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Itemized Deductions, Charitable Gifting, and Investment Expenses

KEY TAKEAWAYS

1) The Tax Cuts & Jobs Act (TCJA) made significant changes to the Standard Deduction and Itemized Deductions; as such, taxpayers' itemized deductions may be drastically different as of 2018 & beyond.

2) The deduction for State and Local Taxes ('SALT') is now capped at $10,000; this category includes state and local income taxes and property taxes.

3) For taxpayers who previously had a high SALT deduction *and* who have little-to-no mortgage interest *and* who are charitably inclined, there may be planning opportunities related to accelerated charitable giving ('bunching' strategy).

4) Miscellaneous 2% AGI deductions were eliminated under TCJA; this group included investment advisory expenses. As part of this change…
   - Taxpayers with Traditional IRAs should have their respective Traditional IRAs pay their own share of advisory expenses.
   - Taxpayers with Roth IRAs should (ideally) choose to pay for Roth IRA-related expenses out of a taxable account, which further preserves Roth IRA assets.
   - Taxpayers cannot use an IRA to pay non-IRA expenses.
   - Taxpayers cannot use a Traditional IRA to pay Roth IRA expenses.

2019 FEDERAL TAX PROVISIONS

The Tax Cut and Jobs Act (TCJA) – which became effective as of 2018 – included major changes to the Standard Deduction & Itemized Deductions while it eliminated Personal Exemptions and "Miscellaneous 2% AGI" Deductions.

A taxpayer takes the ***greater of*** their standard deduction ***or*** itemized deduction total.

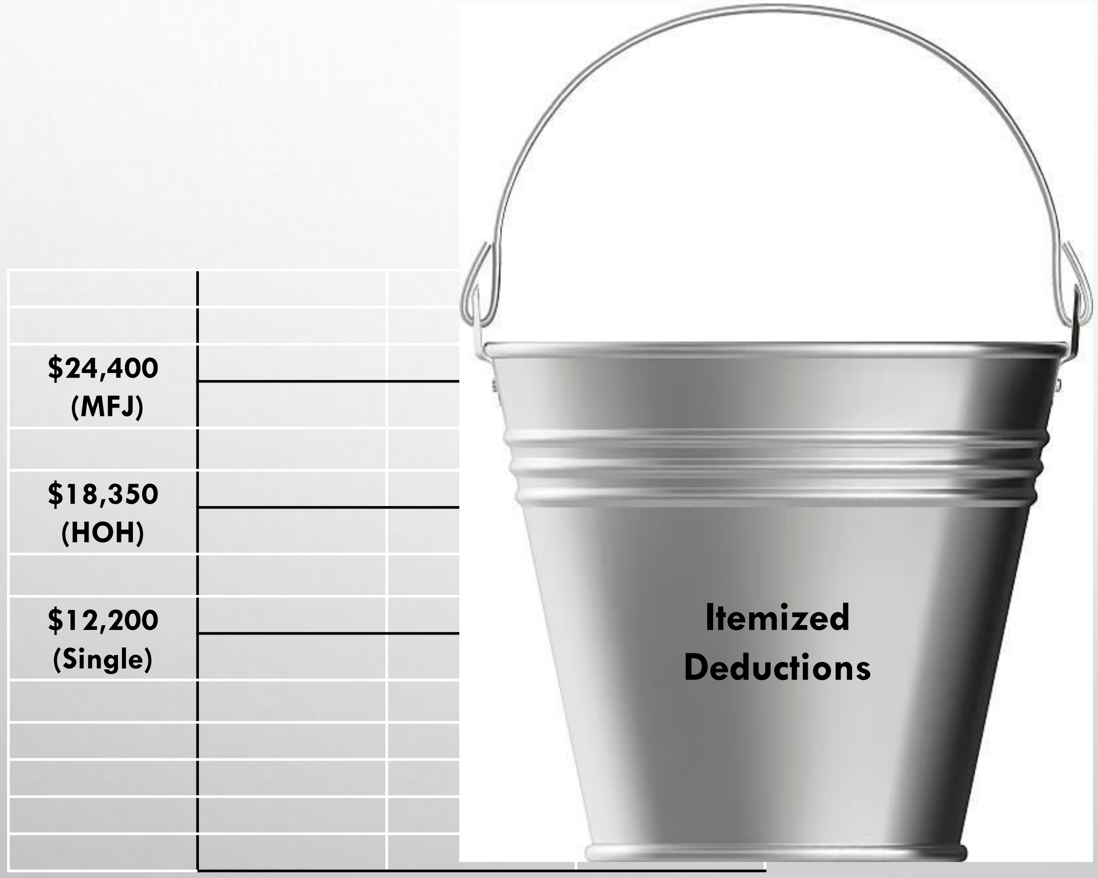
Standard Deduction	Itemized Deductions

$12,200 Single
$18,350 Head of Household
$24,400 Married Filing Jointly
	• Medical & Dental Expenses (in excess of 10% of AGI)
	• State & Local Taxes ('SALT' Deduction) (now capped at $10,000)
	• Home Mortgage Interest
	  o Pre-12/15/2017 mortgages, deductible for mortgages up to $1MM
	  o Post-2017 mortgages, deductible for mortgages up to $750k
	• Investment (Margin) Interest
	• Charitable Gifts
	• Casualty & Theft Losses ($100 deductible per loss event, 10% AGI exclusion)

Individuals who have significant taxable income at the state level and/or who have significant property taxes now have a much different itemized deduction picture ($10,000 cap on SALT).

