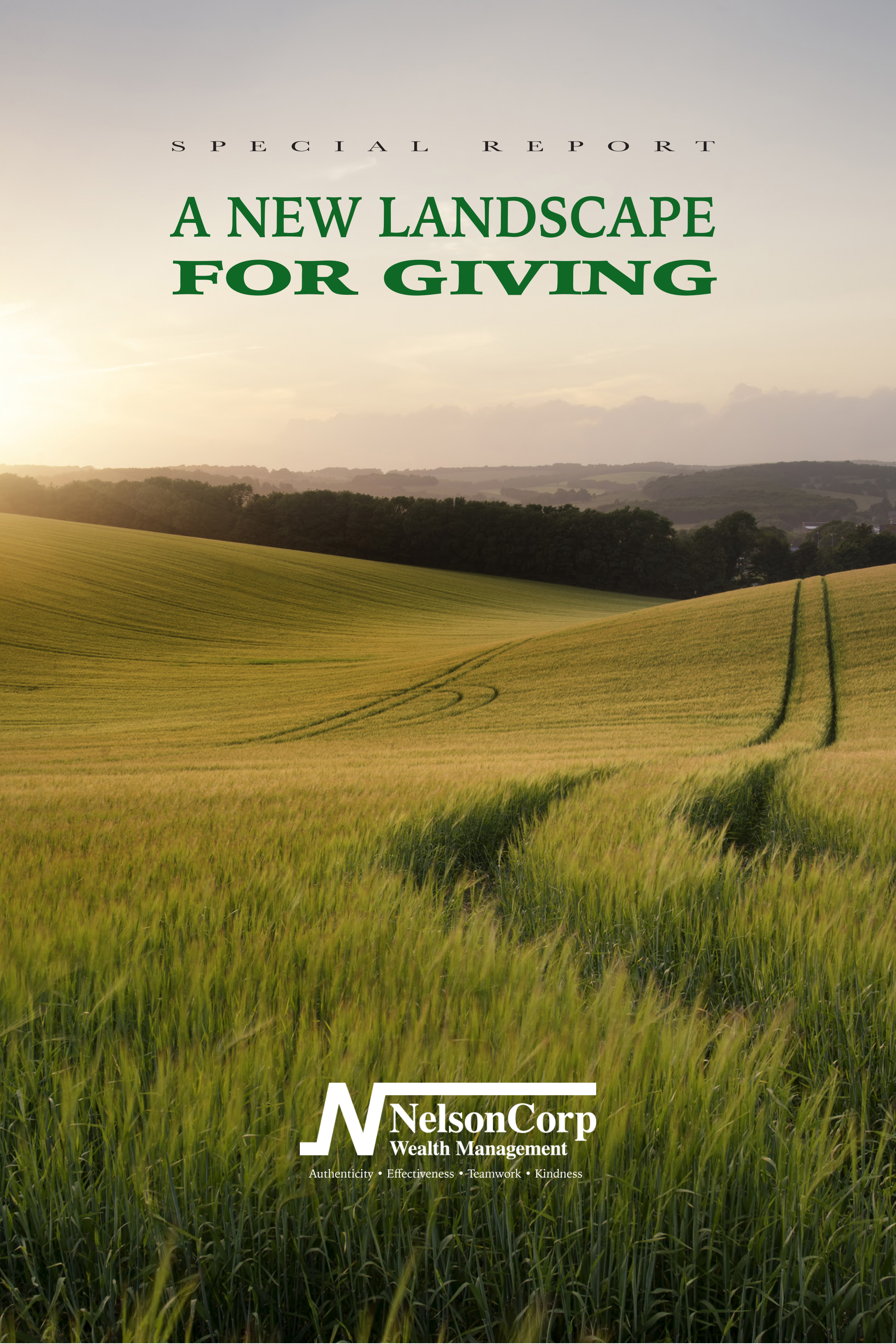
SPECIAL REPORT

A NEW LANDSCAPE FOR GIVING



NelsonCorp Wealth Management

Authenticity • Effectiveness • Teamwork • Kindness

“I resolved to stop accumulating and begin the infinitely more serious and difficult task of wise distribution.”

- Andrew Carnegie

INTRODUCTION

At NelsonCorp Wealth Management, we understand giving. One of our four core values is Kindness. For over 35 years we have improved our community by assisting our clients fund a variety of charitable efforts, as well as through our own giving efforts.

