



Tax Implications of the Next President

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“It ain’t what you don’t know that gets you into trouble. It’s what you know for sure that just ain’t so.” The Oscar Award winning 2015 film “The Big Short” opens with these words attributed to Mark Twain. Ironically enough, scholars at the Center for Mark Twain Studies of Elmira College have found no substantive evidence that Mark Twain ever said them.

In this article we will speculate and offer commentary about impending changes to Federal tax policy and the possible impacts on charitable giving. However, written on the eve of America’s transition to the Biden/Harris administration and the beginning of the 117th Congress, there’s a good chance that parts of it will pass into the category of “things we know for sure that just ain’t so.”

Nevertheless, it is worth exploring some of the potential tax proposals with a focus on those that could have a direct impact on charitable gift planning and to consider strategies and ways in which donors might adapt their giving to accommodate new tax realities because, as the management guru Peter Drucker said, “The best way to predict the future is to create it.”

At this point, the best indicator of future tax policy can be found in the positions articulated during the campaign. Although the President can advocate, it is Congress – specifically the Ways and Means Committee of the House of Representatives – that will draft tax legislation which must pass both the House and the Senate before the President can enact it. Since the President Elect’s party will control the House of Representatives, it is most likely that the Ways and Means Committee will give significant weight to his proposals.

It is also important to bear in mind the environment in which new tax policy will be formed. The ongoing pandemic and continuing economic turbulence demand increased and costly Federal responses. At the same time, Federal budget deficits and the accumulated debt are at record levels. Any new tax proposals will be driven by an overriding need for increased revenue.

Federal Income Tax

Future tax policy will almost certainly be more progressive, increasing taxes more for those in the upper income ranges and relatively less for those lower on the income scale. During the campaign, President Biden repeatedly promised that there would be no tax increases for those making less than \$400,000. As always, the devil is in the details. The following is a short summary of some of the income tax proposals.

- **Restore 39.6% tax rate** – The Tax Cuts and Jobs Act of 2017 eliminated the 39.6% income tax rate, reduced most other rates, and expanded the ranges for some brackets. In its final year, the 39.6% rate applied to single filers with income over \$418,400 and married couples filing jointly with income over \$470,700. Simply restoring the 39.6% rate for top incomes would generate additional revenue, honor the campaign pledge to those making under \$400,000, and be viewed as a progressive step.
- **Recalibrate tax brackets** – A married couple filing jointly in 2021 enters the top bracket (37%) only after they surpass \$628,300 in taxable income. In addition to restoring the 39.6% rate, lowering the dollar thresholds, especially those at which the upper tax brackets begin, would generate additional revenue and, again, be a progressive step.
- **Limit tax savings for itemized deductions** – Itemized deductions generate tax savings at the taxpayer's top marginal income tax rate. One proposal would limit these tax savings to a maximum rate of 28% regardless of the taxpayer's actual top marginal rate. (Interestingly, the Tax Cuts and Jobs Act of 2017 reduced the 28% income tax rate to 24%, but the proposal suggests a 28% cap – perhaps a harbinger of future income tax rate adjustments.)
- **Revise capital gains tax** – Under current law, long term capital gains are taxed at a rate of 15% for most taxpayers and 20% for those in the highest income ranges (and a 0% rate for the lowest income tax brackets). Among the proposals is one that would create a 39.6% long term capital gains rate for those with taxable income of \$1 million or more.

Gift and Estate Tax

Given that about one-tenth of one percent of Americans pay the Federal Gift and Estate tax, it seems certain that progressive tax reformers will set their sights on the Gift and Estate Tax. Under current law for a taxpayer who dies during 2021, the first \$11,700,000 in accumulated lifetime taxable gifts plus the value of transfers at death is exempt from Gift and Estate Taxes. Any amount over this threshold is taxed at a flat rate of 40%. The exemption amount is adjusted each year for inflation, and any unused exemption can be transferred to a surviving spouse. Among the proposals under discussion is one that would lower the exemption amount, thereby decreasing the amount that can be transferred tax free. In addition, there is discussion of increasing the Gift and Estate Tax rate and changing the taxation of capital gains when appreciated property is passed on to heirs.

