THE
ESTATE PLANNER

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Charitable giving in 2021

Plan carefully to maximize the tax benefits

In the early days of the COVID-19 pandemic, lawmakers enacted the CARES Act to provide some relief to the ailing economy. One of its provisions, meant to encourage charitable giving, temporarily suspended limits on tax deductions for certain charitable gifts made in 2020.

More recently, the Consolidated Appropriations Act (CAA) extended this relief to charitable gifts made in 2021. The CARES Act also created a temporary charitable deduction for non-itemizers, which was extended through 2021 (and expanded) by the CAA. (See "Above-the-line charitable deduction for non-itemizers" on page 3.)

If you're willing and able to make charitable donations, be sure to study the tax implications carefully. Unlimited charitable deductions — which theoretically enable you to reduce your 2021 tax bill to zero — may be appealing, but for some people a more measured approach can lead to more favorable tax results.

Deduction limit increased to 100% of AGI

Ordinarily, if you itemize, you're permitted to deduct charitable gifts up to a specified percentage of your adjusted gross income (AGI). Excess gifts may be carried forward and deducted (subject to applicable limits) for up to five years.

The AGI percentage varies depending on the type of assets donated and the type of charitable organization that receives them. For example, cash donations to religious organizations, educational institutions, donor-advised funds, supporting organizations and other public charities are generally limited to 50% of AGI, while gifts of capital gain property, such as appreciated stock or real estate, are generally limited to 30% of AGI.

Above-the-line charitable deduction for non-itemizers

Charitable deductions are usually available only to those who itemize deductions, but the CARES Act provided non-itemizers with an above-the-line deduction — that is, a deduction from gross income in arriving at adjusted gross income — of up to $300 for cash gifts to public charities other than donor-advised funds or supporting organizations. The act was ambiguous as to whether joint filers were entitled to a $600 deduction, but the Form 1040 instructions for 2020 made clear that the deduction limit was $300 for both individuals and joint filers.

The Consolidated Appropriations Act extended the deduction for non-itemizers through 2021. It also provided that joint filers who don't itemize are entitled to deduct up to $600 in eligible charitable gifts.

The deduction limits for gifts of cash and capital gain property to private foundations are 30% and 20% of AGI, respectively. The Tax Cuts and Jobs Act increased the limit for cash gifts to public charities to 60% for gifts made through 2025.

When you use charitable gifts to reduce your taxable income to zero, a portion of those gifts offset income that would otherwise have been taxed at low rates, essentially diminishing their tax-saving power.

For gifts made in 2020, the CARES Act gave taxpayers the option of deducting "qualified charitable contributions" up to 100% of AGI, and the CAA extended the 100% limit to gifts made through the end of 2021. Qualified charitable contributions generally include cash gifts to public charities other than donor-advised funds or supporting organizations.

Should you erase your tax bill?

If you have the resources and the desire to make substantial charitable gifts, in theory, you can make a qualified charitable contribution large enough to offset all of your taxable income in 2021 and reduce your tax bill to zero. That may be an enticing proposition, but it's not the most effective way to generate tax savings.

The reason being is because when you use charitable gifts to reduce your taxable income to zero, a portion of those gifts offset income that would otherwise have been taxed at low rates, essentially diminishing their tax-saving power. In most cases, you're better off preserving a portion of these deductions for future years, when they can be offset against higher-taxed income.

Consider this example: Ben and Geri, a married couple in their late 50s with taxable income of $450,000 per year, wish to make a $450,000 cash donation to a local hospital. Without the charitable deduction, they would be in the 35% tax bracket, with a tax bill of $106,589. So, if they donate $450,000, they'll save $106,589 in taxes.

Another approach would be for Ben and Geri to donate enough to bring their tax bracket down to 12%. This year, the top end of that bracket is $81,050, so that would mean donating $368,950 this year and the remaining $81,050 next year.

Presuming for illustrative purposes that a) this is the only charitable contribution that they're considering,

b) their deductions other than the charitable contributions would allow them to itemize, and c) the 2021 tax rates are used for the 2022 calculations, the couple's tax bill is $9,328 in 2021 and $79,718 in 2022, for a total tax savings of $124,132 [a $97,261 tax reduction in 2021 ($106,589 – $9,328) and a $26,871 tax reduction in 2022 ($106,589 – $79,718)].

