The Impact of the *"Tax Cuts and Jobs Act of 2017"* on Charitable Giving

A Sharpe Group White Paper

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EXECUTIVE SUMMARY

The following provides an overview of the impact of the ***Tax Cuts and Jobs Act of 2017*** on charitable giving.

In the months and weeks leading up to the passage of the largest tax reform act since 1986, many in the nonprofit world feared that charitable contributions would be adversely affected by proposed changes reducing the number of donors who itemize their charitable gifts to as few as 5%. Reliable industry sources predicted that the new tax law would cause charitable giving to fall by billions of dollars.

These dire predictions were based on various studies of the House/GOP Tax Reform Blueprint released in early summer, which called for broad tax cuts for businesses and individuals and overall tax simplification. In the final analysis, the *Tax Cuts and Jobs Act of 2017* did in fact provide tax cuts for most businesses and individuals but failed to deliver much in the way of simplification. The bill encompasses some 500 pages and maintains a high degree of complexity for many middle- and high-income taxpayers.

While a number of deductions, credits and adjustments were repealed or curtailed, the charitable deduction came through the process basically unscathed and was even enhanced for some donors making larger gifts. The House, Senate and final conference versions maintained the charitable deduction and expanded the overall AGI limitations for the deductibility of charitable gifts by 20%, raising the annual limitation from 50% to 60%.

In addition, the legislation repealed the Pease Amendment which phased out some of the benefits for itemized deductions, including charitable gifts, for those with high incomes. These two changes actually expand the charitable deduction for a number of America’s most generous donors.

According to Giving USA, over 80% of charitable gifts are made by people who itemize their deductions for income tax purposes. While the initial blueprint and House proposal would have drastically reduced the number of taxpayers who itemize and potentially affect the amount they give, the final tax legislation featured changes introduced in the Senate version that preserved the benefit of itemizing for a much larger percentage of individuals who itemized deductions in the past.

For those who will no longer itemize deductions because of the expanded standard deduction and other factors, many will find their overall income tax bill will be reduced under the new tax law and they will enjoy increased discretionary income that can be spent, saved or donated to charity.

While the nuances of the new law are very complex and impact different people in different ways depending on where they live, their sources of income and other provisions, it is clear that the income tax deduction for charitable giving not only survived but was expanded in some cases.

This is true of both current and deferred gifts. The new law makes no changes in provisions related to charitable gift annuities, remainder trusts, lead trusts or other tax-qualified deferred gifts. These gifts should in fact hold greater attraction than ever for aging Baby Boomers.

There were also no changes to the IRA Rollover provisions that will also grow in importance as over 3 million Baby Boomers reach the qualifying age of 70 ½ every year during the coming decade.

The virtual elimination of the federal estate tax for 99.9% of Americans will create additional resources and incentives for those donors who wish to extend the reach of their philanthropy beyond their lifetime.

Unfortunately, many donors, advisors and fundraisers are working under the assumption that both current and deferred charitable giving will be substantially less attractive under the new law.

The challenge now is for charities to take a positive approach in donor communications and provide an "antidote" to negative perceptions based on a broad-scale misunderstanding of what the final results of the new law are. Wise charitable organizations will help donors understand the benefits of these changes, as opposed to solely the adverse consequences that could have been brought about by early versions of the law.

It is essential to inform and educate donors about the survival of tax incentives that have been a vitally important part of our federal income tax code for over 100 years. See suggested Action Steps following the report.

The Impact of the "Tax Cuts and Jobs Act of 2017" on Charitable Giving

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In December 2017, Congress enacted the most far-reaching changes in the federal tax code in more than 30 years. Virtually every taxpayer is affected in some way by the sweeping modifications of the federal income, estate and gift tax codes.

The process began with calls for tax simplification, and early proposals would have greatly simplified our nation's tax system with fewer brackets, higher standard deductions and fewer itemized deductions. The goal was for most people to be able to fill out a tax return that was as simple as a postcard. In the end, however, the bill falls short of simplification, with its impact on individual taxpayers dependent on many factors, including their marital status, where they live, whether or not they own a home, their sources of income and many more.

Promises for Charitable Giving

Charities took heart early in the process as lawmakers pledged to leave the 100-year-old deduction for charitable gifts intact, with no limits. Some even pledged to take steps that would encourage further increases in giving. This was good news as proposals had been floated over time that would limit charitable deductions to gifts only over a certain percentage of income or cap them at some level along with other deductions.