Another of our four core values is Effectiveness. We know that people give to make a difference. We know that people want to make their giving as impactful as possible. This means we have a responsibility to take great care in constructing thoughtful giving strategies. We use our knowledge and expertise to allow individuals to make gifts they might not otherwise have thought possible, or to make planned gifts go further than they realized they could.

Many of the tactics and tools available to assist individuals with their charitable goals have been impacted by recent tax changes. We created this report to help you understand what has changed and what opportunities currently exist.

WHY PEOPLE GIVE

> "The deed is everything, the glory naught."
>
> \- Johann Wolfgang von Goeth
>
> "When I do good, I feel good; when I do bad, I feel bad; and that's my religion."
>
> \- Abraham Lincoln
>
> "Helping people doesn't have to be an unsound financial strategy."
>
> \- Melinda Gates

As the quotes above illustrate, people give for many different reasons. Some of these are completely altruistic. We might give to others simply because they are less fortunate and we want to ease their burden. Some give because it makes them feel better. Another reason for giving is that there is a financial benefit involved. A great deal of giving involves a combination of these reasons.

Rarely would an individual make charitable gifts for the sole purpose of receiving a tax break. However, tax breaks can be an important consideration. Taking advantage of these types of financial benefits will be the focus of this report.

HOW PEOPLE GIVE

In 2017, individuals in the US gave nearly $287 billion dollars to charity[1]. That's a lot! And it isn't all just Warren Buffet and Bill Gates giving away their money. A lot of it is given by you and your neighbors.

These gifts go to organizations you care about. You give some to your church every week; the local school runs a fundraiser so you write them a check; you give money to the local organization where you volunteer doing stuff for people who need help with the stuff that you do for them. The cashier at the local grocery store asks if you want to give five dollars to help feed a family in need and you agree.

[1]Giving USA 2018: The Annual Report on Philanthropy for the year 2017

A LOT CAN HAPPEN IN A YEAR

All of this giving is wonderful and does an enormous amount of good in our communities. This giving by individuals is being done for the altruistic and feel good reasons listed previously. And since tax breaks are generally offered for charitable giving and everybody likes a good tax break, you diligently collect receipts and track your giving throughout the year so you can provide these necessities to your tax preparer come the following April.

Your belief, along with that of most others, is that your tax person will take all of that documentation and plug the numbers into their fancy software. Then, after some heroic number crunching and analyzing, at least to some small extent, your tax bill will be lowered.

This is mostly how it worked in the past, but the landscape has now changed. There are many out there who are unaware of these changes, and unfortunately, this is not one of those times where ignorance is bliss.

TAX CUTS AND JOBS ACT

Also known as TCJA, because who doesn't love a good acronym, the Tax Cuts and Jobs act of 2017 made lots of changes to all things tax. The biggest impact on the charitable giving boils down to three things: lower rates, higher standard deductions, and fewer itemized deductions. Fair warning, this section has lots of numbers and charts! If that is not your thing, feel free to skip to the "New Landscape for Giving" section.

LOWER MARGINAL RATES

Here is what lower marginal rates look like for a married couple:

Figure 1

2017 and Before		Current Rates	
Rate	Taxable Income	Rate	Taxable Income
10%	$0 to $19,050	10%	$0 to $19,050
15%	$19,051 to $77,400	12%	$19,051 to $77,400
25%	$77,401 to $156,150	22%	$77,401 to $165,000
28%	$156,151 to $237,950	24%	$165,001 to $315,000
33%	$237,951 to $424,950	32%	$315,001 to $400,000
35%	$424,951 to $480,050	35%	$400,001 to $600,000
39.6%	$480,051 or more	37%	$600,001 or more

Source: IRS

Most brackets ended up with lower rates. This makes charitable deductions slightly less valuable, thought it probably is not significant enough to influence your decision to give.

HIGHER STANDARD DEDUCTION

This is perhaps the item with the largest impact on the financial benefits of charitable giving for most people. Let's first consider what a deduction is. Let's say that you have $100,000 in taxable income. Without any deduction and using the current rates above, you would owe $13,879 in tax. However, there is good news. You do have deductions!

