

Politics, Tax Reform
&
Philanthropy
A Special Postelection
Sharpe Group Webinar


Presented by

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Washington | Atlanta | Memphis | San Francisco
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Experts Think
Tax Reform
Possible in
2017



OVERVIEW

- Republican Party Controls White House, Senate and House of Representatives
- Historically This Means Gridlock Less Likely
- But Not Necessarily



OVERVIEW

- Corporate Tax Changes May Come First
- Followed By Individual Income, Gift and Estate Tax Changes
- Or Combined in a Major Tax Reform Bill

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Taxes & Giving:
A Brief History



EGYPTIAN “FLAT TAX?”

“And Joseph made it a law over the land of Egypt unto this day, that Pharaoh should have the fifth part; except the land of the priests only, which became not Pharaoh's.”

Genesis 47:26

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**PHILANTHROPY
AND TAXES IN MODERN ERA**

- Only Temporary Income Taxes in U.S. Before 1913
- No Income or Estate Tax Implications Prior to the 20th Century
- Americans Gave Generously Prior to That Time

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**CURRENT SYSTEM
ENCOURAGES PHILANTHROPY**

- Relatively High Income Tax Rates
- As High as 70% in the 1980s
- Charitable and Other Deductions Serve to Reduce Amount Subject to Tax

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WILL THAT CONTINUE?

- Rate Cuts Being Proposed Require Tax on Broader Base to Reduce Revenue Loss
- Achieved in Part By Reducing Deductions and Credits

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WINNERS AND LOSERS

- Those Who Don't Use Deductions Benefit When Deductions Are Curtailed and Rates Drop
- But Those Who Have Large Amounts of Itemized Deductions May See Increase in Cost of Giving

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CURRENT TAX TREATMENT
OF CHARITABLE GIFTS

- Current Income Tax System Established in 1913
- Charitable Deduction Was One of First Deductions
- Introduced in 1917

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New York Times

July 12, 1917

An amendment to the War Revenue bill which would exempt from income taxes money given to charity up to 20% of the donor's total income during the year is regarded in the financial district as of vital necessity to the welfare of the Red Cross so long as it is dependent upon voluntary contributions for its funds. On its face the amendment seems income wealthy men would bring their total subject to supertaxes down to a point where they would have the benefit of a lower rate. To see how this would work out it is only necessary to apply the proposed plan against a concrete instance.

FUNDAMENTALS OF
TAXES AND GIVING

- U. S. Tax System Allows Deductions for Gifts
- Must Be Distinguished From a “Tax Credit”

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TAX CREDITS TO REDUCE TAXES DOLLAR
FOR DOLLAR

Income	\$75,000
Tax Before Gift	15,000
Charitable Gift	1,000
Tax Credit	(1,000)
Final Tax	\$14,000
After-Tax Cost	-0-

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TAX CREDITS TO REDUCE TAXES DOLLAR
FOR DOLLAR

Income	\$75,000
Tax Before Gift	15,000
Charitable Gift	1,000
Tax Credit	(1,000)
Final Tax	\$14,000
After-Tax Cost	-0-

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COST OF A CASH GIFT

$G - (G \times T) = \text{Cost}$

$\$1.00 - (\$1.00 \times 39.6\%) = \$.604$

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RICHARD’S GIFT IF DEDUCTIBLE

Tax Bill Before Gift	\$10,000
Charitable Gift	\$1,000
Tax Rate	39.6%
Tax Savings	(\$396)
Tax Bill After Gift	\$9,604
After-Tax Cost	\$604
Income Required	\$1,000

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RICHARD’S GIFT IF NOT DEDUCTIBLE

Tax Bill Before Gift	\$10,000
Charitable Gift	\$1,000
Tax Rate	39.6%
Tax Savings	-0-
Tax Bill After Gift	\$10,000
Income Required	\$1,656

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MUST REDUCE GIFT TO KEEP INCOME REQUIRED THE SAME	
Tax Bill Before Gift	\$10,000
Charitable Gift	\$604
Tax Rate	39.6%
Tax Savings	-0-
Tax Bill After Gift	\$10,000
Tax on Amount Donated	\$396
Income Required	\$1,000

