

REVIEW CHARITABLE GIVING IN LIGHT OF NEW TAX ACT

Taxpayers who donate to their favorite charities – particularly more affluent donors – should review their charitable giving plans in light of the new tax act. While the Jobs and Growth Tax Relief Reconciliation Act does not directly alter any charitable planning laws, the reduction of ordinary income tax rates and capital gains and dividend tax rates will have an impact on *how* you design a charitable giving program.

As with many tax law changes, there are positives and negatives. On the one hand, donating to charities has become, in one way, more expensive for taxpayers. For example, a taxpayer in the highest tax bracket in 2002, which was 38.6 percent, who donated \$10,000 in cash to a charity, saved \$3,860 in federal income taxes. Or looked at in reverse – it *cost* the taxpayer \$6,140 out of pocket to make the \$10,000 gift. With the top rate lowered to 35 percent for 2003, it will cost the taxpayer \$6,500 out of pocket to make the same gift – an increase of \$360. On the other hand, the new lower tax rates means taxpayers end up with more after-tax dollars in their pockets, giving them that much more to donate to charity.

The new tax act also has an impact on decisions involving the donation of appreciated assets such as stocks, bonds and real estate that have a low cost basis. The act lowered the maximum capital gains on financial securities such as stocks and bonds from 20 percent to 15 percent. As with the case of the lower ordinary income tax rates, that means it costs you more to gift such assets. Yet you're usually still better off donating, say, appreciated stock rather than selling it first, paying 15 percent to taxes, then donating the remaining cash to the charity.

The new act also raises the question of whether you might do better donating other appreciated assets. For example, any capital gains on collectibles, such as artwork or antiques, or other personal tangible property such as jewelry, remain taxed at 28 percent. Thus, you'd receive a better tax break donating a \$10,000 painting than \$10,000 in stocks, assuming each has the same amount of capital gains.

The main hitch here is that you can deduct the fair market value of the asset only if the gift is related to the mission of the charity – for example, donating a painting to an art museum. Donate the painting to your church, on the other hand, and you can deduct only your adjusted basis for the painting.

Real estate also may be a more tax-valuable gift than stocks or bonds. That's because the difference between the original cost basis of the real estate and the amount deducted previously for depreciation is subject to a 25 percent recapture tax, which you can avoid through donation. Keep in mind, however, that the real estate must be un-mortgaged.

Popular charitable vehicles such as charitable remainder trusts (CRTs) and charitable gift annuities also should be reexamined. Donors with CRTs, which pay out income to the donor with the remaining assets eventually passing to the charity, may want to consider shifting the trust's asset mix more heavily into stocks to take advantage of the lower capital gains and dividend tax rates, though they also have to consider the added investment risk.

Charitable gift annuities, in which the charity pays out an annuity based on the donor's gift, may look even more attractive than CRTs. With CRTs, the highest-taxed income – usually ordinary income – is distributed first. With a charitable gift trust, capital gains and dividend income figure into a larger portion of each payment than they would under a CRT. Thus, with the lower capital gains rates, donors end up with a larger after-tax payout.

Another charitable trust to review is the charitable lead trust, whose income goes to the charity and whose remaining assets eventually pass to non-charitable heirs. Some experts think that the lower individual tax rates may make what's called a "non-grantor" version of CLTs more attractive than a "grantor" trust.

Even with the lower tax rates on gains and dividends, it generally still makes tax sense to donate appreciated property. But exactly how to do it best can be complicated, so consult with your CERTIFIED FINANCIAL PLANNER™ professional or other charitable expert to see which strategy works best for you under the new tax act.

September 2003 – This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by Bill Rodau, MS, MBA, CFP® at *Creative Financial Services*, 262-820-0870, www.cfsfeonly.com, a local member in good standing of the FPA.