By **Robert F. Sharpe, Jr.**

Outlook for Philanthropic Planning in 2021

What a difference a year makes

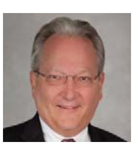
As we now move beyond the unprecedented challenges of 2020 and transition to a new year, what might we focus on in the realm of philanthropic planning as we consider how best to advise charitably inclined clients?

The environment for planning larger charitable gifts is very different this January than last. At the beginning of 2020, no one had heard of COVID-19, investment markets were trading at or near record levels, interest rates were low, inflation was under control, unemployment was low and perhaps the greatest uncertainty was the upcoming Presidential election in the fall. Charitable giving had just hit record levels despite reduced tax incentives ushered in by the 2017 Tax Cuts and Jobs Act (TCJA).

What a difference a year can make. While this column in January is typically devoted to a review of the year just ended, this year, we depart from that approach and focus primarily on the year ahead. My October article summarized the impact of COVID-19 on philanthropy to date, and I would refer readers to that column for an overview of trends in philanthropy in 2020.[1]

Looking Forward

As we look to the future from today's vantage point, few would hazard a guess about what the new year holds in store. As always, when making current and future financial plans, we must work with the relative certainties we can anticipate and make decisions that take advantage of factors that seem stable enough to support constructive action.



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We start with the fact that the COVID-19 pandemic has had, and continues to have, a very uneven impact on the U.S. economy in terms of both sectors and regions. Certain sectors such as travel, hospitality, commercial real estate and others remain battered with what may be a long recovery road ahead. That also applies to those workers whose employment depends on those sectors of the economy.

There are other sectors that have seen less of an impact, or even prospered, as a result of the many changes wrought by COVID-19. The same is true of U.S. regions that have experienced disparate impact from the virus as infection rates and, more importantly, mortality rates have varied greatly.

This disparity is also true of the non-profit sector of the economy, as organizations that are perceived to be addressing the pandemic's impact on our society, and/or raise funds in ways that don't require close personal interaction, have experienced less damage or even experienced funding growth. Causes supported by older, retired and/or wealthier donors who have been less affected in their financial lives have likewise been cushioned from the more severe losses of disposable income experienced by others.

We expect these trends to continue and slowly dissipate as 2021 is anticipated to be a bridge year back to some semblance of pre-2020 normalcy.

Predictable Factors

There are, however, some factors that appear to be predictable enough to in some cases serve as the basis of prudent philanthropic planning in 2021.

Despite the pandemic, stock markets seem to be positioned to hold on to Trump-era gains at least at the beginning of the new administration. For individuals who have outstanding charitable commitments, the opening months of 2021 may be an excellent time

to take advantage of historically high market values to fulfill pledges with gifts of appreciated securities, real estate and other property. This strategy can give rise to deductions equal to the fair market value of the donated assets that serve to reduce income taxes without triggering tax on the underlying gains that would be taxed should the assets instead be sold.

When donors give securities, they can use cash they would have otherwise donated to repurchase the same or other shares. When the dust settles, the donor owns investments with the same value as the donated shares, but enjoys a new cost basis equal to the replacement cost and will realize less gain, or perhaps a deductible loss, in the event of a subsequent sale.

It's also important to remember when advising clients that required minimum distributions (RMDs) from individual retirement plans that were suspended for 2020 are back in 2021. Individuals reaching age 72 (up from age 70½ for years before 2020) must resume RMDs.

Remind these donors that they can make qualified charitable distributions of up to $100,000 per year to appropriate charities. This provision serves, in effect, as an above-the-line deduction for older taxpayers in a position to benefit from this opportunity, without increasing their adjusted gross income in ways that could otherwise negatively impact their tax picture.

Potential Tax Law Changes

Depending on the outcome of the January senatorial elections and other political factors, gifts made in 2021 may lead to greater tax savings this year than in the future. President-elect Biden's stated tax policy plans would revisit proposals for treatment of charitable deductions put forward unsuccessfully during the Obama administration.

The Biden plan caps savings from charitable deductions for those making $400,000 or more. They would only be allowed to deduct charitable gifts from the portion of their income taxed at 28%, rather than the portion of their income taxed at higher rates paid, currently up to 37% and possibly as much as 39.6%. The net effect would be to increase the after-tax cost of gifts by those affected by as much as 13% per dollar donated.