ITEMIZED DEDUCTIONS

How does your itemized deduction "bucket" compare to your standard deduction?



- Medical & Dental Expenses
- State & Local Taxes ('SALT')
- Home Mortgage Interest
- Investment (Margin) Interest
- Charitable Gifts
- Casualty & Theft Losses

ITEMIZED DEDUCTIONS: THEN VS. NOW

	Example #1 With Mortgage Interest		*Example #2* Without Mortgage Interest	
	Pre-2018	**2019**	**Pre-2018**	**2019**
Medical & Dental Expenses	-	-	-	-
State & Local Taxes		10,000		10,000
* State Income Taxes	50,000		50,000	
* Property Taxes	30,000		30,000	
Home Mortgage Interest	10,000	10,000		
Investment (Margin) Interest	-	-	-	-
Charitable Gifts	40,000	40,000	40,000	40,000
Casualty & Theft Losses	-	-	-	-
Itemized Deduction Total	**130,000**	**60,000**	**120,000**	**50,000**
Standard Deduction (MFJ)	12,700	24,400	12,700	24,400
Greater of Standard Deduction or Itemized	**130,000**	**60,000**	**120,000**	**50,000**
Tax Deduction from Charitable Gifts:				
Itemized Deductions *before* Charitables	90,000	20,000	80,000	10,000
Tax Deduction from Charitables	40,000	35,600	40,000	25,600
(Excess over Standard Deduction Threshold)				
Charitables without Tax Benefit	**-**	**4,400**	**-**	**14,400**
(Standard Deduction Threshold – Itemized Deductions before Charitables)				

CHARITABLE GIFTS

	30% Limit Organization **(ex. Fraternal Organizations, Private Foundations)**	**50% Limit Organization** **(ex. Public Charities, Donor-Advised Funds)**
Cash	Cash Amount, Up to 30% of AGI	Cash Amount, Up to 60% of AGI *
Non-Cash Donations	Value of Property, Up to 30% of AGI	Value of Property, Up to 50% of AGI
Short-Term Appreciated Securities (“Ordinary Income Property”)	Cost Basis, Up to 30% of AGI	Cost Basis, Up to 50% of AGI
Long-Term Appreciated Securities (“Capital Gain Property”)	Fair Market Value, Up to 20% of AGI	Fair Market Value, up to 30% of AGI
Qualified Charitable Distributions (QCD) from IRAs	• Available to taxpayers over age 70½ • Up to $100k per year to qualified public charities • The distribution *cannot* be made to donor-advised funds • Distribution neither counts as taxable income nor as a tax deduction	

For additional resources, see IRS Publication 526, *Charitable Contributions*, and IRS Publication 561, *Determining the Value of Donated Property*.

AGI LIMITS FOR CHARITABLE GIFTS

If a taxpayer has multiple gifts with varying AGI limitations, an ordering process is used to determine which gifts will be deductible in the current year versus which gifts will produce a charitable carryforward.

1) Cash contributions subject to the limit based on 60% of AGI
2) Non-cash contributions (other than qualified conservation contributions) subject to the limit based on 50% of AGI
3) Cash and non-cash contributions (other than capital gain property) subject to the limit based on 30% of AGI
4) Contributions of capital gain property subject to the limit based on 30% of AGI
5) Contributions of capital gain property subject to the limit based on 20% of AGI
6) Qualified conservation contributions subject to the limit based on 50% of AGI
7) Qualified conservation contributions subject to the limit based on 100% of AGI
8) Qualified contributions for California wildfire relief efforts subject to the limit based on 100% of AGI

For additional resources, see IRS "Tax Map" on Charitable Deductions
https://taxmap.irs.gov/taxmap/pubs/p526-005.htm

CHARITABLE CARRYFORWARDS

Per the IRS…

- “You can carry over any contributions you can't deduct in the current year because they exceed the limits based on your adjusted gross income.
- Except for qualified conservation contributions, you may be able to **deduct the excess in each of the next 5 years** until it is used up, but not beyond that time.
- A carryover of a qualified conservation contribution can be carried forward for **15 years.**
- Contributions you carry over are subject to the same percentage limits in the year to which they are carried.”

Note that, when calculating the charitable deduction for a given year…
…current year gifts are used first, after which the charitable carryforward applies.

Taxpayers using an accelerated gifting strategy should be reasonably certain that they will be able to fully use (deduct) their charitable carryforward total within the next 5 tax years.

