Gift Planning Now

A Newsletter for Berkeley's Donor Advisors

Spring 2013

Deduction Reduction and Personal Exemption Phase-out Return for Higher-Income Taxpayers

The American Taxpayer Relief Act of 2012 (ATRA) has brought back limitations to itemized deductions and personal exemptions for higher-income taxpayers. Phaseouts begin when adjusted gross income (AGI) exceeds $250,000 for single taxpayers, $275,000 for heads of households and $300,000 for couples. Phaseout levels are adjusted annually for inflation. These cutbacks first appeared in the Revenue Reconciliation Act of 1990, but had been eliminated by 2010.

Under ATRA, the personal exemption phaseout reduces the exemption the taxpayer can claim by 2% for each $2,500 (or portion thereof) the taxpayer's AGI exceeds the threshold limits.

ATRA also provides that certain itemized deductions are reduced by 3% of the amount by which a taxpayer's AGI exceeds the threshold amounts, up to a maximum reduction of 80%. The reduction applies to the deductions for home mortgage interest, real estate taxes, state and local taxes, miscellaneous itemized deductions and charitable contributions.

How does the reduction work? Take the case of Roger and Linda who have combined AGI of $375,000. They lose $2,250 of itemized deductions ($375,000 - $300,000 = $75,000 x 3%). Does that mean they will lose some tax benefit when they contribute to their favorite charity in 2013? Most likely, the $2,250 reduction occurs whether they give anything to charity or not.

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Berkeley's Top Teaching Honor Goes to Five Faculty

Five outstanding UC Berkeley faculty have been selected as recipients of the 2012 Distinguished Teaching Award, the campus's most prestigious honor for teaching. The award recognizes teaching that incites intellectual curiosity in students, engages them thoroughly in the enterprise of learning, and has a lifelong impact. They include: Rauri Bow, assistant professor in Integrative Biology, Darcy Grimaldo Grisby, professor of Art History, Timothy Hampton, professor of Comparative Literature and French, Terry Johnson, lecturer of Bioengineering, and Ula Taylor, associate professor of African-American Studies.

Deduction Reduction . . . *(continued from page 1)*

Although technically the charitable deduction is subject to the reduction, in most cases donors will have sufficient "fixed" expenses to more than absorb the reduction. At their income level, Roger and Linda will most likely have deductions for mortgage interest, real estate taxes, and state and local taxes – nondiscretionary items – that far exceed the $2,250 reduction. Charitable gifts, on the other hand, are purely discretionary. It's reasonable to advise clients that charitable deductions won't be diminished if the reduction is already absorbed by deductions for mortgage interest, real estate taxes, and state and local taxes.

According to the latest Statistics of Income Bulletin, in 2010 (the most recent year for which figures are available), taxpayers with AGI of $200,000 to $250,000 claimed average deductions for state and local income taxes of more than $11,400. Those same taxpayers claimed mortgage interest deductions of more than $16,350, on average. Either amount would be more than sufficient to absorb any deduction reductions at that income level.

There might be a few taxpayers – those with extremely high income and very low fixed deductions – who would lose some of the tax benefits of charitable gifts. Here's a simple formula to determine if a client's gifts to charity will be affected by the reduction:

1. Estimate all deductions for home mortgage interest, real estates taxes, state and local taxes, and miscellaneous itemized deductions over 2% of AGI $______
2. Divide line 1 by 3% $______
3. Add $250,000/$275,000/$300,000 (depending on filing status) to line 2 $______

The amount on line 3 is the AGI a donor can have before the deduction reduction affects charitable contributions. For example, a single donor with relatively few deductions for mortgage interest and taxes ($15,000) would need AGI of more than $750,000 before charitable deductions would be subject to reductions. It's highly unlikely that a client with income that high could have itemized deductions of only $15,000. In most cases, it's safe to advise clients that no deductions for gifts to charity will be "lost."

Tax Planning Pointer

Donors of noncash gifts to charity must file Form 8283 and obtain a qualified appraisal if the value of any one item or group of similar items exceeds $5,000 ($10,000 for shares of closely held stock). The cost of the appraisal is deductible as a miscellaneous itemized deduction, subject to a 2%-of-AGI threshold [Code §212(3)]. Donors occasionally ask charity to pay for the appraisal. However, if the charitable donee pays, the charity must acknowledge the value as goods or services received by the donor in exchange for the gift [Code §170(f)(8)] and the charitable deduction is reduced.

IRA Charitable Rollovers Return for 2013

The American Taxpayer Relief Act of 2012 reinstated qualified charitable distributions from IRAs for 2013. Taxpayers age 70½ and older can direct custodians to make distributions to public charities of up to $100,000 without having to report the distribution as income. Although no income tax charitable deduction is available for these distributions, gifts can satisfy part or all of the IRA owner's required minimum distribution, resulting in tax savings, even for donors who don't itemize. Distributions must be from traditional or Roth IRAs. Transfers must be made by the IRA custodian directly to the charity and may not be used to establish a charitable remainder trust or fund a charitable gift annuity. Distributions can, however, be used to satisfy existing charitable pledges (Notice 2007-7).