On the positive side, possible gift reductions by the top 1% of taxpayers affected by this change may be offset in whole or in part by efforts to expand the temporary above-the-line charitable deduction included in the Coronavirus Aid, Relief, and Economic Security Act in a manner that would allow all taxpayers to make gifts capped at some amount from pre-tax dollars. This would at least partially restore tax incentives for many who no longer itemize charitable and other deductions due to the TCJA. Some have speculated that a Democrat-controlled Congress may also eliminate the unpopular state and local tax deduction limitations. This elimination would enable another sizable group of donors who live in high tax states to once again itemize all or a portion of their charitable deductions.

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Changes ushered in by the new administration and a favorably disposed Congress could also lead to more strict regulation of donor-advised funds and private foundations that could reduce incentives to fund them in future years and provide that they must distribute more of their assets over condensed time frames. This could boost funding for charitable purposes in the near term, but could lead to less funds being directed to these gift planning vehicles in future years.

Another relevant Biden proposal would be to end the step-up in basis for assets left to others at death. If heirs have to pay capital gains tax on assets that were worth more than their cost basis when sold, this could lead to more gifts of appreciated assets to charity during lifetime while conserving cash and their least appreciated property to fund legacies for heirs through one's estate. This is another reason for donors to consider making gifts of appreciated assets while stock market and real estate values remain high in many instances.

The Interest Rate Factor

Lower interest rates are another factor in the charitable planning equation that seem to present little prospect for change in 2021. In a pandemic-battered economy, increases in lending rates aren't thought likely and

would no doubt dampen the prospects for post-pandemic economic recovery and renewed broad-based prosperity if they occurred.

From a charitable planning perspective, the combination of large amounts of cash and low yielding appreciated assets could lead to increased interest in 2021 in split-interest charitable gifts such as charitable remainder trusts and charitable gift annuities. The combination of a charitable deduction for the gift portion of such transfers that could result in lower income taxes and the bypass of capital gains tax that would otherwise be due, coupled with a stable source of increased income, could prove to be a very attractive combination.

SPOT LIGHT

Primary Colors

Untitled by Giorgio Cavallon sold for $35,000 at Swann Auction Galleries Modern & Post-War Art sale on Dec. 3, 2020 in New York City. The Italian born Cavallon forged a long and successful art career after immigrating to the United States as a teenager. He was a pioneer Abstract Expressionist who brought a "Mediterranean feeling for color and light" to America. Though not as well recognized as some of his peers, Cavallon's work is well respected. He was also known to be an excellent cook, with his recipes published in *The New York Times*.

Lower interest rates also interact with prospects for certain other major tax law changes in the event of a Biden administration combined with Democrat control of both houses of Congress. As noted in my October column,[2] the sunset of the increased gift and estate tax exemption amounts provided for in the TCJA that's slated for 2025 could be brought about sooner as part of revenue-raising measures to help fund the unprecedented relief spending during, and perhaps in the wake of, the pandemic.

Well-advised high-net-worth individuals may want to take advantage of current exemption levels, the benefits of which the Treasury has indicated won't be clawed back, and make inter vivos gifts to heirs that lock in current exemption levels even if the exemptions are reduced by 50% or more prior to the death of the donor.

The anticipated continuation of lower interest rates during 2021 also serves to make certain charitable transfer tools such as non-reversionary charitable lead annuity trusts (CLATs) that benefit from low applicable federal rates more attractive. That's because low interest rates make it possible to pass greater amounts of property to heirs with lower trust payout rates and reduce the length of time the payments that "lead out" to charity must last to result in elimination of gift and/or estate tax. With low interest rates, it takes a shorter amount of time to zero out the gift tax through the use of a CLAT. If inflation rates go up in coming years, the real value of the inheritance to be received by heirs will go down. In this event, the shorter time period before heirs receive their inheritance on account of low interest rates today could help blunt the possible reduction in the value of the real funds they receive.

The coming year, like all others, will offer both pitfalls and opportunities for those who pause and reflect on how the factors in play can be combined in ways that result in clients making their charitable gifts most effectively. This can often be accomplished by using time-tested methods that maximize available financial benefits for themselves and their loved ones by carefully considering the timing of their gifts and the property used to fund them.

Endnotes

1. Robert F. Sharpe, Jr., "Five Factors That Impact How COVID-19 Affects Philanthropy," *Trusts & Estates* (October 2020).
2. *Ibid.*