

The Impact of ATRA and Affordable Care Act on Charitable Giving in 2013

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Poll Q 1: Opinion of the Tax Code

What is your opinion of the tax code?

- A. **Exciting Stuff!** It's what gets me out of bed in the morning, eager to head to work!
- B. **Ugh.** I'm REALLY not a tax person.
- C. Somewhere in-between

Today's Agenda

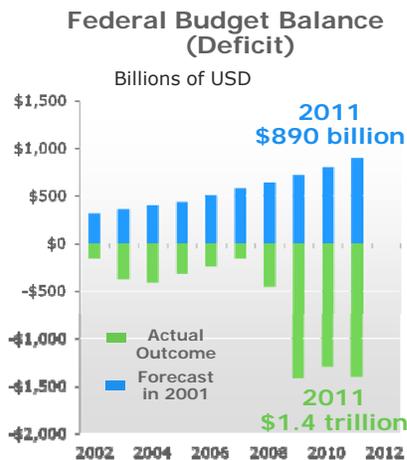
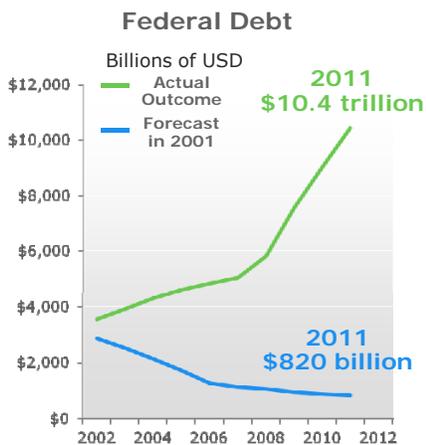
Policy Detours and 2013 Outlook

Tax Changes for 2013

What Does This Mean for Philanthropy?

How We Got Here: Massive Forecast Error

Instead of surpluses, the federal debt has nearly tripled in ten years.

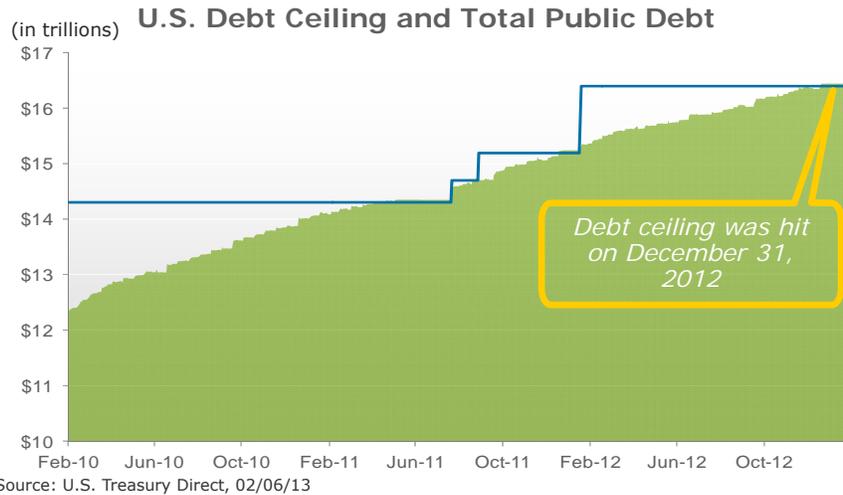


Sources: BCA Research Inc, Congressional Budget Office, 04/12

Policy Detour – U.S. Debt Ceiling

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An agreement has been reached to temporarily suspend the debt ceiling until May 19, 2013.



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Poll Q 2: Government Debt

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U.S. and Japan are home to seven percent of the world's population, but account for what percent of the world's total government debt?

- A. 25%
- B. 33%
- C. 50%

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Poll Q 3: Medical Costs

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A 65-year-old retiree contributed what portion of the Medicare benefit they will receive in their lifetime?

- A. 100%
- B. 70%
- C. 40%

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What Could Go Wrong?

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Policy Risk—Mistake or Delay

Economic Paralysis—Extension of Status Quo

Global Recession

War/Terrorism/Arab Winter

Leadership Transition in China

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What Could Go Right?