The charitable deduction, along with mortgage interest and state and local taxes, is historically one of the "big three" when it comes to deductions that are most valuable to individuals.

Fortunately, the charitable deduction is the only one of the "big three" that was not limited—and was actually expanded—by the final tax legislation. State and local taxes are limited to $10,000. Mortgage interest was disallowed for home equity loans and limited to interest on mortgages of $750,000 or less (down from $1 million under current law). In contrast, the amount of charitable gifts that can be deducted each year was increased to 60% of adjusted gross income (AGI) for cash gifts (30% of AGI remains the limit for appreciated property). More on the impact of this later.

The good news is that the basic form of the charitable deduction emerged virtually unscathed, and its benefits are expanded for some donors. More good news is that the Pease Limitation that phased out as much as 80% of the benefits of charitable and other itemized deductions for individual taxpayers with incomes over $261,500 and couples over $313,800 was repealed by the legislation. This largely negates the impact of lower maximum tax rates on the after-tax cost of charitable gifts and other deductions for high earners.

In a nutshell, the impact of tax reform on charitable giving by most upper-middle and higher-income donors will be negligible and should have little impact on gifts from this group.

As a whole, tax reform in its final form should have little impact on charitable giving by lower-income individuals as well. That is because most of the donors who do not currently itemize their gifts will remain in that category and should continue to make their gifts which historically account for a relatively small portion of total giving by individuals.

This conclusion obviously differs from many press reports predicting dire consequences of tax reform on charitable giving. These reports, while no doubt accurate when attempting to describe the impact of early tax reform proposals, have not yet been appropriately moderated to reflect the final provisions of the tax bill as modified in conference.

Charities should now step out boldly to counteract negative press reports that could become self-fulfilling prophecies. The bottom line is the vast majority of individual charitable gift decisions are not made with tax considerations in mind. Certainly, the $10 bill in the kettle, the $20 bill in the offering plate or the $100 annual gift are not typically made after a detour through the math centers of the brain.

Gifts of larger amounts relative to a donor's income and asset base, whether or not they are completed now or in the future or considered "major" gifts by the charity, are a different story. These gifts are much more likely to involve careful thought and planning regarding tax considerations in terms of what type of property should be given, when it should be given and how the gift should be structured.

Back to Basics—Understanding the Charitable Deduction

After decades of misreporting by the press and others on the purpose and impact of the charitable deduction, it is understandable that generations of donors, advisors and fundraisers have a distorted understanding of the charitable income tax deduction. It is no wonder, then, that most observers are ill-equipped to properly interpret the true impact of tax law changes on charitable giving.

Let's start with basic economics. Every dollar that is earned is first taxed and then what is left is either spent, saved or given away to charities or others. If there is no income tax, as was the case prior to 1913, the choice is whether to spend, save or give.

Today all we have to spend, save or give is what is left after payment of federal, state and local taxes. This is what is known as "after-tax income."

In order to understand the charitable deduction, it is necessary to dispense with political and ideological trappings and consider the pure economics. The original purpose of the charitable deduction was not to be an "incentive" to encourage charitable giving by people who would not otherwise decide to give. It was, in fact, the opposite.

The language that appeared in a *New York Times* article in 1917 at the time the deduction was first enacted stated that the purpose of the new provision in the law was to "exempt from income taxes money given to charity up to 20% of the donor's total income during the year."

Our tax law professors taught us that the charitable deduction was originally intended as a conservative provision designed to avoid creating a "disincentive" for charitable giving that would arise if donors were required to pay taxes on income BEFORE making their gifts.

This point can be illustrated simply. Suppose there is no income tax and you earn $100,000. You decide to give 10% of your income to charity. Under those circumstances it requires $10,000 worth of your income to complete your gift.

Now let's assume that there is an income tax and your maximum rate is 33%. Assume you still earn $100,000 and give $10,000 but the $10,000 is exempt from tax because you voluntarily invested in religious, medical, social, arts or other causes that benefit society rather than you. You now pay tax on $100,000 minus $10,000, or $90,000. The key point is that it still requires the same $10,000 worth of income to make your gift.

Now let's assume that for 100 years Americans have been allowed to deduct from their income and not pay tax on the amounts they voluntarily redistribute to charity and they are suddenly unable to do so.

