Strategies for Maximizing Charitable Impact and Reducing Taxes

The Tax Cuts and Jobs Act became law in December 2017 and the SECURE Act became law in December 2019. These events prompted a discussion about how tax-related laws affect philanthropy and what strategies donors can consider for both maximizing their charitable impact and reducing their taxes.

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Kim Laughton: How have recent tax-related laws and tax benefits influenced individual and family philanthropy?

Hayden Adams: The Tax Cuts and Jobs Act was passed at the end of 2017 and created some situations that could reduce the tax incentive to make charitable donations. While we know tax benefits are not the primary drivers of most individuals' philanthropy, research has shown that tax benefits do impact the amount people give, the timing of their gifts, and their choice of charitable vehicle used to help facilitate their giving.

Kim Laughton: The standard deduction for both individuals and married couples increased with the Tax Cuts and Jobs Act. Does data show that these increased deductions have led to fewer people itemizing deductions, and how has this change impacted charitable giving?

Hayden Adams: In the past, people could deduct almost all state, local, real estate and property taxes. Now there is a $10,000 cap on the total of all of those deductions.

The law also removed all of the miscellaneous itemized deductions and put new limits on the mortgage interest deduction. In the past, people could deduct interest on up to $1 million worth of mortgage debt. Now, the mortgage interest deduction is capped at $750,000 of indebtedness.

These changes to itemized deductions, combined with higher standard deductions, reduce the number of people for whom it makes sense to itemize deductions. Prior to tax reform, around 30% of the population itemized deductions and 70% took the standard deduction. Going forward, we expect that only 10% of the population will end up itemizing.

It is a little too early to know how these changes will impact charitable giving. On one hand, the charitable deduction becomes relatively more important for those who itemize, given the limits placed on other deductions, and this could increase giving from this population. On the other hand, those who do not itemize may have less incentive to give going forward.

Kim Laughton: With 90% of people now expected to take the standard deduction, what advice do you have for anyone who regularly gives to charities?

Hayden Adams: A strategy I especially like and frequently recommend is to bunch charitable gifts. This strategy is great for donors because it can help them maximize their overall deductions. What they can do is concentrate or bunch multiple years of donations—maybe two years—into one year of donations. They can then itemize deductions for that one year and take the standard deduction for the other year. If they chose to continue this strategy, they would flip-flop between itemizing deductions and taking the standard deduction. A donor-advised fund account makes it easy to execute this strategy while maintaining consistent annual support to charities.

Here is an example of how this works. Think about a married couple filing jointly who normally makes $10,000 worth of charitable donations each year. They also have $13,000 of itemized deductions each year, which gives them a total itemized deduction of $23,000. When filing taxes in the past, they would have itemized their deductions. Now, under the Tax Cuts and Jobs Act, it would seem logical to take the standard deduction each year, as that deduction is larger than their itemized amount.

However, if they took two years of charitable donations ($20,000 for 2019 and 2020) and bunched them into a combined donation in 2019, they would accumulate a larger itemized deduction of $33,000 ($20,000 of charitable donations plus $13,000 of other deductions) that pushes them far above the $24,400 standard deduction for 2019. Then they would take the $24,800 standard deduction for 2020.

In this scenario, the couple could potentially increase their overall deductions—above the standard deduction—by $8,600 over two years. And if they bunched three years of donations into a single year, they could have as much as $18,000 worth of additional tax deductions.

Kim Laughton: That is a significant tax benefit from a simple donation strategy! Now let's talk about what people donate to charities. For anyone who typically gives cash or writes a check, can you explain the tax benefits of giving non-cash assets?

Hayden Adams: That's an excellent question, and I have an example that shows the benefits in a very understandable way. Imagine a charitably minded investor who has some stocks she purchased 20 years ago for $10,000. That amount is the cost basis, and after 20 years her shares are now worth $100,000. So she has $90,000 of capital appreciation or gain that would be subject to capital gains taxes if she sold the shares and donated the proceeds to a charitable organization.

If she instead directly donates the stock shares to the charity, the charity would receive the full value of the assets (all $100,000), she would avoid paying capital gains tax on the appreciation (that $90,000), and she would receive a $100,000 deduction (instead of a lower, after-tax amount). This approach is a win-win situation for both the investor and the charity: the investor maximizes her tax deduction, the investor minimizes her taxes paid, and the charity receives more money.

Unfortunately, not all charities have the capabilities to easily accept non-cash assets like stocks, mutual funds, or property. Donor-advised funds can be a very useful giving vehicle, because sponsors have the staff, systems, and processes for accepting and liquidating these types of assets. In the scenario I mentioned, the investor could contribute that $100,000 of stock to her donor-advised fund account and subsequently recommend grants to that charity or to various charities at her convenience.

Kim Laughton: Going back to tax-related laws, a lot of people are wondering if the rules governing Qualified Charitable Distributions (QCDs) from traditional Individual Retirement Accounts (IRAs) are affected by the SECURE Act. What do philanthropists need to know?

Hayden Adams: The good news is that the QCD starting age did not change from 70½ and donors are still allowed to directly give up to $100,000 out of their IRA per year to charity without having to include the money in their income. In addition, QCDs can still be used to cover annual Required Minimum Distributions (RMDs), which previously started at age 70½ and now start at 72.

However, there is an important clause buried within the SECURE Act for those who want to contribute to their traditional IRA after age 70½. Any pre-tax amount contributed to a traditional IRA after age 70½ reduces the allowable QCD by the same amount. For example, if someone over age 70½ contributes $7,000 to a traditional IRA and also donates $9,000 to a charity through a QCD, then $7,000 of that QCD will be disallowed and will need to be counted as taxable income. The disallowed QCD may be used as a charitable deduction for those who itemize, but this generally is not as much of a tax benefit as making a QCD. People obviously can avoid this negative scenario by not contributing pre-tax money to a traditional IRA after age 70½.

Kim: All of your insights are very helpful. As a final point, when people are meeting with their advisors, is there one essential topic you would suggest for a conversation that bridges philanthropy and taxes?

Hayden: Definitely. In addition to maximizing their overall deductions in any given year, people should look at tax planning strategies for those years during which they may have income that is higher than normal. An example is a year when they sell a business or a rental property. Those years are special opportunities to make larger contributions to a donor-advised fund or other charitable vehicle to offset a portion of the income that would otherwise be taxed at a higher rate.

WHAT YOU CAN DO NEXT

- Review our bunching strategy case study.
- Read our non-cash asset contribution articles.
- Read our Qualified Charitable Distributions article.

Visit **www.schwabcharitable.org/taxstrategies** to learn more.
For more information, call us at **800-746-6216.**