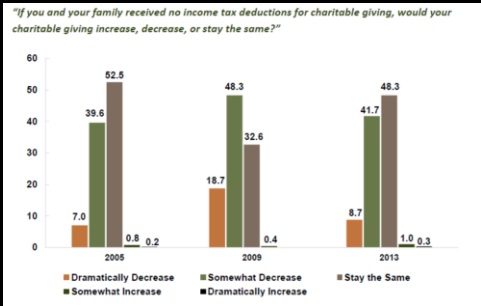
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WHAT IF NO CHARITABLE DEDUCTION?

- Surveys of High Net Worth Donors
Reveal That Many Would
Somewhat or Dramatically
Decrease Giving if No Deduction

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What Are Current Proposals?

WAYS AND MEANS COMMITTEE

- Reduce System to Three Rates
- 12%, 25%, 33%
- Raise Standard Deduction to \$12,000 for Single and \$24,000 Married Couples

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**WAYS AND MEANS
COMMITTEE**

- Eliminate All Deductions Except Charitable Gifts and Mortgage Interest
- Apparently No Cap on Deductions for High Income Donors

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**WAYS AND MEANS
COMMITTEE**

- Only 5% Will Itemize Deductions
- Down From 33% Under Current Law
- Effectively Eliminates Charitable Deduction for 95% of Donors

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**WAYS AND MEANS
COMMITTEE**

- Justification Is That Estimated Amount of Charitable Gifts Included in Standard Deduction
- Taxpayer Enjoys the Benefit Whether or Not They Give
- Donors Pay Tax on Amounts They Actually Give

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**WAYS AND MEANS
COMMITTEE**

- Reduces Capital Gains Tax Rates
- Results in Less Benefit for Gifts of Appreciated Assets
- Eliminates Alternative Minimum Tax (AMT)

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**WAYS AND MEANS
COMMITTEE**

- Net Effect Appears to Increase Cost of Giving for Those Who Do Not Itemize
- Little Effect on Itemizers Giving Larger Amounts With Exception of Less Incentive to Give Assets

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TRUMP PROPOSAL

- Same Three Tax Rates as Ways and Means Plan
- Increase Standard Deduction to \$15,000 Singles, \$30,000 for Married
- All Deductions Remain
- Capped at \$100,000 for Single and \$200,000 for Married

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TRUMP PROPOSAL

- Capital Gains Tax Rates Unchanged
- Eliminates Alternative Minimum Tax (AMT)

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THE TRUMP CHARITABLE
“DONUT”

- Trump Proposal Has Uneven Impact on Charitable Giving
- Some Will See Little Change in Charitable Incentives
- For Others There Will Be “Holes” in the Donut

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WHO IS ADVERSELY
AFFECTED?

- Will Depend on Income Level
- Will Depend on Where One Lives
 - Real Estate Values Affect Mortgage Deductions
 - State Property and Income Taxes
- Will Depend on Marital Status

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NON-ITEMIZERS LOSE

- Increased Cost of Gifts for Those Who Will No Longer Itemize
- Gifts Must Be Made From After-Tax Income
- Will Require More Income to Make the Same Gift
- Mostly Donors of Smaller Amounts
- Same as Under Ways & Means

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ARTHUR’S GIFT

Income	\$90,000
Standard Deduction	\$15,000
Charitable Gifts	\$ 2,500
Other Deductions	\$10,000
Tax Rate	25%
Tax Savings	-0-
Income Required	\$3,333
Less Tax	<u>\$ 833</u>
Net to Give	\$2,500

SOME DONORS STILL
EXPERIENCE SAVINGS

- Those With Itemized Deductions in Excess of Standard Deduction of \$15,000 or \$30,000
- But Whose Deductions Are Also Below Ceiling of \$100,000 or \$200,000