Returning to the above facts, in order to give $10,000, you would now have to earn $15,000 and pay a tax of $5,000 (33% of that amount) to net the $10,000 you would like to give. This is what all the concern is about: the fact that the "cash cost" of making the $10,000 gift goes up by 50%.

To continue giving the same amount you must reduce your spending or saving by $5,000—your choice of which. To avoid that reduction, you would decrease your giving by 33% to $6,700, thereby keeping the earnings required to make your gifts of $10,000. The higher your tax bracket the larger the amount of additional income required to make your gift. That is why non-deductibility of larger gifts by high income donors creates the greatest disincentive to give.

We have never met a donor who gave away $10,000 just to save $3,300 in taxes. A person who is able to make a gift of $10,000 is probably well aware that if they didn't make the gift they would have $6,700 left for themselves. The truth is it still "costs" the donor $6,700 to make a $10,000 gift. Those who tout charitable "write-offs" seem to believe that a "deduction" is the same as a "credit," and it therefore costs you nothing to give if your gift is deductible. Not true—it simply costs MORE to make your gift if it is NOT deductible.

It doesn't "cost" the entire amount of a gift if it is tax deductible. But more importantly, if you remove deductibility after 100 years of baking that into economic decision—and thereby greatly increase the pre-tax income required to make the same gift—it requires adjustments in the amount given or compensatory changes in other uses of discretionary income to keep the cost the same.

The Fine Print

There is another important concept that one must grasp to understand where we find ourselves today.

During World War II, income taxes were increased dramatically to fund the cost of the war. Prior to WWII, most Americans did not meet the income threshold at which income taxes applied. War taxes for the first time reached further down the income scale.

To keep average income Americans from having to keep shoeboxes of receipts for their charitable gifts and other deductible expenses, a "standard deduction" was introduced. This was intended to allow most Americans a flat amount they could deduct without having to keep track of deductible expenditures.

Under this system other taxpayers who could prove they had deductible expenditures greater than the standard amount were allowed to "itemize" their deductions and deduct any total amount above the standard deduction. This system was designed to protect those who had extraordinary personal expenses in a given year or decided to give larger amounts of their income than average to charity.

Over time, however, the standard deduction did not keep up with inflation, and more and more Americans found themselves itemizing their deductions. This provided the impetus underlying recent efforts to restore the standard deduction to a level that would not require as many taxpayers to itemize their deductions.

Keep in mind, though, if you take the standard deduction, the "cost" of otherwise deductible activity is the same, whether or not you engage in that activity. Put another away, a taxpayer receives the benefit of a standard deduction whether or not they purchase a home, give to charity or engage in other tax-favored activity. There is, then, no real "tax incentive" for making gifts to charity or making mortgage payments. There is, however, a real increase in the cost of those activities for those who choose to engage in them after first benefiting from the standard deduction that is available to all regardless of how they spend their discretionary income.

This is an important concept to understand when grappling with the complexities of the 2017 tax reform legislation.

For example, assume your standard deduction is $12,000. You have mortgage interest of $8,000 and property taxes of $5,000. Your total deductions are $13,000. You can now deduct $13,000 instead of $12,000, and your net additional deduction is $1,000. Now assume you give $5,000 to charity. Because your "fixed" deductions have more than "absorbed" your standard deduction, you are allowed to deduct all of your charitable gifts. It then only requires $5,000 to make your gifts because that amount isn't taxed.

Now suppose your standard deduction is $24,000. You are allowed to forego taxes on this amount whether or not you have a mortgage, pay property tax or give to charity. Your total deductions are $18,000 (based on the same figures above), and you no longer itemize any of your deductible expenses because they are less than the standard deduction.

You now must pay tax on the amount you give to charity and are in the situation described previously where the amount of income required to make your gifts goes up. But wait, the argument can be made that you are being "covered" by the standard deduction. This is true, but everyone enjoys the benefit of the standard deduction whether or not they give. The standard deduction only guarantees that you don't pay tax on your first $24,000 in income, regardless of where you spend it.

Enter the "Universal Deduction"

Because state and local taxes and other deductions were eliminated or greatly curtailed under early proposals, it became clear that as few as 5% of taxpayers would itemize their deductions, and for the first time many Americans would have to begin paying income tax on amounts they gave to charity.

