Giving in a Post-Tax Reform World
Strategies to maximize the value of charitable gifts[1]

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Following Congress' recent enactment of the most comprehensive federal tax reform in several decades, the topic of charitable giving has received significant attention in news outlets across the nation. Many commentators report that the new law is certain to devastate charitable giving by reducing tax incentives to give. Others counter that the changes will encourage donations by producing economic growth and increasing incomes.

Lower income donors were likely not in a position to deduct their charitable gifts for federal income tax purposes prior to tax reform and will unlikely be able to do so now. Unless the reforms change these taxpayers' financial profiles in other respects, the new law will have minimal impact on the amount they give.

What about other donors? Below, we discuss the principal tax reforms that may affect charitable giving, as applied to hypothetical middle and higher income taxpayers. We also discuss a variety of strategies that these donors may consider to maximize the value of their contributions under the new law, as well as the impact of their gifts.

The reforms discussed below will expire at the end of 2025 unless extended by future legislation.

Standard and Itemized Deductions

The new law nearly doubles the standard deduction to $12,000 for unmarried individuals, $18,000 for heads of household and $24,000 for married individuals tiling jointly. In addition, it eliminates or limits various itemized deductions. In particular, the law generally caps the deduction for state and local property, income and sales taxes at $10,000 annually. Likewise, it reduces the availability of the home mortgage interest deduction and eliminates miscellaneous itemized deductions in their entirety. As a result, the number of individuals who itemize their deductions is expected to decrease significantly. An individual who doesn't itemize may not claim a federal income tax deduction for charitable gifts.

Example: Middle income donor. Tom is an unmarried professional who lives in a high tax state, has anticipated taxable income of $140,000 and anticipated state and local income taxes of $12,000 (now limited to a $10,000 deduction). Tom rents his home and has no debt. He's historically made modest charitable contributions each year-of approximately $1,500-motivated in part by the tax savings. He's read the news reports, though, and is now concerned that he won't be eligible to deduct his gifts.

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While torn previously itemized, he won't itemize now because his deductions don't exceed the standard deduction. He, therefore, won't receive a tax benefit from his charitable gifts. That said, his itemized deductions are only $500 below the standard deduction.

Bunch gifts. If Tom can afford it, he could bunch the donations he would otherwise give over the course of multiple years into one or more gifts this year that are large enough to exceed the standard deduction. Tom could then make bunched gifts every three years, for instance, rather than giving smaller amounts annually. This strategy would enable Tom to continue to support the organizations he cares about, while receiving a quantifiable tax benefit.

Use a donor-advised fund (DAF). If Tom is able to bunch his gifts, but is concerned that the recipients would prefer to receive (and will request) annual donations, he could alternatively make his gifts through a DAF. The entire amount of Tom's initial contribution to the DAF would be deductible in the year of contribution. Tom would then have the flexibility, subject to certain restrictions, to recommend distributions from the DAF to the charitable recipients of his choice at the times of his choosing, (Tom wouldn't receive any further deductions for such distributions because he already received a deduction for his initial contribution to the DAF.) As an added benefit, Tom could provide guidance to the sponsoring organization of the DAF concerning the investment of the assets in the DAF account, and the assets may grow over time on a tax-free basis. A contribution to a DAF could therefore enable Tom to have a greater charitable impact.

Example: Higher income donor. Cathy is an unmarried professional who lives in a high tax state. She anticipates having taxable income in excess of $300,000, state and local income and property taxes of $27,500 (now limited to a $10,000 deduction) and deductible home mortgage interest of $15,000. Cathy has regularly made charitable gifts of $20,000 annually to organizations that have had a personal impact on her life and serves on the board of trustees of her alma mater. The board of trustees is concerned that gifts to the school from middle-income donors may decline because fewer donors will itemize under the new law. In addition, Cathy would like to increase the amount she gives annually to 10 percent of her income. She would like to use this additional giving to support organizations in her immediate community.

