GIVE & TAKE®
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Understanding the Proposed Tax on Charitable Gifts by Higher-Income Donors

By Robert F. Sharpe, Jr.

One of the items included in the President's proposed budget has given rise to a great deal of discussion in the press and elsewhere—namely the proposal to raise taxes on the wealthy by taxing a portion of the amount of income they give for charitable use.

Unfortunately, few commentators have correctly interpreted what the actual impact of the proposed changes would be. Some have said that the bill would reduce the amount that the wealthy could deduct from 35% of their gift to 28%. Others have said the savings would be reduced from 35% to 28%. Many of the descriptions are flawed in various ways; some are simply erroneous and/or misleading.

By the time you are reading this article, the issue may have been decided. If the proposed changes have become law, then take a moment to read on to understand what this may mean for fund raising in the future. If the provision has been dropped, then continue reading for a primer on how the charitable deduction actually affects the cost of a charitable gift. If the matter is still in flux, then we hope what follows will be helpful to readers in forming their opinion of the proposal—positive or negative.

Starting at the beginning

Let's start with the difference between a tax "credit" and a tax "deduction." Tax credits allow for a relatively straightforward reduction in the amount of tax paid to the government. For example, suppose I earn \$100,000 in a given year. If my federal tax rate is 25%, my tax bill would be \$25,000. Now imagine there is a tax credit of up to \$10,000 for amounts given for charitable purposes. As a "credit," that amount would be offset against my tax bill and would lower it from \$25,000 to \$15,000. After taxes, the \$10,000 I donated to charity would cost me nothing, as I would have paid the \$10,000 to the government in taxes had I not donated it to charity. Thus, a credit is the strongest of the various available tax incentives. Unfortunately, as the law stands today, tax credits are not awarded for charitable gifts.

Sharpe's popular seminar "An Introduction to Planned Giving" will be offered in Boston this August. See page 3 for more about this and other training options.

Under our current system, charitable gifts, within certain limits, are instead allowed as "deductions" from income before the tax rate is applied. In the example above, I would report \$100,000 in gross income and take a charitable deduction of \$10,000, leaving a taxable income of \$90,000. I would then owe only \$22,500 in taxes instead of \$25,000. The deduction would result in tax savings of \$2,500 and reduce the cost of my gift to \$7,500. The \$7,500 is called the "cost" of the gift because I would have been able to spend, save, or give that amount to loved ones had I not made the charitable gift.

The formula to determine the after-tax cost of a charitable gift of cash is ***Gift – T(Gift) = Cost,*** where T is the tax rate. Because my tax

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INSIDE: How to approach market research   Is it time to restock your library?

The Road to Mismarketing May Be Paved With Good Intentions

By Donald Mann

It is well known among marketing professionals that statistical reports and research surveys can lead to dangerously flawed conclusions. Statistics can be used to prove almost any point, depending on how a question is asked.

For this reason, professional market researchers strive for total objectivity when conducting a survey or study in order to keep the research from becoming tainted by any bias or preconceived conclusion. Such biases can be almost impossible to detect in the final report because the numbers, printed starkly in black and white, invariably support the conclusions presented in the summary.

For this reason, it is important to approach marketing studies with a critical eye, including understanding whether the research measures statements of intent or measures of actual behavior. One might compare this to pre-election polling versus election results. This "Marketing 101" rule is perhaps the most commonly violated in all of market research, often without any conscious decision on the part of the survey sponsor.

Intentions vs. behavior

The goal of much market research is to predict future behavior, which can differ significantly from statements of intent. Ideally, researchers should take care to identify and examine relevant behavioral data to see if it aligns with statements of intent, then qualify the research results accordingly. Sometimes, however, relevant behavioral data is not readily available. In such cases, clearly explained surveys of intent alone can be very useful. Fortunately for those involved in planned giving, there is a long, well-documented history of planned giving activity that we can look to for guidance.

Over the past few years, several well-publicized surveys and research studies have claimed to have "discovered" that the best planned giving prospects are between the ages of 40 and 60. These studies focused primarily on giving through bequests or, more specifically, on survey respondents' reported intentions regarding preparing a will and the likelihood of including a charitable bequest.

