

Give & Take

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Special Issue

This issue of *Give & Take* contains an overview of the impact of the Taxpayer Relief Act of 1997 on charitable gift planning.

How Do You Spell Relief?

Charitable Giving in the Wake of the New Tax Law

by Robert F. Sharpe, Jr.

In the days since its passage, there has been much speculation about the impact of the Taxpayer Relief Act of 1997 (TRA) on charitable giving in America.

Since the original enactment of the charitable deduction in 1917, numerous tax acts have made changes in the law that affected charitable giving in many ways. Periodic changes restricted who could take charitable deductions, how much could be deducted, whether the alternative minimum tax system came into play, and other assorted tinkering that had, and were intended to have, a direct impact on Americans' decisions regarding their charitable gifts.

This time it is different

If you search a digest of the law, read press reports, or browse the web, you will find few references to the charitable dimension of this law. Does that mean that nonprofit executives need not concern themselves with this one? Hardly.

The impact of the TRA on charitable giving, though subtle, will be immediate and deep. Organizations that quickly grasp the meaning of this legislation for funding programs stand to benefit; others may be in for some surprises.

It is best to start with the basics. There are five "parts" to a charitable gift—*who* makes it, *why* it is made, *what* is given, *when* it is given, and *how* it is given. Various changes in basic underlying tax laws brought about by the TRA will have a great

impact on the what, when, and how of charitable gifts.

Changes in capital gains tax rates

Most Americans now know that Congress has finally acted to reduce the capital gains tax. Ostensibly, the maximum rate has been reduced from 28% to 20%. That is the same thing Congress did in 1981 at the beginning of the Reagan years.

One unintentional, though very real, effect of this reduction is a rise in the after-tax cost of making gifts of stock and other non-cash assets to charity. Without going through the math, the minimum cost of giving the appreciation element in a gift of an asset that has increased in value has now gone from \$.324 to \$.404 per dollar donated, an increase of some 25%. In economic terms, if you assume that the "demand" for gifts is "elastic" and it will fall with price increases, then we can expect a big decline in gifts of appreciated assets. Right? Wrong. At least we had better hope that is wrong because each year America's charities depend heavily on gifts of appreciated assets, especially in a period when the Dow is hovering in the 8,000 range. History reveals that gifts of appreciated assets actually increased during the period from 1978 to 1981 when maximum capital gains tax rates were cut from 35% to 20%.

There are two reasons why the new decreases in capital gains tax rates should also not have a large negative impact on charitable gifts.

First, when a motivated donor compares the minimum after-tax cost of

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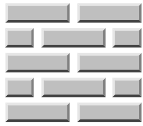
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Give & Take

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The state(s) of giving

Which state's residents claimed the most charitable deductions in tax year 1995?

According to *The Chronicle of Philanthropy*, Utah ranks number one in the U.S. with the average itemizer's contribution deduction totaling \$4,953.

Rounding out the top ten list of the largest states for average charitable deduction for itemizers are Wyoming, Tennessee, Washington, D.C., Mississippi, Texas, Alabama, Arkansas, Louisiana, and Oklahoma. Rhode Island, the smallest state, also had the smallest average itemized amount, nearly \$1,000 less than the national average charitable deduction of \$2,449.

Source: *The Chronicle of Philanthropy*; July 24, 1997

Fund raisers in high demand

It should be easier to find a job in fund-raising these days because there are more jobs to be had.

In a survey conducted by the Development Research Group, over 50% of the charitable organizations surveyed said they had created new fund-raising positions in 1995-1996.

This number is up from 1991's results of 45%. Additional findings of the survey

reveal that organizations prefer to hire experienced fund-raising executives who have worked for different kinds of charities.

And, if you're worried that you don't have a background in business, this survey should ease your mind. Its findings indicate that only 29% of organizations hired individuals with business experience.

Source: *The Chronicle of Philanthropy*; July 24, 1997

For a free copy of the survey results, write to the Development Resource Group, 104 East 40th Street, Suite 304, New York, NY 10016-1801 or call (212) 983-1600.


"Cultural Creatives": Emerging social group embraces charitable causes

They are well-educated, affluent, and their average age is 42. Six in ten of them are women and all are concerned with social issues.

