

Planning After the Fiscal Cliff Legislation

Just before the country would have rolled off the fiscal cliff, Congress reached a compromise agreement to extend the existing rates for approximately 98% of the population in legislation known as the American Taxpayer Relief Act of 2012 (ATRA).

The legislation added a number of bells and whistles to the tax system in addition to creating one new, higher income-tax bracket. Several of these tweaks were elements of tax-law past brought back for a 2013 encore.

By the time the ink dried on the new tax law, two things were apparent:

- Americans could approach their personal tax planning with a higher degree of certainty than they had experienced in years.
- ATRA contained a host of provisions that created enhanced incentives and enhanced benefits for those with significant charitable goals.



SIPINESS

"I can raise your allowance, but I'll have to slash your entitlements."

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New Tax Bracket Affects Some Donations

Much of the controversy prior to enactment of the new law centered on whether the highest-income taxpayers should pay more taxes. The new law increased the top rate from 35% to 39.6% for singles with taxable income of more than \$400,000 and married couples filing jointly with taxable income of more than \$450,000. These high-income individuals will realize larger tax savings from charitable gifts, while savings for all other donors will remain essentially the same.

Assuming you itemize deductions, your tax savings can be estimated by multiplying the amount of your gift by the rate for the applicable tax bracket in the chart on page 2.

continued on page 2



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Inside:

- ◆ Some Capital-Gain Tax Rates Increase page 2
- ◆ Estate Tax Now Made Permanent page 2
- ◆ More Key Provisions of ATRA page 2
- ◆ Receive Extra Benefits with Gifts of Appreciated Property page 3
- ◆ The Gift Annuity: The Perfect Gift for Increasing Cash Flow in Uncertain Times page 4
- ◆ From the Director: Problem Solved—Halfway page 4

continued from page 1

2013 Tax Brackets			
Rate	Single	Married Filing Jointly	Head of Household
10%	0-\$8,925	0-\$17,850	0-\$12,750
15%	\$8,926-\$36,250	\$17,851-\$72,500	\$12,751-\$48,600
25%	\$36,251-\$87,850	\$72,501-\$146,400	\$48,601-\$125,450
28%	\$87,851-\$183,250	\$146,401-\$223,050	\$125,451-\$203,150
33%	\$183,251-\$398,350	\$223,051-\$398,350	\$203,151-\$398,350
35%	\$398,351-\$400,000	\$398,351-\$450,000	\$398,351-\$425,000
39.6%	>\$400,000	>\$450,000	>\$425,000

Some Capital-Gain Tax Rates Increase

ATRA also modified the way long-term capital gain is taxed. In 2012 those in the 10% or 15% tax bracket paid no tax on such gain, while all others paid 15%. Those in the two lowest brackets still pay no capital-gain tax, and the rate continues to be 15% for everyone else except those in the new 39.6% regular income-tax bracket, who will now pay 20% on capital-gain income.

These changes are in addition to another new provision that is not part of ATRA that affects the way capital-gain income is taxed. Starting this year the Affordable Care Act levies a 3.8% tax on certain investment income. This surtax applies to single taxpayers with adjusted gross income of more than \$200,000 and couples with AGI of more than \$250,000—a much broader swath than those with taxable income over \$400,000 or \$450,000 respectively and capturing many people selling a house or other high value capital assets in a given year. This means that taxpayers in regular income-tax brackets as low as 28% could be subject to this tax, making

their capital-gain rate 18.8%. For taxpayers in the 39.6% bracket, the total capital-gain rate, including surtax, would be 23.8%.

Estate Tax Now Made Permanent

Before ATRA one of the biggest questions was what would happen to the federal estate tax. It had been on a roller coaster ride since the turn of the millennium, but the general trend was to increase the exemption and decrease the estate-tax rate.

The final outcome of ATRA was to increase the estate-tax rate from 35% to 40% while retaining the high exemption, indexed for inflation. The exemption for 2013 is \$5.25 million. The new law keeps the gift tax and estate tax unified as one system and also allows a surviving spouse to use any part of the exemption not used by the estate of the first spouse to die. Taken together, all of these provisions let taxpayers approach their estate planning with more assurance.

Greater Tax Savings from Some Estate Gifts. Most people make bequests to Pomona because they believe in our mission and are able

to support it after providing for family. High-net-worth donors, however, realize the added benefit of estate-tax savings, and those savings will now be 40% of the gift.

Charitable pointer: Whether or not your estate is large enough to be subject to estate tax, it is generally a good idea to use assets from an IRA or other retirement fund to fund your end-of-life estate gift to Pomona. If heirs are beneficiaries of those assets, all distributions to them (unless from a Roth IRA) will be subject to income tax, but the assets will escape income tax if paid to us.

It is better to make your gifts to heirs with cash and appreciated property. They will not pay income tax on the gain in those assets that accrued prior to your death.