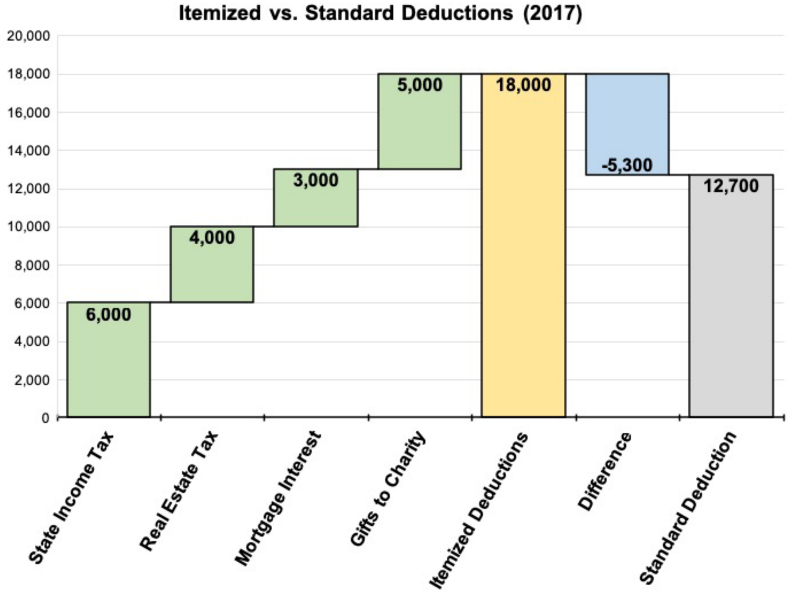
There are two approaches that you can take: use the standard deduction available to everyone, or itemize your deductions which lets you add up specific items allowable as deductions if they are more than the standard deduction (most charitable giving is handled as an itemized deduction). These deductions reduce your taxable income and your tax is calculated based on that lower amount. The standard deduction for a married couple was raised from $12,700 last year to $24,000. This means that in the above example of $100,000 of taxable income, you can now offset $24,000 of that reducing your taxable income to $76,000 and reducing your tax payment from $13,879 to $8,739.

With that understanding of deductions, we can now look at how this change affects the benefits of giving. To start with, let's look at the difference between standard and itemized deductions as they existed before 2018.

STANDARD VS. ITEMIZED DEDUCTIONS

This report won't discuss all itemized deductions (for more information, go to www.IRS.gov). For our example, we will just look at the most common itemized deductions: state income tax, real estate tax, mortgage interest, and gifts to charity. Figure 2 provides an illustration of a hypothetical married couple with some of each of these deductions.

Figure 2

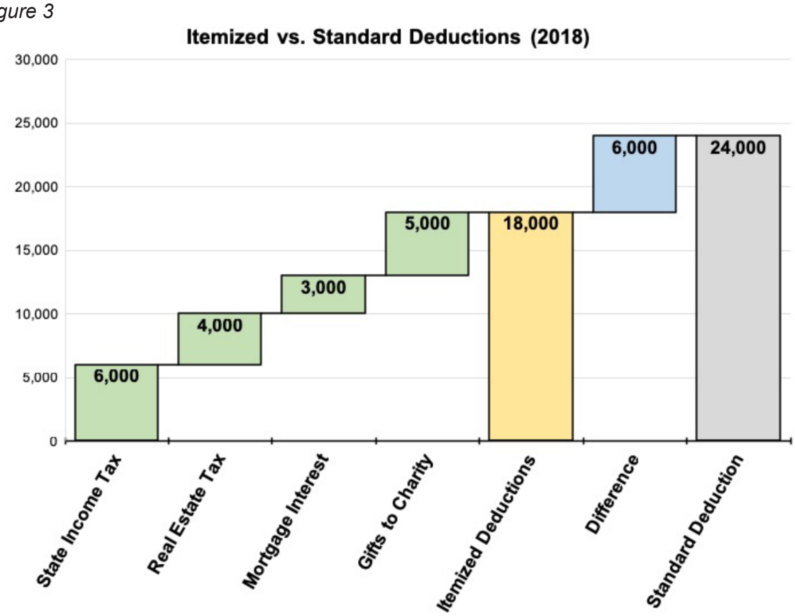


Source: IRS, NelsonCorp Wealth Managment

The gold bar shows total itemized deductions. The gray bar represents the available standard deduction. The blue bar shows the difference between these two. If the blue bar is a negative number, as is the case here, it means the itemized deductions are higher than the standard deduction. This is important because you can only deduct charitable contributions if you itemize deductions. If your standard deduction is higher, you can still feel good about giving, you just don't get a tax deduction for it.

