The Tax Cuts and Jobs Act of 2017

How the Act Will Affect Individual Charitable Giving

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THE TAX CUTS AND JOBS ACT OF 2017: HOW WILL THE ACT AFFECT INDIVIDUAL CHARITABLE GIVING?

With the recent massive overhaul of the United States Tax Code (the largest of its kind in nearly 30 years), there is much discussion regarding how these changes may impact charitable giving. Despite the inferences given by the majority of headlines addressing this issue, the deduction for charitable contributions still remains intact and in fact, is one of the only itemized deductions which was enhanced by the Code revisions. There are many reasons for charitable organizations to be optimistic that charitable giving will continue its rising trend by both individuals and corporations if they can look beyond the technical reality that fewer people will be itemizing their deductions and thus will not be able to deduct their charitable contributions. My focus in this article will be on how these changes are expected to impact charitable giving, and more specifically, charitable giving by *individuals*. With the largest tax cuts applying to corporations, why am I focusing on individuals? Because individual charitable giving makes up the substantial majority of all donations. In 2016, giving by individuals totaled \$281.86 billion, bequests from decedent's estates totaled \$30.36 billion and, when combined, represented 80% of all donations made in that year.[1] Will the new tax laws create any significant influence on an individual taxpayer's decision to donate? Let's start by taking a look at the big changes that are likely to have the largest impact, mainly, the (almost) doubling of the standard deduction and reduced tax rates applicable to individuals.

MARGINAL RATE REDUCTIONS

President Trump signed the Tax Cuts and Jobs Act into law on December 22, 2017 (the "Act"). The Act maintains seven (7) federal income tax brackets for individual taxpayers, however, reduces the marginal income tax rates at virtually every level. The marriage "penalty" (the phenomenon where a married couple with similar income levels will pay more in taxes than if they were not married and paying at the single filer rates) is eliminated at every bracket level until you reach the 35% bracket, so that couples filing jointly could still see a penalty if their combined incomes exceed \$500,000.00. Although the overall marginal tax rate reduction is significant, an individual's taxable income (the figure on which the applicable tax rate is based) will be reduced for many by several major changes, most notably, the increased standard deduction and elimination of the personal exemption. For families with children, the doubled child tax credit should more than offset their loss of the personal exemption and the substantial increase in the phase-out limitations for families who qualify for the child tax credit (threshold is \$400,000.00 under the Act for married filing jointly compared with \$110,000.00 for 2017) will allow many taxpayers to benefit from such credit who never could before. The Act increases the refundable portion of the child tax credit as well, ensuring that these changes will be felt by both low and high income earners. Even though some tax filers will see an increase in their taxable income due to these factors, the overall rate reduction should still provide all taxpayers with a lower tax bill.

THE STANDARD DEDUCTION

With the standard deduction nearly doubling (from $6,500.00 to $12,000.00 for single filers and from $13,000.00 to $24,000.00 for married filing jointly) it necessarily follows that fewer taxpayers will be able to itemize their deductions. The Congressional Research Service (CRS) reports that in 2014 (the most recent calendar year with analysis available), 30% of *all* tax filers itemized their deductions, however, a much greater share of higher income earners itemized when compared with lower income earners.[2] Presumably, those tax filers who took the standard deduction did so either because their itemized deductions did not exceed the applicable standard deduction in that year or because they simply didn't know they could itemize. When you look at the statistical data for 2014, as analyzed by the CRS, you see that in the $100,000.00 to $200,000.00 income range, 77% of these tax filers itemized deductions with the average amount claimed by each filer of $25,598.00.[3]

When you move to the income range of $200,000.00 to $500,000.00 you find that 93% of these tax filers itemized with an average amount claimed by each filer of $43,131.00.[4] Based on these figures, it is arguable that many, if not most, tax filers in these income groups will still itemize despite the increased standard deduction. The Act limits the state and local tax deduction to a maximum deduction of $10,000.00 per household, so those in this group who depended on this deduction to allow them to itemize will likely be the ones who are the most affected, as such deduction is the single largest one claimed by households making over $200,000.00.[5] However, the next two largest deductions, namely the charitable deduction and the home mortgage interest deduction, still remain and this income range is responsible for claiming 51% of all charitable deductions.[6] This fact, combined with the $10,000.00 allowance remaining for the state and local tax deduction likely means that households making over $200,000.00 will still itemize and so will still see the direct tax savings from being able to claim a charitable deduction. Further, the Act's elimination of the Pease[*] limitation on itemized deductions may give higher income earners some additional relief.

[*] The Pease limitation phased out itemized deductions by 3% of every dollar over a threshold adjusted gross income figure.

WHICH IS MORE MOTIVATING, A DEDUCTION OR MORE DISPOSABLE INCOME?

