Philanthropic Advisor

A Guide to Charitable Giving for Professional Advisors

The Boston Foundation tBf

Advisor Insights

The New Tax Environment: What Will It Mean for Your Philanthropy?

Affluent taxpayers face a "Perfect Storm" of new levies

Andrew Clark, a Manager at Marcum LLP, isn't looking forward to the next three months. That's when he has to explain to his very high-net-worth clients that they might see their tax bills soar by as much as 25 percent next year.

"Clients are not as focused as they should be on this," he says, laying out a scenario that looks like an affluent taxpayer's Perfect Storm:

- The top income tax bracket will rise from 35 percent to 39.6 percent;
- Long-term capital gains and dividends will be taxed at 20 percent instead of 15 percent;
- People with adjusted gross incomes (AGI) above a certain threshold ($250,000 for married filing jointly and $200,000 for head of household or single) will pay a new 3.8 percent Medicare surtax on net investment income in excess of $50,000 (part of the Affordable Care Act);
- People whose earnings exceed the above AGI thresholds will also owe a .9 percent Medicare surcharge on the portion of their earnings above that dollar amount (also part of the Affordable Care Act);
- High-income people will be subject to the newly reinstated "Pease Limitation," which basically means "you can't take any of your itemized deductions until in aggregate they exceed the lesser of 3 percent of your AGI or 80 percent of the itemized deductions otherwise allowable for the year," says Michael D. Hough, Managing Director at WTAS, LLC and a member of the Boston Foundation's Professional Advisors Committee.

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What does this mean for philanthropy? "It's a very intriguing question," says Mr. Clark, who is part of the Foundation's Professional Advisors Network. "I do see a potential where you could have a drop-off in charitable giving, but the saving grace is that it's still one of the more attractive deductions out there.

Mr. Hough notes that some of his clients are concerned that the Pease Limitation will significantly reduce the tax benefit of their charitable giving. While Pease will reduce the total amount of allowable deductions, it is important to remember that the limit is a function of adjusted gross income, not total deductions, he explains. "Once you're over the Pease 'floor,' the tax benefit of incremental deductions will not be reduced—if you want to give $100,000 to charity, you're going to get a deduction for that." (This year, the limitation will apply to AGI over $300,000 for married couples filing jointly and $250,000 for singles.)

"The Pease limitation may not change an individual's thinking on whether or not to donate, especially if it is soaked up by other deductions," says Mr. Hough. "But I do think the tax rate is going to affect it. Because their overall tax bill has gone up, some folks may feel like they have less available cash to donate."

Ways to limit tax impact

Both advisors say there are some things people can do to minimize their tax burdens such as contributing the maximum allowable amount to retirement accounts, moving some of an investment portfolio into tax-free vehicles like municipal bonds, and exploring deferred compensation plans that push income into future years. "But if your AGI is consistently $500,000 to $10 million a year," says Mr. Clark, "it is highly unlikely that even the best planning will allow you to work around the $300,000 Pease limit."

Despite the new challenges on the income-tax side of the tax equation, estate planning got a little easier this year, says Amy Naughton, an estate-planning attorney and Principal at Lourie & Cutler. The American Taxpayer Relief Act of 2012 (ATRA) established a $5.0 million per person exemption from federal estate and generation-skipping transfer taxes (indexed to inflation, resulting in $5.25 million per personal exemption for 2013), allowed unused portions of the estate tax exemption to pass from a deceased spouse to his or her survivor and raised the estate tax rate from 35 percent to 40 percent.

"On the estate and gift side there are all kinds of exciting planning opportunities associated with the tax laws," says Ms. Naughton, a former member of the Boston Foundation Professional Advisors Committee. In cases where people have retirement plan assets that their heirs won't need, it makes sense for tax purposes to name a charity as the beneficiary of the IRA or 401K account because a charity does not have to pay taxes on the money as an heir would." TBF

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