Viabie Tax and Spend Plan

U.S. Housing/Employment

European Economic and/or Policy Progress

Emerging Economies Accelerate
after Inflation Fighting

Tax Changes for 2013

Top U.S. Federal Income & Estate Tax Rate History

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Source: www.irs.gov

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Poll Q 4: Most Important Aspect of ATRA

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In my opinion, the MOST IMPORTANT aspect of ATRA is:

- A. It extended the Charitable IRA Rollover
- B. It makes permanent certain federal tax rates, exemptions, and deductions, and creates temporary extensions
- C. It averted scheduled income and estate tax increases
- D. Improved clarity on income and estate taxes
- E. It's really good for the paper industry

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Tax Changes for 2013

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Overview

There are significant changes to the tax landscape for 2013. The **American Taxpayer Relief Act** of 2012 (ATRA) along with the implementation of the **Patient Protection and Affordable Care Act** of 2010 combine with several expiring tax codes to present some important changes.

American Taxpayer Relief Act

The American Taxpayer Relief Act (ATRA) of 2012 was signed into law by President Obama on **January 2, 2013**.

The **ATRA makes permanent certain federal tax rates, exemptions and deductions**, while temporarily extending certain expired or expiring tax provisions.

The **ATRA averted scheduled income and estate tax increases** from the expiration of the Bush-era tax acts and delayed by two months the scheduled spending reductions required by the Budget Control Act of 2011.

It is anticipated that as the President and Congress address the scheduled spending reductions, the nation's debt ceiling and the annual budget process that some of these now **"permanent" laws may continue to evolve**.

The Patient Protection and Affordable Care Act

The Patient Protection and Affordable Care Act (PPACA) was signed into law by President Obama on **March 23, 2010**. While certain elements of the legislation had already been implemented, several components are set for implementation in 2013 that will have significant tax implications.

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Social Security Payroll Tax

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- **SS Payroll Tax- impacts 77.5% of US Tax Payers**
- **SS payroll tax was 4.2% in 2011 and 12**
- **Under ATRA, the tax goes back up to 6.2%**
- This will impact everyone with income from wages or salary

- **Charitable Impact: Fewer resources available** for individuals to make gifts (both itemizers and non-itemizers)

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Poll Q 5: Percent of Taxpayers Affected

ATRA's income tax provisions affect nearly all taxpayers:

A. TRUE

B. FALSE

Income Tax Rates

- **Income Tax- will impact 0.9% of US Tax Payers**
- **Impacts taxable income over \$450k Married, \$400k singles.**
 - (Below these brackets, the Bush-era tax rates remain.)
- Gross income can be reduced to amounts below this level through exemptions and deductions

- **Charitable Impact:**
 - Impacts fewer than 1% of individual taxpayers
 - **Value of charitable deduction will increase** for those earning in excess of \$450k Married/ \$400k Single/ \$225k married filing separately

Poll Q 6: Medicare Surtax

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The Affordable Care Act imposes a 3.8% surtax on investment income for taxpayers in ALL brackets.

A. TRUE

B. FALSE

C. No Clue

D. Undecided

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Medicare Investment Income Surtax

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- The Affordable Care Act imposes a **3.8% surtax** on the lesser of:
 - Net investment income, or
 - The excess of modified adjusted gross income (MAGI) over **\$250k married, \$200k single, \$125K married filing separately**
- **Investment Surtax applies to individuals, trusts, and estates**
 - **Tax-exempt entities** (charities, charitable remainder trusts, IRA (traditional and Roth)) **are exempt from this tax**
 - Non-grantor lead trusts with excess income above \$11,950 will be subject to this surtax
 - Distributions to beneficiaries of CRTs, CGAs, and PIFs will be subject to this tax for amounts above their applicable threshold
- **Charitable Impact:** Some taxpayers will have fewer resources available to make charitable gifts and the charitable income tax deduction will not reduce this surtax

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Medicare Payroll Tax

- New tax from Patient Protection and Affordable Care Act of 2010 (effective Jan. 1, 2013)
- Applies to wage and self employment tax income
- **0.9%** for this income in excess of \$250k married and \$200k single

- **Charitable Impact:** Some taxpayers will have fewer resources to make charitable gifts

Medicare Taxes on Earned Income

Lower Brackets:

	2012	2013 and beyond
Employee	1.45%	1.45%
Employer	1.45%	1.45%
Combined	2.90%	2.90%