One proposed solution was to return to a concept included in an earlier tax reform in 1981 under which all taxpayers were allowed to exclude a certain amount of their income for charitable gifts if they did not otherwise "itemize" their gifts. Known as a "non-itemizer deduction," "universal deduction" or "above the line deduction" this provision was intended to make sure that donors were not required to pay taxes on earnings they gave to charity.

Unfortunately, the universal deduction was not included in the final tax reform compromise bill, though it was proposed as an amendment or separate bill by legislators in both the House and Senate.

The cost of this provision was deemed to be too high when Congress was under pressure to not leave the mortgage interest deduction "stranded" by itself with few people being able to itemize interest. It was feared this could inadvertently cause stress in the housing markets when combined with disallowing property taxes and making the standard deduction so high that few would itemize mortgages if their charitable gifts moved "above the line."

Welcome to tax simplification gone complex. After initial proposals, Congress was faced with outcries from residents of high-tax states, homeowners, donors, charities and the housing industry denouncing increases in the after-tax cost of home ownership and charitable giving. Lawmakers then went back to the drawing board. Representatives from states with high income taxes, property taxes and expensive homes with high mortgages demanded changes and made it clear they could not support a system that featured few deductions and a high standard deduction, the original underpinnings of the simplification proposals.

What then began with a modification of the House bill in the Senate by adding up to $10,000 in property tax deductions morphed into allowing a total of up to $10,000 in a combination of property tax, state income taxes or sales taxes in the final bill. This was necessary to avoid favoring homeowners in states with high property taxes over those in low property-tax states that rely more on higher income and sales taxes rather than property taxes for revenue.

The net result of these last-minute negotiations and consequent changes to tax reform is that the much-feared impact on charitable giving is not as likely to materialize—at least not to as potentially debilitating an extent.

What Are the Stakes?

Let's look at some facts. First, the most recent reliable data we have on tax-favored individual giving is the 2015 IRS data. In that year some 30% of Americans itemized their tax deductions. The remaining 70% used the standard deduction in keeping with its purpose to minimize paperwork for most.

According to Giving USA, total individual giving in 2015 was $271 billion. IRS data reported that $221 billion, or 82% of that amount, was itemized on tax returns.

That amount was donated by 36 million taxpayers who made charitable gifts that they were able to itemize in 2015. Digging deeper, some $114 billion, more than 50% of the amount itemized, was claimed by taxpayers with household income of $200,000 and above. If we drop to the $100,000 income level, we can account for $166 billion, or 80% of the itemized gifts.

Because of the last-minute changes in the tax reform bill, a large percentage of higher income donors are expected to continue itemizing their charitable gifts, and many more than the originally estimated 5% of taxpayers will continue to itemize deductions, greatly blunting the original impact on charitable giving.

Let's look at a concrete example of couple Mary and George. They are married and live in the state of Illinois. George is a police captain earning $81,000 per year. Mary is a nurse supervisor and makes $83,000. Their total household income is $164,000. They pay state income tax of $7,900 per year. Their mortgage is $335,000 and they will pay interest of $14,964. Their property taxes are $6,300. Their property and income taxes exceed the aggregate limit of $10,000, so they are "capped" at that amount.

Their itemized deductions without making charitable gifts amount to:

Mortgage interest	$14,964
State taxes	$10,000
Total	**$24,964**

Under this example, they would be able to itemize their deductions as their deductions slightly exceed their standard deduction amount of $24,000.

But note they have not yet accounted for their charitable gifts. They make total gifts to their religious and other charitable interests of $7,500 per year. Because their "fixed" deductions already exceed their standard deduction, they are able to fully deduct their charitable gifts, the same as under current law.

Had the last-minute change in the law not included the $10,000 additional state and local tax deduction, their total deductions of mortgage interest and charitable gifts would have totaled just $22,464. They would have been among the 95% of taxpayers who would no longer itemize and would have to make their charitable gifts after first paying tax on the income used to make them.

Because the standard deduction is only $12,000 for single taxpayers and the $10,000 cap on state taxes presumably applies to both single and married taxpayers, many single donors will be able to clear the standard deduction "hurdle" at much lower income levels.

<u>It now appears that by virtue of the combination of mortgage interest and the partial restoration of state and local taxes, most households at roughly the $150,000 and above income level will continue to itemize their deductions—including their charitable gifts</u>.

As noted earlier, taxpayers reporting income of $100,000 or more accounted for 80% of the charitable gifts itemized on tax returns in 2015. If you drop the income level to $50,000 or more, you pick up 92% of all itemized gifts.