Now let's fast forward to today. Remember we said that the standard deduction has increased to $24,000 for this married couple. If everything else stays the same, here is what the same example looks like:

Figure 3



Source: IRS, NelsonCorp Wealth Management

The gray bar (showing the standard deduction) is now much larger. And notice now that the blue bar showing the difference between standard and itemized deductions is positive, indicating that the standard deduction is larger. The blue bar shows a difference of $6,000, meaning that this household will not get any benefit out of additional itemized deductions until they fill up that $6,000. For example, if instead of $5,000, this couple gave $11,000 to charity, they would still get no additional tax benefits. If instead of $11,000 they gave $15,000, they would now get an additional $4,000 tax deduction because their itemized deductions would now be higher than the standard deduction by $4,000.

At the end of the day, this doesn't mean that you are paying more in tax than you were last year. What it does mean is that a lot of individuals who give money to charitable organizations are going to pay the same amount of tax whether they give that money or not. This is a different dynamic than in previous years where you might have been able to give a little more to your favorite charities because of the tax benefits you received. This is still possible, but it now takes more planning and effort. Before that discussion however, let's look at the last tax change with big impact on the financial benefits of giving.

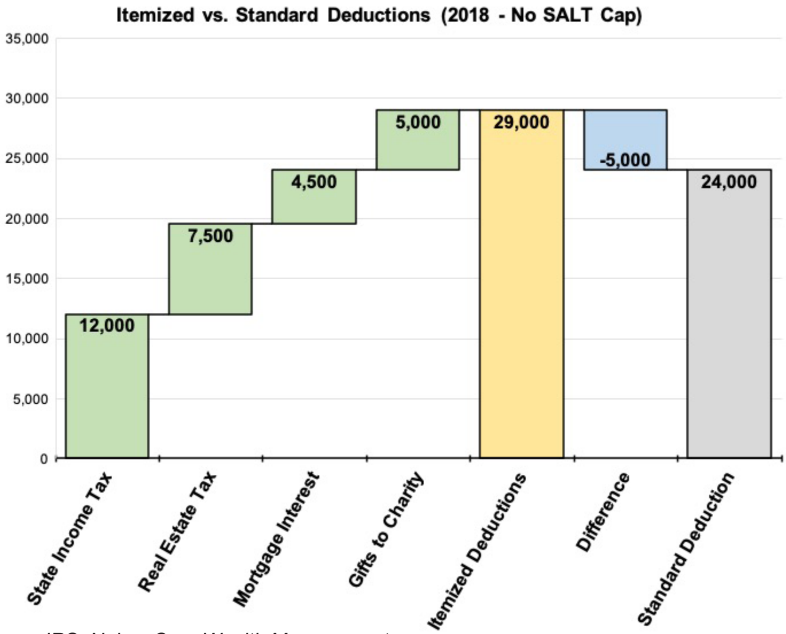
FEWER ITEMIZED DEDUCTIONS

In 2018 there will be items that you will not get a tax deduction for even thought you did in 2017. These include fees paid to tax preparers and investment advisors, unreimbursed travel expenses for work, union dues, and a few others (see www.IRS.gov for full information). This matters because any itemized deduction moved you closer to exceeding the standard deduction and that increased the chances that your charitable giving would exceed the standard deduction and result in a tax benefit. Those deductions were subject to certain rules that reduced their value and were, for most people, not hugely impactful.

The bigger change that will impact the benefits of giving for households is a new limit imposed on state and local tax deductions. In the prior scenario, our hypothetical household's itemized deductions were made up of state income tax, real estate tax, mortgage interest, and charitable gifts. While these all still count towards itemized deductions, state income tax and real estate tax get lumped together in a state and local income tax (SALT) deduction limit, which is $10,000 for individuals and married couples. That scenario's SALT total came to right at $10,000, so they would not have been effected by this limitation. Let's look at a scenario that is.

In this example, the household has a little higher income, so their state income tax is a little higher. They also have a more expensive house, so their real estate tax is higher. Altogether, their SALT total comes to $19,500. This is how it would look without the SALT cap:

Figure 4

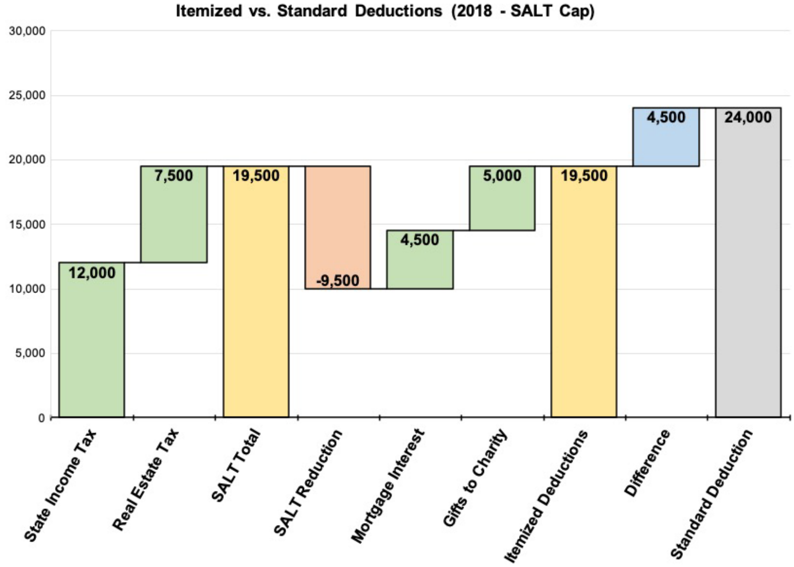


Source: IRS, NelsonCorp Wealth Management

Notice in this scenario, if the SALT cap didn't apply, the $5,000 that this household is giving to charity provides them with a $5,000 tax deduction. This is due to the fact that, as shown by the blue bar, the difference between their itemized deductions and standard deduction is $5,000 with the itemized deduction being larger.

What happens when we apply the SALT cap? (Hint, it isn't good!):

Figure 5



Source: IRS, NelsonCorp Wealth Management

We total the SALT deductions in a new column, which is now the first gold bar. Since that total of $19,500 exceeds the $10,000 cap, there is now an orange bar that removes the excess from the total. Now when overall itemized deductions are totaled, they only amount to $19,500. That total is now $4,500 lower than the standard deduction as shown by the blue bar. This means that none of the $5,000 this household gifted to charity qualified them for any type of tax benefit.

Phew! That was some heavy lifting, but now we're ready for what comes next.

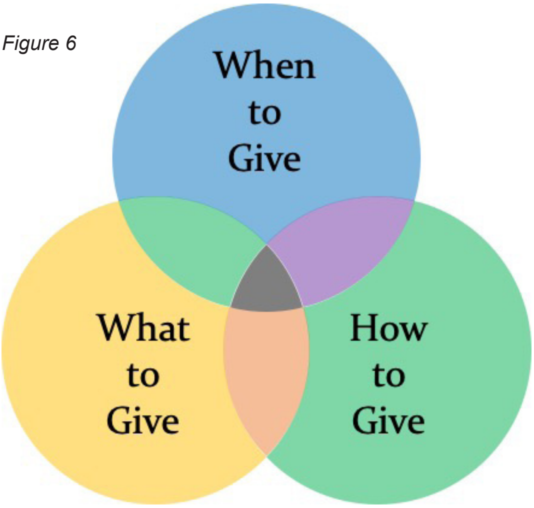
A NEW LANDSCAPE FOR GIVING

We've covered the changes to the tax code and how that alters the dynamics of charitable gifts. Now we get to discuss what you can do to retain some tax benefits to allow you to keep more money in your pocket or give more money away.

Generally speaking, the desired tax benefit of giving takes two basic shapes: receiving a tax deduction or avoiding capital gains tax. These both have the effect of lowering your tax bill, but their effectiveness and potential use varies greatly by individual circumstance.

Strategies and tools for achieving the desired tax effects can be thought of as falling into three intertwined categories, each of which we will discuss:

Figure 6



WHEN TO GIVE

When to give is the category most impacted by the changes introduced by the TCJA. Why is it that the timing of giving makes a difference? As it applies to charitable giving, this question generally comes down to a version of: "How will my tax rate change over time?" This might appear like a daunting thing to try and figure out a first, but there are things you can focus on to help get you in the ballpark. Here are some important events that tend to create changes in an individual's tax picture:

- **You change jobs and your income is significantly different**
- **You retire**
- **You start receiving a pension or social security benefits**
- **You die**

Certainly this list isn't exhaustive, but it should help get you thinking about the types of things that matter here. With this in mind, there are two big timing opportunites we want to focus on.

DEATH AND TAXES

The most straightforward of these is the difference between giving while you are alive, and giving at your death. The reason this matters is because different assets left behind have difference tax consequences depending on who they go to. Specifically, appreciated assets receive what is called a step up in basis.