\$200k+ single / \$250k+ joint:

	2012	2013 and beyond
Employee	1.45%	1.45% + 0.9% = 2.35%
Employer	1.45%	1.45%
Combined	2.90%	3.80%

Long-Term Capital Gains & Qualified Dividends



- **ATRA increases capital gains rates from 15% to 20% for Individual taxpayers in the top tax bracket** (\$450k married filing jointly/\$400k single/\$225k married filing separately)
- Qualified dividends for all taxpayers will continue to be taxed at LT capital gains rates.
- **Charitable Impact:** Makes gifts of highly appreciated property more attractive (more capital gains taxes potentially will be avoided)

Summary of 2013 Income Tax Rates



Individual Income Tax Rates for 2013					
Taxable Income		Ordinary Income	Capital Gains and Dividends	Medicare Tax	
Single	Joint			Earned Income ¹	Investment Income
\$0+	\$0+	10%	0%	2.90%	0%
\$8,925+	\$17,850+	15%			
\$36,250+	\$72,500+	25%	15%	3.8%	3.8%
\$87,850+	\$146,400+	28%			
\$183,250+	\$223,050+	33%			
\$200,000+ (AGI)	\$250,000+ (AGI)				
\$250,000+ (AGI) ²	\$300,000+ (AGI) ²	35%			
\$398,350+	\$398,350+	39.6%	20%		

¹ Earned income Medicare Tax includes 1.45% employer portion

² Phaseout of personal Exemptions and Itemized Deductions begins

Personal Exemption (PEP) & Itemized Deduction Limits (Pease)

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- ATRA brings back the **personal exemption phase out (PEP)** and **itemized deduction limitations (Pease)**
- Both these rules were repealed under the Bush era tax cuts
- Applies to married couples with AGI over \$300k and singles with AGI over \$250k
- **Reduces itemized deductions by 3% for every dollar over these limits**
- Alternative was a cap on itemized deductions which would have been worse for charitable giving

- **Charitable Impact:**
 - History shows that individuals were just as charitable during the Clinton era tax regime where these limits were in place
 - The reduction in deductions is fairly slight and is based on income as opposed to the size of the deduction

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Poll Q 7: Influence of Tax Deduction

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An income tax deduction for charitable contributions has a *strong* influence on donors' willingness to make contributions.

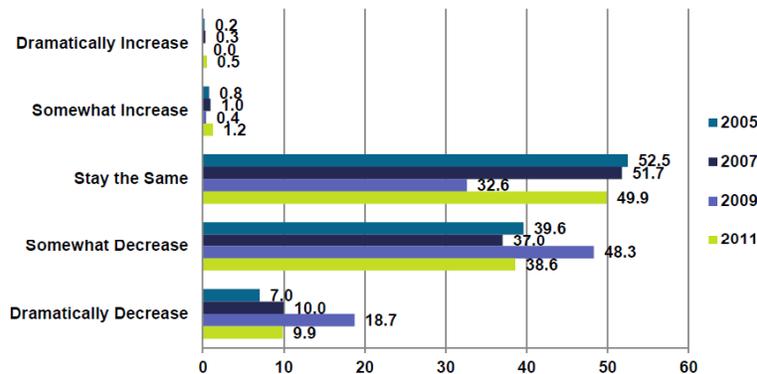
- A. Yes, for all income tax brackets
- B. Yes, but only for upper income tax brackets
- C. No, philanthropic intent is the primary driver
- D. Maybe, depends on the donor

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What if the Deduction was Eliminated?

FIGURE 53: CHANGE IN HIGH NET WORTH HOUSEHOLD GIVING IF INCOME TAX DEDUCTIONS FOR DONATIONS WERE ELIMINATED IN 2005, 2007, 2009, AND 2011* (%)

"If you and your family received zero income tax deductions for charitable giving, would your household charitable giving increase, decrease, or stay the same?"



*2009 and 2011 results are statistically different.