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SUSAN’S GIFT

Income	\$200,000
Standard Deduction	\$15,000
Other Deductions	\$18,000
Charitable Gifts	\$15,000
Charitable Deduction	\$15,000
Tax Rate	33%
Tax Savings	\$4,950
Income Required	\$15,000

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HIGHER COST FOR
OTHER DONORS AS WELL

- Increased Cost of Gifts for Those Over Deduction Cap of \$100,000 or \$200,000
- Gifts Must Then Be Made From After-Tax Income
- Will Require More Income to Make the Same Gift

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RICHARD’S GIFT

Income	\$950,000
Deduction Ceiling	\$100,000
Other Deductions	\$110,000
Charitable Gifts	\$100,000
Charitable Deduction	-0-
Tax Rate	33%
Tax Savings	-0-
Income Required	\$149,250
Less Tax	\$ 49,250
Net to Give	\$100,000

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THE JUSTIFICATION

- For Some High Income Donors
Their Tax Cuts Will Save More
Than the Cost of Losing the
Tax Deduction

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Current Law

Taxable Income at Margin	\$1,000,000
Deductible Gift	\$100,000
Taxable	\$900,000
Tax Rate	39.60%
Tax	\$356,400
Remaining Cash	\$543,600

Trump Proposal

Taxable Income at Margin	\$1,000,000
Non-Deductible Gift	\$100,000
Taxable	\$1,000,000
Tax Rate	33.00%
Tax	\$330,000
Remaining Cash	\$570,000
Reduction in Cost of Gift	(\$26,400)

THE JUSTIFICATION

- For Others the Tax Cuts Won't
Replace Loss of Deduction

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Current Law	
Taxable Income at Margin	\$1,000,000
Deductible Gift	\$200,000
Taxable	\$800,000
Tax Rate	39.60%
Tax	\$316,800
Remaining Cash	\$483,200
Trump Proposal	
Taxable Income at Margin	\$1,000,000
Non-Deductible Gift	\$200,000
Taxable	\$1,000,000
Tax Rate	33.00%
Tax	\$330,000
Remaining Cash	\$470,000
Increased Cost of Gift	\$13,200

WHO ARE NET LOSERS?

- Crossover Point Is in Range of 17%
- Higher Income Taxpayers Who Give More Than That Percent of Income Experience Tax Increase
- That Is Where Tax Reduction Equals the Cost of Loss of Deduction

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Current Law	
Taxable Income at Margin	\$1,000,000
Deductible Gift	\$166,666
Taxable	\$833,334
Tax Rate	39.60%
Tax	\$330,000
Remaining Cash	\$503,334
Trump Proposal	
Taxable Income at Margin	\$1,000,000
Non-Deductible Gift	\$166,666
Taxable	\$1,000,000
Tax Rate	33.00%
Tax	\$330,000
Remaining Cash	\$503,334
Amount of Increased Cost	(\$0)

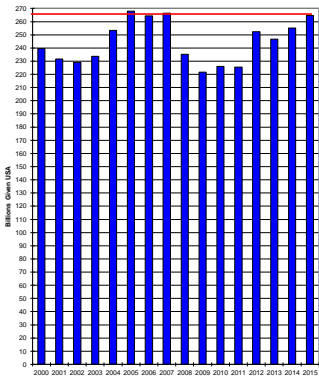
THOSE UNDER CROSSOVER
PERCENTAGE BENEFIT

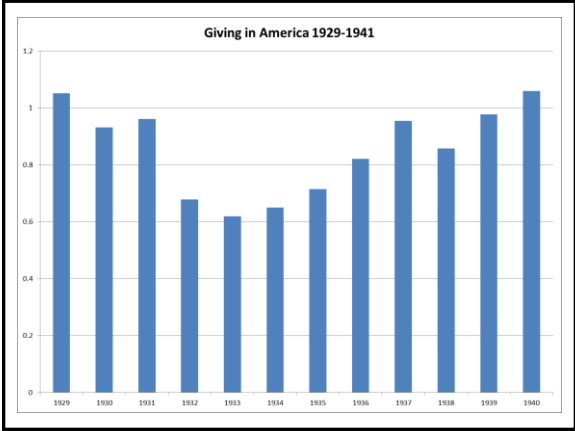
- Those Who Give Less Than 17% of Income Enjoy Net Tax Cut
- Those Who Give Nothing Experience Largest Tax Cuts



What Difference
Does It Make?