What if it's important to Ben and Geri to donate the full $450,000 this year? In that case, they could simply elect not to treat the gift as a qualified charitable contribution. The normal limits, 60% of their adjusted gross income, would apply, meaning that any amount that went unused this year would be carried forward to next year. Presuming their tax picture — other than the charitable contribution — is the same in both years, their total tax savings over the two years would be $128,941.

Do the math

If you're thinking about taking advantage of 100% of AGI charitable deductions, be sure to do the math and determine whether there are more tax-efficient options. As the above example illustrates, most people are better off spreading out charitable deductions over two or more years. With the possible exception of taxpayers with income well into seven figures, offsetting all of your income in one year usually isn't the best strategy.

Is it time to review your beneficiary designations?

A will or revocable trust may form the core of your estate plan, but for most people, a substantial amount of wealth bypasses these traditional estate planning tools and is transferred to their loved ones through beneficiary designations. These "nonprobate assets" may include IRAs and certain employer-sponsored retirement accounts, life insurance policies, and some bank or brokerage accounts.

Too often, people designate a beneficiary when they acquire a nonprobate asset and then forget about it. But over time, these beneficiary designations may become inappropriate or obsolete as a result of changes in life circumstances (such as divorce, death of a beneficiary, or the birth of a child or grandchild), estate planning goals or tax laws. So, it's a good idea to review beneficiary designations periodically — or when circumstances change — and update them if necessary.

As you conduct this review, consider the following best practices and potential pitfalls:

Name a primary beneficiary and at least one contingent beneficiary. Without a contingent beneficiary for an asset, if the primary beneficiary dies before you — and you don't designate another beneficiary before you die — the asset will end up in your general estate and may not be distributed as you intended. In addition, certain assets, including retirement accounts, offer some protection against your creditors, which would be lost if they're transferred to your estate. To ensure that you control the ultimate disposition of your wealth and protect that wealth from creditors, it's important to name both primary and contingent beneficiaries and to avoid naming your estate as a beneficiary.

approach may be to establish a special needs trust for your loved one and name the trust as beneficiary.

Keep an eye on tax developments. Changing tax laws can easily derail your estate plan if you fail to update your plan accordingly. For instance, the SECURE Act, passed in late 2019, sounded the death knell for the "stretch" IRA. Previously, when you left an IRA to a child or other beneficiary (either outright or in a specially designed trust), distributions could be stretched out over the beneficiary's life expectancy, maximizing tax-deferred savings. But the SECURE Act now requires most nonspousal beneficiaries of IRAs to distribute the funds within 10 years after the owner's death.

Designating a beneficiary isn't a "set it and forget it" activity.

In light of this change, you should review the designated beneficiaries for your IRAs and other retirement accounts, evaluate the impact of the SECURE Act on these beneficiaries, and weigh your options. For example, you might consider naming different individual beneficiaries or leaving IRAs to a charitable remainder trust or other vehicle that mimics the benefits of a stretch IRA.

To avoid unintended consequences, review your beneficiary designations regularly to make sure they're still appropriate and that they align with your overall estate planning goals.

Update beneficiaries to reflect changing circumstances. Designating a beneficiary isn't a "set it and forget it" activity. Failure to update beneficiary designations to reflect changing circumstances creates a risk that you will inadvertently leave assets to someone you didn't intend to benefit, such as an ex-spouse.

It's also important to update your designation if the primary beneficiary dies, especially if there's no contingent beneficiary or if the contingent beneficiary is a minor. Suppose, for example, that you name your spouse as primary beneficiary of a life insurance policy and name your minor child as contingent beneficiary. If your spouse dies while your child is still a minor, it's advisable to name a new primary beneficiary to avoid the complications associated with leaving assets to a minor (court-appointed guardianship, etc.).

