TAX AND WEALTH ADVISOR ALERT: 'TIS THE SEASON FOR CHARITABLE GIVING AND TAX DEDUCTIONS

As we enter the holiday season and focus on what we are most thankful for, many of us will begin planning for our annual charitable contributions. While tax benefits are not the primary reason behind most giving—giving back is its own reward—the IRS has established these tax benefits to encourage charitable giving. This year, as you begin making decisions about your gifting, make sure you understand and consider the recent changes under tax reform so you can stay on the nice list and get the most out of your charitable giving tax deduction!

Standard or Itemized Deductions

A common thought with charitable giving is that you can take a charitable contribution deduction for the full amount of your donation and directly offset your income. This thought will get you on the naughty list! You can *only* receive a charitable donation tax deduction if you "itemized" your deductions. You will not receive a charitable donation tax deduction if you take the "standard deduction."

The Tax Code allows you to subtract a standard deduction based on your filing status or subtract your total itemized deductions—whichever is greater. For 2019, the standard deduction will be $12,200 for single taxpayers, $18,350 for heads of households, $24,400 for joint filers, and $12,200 each for married couples filing separately. Allowable itemized deductions, sometimes subject to limits, include such expenses as mortgage interest, charitable contributions, state and local taxes and medical expenses. Look at the following example. If you are a single taxpayer, and the sum of your itemized deductions (contributions included) do not exceed $12,200, you will take the standard deduction over the itemized deduction. In this scenario, you will technically not receive a tax deduction for your charitable contribution.

Before the new Tax Cuts and Jobs Act, the standard deduction for each filing status was about the half the amount that it is for 2019. The increase in the standard deduction makes itemizing a difficult hurdle to jump, and many may now find it harder to itemize and take advantage of the charitable contribution deduction.

However, if you can itemize, the allowable charitable contribution deduction will depend on the type of contribution made (i.e., of cash, securities, property, etc.), as well as the type of organization to which the donation was made. While most charitable deductions are limited to 60% of your adjusted gross income (AGI), some are limited further—to 30% or, in some cases, even 20%. Therefore, your total AGI is an important consideration if you plan to benefit from a charitable donation deduction.

In short, at a minimum, you will be able to deduct 20% of your AGI. At a maximum, you will be able to deduct 60%. If you made charitable contributions during the year, and one or more limits described below apply, you can use the IRS's Worksheet 2 to help compute your deduction.

Eligible Donations

Before understanding the deduction limitations for each type of charitable contribution, it is important that your charitable contribution be eligible to claim as an itemized deduction. Only donations to 501(c)(3) public charities or private foundations are generally deductible as qualified charitable donations. Of note, gifts given to benefit specific individuals are not deductible, which includes most online crowdfunding websites. Moreover, gifts made to political parties, political campaigns, political action committees, labor unions, chambers of commerce, business associations, for-profit schools or hospitals and foreign governments are also not tax deductible.

Additionally, gifts to donor-advised funds, a recently popular vehicle for gift giving, have further eligibility restrictions which should be evaluated before funding. The IRS offers a search tool (Tax Exempt Organization Search) so you can confirm the 501(c)(3) status of an organization you are considering donating to.

Lastly, it is important to remember that your donation to a qualified charity is deductible only in the same year in which it is made. Therefore, if you plan to take a deduction for 2019, you must make sure your deduction is made before December 31 and you ring in the new year!

Charitable Gifts of Cash

Under the old law, your deduction for charitable contributions of cash to qualified organizations was limited to 50% of your adjusted income. If your contributions exceeded this limit, you could carry them forward for up to five years. Under the new Tax Cuts and Jobs Act, until 2026 (unless otherwise extended), the limitation is raised to 60% of your adjusted gross income for gifts of cash to qualified organizations; the five-year carryforward is still allowed.

For example, if your adjusted gross income is $220,000 for the year, you can take a charitable deduction of up to $132,000 (60% of $220k) as long as the gift was in cash and made to a 501(c)(3) public charity. Therefore, if you made a gift of cash that year to the

Salvation Army of $150,000, your gross income can be offset by the $132,000 charitable deduction limit (reducing it to $88k) and the remaining $18,000 of your charitable deduction that you were not able to utilize due to the percentage limitations can be carried forward for the next five years.

Charitable Gifts of Non-Cash Items

The IRS will allow a deduction for donations of non-cash items as well, if the item is in "good working condition or better." Therefore, stop and think before claiming a deduction for the donation of a dusty old toaster that is missing a few parts that you received 35 years ago as a wedding gift. There is no fixed method for determining the value of these items, but the IRS, Salvation Army, and Goodwill, all provide helpful valuation guidelines.

If you make noncash contributions, your deduction for the noncash contribution is limited to 50% of your adjusted gross income minus your cash contributions subject to the 60% limit. If your total deduction for all noncash contributions for the year is over $500, you must complete Form 8283 and list the donated items, as well as their value, and attach it to your Form 1040. Additionally, any non-cash contribution over $5,000 will most likely require a qualified appraisal attached to the Form 8283 to substantiate the value (publicly traded stock may be an exception).