For additional resources, see IRS “Tax Map” on Charitable Deductions
https://taxmap.irs.gov/taxmap/pubs/p526-005.htm

ACCELERATED CHARITABLE GIVING

If a portion of charitable giving would not produce a tax benefit, taxpayers might benefit from **accelerating ("bunching") charitable gifts** to maximize itemized deductions in a single tax year while taking the standard deduction in other years. This planning strategy can be particularly effective for charitably-inclined taxpayers without deductible medical expenses (>10 percent of AGI) and with no/minimal mortgage interest.

Tax Savings = Charitable Gifts not producing a Tax Benefit x (Years 2 thru Y)

Example:

- Taxpayer has $10,000 of Itemized Deductions before Charitable Gifts (i.e. SALT deduction capped at $10,000) and has $40,000 of Charitable Gifts
- Of the $40,000 of annual charitable giving, the first $14,400 of charitable gifts do not produce a tax benefit
    - Calculated as Standard Deduction Threshold of $24,400 – Itemized Deductions before Charitables of $10,000 = $14,400)
    - As such, the $40,000 of charitables produces a "net" tax deduction of $25,600
- Taxpayer chooses to give four years' worth of charitables in a single year ($40k x 4 = $160k), which produces a larger-than-normal itemized deduction total in Year 1, with the standard deduction taken for Years 2-4
- With the accelerated charitable giving, the taxpayers no longer "loses" the tax benefit of $14,400 of charitables over Years 2-4
- Additional Tax Savings = $14,400 x 3 Years (i.e. Years 2-4) = $43,200

CHARITABLE GIFTING FROM IRAS

Qualified Charitable Distributions (QCDs) from an IRA

- Available to taxpayers over age 70½
- Taxpayers can gift up to $100,000 from the IRA directly to 501(c)(3) charities
  - Donor-advised funds, private foundations, and supporting organizations are *not* eligible recipients under the QCD rules
- The distribution counts towards satisfying the RMD for that tax year
- The distribution does *not* count as income and does *not* count as a charitable deduction
- This strategy also has the added benefit of reducing Adjusted Gross Income (AGI) which may result in lower Medicare premiums (depending on taxpayer's income)

Bottom Line: This provision may be beneficial for individuals who are charitably inclined <u>and</u> who would receive a greater tax benefit from the standard deduction rather than from itemized deductions

ADDITIONAL TAX PLANNING

Donor-Advised Funds vs. Private Foundations

There are numerous considerations to evaluate whether a donor-advised fund or a private foundation (or a combination) might be an effective charitable giving vehicle. The table below provides an abbreviated comparison.

	Donor-Advised Fund	Private Foundation
Start-up Time	Immediate	May take several weeks or months
Start-up Costs	None	Legal & other fees
Initial Contribution/ Minimum	Varies by sponsor, but often as low as $5,000 - $10,000	No minimum, though due to start-up and ongoing administrative expenses, a larger starting balance (several million dollars) is generally advisable
Minimum Grant to Charity	Varies by sponsor, but often as low as $50-$100	No minimum
Ability to Give Anonymously	Yes, donor can choose whether to give publicly or anonymously	No, IRS Form 990 must report gifts
Ongoing Administrative Expenses	Varies by sponsor, but typically starts ~0.60%	Various tax & other expenses
Underlying Investment Expenses	Varies by sponsor, with some investment options as low as 0.03%	Varies based on investments chosen & advisor
Tax Deduction for Gifts	Up to 60% of AGI for cash gifts Up to 30% of AGI for long-term securities	Up to 30% of AGI for cash gifts Up to 20% of AGI for long-term securities
Annual Distribution Requirement	None	IRS requires minimum 5% annual distribution based on prior year's net average assets
Tax Reporting	Handled by the sponsor; donors do not report charitable grant activity	Responsible for tax filings and must annually file IRS Form 990
Excise Taxes	None	1-2% each year

MISCELLANEOUS 2% AGI DEDUCTIONS

Miscellaneous 2% AGI deductions were eliminated under the Tax Cuts & Jobs Act (TCJA); this group included investment advisory expenses (among other items).

With investment advisory expenses no longer tax-deductible (subject to a 2% AGI hurdle)….

1) Traditional IRAs should pay their own share of advisory expenses
- This effectively allows the taxpayer to use pre-tax money (rather than after-tax dollars from a taxable account) to pay for advisory expenses

2) **Roth IRA expenses should ideally be paid from a taxable account**
- By doing this, the taxpayer further preserves Roth IRA assets, which is key given the preferential tax treatment associated with Roth IRAs

3) **An IRA must never pay any expenses but its own**
- A Traditional IRA cannot pay for the expenses of a Roth IRA
- From Financial-planning.com, *"If an IRA pays expenses for a non-IRA account, at best the payment will be a taxable distribution and at worst may be deemed a "prohibited transaction." That may result in the termination of the IRA and its full balance being distributed and subject to tax."*

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