Something Old, Something New

There are lots of changes in the recently passed Tax Cuts and Jobs Act of 2017 – lower corporate and personal tax rates, elimination of the personal exemption, a near doubling of the standard deductions – but there are also tax provisions that haven’t changed. Among these:

Long-term capital gains taxes – The top rate remains at 20% for taxpayers in the new 37% tax bracket. The 15% capital gains rate applies to those in the 35%, 32%, 24% and 22% brackets, with a 0% rate for taxpayers in the 10% and 12% brackets. (Additionally, California’s capital gains tax rates are some of the highest in the nation.) A 25% rate applies to depreciation recapture and a 28% rate applies to the sale of collectibles. The 3.8% tax on net-investment income applies when adjusted gross income reaches $200,000 for single taxpayers or $250,000 for married filers. Exemption on the sale of a principal residence – Single taxpayers can exclude up to $250,000 in capital gain on the sale of a home used as a principal residence for at least two of the previous five years. The exemption is doubled to

Term Endowments Offer the Best of Both Worlds

The UC Berkeley Foundation has launched a term endowment program to give donors another giving option. As these funds will not be permanently invested, a different investment pool, outside of the Foundation’s general endowment pool, will be used. This option may work for a donor who wants to a) create seed funding for a new or innovative project that needs a robust source of funds now, or b) wants the gift to be spent down over a 5-20 year time period. The donor gets to see his/her gift making a bigger impact at Cal right away, rather than just seeing the incremental endowment payout year after year. The UC Berkeley Foundation’s planned gift asset manager ($150 million under management) TIAA Kaspick will manage new term endowments on the Foundation’s behalf.
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$500,000 for married couples.

Qualified charitable distributions (QCDs) from IRAs – IRA owners who have reached age 70½ can continue to make gifts directly to public charities, up to $100,000 annually. No charitable deduction is available, but if QCDs take the place of required minimum distributions, donors enjoy tax savings.

Student loan interest – The above-the-line deduction of up to $2,500 for student loan interest remains, subject to earnings limits.

Interest exclusion on U.S. savings bonds used for higher education expenses – Interest on certain bonds purchased after 1989 can be excluded to the extent proceeds are used for qualified higher education expenses. The exclusion begins phasing out in 2018 when modified adjusted gross income exceeds $79,700 for single filers and $119,550 for married filers.

Among the changes for charities and their donors starting in 2018:

Higher deduction limit – Donors who contribute cash to charity can now claim deductions of up to 60% of adjusted gross income, versus the 50% previously in effect. The limit for gifts of appreciated assets remains at 30% of AGI. Excess deductions can be carried over for up to five additional years.

Excise tax on endowments – A 1.4% excise tax is imposed on the net-investment income of private colleges and universities with more than 500 full-time students to the extent their endowments exceed $500,000 per student. (This provision does not apply to the University of California, Berkeley, which is a public university.)

UC Berkeley Planning Pointer:
What’s Better than a Charitable Gift? A Bunch of Charitable Gifts!

The tax code allows most taxpayers to utilize the standard deduction or itemize their deductions if that provides a greater benefit. In light of the Tax Cuts and Jobs Act of 2017, the combined value of your clients’ deductions would need to exceed the new standard deductions ($12,000 for singles and $24,000 for married couples who file jointly) in order for itemizing to make sense.

While some of your clients may fall short of the threshold level to itemize, one strategy is to ramp up or cram two or more years of giving into one year, also known as “bunching.” This way, clients can alternate by itemizing on their taxes one year and taking the standard deduction the next. While charitable gifts of appreciated assets may still be used to offset up to 30% of a donor’s adjusted gross income in the year of the gift, under the new law gifts of cash can offset up to 60% and any excess deduction can still be carried forward for an additional five years. Charitable contributions are ideal for “bunching,” as they are entirely payable at your clients’ discretion with regard to the amount and the timing.

In short, the ability to bunch may be a win-win for both your clients and their favorite charities. Please contact us at 510.642.6300 if your clients would like to explore this tax-wise giving option.
A Perfect Storm for Itemized Deductions

The combination of increased standard deductions and limitations on or even elimination of some itemized deductions means that only about 5% of taxpayers will itemize in 2018, compared with about 30% in prior years. As stated previously, under the Tax Cuts and Jobs Act of 2017, the basic standard deductions are $12,000 for single taxpayers, $18,000 for heads of households and $24,000 for joint filers. These rates are increased for taxpayers age 65 or older or who are blind. As a result, a couple, both age 65 or older, have a standard deduction in 2018 of $26,600, while a single taxpayer age 65 or older has a $13,600 standard deduction.

Most itemized expenses are subject to new restrictions. For example:

- The interest deduction on home acquisition indebtedness is limited to mortgages of up to $750,000 for loans entered into on or after December 15, 2017. Interest on home equity loans is no longer deductible.
- The deduction for state and local income tax or sales tax and real estate taxes is capped at $10,000.
- Miscellaneous itemized deductions subject to a 2%-of-AGI threshold are eliminated.