Cathy previously itemized her deductions and will itemize now. Her gifts were previously deductible in full in the year in which she made them, and her future gifts-including the increased contributions that she's contemplating-will likewise be deductible in their entirety on a current year basis. Cathy's ability to save taxes as a result of her philanthropy isn't impacted by the new legislation.

Offer matching gifts. If Cathy would like to help boost fundraising by her alma mater, she might take advantage of her ability to give on a tax-favored basis by offering to match a certain dollar amount of gifts made by donors to the school. A matching gift program would encourage contributions by those who might otherwise be less inclined to give because of the increased standard deduction. It would also enhance the impact of Cathy s donations.

Give locally. If Cathy would also like to assist smaller organizations in her community, she could support them directly. Alternatively, if Cathy is concerned about the organizations' ability to manage the gifts, she could con-sider making her contributions through a tax-exempt intermediary, such as a community foundation, that supports local nonprofits. Community foundations and other intermediary organizations exist in many fields to direct funds and technical support to community-based entities. Cathy might also find a community foundation helpful if she's unsure of which organizations would best advance her philanthropic goals, Community foundations are often able to identify organizations that best dovetail with a donors interests.

If middle-income donors reduce the amount they give because they no longer itemize, community-based organizations might be disproportionately disadvantaged. Data on giving patterns shows that middle-income donors tend to give more to social service and religious organizations than their higher income counterparts. Every dollar that Cathy directs to organizations in her community may therefore also have the important impact of defraying lost revenue from other donors.

Lower Marginal Income Tax Rates

The new law lowers marginal income tax rates in general and notably reduces the top marginal rate from 39.6 percent to 37 percent. Lower tax rates reduce the tax savings generated by deductions, charitable or otherwise. The tax rates for capital gains, in contrast, have largely remained the same. Likewise, the 3.8 percent net investment income tax remains in force.

Example: Middle income donors. Pam and John anticipate having taxable income of $175,000, consisting primarily of compensation, and hold a moderate number of investment assets. They live in a state without an income tax, but pay property taxes and have a mortgage. Nevertheless, their itemized deductions don't typically exceed $15,000. While Pam and John have children and a good deal of expenses, they manage their finances well and live comfortably. They would like to add charitable giving to their budget.

Because of the reduction in tax rates, Pam and John's federal income tax liability will likely decrease under the new law. They'll therefore have increased cash in their pockets following the payment of taxes.

Give tax savings. Unless their deductions increase materially, Pam and John won't itemize under the new law. Nevertheless, Pam and John might take advantage of their tax savings from the higher standard deduction and reduced tax rates to make a charitable contribution they previously couldn't afford.

Bunch appreciated property in a DAF. As discussed above, Pam and John might also strategically structure their gifts to take advantage of the charitable deduction -by bunching their donations and using a DAF.

In particular, if Pam and John need to retain cash for expenses but have some appreciated investment assets that they've held for more than one year, they could maximize their tax savings by contributing some of those assets to a DAF. Pam and John would receive a charitable deduction in the year of contribution. Moreover, donating appreciated long-term capital gains property is an especially tax-efficient strategy because it provides two tax benefits: Pam and John would avoid recognition of capital gains tax on the contributed property and, subject to certain restrictions, would be eligible for a deduction equal to the fair market value (FMV) of the property.

This approach would also enable Pam and John to provide regular support to the causes they care about through periodic distributions from the DAF account.

Example: Higher income donors. Henry and Chris anticipate having taxable income in excess of $700,000, largely consisting of capital gains and dividends from well-performing mutual fund and public security investments. They also hold some more complex investments in real estate and private equity. Their itemized deductions, primarily consisting of home mortgage interest, typically exceed $30,000 annually. Having had significant financial success, Henry and Chris want to give back by contributing to charity.

While the federal tax liability on Henry and Chris' ordinary income will likely decrease under the new law, the liability on their capital gains will be comparable to prior years.

