Tax Cuts and Jobs Act

Maximizing Charitable Gifts for Income Tax Purposes

With the newly expanded standard deduction under the Tax Cuts and Jobs Act (TCJA) of 2017, many individuals will no longer itemize their deductions. Deductions, such as the charitable contribution deduction, may lose its utility. For those individuals who don't have enough itemized deductions to exceed the threshold of the standard deduction, how can an individual still maximize their charitable tax benefits?

Lumping charitable contributions

Every few years, consider lumping charitable deductions in order to clear the standard deduction hurdle. For example, consider doing 5 years' worth of charitable contributions all at once.

This strategy may be more relevant for high-income single taxpayers who do not own property (with a mortgage), or a married couple who does own property. High-income single individuals who don't own property can get close to the $12,000 standard deduction by first getting up to the maximum state and local tax (SALT) cap of $10,000, then adding charitable contributions on top of that. They would benefit as long as total charitable contributions exceeded $2,000.

For a married couple to get to the $24,000 standard deduction, they would have to use the $10,000 SALT cap with a larger amount of charitable contributions. If they have deductible mortgage interest that can bring them closer to the $24,000, lumping charitable contributions may not be as relevant.

Consider setting up a donor advised fund

Alternatively, consider funding a donor-advised fund. A donor-advised fund is a contractual arrangement that a donor enters into with a sponsoring charity to establish an account to benefit the donor's chosen charities. The donor can transfer assets to the account and receive an immediate charitable deduction subject to adjusted gross income (AGI) limitations. The donor can then make grant recommendations to charities spread out over future years. There is no minimum amount or frequency of distribution requirement.

A few points to remember about the donor-advised fund strategy:

- The charitable gift is irrevocable.
- The sponsoring organization technically controls the grant-making decisions. It has the authority to accept or reject the donor's recommendations.
- Grants may be limited geographically to a particular state or community. There may be some sponsoring organizations that have a broader reach.
- This strategy cannot be used to satisfy pledges directly.

Gifting appreciated stocks to charity

Instead of just writing a check to charity, consider gifting low-basis stock. In addition to the charitable deduction (taken at the fair market value of the stock), you get the additional benefit of bypassing any capital gains on the securities. The charity can later sell the stock and pay no tax on the gain. Even if you don't get your charitable deduction because you didn't itemize your deductions this year and took the standard deduction, you still benefit from not having to pay tax on the capital gain.

Consider a charitable IRA rollover

If you are 70½ or older and have one or more traditional IRAs, consider a charitable IRA rollover (also known as a “qualified charitable distribution” or “QCD”.) Although this strategy will not result in a charitable deduction, you can exclude the gifted amount, up to $100,000 per year, from your AGI and it would count towards satisfying your required minimum distribution.

If filing a joint return, and your spouse is over 70½, an additional $100,000 may be gifted from the spouses own IRA. This strategy is not available if separate returns are filed. The lower AGI could result in additional tax benefits such as reduced Medicare premiums, reduced taxation of Social Security benefits, or reduction of exposure to the 3.8% tax deductions on investment income. This strategy is useful regardless of whether you itemize deductions or take the standard deduction.

Here are a few points to remember about the qualified charitable distributions strategy:

- The definition of a QCD specifically excludes distributions to private foundations, donor advised funds, or supporting organizations.
- The rollover is excluded from income only if 100% of the rollover would qualify for the charitable deduction under present law. Thus, rollovers to fund partial gifts won’t qualify (i.e., gifts to split interest trusts, charitable annuities or if the donor receives any quid pro quo benefit in exchange for the contribution).
- The exclusion applies to traditional IRAs and Roth IRAs only. Other forms of retirement plans such as 401(k), 403(b) annuities, defined benefit and contribution plans, profit sharing plans, Keoghs, and active SEP and SIMPLE plans are not eligible.
- Charitable rollovers will be reported to the IRA owner as normal distributions. You should consult your tax preparer for completing your federal income tax return.
- If you have IRAs with non-deductible contributions or multiple IRAs, there are special rules in determining what portion of deductible and non-deductible contributions has been distributed as a QCD and what portion of the remaining IRA is treated as including non-deductible contributions.
- Some states may not follow federal tax law and will not allow an exclusion of the QCD from state taxable income. The IRA owner should consult with their tax preparer regarding state taxability of QCDs.

Consider setting up non-grantor trusts with 642(c) language

Unlike individuals, whose charitable deductions are limited by AGI, complex trusts can deduct up to 100% of the net income in any given year. The deductibility of charitable contributions for a trust must meet the following guidelines:

- The charitable contribution must be paid out of the trust’s gross income and not from the underlying principal of the trust.
- It must be paid pursuant to the terms of the governing instrument. The trust must be drafted with unambiguous authority to make charitable contributions.
- It must be paid for a charitable purpose described in IRC Section 170(c).

You could donate enough investment assets to generate sufficient income to pay intended contributions. There would be no immediate income tax deduction upon initial funding of the trust. However, the future gross income of the trust will be offset with a charitable deduction. Again, you would have to work closely with an attorney to ensure the trust is drafted appropriately, and a tax advisor to make sure that the trustee's charitable contributions are qualified. The downside to this strategy would be the professional fees associated with an attorney and annual tax filings. Also, remember that trusts are subject to higher compressed income tax rates than individuals. A cost benefit analysis should be considered to evaluate the best option.

For individuals fortunate enough to make charitable gifts and not be impacted by the change in the standard deduction rules, remember that your overall charitable contributions are limited by your AGI. How much is deductible in a particular year is determined by what type of property you give away (e.g., cash, long-term capital gain property, short-term gain property, tangible personal property, self-created property). The deductible amount is also dependent on what type of organization the property is given to—a public charity or a private foundation. Any excess charitable contributions are carried over for five years.

Also remember that you must comply with the substantiation requirement to claim a charitable deduction.
That substantiation must be contemporaneous.

For more information, please contact your Key Private Bank advisor.