2012 Bank of America Study of High Net Worth Philanthropy, The Center on Philanthropy at Indiana University, November 2012

Alternative Minimum Tax

- AMT was designed to make sure taxpayers could not avoid a "minimum tax" by taking significant deductions against income
- In order to make sure that the tax was targeted at "high income" taxpayers, AMT provisions allow for certain exemptions
- **The exemptions were not indexed for inflation**, so Congress had to patch (modify) exemption amounts
- **ATRA makes the AMT patch permanently indexed to inflation**

- **Charitable Impact:** By further protecting middle income taxpayers from AMT, ATRA may lead to more gifts from middle income donors

Poll Q 8: Transfer Taxes

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- A. It maintains the estate tax exemption at \$5MM and indexes it for inflation (\$5.25MM in 2013)
- B. It unified the estate, gift, and GST tax exemptions
- C. It increased the transfer tax rate above the exemption amount to 40%
- D. All of the above

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Gift and Estate Tax

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- **ATRA Unified exemption** for estate, gift and generation-skipping transfers made permanent
- ATRA maintains \$5 million exemption for estate, gift and generation-skipping transfers, and indexes it for inflation (i.e. \$5.12 million for 2012, **\$5.25 million for 2013**)
- **Increases tax rate from 35% to 40%**
- Portability made permanent
- **Annual exclusion amount increased to \$14k** per taxpayer (previously \$13k)

- **Charitable Impact:** As only 1 in 500 estates is taxable; the impact on charity should be insignificant. With that being said, removing assets from an estate in order to avoid the tax may be a well used planning strategy.

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Poll Q 9: Charitable IRA Rollover

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Taxpayers over age 70½ with IRAs may take advantage of QCDs to prevent a bump up to a higher tax bracket.

- A. TRUE
- B. FALSE
- C. MAYBE

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Charitable IRA Rollover

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- Donors are permitted to satisfy their required minimum distribution of an IRA plan by having the plan administrator make a QCD (qualified charitable distribution)
 - Qualified Charitable Distribution
 - Donor must be at least **age 70 ½**
 - Plan must be a Traditional IRA or Roth IRA
 - Distribution must be **\$100k or less and made directly to public charity**
 - Gift must be made to a **public charity** (not private foundations, donor advised funds)
 - The donor cannot receive a benefit in exchange for the gift (lifetime split interest gifts will not qualify)
 - (January Do-Over: Rules applied for 2012 if transfer made before January 31, 2013)
- **Charitable Impact:**
 - More gifts most likely will be made from qualified IRAs during 2013.
 - QCDs may be used to prevent bump up to higher tax bracket due to normal IRA distribution

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American Taxpayer Relief Act/Affordable Care Act: Top Take Aways

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1. **Unified Exemption** of Estate, Gift, and GST at **\$5.25MM** in 2013 (indexed for inflation)
2. **Highest estate tax rate increased to 40%** (from 35%)
3. **Highest income tax bracket is \$400k single / \$450k joint and above: 39.6% ordinary income / 20% cap gains**
4. Highest income tax bracket including **MEDICARE TAXES** of 3.8%: **43.4% and 23.8%** (an increase of 5.5% and 3.8%)
5. **Annual exclusion increased to \$14k** (indexed for inflation)
6. **Charitable IRA Rollover extended through 2013** (70½, \$100k, direct to public charity, Traditional or Roth IRA, no DAF or PF)
7. Social Security Payroll Tax Holiday is over: back to **6.2%** from 4.2%
8. Personal Exemption Phaseout (PEP) and Itemized Deduction Limits (Pease) reinstated
9. AMT Patch permanently indexed for inflation

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Tax Law and the Future

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Future

The ATRA made permanent many of the most recent taxpayer-friendly changes in the areas of estate, gift and GST tax law. As part of the legislation, there was no significant attempt to increase revenue from these types of taxes other than the minor increase in the tax rates.

These changes are permanent in the sense that they have **no sunset expiration provisions**, but taxpayers should be aware that many revenue raising proposals in the past few years have involved tax reform efforts in these areas that do not involve exemptions or rates.

Additional Revenue

If additional revenue is needed in future legislation, there are a number of possible "loophole closers" for Congress to get that revenue from the transfer tax regime. **Previous proposals have called for:**

- Minimum 10 year terms for grantor retained annuity trusts
 - Restrictions limiting the use of valuation discounts on transferred property in intrafamily transactions
 - Requiring consistency in basis calculations for income and estate tax purposes
 - Adding Intentionally Defective Grantor Trusts (IDGTs) to the taxable estate of the grantor
 - Limiting the duration of GST exempt trusts
- While it appears that there is "permanence" in transfer tax laws for the first time since 2001, that permanence will only last until **Congress** makes additional changes.