Bucking the cutback trend are the deductions for medical expenses, which dropped to a 7.5% (from 10%) -of-AGI threshold for 2018, (reverting back to 10% in 2019) and the 60% of AGI limit for cash gifts to charity, an increase from the previous 50%.

Strategies for Charitable Giving

The itemized deduction allowed for gifts to charity is not the reason donors contribute billions of dollars nationally each year, but deductions do allow some donors to give more than they might otherwise. What strategies are available for philanthropic clients to make tax-smart gifts?

- **Bunching** (See “UC Berkeley Planning Pointer”) – Donors can accelerate two or three years’ worth of gifts into one year, possibly itemizing every second or third year.

- **QCDs from IRAs** – Qualified charitable distributions from IRAs by those age 70½ or older offer tax savings, even though no charitable deduction is allowed. To the extent the QCD takes the place of required minimum distributions, the donor avoids income taxes that would otherwise be owed.

- **Donor advised funds** – UC Berkeley Foundation (UCBF) offers a donor advised fund (DAF) and a donor designated fund (DDF) to which donors can make larger gifts of cash, appreciated securities or real property. A deduction is allowed in the year of the gift, even though donors can wait to make recommendations for particular areas of interest. The minimum gift amount to establish a DAF with the UC Berkeley Foundation is $500,000. At least 51% of the grants must pass to UCBF. A $100,000 minimum applies to gifts to the DDF, with 100% of the distributions supporting UC Berkeley.

- **Charitable gift annuities and charitable remainder trusts** – Gift vehicles that enable donors to boost deductions while retaining payments for life may be attractive options. These can also be funded with appreciated securities. Payments are based on the full fair market value of the securities, with no loss to capital gains tax. Some donors may enjoy tax-free income or favorably taxed capital gains payments.

- **Indirect charitable gifts** – A couple, both over age 65 and unable to exceed the $26,600 standard deduction might have an adult child who is able to itemize. For example, a single adult child might have $10,000 in state and local taxes and mortgage interest that puts him or her near the $12,000 standard deduction. The parents could take advantage of the (now $15,000) annual exclusion to give the child the $5,000 that they normally contribute to charity each year. The child can then make gifts in the parents’ names and save additional taxes by itemizing. These gifts are a great strategy for families with multiple generations of Cal grads.
DAF Questions Addressed

The IRS recently issued guidance to donor advised fund sponsors, charities and taxpayers regarding incidental benefits and distributions to charities at which the taxpayer has an outstanding pledge.

Incidental benefits

An excise tax is imposed if a person advising a distribution from a DAF receives, directly or indirectly, a more than incidental benefit [Code §4967 (a)(1)]. A DAF payment towards the price of a ticket to a charity-sponsored event, even where the account owner pays the non-charitable portion, would be more than an incidental benefit. The IRS gave the example of a $1,000 ticket to an event where $900 is a charitable gift and $100 is considered the fair market value of the goods or services received (e.g., meal, greens fees). If the DAF distribution pays for the $900, with the account owner paying the remaining $100, the IRS said the DAF would be subsidizing the account owner’s attendance or participation, resulting in more than an incidental benefit.

Pledges

Under Code §4941, it is self-dealing for a private foundation to fulfill the legal obligation, such as a pledge, of a disqualified person. The IRS acknowledged that it can be difficult for the DAF sponsor to know if an account owner’s pledge is legally binding or merely an indication of charitable intent. A distribution from a DAF to a charity to which the account owner has made a pledge, whether or not legally enforceable, will not be considered to be more than an incidental benefit, provided (1) the DAF sponsor does not reference the pledge when making the distribution, (2) the account owner receives no other benefit that is more than incidental and (3) the taxpayer does not attempt to claim an income tax charitable deduction under Code §170(a) with respect to the distribution, even if the receiving charity erroneously sends the donor substantiation that would constitute a contemporaneous written acknowledgment [Code §170(f)(8)] for an outright gift (Notice 2017-73).

Trust Modified, But No Deduction Allowed

An unlimited deduction from gross income is allowed to trusts for amounts paid to charity during the year, pursuant to the terms of the governing instrument [Code §642(c)]. A trust that did not provide for distributions to charity sought a judicial reformation to permit the grantor’s child to exercise a power of appointment in favor of two foundations.

The IRS noted that the trust, which was not ambiguous, did not authorize charitable distributions during the lifetime of the beneficiaries. Judicial reformations and settlement agreements will be given effect by the IRS if they arise from an ambiguity or will contest. In the case of this trust, however, the modification did not stem from a conflict. Therefore, said the IRS, the modification would not be considered to be the governing instrument for purposes of the deduction, since it changed the terms beyond the original intent of the trust.

The trust modification is not invalid and is considered binding on the parties under state law, said the IRS, but that treatment does not determine federal tax consequences. Because distributions to the foundations were outside the terms of the governing instrument, they did not qualify for the deduction [IRS Chief Counsel Advice (CCA) 201747005].