First Quarter 2013

Kanawha Currents

Planning To Be Charitable

This Quarter's Highlights

- Charitable Contribution Limits
- Gifts: Cash, Appreciated Securities, or IRA Charitable Rollover?
- 2013 Important Financial Data

Many of our clients donate generously to their favorite charities each year as part of their overall financial plan. Charitable contributions are driven primarily by philanthropic motivation, but because contributions are deductible for income tax purposes, it is important to know the basic rules so you can minimize your after-tax cost of giving.

Many strategies are available to help families support non-profit organizations and at the same time unlock the greatest tax benefits. Our discussion will focus on donating cash and securities from investment accounts, either through the standard approach or via an IRA Charitable Rollover. We will highlight the basic tax rules associated with charitable giving and then use examples to illustrate how one might evaluate the different approaches.

A charitable contribution is treated as an itemized deduction for federal income tax purposes. The annual deduction is limited to a certain percentage of a taxpayer's Adjusted Gross Income (AGI). Your AGI can be found at the bottom of the first page of your IRS Form 1040, line 38. Cash donated to public charities may be deductible as an itemized deduction up to 50% of AGI. Cash donated to other charities (also known as 30% organizations) can be deductible only up to 30% of AGI. The AGI deduction limit for donation of capital-gains property, such as shares of a publicly traded stock, is either 30% (for public charities) or 20% (for other organizations).

Charitable Contribution Limits (% of AGI)

	Public Charities [1]	Other Organizations [2]
Cash & Ordinary Income Property	50%	30%
Long-Term Capital Gain Property	30% [3]	20%

Source: IRS Publication 526 and Joint Committee on Taxation, JCX-4-13

A taxpayer's total deduction for contributions cannot exceed 50% of AGI in a given year.[4] Unused contribution amounts generally may be carried forward for five years. For example, if you have AGI of $100,000 and are donating $40,000 of stock to your church, your current year's deduction will be limited to $30,000 ($100,000 x 30%). You may carry forward the remaining $10,000 to the next tax year.

Charitable deductions may also be affected by the recently reinstated *Pease* limits that were a part of the American Taxpayer Relief Act (ATRA). Under the new rules, joint filers with AGI greater than $300,000 ($250,000 for single filers) will see their total itemized deductions reduced by 3% of every dollar of AGI above these thresholds. This phaseout cannot lower your itemized deductions by more than 80%.

[1] These also include private operating foundations and other private foundations that meet certain requirements.
[2] Certain private non-operating foundations, veterans' organizations, fraternal societies, and nonprofit cemeteries.
[3] Donor may elect to reduce the fair market value by the amount of the long-term capital gain and be subject to the higher 50% limit.
[4] If gifts are subject to more than one of the AGI limits, a special ordering process will determine the allowable deduction (see IRS Publication 526 and consult your tax advisor).

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A common question for investors who wish to donate to charitable organizations is whether to gift cash or securities. With the recently extended IRA Charitable Rollover, the issue is further complicated for those IRA owners age 70½ and older. Should they donate cash from their savings, securities from an investment portfolio, or cash directly from their IRA?

Note: ATRA recently extended the IRA Charitable Rollover (also referred to as a Qualified Charitable Distribution), which allows IRA owners age 70½ and older to make direct gifts up to $100,000 to a qualified charity through 2013. Importantly, these direct gifts may satisfy the IRA owner's Required Minimum Distribution (RMD).

To illustrate the true economic cost of giving, let's turn to an example. We will assume John and Jane Doe, both in their early 70s, have a federal marginal tax rate of 33% and they itemize their deductions. Their long-term capital gains rate is 15%. John has a large Traditional IRA and will be required to take his first RMD of $50,000 this year. The RMD will increase their AGI to $325,000. They also have a sizeable taxable investment account, which includes appreciated XYZ stock valued at $50,000 (the cost-basis is $10,000 and the embedded gain is long-term). Lastly, they have a considerable amount of money in a savings account. The Does have decided to make a current gift of $50,000 to a local non-profit organization and wish to determine the most tax-efficient way to achieve this.

For the purpose of this analysis, we are going to explore three different options. The Does can write a check from their savings account (Option 1), donate appreciated stock (Option 2), or make a direct gift from John's IRA under the IRA Charitable Rollover (Option 3).