Basis represents your cost and is what is used to determine the gain on an asset (and by extension, the tax paid when it is sold). For example if you buy $10,000 worth of a stock and hold it for 20 years at which point it is worth $50,000, your basis is still $10,000. If you sell the stock, you must pay tax on the gain. You determine the amount by taking the current value ($50,000) minus the your basis ($10,000) to come up with $40,000. If your tax rate is 25%, then you would owe $10,000 on that transaction ($40,000 x 25%).

However, if instead of selling the stock you leave it to your children when you die, they get a step up in basis. If the current value of the stock is $50,000 when you die, their basis will become $50,000 instead of the $10,000 basis you had. If they turn around and sell the stock right away, they will not owe any tax (current value of $50,000 minus their basis of $50,000 equals $0 gain).

If you give this same stock with the same $40,000 gain to your children while you are alive and they turn right around and sell it, they would then owe the same $10,000 in tax that you would have. This is because they don't get a step up in basis on a gift you give while you are alive.

If instead, you gave this same asset to a charity, they could turn around and sell it without paying any tax, since they generally are exempt from income tax. This illustrates the difference in giving when you are alive or giving after you die. There is advantage to leaving appreciated assets to non-charity beneficiaries at death, and an advantage to giving appreciated assets to charities while you are alive.

EVERYTHING ALL AT ONCE

The other big issue in the timing of gifts is the potential for bunching. When we talk about bunching, what we are referring to is taking several years of gifts that you would have given anyway, bunching them all up, and giving them all in the current year.

There are strategies and tools that can accomplish this in ways that have an end result nearly identical to what it would have looked like had you given those gifts in different years, but those will be covered in the "How to Give" section. Here we will discuss why the timing matters and how bunching helps.

BIGGER, BETTER, FASTER, MORE

The first use case for bunching is in optimizing gifts based on changing tax brackets. As an example, let's say that you are getting a big bonus at work this year. As a result of that bonus, you will have income that is pushed into a higher tax bracket, maybe from the 24% bracket into the 32% bracket. As a result of this bracket shift, charitable gifts that you make (assuming they are deductible) are now more valuable than they were in the previous year, and possibly than in the next year if this is a one-time bonus that will not be repeated in following years. This is because if I give $1,000 and receive a deduction when I am in the 24% tax bracket, the deduction is worth $240 ($1,000 x 24% = $240). However, that same $1,000 gift when I am in the 32% bracket is worth $320 ($1,000 x 32% = $320).

To take advantage of these deductions higher value in this year, you may want to accelerate the gifts that you had been planning on making. This is where the bunching comes into play.

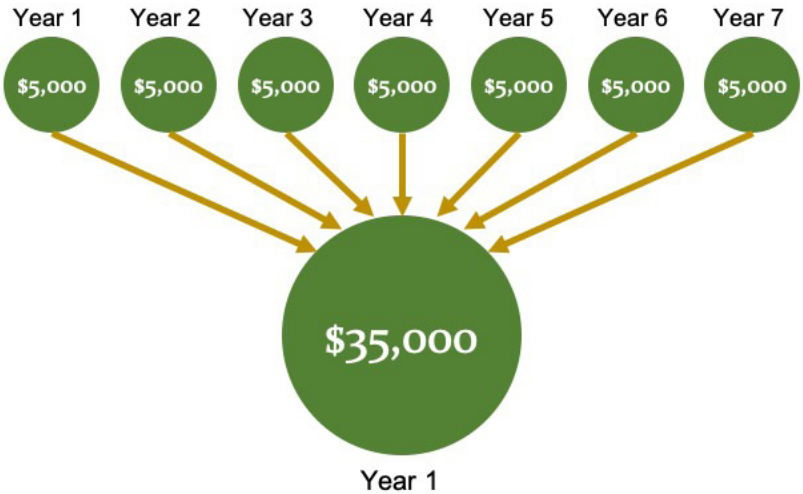
SO CLOSE, YET SO FAR AWAY

The other big use case for bunching is related to the conversation from earlier regarding itemized deductions. Don't worry if you didn't pay that close of attention, this is what it boils down to: Only charitable gifts that result in itemized deductions that exceed the standard deduction get to realize a tax benefit. Also for reference, that standard deduction for a married couple is now $24,000.