Let's put aside for the moment, as the surveys did, that planned giving can encompass many philanthropic behaviors in addition to bequests. We'll focus our attention on those people who actually leave bequests to charity that are ultimately realized by the charity. As mentioned above, there is a great deal of reported history on this specific behavior to which leading programs look when constructing their fund-raising plans.

A look at bequests

While some bequests are realized from donors who die before age 60, these bequests normally represent a relatively small portion of the total number of bequest donors—fewer than 3% of bequests reported by the IRS from 2001 through 2005, in fact.

However, the surveys suggest that what's really important is getting mentioned in the first will, which is sometimes prepared well before the age of 60 or even 50. Or, at the very least, the surveys indicate that it may be worthwhile to take extra care to communicate with those who are age 40 to 60 who report they would consider a charitable bequest when they make a will.

Reality check

Let's go back to examining what is actually being presented here. These surveys indicate that a majority of people between 40 and 60 do not have a will, a fact that pretty easily passes the reality test, and go on to state that a large percentage of this group would consider making a charitable bequest when they prepare a will.

At this point, it is critically important to understand that this statement reflects intent, not behavior. We've all heard someone say, "I'm going to lose weight (or stop smoking or own my own company or buy a Ferrari)." The people making these statements may be completely sincere, yet the statements alone cannot predict their future behavior. They reflect an intention at a given moment in time, but one which could change due to any number of unpredictable occurrences.

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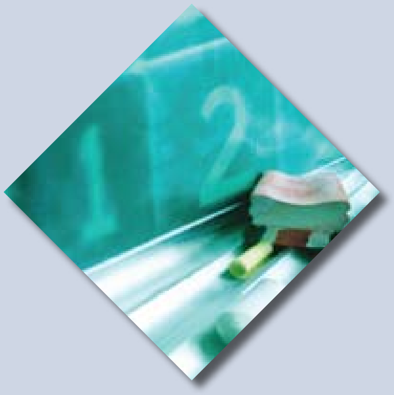

On the Agenda for 'An Introduction to Planned Giving'

Day One

- Charitable Gift Planning in Perspective
- Overview of Property and Tax Considerations
- Gift Planning Tools: Part 1
- Gift Planning Tools: Part 2
- Practical Case Studies
- Gift Acceptance Policies and Infrastructure

Day Two

- Planned Gift Marketing
- Preparing for Donor Contact
- Creating Proposals and Other Written Communications
- Effective Use of the Telephone
- The Personal Visit
- Stewardship and Recognition—The Margin of Excellence

See www.sharpenet.com/seminars for a complete agenda and dates for this and other Sharpe seminars.

Sharpe Gift Planning Institute

Featured Seminar: An Introduction to Planned Giving

This seminar provides an introduction to charitable gift planning in today's environment. It is designed for those assuming responsibility for planned giving, as well as executives with multiple duties who are looking for the best ways to spend their time and resources on planned giving.

Beginning with an overview of the role of gift planning in maximizing charitable giving, this seminar examines the personal priorities of donors at different stages in life and explains how more effective gift planning can help them make significant current gifts as well as plan legacies through bequests, trusts, gift annuities, and other popular gift planning techniques.

Also included is instruction on communicating the benefits of planned gifts to broad groups as well as the use of the telephone, written correspondence, personal visits, and other ways to manage relationships with planned gift donors and prospective donors that are appropriate, tasteful, and effective.

What Attendees Are Saying . . .

