Charitable Giving Strategies Under the New Tax Law

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The Tax Cuts and Jobs Act became law in late December and has generated a host of questions about tax and charitable planning. Many donors are wondering how the new law may impact charitable giving.

Kim Laughton, President of Schwab Charitable, sat down with Hayden Adams, CPA, Director of Tax and Financial Planning at the Schwab Center for Financial Research, to discuss their thoughts on the matter and share strategies to help donors give more efficiently in the new tax environment.

Kim Laughton: What are the biggest changes in the new tax law?

Hayden Adams: The big changes are in tax rates. Some rates have gone down and the tax brackets themselves have shifted, so more income is going to be taxed at lower rates. In addition, the standard deduction has been significantly increased. Some itemized deductions have also been limited or eliminated. There are people who may be negatively impacted by some of these changes, but there are planning strategies people can use to mitigate some of the adverse effects. Overall, the vast majority of taxpayers should see a reduction in their tax bill due to the changes.

Kim Laughton: You mentioned itemized deductions have been limited or eliminated. The charitable deduction has been a very popular itemized deduction. Are there any changes to the charitable deduction, and if so, do you think that will impact giving?

Hayden Adams: That has been a big topic of discussion, but nothing has really changed that directly affects charitable contributions or deductions. It's the other itemized deductions that have been restricted, such as the deductions for property and real estate taxes — and state and local income taxes. Those deductions have been capped at a combined total limit of $10,000 and because of that, it limits the amount of itemized deductions people might be able to take overall — which could push more people into taking the standard deduction. Individuals who stop itemizing and take the standard deduction won't receive a tax benefit for their charitable giving. But I think the reality is most people are going to give because they want to give, not because they get a tax deduction.

Kim Laughton: We find that to be true. While taxes are definitely an incentive, most people are driven by their philanthropic mission.

What about people who are already itemizing, have lots of deductions, and will probably continue to itemize – are there any changes in the tax bill that are going to impact them and their ability to get the tax benefit from their charitable giving?

Hayden Adams: That's a great point because even with these limits on deductions, there are still going to be people who end up itemizing their deductions, and there are some positive changes that many people could take advantage of. For example, there used to be a 3% overall limitation on itemized deductions that could potentially phase out a lot of the value that people would receive from itemizing. That limitation was removed. In addition, donors are now allowed to deduct cash contributions of up to 60% of their adjusted gross income (AGI). In the past, the deduction could not exceed 50% of their AGI.

Kim Laughton: That's terrific news. Now let's talk about the people who are in that larger camp who may have itemized in the past, but will most likely take the standard deduction in the future. How does this new tax law affect them and are there any strategies they can use to give more tax efficiently?

Hayden Adams: There are definitely some strategies that can be implemented for individuals who are at that marginal point where they may or may not be able to itemize deductions — because the standard deduction has increased so much.

For example, let's say you have a married couple filing jointly who in the past takes about $23,000 of itemized deductions per year. Because their itemized deductions are less than the new $24,000 standard deduction, they will be better off by taking the standard deduction going forward.

But let's say $13,000 of their deductions are related to state taxes, property taxes and other itemized deductions, while $10,000 is related to charitable donations. In that case, the couple may want to consider concentrating multiple years of charitable contributions into one year. So in one year, they could double their charitable giving and itemize $20,000 worth of donations plus $13,000 of their other normal itemized deductions, which gives them $33,000 of total itemized deductions. This puts them above the standard deduction. The very next year, they can skip donating and take the $24,000 standard deduction. The net result would be a lower tax bill over that two-year period.

Kim Laughton: That sounds like a great idea that allows people to get the best of both worlds. The years that they use the standard deduction, they're getting the benefit of that higher standard deduction, but every few years when they itemize and make bigger gifts, they're getting the full tax benefit of those charitable gifts.

Hayden Adams: It's definitely something that people should consider. It's very tax effective to concentrate giving in that manner and one of the simplest and most flexible methods to do so is to use a donor-advised fund (DAF). Individuals can contribute a large amount into a donor-advised fund in one year and then they can grant it out to various charities over time.

Kim Laughton: That's what we see people do quite a bit at Schwab Charitable. It's a really good way to give appreciated investments and assets, which are still tax-advantaged under the new tax law. Donors don't have to pay capital gains tax when Schwab Charitable or another public charity sells them. If donors were to sell a highly appreciated investment themselves, they would have to pay capital gains tax and they would be able to give perhaps 80% of the proceeds after taxes. When they give appreciated assets to a charity, they get to give the whole amount.

Hayden Adams: One of the other things that people need to focus on is developing a plan to specifically address their charitable giving and determine exactly how much they can give and when. Of all the itemized deductions that you have today, the one that you have the most control over is the charitable deduction.

Kim Laughton: That's great to hear. So the charitable deduction in many ways is one of the more valuable deductions because it's not being capped. For people who are philanthropically minded it's a good thing to discuss their charitable giving strategy with their tax and financial advisor.

Hayden Adams: Definitely. People should consider that it's not just about maximizing the deduction in any given year. They should also look at strategies to maximize their deduction in years when they have high income. So, for someone who has a big windfall related to their personal business, they can use that year as an opportunity to give a large donation to a donor-advised fund or a charity and offset a lot of that income that would otherwise be taxed at a very high rate in that year.

Kim Laughton: That's excellent advice. Thank you so much for being with us and for helping us to decipher the complexities of the tax law and how it impacts clients, investors, and charitable donors.

Schwab Charitable will continue to provide convenient tools and knowledgeable support so donors can focus on maximizing their impact on the charities and causes that are most important to them. Visit schwabcharitable.org to learn more.

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A donor's ability to claim itemized deductions is subject to a variety of limitations depending on the donor's specific tax situation. Consult your tax advisor for more information.

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