The first example in that section showed our married couple as having $13,000 in itemized deduction and giving $5,000 in charitable gifts each year, bringing their itemized deduction grand total to $18,000. Since this is under the standard deduction amount, no tax benefits result from the gift. If you are in this same boat, and plan to give that $5,000 a year to charity every year for the foreseeable future, there is something you can do. Bunch!

Consider the impact of bunching 7 years' worth of giving into the current year. Rather than the $5,000 gift this year, it would be a $35,000 gift. Now instead of a total of $18,000 in itemized deduction and no tax break for the gift, you would have $48,000 in itemized deductions and $24,000 of that would exceed the standard deduction and earn you an additional deduction. This is illustrated in Figure 7:

Figure 7



In future years, you would not be making any charitable gifts, but would continue to use the $24,000 standard deduction on your tax return. Bunching allowed you to capture some of the tax benefits of giving that you never would have been able to use when your itemized deductions were below the standard deduction amount.

WHAT TO GIVE

As with timing, what you give also matters. Different assets and account types have different tax consequences when it comes to charitable giving. As mentioned previously the "When, What, How" framework is not mutually exclusive and we talked a bit about the what as it pertains to the when in the conversation about step-up in basis. Let's go a bit further and take a look at the three main categories of what can be given and the properties of each.

CASH

As discussed in the introduction, cash is one of the more common ways to give to charity. You might give actual cash, you might write a check, or have money pulled from your paycheck. These are all forms of cash and it is the most basic form of giving. Giving cash can qualify you for tax deduction as long as you are otherwise eligible (see discussion on itemized deductions), but unlike some other items that can be given, that deduction is as far as the tax break can go.

APPRECIATED ASSETS

This category is filled with lots and lots of different items. Publicly traded stocks and bonds, mutual funds, real estate, farmland, and privately held company stock are the most common assets used in charitable giving. When you give appreciated assets to charity, you get a deduction for the current value of that asset, just like the deduction that you get for giving cash.

However, with the appreciated assets, you get an additional benefit mentioned earlier; you get to avoid the capital gains tax that you would have had to pay if you sold the asset yourself. Let's consider the example from earlier where you have a stock worth $50,000 that you paid $10,000 for. If you want to give this to charity, you could sell it outright, pay the $10,000 in tax due and have $40,000 left to give to the charity. Or you simply give the stock to the charity, they sell it at its current $50,000 price, pay no tax, and end up with the full $50,000.

What is notable here is that the avoidance of capital gains tax can be realized even if you are not otherwise eligible for a tax deduction for any of the reason we that have been previously discussed.

ORDINARY INCOME ASSETS

This category consists of assets held in qualified retirement accounts. Normally, when you take assets out of these accounts, you would be required to pay taxes on the amounts as ordinary income. Unlike capital gains, which have favored rates, ordinary income is taxed at whatever your marginal rate is. However, there are a couple of situations where you can use these assets in a charitable giving strategy and avoid paying the ordinary income tax that would otherwise be due.

The first situation can be used if have an IRA and you have reach the age of 70 ½. At this age, you are able to direct payments from your IRA directly to a charity and that distribution will not be taxed to you.

The other situation is when you leave your qualified retirement account to charity at death. In this case, the charity receives the account is able to take distributions without incurring any income tax. You and your human beneficiaries would always pay tax on these distributions.

Now that we have a sense for when and what, it's time to look at the final piece of the puzzle, which is how.

HOW TO GIVE

Finally, the homestretch! How is the last thing needed to round out a good base of understanding for creating thoughtful charitable giving strategies. How, maybe more than when and what, requires having a good sense of the decisions you will make regard to the other two categories in order to be most effective.

How to give can be divided into two distinct options. The first of these is to simply give a gift directly to charity. Regardless of what you decide on timing or what asset you want to give, it looks the same. You just work with the charity to give them the thing you are going to give them when you want to give it to them. This has the advantage of being straightforward, but doesn't always give the flexibility to accomplish what you want.

The second option on how to give is to use one or more of the available special purpose vehicles that exist specifically for giving This is another area that will not be covered in its entirety, but we will share several of the most common vehicles used for the purpose of giving. The vehicles come in two formats: outright gifts or gifts where you as the giver retain some interest in the gift.

DONOR-ADVISED FUNDS

A donor-advised fund, or DAF, works a lot like a private foundation, but it is much simpler to setup and administer. Of the vehicles that we will discuss, the DAF is the only outright gift, meaning that once we make a gift to a DAF it is complete and irrevocable. DAFs are run by public charities that allows individuals to make gifts and to a direct grants to charities. The steps go like this:

Figure 8

These vehicles are extremely flexible. When it comes to the bunching of gifts that was discussed earlier, DAFs are one of the best tools for the job. This is because you can make a gift now that may represent many years of giving, get the deduction, but you can still give the money to your charities of choice in the same manner you would have before.

