



Horizons

AN EXCLUSIVE PUBLICATION FOR LOYAL SUPPORTERS OF THE PI KAPPA ALPHA EDUCATIONAL FOUNDATION

Can You Find A Break In The New Tax Cloud?



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The status of charitable giving has been elevated as a result of the Omnibus Budget Reconciliation Act of 1993 ("OBRA"). In fact, this is an opportune time to make a significant donation to the Pi Kappa Alpha Educational Foundation. No one would suggest that a tax deduction provides sufficient motivation for a charitable gift, but it certainly provides an incentive. Under the Clinton tax law, tax deferral and tax avoidance are significantly more important than in the recent past. Many above average income individual taxpayers are now subject to marginal tax rates of 36% and 39.6%, and large estates are now "permanently" subject to a 55% top estate tax rate.

The confiscatory impact of the tax base and tax rate hikes is exacerbated by ever-increasing sources of income subject to taxation and ever-decreasing deductions with which to offset such income.

Avoiding the Tax Bite

With taxpayers facing these gray clouds, thunderstorms, and the I.R.S., they cannot help but hunt for a few umbrellas. Consequently, charitable giving should experience a significant increase in popularity. Several factors militate toward this conclusion. *Gifts to charities, like the Fraternity's Educational Foundation, made during life are now more valuable and, in certain states with high tax rates, could result in a \$.50 refund for every \$1 gift.* In other words, the same gift will generally result in a bigger refund under current law. In addition, once donated, the contributed property and its future appreciation are removed from the reach of estate taxation because they are no longer owned by the donor.

Charitable gifts made at death also qualify for a deduction and reduce estate taxes at the estate's top marginal bracket. The relatively high estate tax rates starting at 18% on taxable estates up to \$10,000 and culminating at 55% on taxable estates of \$3,000,000 or more are not expected to be reduced. *Taxpayers are, therefore, more likely to include charitable bequests in their wills and trusts in order to better*

control the distribution of their assets. By leaving assets inside their taxable estates, taxpayers can be certain that federal and state governments will collect higher taxes and allocate the proceeds to government programs of their choice. *By including a charitable bequest in an estate plan, conversely, taxpayers can allocate their assets to causes and institutions of their own choice.*

For example, a problem results when a taxpayer passes away owning assets held in qualified plans such as defined benefit plans, profit-sharing plans and IRAs. These types of assets, which would have been subject to income tax if the decedent made withdrawals during life, are also subject to income tax at death. This treatment results from "income in respect of a decedent" whereby the estate pays the income taxes that would otherwise have been paid by the decedent. The estate is entitled, however, to a corresponding estate tax deduction for the amount of income taxes paid. Unfortunately, this deduction serves only to ameliorate the tax pain; the entire amount held in qualified plans and IRAs is included in the gross estate. Consequently, these assets are now potentially subject to a 55% estate tax and a 39.6% income tax in addition to state inheritance taxes and income taxes. *The net effect of these taxes is that it is not unusual for only 30% of plan assets to make it intact to the next generation.*

This tax cloud has an even darker lining. When the cumulative assets held in all qualified plans, tax sheltered annuities and IRAs, when aggregated, are significant, there is a special 15% estate excise tax imposed. Although calculations are complicated and are indexed annually, taxpayers with over \$1,000,000 of the above assets should be concerned. The actual calculation, however, is based on the actuarial life expectancy of the plan participant immediately before death. *The net result of all of this is that precious little of plan assets will ever make it to your beneficiaries if you plan poorly by dying before you can withdraw your IRA and pension assets.* Under prior law, taxpayers were likely to allow IRA and qualified plan assets to accumulate until age 70½ when they have to withdraw these assets and pay the

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related income taxes. In the current tax environment, taxpayers are likely to change direction and begin withdrawing plan assets at the earliest possible time, age 59½, in order to avoid the potential impact of the income tax, estate tax and excise tax. If they are unable to spend the amounts withdrawn, the assets are likely to be gifted to children or charities.

Help Yourself by Helping Others

By increasing your charitable donations and donating the right property to organizations like the Fraternity's Educational Foundation, you can be rewarded under the new tax law. You can now deduct the full value of works of art or other appreciated assets you give to a charity not just when computing your regular taxes, but even if you have to pay the alternative minimum tax. Accordingly, you can avoid paying capital gains and the alternative tax under the new law. Effective June 30, 1992, the difference between the value of the asset you donated and your cost basis (generally the amount you paid for it) was not deductible for alternative minimum tax purposes.

For the first time beginning in 1993, the full value of gifts of real estate will be deductible for

alternative minimum tax purposes. This means that *you can now make gifts of appreciated land, buildings and other real property without incurring capital gains and without the alternative minimum tax watering down the tax benefit of your gift.* Consequently, use of charitable remainder trusts, wealth replacement trust arrangements and other deferred gifts with income tax benefits is expected to increase. In fact, the Educational Foundation has already begun to see a dramatic influx of planned giving inquiries during the first half of its 1993-1994 fiscal year.

Now that we have just begun to understand and react to OBRA 1993, Congress has its sights set on two more tax bills. The Tax Simplification and Technical Corrections Act of 1993 runs for more than 400 pages and contains over 150 provisions. In future issues of *Horizons*, we will keep you abreast of the changing tax laws and their impact on you and your estate.

If you are interested in determining how you may best avoid the pitfalls of OBRA 1993, while making a significant deferred gift to the Fraternity's Educational Foundation, please contact your attorney and Foundation Executive Director Jeff Abraham.

(This text contains excerpts from Tom Handler's article, "Charitable Giving in the Wake of Tax Reform.")

Editor's Note

As the Fraternity's 125th anniversary year ends, I would like to extend special thanks to the many alumni and friends who made commemorative gifts of \$125 or more to the annual fund and/or to their respective chapter endowments. For many of you these donations were significantly larger than your past contributions. Your increased generosity is appreciated by all of us here at the Memorial Headquarters and it exemplifies your lifelong commitment to the ideals of phi phi kappa alpha.

As of December 4, 1993, the Foundation has raised over \$82,000 in annual giving for the 1993-1994 fiscal year. If you have not yet made a donation to the Foundation this year (July 1, 1993 - June 30, 1994), please do so as soon as you are able.

If you have any questions about the Foundation's programs or if you would like to volunteer your services, please contact Foundation Executive Director Jeff Abraham or me.

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