Important Considerations with Charitable Bequests

Including a charitable bequest in an estate plan means more than just determining the charity's correct legal name. The size of the bequest, whether it is to be in trust or outright, and the assets to be used are also important considerations.

An outright bequest can be a specific dollar amount, such as "$50,000 to University of California, Berkeley Foundation." It can also be a specific asset, such as "my baseball card collection," which can be satisfied only by that asset. If the testator disposes of that specific asset prior to death, the bequest is extinguished. Outright bequests also can be made in the form of a percentage of the net value of the estate (e.g., "10% of my estate"), as the residue of the estate or as a portion of the residue (e.g., "one-half the residue of my estate").

Bequests in trust offer flexibility and estate tax savings. An outright bequest to charity produces a larger charitable deduction than a bequest in trust because charity receives the money immediately; there is no wait for intervening income interests. However, some testators need to provide continuing financial support for family members or other loved ones. A split-interest bequest serves both purposes.

Split-interest bequests come in many forms including charitable remainder trusts, QTIP trusts, charitable gift annuities, charitable lead trusts, and remainder interests in homes and farms.

Certain assets make more sense from a tax standpoint when planning a charitable bequest. Property that would cause problems if given during the donor's life often makes an excellent bequest. One example is ordinary income property. The charitable deduction for an inter vivos gift of ordinary income property, such as a painting in the hands of the artist, is limited to the donor's cost basis [Code §170(e)(1)(A)]. In contrast, a bequest of a painting by the artist produces an estate tax charitable deduction equal to the fair market value of the artwork.

Tangible personal property that will be put to an unrelated use by the donee is also more valuable as a bequest. If given during the donor's life, the income tax charitable deduction is limited to basis (or fair market value if lower) [Reg. §1.170A-4(b)(3)(i)]. As a bequest, the transfer will produce an estate tax deduction equal to fair market value.

Testators may be wise to make charitable bequests of income in respect of a decedent (IRD). IRD is subject to both estate tax and income tax. Items of IRD include assets in qualified retirement plans, U.S. savings bonds with untaxed interest, accounts receivable of cash-basis taxpayers, renewal commissions of insurance agents, accrued royalties under a patent license, payments on installment obligations, and a deceased partner's distributive share of partnership income. It has been suggested that a testator could direct that all chari-

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UC Berkeley Ranks 5th out of Top 100 in World Reputation Rankings by *Times Higher Education*

1. Harvard University
2. Massachusetts Institute of Technology
3. University of Cambridge
4. University of Oxford
5. University of California, Berkeley

The 2013 rankings are based on 16,639 invitation-only responses from scholars in 144 countries. Scholars are questioned at the level of their specific subject disciplines. They are not asked to create a ranking or to list a large range of institutions, but to name no more than 15 of those they believe to be the best, based on their own experience.

Important Considerations . . . *(continued from page 3)*

table bequests be made, to the extent possible, from assets constituting IRD. However, in final regulations issued in 2012, the IRS said that provisions in an estate or trust or under local law that contain ordering provisions for payments to charitable beneficiaries will not be given effect for federal tax purposes unless there is an economic effect independent of income tax consequences (T.D. 9582). Testators can avoid this problem by specifically bequeathing IRD assets or naming the charity as beneficiary of retirement accounts.

Compliance Lax on Noncash Gift Substantiation

The Treasury Inspector General for Tax Administration (TIGTA) estimates that 60% of taxpayers claiming large, noncash charitable deductions are not complying with the reporting requirements, resulting in "approximately $3.8 billion in potentially erroneous noncash charitable contributions in 2010." TIGTA made several recommendations to improve reporting, although the IRS did not agree that all of these will substantially improve compliance.

Among the recommendations:

• Expand the current process to identify all tax returns claiming noncash charitable contributions of more than $500 that do not have a Form 8283 attached. Deductions should not be allowed until the missing documentation has been provided.

• Revise Form 8283 and instructions to require that taxpayers include the date of the contribution in addition to the donee acknowledgment for noncash gifts of more than $5,000.

Trust Clear on Intended Beneficiary

At Elaine Hillman's death, 25% of the remaining investments in her trust were to pass to "MIAMI children's hospital foundation, cranial/facial FOUNDATION" to the attention of Dr. Anthony Wolfe. Both Miami Children's Hospital Foundation and Miami Care Foundation claimed to be the intended beneficiary. Dr. Wolfe was the director of the program at Miami Children's Hospital and also the head of Miami Care at the time the trust was executed and at the time of the contest.

The trial court found that the trust was ambiguous and ruled that Hillman wanted Dr. Wolfe to have the ability to direct and control the assets. The court found Miami Care Foundation to be the intended beneficiary.

The Florida District Court of Appeal found no ambiguity in the trust, saying there was no indication Hillman intended to benefit Miami Care. Although a court may look beyond the face of a will or trust if there is an ambiguity as to the intended beneficiary, the court noted that the general rule is that a misnomer of a legatee will not defeat a bequest where the intended beneficiary can be identified with certainty. The court found no ambiguity in Hillman's trust, adding that Miami Care did not even exist at the time the trust was executed. *Miami Children's Hospital Foundation, Inc. v. Estate of Hillman*, No. 4D11-2153.

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