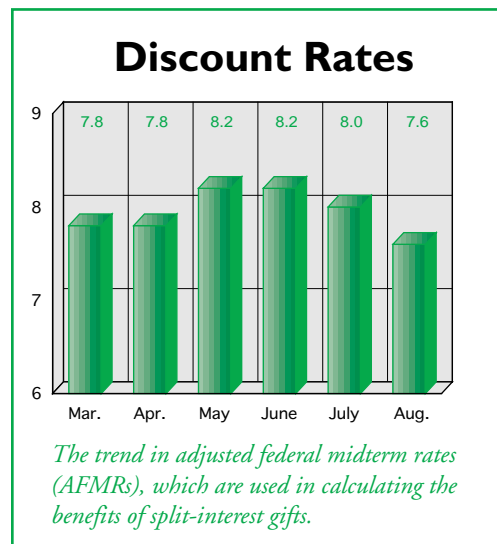
They are the Cultural Creatives, a new subculture that claims to make up 24% of U.S. adults.

One of the most important characteristics of this group is its involvement in charitable pursuits. Three out of four Creatives are volunteering an average of four hours a month.

When compared with the national average of six out of ten adults volunteering only two hours per month, the Cultural Creatives are becoming a powerful charitable force in our society. The causes that most Creatives support are usually global in scope and include organizations focusing on community development, environmental and ecological issues, as well as women's and family issues.

Their optimism coupled with a desire to "heal" society both physically and spiritually will no doubt play a large role in the future success of many charitable organizations. 

Source: *American Demographics*, February 1997



New Tax Law . . . *Continued from page 1*

making a gift of cash versus a gift of securities or other qualified non-cash property that has increased in value, that donor will discover that the gift of property is still the way to go. The minimum cost per dollar of cash donated is \$.604. That is still some 50% more than the new minimum cost of a gift of appreciated property under a 20% maximum capital gains tax rate. The exact numbers will vary depending on the cost basis of the property involved. In the case of a \$10,000 gift of cash versus a gift of \$10,000 worth of stock with a \$2,000 cost basis, the gift of cash still costs 36% more for a person who is in top ordinary tax brackets and would be subject to the new 20% capital gains tax rate if the donated property were sold. For someone who is considering a larger gift for whatever the non-tax motivators may be, it is still good planning to make the gift in the form of appreciated assets. A better use for cash is to then repurchase the same or other securities at a new, higher cost basis.

Second, for many persons, the cost of making gifts of appreciated assets has not really changed at all! The key to understanding why this statement is true in light of the previous paragraph is comprehending the mind-numbing complexity of what Congress has just done to our nation's capital gains tax structure. Hidden in the fine print of the legislation is the reality that the new 20% capital gains tax rate only applies

to certain property. Through a process of elimination, the new maximum rate only generally applies to investment securities and certain real estate that has been held for longer than 18 months. Other property, including securities held between 12 and 18 months, works of art, and other collectibles, will still be subject to the previous maximum rate of 28%. (See chart below.)

A person who sells commercial real estate that has been subject to depreciation

will pay tax on the "appreciation" that is due to previous utilization of straight-line depreciation at a new capital gains tax rate of 25%. Any "gain" that is due to more rapid methods of depreciation (known as "accelerated depreciation") will be taxed at ordinary income tax rates as high as 39.6%. Finally, gain in excess of the adjusted basis that does not result from prior de-

preciation will be taxed at the 20% maximum rate provided it has been held for 18 months. If held between 12 and 18 months, the maximum tax rate on that portion of the gain will be 28%. The charitable deduction for the donation of a commercial building that has been held for 12 months or longer will still be the fair market value less accelerated depreciation that has been taken.

Had enough? Some donors and advisors may, in fact, decide that it may be

Gifts of appreciated property remain a good option.

Maximum Capital Gains Tax Rates for Qualified Investment Assets (1997-2000)*

		DATE SOLD		
		Before 5/7/97	Between 5/7/97 & 7/28/97	After 7/28/97
T I M E H E L D	0-12 Months**	39.6%	39.6%	39.6%
	12-18 Months	28%	20%	28%
	18+ Months	28%	20%	20%

* Slightly lower rates may apply for some taxpayers in tax years beginning in 2001.

** All property held less than one year will still be considered "short-term" property and will be taxed at the same maximum tax rate as salary, interest, dividends, and other ordinary income.

