What You Should Know about Recent Changes in the Tax Law

How Charitable Giving Fits In

A 2013 Perspective

Every year, the tax laws change. Usually changes are minor — Income tax brackets expand slightly or the standard deduction increases a bit — nothing that is radically different.

But the 2013 changes are not the usual. Today, the outlook on federal taxes is both *clearer* and *more complicated* than it was just a year ago.

Clearer because many parts of the tax law that were once temporary are now permanent. This allows you to plan with greater assurance.

More complicated because there are new rules and new taxes which mainly affect higher-income taxpayers. On the whole, taxes will go up for some people, and tax planning will require more foresight.

In this booklet, we outline the recent changes in the tax law and how it impacts our donors.

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TWO TYPES OF CHANGE

Two major tax law changes will have an impact on tax planning in 2013:

1. Changes brought by the American Taxpayer Relief Act of 2012
2. Changes introduced by the 2010 healthcare law

Let's take a look to see how . . .

The American Taxpayer Relief Act of 2012

Congress passed the American Taxpayer Relief Act of 2012 (ATRA) on January 1, 2013 — perhaps a day late, but not a moment too soon. The wide-ranging tax law affects taxpayers in a variety of ways, and there are important new features on charitable giving donors should keep in mind — including the IRA Charitable Rollover. Here are some of the key items included in the new law:

Income Tax Changes

- The top tax rate is 39.6% for income over $400,000 (for a single taxpayer) or $450,000 (for married couples filing jointly)
- The income tax "marriage penalty" is addressed through widening the 15% income tax bracket and increasing the standard deduction for married taxpayers filing jointly
- Capital gains and qualified dividends have a higher top tax rate of 20% for those taxpayers in the highest income tax bracket
- Several tax credits are extended, such as the child tax credit, the adoption credit and the American Opportunity Tax Credit
- Certain deductions are extended, such as the option to deduct state and local sales tax (rather than the income tax) and the above-the-line deduction for tuition and related expenses
- Both the phase-out of personal exemptions ("PEP") and the limitation on itemized deductions ("Pease") are back
- The exemption amounts for the Alternative Minimum Tax ("AMT") are increased and set to rise with inflation from year to year (finally — a permanent AMT fix)

Note: The payroll tax cut was left out of the new law, which means the social security tax rate returns to 6.2% this year.

"EXPLAIN PEASE AND PEP, PLEASE?"

- The Pease limitation (named after the lawmaker who originated the rule) and PEP are not necessarily new — they returned this year after vanishing in the late 2000s
- Higher-income taxpayers gradually lose their personal exemption amounts and itemized deductions as income rises
- For PEP, personal exemptions go down by 2% for each $2,500 of adjusted gross income (AGI) above a certain level
- For Pease, itemized deductions go down by 3% of AGI above a certain level, or 80% of the total amount of deductions — whichever amount is less

Gift and Estate Tax Changes

- The top tax rate for estates, gifts and generation-skipping transfers rises from 35% to 40%
- The applicable exclusion amount remains the same — about $5 million and this amount is linked to inflation
- The option of portability for the unused applicable exclusion amount of a deceased spouse — that part of the exclusion an estate uses to avoid federal taxes — is now permanent

Charitable Giving

- The enhanced deduction rules for contributions of real property for conservation purposes are kept in place

- The IRA Charitable Rollover is extended through 2013, allowing someone age 70½ or older to direct a distribution straight from an IRA to a charity as a gift without including the distribution amount on federal income tax returns

WHO TO TALK TO

Be sure to discuss the changes with your accountant or tax advisor, and keep charitable giving in mind as a way to match your personal planning with your philanthropic goals.

The 2010 Healthcare Law

The Patient Protection and Affordable Care Act of 2010 (also known as "Obamacare") is a complex law affecting consumers, business and the healthcare industry. Two small parts of this enormous law will have a big effect on higher-income taxpayers — a 3.8% tax on net investment income, and a 0.9% tax on wages.

Who is considered a higher-income taxpayer? Individuals with more than $200,000 in income or $250,000 for a married couple filing jointly are considered higher-income.