"This was a well-presented conference and will be very helpful to me back at the 'ranch'!"
—Stephanie Neff, Genesis Health Care Foundation, Zanesville, OH

"Thanks for having an ethics-based approach to donor contact/relations."
—Katherine Foreman, Blue Ridge PBS, Roanoke, VA

"Excellent seminar! Presenters were engaging and entertaining. Kept the group motivated throughout."
—Barbara Taylor, Lutheran Social Services, York, PA

Upcoming Seminar Training Dates

An Introduction to Planned Giving

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Integrating Major and Planned Gifts

New York **August 10-11**	**Seattle** **September 17-18**

Multiple registration discounts are available. For more information or to register, please contact The Sharpe Group. Phone: 1-800-238-3253, ext. 5313 • Fax: 901-761-4268
Web site: www.sharpenet.com • E-mail: seminars@sharpenet.com

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rate is 25%, my cost is $.75 per dollar given. If my tax rate were 40%, my cost would be $.60 on the dollar. If my rate were 10%, my cost would be $.90. The higher the tax bracket, the lower the after-tax cost of the gift. The cost of making a gift is lower for persons in higher tax brackets only because they would owe more in tax if the dollars were not donated to charity.

Another way to look at it is that Congress is giving up more revenue when a wealthy person makes a gift than when a lower-income person gives to charity. Under the current system, however, in no event does a donor at any income level actually pay income tax on the deductible amount given to charity.

Some have argued that it is unfair that the government gives up more revenue when a wealthy person gives than when gifts are made by others. Others point out that it is not fair that wealthy persons should have a lower after-tax cost of giving than others. Those two concerns are at the root of the administration's proposal to limit the tax benefits of higher-income taxpayers to only the tax savings they would enjoy if they were in a 28% tax bracket. That way the government gives up no more than 28% per dollar donated, regardless of the donor's tax bracket. It also means that the cost per dollar donated by the wealthy would be no less than $.72 per dollar donated even if they were in a higher tax bracket—or does it?

To get to the heart of the issue, it is important to return to the perspective of a donor considering making a gift. Let's take the case of Ms. Greene. After looking at her overall finances, she decides to make a cash gift of $10,000 to her favorite charity. Regardless of her tax bracket, she must allocate $10,000 in cash to fund the gift.

Recall Ms. Greene has an income of $100,000. If she decides to give $10,000 to charity, invest $10,000 in mutual funds, pay taxes on the amount not donated to charity, and spend what remains, here is what her "budget" would look like:

Spending	$57,500
Taxes	$22,500
Investment	$10,000
Charitable Gifts	$10,000
Total	**$100,000**

Under current law, no tax is due on the amount given to charity, which is the case under current tax law. Now suppose Ms. Greene sees her tax rate increase on all of the income she did not give to charity. Her tax bill would then go up even if the amount donated remained the same. When taxes increase, then her spending, savings, or giving must decrease to keep the total outlays within $100,000.

This proposal does more than simply raise or lower tax rates in general. For the first time, the federal government is considering taxing income that is given to charity.

But suppose instead of raising taxes on all income, Congress decides to impose a targeted tax increase. Imagine Congress accomplishes this by limiting the amount of revenue it is willing to forego on amounts donated by the wealthy. In effect, this is what the administration's budget proposal would do.

How does it work?

Despite reports to the contrary in the media, no one is proposing limiting the amount that can be deducted for charitable gifts. The press in some cases has inaccurately reported that Congress would limit the amount that is deductible from 35% to 28%. That is not the case. Under the proposed legislation, a donor would still deduct the same amount as before, subject to normal adjusted gross income (AGI) limitations. What is limited is the amount of revenue Congress would give up as a result of the gift.

For example, suppose a taxpayer in the 35% tax bracket reports $100,000 in income taxed at that rate and donates $10,000 to charity. Under current law, this donor would deduct $10,000, reduce his taxable income by that amount, and lower his taxes by $3,500. If the maximum tax bracket were reduced to 28%, he would still deduct $10,000 but save only $2,800 in taxes.

Under the proposed changes, even though the donor is in the 35% tax bracket, Congress would pretend his maximum tax bracket is 28% when he takes his charitable deduction. The donor would then be able to reduce his taxes by only $2,800, not $3,500—a difference of $700.

This donor would still owe $700 in taxes. Therefore, he may give $10,000, take a tax deduction of $10,000, and still owe an additional $700 when the final bill is computed.

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Something for Everyone

"Reflecting on Tomorrow"

Imagine this: You've just hung up with a prospective donor and her last words were, "Can you send me some more information about possible ways to make gifts?" While it's clear (and wonderful) that this donor may wish to do something special for your organization, it is also clear from your conversation that she has no idea which gift plan best meets her needs.

