TAX-SAVVY GIVING STRATEGIES MAY PROVIDE SOME RELIEF FOR HIGH-INCOME EARNERS

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Properly structured, charitable giving is a valuable form of tax planning that may achieve a wide range of specific objectives.

The Tax Cuts and Jobs Act (TCJA),[1] which went into effect in 2018, is full of surprises that may prove costly for individual taxpayers. Like the Grinch who stole Christmas, Congress took away many deductions and limited others. Miscellaneous itemized deductions were eliminated altogether. However, the most radical change is the limit on state and local taxes (including property taxes) to $10,000 per year, per filer. For married couples in high tax jurisdictions like the District of Columbia, New York, and California, this could result in losing tens of thousands of dollars of deductions each year. Although tax brackets are lower, for most high-income earners this does not compensate for the loss of itemized deductions. (Note, however, that for taxpayers subject to the alternative minimum tax (AMT) who were limited in taking many of these deductions, there may be little or no impact.)

As an example, prior to 2018, a professional couple living in New York earning $750,000 per year may have deducted $60,000 in state income taxes, $13,000 in property taxes, and $10,000 in Miscellaneous Itemized Deductions. Instead of deducting $83,000, the limit on state, local, and property taxes (called "SALT") reduces these deductions to $10,000. Mortgage interest and charitable deductions remain.

What can an individual do to avoid higher taxes when faced with the loss of significant deductions? A radical response may be to move to a low-tax or no-tax state such as Florida or Nevada. Many taxpayers grudgingly acquiesced to pay high state taxes because they were deductible. Absent the deduction, some may opt for not paying state taxes at all. Although outside the scope of this article, relocation to a no-tax or low-tax jurisdiction may be a viable option for those not tied to a specific locale for employment or family reasons.

For those who remain in high-tax jurisdictions—and for all who are philanthropically inclined—charitable planning is likely to assume a more prominent role going forward. In addition to offering federal and state tax deductions, charitable gift planning is highly customizable. Taxpayers exercise control over the amount and timing of donations. They may retain a partial interest in gifted property or receive a current deduction for a gift of a future interest. Properly structured, charitable giving is a veritable Swiss Army knife

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of tax planning that may achieve a wide range of specific objectives.

General tax considerations

Prior to commencing a round of charitable planning and due to the rule changes under the TCJA, taxpayers should consult with their team of financial advisors. Common tax considerations include whether the taxpayer (1) itemizes or takes the standard deduction; (2) holds appreciated assets that may be a candidate for charitable giving; (3) wishes to retain an interest in donated property; or (4) is over the age of 70¹/₂, as well as (5) the amount and timing of gifts.

A little homework may be in order to determine whether to itemize or take the new and higher standard deduction. The standard deduction is now $24,000 for joint filers and $12,000 for single filers.

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SALT deductions are limited to $10,000. Therefore, a joint filer must now have at least $14,000 in other deductions such as charitable and mortgage interest to itemize.

In general, those who have a mortgage are more likely to itemize while those who do not have a mortgage may achieve a better tax result by taking the standard deduction. Taxpayers may switch back and forth, itemizing deductions one year and electing the standard deduction another, depending on the level of charitable giving. The concept of "bunching" deductions into one calendar year may enable an individual to exceed the threshold for the standard deduction and realize a tax benefit for charitable donations in one year, while using only the standard deduction in the following year.

Bunching deductions and donor advised funds

As an example, married taxpayers who donate $10,000 per year to charity and have no mortgage would elect the standard deduction of $24,000 because this is greater than the sum of allowable SALT deductions ($10,000) and combined charitable contributions ($10,000). Consider the benefit if instead of donating $10,000 a year to charitable organizations, the taxpayers make five years of contributions to a donor advised fund (DAF) in 2019.

They would deduct the full $50,000 of charitable donations plus $10,000 of SALT deductions for a total of $60,000 in 2019—a $36,000 increase in deductions over what they would receive by donating $10,000 per year to charitable organizations. The taxpayers receive the $24,000 standard deduction the following four years. By bunching deductions in 2019, they save as much as 37% in federal taxes on the excess deductions of $36,000. If the taxpayers reside in a high-tax state, they may save an additional 9% to 10% or more.

A DAF has always been a popular vehicle for individuals who wish to make a large contribution in a given calendar year. In the past, DAFs have been a viable strategy for individuals who wish to offset income from a high-tax year—perhaps the sale of a business or receipt of a large bonus—with a high level of deductions. What is new is using a DAF to front-end load deductions into one tax year for someone who would otherwise take the standard deduction and lose the tax benefit associated with the charitable donation. A DAF is especially well suited to this so-called "bunching" application because it bunches deductions but does not disrupt established giving patterns.

With a DAF, a deduction is received the year assets are donated. Monies are invested and grow tax-free until the donor authorizes gifts to public charities in amounts and at the times specified. This enables the donor to maintain the existing level of annual giving while receiving a full deduction when it provides the greatest tax benefit.

Gifts of appreciated assets

Gifts of appreciated assets have long been a popular vehicle for charitable donations. Regardless of whether contributed to a DAF or outright to a public charity, the ability to deduct the fair market value rather than the acquisition cost of an asset leverages the value of the donation. The avoidance of capital gain on the embedded appreciation adds value to the selection of appreciated assets vs. cash or non-highly appreciated securities.

