference
Ordinary Income	$150,000	$150,000	$0
AGI	$170,000	$170,000	$0
Itemized Deductions			
Medical Expenses (Over 7.5% of AGI in 2017 and 2018)	$0	$0	$0
State & Local Taxes (Limited to $10K)	$6,200	$10,000	-$3,400
Real Estate Taxes (Limited to $10K)	$7,200		
Mortgage Interest (Limited to $750K Debt, $1M if Before 12/15/17)	$6,800	$6,800	$0
Charitable Donations (No Change)	$7,000	**$7,000**	$0
Miscellaneous Deductions (Eliminated in 2018)	$3,000	$0	-$3,000
Pease Limitation (Eliminated in 2018)	$0	$0	$0
Total	$30,200	$0	-$30,200
Standard Deduction (Increased from $12.7K to $24K)	$0	$24,000	$24,000
Personal Exemptions (Eliminated in 2018)	$8,100	$0	-$8,100
Taxable Income (Excluding LT Cap Gains & Qualified Dividends)	$111,700	$126,000	$14,300
			$0
Tax	$19,402	$19,599	$197
AMT	$0	$0	$0
Child Tax Credit (Increased to $2K per child, $440K AGI Phaseout)	$0	$0	$0
Total Tax	$19,402	$19,599	$197
Marginal Income Tax Bracket	25%	22%	-3.00%
Effective Tax Rate	17.37%	15.55%	-1.81%
Average Tax Rate	12.93%	13.07%	0.13%

How to Estimate your 2018 Tax

Start with: 2017 Taxable income

Add back: Personal Exemptions

Decrease in Gross Itemized Deductions (w/o Pease limitation)

2018 Ordinary Taxable Income

Calculate Tax: Use 2018 Tax Rates (Cap Gain Rates, if necessary)

Subtract: Child Credits (remember phaseouts at $400,000)

Approx. 2018 Tax to compare to 2017 Tax

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Will TCJA Reduce Charitable Contributions?

<u>Cited Reasons for Concern</u>:

1. Fewer filers will itemize based on SALT caps and higher Standard Deduction

    -Prior to TCJA – Approximately 70% of filers used the standard deduction

    -Post TCJA - Tax Policy Center estimates that will increase to 90%

2. Lower Top Tax Rates – Increases "cost to give" in higher brackets:

    <u>Example</u>:

    $100 gift in the old 39.6% rate = $39.60 of tax savings

    $100 gift under new 37% rate = $37 of tax savings

        Increases "cost" to give by $2.60

3. Higher applicable exclusion amounts for estate and gift tax reduces incentives for charitable giving

Charitable Planning Strategies – Contribution Bunching

Idea: Consider bunching future charitable gifting into one year with a donor advised fund.

Example: MFJ couple in 37% bracket gifts 5 years worth ($50,000) of appreciated securities to a DAF in year 1, and uses the standard deduction in following years.

Annual Gifts	2018	2019	2020	2021	2022
Mortgage Int.	$8K	$8K	$8K	$8K	$8K
SALT	$8K	$8K	$8K	$8K	$8K
Charitable Gifts	$10K	$10K	$10K	$10K	$10K
Total Deductions	$26K	$26K	$26K	$26K	$26K
Amount above Standard Deduction	$2K	$2K	$2K	$2K	$2K

Lumping	2018	2019	2020	2021	2022
Mortgage Interest	$8K	$8K	$8K	$8K	$8K
SALT	$8K	$8K	$8K	$8K	$8K
Charitable Gifts	$50K	$ -	$ -	$ -	$ -
Total Deductions	$66K	$24K	$24K	$24K	$24K
Amount above Standard Deduction	$42K	$ -	$ -	$ -	$ -

Outcome:

- Tax savings for Annual Gifts is $3,700 over 5 years vs. $15,540 in Bunching strategy = Total tax savings of $11,840.
- Assets in the DAF can be invested and any growth can be used for future gifts
- Diversify portfolio of concentrated position

Charitable Planning Strategies – Qualified Charitable Distributions (QCD's)

Idea: QCD vs. taking RMD and giving cash

Example: Retired Couple = 70.5+
RMD = $100,000
Annual Charitable Gifts = $10,000

Strategy: Enhanced for those under the larger standard deduction of $26,600.

Outcome:

- The QCD reduces AGI which impacts taxation on SSI and Medical Expense deduction, Medicare Part B & D, capital gains rates and state income taxes

Charitable Planning Strategies – Qualified Charitable Distributions (QCD's)

Idea: QCD from an IRA vs. gifting appreciated securities when standard deduction is larger than itemized deductions.