	Option 1	**Option 2**	**Option 3**
$50,000 Gift	Cash	Appreciated Securities	IRA Charitable Rollover

Option 1: Gift $50,000 in Cash

In Option 1, the Does decide to donate cash in the amount of $50,000. Their itemized deductions will increase by the entire $50,000, since the gift amount falls below 30% of their AGI. We will assume, however, that they lose a small amount of this deduction due to the Pease phasesout and their higher AGI floor (miscellaneous itemized deductions and healthcare costs are deductible only above certain AGI thresholds). Therefore, if we apply a slight offset of $1,000 to their charitable deduction, the Does are able to recoup about $16,170 ($50,000 - $1,000 x 33%) in the form of lower taxes from this charitable gift. After adding these savings back, we get a true cost of the cash gift of $33,830.

Option 2: Gift $50,000 of Appreciated Stock

In Option 2, the Does donate their $50,000 of XYZ stock. Just as in the previous scenario, the gift yields them a net tax savings from the deduction of $16,170. However, they have also avoided paying capital gains taxes on the embedded long-term gain. After adding back $16,170 from the deduction and $6,000 in capital gains tax avoided, the real cost of the stock gift is $27,830.

Option 3: Gift $50,000 via IRA Charitable Rollover

In Option 3, the Does donate $50,000 directly from John's IRA in lieu of taking his RMD. Because he doesn't have to treat this distribution as taxable income, they are not able to take a charitable deduction. Under this scenario, however, they minimize their AGI and avoid ordinary income taxes of $16,500 on their RMD. This gives the Does a net cost of the IRA gift of $33,500.

	Option 1	Option 2	Option 3
Gift	**Cash**	**Appreciated Securities**	**IRA Charitable Rollover**
Gross Gift	$50,000	$50,000	$50,000
Deduction Offset	($16,170)	($16,170)	-
Capital Gains Savings	-	($6,000)	-
Income Taxes Saved	-	-	($16,500)
Net Cost of Gift	*$33,830*	*$27,830*	*$33,500*

Under these circumstances, donating the appreciated stock minimizes the economic cost of the Does' $50,000 charitable contribution. The combination of a current tax deduction *and* avoiding capital gains taxes on the low-basis stock makes this an attractive gifting strategy. Generally, the greater the gain and the higher the assumed capital gains rate, the more advantageous this strategy will be for the donor. On the other hand, in situations where the donor does not itemize deductions or is opposed to donating appreciated securities, the IRA Charitable Rollover may be the better solution. There would be no deduction benefit, but the IRA owner would avoid paying ordinary income taxes on the portion of the RMD that was directed to charity.

Of course, some might question the economic advantages of donating appreciated stock if the company is expected to continue to perform well. In this case, the client may use their cash to purchase the same amount of shares at the time of the gift. This will maintain their investment position in the security and also increase the cost-basis to the current market value. Another important caveat to donating appreciated stock is that the family might get an increased cost-basis upon the death of the owner. If a donor is in poor health, it may be in the best interest of the family to choose one of the other options. With respect to the IRA Charitable Rollover, it is important to reiterate that only IRA owners who have attained age 70 ½ are eligible, and the provision is due to expire on December 31, 2013.

> Note: The IRS requires donors to maintain proper records for any monetary gift amount. Also, a donor cannot deduct contributions of $250 or more unless a written acknowledgement is obtained from the recipient organization. This acknowledgement should include the statement that *no goods or services were provided by the organization in return for the contribution,* if that was the case (IRS Publication 1771).

While we have focused on donating cash and securities from investment accounts and minimizing the costs of such gifts, there are many other strategies that may be worth pursuing with your tax accountant or trust and estate attorney. A plan that achieves your philanthropic objectives and also maximizes current and future wealth through sound income and estate tax planning is preferable. Strategies may include the use of charitable trusts, donor advised funds, charitable gift annuities, and private foundations, among others.

