Does Philanthropy Still Make Financial Sense? How New Tax Rules Affect Charitable Giving

By Susan Queary

For some, it's purely altruistic. They give to charity because they want to support the good work of a cause or an organization they care about, independent of any personal benefit. Others want the tax deduction. Yet most people fall somewhere in between — inclined to be charitable, but also motivated by tax and financial considerations.

Regardless of why you give to charity, provisions of the Tax Cuts and Jobs Act (TCJA) may affect your strategy. The TCJA, which took effect Jan. 1, 2018, changed the tax rules in ways that may alter how, when, or even if people choose to give.

Changes to the Standard Deduction and Itemized Deductions

To claim a charitable deduction, you need to itemize deductions. However, the TCJA significantly increased the standard deduction, essentially doubling it for most people. For example, a married couple filing a joint tax return can claim a standard deduction of $24,400 in 2019, up from $12,700 prior to the TCJA in 2017.

At the same time, deductions for state and local taxes and other miscellaneous deductions were capped or eliminated.

The increased standard deduction, along with fewer options for itemized deductions, means far more people will take the standard deduction. And this means fewer people are predicted to give to charity.

The nonprofit Tax Policy Center estimates that the TCJA will cut the number of people who itemize for a charitable deduction by more than half (from 21 percent to about 9 percent of households). If your charitable motivation is based largely on getting a tax benefit, but you don't actually get a tax deduction, you have less incentive to give.

So what can you do? To qualify for a charitable deduction in this environment, some people are adopting a strategy known as "bunching." You give the same amount in total, but alter the pattern and timing of your giving. Instead of giving smaller amounts every year and not itemizing, you make a larger contribution in one year to be able to itemize. In one or more subsequent years you don't give to charity and take the standard deduction. Then, when you give a larger amount again, it is essentially equal to the amount you would have given in the years you took the standard deduction.

For the taxpayer, bunching may provide a tax benefit that you wouldn't otherwise qualify for. However, the impact of bunching on a charity can be problematic. It affects the timing of charitable giving and therefore makes it more difficult for charities to predict, plan for and smooth their revenue streams.

Reduced Tax Rates Means Reduced Tax Benefits

The TCJA cut income tax rates for many people. So even if it still makes sense for you to itemize, you may get less of a tax benefit for each dollar you contribute. This reduced tax benefit may affect your charitable decision making. And with a federal estate tax exemption of $11.58 million per person in 2020, wealthier households may find planned giving that is motivated by estate tax savings at death to be less advantageous.

Giving Strategies Expanded For Some

A possible ray of sunshine for charities: the TCJA includes two beneficial provisions affecting itemized deductions for wealthier taxpayers.

The TCJA increased the maximum current deduction for cash gifts from 50 percent of adjusted gross income to 60 percent. It also eliminated an income-based cap on itemized deductions known as the Pease Limitation. For example, prior to TCJA, if a married couple filing jointly with adjusted gross income of $313,800 (the Pease limitation threshold for 2017) whose only itemized deduction was a cash charitable gift of $100,000, they could deduct the full amount. If that same couple had adjusted gross income of $500,000 more, they would be allowed a deduction of only $85,000, which is 3% of the income over the threshold amount. Today, that haircut no longer applies.

Both of these changes increase the maximum amount you can deduct if you make very large gifts.

Charitable Distributions from an IRA

It's notable that one popular form of giving was not affected by the TCJA. If you are over 70 ½ years old, you may still make direct transfers of up to $100,000 per year from your Individual Retirement Accounts to qualified charities. Although not deductible, these transfers are not counted as taxable income for federal tax purposes, so you still get a significant tax benefit.

These direct-to-charity contributions may also be used to satisfy required minimum distribution (RMD) requirements. And while recent tax law changes under the SECURE Act raised the start date for RMDs to age 72, you can still make qualified charitable distributions beginning at 70 ½.

This combination of TCJA and SECURE ACT provisions, plus other recent legislative changes, could greatly impact the options for and success of your income tax, estate tax and retirement plans. Regardless of your motivation for giving, it's probably time to revisit your charitable giving strategy.

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