

Charitable Opportunities of the American Taxpayer Relief Act of 2012

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This past January, Congress and the President agreed on a tax package to avoid the much publicized “fiscal cliff.” This deal became the American Taxpayer Relief Act of 2012 (“ATRA”) and includes a number of provisions that are favorable for charitable giving. Fortunately, it did not enact some of the proposals touted by politicians last Fall during the negotiations over the tax law (such as capping the charitable deduction or limiting the tax savings from charitable gifts). In general, ATRA resulted in higher income taxpayers likely owing more income tax, motivating many to consider the benefits of charitable giving. Two particular techniques are of particular relevance in light of the ATRA – the IRA Charitable Rollover and the Charitable Remainder Trust.

The IRA Charitable Rollover

IRAs are a popular type of retirement savings device – people in all tax brackets have IRAs, not just the wealthy. Traditionally, individuals have found on-death charitable planning with IRAs to be particularly appealing. By designating a charity as a beneficiary of an IRA to receive the balance of the IRA at the donor’s death, the IRA will avoid both income and estate taxation.

ATRA renewed an opportunity for donors over the age of 70½, who wish to make lifetime charitable gifts, to use their individual retirement accounts (IRAs). This benefit has been available each year since 2006 to certain IRA owners, but expired on December 31, 2011. The recent legislation extended its use through December 31, 2013 and implemented special transitional relief provisions.

Lifetime Charitable Gifts. It is becoming more common for donors to look to their IRAs as potential sources for *lifetime* charitable gifts. This charitable giving technique may simplify matters for you and may provide for a more desirable tax result.

- It allows you, if 70½ and older, to make charitable gifts of up to \$100,000 annually (\$200,000 annually if you are married) from your IRAs in one step. You simply instruct the institution holding the IRA to transfer funds directly to the designated charity.
- This transaction, nicknamed the *IRA Charitable Rollover*, is completely tax-free.
- In contrast to the two-step process required under the prior law, you do not report the transferred funds as income (nor do you take a charitable deduction for the gift). Non-itemizers and those whose charitable deductions are subject to limitations will now find lifetime IRA gifts more attractive.

Transitional Relief. ATRA includes transitional relief provisions that were mainly available during January, 2013, to extend this opportunity to 2012 despite the retroactive nature of the Act. While the timing of these relief provisions for tax year 2012 has passed, it is important to remember that a second IRA Charitable Rollover may be

possible in 2013. For example, if a donor made an IRA Charitable Rollover during January 2013 and such gift could be retroactively qualified for 2012, he or she still has the option of making another IRA Charitable Rollover before December 31, 2013.

The Charitable Remainder Trust

As a result of ATRA, the total federal income tax rate on earned income can be as high as 43.4% (39.6% income tax plus 3.8% Medicare tax). At the same time, the maximum federal rate for long-term capital gains can now be as high as 23.8% (20% capital gains rate plus 3.8% Medicare tax rate). These tax law changes coupled with a somewhat improved economy has renewed interest in the use of a charitable remainder trust. With this technique, a donor can provide for his or her favorite charities and retain an economic benefit in the transferred property for themselves or other individuals whom he or she wishes to benefit.

A Charitable Remainder Trust ("CRT") is an irrevocable trust, created during life or at death, to which cash or other property is transferred. Generally, it is structured as follows:

- One or more individuals will receive payments each year for a period of time measured by a term of years (not to exceed 20 years) or by the lives of one or more individuals.
- The payments are equal to either a fixed percentage of the value of the CRT at the time it is established (called a *Charitable Remainder Annuity Trust*) or a fixed percentage of the value of the CRT valued annually (termed a *Charitable Remainder Unitrust*).
- The payments must be at least 5% of the CRT and, subject to certain limitations, can be much higher. As the percentages increase, however, the charitable deduction is reduced and, ultimately, eliminated.
- After all the required payments have been made, all the property is distributed to charities selected by the donor. As an alternative, the donor may allow the Trustees to select one or more charities.

Establishing a CRT can provide you with income tax benefits. You receive a charitable deduction equal to the value of charitable remainder interest calculated at the time the CRT is established. If you are unable to fully utilize the income tax deduction in the year that the CRT is funded, you may carry forward the unused deduction amount and deduct it in the five subsequent years. A CRT is a tax exempt entity, if it is properly administered. For this reason, you may transfer an appreciated asset (like stock or real estate) to a CRT, which can then sell the asset. Neither the CRT nor you will be required to pay an immediate capital gains tax on the sale. Unless an individual other than you or your spouse receives the annuity payment, property transferred to the CRT will not be subject to gift taxes at the time of the transfer or estate taxes at the time of your death. At the time of the death of the last individual beneficiary, all of the trust property remaining in the CRT qualifies for an estate tax charitable deduction.

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