In an example we used earlier, if you were giving $5,000 per year and wanted to bunch 7 years' worth of giving, you would make a current year gift of $35,000. Using a DAF, that $35,000 would now be in an account, while no longer owned by you, is advised by you. You could direct the DAF administrator to give $5,000 each year for the next 7 years to whatever charity you would have supported like this had you not used the DAF.

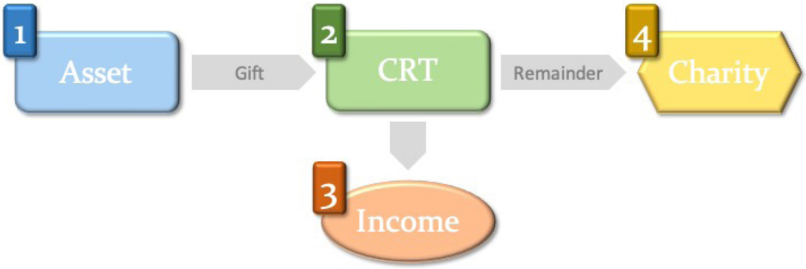
CHARITABLE TRUSTS

Charitable trusts are legal entities designed to provide a gift to charity while retaining some benefit for the person giving the gift. These vehicles are unique among the ones we will discuss in that there is not really a prepackaged solution. These trusts are drafted by lawyers specifically for the person giving the gift and have a huge laundry list of things that can be tweaked in order to design the outcome desired.

The most common form of these trusts is called a charitable remainder trust, or CRT. This type of trust is designed to pay income to you while you are alive and whatever is left in the trust when you die goes to a charity that was identified when the trust was created. Within certain established parameters, you get to decide how much income will go to you during your life.

You can decide to pay the interest and dividends from the investments in the trust, or you can choose to pay a fixed percentage of the trust assets each year. The process looks like this:

Figure 9



The key to this is that the tax benefit you get from making a gift to this type of trust is based on the amount that is expected to go to charity upon your death. The more income you pay to yourself while alive, the less that is expected to go to charity in the end, which in turn reduces your upfront tax benefits.

POOLED INCOME FUNDS

Pooled income funds (PIF) have similarities to donor-advised fund and a charitable remainder trust. Like a DAF, pooled income funds are run by public charities. Like the CRT, pooled income funds are split-interest gifts, so the person giving the gift is expected to receive a benefit. In this case the gift giver will be getting income from the fund while they are alive. Also like the CRT, since it isn't a full gift, the tax benefit received is based on the amount expected to go to charity after the gift giver dies.

Unlike the CRT however, the gift giver doesn't have the flexibility to choose the income stream, the only option they have to take the dividends and interest from the fund investments.

Also, the calculation used to determine the remainder that will go to charity is different that the calculation used for the CRT and often the way pooled income funds are setup, their deductions are generally closer to that of DAFs.

GIFT ANNUITIES

Gift annuities have a lot of similarities to pooled income funds. Like the PIF, the gift givers makes a contribution and receives an income stream as well as being given a tax deduction. While the PIF is run by a large public charity and the gift givers cash flow is provided by investments in a fund, a gift annuity is run a specific charity who themselves have the responsibility of providing the gift giver with their income payments. Also unlike the PIF where the income stream can change depending on the investments, the income stream from a gift annuity is a fixed amount determined by a formula similar to commercial income annuities. Similar to PIFs, the amount of the tax deduction is determined by the amount expected to be available to the charity after the gift givers death.

CONCLUSION

That's it! Easy, right? To try and help a bit more, let's summarize the important pieces here.

ONE. Understand how the new tax changes impact you.

TWO. Know what you are trying to accomplish. Know what giving you want to do. Know your financial picture.

THREE. The when, what, and how framework.

When: Should you give now or later if your tax rates are going to change?

What: Do any of the assets you have available for gifting give you more bang for the buck?

How: Does your giving require fancy implementation?

FOUR. Seek help. Thoughtful giving strategies can get complicated. If your favorite charity is a large organization, they often have staff that can help you understand a lot of the options. Also, be sure to include your financial advisors and accountants in the conversation. The good ones have experience with everything that has been covered here.

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