Example: Retired Couple = 70.5+
RMD = $100,000
SALT = $10,000
Mortgage Interest = $6,000
Annual Charitable Gifts of securities with 30% basis = $10,000

Total Deductions = $26,000 still **less** than Standard Ded.

Strategy: With a QCD from their IRA for $10,000 to charity, they still benefit from the use the standard deduction. The $10,000 charitable distribution wouldn't be included in federal or state income and they would retain the appreciated security.

Outcome:

- The QCD reduces AGI which impacts taxation on SSI and Medical Expense deduction, Medicare Part B & D, capital gains rates and state income taxes
- Limited benefit of avoiding capital gains taxes

Charitable Planning Strategies – Qualified Charitable Distributions (QCD's)

Idea: Is giving appreciated securities vs. QCD from an IRA **always** better?

Considerations:

- Impacts of increased AGI
- Basis in appreciated security
- Step up in basis

Charitable Planning Strategies – Roth Conversions

Idea: Consider using charitable contributions to assist with Roth IRA conversions.

Example: A retired couple in early retirement before age 70 who take standard deduction but expect to be in higher brackets due to pension income and RMD's.

Strategy: Couple could accelerate charitable contributions to offset additional taxable income from a Roth conversion.

Outcome:

- Reduces taxable income and converts tax-deferred IRA assets to tax-free Roth in lower marginal rates than what is expected in the future.
- Charitable contributions could be made to a donor advised fund to satisfy future charitable gifts.
- Leverage lower rate environment and be more aggressive in converting larger amounts given sunset and potential for higher future rates.

199A Deduction for Passthroughs

General Rules:

- <u>If your personal taxable income is under $315,000(MFJ)</u>, you deduct 20% of the passthrough income, regardless of whether your a Specified Service Business or a Non-Service Business.

  -The deduction is phased out between $315,000 and $415,000 for Specified Service Business

- <u>If your personal taxable income is over $415,000(MFJ)</u> **and**

  1) your a Specified Service Business, you lose your 20% deduction.

  2) your not a Specified Service Business, your deduction <u>is lesser of</u>:

     i) 20% of QBI; or

     ii) <u>greater of</u>:

     -50% of W-2 wages or

     -25% of W-2 wages + 2.5% of unadjusted basis of Qualified Property

  -The limitation is phased in between $315,000 and $415,000 for Non-Service Business.

<u>Overall Limitation:</u>

- The deduction cannot <u>exceed the lessor of</u>:

  -Combined QBI Amount (deduction for each business + 20% of REIT dividends and PTP income)

  or

  -20% x (Taxable Income – Capital Gain)

<u>Specified Service Business</u>: "any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees". However, specifically excludes architects and engineers.

Charitable Contributions to Enhance QBI Deduction

Considering Limitations

Mark and Kim are married. Kim works as an attorney with business income of $300,000. Mark earns $150,000 They have itemized deductions of $50,000.

Mark & Kim's Taxable Income:

Business Income	$300,000
Wages	$150,000
Itemized Deductions	<$ 50,000>
Taxable Income	$400,000

Qualified Business Deduction:

1) 20% of Business Income (.2 x $300,000) = $60,000
2) Phaseout due to taxable income being over $315,000 reduces it:

   1-((400,000-$315,000)/100,000) = 15%

   $60,000 x 15% = $9,000 of a QBI Deduction

What if Mark and Kim make a charitable deduction of $85,000?

QBI Deduction becomes $60,000 — Tax Savings of $14,400 (@24%)

Charitable Deduction of $85,000 — Tax Savings of $20,400 (@24%)

Charitable Contributions to Enhance QBI Deduction

Considering Limitations

What if Mark and Kim make a charitable deduction of $85,000?

Mark & Kim's Taxable Income:

Business Income	$300,000	
Wages	$150,000	
Itemized Deductions	<$135,000>	($50,000 + $85,000)
Taxable Income	$315,000	

Qualified Business Deduction:

1) 20% of Business Income (.2 x $300,000) = $60,000
2) **NO** Phaseout due to taxable income being over $315,000:

    QBI Deduction becomes $60,000

    ***plus*,**

    Charitable Deduction of $85,000

Charitable Contributions to Enhance QBI Deduction

Considering Limitations

What if Mark and Kim make a larger charitable deduction of $150,000?