- **Reduce exemption** – A proposal would reduce the Gift and Estate Tax exemption amount from \$11.7 million to a maximum of \$3.5 million for transfers at death including up to \$1 million in lifetime transfers.
- **Increase tax rate** – The Gift and Estate Tax Rate would increase from 40% to 45%, significantly higher than the top income tax rate.
- **Eliminate stepped-up basis** – Currently, an individual who sells inherited appreciated property pays capital gains tax only on the appreciation that has accumulated since the date of death. A proposal would eliminate this step-up in cost basis, which means, upon sale, the heir would pay capital gains tax on all appreciation since the property was acquired by the decedent.

Sunset of the Tax Cuts and Jobs Act

As the debate over tax policy unfolds, it is important to keep in mind that most of the changes wrought by the Tax Cuts and Jobs Act of 2017 (TCJA) will expire at the end of 2025. The sunset provision was an important part of the legislative strategy, and the intention was that Congress would find a way to overcome the sunset clause before 2026 rolls around. It is difficult to foresee how the sunset of the TCJA will be addressed, especially given demands for Federal revenue and a political cycle that could include another Trump for President campaign. One option is no action at all, in which case much of the TCJA will expire as planned. However, another option would be for Congress to selectively accelerate the expiration of some of the provisions of the TCJA.

Considerations for donors

Historical data from the Giving USA annual survey of charitable giving indicates that elections and changes in political control do not have an immediate impact on charitable giving. Giving is more highly correlated with economic conditions than either the party in power or the stock market. Nonetheless, we close with some thoughts about strategies your donors may wish to consider.

- **Income tax rates and brackets** – Restoration of the previous top tax rate or adjustments to tax brackets would increase income taxes for many taxpayers – especially those in the higher ranges. However, it would also increase the value of the charitable deduction and, therefore, reduce the donor's after-tax cost of giving. If they anticipate higher income taxes, donors might be tempted to postpone their gift decisions to maximize their tax savings.
- **Capital gains tax** – If long-term capital gains become subject to increased taxation, the advantages of a contribution of appreciated property will be multiplied (assuming that the exemption for charitable contributions remains, and there is no reason to expect otherwise).
- **Estate tax** – It seems inevitable that many more donors will find themselves confronting the Estate Tax, and probably at a tax rate much higher than the highest income tax rate.

Reminding donors that there is an unlimited charitable deduction for the Estate Tax and showing them the substantial Income Tax and Estate Tax benefits of testamentary contributions of qualified retirement plans would be in order. For select donors, consider opening a conversation about the Gift and Estate Tax savings and other benefits of charitable lead trusts.

Universal Charitable Deduction

Finally, a note about the Universal Charitable Deduction. With leadership from the National Association of Charitable Gift Planners, there has been growing momentum to allow all donors, not just those who itemize, to benefit from an income tax deduction for their charitable contributions. The CARES Act of 2020 included a modest \$300 deduction for non-itemizers who made cash contributions to public charities, but it was for tax year 2020 only. While the sector continues to work toward the Universal Charitable Deduction, this provision may have difficulty gaining traction in the current fiscal environment. That being said, some speculate that Congress may choose to encourage philanthropy during the ongoing pandemic by extending the \$300 deduction for non-itemizers, as well as the special 100% of AGI limit on the deduction for gifts of cash to public charities, through 2021.

Conclusion

The Federal tax system has always been a work in progress, and further change is inevitable in the coming years. Whatever the future may bring, we know that your donors give because of their belief in your mission and that good gift planning will increase the quantity and quality of their gifts. We will remain on the alert for tax changes that could affect your donors and your program to help you make the very best of every charitable gift.