Charitable Gifts Quid Pro Quo

If you receive some sort of compensation for your donation (such as tickets to a charity gala, a theatrical performance, a sporting event, or merchandise, goods, or services), you can only deduct the amount of the donation that exceeds the fair market value of what you received. Moreover, you cannot deduct the cost of raffle, bingo, or lottery tickets bought from a charitable organization or deduct the value of your donated time or professional services, or the value of donated blood. Additionally, important for all of those college sports fans to know, is that under the new Tax Cuts and Jobs Act, if you make contributions in exchange for the right to buy college athletic tickets, you are not allowed a deduction for this donation (previously, you could deduct 80%).

Charitable Gifts of Securities

Direct donation of publicly traded securities (or other illiquid gifts) is another common way to fund a charity for donors. This is a particularly tax-efficient method if you have long-term appreciated stock, because with a direct charitable gift of appreciated securities held long-term, you avoid paying the capital gains tax (typically 20% of the appreciated value). If you were to sell the shares and donate the cash proceeds instead, while you would get the higher percentage limitation with the donation of cash (60%), you would have to pay the capital gains tax upon the sale of the shares. This usually does not result in a greater tax benefit than a direct donation of securities.

The amount of the charitable deduction and the limitation on the deduction depends on how long the securities (or other illiquid gifts) have been held and, in part, on the type of charity receiving the property (for example, private foundations are subject to different limitations – but that is beyond the scope of this discussion). If you donate short-term securities to a public charity, a deduction is allowed only for the lesser of (1) the FMV of the securities or (2) your cost basis. In most cases, if the stock appreciated, this will mean your deduction is your cost basis. You may then deduct up to 50% of AGI, reduced by the amount of any cash contributions you made that year allowed under the 60% limit. If you donate long-term securities to a public charity, a deduction is generally allowed for the FMV of the securities. You may then deduct the lessor of (1) 30% of your AGI or (2) 50% of your AGI less other contributions to 50% charities and cash contributions allowed under the 60% limit.

Charitable Gifts from Your IRA

If you meet the requirements, you can also make a charitable contribution from your IRA. However, your ability to take a charitable deduction will depend on whether the contribution is made from your traditional IRA or Roth IRA. If you are age 70½ or older, you may make direct charitable gifts from your traditional IRA (which counts toward your required minimum distributions) of up to $100,000 to public charities (other than donor advised funds and supporting organizations) and not have to report the IRA distributions as taxable income on your federal income tax return. There is no charitable deduction for the distributions, so you benefit from this if you do not itemize your deductions. However, not paying tax on otherwise taxable income is essentially the equivalent of a charitable deduction.

Assuming the Roth IRA distribution requirements are met (generally, over the age of 59½ and held Roth for over 5 years), your cash distribution from a Roth IRA will be tax free. You can then use this distribution to make a cash donation to a charity. The bonus here is that there are no restrictions on the type of charity like there are with the traditional IRAs. Additionally, unlike traditional IRAs, you can claim an itemized deduction for your charitable cash contribution up to the 60% of AGI limitation. Nevertheless, it generally is not the best option to take distributions from your Roth IRA and donate to charity because the tax rules for Roth IRAs are so favorable. Usually, it is best to leave your Roth balances untouched and earning more tax-free income rather than taking money out for charitable contributions if you can make your contributions from a different source.

Documentation

No matter what you end up donating and how limited your deduction may be, the most important thing to remember if you intend to reap the tax benefits of your charitable contribution is that you must keep accurate records of your contribution. Any contribution over $250 must be acknowledged with a receipt from the charity indicating the organization's name, the date of the contribution and the amount. The IRS notes that you, the donor, are responsible for requesting and obtaining the written acknowledgment from the charity. Typically, charities will provide donors with written letters of acknowledgement or receipt; however, you can write it yourself ahead of time, and simply have it signed when you drop off your items. This way you can trust that the receipt is correct and that it includes all the information you need.

The IRS can disallow charitable donations of $250 or more if you do not have a written acknowledgment from the charity to document your gift. So, while your canceled checks, receipts, bank statements, telephone bills or photographs (all of which you should keep) can be useful if your return is audited, the IRS may not allow the deduction in case of a missing acknowledgement receipt or letter.

Conclusion

While taxes might not be at the forefront of your mind when gifting this holiday season, the tax deduction for charitable contributions is a nice added benefit under the tree! To make the most out of this tax benefit it is important to familiarize yourself with the deduction rules and limitations.

The attorneys at O'Neil, Cannon, Hollman, DeJong and Laing S.C can ensure that you are making donations that best serve organizations while helping you maximize tax benefits this holiday season. If you need assistance in developing individual tax strategies or have questions about tax and estate planning, please contact Attorney Britany E. Morrison to discuss how we can assist you in your needs.