Donate appreciated property. As discussed above, Henry and Chris could obtain two tax benefits from their charitable gifts and thus maximize the tax impact of their philanthropy, by donating appreciated long-term capital gains investments-including the more complex investments- rather than cash. Henry and Chris would avoid the realization of gains on the donated property and may be able to lower their income, for example, by transferring mutual fund investments before capital gains distributions are declared. In addition, subject to certain restrictions, they would receive an FMV deduction for gifts funded with such assets. Gifts of investment assets also wouldn't deplete Henry's and Chris' cash reserves. As a result, they may be required to realize less overall capital gains on their investment assets to meet regular living expenditures.

Use a DAF. If Henry's and Chris' chosen charitable recipients don't have the capability to accept a gift of appreciated securities, Henry and Chris could instead contribute such assets to a DAF. They could then support the organizations by recommending distributions from the DAF account to them. DAF sponsors typically have the resources and expertise required to accept and manage non-cash assets- whether marketable securities or more complex investments.

New Charitable Contribution Limit

The new law increases the amount an individual who itemizes may deduct with respect to cash gifts to public charities and certain private foundations to 60 percent of the donor's contribution base (up from 50 percent). The law also repeals the so-called "Pease" limitation on certain higher income taxpayers. When applicable, this provision limited certain of a taxpayer's otherwise allowable deductions, including the charitable contribution deduction.

Example: Middle income donor. Mark, a 75-year-old retiree, lives in a state without an income tax and rents his home. He doesn't have any itemized deductions. Mark anticipates having taxable income of $75,000, primarily consisting of distributions from an individual retirement account. A family member also recently left him a moderate inheritance, and Mark would like to make a $10,000 charitable gift in the family member's memory. At the same time, Mark anticipates his expenses increasing with age and so has some reservations about the gift.

Mark didn't previously itemize his deductions. As a result, he wasn't subject to the Pease limitation, but was also unable to deduct his charitable gifts. Going forward, his income and expenses might prevent him from strategically bunching his donations. Mark may therefore continue to be unable to claim an income tax benefit for his charitable gifts.

Use the IRA charitable rollover. Mark could obtain a meaningful tax benefit for a gift in his family member's memory-regardless of whether he itemizes-by using the IRA charitable rollover to make a qualified charitable distribution. The IRA charitable rollover permits taxpayers age 70½ or older to transfer up to $100,000 annually from their IRAs directly to most types of public charities (but not, for example, to DAFs) without recognizing the amount contributed as taxable income. Donors who make qualified charitable distributions from ai1 IRA therefore avoid federal income tax on the IRA withdrawal. At the same time, the amount of the qualified charitable distribution is an offset against the donor's required minimum distribution for the year.

Make a planned gift. If Mark remains concerned about future expenses, he could alternatively consider using a portion of his inheritance to fund a charitable gift annuity (CGA) or other planned gift. Mark wouldn't receive a charitable deduction if he doesn't itemize.

Nevertheless, a CGA would enable him to accomplish his charitable objectives while providing him with an income stream that would mimic the investment income he would otherwise have earned on the inherited assets.

Make a bequest. Alternatively, if Mark concludes that he's uncomfortable parting with assets during his lifetime, he could consider making a charitable bequest in his will. The new law dramatically increased the amount an individual may transfer at death without being subject to federal estate tax. The exemption is now $10 million, adjusted for inflation since 2011, or $11.18 million in 2018. A bequest is, therefore, unlikely to provide Mark's estate with any estate tax savings, and no income tax benefit flows to an estate from a general bequest of a fixed amount.

Mark could direct the use of retirement assets remaining at his death to fund a charitable gift at that time, however. The charitable organization receiving the retirement plai1 distribution wouldn't pay income taxes on the distribution. In contrast, if Mark names an individual to receive the remaining plan assets after his death, the individual would pay income taxes on amounts taken out of the plan. In this way, Mark could still make a bequest at death that would produce a tax benefit; he could then leave other assets without built-in income tax liability to his family and friends.