More Key Provisions of ATRA

- **Marriage-penalty relief.** The new law continues the practice of setting the amount of income subject to the 10% or 15% rate for married couples at two times the amount for singles.
- **Alternative minimum tax.** ATRA has created a permanent patch to avoid unintended consequences of having the AMT apply to unintended target groups. It sets the exemption for 2013 at \$50,600 for singles and \$78,750 for married couples, indexed for inflation in the future.
- **Deduction of state and local sales tax.** The new law continues the option to take an itemized deduction for these amounts in lieu of the deduction for state and local income taxes.

- Personal exemption phaseout.** ATRA reintroduced the phaseout of the personal exemption for taxpayers with income above a certain threshold. Those thresholds are \$250,000 for singles, \$275,000 for heads of household, and \$300,000 for married couples. The phaseout is 2% of any personal exemptions claimed for every \$2,500 or a fraction thereof for income exceeding the applicable threshold.
- Qualified conservation contributions.** The law continues special benefits of qualified conservation contributions that provide for increased contribution limits and extended excess-deduction carryforward provisions.
- Gifts by subchapter S corporations.** The new law also extends the special benefits for contributions of appreciated assets by S corporations.
- Corporate gifts of food inventory.** The new law also continues the enhanced deduction for gifts of inventory to benefit the needy.
- Generation-skipping tax exemption.** This exemption will be continued at an amount equal to the gift- and estate-tax exemption, which is \$5.25 million in 2013 (indexed for inflation).

Receive Extra Benefits with Gifts of Appreciated Property

Tax-savvy donors know that appreciated assets such as stock or real estate are ideal for charitable gifts. This is because a donor can deduct the full fair-market value of the assets and not be taxed on any of the gain. The exact extent of the potential capital-gain tax savings depends on the donor's personal income circumstances.

Even if you do not itemize deductions on your federal income tax, you still avoid potential capital-gain tax when you give appreciated property instead of selling such property and making a gift of the cash proceeds.

Charitable pointer: What if you are inclined to give cash because you want to continue to own a stock that has increased in value? Instead of using the cash to make your gift, give the stock and use the cash to buy the same number of shares. This locks in your capital-gain tax savings because any future gain will be based on the cost of the new shares rather than on the cost of the shares you used to make your gift.



“The damsel-in-distress thing is just one of several income streams that I pursue.”

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The Gift Annuity: The Perfect Gift for Increasing Cash Flow in Uncertain Times

Interest rates on CDs are currently very low, and so is the interest paid on money market funds and bonds. Consequently, many people who have shifted to safer fixed-income investments have seen their income diminish. For those who would like to increase their cash flow and also give to charity, a gift annuity could be the answer.

A gift annuity makes fixed payments for life to one or two persons, unaffected by fluctuating interest rates and volatile stock markets. The size of the payments depends on the age(s) of the person(s) receiving them, but it is common for the payments to be two or three times larger than what is now being received from fixed-income investments.

Charitable pointer: If a gift annuity is funded with cash, a substantial portion (50% to 80%) of the payments

will likely be tax-free for the life expectancy of the beneficiary(ies). Besides the obvious advantage of receiving money and not being taxed on it, there are two other benefits. If you are receiving Social Security payments and your income is too low for you to be taxed on those payments, the tax-free portion of your annuity payments will not be taken into consideration in determining the taxation of Social Security payments. If your adjusted gross income is considerably higher and approaching the level where the 3.8% Medicare surcharge would apply to your investment earnings, having tax-free payments may keep you below that level.

In summary, if you can afford to part with some capital, a gift annuity can give you certainty in uncertain times.

FROM THE DIRECTOR:

Problem Solved—Halfway

Following the fall elections, much of the daily news cycle focused on the pending “fiscal cliff” created by Congress the year before when it passed the Budget Control Act of 2011. Because there was no agreement at that time regarding the best way to bring balance back into the federal budget and fiscal policy following the last Great Recession, Congress created the sequester—a legal procedure in which automatic spending cuts are triggered. The idea was to create a mechanism for automatic cuts in all discretionary programs and to make those cuts so unpopular that Congress would return to the issue with a different, permanent solution before the cuts were enacted.

Of course, what was difficult to begin with remained politically difficult this past fall and winter. In early January, however, Congress did pass the American Taxpayer Relief Act of 2012 (ATRA) as an initial and partial solution before the cuts mandated by the Budget Control Act went into effect. In doing so, it dealt with what most people see as one part of a two-

part equation: federal revenue. The other part, federal spending, was left for another day. While significant uncertainty remains with regard to spending policy, the new laws regarding taxation have brought a degree of clarity sought by many as they make important financial and estate planning choices. This issue of *Flash!* summarizes some of the most important of these changes from the standpoint of their impact on philanthropic giving.

In sharing this with you we hope to help you gain some of that clarity for yourself as you make important retirement, estate, and philanthropic plans for the

future. I am fond of being able to declare at the end of each of my columns, “Problem solved!” In this case, I think instead I must add the qualification “halfway.” In the meanwhile, we hope you will find this summary useful.

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