



Charitable Giving Strategic Planning for Mr. Joe Smith

Charitable Causes

Joe has indicated that he is interested in giving during his lifetime and/or at death, in a tax efficient manner to the following charities:

1. Salvation Army
2. Holy Trinity Catholic Church

Joe's passion/motivation for giving to the entities above is for the following direct/indirect reasons:

1. His family grew up donating their time and resources to the Salvation Army
2. Every winter, Joe 'rings the bells' with his grandchildren to raise funds for the Salvation Army
3. Joe attends church services weekly at Holy Trinity and is an active member in the church community

Below is some information about the Salvation Army, based on the most recent tax filing.

2016 Breakdown

Total Revenue:	\$21,898,854
Contributions:	\$17,387,464
Gov't Grants:	\$303,066
Investments:	\$4,208,324
Total Expenses:	\$23,640,735
Program Services	\$22,557,169
Administration:	\$589,448
Fundraising:	\$494,118

This information, along with other statistics can be found at:

<https://www.guidestar.org/profile/13-2923701>

You can also find more information at the Salvation Army Website:

<https://www.salvationarmyusa.org/usn/>

Financial Assessment

Joe's Net Worth Statement (see below) was generated through his financial plan. As part of Joe's Financial Plan, Joe has indicated that he would like to give \$1,000,000 to the various charities over the next 10 years during his lifetime.

Investment Assets	\$8,000,000
Other Assets	\$1,500,000

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<u>Liabilities</u>	<u>(\$200,000)</u>
Total	\$9,300,000

Tax Assessment (based on prior year tax return)

Joe's adjusted gross income was \$572,589

Joe's taxable income was \$501,869

Joe's itemized deductions totaled \$70,729 of which \$7,150 was from charitable giving

Joe is not taking RMDs from his IRAs.

Joe's current tax year itemized deductions will be roughly \$36,732, excluding charitable giving

Joe's current tax year standard deduction is \$24,000, so he will continue to itemize, meaning this giving will continue to provide a tax benefit; if his other itemized deductions go down in future years, it is possible that he may not see a tax benefit from his giving.

Joe is in AMT.

Joe's MAGI will Medicare Premiums two years from now.

Planning Opportunities/Solutions

Based on Joe's tax situation, his net worth and charitable goals, we have identified the following strategies for Joe to consider for implementation:

1. During Joe's lifetime, Joe's charitable giving plan is to:
 - a. Gift the appreciated Apple stock to Holy Trinity Church
 - b. Gift \$50,000 directly to the Salvation Army starting in 2018 through 2020
 - c. Gift \$ 100,000 from Joe's Traditional IRA starting in 2021 at Joe's age 70.5, which will reduce/eliminate Joe's required minimum distribution amount for the year.However, Joe will not receive a charitable income tax deduction since the Qualified Charitable Distribution amount is not considered taxable income to Joe.

Supplemental Materials (see attached):

- Qualified Charitable Distribution
- Rules for Deducting Charitable Gifts
- Eight Tips for Deducting Charitable Contributions

Qualified Charitable Distributions

Direct gifts from IRAs can provide additional tax benefits

Charitable gifts made directly from an IRA can provide added tax benefits for many taxpayers, but they aren't right for everyone.

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The Qualified Charitable Distribution (QCD) rules allow taxpayers to make IRA distributions payable directly to a qualified charity without treating the distribution as taxable income. This law permits up to \$100,000 per eligible IRA owner to be contributed directly from their IRA to charity. In addition, the distribution can be used to fulfill the IRA owner's Required Minimum Distribution (RMD) for the year.

The initial QCD rules were intended to expire after 2007, but they were reenacted periodically over the years. The Protecting Americans from Tax Hikes (PATH) Act of 2015 made these rules a permanent part of the tax code.

TAX RULES

In order to be considered a Qualified Charitable Distribution, the following conditions must be met:

- The IRA account holder must be age 70½ or older as of the date of the distribution.
- The IRA can be a Roth IRA, but may not be a SEP IRA or SIMPLE IRA to which the employer has contributed during the year in which the QCD would be made.
- Eligible recipients of a QCD are public charities only. Gifts to private foundations, donor advised funds and supporting organizations do not qualify for QCD treatment.
- The exclusion from income only applies if the distribution otherwise would have been treated as taxable income (which leads to a planning opportunity – see below).
- The full payment to the charity must otherwise be an allowable charitable contribution.
- The distribution must be a direct transfer from the IRA trustee to the charity. The IRA owner cannot use the QCD as a way to reimburse themselves for gifts they previously made on their own.

The amount distributed to the charity is not limited to the RMD amount for the year, nor does the distribution have to be the RMD. IRA owners can withdraw – and keep – their RMD and still make additional distributions to charity from the account.