2013 Important Financial Data

2013 Tax Rate Schedule	
Taxable Income	Marginal Rate
Single	
$0 to $8,925	10%
$8,926 to $36,250	15%
$36,251 to $87,850	25%
$87,851 to $183,250	28%
$183,251 to $398,350	33%
$398,351 to $400,000	35%
$400,001 +	39.6%
Married Filing Jointly & Surviving Spouse	
$0 to $17,850	10%
$17,851 to $72,500	15%
$72,501 to $146,400	25%
$146,401 to $223,050	28%
$223,051 to $398,350	33%
$398,351 to $450,000	35%
$450,001 +	39.6%
Head of Household	
$0 to $12,750	10%
$12,751 to $48,600	15%
$48,601 to $125,450	25%
$125,451 to $203,150	28%
$203,151 to $398,350	33%
$398,351 + $425,000	35%
$425,001 +	39.6%
Married Filing Separately	
$0 to $8,925	10%
$8,926 to $36,250	15%
$36,251 to $73,200	25%
$73,201 to $111,525	28%
$111,526 to $199,175	33%
$199,176 to $225,000	35%
$225,001 +	39.6%
Estates and Trusts	
$0 to $2,450	15%
$2,451 to $5,700	25%
$5,701 to $8,750	28%
$8,751 to $11,950	33%
$11,951 +	39.6%

Capital Gains Tax Rates	
Short-term (held 1 year or less)	Same as ordinary income
Long-term (held > 1 year):	
If income falls in 10% or 15% brackets	0%
If income falls in 25%,28%,33%, or 35% brackets	15%
If income falls in 39.6% bracket	20%
Unrecaptured gains on Section 1250 property	25%
Collectibles	28%
Qualified Dividend Income Tax Rates	
If income falls in 10% and 15% brackets	0%
If income falls in 25%,28%,33%, and 35% brackets	15%
If income falls in 39.6% bracket	20%
Income Tax Deductions and Exemptions	
Standard Deduction	
Single	$6,100
Married filing jointly	$12,200
Head of household	$8,950
Over age 65 or blind additional standard deduction	
Married or surviving spouse	$1,200
Single or not a surviving spouse	$1,500
Itemized deduction may be reduced by 3% of every dollar that exceeds certain AGI thresholds	
Personal exemption	$3,900
Personal exemption may be reduced by 2% for every $2,500 that exceeds certain AGI thresholds	
Retirement Plan Contribution Limits	
401(k), 403(b), 457 plans elective deferrals	$17,500
Catch-up contributions for 50 and older	$5,500
Defined contribution plans	$51,000
Defined benefit plans	$205,000
SIMPLE plans elective deferrals	$12,000
Catch-up contributions for 50 and older	$2,500
Traditional and Roth IRA	$5,500
Catch-up contributions for 50 and older	$1,000
Traditional IRA deductibility for active participants	Phaseout Limits:
Single	$59,000 to $69,000
Joint	$95,000 to $115,000
Spousal IRA if one spouse is covered by a plan	$178,000 to $188,000
Married filing separately	$0 to $10,000
Roth IRA income phaseout	
Single	$112,000 to $127,000
Joint	$178,000 to $188,000
Married filing separately	$0 to $10,000

Estate and Gift Tax	
Annual gift tax exclusion	$14,000
Estate and gift tax exclusion	$5,250,000
Maximum estate tax rate	40%

New Medicare Surtaxes

0.9% on wages that exceed $200,000 (single filers) or $250,000 (joint filers)

3.8% on net investment income that falls above MAGI of $200,000 (single filers) or $250,000 (joint filers)

Medicare			
Part A Hospitalization			
First 60 days inpatient deductible		$1,184	
Days 61 - 90		$296 per day	
Days 91 +		$592 per day, up to 60 days over lifetime, then full amount per day	
Part B Premium			
MAGI Single	MAGI Joint	Part B Monthly Premium	Part D Increase
$85,000 or less	$170,000 or less	$104.90	$0
$85,001 to $107,000	$170,001 to $214,000	$146.90	$11.60
$107,001 to $160,000	$214,001 to $320,000	$209.80	$29.90
$161,001 to $214,000	$320,001 to $428,000	$272.70	$48.30
$214,001 +	$428,001 +	$335.70	$66.60
Part B Deductible	$147		
Coinsurance	20% of Medicare-approved amount		

Long Term Care Insurance: Potential Deductibility of Premiums for Qualified Policies (medical expenses are subject to % of AGI thresholds)	
Age	Amount of premium that may be treated as a medical expense
40 or less	$360
41 to 50	$680
51 to 60	$1,360
61 to 70	$3,640
71 +	$4,550

Source: www.irs.gov, IRS Rev. Proc. 2013-15, IR-2012-77, Centers for Medicare & Medicaid Services

This is for informational purposes only and should not be interpreted as tax or investment advice. Consult your tax professional for specific tax advice about your personal situation.