Mark & Kim's Taxable Income:

Business Income	$300,000	
Wages	$150,000	
Itemized Deductions	<$200,000>	($50,000 + $150,000)
Taxable Income	$250,000	

Qualified Business Deduction:

1) 20% of Business Income (.2 x $300,000) = $60,000
2) Taxable income is under $315,000

However,

Overall Limitation:

- The deduction cannot <u>exceed the lessor of</u>:

  -Combined QBI Amount

  or

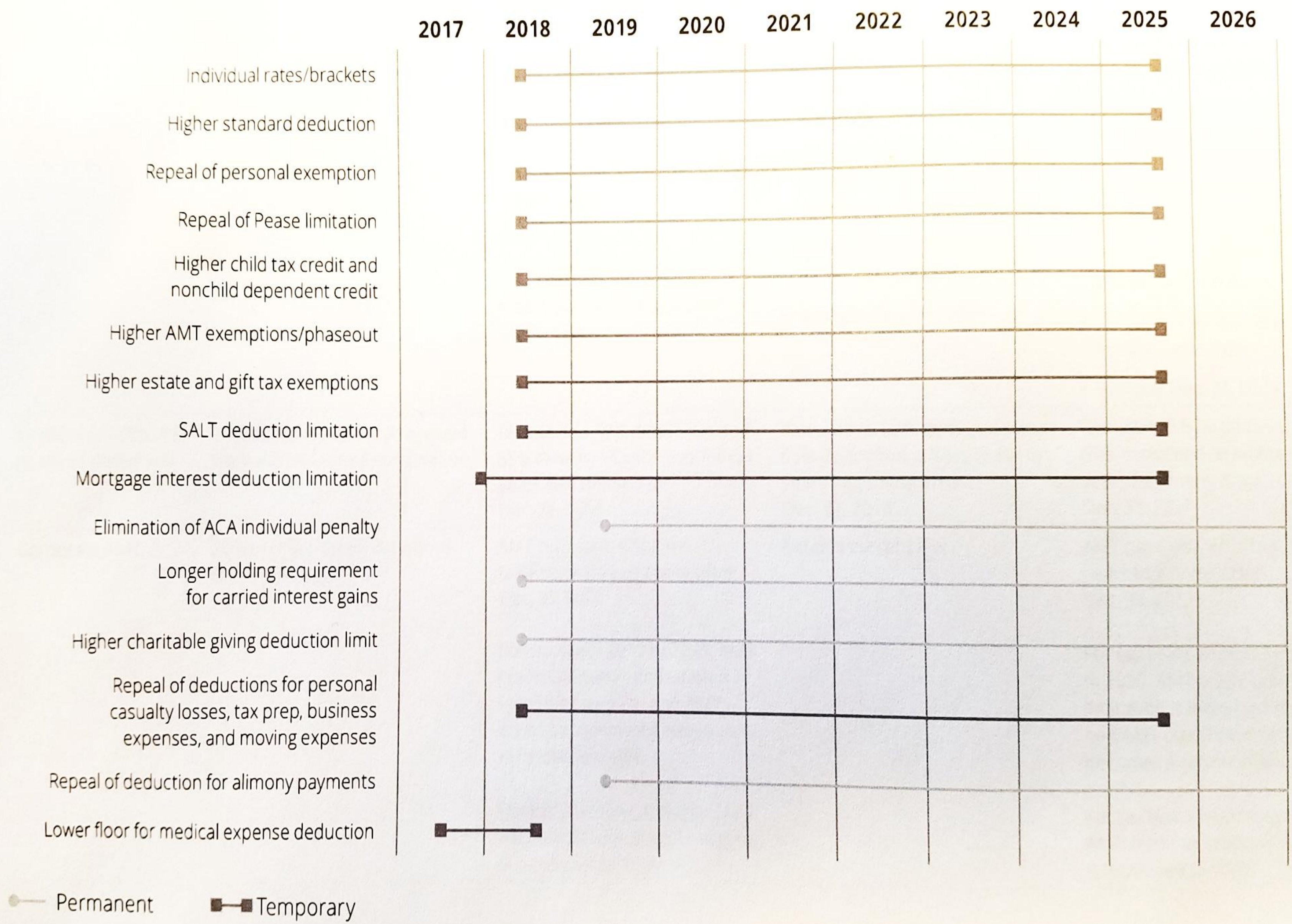
  -20% x (Taxable Income – Capital Gain)