What is net investment income? Income from interest, dividends, annuities, rents, capital gains. But not retirement plan distributions, nor income from an S corporation or partnership subject to self-employment tax.

How does the tax on net investment income work? The 3.8% tax applies to the net investment income or the amount above the threshold level (the $200,000 or $250,000 amount) — whichever amount would be less.

How does the tax on wages work? The 0.9% tax applies to wages earned above the stated threshold level ($200,000 or $250,000). This is an increase of the Medicare payroll tax, so instead of 1.45%, higher-income wage earners pay 2.35%.

ANOTHER PART OF THE NEW HEALTHCARE LAW

When you deduct medical expenses, the threshold for taking the deduction has been 7.5% of adjusted gross income for several years. Starting in 2013 the threshold increases to 10% for persons younger than 65 (though it remains at 7.5% for older taxpayers for the next few years).

Return of the IRA Charitable Rollover

As mentioned earlier, Congress decided to extend the IRA Charitable Rollover through 2013. This allows individuals over age 70½ to direct a distribution (up to $100,000) straight from their IRA to a charity as a gift without including the distribution amount on federal income tax returns.

Advantages of an IRA Charitable Rollover

There are two key advantages to completing an IRA Rollover:

- One, the amount counts towards your required minimum distribution. Every year, you must take a certain amount out of your IRA. Directing the money to a charity satisfies this requirement.

- Two, the amount directed to charity is excluded from your federal income. This can be very important since a variety of taxes are triggered by higher income. Keeping your income down can avoid taxes in more ways than one.

Steps to Take to Make an IRA Charitable Rollover

In writing, you direct your IRA administrator to send the money directly to charity. Do not first take a distribution then send the money to us because this does not count as an IRA Rollover. Contact us for details on exactly where the administrator should send the money so that we can be aware of its imminent arrival.

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Going Forward with the IRA Charitable Rollover

Congress first passed the IRA Charitable Rollover in 2006. Since that time, Congress has renewed the provision, but only on a temporary basis. The most recent tax law set a deadline of December 31, 2013 for this opportunity. After that date, the law may or may not be effective, depending on what Congress does. So keep the temporary nature of the IRA Charitable Rollover in mind.

How Philanthropy Fits In

The tax laws might have changed but charitable giving still can play a significant role in overall planning — retirement, tax and estate planning.

The most direct way that a charitable gift can make a difference tax-wise is to deduct the contribution. Consider that the value of the deduction depends on your top marginal tax rate. For instance, a taxpayer who pays a 33% marginal tax rate would save $330 on federal income taxes by contributing $1,000 to charity. In 2013, the top income tax rate jumped to 39.6%. A taxpayer in this top bracket would save $396 on federal taxes from a $1,000 gift.

Another way that philanthropy can help in tax planning is the avoidance of capital gains tax. Giving a stock is not considered a sale. Yet, you can take a deduction on the full value of the stock, even though the capital gain has never been taxed. In 2013, the capital gains tax rate, combined with the investment income tax, can be as high as 23.8% — a significant increase over last year.

Keep in mind that tax benefits are never the reason to initiate a charitable gift. But, planning with the tax benefits in mind can make the gift (a possible larger gift) more satisfying. Consult with your tax advisors before making a planned gift and let them know that you want to realize philanthropic goals as well as financial ones.

A Lasting Impact on Others

There are many ways to support your favorite charitable organizations, from volunteering your time to making gifts of cash or property. And although the options are many, we realize that charitable giving is not a matter of convenience but a matter of conviction. Every gift you make to our organization is a personal statement — a vote of support for the work we do.

We hope the information presented here is helpful in your planning. We greatly appreciate the thoughtfulness of our friends and supporters, and we are happy to help in any way we can if you are considering a gift. Please contact us if we can be of service.

Figures in our examples are based on average interest rates, and may be different at the time of a gift. Tax information provided herein is not intended as tax or legal advice and cannot be relied on to avoid statutory penalties. Always check with your tax and financial advisors before implementing any gift.

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