Even for those who will no longer itemize deductions under the Act, they will likely still continue to make donations to charities as they have in the past, if not more. Why? First, a charitable contribution deduction does not leave the taxpayer with more money. The fact is that making a charitable donation, despite the ability to claim a tax deduction, always leaves the taxpayer with less money than if they didn't make the donation. As we know, the charitable deduction is just that, a deduction, and not a dollar for dollar credit against tax you otherwise owe. As such, a taxpayer who will owe $20,000.00 in income taxes is not going to be encouraged by giving up additional cash of $10,000.00 which will reduce their taxes by $2,500.00, when their cash outflow still increases by $7,500.00. On the flipside, a taxpayer who consistently makes charitable donations is certainly encouraged that doing so will reduce his or her overall tax burden, but is not motivated by the deduction itself. The good news for charities is that overall donations continue to increase and, in 2016, giving by non-itemizers grew by an estimated 3.4%.[7]

It is impossible to look at data showing how many people itemize or not and relate that to whether or not those taxpayers made charitable donations based on that fact. If not that data, then what data can we look at? With tax, regulatory and other economic factors changing over time and with each individual household's deductible expenses fluctuating based on those and other personal factors, perhaps we should look at the most consistent data available relating to charitable giving, that is, giving as a percentage of disposable personal income and gross domestic product.

Giving USA Foundation's data table showing individual giving as a percentage of disposable income (DPI) summarizes data from 1976 through 2016 and shows this percentage floating right at 2% throughout this time period.[8] The percentage jumps as high as 2.4% in 2000 and as low as 1.7% in 1995 but in most years the percentage of giving based on DPI stays right around 2%. Similarly, Giving USA Foundation's data on giving as a percentage of gross domestic product (GDP) shows the percentage for the same dates ranging from 1.6% to 2.2% with the percentages over the last 20 years lingering right at 2%.[9] This data clearly indicates that individuals will give more as their disposable income increases in a manner consistent with their prior giving. If we assume that the Act results in more disposable personal income and an increased GDP, we can expect giving to continue and hopefully to continue to increase.

THE ENHANCED CHARITABLE DONATION DEDUCTION

The Act increases the charitable contribution deduction allowance from 50% to 60% of a taxpayer's adjusted gross income. This will clearly benefit high net worth, high income individuals making large donations, especially those who have an unusually large taxable event such as the sale of a business. This increase, in combination with charitable split interest gift planning techniques, creates significant planning opportunities for these individuals. Those with lower incomes can also benefit from this change. For example, a single individual who is retired and receives a large portion of tax exempt income but who is able to itemize due to expenditures for state and local taxes, medical expenses (10% floor reduced to 7.5% under the Act) and charitable donations will likely be able to deduct more of his or her charitable contribution each year.

THE CHARITABLE IRA ROLLOVER

The Act left intact the Qualified Charitable Distribution (a/k/a charitable IRA rollover) which allows individuals over 70 ½ to make charitable gifts directly from an IRA (traditional or Roth) up to $100,000.00 a year to a qualifying charitable organization. The distribution can be used by individuals to satisfy part or all of that individual's required minimum distribution (RMD). This provision of the Code will allow those over 70 ½ who cannot itemize, due to the standard deduction increase and related changes, to make donations directly from their IRA to a charity, with the result being that any such distribution (up to $100,000.00) bypasses the individual's income for federal tax purposes. Low income earners over 70 ½ who make donations each year, but not enough to justify itemizing their deductions, can now make charitable donations directly from their RMD, thus excluding that portion from being reported to them as income and still taking full advantage of the standard deduction to offset whatever other income they may have. For taxpayers over 70 ½ who itemize already and who will continue to itemize, this provision allows them to, in effect, take a 100% deduction for a Qualified Charitable Distribution, because it is excluded from AGI and so is not subject to any limitations that the taxpayer may otherwise encounter based on their adjusted gross income. Because this provision can potentially provide benefits to all levels of income earners over 70 ½, it is so important that we, as legal and financial planners, educate our clients about this very important option *before* they begin making their charitable donations in any given year.

CONCLUSION

The Tax Cuts and Jobs Act implements sweeping changes to the U.S. Tax Code, so much so, that it is difficult to make broad assumptions regarding how these changes will affect different groups of taxpayers. The combination of reduced marginal tax rates, increased standard deductions and various limitations on certain itemized deductions, among other changes, will require each household to apply these new provisions to their own unique situation in order to see if their tax bill will be reduced. If the Act truly creates the promised economic growth and increased disposable incomes for most Americans, we can expect individuals to keep giving to charity and hopefully to give more, maintaining the United States' record as the most generous country in the world.[10]

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[1] Giving USA Foundation/ Giving USA 2016/Annual report on philanthropy for the year 2016

[2] Congressional Research Service/ 2017 Data Analysis for Itemized Deductions for Individuals

[3] *See* endnote #2 above

[4] *See* endnote #2 above

[5] Tax Foundation/ The Largest Deductions Taken by High-Income Households/ July 3, 2017

[6] *See* endnote #5 above

[7] *See* endnote #1 above

[8] Giving USA Foundation/ Giving USA 2016/ Giving USA Data Tables for Charts in the Numbers/ Individual giving as a percentage of disposable personal income (DPI), 1976-2016

[9] Giving USA Foundation/ Giving USA 2016/ Giving USA Data Tables for Charts in the Numbers/ Giving as a percentage of gross domestic product (GDP), 1976-2016

[10] The Almanac of American Philanthropy, January 8, 2016, states that charitable giving in the United States is two to twenty times higher than in comparable nations.