Tax Proposals (updated 12/10/2020)

| Proposal | | Notes | Gift Planning Considerations |
|------------|--|--|---|
| Income Tax | | | |
| 1) | Increase income taxes for high income taxpayers: reinstate top income tax rate; restore some or all income tax rates to pre-TCJA levels; adjust tax brackets | <ul style="list-style-type: none"> • Current law: top rate is 37% starting at \$628,301 for a married couple filing jointly in 2021 • Increasing tax rates and/or lowering tax brackets increases the value of the charitable deduction and decreases the after-tax cost of giving | <ul style="list-style-type: none"> • Donors may delay giving to take advantage of greater tax savings • Careful bunching of gifts could take advantage of years when tax savings are greater • Qualified Charitable Distributions remain an attractive option for those age 70½ or older, especially those who do not itemize deductions |
| 2) | Limit value of itemized deductions to 28% | <ul style="list-style-type: none"> • Current law: itemized deductions save income taxes at the taxpayer's marginal rate • Capping the value of itemized deductions would limit the value of the charitable deduction for donors whose marginal tax rate is greater than 28% | <ul style="list-style-type: none"> • High income donors may consider making more gifts prior to enactment • Even with a cap, appreciated property gifts will continue to generate significant tax savings |

Tax Proposals (updated 12/10/2020)

| Proposal | | Notes | Gift Planning Considerations |
|----------|--|---|---|
| 3) | Increase capital gains taxes for high income taxpayers | <ul style="list-style-type: none"> Current law: long term capital gains taxed at 20% maximum, 15% for most taxpayers Proposal would tax long-term capital gains at the top income tax rate (37% or perhaps 39.6%) for taxpayers with income greater than \$1 million | <ul style="list-style-type: none"> Gifts of appreciated property become even more appealing to very high income donors due to greater tax savings A bargain sale could produce a charitable deduction to offset some of the increased capital gains tax A charitable remainder trust could avoid payment of capital gains tax on the sale of appreciated assets and provide income for the donor or others |
| 4) | Resurrect Pease limitation on itemized deductions | <ul style="list-style-type: none"> Current law: no reduction in itemized deductions for donors with AGI over a threshold amount Proposal would bring back the "Pease" limitation: Taxpayers with AGI over a certain threshold must reduce itemized deductions by 3% of excess. Itemized deductions can be reduced up to 80% | <ul style="list-style-type: none"> Total value of itemized deductions reduced, but tax savings from charitable deductions may or may not be affected. Depends on amount of other deductions. |

Tax Proposals (updated 12/10/2020)

| Proposal | Notes | Gift Planning Considerations |
|---------------------|--|---|
| Gift and Estate Tax | | |
| 1) | <p>Increase scope and amount of estate tax: reduce Gift & Estate Tax exemption amount; increase Gift and Estate Tax rate</p> | <ul style="list-style-type: none">• Current law: (in 2021) a total of \$11.7 million in accumulated lifetime taxable gifts plus transfers at death is exempt from tax; excess is taxed at 40%• Proposal would reduce the exemption amount to a total of \$3.5 million with a maximum of \$1 million in lifetime taxable gifts and increase the Gift and Estate Tax Rate to 45% |
| | | <ul style="list-style-type: none">• Charitable gifts made during life reduce the size of the taxable estate (while producing income tax deductions)• Charitable bequests avoid estate tax and reduce the size of the taxable estate• A charitable lead trust funded either during lifetime or at death produces Gift and Estate Tax deductions and reduces the size of taxable estate |

Tax Proposals (updated 12/10/2020)

| Proposal | | Notes | Gift Planning Considerations |
|----------|---|---|---|
| 2) | Increase capital gains taxes by eliminating stepped-up basis for transfers at death | <ul style="list-style-type: none"> • Current Law: Heirs who inherit appreciated property receive a step up in cost basis and therefore pay capital gains tax only on appreciation accumulated after the date of death • Proposal: transfers at death would be treated the same as lifetime gifts: heirs would inherit the decedent's cost basis resulting in increased capital gains tax when the heir sells the property | <ul style="list-style-type: none"> • Heirs could become prospects for lifetime gifts of the inherited appreciated property • A carefully planned bargain sale could produce a charitable deduction to offset some of the capital gains tax • Charitable remainder trust could avoid payment of capital gains tax on the sale of appreciated assets and provide income to the heir or other individuals |