The gifts that now appear to be most “at risk” under tax reform amount to an estimated 20% of amounts currently being itemized by households reporting income of less than $100,000. If itemized gifts are 80% of total individual giving, then that amounts to 16% of total giving by individuals. The average amount itemized by households with income under $100,000 in 2015 was approximately $3,000. At a marginal tax rate of, say, 25%, this amounts to only $750 in lost tax savings. Some have opined that since much of that amount is religious in nature, donors will continue to make those gifts given the relatively low additional cost and strong spiritual motivations.

On the other hand, let’s look at the impact on a couple in the highest income ranges.

Consider the case of New York residents, Mike, a corporate executive making $750,000 per year and Barbara, an architect making the same amount. Their household income of $1,500,000 is well into the highest marginal tax bracket of 39.6% under current law and the 37% maximum rate under the new legislation.

They have a $1.5 million mortgage on their home and pay interest of $67,000, of which $44,000 is currently deductible given the $1 million mortgage limit for interest deductibility. (The maximum mortgage for which interest can be deducted is reduced to $750,000 for mortgages incurred after 2017.) Their state income taxes are $75,000 and their property taxes are $25,000 per year. They also make annual charitable gifts totaling $25,000. Under current law their total deductions are $169,000. They are not, however, allowed to deduct this entire amount in 2017 because the Pease Limitation requires them to reduce their total itemized deductions by 3% of the amount their income exceeds $313,800, or $35,586.

Under the new law, their deductions will be reduced to $10,000 worth of state and local taxes and their mortgage interest deduction that will be remain at $44,000 because the mortgage was obtained prior to 2018. Along with their $25,000 in charitable gifts, they will still have total deductions of $79,000. Because the Pease Limitation is repealed, they will not have to reduce this amount.

Their new standard deduction is $24,000. Even without their charitable gifts, the $54,000 in other deductions places them well above the $24,000 standard deduction.

Note that when the dust settles, they are still able to fully deduct their $25,000 in charitable gifts and they will not have to pay tax on the income required to make their gifts. So what is the damage from tax reform in this case?

To answer that we must turn our attention to the marginal tax rate they pay. Under current law they would pay federal income tax of 39.6% on income of $25,000 if they did not donate to charity. That means their gift saves them $9,900 in taxes, and the after-tax cost of making their gift is $15,100.

Under the new law, their maximum tax rate is 37%. If they didn't make the gift they would pay $9,250 in tax on the income and the after-tax cost of the gift rises to $15,750.

Let's stop and think for a moment. Does anyone really believe this couple will cut the amount of their gift when it takes the same amount of their discretionary cash to make the gift, and the after-tax cost of a $25,000 gift increases by only $650?

Some have argued that many gifts, especially relatively small ones, are made impulsively from a portion of discretionary income that is in one's checking account at the time. If a donor enjoys an overall reduction in their tax bill due to the increased standard deduction and other factors, they may be more likely to make gifts from their additional discretionary income, whether or not the gifts are deductible. Only time will tell whether this will, in fact, be the case.

In our experience this is less likely to be the case as we move up the income scale, but at the income levels where donors of relatively larger amounts are more prone to considering the tax ramifications of their gifts, they are likely to continue to itemize under the new tax law. This is another example of how the final tax reform "product" has the intended, or more likely unintended, consequence of being more "tax neutral" and not discouraging charitable gifts as much as might have been the case under early proposals.

Combat Misinformation

While the partial or total loss of the benefits of the charitable deduction for taxpayers giving an estimated 16% of individual gifts will no doubt result in a reduction of some amount of giving, this does not amount to the disaster predicted by some early reports. Millions of donors may have read dire predictions and believe these fears could erroneously extend to them, potentially impacting their behavior.

What we now face is a communications challenge—knowledgeable charities must undertake efforts to counter the waves of misinformation now flowing over their donors.

Donors who will still itemize their deductions should be advised that there were no changes to the charitable deduction or to the types of property that can be donated. There were also no changes in the tax treatment of charitable remainder trusts and other split interest trusts.

Those who may no longer itemize without special planning should be advised that there may be ways to change their giving patterns that will allow them to once again deduct their gifts.

Other Gift Planning Considerations

Speaking of the new 60% of AGI limit for cash gifts, this provision was added to the code after lawmakers were educated on the impact of the 50% of AGI limit on gifts of cash. Few were aware, for example, that in some years donors over age 65 make up over 75% of people affected by this limit.