<u>Overall Limitation</u>

20% of Tax Income-Capital Gains

$250,000x 20% = $50,000

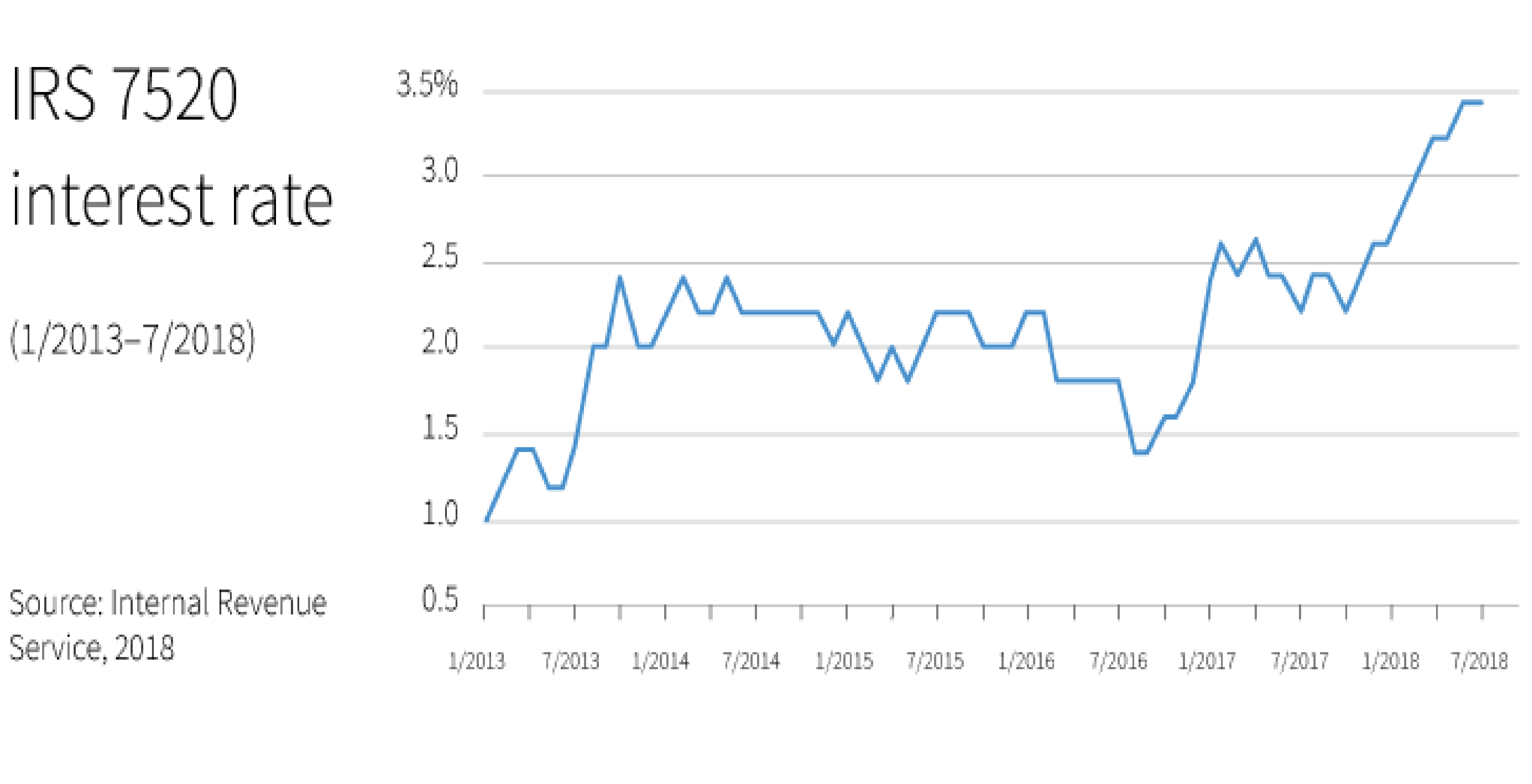
Tax Provision Sunsets



Impact of Rising Interest Rates on Charitable Giving Techniques

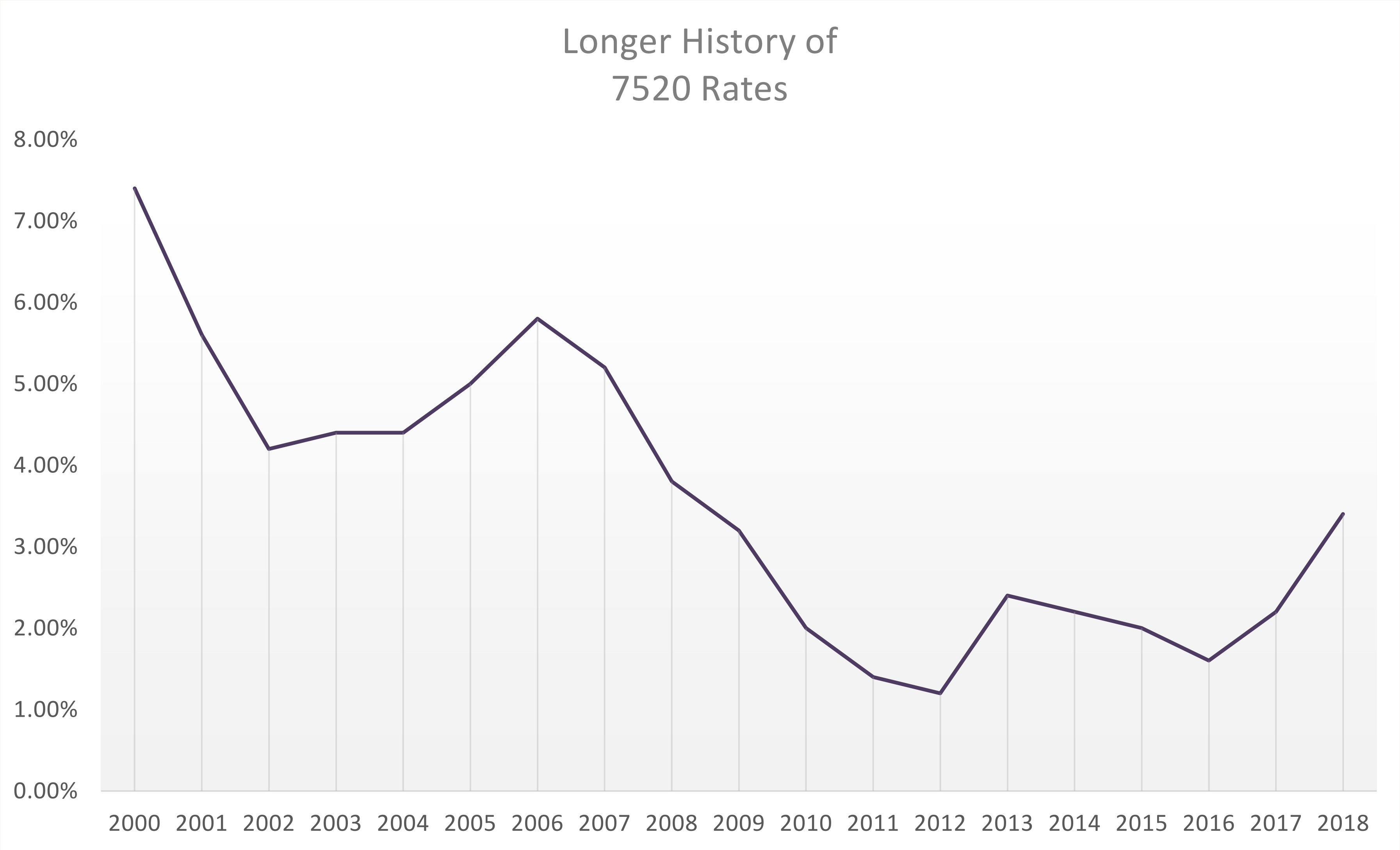
- Section 7520 Rate – Based on AFR Mid-term rates & used to value certain charitable interests in trusts
- Determines the value of the interest that is either retained or transferred to charity.

Recent history of rising 7520 rates – 30% rise from 2.62% to 3.4% so far in 2018.



Impact of Rising Interest Rates on Charitable Giving Techniques

- Section 7520 Rate History – Longer history based on October rates from 2000 to 2018



Impact of Rising Interest Rates on Charitable Giving Techniques

CLT's & CRT's and CGA's:

- CLT – Charitable Lead Trust – Annuity stream to a charity for a set term, "lead interest"; remaining assets pass to a non-charity beneficiary.
    - Similar to a GRAT, the 7520 rate is the "hurdle" rate that sets the annuity payment; the lower the rate the greater potential remainder interest to the beneficiaries.
    - As interest rates rise, the higher the "hurdle" rate, lowering potential assets being passed to beneficiaries.