While you could send her in-depth material about bequests, remainder trusts, lead trusts, and other gift plans, you don't want to overwhelm her with too much technical information. Wouldn't it be nice if there were just one booklet that could give her an overview of different plans that she might find appealing?

Sharpe's **"Reflecting on Tomorrow"** may be just what you need. By providing basic information about various gift options, this booklet gives undecided donors a chance to consider which planned gift options may be most appropriate for them. Along with a brief explanation of each plan are helpful examples so donors can see an outline of the gift vehicle in action. "Reflecting on Tomorrow" concentrates on nine of the most popular plans, from bequests and gift annuities to charitable remainder trusts and lead trusts.

Given its versatility, you'll want to have "Reflecting on Tomorrow" on hand to give to donors in person or in response to inquiries. You may also wish to consider mailing "Reflecting on Tomorrow" to members of your legacy society or other faithful donors who have reached the point in life when they would consider making a planned gift. This booklet also makes an ideal follow-up piece for those who respond to newsletters and other gift planning communications.

Like all Sharpe publications, "Reflecting on Tomorrow" has been updated for 2009 and may be personalized for your organization—either with an imprint of your logo on our standard cover or through a custom cover and content created by Sharpe's team of designers, editors, and consultants.

Call 1-800-238-3253 to speak with a Sharpe customer service representative or visit us on the Web at www.sharpenet.com/pubs to view "Reflecting on Tomorrow" or to learn more about any of Sharpe's booklets, newsletters, brochures, or other services.

Make the most of this year's budget

While June heralds the beginning of summer, it can also mark the end of the current fiscal year. Some may be facing dwindling funds at the end of this budget cycle while still needing to fulfill this year's goals. Others have unused funds in their budget and do not want this year's funds to go to waste. Whatever your budget needs, Sharpe can help. Sharpe's flexible billing options may allow you to:

1. Use this year's funds to purchase publications, training, or consulting services to meet next year's needs.

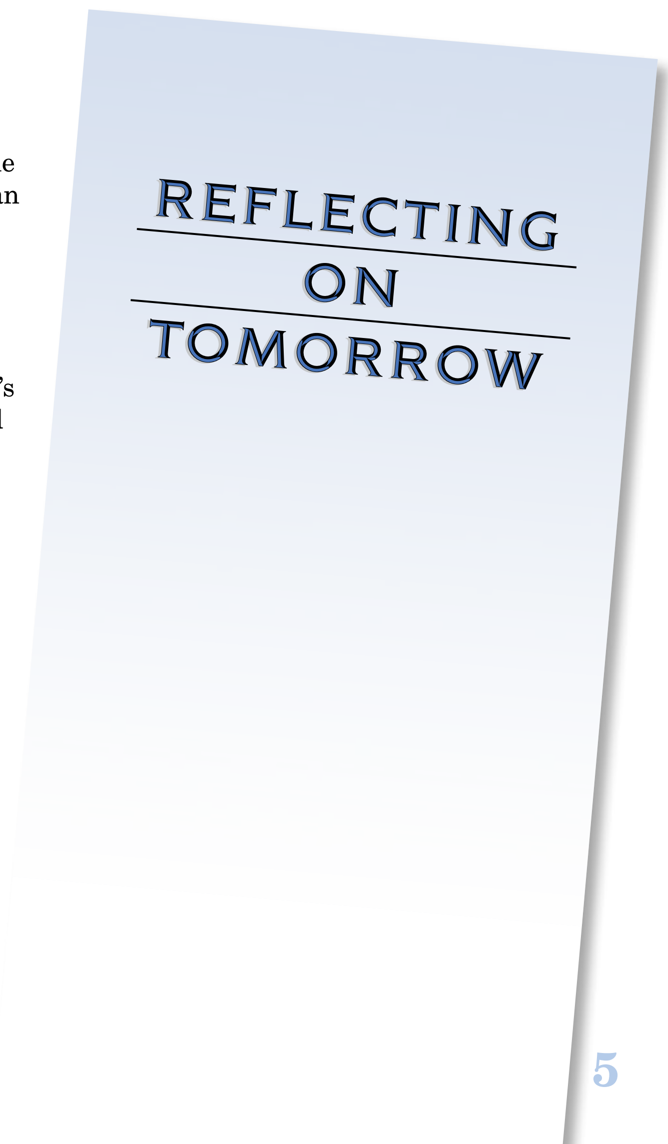
2. Postpone billing of materials and services you need now until the next budget cycle.