In many cases these donors have large amounts of tax exempt income that is not part of their AGI and are thus more likely to be affected. Congress listened and expanded the AGI limit for gifts of cash. This will increase the amount many older donors can deduct when they make outright gifts, but also when they use cash to fund a charitable gift annuity or other split interest gift, making the income tax benefits of various deferred gift arrangements greater than under current law.

Appreciated Property a Winner

Another key accomplishment of those lobbying for the charitable sector was to protect gifts of appreciated assets and keep the fair market value deduction for such gifts.

Going back as far as 1980, numerous proposals have been made to limit gifts of noncash assets to cost basis. In some cases, this has been proposed for all such gifts. Most recently, the 2014 Camp Proposal would have allowed this treatment only for marketable securities and tangible property donated for a related use. Gifts of real estate and certain other assets would have been limited to cost basis.

Fortunately, there was no change in the tax treatment of gifts of appreciated assets in the final bill. This will be especially important going forward as Baby Boomers will own a greater percentage of their donatable assets in the form of highly appreciated real estate and business interests. In many cases their marketable securities will be locked up in 401(k)s, 403(b)s, IRAs and other qualified retirement plans where the securities cannot be directly accessed for charitable purposes.

This is also good news for charitable gift annuities and other gifts funded with appreciated securities and other assets. IRS data reveals that most securities donors are over age 65. This change will also bode well for seniors funding life income gifts in the future.

Keep in mind that gifts of appreciated securities will also be more important than ever for consideration by donors who may no longer be able to fully deduct their charitable gifts. As described earlier, it could require more income pre-tax to make their gifts. If affected donors instead give appreciated assets, they will not have to use ANY income to make the gift and they will not owe capital gains tax in any event.

Reduction or elimination of income tax deductions has no impact on the capital gains tax issues associated with gifts of appreciated property. Regardless of whether there is a deduction allowed, there is no sale of the property and no gain realized. The capital gains tax is not due until the charity sells the property, and as the charity is tax-exempt, no one ever pays the capital gain tax.

It is thus more important than ever that donors understand the dual (and in some cases only) tax advantages associated with gifts of securities and other appropriate classes of noncash property.

IRA Rollover (Qualified Charitable Distributions) Unchanged

While some charities have been advocating for increased benefits of gifts from IRA funds, this was not in the cards in this round of tax reform.

The ability for those 70 ½ or older to make IRA Rollover gifts was, however, left untouched by tax reformers. It will still be possible for these donors to make tax-free gifts of up to $100,000 per year from their IRAs that will also qualify as part of their mandatory withdrawal for the year.

While the universal charitable deduction for “above the line” gifts for all taxpayers did not make it into the final legislation, the IRA Rollover, a limited version of the same concept, was preserved for seniors.

The key to understanding the power of the IRA Rollover in light of tax reform is realizing that not having to report income that you give to charity is essentially the same as being required to report it with it then being fully deductible.

When donors give funds directly from an IRA to charity they are not required to report the income on their tax returns. This achieves the same result as if they reported the withdrawal, made a gift of the funds and were able to fully deduct their gift. If they could not deduct the gift, they would have to pay tax on the donated funds using other income. They would then give the funds to charity and owe tax on those same funds that would have to be paid from other income. That would be the case for many over 70 who do not itemize due to lack of a mortgage and/or sufficient other deductions to make them itemizers.

So let’s recognize the IRA Rollover for what it really is which is a targeted “above the line deduction” for seniors over the age of 70 who can afford to give away up to $100,000 per year of their retirement savings.

One of the arguments that needs to be put forth in future attempts to modify charitable tax law is to make this benefit available to younger taxpayers as well as older donors who hold assets in a form other than an IRA. A good place to start might be to expand the rollover to all taxpayers 59 ½ or older and include all types of retirement plans, not just the IRA.

In any event, the IRA Rollover will now assume greater importance as the first Baby Boomers are now moving into their early 70s and qualify for this benefit. This should be incorporated in a greater way in gift solicitation activities, especially where older donors considering larger gifts are concerned.

Estate and Gift Tax Considerations

Another area of possible misunderstanding surrounding tax reform is the changes in federal estate and gift taxes.

Under prior law, an individual could leave their heirs up to $5.49 million free of federal estate and gift taxes. A couple could leave up to $10.98 million. This has been the level of exemption adjusted for inflation since 2011 when a $5 million and $10 million exemption were introduced.

