Douglas County Community Foundation
CELEBRATING 20 YEARS

Financial Advisor News

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Taking chances:

Will hindsight point to 2020 as the year to maximize giving?

The November 3 election left wealth managers, tax professionals, and estate planners with a dilemma: Should advisors counsel their clients to implement planning techniques in anticipation of sweeping changes to the tax laws, or instead assume the status quo will continue and stay the course with clients' current plans?

Here's what's going on and how the proposed changes might affect charitable giving strategies:

Under Joe Biden's proposed tax plan, taxpayers making more than $400,000 per year would be taxed at a top income tax rate of 39.6%, an increase from 37% under current law. That would mean charitable giving would become more tax efficient under the new law for some taxpayers.

However, a separate provision in Biden's proposed plan would impose a 28% limit on charitable deductions for taxpayers who make more than $400,000 per year. This would mean that instead of avoiding income tax on charitable gifts at the rate of 39.6% as described above, these taxpayers would escape income tax only at a rate of 28%. (A similar provision was proposed, but never enacted, during the Obama Administration.)

Biden's tax proposal also calls for increasing — from a maximum rate of 20% to 39.6% — the capital gains and dividend tax rates for taxpayers whose annual earnings exceed $1 million. For affected taxpayers, this change would create opportunities to avoid significantly more tax than is possible under current law for gifts of appreciated assets. An increase like this would create a huge incentive for philanthropists to support charitable organizations.

Next, Biden's proposal calls for a 3% reduction of itemized deductions for taxpayers making more than $400,000 per year. This is reminiscent of the so-called "Pease Amendment" that was repealed in 2018. Although the reinstatement of this rule could have some negative effects on charitable giving, the rule's impact would be blunted for taxpayers for whom the reduction is absorbed by other types of itemized deductions (mortgage interest payments, for instance).

Charitable legacies: What's on tap for bequests?

Perhaps the component of Biden's proposal with the biggest potential impact on ultra-wealthy philanthropists is Biden's intention to raise estate taxes and change the way capital assets are taxed after death.

Currently, the gift and estate tax exemption per person is $11.58 million and $23.16 million for a married couple. These amounts are effectively double what they were before the Tax Cuts and Jobs Act of 2017 (TCJA). The TCJA calls for an automatic sunset of these increases on December 31, 2025, at which point the exemption will drop back down to $5 million per person, as adjusted for inflation. Under Biden's proposed tax plan, though, the estate and gift tax exemption and rates would be restored to the lower levels of more than a decade ago.

In addition, Biden's proposal calls for substantial elimination of the step up in basis from the taxpayer's cost to fair market value at the time of death, further complicating existing estate plans for many families.

Some philanthropists are maximizing gifts to family members in 2020 to take advantage of their remaining exemptions and deferring charitable gifts to 2021 and beyond, under the assumption that tax laws will change dramatically. Others simply are not comfortable with making such large gifts immediately — thereby significantly reducing their own net worth — when it might not matter in the end.

Planning power: Bundling, bunching, and bequests

The significant community needs arising from the events of 2020, coupled with recent tax law changes, make it very important that you help your clients plan their charitable giving strategies.

For the last couple of years, your clients likely have been hearing about a tax-efficient charitable giving strategy called "bundling" or "bunching." The popularity of this tool increased significantly under the Tax Cuts and Jobs Act provisions that reduced the incentive for taxpayers to itemize deductions on their income tax returns, starting with tax year 2018, because of the now doubled standard deduction. In other words, your clients now have to give a lot more to charity to reap the tax benefits.

"Bundling" or "bunching" can involve using a donor-advised fund to separate the tax event of the charitable gift itself from the financial support of charities. Because contributions to a donor-advised fund at the community foundation are immediately deductible for tax purposes — but not required to be granted out of the fund to charities right away — your clients can "front-load" donations into a donor-advised fund at a level where they will be able to take advantage of itemizing deductions. Then, your client can recommend grants from the donor-advised fund to their favorite charities according to the timeframe that aligns with their targets for providing philanthropic support to community organizations.

Finally, as you are assisting your clients with their charitable plans, now is no time to forget about bequests! A report issued by FreeWill cites a 400% increase in the number of wills with bequests in March 2020 over March 2019. Encourage your clients to think about their legacies, especially as they reflect on the ways 2020 has put a spotlight on just how important it is for communities to be able to rely on sustainable nonprofit organizations to help people in need.

Seek clarity about clients' commitment to community

Despite the uncertainty about tax laws in 2021 and beyond, there are opportunities for you to advise your charitable clients with conviction that they are doing the right thing for themselves and for the causes they care about.

Keep in mind that the CARES Act includes charitable giving incentives for 2020:

- Even for taxpayers who take the standard deduction, a reduction in adjusted gross income is available for charitable contributions up to $300 per taxpayer. Donations to donor-advised funds don't count; nonetheless, this deduction is a great way for clients to help their favorite organizations in this challenging year.
- Individuals who itemize deductions can elect to deduct donations up to 100% of their 2020 adjusted gross income instead of being capped at 60%. For corporations, the CARES Act increased the cap from 10% to 25% of taxable income. (Again, contributions to donor-advised funds and private foundations are not eligible.)

Remember that the community foundation can help you develop your clients' future plans. A donor-advised fund is a powerful estate planning tool. A client can execute wills and trusts that leave a specific bequest or remainder interest to a donor-advised fund at the community foundation. This bequest triggers all the tax benefits of a direct bequest to a charity because the community foundation, and therefore the donor-advised fund, qualifies as a 501(c)(3) organization. Here are key takeaways:

- Your client may already have established a donor-advised fund at the community foundation that the client is using to make annual gifts to charity. This donor-advised fund can be the recipient of a charitable bequest.
- Your client can set up what is known as a "shell fund" now to receive a bequest later, even if they are not currently using a donor-advised fund. A shell fund is governed by a donor-advised fund document, but the fund itself does not contain any assets until the client passes away and the bequest is activated.
- A client can adjust the terms of the donor-advised fund anytime before their death. This gives your client maximum flexibility to adjust charitable beneficiaries without the need to amend a will or trust.
- Please contact our team for assistance with the proper language for designating a donor-advised fund at the community foundation as a bequest recipient. Our team also will work with you on the terms of the donor-advised fund itself. For example, your client can use the donor-advised fund as a way to keep the next generation — or generations — involved with the family's philanthropy to carry on the family's legacy of community support. Surviving family members can serve as advisors to the fund and make decisions about which causes and organizations to support. It's also possible to create several donor-advised funds — one for each grandchild, for example — so that each beneficiary has their own charitable giving account.

Your team at the community foundation is always happy to help. We look forward to hearing from you and wish you all the best for the season.

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900 Massachusetts, Suite 406
Lawrence, KS 66044
785-843-8727
785-843-8735 fax
www.dccfoundation.org