A Practical Approach: Charitable Contribution Tax Planning Opportunities

While the new tax law (effective 1/1/2018) didn't specifically create significant new opportunities to claim tax deductions resulting from charitable contributions, there are several charitable contribution opportunities that should be considered.

Gifting of Appreciated Securities

A donation of long-term appreciated stock provides a tax deduction equal to the fair market value of the stock without being taxed on the unrealized gain. Assume a taxpayer that is in the 37% ordinary income tax bracket and the 20% capital gains tax bracket (plus the 3.8% net investment income tax) owns 100 shares of ABC Corporation worth $10 per share with $0 basis.

- Option 1 is to sell the shares, pay tax of $238 and donate the remaining $762 to charity (yielding federal tax savings of $282), which results in a net tax savings of $44.
- Option 2 is to donate the shares to the charity directly, completely avoiding the capital gains and net investment income taxes, and claiming a deduction of the full $1,000, which yields a federal tax savings of $370. Clearly, Option 2 is the better deal.

The New Standard Deduction Amounts and Bunching of Charitable Contributions

The new tax law increased the 2019 standard deduction to $12,200 for single taxpayers and $24,400 for married taxpayers filing jointly. This change (and the new $10,000 cap on the state and local tax deduction) greatly reduces the number of taxpayers that will benefit from itemizing their deductions. Assume a married couple owns a home and pays $10,000 of mortgage interest and is over the maximum allowable state and local tax deduction of $10,000.

- If, in a normal year, they gift $4,400 to charities, and their deduction amounts do not deviate from year to year, then their combined itemized deductions will approximate $24,400, which is the standard deduction. They receive no additional tax benefit for their contribution since they get the same $24,400 standard deduction amount whether or not they make the $4,400 gift to charities.
- Instead of this, the couple can make several years' worth of charitable contributions in one year to push their total deductions to an amount that is in excess of the standard deduction, thereby saving taxes from their additional, bunched charitable contributions.

Donor-Advised Funds

A donor-advised fund allows a taxpayer to receive a current tax deduction for amounts contributed into the fund, and provides for the future ability of the taxpayer to direct the funds to charities, even after the year in which the initial donation into the fund is made by the taxpayer. Using a donor-advised fund can make the bunching of charitable contributions, discussed above, very easy.

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Qualified Charitable Distributions (QCD)

A taxpayer that has reached the required minimum distribution age of 70 ½ may donate up to $100,000 from their IRA directly to a charity. The distribution counts toward the RMD, but is not included in the taxpayer's income.

- This could provide a benefit in regards to the calculation of the amount of Social Security benefits that are taxable and in addition may help to keep the amount of Medicare incurred premiums lower.
- In regards to income tax savings, assume a married couple's only sources of income are $30,000 of Social Security benefits, $5,000 of investment income, and an RMD of $15,000. The couple would like to make a charitable contribution of $10,000; however, the charitable contribution plus their other deductions do not exceed $24,400 (i.e. they will take the standard deduction instead of itemizing), so they are unable to claim a tax benefit for the contribution. They could instead request that $10,000 from their RMD go directly to the charity. This reduces their tax bill because they will still claim the $24,400 standard deduction without being taxed on the $10,000 RMD.
- If your taxable income is low relative to the amount you would like to contribute to charity, a QCD also helps to circumvent the adjusted gross income % limitations that are in place for charitable contributions. Note that certain charities are not eligible to receive QCD's, such as donor-advised funds and private foundations.

State-Sponsored Tax Credit Program (Such as PA EITC/OSTC Special Purpose Entity)

PA law allows for the establishment of special purpose entities to take advantage of certain charitable tax credits. The credits are utilized to fund tuition assistance to students from low-income families. The state tax credits are 75% of the contribution amount for a one-year contribution, and 90% of the contribution amount for a two-year contribution. From a tax standpoint, these credits allow taxpayers to shift some or all of their state tax liabilities to an educational program or institution.

Other Ideas

There are other charitable contribution ideas that taxpayers can consider, such as donating real estate, or private company stock, directly to a charity. In addition, estate tax strategies can be considered for taxpayers whose estates exceed the Federal exemption amounts of $11,400,000 for an individual or $22,800,000 for a married couple.

What should you do?

As illustrated above, there are opportunities to take advantage of tax deductions beyond simple donations of cash to charities. While some of these opportunities are fairly straightforward, taking advantage of other opportunities requires careful planning and consideration of various alternatives. Please contact us so that we may assist you in calculating the best possible tax savings.