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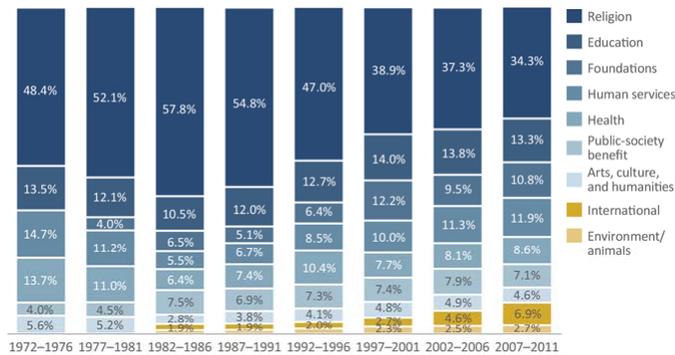
What Does This Mean for Philanthropy?

The Charitable Donation

- Not as straight forward as one might think
- Considerations:
 - Giving What?
 - To Whom?
 - When?

Giving by type of recipient: Percentage of the total in five-year spans, 1972–2011

Giving by type of recipient: Percentage of the total in five-year spans, 1972–2011* (adjusted for inflation, does not include “unallocated”)



*Charitable giving to foundations began to be tracked in 1978, and the environment/animals and international affairs subsectors began to be tracked in 1987.
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Source: Giving USA Foundation™ / GIVING USA 2012

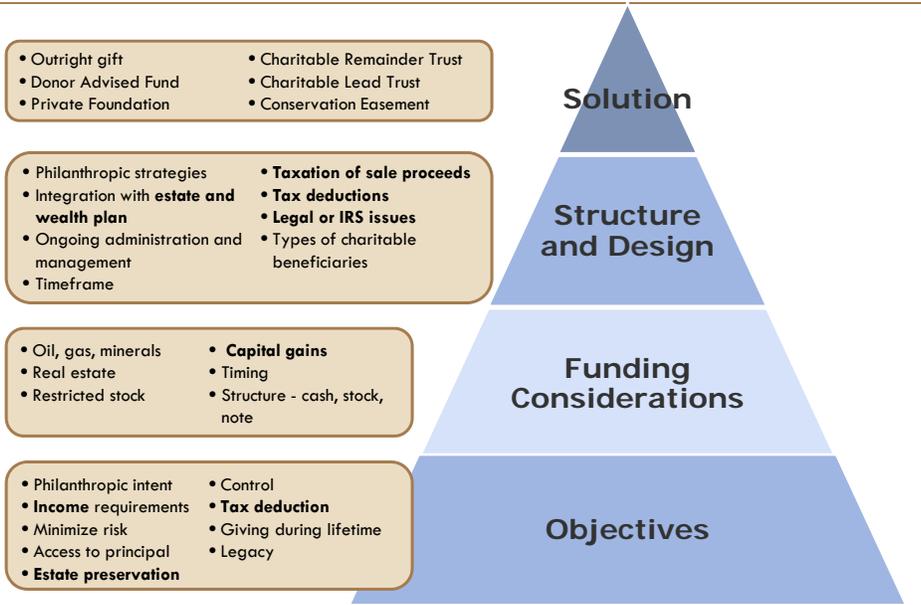
2013 Tax Changes and Impact on Charitable Giving

- Many of the proposals and alternatives that were addressed through ATRA could have been detrimental to tax-efficient giving
- Most donors give because they support a charity’s mission (donors were generous during the Clinton years)
- While generous, most donors desire to make gifts in a tax-efficient way when possible
- Donors will continue to give; however, they may change what they give, when they give, and possibly at what level
- Charitable deductions will be an important tool for high income earners to off-set higher taxes
- Gifts of appreciated assets remain attractive to generate income tax deductions and to avoid capital gains tax, especially for taxpayers above the \$200k/\$250k and \$400k/\$450K thresholds
- IRA qualified charitable distributions can be used to avoid adding traditional IRA distributions to AGI