TAX BENEFITS OF A QUALIFIED CHARITABLE DISTRIBUTION

Prior to the QCD rules, a taxpayer could take a distribution from their IRA (which would be included in their Adjusted Gross Income, or AGI), donate the same dollar amount to a charity, and offset the IRA income by claiming an itemized deduction for the donation. These two amounts would offset each other and there would be no net impact on the taxpayer's taxable income. For an IRA distribution treated as a QCD, however, the taxpayer neither reports the income

as part of their AGI nor claims a charitable deduction. This treatment may seem to provide the same tax benefit as just donating the cash from the RMD, but it does offer some unique benefits.

- Excluding the IRA distribution from income lowers the taxpayer's AGI, which provides several indirect tax benefits:
 - The amount of Social Security benefits that are taxable is driven by the recipient's Modified AGI. A lower AGI could keep a larger amount of a retiree's Social Security benefits tax-free.
 - Medicare premiums are adjusted upwards for those with income over certain thresholds. The QCD can help avoid this increase.
 - Some deductible expenses are subject to AGI thresholds, meaning they're only deductible if they exceed a certain percentage of AGI. For example, keeping AGI lower via the QCD technique can make it easier to deduct medical expenses, which are only deductible to the extent they exceed 7.5% of AGI.
 - The 3.8% Medicare tax on investment income can also be avoided by using QCD. This tax is assessed on couples with Modified AGI over \$250,000 (singles over \$200,000), and the QCD technique can help keep a taxpayer below this threshold.
- In order to receive a tax benefit for a charitable contribution, a taxpayer must itemize their deductions instead of claiming the standard deduction. If the taxpayer doesn't have enough other expenses to justify itemizing, the tax benefit of the charitable contribution would be lost. By following the QCD rules, the tax benefit of the charitable gift is realized (by not having to report the RMD as income), regardless of whether or not the taxpayer itemizes their deductions.
 - This is especially true as a result of the tax law changes taking effect in 2018. The combination of a larger standard deduction with the new caps on, or even elimination of, many itemized deductions means fewer taxpayers will be itemizing going forward. The QCD can be a way to still receive a tax benefit from the charitable gift.
- The tax deduction for charitable gifts is limited to a percentage of the taxpayer's AGI. The QCD rules allow taxpayers to realize the tax benefit of the gift without being subject to this limitation.
- For taxpayers whose IRA contains both pre-tax and after-tax money, the QCD provides a unique opportunity. When a normal distribution is taken from an IRA, it is considered a pro rata distribution from the pre-tax and after-tax portions of the account. A QCD, however, is treated as only coming from the pre-tax portion of the IRA. As a result, a QCD can be an efficient way to use the pre-tax money while leaving the after-tax money in the IRA.
 - **Example:** A taxpayer has an IRA worth \$50,000, of which \$10,000 comes from after-tax contributions. If this taxpayer makes a QCD of \$40,000 to a charity, it would all come from the pre-tax portion of the account. The remaining \$10,000 would all be tax-free when withdrawn from the IRA, either as part of a regular withdrawal or a Roth conversion.

GIFTS OF APPRECIATED STOCK MAY STILL BE A BETTER ALTERNATIVE

While there are certainly cases where a QCD transaction provides a real tax benefit to the IRA owner, there are also cases where keeping the RMD and giving appreciated securities to charity will be a better tax strategy. For example, assume a taxpayer is considering two options:

- Gifting \$30,000 from their IRA to charity, via the QCD, and then selling \$30,000 of stock to fund their spending needs.
- Withdrawing \$30,000 from their IRA to fund their spending needs, but then donating \$30,000 of stock to charity and taking a tax deduction for the gift.

Qualified Charitable Distributions, *continued*

The first column in the table below shows the tax impact of keeping the RMD and donating the stock to charity. The next four columns show the tax impact of giving the RMD to charity but then selling the stock, assuming different cost basis amounts and therefore different capital gains upon the sale.

	Donate Stock from Taxable Account	Donate \$30,000 RMD to Charity (QCD), Sell Stock from Taxable Account			
Cost Basis of Stock	n/a	\$20,000	\$15,000	\$10,000	\$5,000
Gain on Stock	n/a	\$10,000	\$15,000	\$20,000	\$25,000
Impact on Taxable Income					
IRA Distribution	\$30,000	\$0	\$0	\$0	\$0
Capital Gain	0	10,000	15,000	20,000	25,000
Charitable Donation of Stock	(30,000)	0	0	0	0
Net Increase to Taxable Income	\$0	\$10,000	\$15,000	\$20,000	\$25,000
Federal Ordinary Income Tax – 37%	\$0	\$0	\$0	\$0	\$0
Net Investment Income Tax – 3.8%	0	380	570	760	950
Federal Capital Gain Tax – 20%	0	2,000	3,000	4,000	5,000
Total Tax Cost	\$0	\$2,380	\$3,570	\$4,760	\$5,950

As this table shows, the greater the gain on the stock held by the taxpayer, the greater the tax benefit of donating that appreciated stock rather than donating the RMD and then selling the stock. In other words, taxpayers who use their RMD to cover their living expenses but also want to make charitable gifts may be better served by keeping their RMD and donating appreciated stock they own.