Consider the following example. A taxpayer has the choice of gifting $100,000 of cash or $100,000 of stock purchased five years ago for $15,000. To remove any guesswork about the future appreciation of the stock, assume the company announces it is likely to be acquired in an all-cash transaction later this year. If the taxpayer does nothing, there is a

high probability of an $85,000 long-term capital gain. The taxpayer elects to gift the stock to charity before the acquisition is completed. She receives a charitable deduction of $100,000—the same as if she gifts cash—and avoids paying capital gains tax on the appreciation. Capital gains can be taxed as high as 23.3% federally and possibly another 9% to 10% if in a high-tax state.

Deductions for gifts of appreciated stock are limited to 30% of adjusted gross income (AGI) while donations of cash are allowed up 60% of AGI under the TCJA. The 60% limit applies to donations to public Section 501(c)(3) charities. The 60% threshold is reduced to the pre-TCJA limit of 50% of AGI unless all contributions in a given year are made in cash.

To avoid basing selection of gifted securities solely on tax criteria, it is advisable to consult with an investment professional to consider factors such as (1) the potential future growth of an asset (i.e., whether it should be retained in favor of a less highly-appreciated holding because the perceived growth trajectory is high), and (2) whether the holding is overweight in a portfolio and should be trimmed to reduce company specific risk. Of course, it is possible to donate a highly appreciated security and repurchase the asset, resetting the tax basis while maintaining the same portfolio composition.

Partial gifts

Taxpayers may elect to make a partial gift and retain an interest in donated property. Charitable gift annuities, charitable remainder annuity trusts (CRATs), charitable remainder unitrusts (CRUTs), and lead trusts are well established strategies that enable a donor to receive a deduction for the interest contributed, as well as income or reversion of the property for the portion retained. Although not new, they may receive a fresh look under the TCJA as vehicles that bunch or accelerate deductions into one tax year.

Gifts from IRA

A popular strategy available for taxpayers age 70 $^{1}/_{2}$ and over is the ability to direct up to $100,000 a year from an individual retirement account (IRA) to a public charity through a Qualified Charitable Distribution (QCD). Anyone age 70 $^{1}/_{2}$ or older can elect a QCD from an IRA. The QCD counts toward satisfying the Required Minimum Distribution (RMD), and all or a portion of an RMD may be directed to charity tax-free.

This strategy is available to all taxpayers, regardless of whether one itemizes or takes the standard deduction. However, it may hold special appeal to taxpayers who take the standard deduction as they would not receive a tax benefit for charitable contributions. Fortunately, a QCD removes income donated to charity from taxation, achieving the same result. As with a DAF, distributions must be made directly and completely to an organization recognized by the IRS as a domestic Section 501(c)(3) entity.

Current law does not allow DAFs to accept QCDs, although community foundations that sponsor DAFs usually have their own charitable funds that would qualify. QCDs cannot be made to private foundations, split-interest charitable trusts, or supporting organizations. The distribution must be made directly to support a qualified charity. It cannot go to an intermediary, a DAF, or similar entity where the distribution to the ultimate charitable beneficiary is deferred, and cannot be a partial or retained interest gift.

A donor advised fund can be used to front-end load deductions into one tax year for someone who would otherwise take the standard deduction and lose the tax benefit associated with the charitable donation.

QCDs are actively promoted by many tax-exempt organizations. However, a word of caution is in order regarding the reporting requirements, or lack thereof. IRA custodians do not report a QCD as they are not in the business of determining whether a distribution is made to a qualified Section 501(c)(3) organization. Nothing on the Form 1099-R (Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.) indicates that all or a portion of a distribution from an IRA is a QCD, exempt from taxation. The charity often does not know it has received a QCD as it may be unaware of the source of the funds or type of account from which a donation is received.

Charitable organizations solicit QCDs but do not have a means of tracking whether funds are from a taxable or deferred account. The taxpayer or the preparer reports the total distributions from 1099-Rs on line 4a of the return, and reports taxable distributions on line 4b. The difference between

[1] P.L. 115-97, 12/22/17.

the numbers is the QCD. The taxpayer then writes "QCD" to the left of line 4b. Up to $100,000 of QCDs may be reported in this manner. Contrast this to noncash charitable contributions in excess of $500, which are reported on Form 8283 (Noncash Charitable Contributions).

Suffice it to say this may be an area of confusion. Taxpayers should maintain records of QCDs and attach acknowledgement letters from exempt organizations, separating them from acknowledgement letters for itemized deductions destined for Schedule A.

Gifts of appreciated assets have long been a popular vehicle for charitable donations, because the ability to deduct the fair market value rather than the acquisition cost of an asset leverages the value of the donation.

Individuals should consult with their financial advisors on the question of whether to contribute appreciated securities to charity or make a QCD. There is no set answer and the recommendation often includes investment, planning, and tax considerations. A portfolio top-heavy in legacy or inherited stock with low basis would offer good candidates for gifts of appreciated stock. Individuals who have most of their wealth tied up in IRAs and little in the way of after-tax assets may be best served by making a QCD and saving after-tax assets as part of an emergency reserve.

AGI limitations may play a role in favoring a QCD over gifts of appreciated stock. Thresholds affecting Medicare premiums and taxation of Social Security benefits should be part of the decision of the most appropriate method of giving. Careful consideration and analysis should be given to all factors.

Conclusion

The TCJA provides lower tax rates but limits itemized deductions. This is likely to result in increased taxes for high-income earners, and increased attention to charitable planning. While fewer taxpayers will itemize deductions, a full playbook of strategies remains available to those who do. Those who normally take the standard deduction may continue to receive a tax benefit by bunching contributions into one tax year. Taxpayers over age 70 1/2 may take advantage of QCDs with careful attention to IRS tax reporting requirements. All high-income earners should consult with their advisors to align tax and investment considerations with personal philanthropic objectives. ■

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