

An Inconvenient Truth Charitable Climate Change on Capitol Hill

While heated issues like health care and the housing market take center stage, the climate for charitable giving in America is quietly headed for the big chill as Capitol Hill turns a cold shoulder to tax breaks and other key incentives. The government's insatiable appetite for spending and regulation combined with current financial woes has created the perfect storm, unlike anything to hit the nonprofit world in our era.

So is giving headed for extinction?

Let's look at some of the underlying philosophy that has given rise to the charitable climate crisis. Since the 1940s, when taxes started to be collected through automatic withholding, there's been a growing belief in government that a taxpayer's paycheck belongs to them. In essence, you're only allowed to spend what the government does not keep, or "withhold" from you.

So if the government allows a tax break for what you spend on charity, they believe that they should mandate the use of those funds (after all, they own it all anyway). In reference to nonprofit funding, Congressman Xavier Becerra (D-CA) has said, "Congress has an obligation to assure that their dollars are being well-spent." Some have even gone as far as to say that the charitable income tax deduction is a government subsidy.

A dangerous equation

The bottom line to all this thinking produces a deadly equation for charities: Less Charitable Deductions = Less Charitable Giving = More Revenue for Government. And what charities do get to keep will be subject to government scrutiny. Some of the current taxation and regulatory issues that are at the forefront now show how this equation is being applied:

Income taxes and capital gain taxes – It's no surprise that taxes are going up, but the question is how high? The highest marginal tax rate could go from 35% in 2010 to rates as high as 39.6% in 2011. Increased taxes on capital gain income could also grow from 15% to 20%.

The charitable income tax deduction – It has been proposed that those who earn over \$200,000 (singles) or \$250,000 (married) would be limited to deducting 28% of their adjusted gross income (AGI). Currently, the limit is equal to the highest marginal rate of 35%. What this means is that those who are over the 28% tax bracket will pay income tax on money that is given away. In other words, the "cost" of giving a dollar will be greater than a dollar, for those in tax brackets above 28%. One alarming new twist on this issue is that the Administration is proposing that revenue generated from this go to reduce the deficit, instead of paying for healthcare, as was originally proposed. This will most likely make it more difficult to defeat. The good news is that the charitable community has fought this before and won, but the battle is on once again.

Estate taxes – Congress did not act as expected to extend the 2009 estate tax exemption of \$3.5 million per spouse and the estate tax rate of 45%. So as of Jan. 1, 2010, there is NO federal estate tax. But Obama has called for a permanent estate tax at the recently expired 2009 levels. If Congress does nothing this year, the exemption will drop to \$1 million per spouse with estate tax rates escalating as high as 41% to 60% in 2011.

5% minimum payout – Senator Charles Grassley (R-Iowa) is again calling for endowments, donor-advised funds, and certain types of Supporting Organizations to be required to make a minimum payout of 5% of their assets each year, as Private

Foundations are required to do. Currently, there are no payout requirements for these types of organizations. Most likely he is suggesting an aggregate percentage in reference to donor-advised funds, but it is uncertain at this time.

IRA charitable rollover – This unique provision for giving tax-free from an IRA also expired on New Year's Eve 2009. But there's a strong chance that it could be reinstated in 2010. And let's hope so, because for some, this is one of the smartest ways to give.

Greenlining – If your client has a private foundation, efforts are underway by several groups to impose radical restrictions that could have a major impact on their giving. The Greenlining Institute is lobbying for proposals that would require private foundations to make mandatory grants to certain "disadvantaged" groups, and require diversity in the sexual orientation of a foundation's management and grant recipients. The effort was successful in pressuring California's top ten private foundations into concessions and they are currently pressing into Pennsylvania, Texas, and Florida.

New Form 990 – For the first time in three decades, the IRS has done a major overhaul to the Form 990 that nonprofits must file. The new form requires charities to report lots of new information on governance issues. This is a bold exercise in government information gathering, which could lead down a slippery slope.

Government-funded nonprofits – As government develops more rules and regulations as to who charities can give to, or hire, or elect to their Board, conflicts will arise in the Christian ministry sector. Religious charities could be excluded from these new standards but if they choose not to comply, they'll no longer receive government funding. This could be devastating for many inner-city ministries, outreaches to the poor and homeless, and some large Christian relief organizations such as World Vision.

