WINTER 2011

How the new tax law affects gift planning

The compromise tax bill, which was adopted by Congress and signed into law by the President last December, contains a number of provisions that affect both charitable and family gift planning. Here are some things you might want to consider this year as you plan your gifts to charities and family members.

Tax Savings from Current Gifts

The federal income tax rates created by the 2001 tax act will continue in effect until December 31, 2012. Thus, the new tax act did not change the federal tax benefits from current charitable gifts. If you live in a state, such as Hawaii, that has a state income tax and allows a deduction for charitable gifts, your total tax savings will be the combined amount by which your federal and state taxes are reduced.

Tax Savings from Bequests and Other Estate Gifts

The new tax act significantly increased the amount that you can transfer to individuals free of tax, either during or at the end of life. It also decreased the tax rate for transfers that exceed the tax-free amount.

The amount that can now be excluded from the estate tax has increased to $5 million ($10 million for a couple), and the maximum rate has been reduced to 35 percent. The $5 million exclusion applies both to lifetime gifts and gifts at the end of life, though as before any portion of the exemption used during life would decrease the available exemption at death. (It should be noted that individuals who live in a state such as Hawaii, which has a state estate tax, may be subject to it even if they will no longer be subject to the federal estate tax. This is because the exemption from the state tax is lower than the exemption from the federal tax.)

Charitable gifts will continue to be fully deductible for gift and estate tax purposes. If you have a very large estate, a charitable bequest can still result in considerable tax savings. For example, a $1 million charitable bequest would reduce federal estate taxes by $350,000. You will also have more freedom to allocate your estate among children and charity without concern about taxes. Suppose, for instance, that your estate is $12 million, and you have four children. You could give each child $2.5 million and $2 million to charity—perhaps creating a named, endowed fund at the Academy with your bequest, for instance—with zero tax. Previously, to have

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given each child this amount would have resulted in tax, considerably reducing the amount available to charity.

The Charitable IRA Rollover

The new law extends a provision allowing taxpayers, who are age 70½ or older, to make tax-free transfers of up to $100,000 to charities through December 31, 2011. Transfers within the allowable limit from a regular or Roth IRA to one or more charities will not be included in a taxpayer's taxable income, and they will count towards the required minimum distributions.

Aside from its simplicity, a direct transfer from your IRA to a charity can be very beneficial if you do not ordinarily itemize your deductions or if, because of the deductible ceiling on charitable gifts, you would be unable to deduct the entire amount if you took a taxable distribution and then contributed it to charity.

Individuals with Private Businesses

The new law contains many provisions designed to stimulate business activity, but one that encourages charitable gifts concerns the Subchapter S Corporation, a type of business structure that many small businesses elect. Sometimes the principal owner of such a corporation decides to make his charitable gift by causing the company to contribute some of its assets. Previously, the shareholders would have had to reduce the cost basis in their S stock by the entire full market value of the gift, which would result is more taxable income in the future. However, the new law permits them to reduce their basis only by the cost basis of the donated asset, which usually is substantially less than the current value.

We would be delighted to assist you in planning your charitable giving. There are many creative, flexible ways for you to support the Academy and meet your personal financial goals at the same time. For more information about any of these planning ideas, please contact Karen Sumner, Director of Development, at (808) 532-8714 or ksumner@honoluluacademy.org. Thank you for your support of the Honolulu Academy of Arts.

Gift opportunities in a low interest environment

There are two gift plans that are very appealing when the IRS discount rate is low. This rate, which is published monthly by the IRS, is to be used in calculating the charitable deduction for gift annuities, charitable trusts, and gifts of a remainder interest in property. The rate has been quite low for several months, but in December it dropped to 1.8 percent, which is its lowest ever.

The low discount rate increases the charitable deduction for two instruments – a charitable lead annuity trust and a gift of a personal residence or farm with a retention of life use. The former is more common and is of more immediate value to the charity. It is often used by high-net-worth individuals to transfer assets to children or grandchildren while minimizing gift and estate taxes.

