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Charitable Planning – Bunching deductions, Donor-Advised Funds, and IRA transfers

The new tax law brings new considerations for charitable planning before the end of the year.

Tax benefits of Charitable Giving:

You are able to take an income tax deduction when you donate to a 501(c)3 public charity. However, the amount of the tax benefit of the deduction can vary greatly depending on your filing status, other deductions, and income level.

The new tax law eliminated the personal exemption and increased the standard deduction for tax filers. The new standard deductions are $12,000 for single filers, $18,000 for head of household, $24,000 for married filing jointly, and $12,000 for married filing separately. The additional standard deduction amount for those 65 or older (or are blind) is $1,300 per person if married and $1,600 if single.

Charitable contributions can only reduce your tax bill if you choose to itemize your deductions. Common itemized deductions are mortgage interest, state and local taxes (now capped at $10,000), charitable giving, and medical and dental expenses (to the extent they exceed 7.5% of your adjusted gross income). Generally, you would itemize your deductions if the total of these expenses add up to more than the standard deduction. However, with the $10,000 cap on state and local taxes along with the higher standard deduction amounts, many taxpayers will not be itemizing their deductions under the new law.

For example, if you are a married couple with a modest mortgage balance and pay $8,000 in mortgage interest, have property taxes of $8,000, pay state income taxes of $12,000, and give $5,000 to charity, under the new law, you would not be itemizing your deductions in 2018:

Mortgage interest deduction	$ 8,000
State and local taxes ($12K + $8K), capped at $10K	$10,000
Charitable contributions	$ 5,000
Total itemized deductions	$23,000

This total does not exceed the standard deduction of $24,000 for a married couple.

What does that mean for charitable giving? If making charitable gifts annually as in the above example, there is no tax benefit for the charitable contributions. However, there are some planning options available that would allow for some benefits:

1. **"Bunching" - Gift two years' worth of contributions in one year.** For example, continuing on the above scenario, double up on your gifting in 2018 and send $10,000 to your charities instead of $5,000, and then skip next year. If $10,000 was contributed to

charities instead of $5,000 in the above example, then the itemized deductions would total $28,000, which exceeds the standard deduction for a married couple by $4,000. For that $10,000 total contribution, $4,000 would benefit your tax calculation as the portion *in excess of* the $24,000 standard deduction. However, doubling up may not work well for some organizations who expect and prefer contributions on an annual basis.

2. **Establish a Donor-Advised Fund (DAF) before the end of the year.** Also known as Charitable Gift Funds, these are like having your own foundation. You contribute cash or highly appreciated stock to the charitable fund and take a tax deduction in the year of contribution. Then over the following year(s), you direct contributions from the Donor-Advised Fund to the charities of your choice. There is no further tax deduction on distribution of the funds because the deduction was taken in the year of contribution, but this helps your charity better manage their cash flow and you can distribute amounts annually while "bunching" the benefit of the contributions into one year to exceed the standard deduction.

3. **Gift Appreciated Stock.** Donating appreciated stock to a qualified charity or a Donor-Advised Fund can be a powerful tool. Gifts of long-term appreciated assets are valued for deduction purposes at fair market value (FMV) on the date of transfer (versus cost basis of the shares). When gifted to a qualified charity, there are no taxes to pay on the appreciation. For example, if you bought 200 shares of Apple at $10 and it is worth $170 today, you can gift these shares to a Donor-Advised Fund and take a charitable deduction for $34,000 (200 shares x $170/share). If you had sold these shares and donated the after-tax proceeds, you would have first recognized a capital gain of $32,000 which translates to about $10,000 in taxes (assuming rates of 20% fed and 10% Cal). Therefore, the net cash donation and charitable deduction would only be $24,000 ($34,000 proceeds less $10,000 tax liability) versus the full $34,000 if the shares had been donated directly. This strategy produces a great result for both you and the charity, and the donation can be made to a Donor-Advised Fund or directly to a qualified charity. Larger national charities are usually set up to accept stock donations, but smaller local charities may not have a broker relationship in place to accept donations of shares.

4. **Gift your RMD.** For those over age 70½ with Required Minimum Distributions (RMD's), you can direct your IRA custodian to distribute directly to a qualified charity. Called a QCD (Qualified Charitable Distribution), the donated amount qualifies as part of your RMD, yet it is excluded from taxable income. Keeping the taxable income lower may also help reduce phase outs and taxation of Social Security.

It is not too late to implement any of the strategies above, but in order to be considered for the 2018 tax year, all transactions need to be settled by December 31, 2018. Items #3 and #4 above may take a week or two to complete. Please do contact us with any questions.