The tax-exempt status – In addition to losing funding, many ministries and para-church organizations will be in danger of losing their tax-exempt status if they don't comply with new government policies. These ministries may try to fold into the umbrella of their local church or synagogue, which has automatic exemption. While churches do not have to apply for exempt status, the legal definition of a church has already been challenged by Senator Grassley and is being tightened.

Increased regulation – The enormous losses suffered by some charities, mainly large private foundations whose assets were lost in the Madoff scandal, have created an outcry for stricter regulations of charitable investments. The backlash may create complex restrictions that will burden all nonprofits in the end.

Consumer Financial Protection Agency (CFPA) – Amid backlash from the banking scandal, the Obama administration has pushed for the creation of a regulatory agency to oversee organizations that engage consumers in financial activity. What's troubling for charities is the expansive definition of "financial activity" that would be regulated by the proposed CFPA. This definition could draw in nonprofits because of their fundraising activity such as charitable giving advice and planning, or nonprofits who offer financial education such as credit counseling, debt management, or tax planning as part of their programming. This could negatively affect nonprofits such as Crown Financial Ministries and The National Christian Foundation.

Social Innovation Fund (SIF) – Seeded with \$50 million of taxpayer money and on Obama's agenda for increased funding, the current administration has set up this organization to identify and invest in innovative nonprofits. While this sounds good in theory, this is yet another attempt to increase the role of government in giving, as they venture into determining who the best charities are and choosing where charitable dollars should go (rather than the private citizens who give).

What's an advisor to do?

With income taxes going up, estate taxes stuck in limbo, private foundations on the chopping block, and the charitable deduction at risk, it seems like giving is headed for the ice age. But you can help your clients find a way to adapt. Increased pressure forces an increased need for planning. Here are some conservation measures you can take to protect your clients' charitable giving environment:

1. Suggest a donor-advised fund – Now is the time to help your clients establish a donor-advised fund, if they don't have one already. If they're able to pre-fund their giving, they can get tax savings at a 35% rate for their contributions to the fund before 2011, and then recommend grants to their favorite charities whenever they choose.

2. Choose a Charitable Lead Trust (CLT) – Because interest rates are historically low, it's a good time for your clients to make gifts to heirs via a charitable lead trust (CLT). The tax calculation for a gift to a CLT is based on the federal "hurdle rate" which is near its alltime low (around 3%), making this tool even more valuable. With interest rates this low, they don't need high returns to make a CLT a worthwhile strategy. For example, in 2009, the hurdle rate never got above 3.4%, which is fairly easy to beat with a moderately aggressive investment strategy. In many cases, by the end of the trust's life, any remaining principal goes to heirs free of estate and gift tax.

3. Consider a Charitable Gift Annuity (CGA) – CGAs are good for individuals that need a higher, more stable annual income. And they are particularly attractive today due to the volatility in the stock market and the very low interest rates on most fixed income investments such as CDs, money markets, and government bonds.

4. Go for the "Give & Hold" – If your client is a business owner whose giving is hindered by limited cash flow and high taxes, Give and Hold is

the perfect strategy. They can donate a non-voting interest in their business to a donor-advised fund and receive a fairmarket value tax deduction for the gifted interest. If their business is growing, they can utilize this strategy every year and only give a portion of the annual appreciation in the business. This allows them to give each year directly to charity, out of the income of the business.

5. Advance to asset-based giving – The law allows taxpayers to deduct up to 50% of their adjusted gross income (AGI) for cash contributions. What most advisors don't realize is that 30% AGI of the total 50% can be given in the form of appreciated, non-cash assets like real estate, business interests, and gold. For their noncash gift, they'll not only get a tax deduction now, but they will also avoid capital gains tax when their asset is eventually sold.

6. Rely on the Rollover (maybe) – If it is reinstated, the Charitable IRA Rollover is an especially attractive way to give. A gift from the IRA does not require income to be reported on your client's individual income tax return. This allows them to keep their taxable IRA distributions out of their income. Although this opportunity is currently expired, there is strong support to extend it. There is also pending legislation that would enhance the current rules allowing more taxpayers to benefit, and allowing greater overall flexibility in planning with this asset (including the use of CRTs and CGAs)...so stay tuned.

7. Fold their foundation – If your client has a private foundation whose value has declined in the last eight months and has no employees, their best alternative might be to fold their foundation into a donor-advised fund. They can grant anonymously to avoid public scrutiny, and unload many other administrative burdens and IRS restrictions. Even if they're not ready to close down, they can still save time and money by using a donor-advised fund along with their foundation giving.