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Congress has decided to disallow charitable remainder trusts where more than 90% of the anticipated economic value of the trust will accrue to the benefit of noncharitable beneficiaries.

easier to donate real estate rather than try to determine how the gain on a sale would be taxed! The bad news is that the tax treatment for gifts of appreciated property is now more complex. The good news is that Congress did not decide to restrict the deduction to cost basis only.

Charities and advisors working with donors who are considering major gifts will now want to point out that it is not only a good idea to make gifts of non-cash assets, but that those gifts be the *right* assets, those that would generate the greatest amount of tax if sold. For most donors that will be investment securities that have been held for between 12 and 18 months, art and other collectibles given for a related use, and certain real estate. Considering the large increases in the stock market over the past 18 months, there is an abundant "supply" of such property in the marketplace. Charities need to quickly inform their major donors of the importance of choosing the right property to give. Left to their own devices, the natural tendency of many donors would be to give the property that has appreciated the most and been held the longest, as they have been trained to do in the past. This could be a costly mistake and one for which major donors may, in some instances, blame charities and advisors they believe failed to adequately inform them.

Gifts of cash remain largely unaffected by the provisions of the TRA. Regular tax rates determine the after-tax cost of such gifts, and those rates have not been changed. There are, however, economic arguments that can be made on the pro and con sides regarding the tangential impact of this bill on gifts of cash.

On the positive side, one could argue that the ability to deduct student loan interest, child credits, and similar tax breaks will put more cash in the hands of middle income taxpayers. With greater discretionary income, they may be prone to increase their charitable giving. Wealthier Americans can now sell homes free of capital gains tax on up to \$500,000 in appreciation in the case of a married couple. This

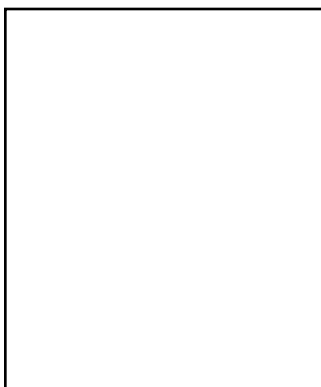
will free up significant amounts of cash that can then be used to fund donations. Now may be a good time to approach donors with large outstanding pledges. Persons who are selling out of the stock markets at new lower capital gains rates may also be flush with cash.

On the negative side, a naysayer could argue that other new provisions in the law will tend to soak up cash that would otherwise be donated. Expanded IRA and educational savings account provisions, incentives that encourage the initial purchase of a home, and increased amounts that can be given to friends and family free of estate and gift taxes under expanded annual exclusion and unified credit amounts are examples.

Time will tell the impact of this law, but fund raisers, especially planned and major gift specialists, have their work cut out for them. This law is not simple and donors will, in most cases, not figure it out on their own. And many advisors will be absorbed in sorting out the enormous implications of this law on investment options.

Impact of the TRA on planned gifts

In a last minute and surprise move, the Congressional conferees joined the IRS in its current initiative to eliminate the use of certain types of charitable remainder trusts as tax avoidance devices in ways they believe were never intended by lawmakers in the past. Buried in the details of this law is a provision that restricts the use of charitable remainder trusts to situations where the anticipated charitable remainder is worth at least 10% of the amount used to fund the gift. This will have the practical effect of eliminating the use of charitable remainder trusts by young persons seeking to avoid capital gains tax, and older persons seeking very high payouts or to provide a life income for children in their twenties or thirties. Put another way, Congress has decided to disallow charitable remainder



Robert F. Sharpe, Jr., is president of the Sharpe company. He advises a number of the nation's leading nonprofits in the design and implementation of their gift planning initiatives.

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trusts where more than 90% of the anticipated economic value of the trust will accrue to the benefit of noncharitable beneficiaries.

For example, in the case of a couple, 71 and 68, with four children ranging in age from 47 to 38, a 5% charitable remainder unitrust will barely generate a 10% remainder factor. A trust with younger children or higher payout, for example, would no longer qualify for tax benefits. In any event, many charities, driven by concerns based in gift accounting and crediting guidelines, already require minimum remainders of 10% or more. Expect much debate in coming months over the wisdom of this provision. The IRS had already proposed new regulations in

May of this year that would effectively eliminate many of what the Treasury perceived to be abusive planned gifts, and this law appears to lend support to that move.