GIVING USA Inflation-Adjusted
Individual Giving
2000-2015

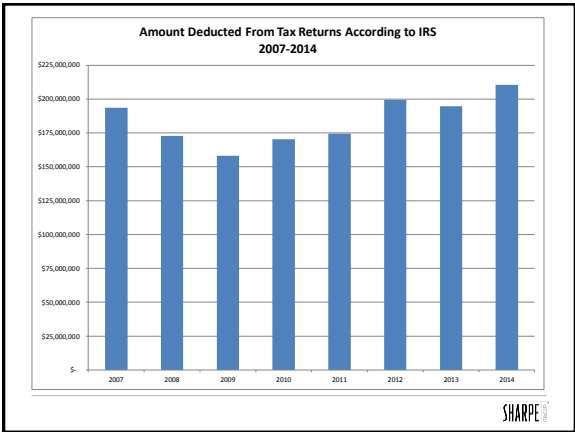


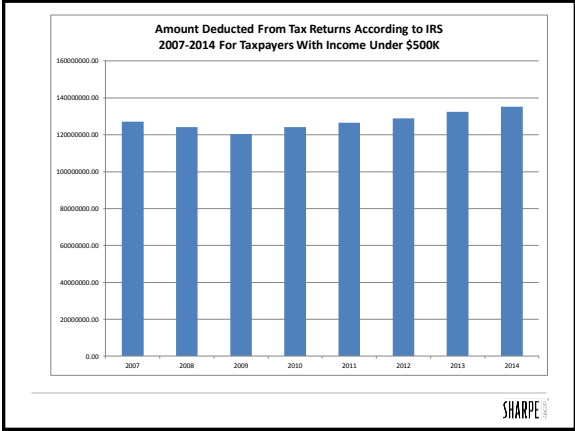


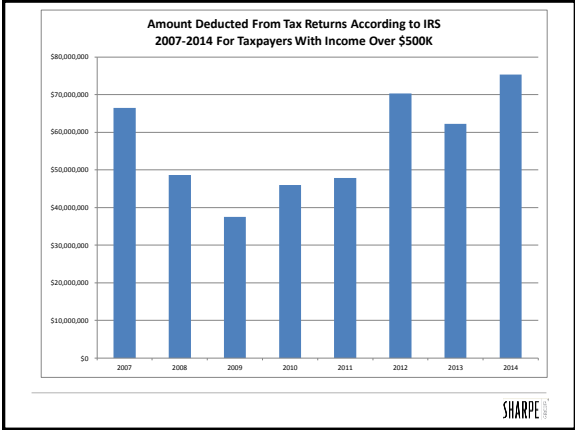
TRENDS IN FUNDRAISING

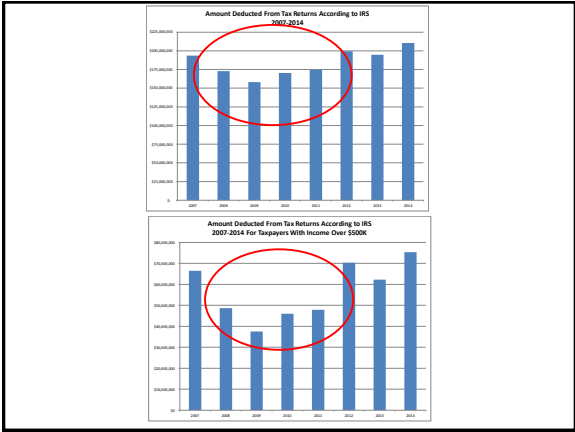
- Where Did the Declines Occur?
- Was Income a Factor?