Consider the impact on government benefits. If a loved one depends on Medicaid or other government benefits (a disabled child, for example), naming that person as primary beneficiary of a retirement account or other asset may render him or her ineligible for those benefits. A better

What a difference six months can make

An alternate valuation date can reduce estate tax liability

If you have money invested in the stock market, you're well aware of potential volatility. Needless to say, this volatility can affect your net worth, thus affecting your lifestyle. Something you might not think about is the potential effect on your estate tax liability. Specifically, your family might unexpectedly owe estate tax on your death if it occurs before the value of stocks or other assets drops precipitously. One strategy to ease estate tax liability is to allow your executor to elect to use an alternate valuation date.

Alternative valuation date eligibility

Typically, assets owned by the deceased are included in his or her taxable estate, based on their value on the date of death. For instance, if an individual owned stocks valued at $1 million on the day when he or she dies, the stocks are included in the estate at a value of $1 million.

Despite today's favorable rules that allow a federal gift and estate tax exemption of $11.7 million, a small percentage of families still must contend with the federal estate tax. However, the tax law provides some relief to estates that are negatively affected by fluctuating market conditions. Instead of using the value of assets on the date of death for estate tax purposes, the executor may elect an "alternate valuation" date of six months after the date of death. This election could effectively lower a federal estate tax bill.

This special election is permissible only if the total value of the gross estate is lower on the alternate valuation date than it was on the date of death. Of course, the election generally wouldn't be made otherwise. If assets are sold after death, the date of the disposition controls. The value doesn't automatically revert to the date of death.

Furthermore, the ensuing estate tax must be lower by using the alternate valuation date than it would have been using the date-of-death valuation. This would also seem to be obvious, but that's not necessarily true for estates passing under the unlimited marital deduction or for other times when the estate tax equals zero on the date of death.

Note that the election to use the alternate valuation date generally must be made with the estate tax return. There is, however, a provision that allows for a late-filed election.

All assets fall under alternate valuation date

The alternate valuation date election can save estate tax, but there's one potential drawback: The election must be made for the entire estate. In other words, the executor can't cherry-pick stocks to be valued six months after the

date of death and retain the original valuation date for other stocks or assets. It's all or nothing.

This could be a key consideration if an estate has, for example, sizable real estate holdings in addition to securities. If the real estate has been appreciating in value, making the election may not be the best approach. The executor must conduct a thorough inventory and accounting of the value of all assets.

Estate plan flexibility

If your estate includes assets that can fluctuate in value, such as stocks, it's important to let your executor know about the option of choosing an alternate valuation date. This option allows him or her flexibility to reduce the chances of estate tax liability. Contact your estate planning advisor for additional information.

ESTATE PLANNING RED FLAG

You and your spouse have elected to "split" gifts

Gift splitting can be a valuable estate planning tool, allowing you and your spouse to maximize the amount of wealth you can transfer tax-free. But in some cases, it can have undesirable consequences, so be sure that you understand the implications before making an election to split gifts.

Gift splitting is helpful if you wish to minimize taxes on gifts of separate property (as opposed to jointly owned or marital property). Suppose, for example, that in 2021 you give your child $30,000 in stock that's your separate property. The annual gift tax exclusion shields half of that amount from gift taxes, but the remaining $15,000 is taxable. However, if you and your spouse elect to split gifts, then half of the gift is deemed to be from your spouse and is shielded from tax by his or her annual exclusion.

It's important to understand that when you make an election to split gifts on a gift tax return, it applies to *all* gifts made by you or your spouse during the year. In some cases, this can have unintended consequences, especially if you plan to leverage the current $11.7 million federal gift and estate tax exemption amount. Because the exemption is scheduled to be cut in half after 2025, many people are taking advantage of the exemption by making large gifts to their loved ones before the current exemption sunsets in 2026. But if you elect to split gifts, you risk losing the benefit of the increased exemption.

Suppose that in 2021 you transfer interests in your separately owned business valued at $11.7 million to your children. If you and your spouse elect to split gifts this year, then each of you is deemed to have made a gift of $5.85 million. Assuming that the exemption amount drops to $5.85 million in 2026 (ignoring inflation adjustments) you and your spouse will both have used up your exemptions. Had you not split gifts in 2021, however, you would have enjoyed your full increased exemption amount, while preserving your spouse's $5.85 million exemption.

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