From the viewpoint of prospective trust donors, the new capital gains tax rate may be considered a "privilege" tax, not a "penalty" tax, and rather than seeking to avoid capital gains tax, they will be seeking to realize gains at 20% rather than other income at 40%. The TRA and other related environmental factors do not add up to good news for those looking to promote planned gifts as ways for financially motivated persons to "come out ahead" while possibly doing good in the long run.

On the other hand, most planned gifts will be more attractive than ever under the

Use the Taxpayer Relief Act to your advantage.

A Case in Point

The following example illustrates the planning process many donors will need to pursue when considering gifts of appreciated property in light of the new tax act.

George and Mary Blake are planning to make a charitable gift of \$10,000. In the past they have written checks to complete their gifts, but this year they have been advised to consider a gift of securities. They have two different investments that have increased in value since purchased. Both have a cost basis of \$4,000.

In the case of Investment A, they have held the asset for three years. This property would qualify as long-term property under the new tax act and be taxed at the new maximum capital gains tax rate of 20% for property held more than 18 months.


In the case of Investment B, they have owned the property for just 14 months. This property falls into the new "mid-term" gain property category for property held between one year and 18 months. Mid-term property is still subject to a maximum capital gains tax rate of 28%.

The Blakes are in the 39.6% tax bracket for each additional dollar of ordinary income. Which property should they give?

As the chart below illustrates, if they give the mid-term property, Investment B, they will bypass a larger amount of capital gains tax than if they give the long-term property, Investment A.

The after-tax cost of their gift will thus be \$480 lower if they decide to donate Investment B. In choosing properties for charitable gifts, therefore, the Blakes and others in their position should give priority to appropriate assets they have owned between one year and 18 months.

	Long-Term Property "A"	Mid-Term Property "B"	Difference
Value of Asset	\$10,000	\$10,000	None
Ordinary Income Tax Saved	-\$3,960	-\$3,960	None
Capital Gains Tax Saved	-\$1,200	-\$1,680	\$480 More
After-tax Cost of Gift	\$4,840	\$4,360	\$480 Less

This example and chart are excerpted from the recently released booklet "A Guide To Charitable Giving after the 1997 Tax Act." See page 6 for more details. 

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Footnotes for Gift Planners

News and ideas about Robert F. Sharpe and Company's services and publications. For more information, join us on the web at www.rfSCO.com.

New Booklet focuses on 1997 Tax Act

How will the new tax law will affect your donors? What questions will they have about the impact of its provisions on their charitable gifts? And, most importantly, how will you answer those questions? Consider our new booklet "A Guide to Charitable Giving after the 1997 Tax Act." With its easy-to-read format and attractive four-color cover design, this booklet will

provide your donors with up-to-date information on the new law's effects on charitable giving.

Because of the impact of this tax legislation, we recommend sending this booklet immediately to your top donors and prospects. You may also want to use them with advisors, at seminars, and on visits with donors. The booklets can also be used as inserts in certain gift receipts and acknowledgments. For a sample copy or to order, use the order form enclosed or call toll free 1-800-238-3253.




New Tax Law . . . *Continued from page 5*

provisions of this law, but for new and different reasons. Due to other tax accounting rules, charitable remainder trusts and gift annuities can actually result in helping donors increase the amount of income they will realize at capital gains tax rates as low as 8% in future years. This will be especially attractive to older donors who wish to make larger gifts while increasing their income in retirement years, precisely the group for whom many planned gifts were intended in the first place. For these and other reasons, this bill should accelerate the process of shifting the emphasis in gift planning more to the "gift" element of the planned gift. Those institutions and advisors who realize this and proceed accordingly will continue to raise significant funds utilizing planned gift methodologies.

In 1986, the maximum capital gains tax rate was raised by as much as 100% for some middle income taxpayers, and the maximum rate of 28% began for persons with earnings that were in the average household income range. This has had a dramatic impact on fund-raising over the past decade. One way to view the TRA is that it is one more step in reversing the Tax Reform Act of 1986. From a charitable gift planning standpoint, it means we may now return to the way things were prior to 1986. A challenge lies in the fact that many development officers in America were not in the field in those days and thus haven't functioned in an environment that featured a maximum capital gains tax rate of 20%.