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TRENDS IN FUNDRAISING

- Donors With Income Over \$500K Accounted for 80% of Decline in Itemized Gifts
- Itemized Gifts Are 80% of Total Individual Giving

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TRENDS IN FUNDRAISING

- A Number of Donors in This Group Will See Increased Cost of Gifts Under Trump Proposal
- Less Negative Impact Under Ways and Means Proposal if No Cap on Charitable Gifts
- Pease Reductions and Limited Benefits Under AMT Removed

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PROPOSED “FIX”

- Reduce Standard Deduction By Amounts Presumed to Be Charitable Gifts
- Otherwise People Receive “Benefit” Whether or Not They Give

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PROPOSED “FIX”

- Don’t Apply Cap on Deductions to Charitable Gifts
- This Avoids Tax Increase for Many of the Most Generous Among Highest Income Taxpayers

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Overview of Estate
and Gift Taxes and
Charitable Giving

**ESTATE AND GIFT
TAXES AND GIVING**

- Charitable Gifts Are Fully Deductible Under U.S. Gift and Estate Tax Systems
- Unlike the Income Tax System There Are No Deduction Limits
- Cost of Gifts Similar to Outright Gifts Under Current Law

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COST OF ESTATE GIFT

$G - (G \times T) = \text{Cost}$

$\$1.00 - (\$1.00 \times 40\%) = \$.60$

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MARY'S BEQUEST

Estate	\$10,000,000
Bequest	\$1,000,000
Tax Rate	40%
Tax Savings	(\$400,000)
After-Tax Cost	\$600,000

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GEORGE'S BEQUEST

Estate	\$5,000,000
Bequest	\$1,000,000
Tax Rate	0%
Tax Savings	(\$0)
After-Tax Cost	\$1,000,000

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ESTATE AND GIFT
TAXES AND GIVING

- Approximately 2.6 Million Die Each Year
- Some 99.6% Do Not Have Estates Over Exemption Amount
- The 4/10 of 1% With Taxable Estates Account for 64% of All Gifts at Death
- This Makes Estate Taxes Relevant to Charitable Bequests

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ESTATE AND GIFT
TAXES AND GIVING

- Are the Wealthy More or Less Likely to Leave Bequests if There Is No Estate Tax?
- Long Tradition of Giving Through Estates Prior to Estate Taxes
- See Annual Report From 1916 Prior to Enactment of Estate Tax

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Boston Children's Aid Society 1916

SPECIAL BENEFACTORS AND DONORS OF THE
SOCIETY SINCE ITS FOUNDATION

Since the foundation of the Society many legacies, bequests, and special gifts have come from friends—their names appear below—who have taken this means of helping needy children.

~~It is best that a Society such as this should have to depend upon~~ the general contributing public for a large part of its yearly receipts, for in this way it is most likely to meet changing needs and conditions, and be eliminated if its services are of no value. If, however, the income from the endowment could be increased to one-third or one-half of the total expenditures and the endowment itself be unrestricted as to use, the budget planning would then be put on a stable basis, and the administrative work could be executed with greater certainty.

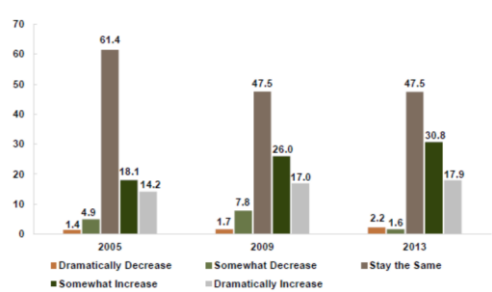
ESTATE AND GIFT
TAXES AND GIVING

- Surveys Show That the Wealthy Would Apportion Estate Tax Savings Among Family and Charity
- Over 90% Say They Would Maintain or Increase Their Charitable Bequests

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"If the estate tax were permanently eliminated, meaning your estate would not be taxed after you died, would the amount you left to charity in your estate plan increase, decrease, or stay the same?"