3. Split billing over two fiscal years.

Call 1-800-238-3253 to speak to a Sharpe representative about how Sharpe's flexible billing options may work for you.

Restock your library

The end of the fiscal year can be a perfect time to review and replenish your gift planning library. Consult the attached order form, visit www.sharpenet.com/pubs, or call 1-800-238-3253 to learn more about how Sharpe's wide variety of booklet offerings can complement your fund-raising efforts.



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Furthermore, these survey respondents report that they would consider adding a charity to a will they may prepare at some point in the future because they would be motivated to do "good" or "what is expected." While it is uncertain how the original survey question was phrased, it's clear from the answer that the respondents wanted to give the "right" answer.

Consider the "stopping smoking" example above: "As a current smoker, with the full understanding of the health dangers to you and those around you caused by your smoking, would you consider stopping at some indeterminate time in the future?" While that's an exaggeration, you get the point. This is a classic case of mistaking intentions for behaviors, as few persons in this situation actually follow through on their stated intentions.

For example, a recent survey reported that over 50% of wealthy Americans said they had included charities in their will. Year after year, IRS reports show that on average about 20% of wealthy individuals actually leave bequests to charity when they die. Perhaps these respondents were attempting to give the "right" answer by claiming to have followed through on what was only a noble intention. Regardless, many of the people were either misstating the contents of their will to surveyors, did not disclose contingencies that later invalidated the bequest, or chose to remove charities later in life when they completed their final wills.

Back to the facts

Fortunately, there are many facts that are beyond dispute that can help us identify actual bequest behaviors. Consider the following information from bequest records supplied by numerous nonprofit groups, large and small, and examined in the course of planned giving consultation work by The Sharpe Group over the past 46 years. While there is a small amount of variation by type of organization—for example, ages tend to be two to three years younger for educational organizations than for health organizations—the figures as a whole paint a consistent picture. Listed below is the median age of those who leave a bequest to a charity, in which the bequest is ultimately realized by that charity upon estate settlement:

Age when the final will is written: 79

Age when the final current gift during life is made: 81

Age when bequest is realized: 84

Another fact is that over two-thirds of charitable bequests and other gifts that are completed at death come from women who make the final decision to give after the age of 70. Why? Women tend to live longer than men, and family assets are typically distributed by the second spouse to die. Furthermore, many donors who ultimately leave charitable bequests do not make their first gift to that charity until after the age of 60. In most cases, these donors are unknown to the charity until that time in life or even later in some cases.

And finally, from a report compiled by the Internal Revenue Service, we learn that over half of bequests reported to the IRS in 2004 were left by widows or widowers, the large majority of whom were in their 80s when they died. Does anyone for an instant believe that in most cases these bequest instructions were not reviewed and either confirmed or changed upon the death of the first spouse?

What to do

If you are tasked with building bequest expectancies for your organization, how should you focus your communication resources? If you are in the fortunate position of having access to an unlimited budget, you might answer, "Everyone on my file over the age of 40!" However, faced with the reality of finite resources, there are probably better prospects than someone who, statistically speaking, has over fifty years to live and probably won't be preparing their final will for over forty years.

This is not to say that it is unwise to take steps to encourage donors to include their charitable interests in the wills they prepare early in life. For those with large numbers of younger donors, it can be important to begin communicating with them earlier in life using the Web and other age-appropriate media.

For most, however, the key to increasing income from bequests and other age-sensitive gifts in the relatively near term is to focus the majority of your time and resources where there is likely to be a more timely return on investment.

Donald Mann is a Senior Consultant with The Sharpe Group. His career has focused on Customer Relationship Management (CRM) strategies and predictive modeling applied to targeting the best prospects for financial services. At Sharpe, he consults on marketing technology services.