There are pitfalls in this law for those who ignore it, and opportunities for those who embrace its provisions and use them for maximum benefit. The key will be to act swiftly to assure that major donors, in particular, are not confused or misled regarding the impact of this law on their philanthropic plans in this and future years.


For a more complete overview and analysis of the impact of the TRA on charitable giving, visit our web site at www.rfSCO.com or send a self-addressed envelope to our offices. 

Something for Everyone at Year-End

For a wider constituency, the following materials offer you additional options.

Attractive and concise six-panel brochures provide an economical way for you to reach broad groups of donors and friends. Our titles this year include "Giving at Year-End 1997," "Giving Before December 31," and "Giving Thanks at Year-End." We also feature a special version specifically designed for use by educational institutions. These three brochures stress the importance of gift-timing and point out the tax advantages of certain gifts. All of our year-end brochures have been updated in light of the 1997 Tax Act.

For your special donors, the four-page year-end gift newsletter features tips on giving at the end of the year. It can be completely customized to fit your needs, if desired. Like the year-end brochures, this newsletter reflects the impact of new tax legislation.

To order, call 1-800-238-3253. If you would like to review year-end materials before you purchase, call for samples or visit our web site. The address is www.rfSCO.com. 

Seminar Update

Major Gift Planning I—Options and Opportunities

In two intensive information packed days, presenters Robert F. Sharpe, Jr., and Jonathan G. Tidd, Esq., discuss the most important information gift planners need to know to successfully guide their organizations into the 21st century. By linking their knowledge and over 40 years of combined experience, Sharpe and Tidd lead participants through the most comprehensive training available.

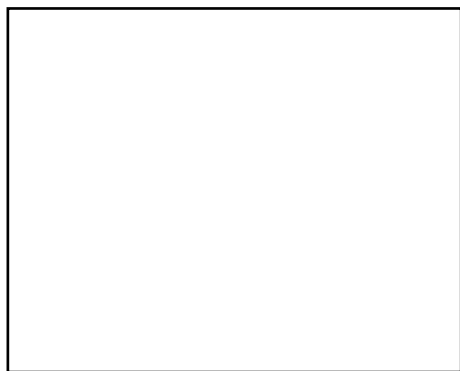
Highlights include:

- The role of gift planning within the fund development program.
- Current and deferred gift planning techniques.
- Deferred gifts in capital campaigns.
- Tax and other financial considerations in planning major gifts.
- Integrating charitable gifts in estate plans.
- Working successfully with donors' advisors.

Make sure you are prepared to meet your donors' needs in the coming years by attending this popular seminar. Registration is always limited to allow for more interaction between participants and instructors.

Major Gift Planning II


For the more experienced gift planner, "Major Gift Planning II" focuses on using



various planning tools to help donors meet multiple goals while making significant gifts. A working knowledge of various gift planning vehicles is assumed.

Presenters Robert F. Sharpe, Jr., and Jonathan G. Tidd, Esq., pay particular attention to the practical challenges facing today's fund raisers.

Planned Giving When That's Not All You Do

This one-day seminar will help you focus your efforts when you're responsible for more than planned giving. One of our most popular training sessions, "Planned Giving When That's Not All You Do," is designed to broaden the basic knowledge of gift planning in your organization, from your CEO or president to the support staff who may be first on the phone with donors. Once they are informed of the benefits of planned giving for your donors and your institution, your co-workers will become some of your best planned giving advocates. 

Tax act addressed

During every Sharpe seminar, presenters will discuss the Tax Act of 1997 and how it affects charitable organizations specifically and philanthropy in general. If you would like more detailed information on the new tax law, please check our web site at www.rfsc.com.

Multiple registration discounts are available. For seminar information or to register, please contact the Sharpe company.

Call 1-800-238-3253, ext. 360

Fax (901) 761-4268

Web site www.rfsc.com

E-mail info@rfsc.com

Major Gift Planning I:

September 8-9
Phoenix

November 17-18
Tampa

December 8-9
Washington, D.C.

Major Gift Planning II:

October 20-21
Pasadena

Planned Giving When That's Not All You Do:

September 12
Saratoga Springs, NY

October 22
Philadelphia

Join us November 17-18 in Tampa at The Don CeSar Beach Resort.