On the other hand, if the taxpayer plans to hold the stock until death (thereby receiving a basis adjustment and eliminating the gain) or otherwise has no need for their RMD, then the QCD technique becomes more attractive. Also, those required to take smaller RMDs from their IRA or in a lower ordinary tax bracket will see less of a difference between these two techniques.

TAX REPORTING

Taxpayers doing a QCD transaction should be aware that the custodian of the IRA will still report the distribution from the IRA as a regular withdrawal. The IRA owner will receive Form 1099-R reporting the entire distribution from the IRA, including the QCD, which should then be reported on line 15a of their Form 1040. On line 15b, the IRA owner will then enter the difference between the entire distribution amount and the QCD amount. The IRA owner should then write "QCD" next to line 15b identifying that the difference between the line 15a and 15b amounts is tax-free under this exception.

Rules for Deducting Charitable Gifts

Documentation requirements vary based on the size and type of gift involved.

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Making a donation to a charitable organization can be personally rewarding but also offers the benefit of a tax deduction for the value of the gift. In order to ensure the deductibility of the donation, it's important to follow the IRS rules regarding substantiating charitable deductions and properly valuing gifts, as well as knowing when a gift is considered completed.

DOCUMENTATION RULES: CASH DONATIONS

In order to claim a charitable contribution deduction for cash gifts, taxpayers must maintain either:

- A bank record, such as a cancelled check or account statement, or
- A receipt, letter or other written communication from the charity stating:
 - The name of the charity
 - The date of the contribution
 - The amount of the contribution
 - A description and good-faith effort at valuing any goods or services the charity provided in return for the contribution (applies to single gifts over \$250 only – multiple gifts are not aggregated for this requirement).
- For donations made via payroll deduction:
 - A pay stub, W-2 or other record provided by the employer, and
 - A pledge card or other documentation prepared by or for the charity showing the name of the organization

In the past, donors were able to maintain their own contemporaneous written records of cash charitable gifts under \$250, but that no longer applies; all cash contributions must be substantiated. Proposed Regulations issued in 2008 reaffirm that there is no de minimus exception to this requirement.

DOCUMENTATION RULES: NONCASH DONATIONS

The documentation rules for property donations are much more stringent than for cash donations.

- For gifts valued at less than \$250, taxpayers must obtain a receipt from the recipient organization (and maintain reliable written records) that contains the following information:
 - The name of the donee charity

- The date and location of the contribution
- A reasonably detailed description of the property that was donated (but not necessarily the value)

You are not required to have a receipt where it is impractical to receive one, such as leaving items at an unattended drop box. You must also maintain written records for each donated item that includes:

- The name and address of the donee charity
 - The date and location of the donation
 - A description of the property with a reasonable level of detail
 - The market value of the property and how you determined that value, and how much you are claiming as a deduction
 - The cost basis of the property
 - Any terms or conditions attached to the property
- For gifts worth at least \$250 but not more than \$500, you must receive the same documentation from the charity and maintain the same personal records as are required for gifts less than \$250. The charity's acknowledgement must also contain a description of what was given and good-faith effort at valuing any goods or services the charity provided in return for the contribution.
 - For gifts valued at more than \$500 but less than \$5,000, you must obtain the same written acknowledgement as is required for gifts valued between \$250 and \$500. In addition, your personal records must include the following:
 - How and when you acquired the property
 - The cost basis of the property (doesn't apply to publicly traded securities)
 - For gifts valued at over \$5,000, you will need all the documentation required for other property gifts. In general, you must also obtain a written appraisal of the item from a qualified appraiser. More information on the appraisal requirements can be found in IRS Publication 561, Determining the Value of Donated Property, which is available at www.irs.gov.

ADDITIONAL CONSIDERATIONS FOR ALL PROPERTY DONATIONS:

All acknowledgements from charities must be in writing, such as a letter, fax or e-mail. You must have this receipt for your donation by the earlier of the due date for filing your tax return (including any extensions you have received) or by the date you actually file your return. If you do not receive a timely receipt, your deduction could be denied.

A letter from a third party that helps facilitate the gift is not likely to meet the IRS requirements, unless that third party is acting as an agent for the recipient. For example, a letter from a brokerage firm indicating shares of stock have been transferred to a charity is not sufficient documentation, unless that brokerage firm also acts as an agent for the charity.