Example: Higher income donor. Susan is a wealthy, 72-year-old retiree. She has substantial IRAs and investment assets, producing anticipated taxable income in excess of $400,000 annually. She's paid off the mortgage on her home, but has anticipated state and local income and property taxes of $25,000 (now limited to a $10,000 deduction). She's extremely generous ru1d would like to give away as much as possible in the form of charitable gifts over the next few years. She also has charitable bequests in her will.

Susan previously itemized her deductions, although the Pease limitation restricted them. She'll itemize under the new law as well, but will no longer be subject to the Pease limitation. She'll be eligible to take advantage of the increased charitable contribution limit.

Give more cash. Under the new law, Susan will be able to contribute a materially larger amount of cash to public charities and certain private foundations on a tax-favored basis.

For example, if Susan's adjusted gross income (AGI) was $400,000 in 2017 and she had $25,000 of state and local income and property taxes, she was eligible to deduct cash gifts to charity of up to 50 percent of her AGI, or $200,000. Susan's itemized deductions were also subject to the Pease limitation, however, reducing them by approximately $4,000. As a result, Susan could ultimately deduct only $221,000, leaving her with $179,000 of taxable income.

If Susan has $400,000 of AGI and $25,000 of state and local income and property taxes in 2018, she may make deductible cash gifts to charity of up to 60 percent of her AGI, or $240,000. In addition, the Pease limitation is no longer applicable. The entire amount of such gifts would therefore be deductible. With her $10,000 deduction for state and local taxes, she would therefore have just $150,000 of taxable income remaining.

Use the IRA charitable rollover. If Susan would like to give away even more, preferably on a tax-favored basis, she could obtain significant additional tax benefits by using the IRA charitable rollover.

For example, assume that Susan anticipates having $400,000 of income in 2018, $150,000 of which will constitute IRA distributions, as well as $25,000 of state and local income and property taxes. If Susan makes qualified charitable distributions of $100,000 from her IRA, the $100,000 would be excluded from her taxable income, and Susan would have AGI of $300,000. Of this, she could make deductible cash gifts to charity of up to 60 percent of that amount, or $180,000. By combining tax incentives, she would therefore be able to make $280,000 of charitable gifts on a tax-favored basis and would have only $110,000 of taxable income remaining (after the application of the state and local tax deduction).

Reconsider charitable bequests. While Susan has charitable bequests in her will, the aggregate value of Susan's assets is well short of $11.18 million. Consequently, Susan's estate is likely to receive little or no tax benefit from her philanthropic goals at death, unless Susan makes her charitable bequests out of retirement funds, as explained above. Susan might want to consider accelerating some or all of her bequests and making them during her lifetime. If she exceeds the current year charitable deduction limits, she could carry forward the excess for up to five years. Additionally, if Susan is concerned about the timing of the charitable gifts- that is, she would prefer to make them posthumously-she could pre-fund them during lifetime, but use a DAF. Under this approach, she would receive an immediate income tax deduction and again could carry forward any excess for up to five years. She could then provide the sponsoring organization of the DAF with a set of recommended distributions to be made from the account following her death.

Looking Forward

As illustrated by the above examples, the recent changes to the law are most likely to adversely affect charitable giving by middle-income donors. Whether giving by donors will actually decline remains to be seen. Many if not most-people give not because of the tax incentive, but out of a personal commitment to the causes they care about.

Perhaps a more critical question is whether the changes will have a long-term effect on charitable giving. The above changes are currently scheduled to expire at the end of 2025, although history has shown that lawmakers are often reticent to scale back changes billed as “tax breaks”. Even if Congress extends the current changes, other policies could help counteract any decreased giving. For instance, legislation proposed late last year would create a universal charitable deduction that would be available to all taxpayers regardless of whether they itemize. Of course, the fate of any legislation in today’s polarized political environment, particularly legislation that would contribute further to the federal deficit, is uncertain.