Example of Charitable Lead Annuity Trust: *H and W would like to transfer money to three children in ten years, and in the meantime they would like to give a substantial amount to the Honolulu Academy of Arts. They transfer $3,000,000 to a charitable lead annuity trust and stipulate that each year for ten years $210,000 (7 percent) is to be paid to the Academy. Then the trust will terminate and the remaining assets will be distributed to the children in equal portions.* In this example the trust remainder is distributed to children. It is also possible to have the remainder returned to the donor.

Amount transferred to trust	$3,000,000
Gift tax charitable deduction	1,886,340
Taxable gift (If H and W have not previously used their lifetime gift tax exemptions, they would not actually pay any tax)	1,113,660
Total payable to the Academy	$2,100,000
Total distribution to children	$3,000,000*

*Could be more or less depending on trust's total returns.

Here is a chart showing how the charitable deduction* for a charitable lead annuity trust is affected by the IRS dicount rate, assuming $1,000,000 is transferred to the trust and $60,000 per year is paid to charity.

IRS Discount Rate	5-year Term	10-year Term	15-year Term	20-year Term
2%	$282,810	$538,960	$770,960	$981,090
3%	274,780	511,810	716,280	892,650
4%	267,110	486,650	667,100	815,420
5%	259,770	463,300	622,780	747,730
6%	252,740	441,610	582,730	688,200
7%	246,010	421,410	546,470	635,640

* Depending on when the trust is established and whether the trust remainder is paid to heirs or returned to the donor, this could be a gift tax, estate tax, or income tax deduction.

Example of a Retained Life Estate: *H and W, both age 75, purchased their home thirty years ago and it has recently been appraised at $800,000. They would like to continue living in their home for the duration of their lifetimes and assure that it then goes to the Honolulu Academy of Arts. They would also like to reduce their income taxes now. H and W transfer title of their home to the Academy, but retain the right to live in the home for their remaining joint lifetime. When they have both passed away, the Academy is free to sell the home and use the net sales proceeds to meet its greatest needs or to use as H and W directed.*

H and W could have left their home to the Academy in their will but because they have made an irrevocable gift of it during their lifetime, they receive an income tax charitable deduction to help them save on their income taxes.

Value of their home	$800,000
IRS Discount rate	2.0 %
Income tax charitable deduction	$536,611
Tax savings (assuming a combined federal and state marginal tax rate of 30%)	$160,983

Here is a chart showing how the income tax charitable deduction for a retained life estate is affected by the IRS discount rate, with the same assumptions as in the example above.

IRS Discount Rate	Income Tax Deduction	IRS Discount Rate	Income Tax Deduction
2%	$536,611	5%	$363,608
3%	469,240	6%	322,120
4%	412,165	7%	268,520

While low interest rates negatively impact the amount of earnings on certain investments, they can work in your favor by making certain charitable gifts more financially attractive. If you would like to know more about either of these gift options, please contact Karen Sumner, Director of Development, at (808) 532-8714 or ksumner@honoluluacademy.org. Karen would be pleased to provide you with a no-obligation financial illustration showing how such a gift could work in your situation.

Anna Rice Cooke Society Reception

Members of the Anna Rice Cooke Society were honored by the Academy's Chairman of the Board of Trustees, Lynne Johnson, at the fifth annual Anna Rice Cooke Society reception. The event, held in October, featured a tour of *Four Thousand Years of Southeast Asian Art* with Shawn Eichman, Curator of Asian Art. Guests also mingled and were treated to a cocktail reception provided by Academy Chef Mike Nevin.

The Anna Rice Cooke Society was established to honor and thank Academy friends who have provided for the museum through gift planning. The Society is named after the founder of the Academy, Anna Rice Cooke. For more information on becoming a member of the Anna Rice Cooke Society, please contact Karen Sumner, Director of Development at 532-8714 or ksumner@honoluluacademy.org.






1 Mary Karyl Thorne, Lynne Johnson, John Thorne **2** Jerome Muller and guest **3** Margaret Won, Daniel Katayama, William Won and Jane Katayama **4** Chris Campbelll and Peter Bihari **5** Frank Boas, Misako and John Pearson **6** Tim Choy and Catherine Levinson