**PRIORITIES OF MOST
WEALTHY BENEFACTORS**

- Decide How Much They Want to Leave to Heirs
- Taxes Paid on Family Inheritance
- Remainder to Charity
- More Funds for Charity if No Tax on Gifts to Heirs

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What Are Current
Proposals?

**WAYS AND MEANS
COMMITTEE**

- Eliminate Gift and Estate Taxes
- Bypass Capital Gains Tax at Death
- Could Argue Either Less Incentive to Make Gifts or More Funds From Which to Give

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TRUMP PROPOSAL

- Eliminate Gift and Estate Taxes
- Replace With Capital Gains Tax on Gains Over Some Amount
- Some Say Gift Tax May Remain
- Could Still Be Some Savings From Charitable Bequests

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Planning for Change

PRIMARY STRATEGIES

- Take Steps to Maximize Benefits of Gifts Where Deductions Are Reduced or Eliminated
- Not Receiving Income Is Same as Receiving and Fully Deducting

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PRIMARY STRATEGIES

- Use Bequest Substitutes Where No Benefits From Estate Gifts
- Accelerate Tax Savings Into Donor's Lifetime

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COMBATING LOST DEDUCTIONS

- Bunch Gifts if Higher Standard Deductions Precludes Itemizing
- Consider Making Charitable Gifts Every Other Year

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COMBATING LOST DEDUCTIONS

- Stretch Gifts Over Time Where Cap Limits Deduction
- Variation on Carryover Provisions Under Current Law
- Normal Pledge Periods Facilitate This Approach

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**GIFTS OF QUALIFIED
APPRECIATED PROPERTY**

- Deductible at Fair Market Value
- No Capital Gains Due Because There Is No Sale
- Advantage Remains Even if No Charitable Deduction

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CHARITABLE IRA PROVISION

- First Baby Boomers Reached Age of 70½ in 2016
- Charitable IRA Provision Will Be Attractive Giving Opportunity
- Up to \$100,000 Transferred Directly to Charity

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CHARITABLE LEAD TRUSTS

- If Estate and Gift Tax Eliminated Will Not Be Needed to Pass Wealth Free of Tax
- Will Remain an Effective Tool for Income Tax Planning
- Income Passes to Charity Outside Donor's Income So Tax Deduction Not Necessary

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**CHARITABLE
REMAINDER TRUSTS**

- Income Tax Deduction Secondary
- Diversify Assets Free of Capital Gains Tax Inside Trust
- Value Builds Inside Trust
- Partial Assignment of Income Passes Income Outside Taxable Income Stream

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INTEREST FREE LOANS

- Donor Loans up to \$250,000 Per Charity
- Charity Can Invest and Enjoy Income
- Could This Be Seen as a “Revocable Endowment”?

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INTEREST FREE LOANS

- Donor Does Not Receive Income That May Not Be Deductible if Given
- Donor Can “Call” the Loan if Funds Needed in Future
- Can Forgive the Loan at Death
- Another Example of “Blended Gift”

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**PLANNING FOR POSSIBLE
ESTATE TAX CHANGES**

- Many Will Be Interested in Gifts Completed at Death With Income Tax Benefits
- Can Be Referred to as “Accelerated Bequests”

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EXAMPLES

- Current and Deferred Gift Annuities
- Charitable Remainder Trusts
- Gifts of Real Estate With Use Retained for Lifetime

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SUMMARY

**PUTTING IT ALL
TOGETHER**

- Donors Will Continue to Give With or Without Being Taxed on Amounts Donated
- Elasticity of Demand in Play
- As “Cost” Goes Up Will “Demand” Go Down?

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**PUTTING IT ALL
TOGETHER**

- Will Depend on Underlying Levels of Donative Intent
- If Donors Reduce Giving By Some Percentage, It Will Not Be “Across the Board”
- Some Nonprofits May See Little Change
- Some May See Major Reductions

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**PUTTING IT ALL
TOGETHER**

- Understand Changing Realities in Terms of Economics, Politics and Demographics
- Be Aware of Opportunities and Challenges They Present

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Conclusion

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