- CRT – Charitable Remainder Trust – Income stream to non-charitable beneficiaries for a period of time; "remainder" interest going to one or more qualified charities.
    - The higher the interest rate, the higher the PV of the remainder interest, thus the higher the charitable tax deduction.
    - Required minimum payout %, limited terms and the probability that charity receives at least 10% of the initial amount transferred to the trust.

        - Under certain instances a CRT may be disallowed given low 7520 rates.

          Eg. Lifetime CRAT for a 65 year old with 5% payout wouldn't be possible in January of 2018 given low 7520 rate of 2.6%. Given current October 2018 rate of 3.4%, this CRAT is possible.

Impact of Rising Interest Rates on Charitable Giving Techniques

CGA's:

- Charitable Gift Annuity – Amount is gifted to a charity in exchange for a guaranteed fixed annuity payment.
  - Can receive a partial tax deduction in the year the CGA is established **IF** the donor itemizes
  - Can be used to defer capital gains taxes on highly appreciated securities
  - The higher the rate, the higher the deduction
  - Annuity rates are established by the charity with most utilize rates set by the American Council on Gift Annuities (ACGA)
  - ACGA just released HIGHER suggested rates in July of 2018. Prior rates have been in effect since 1/1/12.

Will TCJA Reduce Charitable Contributions?

Offsets to Concerns:

-Higher standard deduction and lower marginal rates may free up more disposable income to meet other goals including charitable giving.

-Charitable planning strategies just discussed can retain and even enhance incentives to make charitable contributions.

-All charitable giving is not driven by tax incentives.

Will TCJA Reduce Charitable Contributions?

Charitable Giving Statistics:

- Per the 2017 Giving USA Annual Report on Philanthropy:

  Total Giving - $390.05 billion

  - **Individuals - $281.86 billion**
  - Foundations - $59.28 billion
  - Bequests - $30.36 billion
  - Corporations - $18.55 billion

- Given IRS's Statistics of Income (SOI) for 2016
  - Approximately 20% of the gifts by individuals aren't reported to the IRS and therefore 'un-deducted'.

- 2018 Giving USA Annual Report on Philanthropy:
  - Total giving rose to over $410 billion
  - Individuals leading the way again giving nearly $287 billion.

The Philanthropic Conversation

2018 U.S. Trust Study of The Philanthropic Conversation:
U.S. Trust partnered with The Philanthropic Initiative to repeat a study originally done in 2013.

- Key Findings:
  - Majority of all advisors feel it is important & responsibility to bring up philanthropy with clients.
  - Over half of advisors will revisit the subject even if their clients don't demonstrate an interest in discussing it the first time.
  - Of those clients who discuss philanthropy with advisors, the majority of them say they are the ones to initiate the conversation vs. the advisors who feel they are the ones who do so.
- Focus of Conversation & Reasons for Giving:
  - Majority of advisors focus on tax considerations and wealth transfer strategies vs. the clients' philanthropic goal or passions.
  - Advisors feel that their clients would reduce their giving if estate and income tax deductions were eliminated whereas less than half of clients said their giving is tax motivated.
- Barriers to Giving:
  - Advisors state that not having enough, less money to heirs or clients not feeling wealthy enough are reasons clients don't give
  - Clients state largest reasons are concerns over the use of funds, lack of knowledge and connection to charity and fear of increased requests from others.
- Value of Philanthropic Guidance:
  - There was an increase from the 2013 Study in the # of clients who stated they are more likely to choose an advisor who is knowledgeable in charitable giving
  - They look to these advisors more and more to help them fulfill their philanthropic goals and involve the next generation.

The Philanthropic Conversation

How Can Advisors Help?:

Take a Proactive Approach and Change Focus from How? To Why?

- Determine Motivations & Hesitations:
  - Revisit past gifts to determine why they were important to them and to identify passions.
  - Determine if any obstacles are in the way
    - Scarcity of funds – Solve for giving capacity
    - Identify and frame issues
- Identify Goals and Objectives:
  - What outcome do they hope to achieve?
    - Assess needs
    - Narrow the focus and determine priorities and proportions
    - What will bring about change
- Give Effectively
  - Leverage tax benefits
- Assess Impact
  - Evaluation of results to determine if objectives are being met
    - Social Return On Investment (SROI)
  - Advancement of the cause
- How can Giving Improve
  - Revisit objectives
  - How active and public is your giving
  - Contribute non-financial resources (time, talent, network)
  - Collaborate giving with others to generate better results
  - Involve family for generational impact

Thank you

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Building money towards meaning.