REPORTING REQUIREMENTS

If your total deduction for all noncash contributions for the year is over \$500, you must complete Section A of Form 8283, and attach it to your Form 1040. If you make any single gift that is valued at more than \$5,000 (other than publicly traded securities), you must complete Section B of Form 8283, rather than Section A. Part III of Section B is the Declaration of Appraiser, which the appraiser must complete. Part IV of that section is the Donee Acknowledgment, and this must be signed by an authorized representative of the charity.

WHEN IS A DONATION CONSIDERED COMPLETE?

The IRS considers a gift to be completed the date the recipient "receives" the gift. If the gift is a check that is being mailed, the gift is complete on the date it is mailed. Charges to credit cards are considered complete at the time of the charge, even though the credit card bill may not be paid until later.

If the donation is of real property, such as a car or land, the gift is considered complete when legal title to the

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property passes to the charity, such as when the deed to the property is delivered.

In the case of donations of stock, hand-delivered certificates are completed gifts at the time of delivery. If they are mailed, the gift is complete at the time of mailing. However, if the donor delivers the stock to a third party, such as their broker or the issuing company's transfer agent, to deliver to the charity, the stock must be transferred on the books of the issuing company in order to be complete.

GIFTING PUBLICLY TRADED SECURITIES

In the case of publicly traded securities, the valuation issues are easier to manage. The value of the gift is not necessarily what the security was sold for, if it was sold on the date of the gift. Instead, the gift is valued at the average of the highest and lowest selling prices on that date, assuming there is an active market for the security on the date the gift is completed. If there are no sales on the date of the gift, but there are sales within a reasonable time period before and after the gift, the value of the gift is based on a weighted average of the average values on the most recent trading days before and after the date the gift is complete.

If you plan to make a substantial gift and want to avoid a possible market decline on the valuation of your gift while your stock is being transferred from brokerage account to the charity, encourage the charity to which you are making the gift to open an account at the same firm. When the stock is transferred from your account to the charity's account, the date and value of the gift will be known to both parties and should reduce any chance of confusion over those items.

OTHER GIFT TYPES

For other types of gifts, such as real estate, non-public securities, business interests, etc., a qualified appraiser may be required to determine the actual value of the gift. More information on the valuation of charitable gifts may be found in IRS Publication 561, Determining the Value of Donated Property, which is available at www.irs.gov.

Additional information on the rules regarding charitable contributions can be found in IRS Publication 526, Charitable Contributions, which is available at www.irs.gov.

Eight Tips for Deducting Charitable Contributions

Charitable contributions made to qualified organizations may help lower your tax bill. The IRS has put together the following eight tips to help ensure your contributions pay off on your tax return.

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EIGHT IRS TAX TIPS

1. If your goal is a legitimate tax deduction, then you must be giving to a qualified organization. Also, you cannot deduct contributions made to specific individuals, political organizations and candidates. See IRS Publication 526, Charitable Contributions, for rules on what constitutes a qualified organization.
2. To deduct a charitable contribution, you must file Form 1040 and itemize deductions on Schedule A.
3. If you receive a benefit because of your contribution such as merchandise, tickets to a ball game or other goods and services, then you can deduct only the amount that exceeds the fair market value of the benefit received.
4. Donations of stock or other non-cash property are usually valued at the fair market value of the property. Clothing and household items must generally be in good used condition or better to be deductible. Special rules apply to vehicle donations.
5. Fair market value is generally the price at which property would change hands between a willing buyer and a willing seller, neither having to buy or sell, and both having reasonable knowledge of all the relevant facts.
6. Regardless of the amount, to deduct a contribution of cash, check, or other monetary gift, you must maintain a bank record, payroll deduction records or a written communication from the organization containing the name of the organization, the date of the contribution and amount of the contribution. For text message donations, a telephone bill will meet the record-keeping requirement if it shows the name of the receiving organization, the date of the contribution, and the amount given.
7. To claim a deduction for contributions of cash or property equaling \$250 or more you must have a bank record, payroll deduction records or a written acknowledgment from the qualified organization showing the amount of the cash and a description of any property contributed, and whether the organization provided any goods or services in exchange for the gift. One document may satisfy both the written communication requirement for monetary gifts and the written acknowledgement requirement for all contributions of \$250 or more. If your total deduction for all noncash contributions for the year is over \$500, you must complete and attach IRS Form 8283, Noncash Charitable Contributions, to your return.
8. Taxpayers donating an item or a group of similar items valued at more than \$5,000 must also complete Section B of Form 8283, which generally requires an appraisal by a qualified appraiser.

Baird does not offer tax or legal advice. Please consult your tax professional or attorney to discuss your individual situation.

For more information on charitable contributions, refer to Form 8283 and its instructions, as well as Publication 526, Charitable Contributions. For information on determining value, refer to Publication 561, Determining the Value of Donated Property. These forms and publications are available at <http://www.irs.gov> or by calling 800-TAX-FORM (800-829-3676).