Understanding the Proposed Tax . . . continued from page 4

This proposal does more than simply raise or lower tax rates in general. *For the first time, the federal government is considering taxing income that is given to charity.*

Possible implications

Let's return to our donor above. If he had budgeted $10,000 to make charitable gifts, he would now have to budget $10,700 to make a $10,000 gift.

The additional $700 to be paid in taxes means he will have less to spend, invest, or give to loved ones. The only other alternative to keep his budget in balance is to reduce the gift amount from $10,000 to $9,346. He would retain the $654 difference to cover the additional tax due on the $9,346 he donated.

	Current Law	Proposed Law
Amount Required for Donor to Give $10,000 to Charity	$10,000	$10,700
Amount Donor Could Give to Charity to Maintain $10,000 After-Tax Cost	$10,000	$9,346

Any way you look at it, Congress is raising the cost of the gift in terms of cash outlay by approximately 7%.

If passed by Congress, the proposed changes would come into effect in 2011, the same year that, in another proposal, the maximum tax rate may be raised to 39%. The proposed tax increase would widen the "spread" between the maximum income tax rate (39%) and the rate at which charitable gifts may be deducted (28%) to 11%. A $10,000 gift would require $11,100 in income. If, given budget concerns, only $10,000 is available for the charitable gift, the actual gift to charity would need to be reduced to roughly $9,100, with the remaining amount paid in taxes. In this case the impact on larger campaign gifts could become more significant. Imagine how a donor would feel if faced with writing a check to the IRS for $111,000 to cover the tax on a $1 million fund-raising campaign contribution.

It is unclear how higher-income taxpayers will react to such changes, but it is certain that their accountants will see it as part of their professional role to explain this change and advise them how the "numbers" will work in their case.

Consider the similarities between this situation and the historical impact over the decades of the 50% of AGI limit. How many times have you heard a donor say, "I can't give any more this year. My accountant tells me I have given all I can deduct." Donors tend to cut their giving when told they owe tax on any amounts donated beyond the AGI limits.

In the case of this proposed change, however, higher-income donors and their accountants will not be able to avoid paying tax on amounts they donate to charity by monitoring their proximity to the 50% of AGI limit. Affected taxpayers will find that none of the dollars that are subject to the rule are deductible at full value.

The stated intent of the proposed tax law changes is to raise taxes on the wealthy. Whether that is advisable is beyond the scope of this article. This increase is slated to be accomplished, however, not through an across-the-board increase in tax rates on the wealthy but rather by imposing a targeted tax increase on amounts donated to charity by people with incomes over roughly $250,000. By that standard, this tax could impact a couple with mid-management jobs in high-cost areas of the country; it is certainly not a tax that will affect only the megarich.

No one can really predict the implications of this bill because there is no precedent for it. It would surely affect some charities more than others. Those with the strongest ties to donors would likely fare the best, with the impact felt most by charities to which donors may be giving solely out of social obligation or other less compelling motivations.

Again, our intention is simply to explain the structure and possible impact of the proposal, not to take a position on the advisability of this change. Regardless of what happens, charities will have to find a way to adjust to the resulting funding changes through budget reductions or other means.

If the issue is still in flux at the time you are reading this article, however, take a few minutes to reflect on what this proposal would really accomplish. Once you have decided how you feel about it, exercise your right to contact your representatives and make your opinion known.

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

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Sharpe Gift Planning Institute

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May

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June

An Introduction to Planned Giving	Indianapolis	June 15-16

August

An Introduction to Planned Giving	Boston	August 3-4
Integrating Major and Planned Gifts	New York	August 10-11

September

Integrating Major and Planned Gifts	Seattle	September 17-18
An Introduction to Planned Giving	St. Petersburg	September 28-29

Registration is always limited to allow for more interaction between participants and instructors. Register early to ensure your spot. CEU credits are now available through the College of William & Mary.

For more details or to register, see page 3, call 1-800-238-3253 ext. 5313, or visit www.sharpenet.com/seminars.