To put this in perspective, some 2.7 million people died in the United States in 2015. Just 11,200 died with estates worth more than $5 million. That means that 99.6% of Americans are not currently subject to federal estate tax under current law. On top of that, the majority 60% of Americans live in the 80% of states with no estate or inheritance tax.

For all practical purposes there have been no federal and very limited state estate tax considerations for many years. The new tax law simply reinforces that fact. While initial tax reform proposals called for the complete elimination of federal gift, estate and generation skipping taxes, the final bill kept these taxes in place but doubled the exemption levels to approximately $11.2 million for individuals and $22.4 million for couples. The Treasury is expected to announce exact amounts soon.

In 2015, just 3,600 Americans died with estates worth more than $10 million. This is just one-tenth of 1% of decedents, meaning that the federal estate tax will not apply to 99.9% of estates under the new law.

We have now had nearly seven years to gauge the impact of this increased exemption level on charitable gifts.

According to Giving USA, bequest income was 30% higher in 2015 than 2011. Over the past 20 years, an average of 20% of taxable estates leave funds to charity and that percentage has increased over the years. In 1997, some 18% of taxable estates left funds to charity at a time when the estate tax threshold was $600,000 for individuals and $1.2 million for couples.

At a time when unprecedented bequest commitments have been made in the context of campaigns for future funding with recognition accepted for these commitments, there is little reason to doubt that the majority of those pledges will be fulfilled, regardless of whether the estate is subject to federal and/or estate tax.

In fact, an argument can be made that wealthy individuals may actually increase amounts left to charity absent an estate tax.

How might this be the case?

Consider the case of Thomas, a widower with an estate worth $12 million. He has made a commitment of a $1 million bequest to fund a gift in memory of his late wife, Marilyn. He plans to leave the balance of this estate to his two children after payment of any estate tax due.

From a tax perspective under current law, his taxable estate would be $12 million - $1 million bequest - $5,490,000 exemption = $5,510,000. The tax due would be $2,204,000 and his children would receive $4,298,000 each.

Now suppose he passes away in 2018 with no tax due on the first $11.2 million of assets in his estate. After satisfying the $1 million charitable bequest in memory of his wife, Thomas's children would owe no tax on the $11 million and would receive $5,500,000 each.

Why would Thomas remove the bequest when his children will receive an additional $1.1 million each due to the estate tax repeal? Most would agree that is unlikely.

In fact, Thomas could double his intended bequest and his children would still receive more.

Surveys of high net worth individuals tend to validate the fact that a significant percentage of wealthy donors will actually increase their charitable commitments if their estates are not subject to tax.

In our opinion, changes to Social Security, Medicare and other entitlement programs may hold more long-term threat to bequests to nonprofits than estate tax reduction or repeal. Increases in healthcare and other costs later in life have an inevitable impact on the size of the remainders of estates after providing for family members—the source of the vast majority of unrestricted bequests to charitable organizations of all types.

Golden Age of Planned Gifts?

Speaking of older donors, more good news is that, unlike a number of earlier tax reforms, Congress completely ignored the tax treatment of charitable remainder trusts, charitable lead trusts, gift annuities and other split interest gifts. The charitable advocacy groups successfully convinced Congressional leadership that there were no "issues" in this area of the law, and it was not worth significant attention.

Baby Boomers are entering retirement with unprecedented amounts of assets, and they are concerned more now than ever about long-term preservation of their assets. Under these circumstances, irrevocable gifts completed today that feature immediate income tax benefits, increased income and other financial benefits may be more appealing when compared to gifts through estates no longer offer tax benefits.

Gifts that might have been made at death through an estate may now instead be completed during one's lifetime. This not only produces immediate tax savings in the form of income and capital gains tax savings, it may also boost income and provide a tax-free growth environment for retirement assets.

The irrevocability required for income and capital gains tax benefits of such gifts also results in protection of assets from those who might take advantage of the elderly in later years. This aspect will hold special appeal for childless Baby Boomers as they age.

Charitable remainder trusts can also be structured in ways that result in a portion of annual income being used to make immediate gifts to charity. For those whose ability to itemize gifts has been reduced, this offers another to way achieve full deductibility, much as in the case of those who are making use of the IRA Rollover provision. This income is also not reportable by the donor and is comparable to being received and then donated on a fully deductible basis.

