

Charitable Benefits of the American Taxpayer Relief Act of 2012

On January 1, 2013, both the Senate and House passed the American Taxpayer Relief Act of 2012 (ATRA). The bill resolved the “fiscal cliff” and includes a number of provisions that will be favorable for philanthropy and charitable giving. Fortunately, some of the proposals such as caps on charitable deductions or limits on tax savings from charitable gifts were not enacted. Because the general trend of the bill is to create higher tax rates for upper-income taxpayers, the benefits of charitable giving will be readily apparent to those individuals.

IRA Charitable Rollover

Since 2006, IRA owners age 70½ and older have been able to make a qualified charitable distribution (QCD) up to \$100,000 each year. ATRA extends and expands this option for 2012 and 2013. There are three categories of potential donors.

First, some individuals in 2012 made QCDs directly from their IRA custodian to charities with the hope that the law would be retroactive. These QCDs are qualified retroactive to January 1, 2012. Second, individuals who did not make a QCD in 2012 can do so during January of 2013. This is similar to 2011, when it was possible to do a QCD for the prior year in January and a second QCD in the remaining 11 months of the year. If an individual has not made a QCD in 2012, this allows a generous person to make two \$100,000 QCDs in 2013.

Third, many individuals had hoped to do a QCD in 2012, but in December of 2012 received their IRA required minimum distribution (RMD). If these individuals transfer those funds to charity during January of 2013, they will not report the IRA distribution as income. Effectively, the December 2012 RMD is converted to a January QCD that qualifies for 2012.

Individual Income Tax Rates on Ordinary Income

The existing tax brackets of 10%, 15%, 25%, 28%, 33% and 35% will be extended. There is a new 39.6% bracket for married persons with \$450,000 of taxable income, heads of household with \$425,000 and single persons with \$400,000 of taxable income.

Charitable Impact: Those individuals with higher incomes are now facing larger taxes. However, the tax savings from a charitable gift for individuals with state and federal tax brackets from 40% to 46% are now increased. High-income donors may make larger gifts in 2013.

Long-Term Capital Gains

The capital gains rate of 0% for those in the 10% and 15% bracket and 15% for those in most higher brackets will be extended. However, individuals who are subject to the 39.6% tax bracket will have a 20% capital gain rate. In addition, because capital gains for those with incomes over \$250,000 married or \$200,000 single will be subject to the 3.8% Medicare tax, the capital gains rate for upper-income persons will be 23.8%.

Charitable Impact: The top federal tax rate for sales of major assets will increase from 15% in 2012 to 23.8% in 2013. In those states that also have a state tax, the combined capital gain rate for major sales will be 28% to 32%. This will greatly increase interest in charitable remainder unitrusts and charitable remainder annuity trusts. Charities should appropriately emphasize the much larger tax savings available in 2013 for charitable trusts.

Alternative Minimum Tax

The alternative minimum tax was initially intended to cover only high-income persons. However, with the increase in incomes, AMT continued to apply to larger and larger numbers of individuals. ATRA sets a permanent indexed AMT exemption amount. For 2012, the amounts will be \$78,750 for married couple and \$50,600 for single persons.

Charitable Impact: The permanent indexed AMT exclusion will have fairly modest charitable impact.

Gift and Estate Taxes

Marital portability and the \$5 million (with indexed increases) applicable exclusion amount for gift and estate taxes are made permanent. For 2013, the expected IRS ruling will set the applicable exclusion amount at \$5.25 million. The top rate for gift and estate taxes is 40%.

Charitable Impact: The permanent gift and estate provisions will encourage many individuals to update their estate plans. This is a great marketing opportunity for bequests from estates of all sizes. For larger estates, a testamentary unitrust, gift annuity or lead trust are excellent planning options.

Itemized Deduction Limits

In prior years, there were limitations on itemized deductions that were called the “Pease” limits. The deductions over a floor are reduced by 3% of the adjusted gross income of the taxpayer. The maximum reduction for very-high-income persons is 80% of the itemized deductions.

ATRA creates new fixed limits for the 3% floor. Married couples will be subject to the reduced deductions for adjusted gross income (AGI) over \$300,000. Single persons will use a floor of \$250,000 of AGI.

Charitable Impact: Those donors with larger incomes will suffer a modest to moderate reduction in their charitable tax savings. This historically has not had significant impact on charitable giving. However, very-high-income persons may lose as much as 80% of their charitable tax savings.

Personal Exemption Limits

The personal exemption phase-out will be reinstated for married couples with AGI over \$300,000 and single persons with \$250,000 of AGI.

Charitable Impact: This will have fairly modest impact.

Various Deductions and Charitable Extenders

There are several other provisions that historically have been extended. There are expanded limits for gifts of conservation easements with a 50% deduction level and carry forwards for up to 15 years. In addition to the IRA Rollover, gifts of apparently wholesome food, property gifts by Subchapter S corporations and payments to controlled subsidiaries provisions are all extended until the end of 2013.

Charitable Impact: The enhanced deductions for food gifts will be very welcome for food banks and similar charitable organizations. Because there has been a significant growth of Subchapter S corporations during the past decade, the ability for Sub S corporations to make gifts of appreciated land or stock and flow through the deductions to owners is quite beneficial. Finally, land conservancy organizations and similar charities will appreciate the extension of the conservation gift rules.

Summary

ATRA was on balance fairly kind to philanthropy. Donors with higher incomes and larger capital gains tax bills will find new reasons to engage in charitable planning. The probable level of interest in gift planning education and concepts by donors and their professional advisors will significantly increase during 2013.

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