ATRA / ACA, In Summary

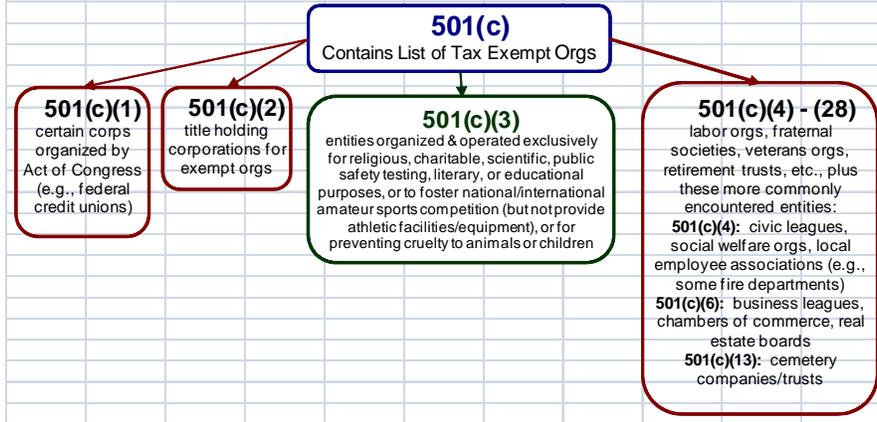
- Times are Changing
- Individuals are Asking the Hard Questions
- Nonprofits are Sharpening their Axes
- Advisors are Adapting their Approaches

Philanthropic Planning Process



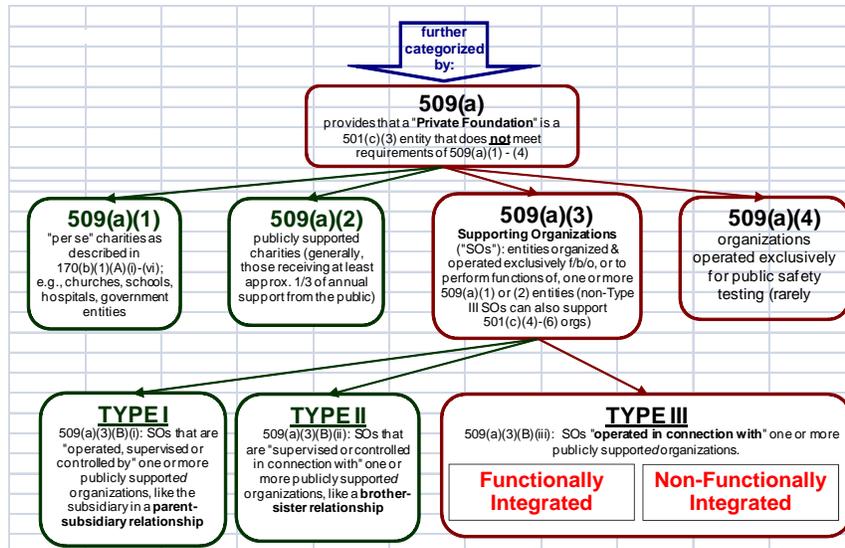
Supporting Organizations

EXEMPT ORGANIZATIONS CHART



Supporting Organizations

§ 501(c)(3) Organizations



Type III Supporting Organizations

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- **Who Cares?**
 - Supporting Organizations and their Supported Orgs
 - Private Foundations and Donor Advised Funds that grant to Type III S.O.s
- **History:**
 - Pre-Pension Protection Act of 2006
 - PPA 2006 Regulations
 - 2009 Proposed Regulations
 - Final and Temporary Regs: December 21, 2012
- **Guidance:**
 - **Notification to Supported Orgs by Type III S.O.s:**
 - Governing documents
 - Written notice describing the type and amount of support provided
 - **Temporary Payout for Type III Non-Functionally Integrated S.O.s:**
 - Distribution requirement equal to the greater of
 - 85% of the org's adjusted net income or
 - 3.5% of the fair market value of the org's non-exempt use assets
 - **Criteria to be satisfied for a Type III SO to be "Functionally Integrated:"**
 - Engaging in activities substantially all of which directly further the exempt purposes of the Supported Org(s) to which it is responsive
 - **And much more!**
- **VERY COMPLICATED; Contact your CPA / Attorney for guidance**

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