Charitable lead trusts will also offer a way to make significant gifts over an extended period in a way that is essentially the same as making fully deductible gifts. Again, this is due to not receiving funds that are directed for charitable use. While gift and estate tax considerations may not be as important when considering the use of lead trusts, the ability to do valuable income tax planning combined with the desire to delay inheritances will continue to lend appeal to this vehicle to certain donors.

Another point worth noting is that Donor Advised Funds emerged with no additional regulations. This was a big change from early proposals for 20% annual distributions and various reporting requirements. We can expect more donors to take advantage of DAFs as a way to generate current tax benefits for gifts to be made at times of the donor's "effective" choosing.

Summary

In conclusion, it is time to step back, take a deep breath and move forward with the knowledge that the world is not coming to an end, and for many donors, especially those making larger gifts, the tax benefits of their gifts will be largely unchanged.

The challenge now is to take a positive approach in donor communications and provide an "antidote" to what may be excessive negativity based on a broad-scale misunderstanding of what the final results of the new law are likely to be.

Hopefully over the next several months, the nation's press and financial community will, as in the case of 1986, gradually discover the reality of this tax act and the tremendous tax and financial planning opportunities that remain for the vast majority of those making larger gifts—whether current or deferred.

ACTION STEPS

Here are a few suggestions for action to be taken in coming months to help minimize any adverse impact on charitable giving in the wake of tax reform.

- Act as soon as possible in 2018 to inform staff, volunteers and donors regarding the largely positive impact of the new law on charitable giving. The final bill left the charitable deduction as the only primary deduction that was not limited or repealed entirely, and the benefits were actually expanded for some donors, particular those making larger current and deferred gifts.

- As 2018 unfolds, continue to educate your donors on the special benefits of gifts of securities and other appropriate non-cash assets, especially if stock markets continue to trade at record levels. Make it clear that no capital gains tax is due when these gifts are made, regardless of whether donors itemize their deductions. For an example of a donor-friendly piece outlining the effects of tax reform on charitable giving, see http://sharpenet.com/product/guide-effective-giving-tax-reform/

- Given the fact that over 8,000 Baby Boomers are passing the age of 70 every day, the benefits of the IRA Rollover will increasingly play a role in fundraising efforts. This opportunity will be a primary way that donors age 70 ½ or older who do not itemize deductions can continue to enjoy tax benefits from their gifts up to a total of $100,000 per year.

- Be prepared to advise the minority of donors who may otherwise be negatively impacted by the tax bill on gift planning strategies that can help restore benefits to them.

- Given widespread confusion regarding the impact of the elimination of the federal gift and estate tax for 99.9% of Americans, it is imperative that donors understand that this provision actually REDUCES the cost of charitable bequests to other heirs. This will be an additional educational challenge to be undertaken in 2018 and beyond.

About Sharpe Group

Since 1963, Sharpe Group has helped nonprofit organizations build and structure their planned giving programs with consulting services, training and a variety of communication materials designed to inform and motivate donors about smart gift planning opportunities. Visit www.SHARPEnet.com for more information.

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Robert is chairman of Sharpe Group, which consults nationwide with leading educational, health, social service and religious organizations and institutions in implementing their major and planned gift development efforts. With offices in Memphis, Washington DC, Atlanta and San Francisco, Sharpe Group has worked with over 10,000 nonprofits nationwide during its 54-year history.

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Robert has authored many articles and other publications covering numerous estate and gift planning topics. His remarks on this subject have been featured in *The Wall Street Journal*, *The New York Times*, *Newsweek*, *Forbes*, *Smart Money*, *CBS Market Watch*, *The Chronicle of Higher Education*, *Trusts & Estates*, *Kiplinger's* and other national publications.

He is a frequent speaker for professional gatherings nationwide, including the National Conference on Philanthropic Planning, the American Bankers Association Wealth Management and Trust Conference, the Association of Fundraising Professionals (AFP) National Conference, the American Institute of CPAs Nonprofit Conference, the International Fundraising Congress, the Association for Healthcare Philanthropy Advanced Planned Giving Institute, Council for Advancement and Support of Education (CASE) National Conference, CASE Advanced Planned Giving Conference and others.

In past years, he served as a development officer for a liberal arts college and practiced law with a national law firm where he specialized in taxation and estate planning. Mr. Sharpe is an honors graduate of Vanderbilt University and Cornell Law School.

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