Kovitz Investment Group

Intrinsic Values®

Financial Planning Corner

Fall 2018

"Bunching" Charitable Contributions

The tax reform bill (Tax Cuts & Jobs Act, or "TCJA") passed in late 2017 had far-reaching consequences that impact taxpayers in a variety of ways, some to the taxpayers' benefit and others to their detriment. Although it was presumably unintentional, a potential result of the TCJA will be a limitation on the ability of some taxpayers to realize a tax benefit for their usual charitable gifting. However, we present a potential solution to this problem.

The potential limitation is due to the combination of the standard deduction roughly doubling to $24,000 from $12,700 (for joint filers, to $10,000 from $6,350 for single filers) and the imposition of a $10,000 cap on the amount of state and local income and property taxes that can be deducted. Broadly speaking, these new parameters mean roughly two-thirds of households who have historically itemized will now claim the standard deduction in 2018 and future years. This also means a certain subset of taxpayers will find the tax benefit that rewards their generosity to be fully negated; in particular, charitably inclined high net worth households whose members are in or nearing retirement and whose home mortgage is nearly or fully paid off (a description that resembles many Kovitz clients).

For example, one such household's income tax deductions for 2018 may resemble the following:

<table>
<tr><th>Expense</th><th>Amount</th><th>Allowable Deductions</th></tr>
<tr><td>State Income Tax</td><td>$10,000</td><td rowspan="2">$10,000</td></tr>
<tr><td>Real Estate Tax</td><td>$10,000</td></tr>
<tr><td>Mortgage Interest</td><td>$5,000</td><td>$5,000</td></tr>
<tr><td>Charitable Contributions</td><td>$5,000</td><td>$5,000</td></tr>
<tr><td>Total</td><td>$30,000</td><td>$20,000</td></tr>
<tr><td></td><td></td><td></td></tr>
<tr><td>Larger of Itemized or Standard Ded.</td><td></td><td>$24,000</td></tr>
</table>

Under the TCJA that takes effect in 2018, this former "itemizer" would claim the now-higher standard deduction since the value of the standard deduction ($24,000) exceeds the sum of their allowable itemized deductions ($20,000). In other words, in 2018, the standard deduction would be taken regardless of whether or not there were any charitable deductions during the year. This is unfortunate, but some relatively simple advance planning can salvage this lost opportunity for tax savings. In many cases, a taxpayer can realize a tax benefit by front-loading (or "bunching") several years' worth of charitable deductions into a single year, taking a large deduction in the year of the gift, and then claiming the standard deduction in ensuing years. In the end, the taxpayer's preferred charitable organizations receive the same level of support, and the taxpayer receives up-front tax savings.

Continuing with the previous example, the taxpayer could bunch 5 years' worth of typical annual charitable contributions in 2018, which would look as follows:

Expense	**2018 Deductions**	**2019 Deductions**	**2020 Deductions**	**2021 Deductions**	**2022 Deductions**
State Inc. Tax	$10,000	$10,000	$10,000	$10,000	$10,000
Real Estate Tax					
Mortgage Interest	$5,000	$5,000	$5,000	$5,000	$5,000
Charitable Contributions	$25,000	$0	$0	$0	$0
Total	**$40,000**	**$15,000**	**$15,000**	**$15,000**	**$15,000**
Larger of Itemized or Standard Ded.	**$40,000**	**$24,000**	**$24,000**	**$24,000**	**$24,000**

Timing the donations in this manner results in an additional $16,000 worth of deductions over the 5-year period in this hypothetical scenario, which equates to several thousand dollars in tax savings that are entirely recognized in that first year.

While this approach works well in theory, there are real-world implications that might make it difficult to implement. What if you don't have cash on hand to front-load the contributions? How do you explain to your favorite charity that they won't be receiving another contribution from you for another five years? Fortunately, there are practical solutions:

1. You can work with your Kovitz advisor to make the donation using highly appreciated stock (in-lieu-of cash) and realize two-fold benefits. First, your deduction is equal to the market value of the stock at the time of donation, subject to certain limitations. Second, you permanently avoid realizing the stock's embedded capital gains and any future tax liability owed on those gains.

2. If you'd prefer to make your usual charitable gifts each year instead of all-at-once, a Donor Advised Fund ("DAF") may offer the most efficient solution. You'll receive a deduction in the year of a completed gift to the DAF, while maintaining the ability to spread out your large charitable donation over many recipients and across several years. For more information on Donor Advised Funds, please refer to our Winter 2017 newsletter, which provides more color around this charitable vehicle.

To discuss how this strategy may apply to your personal situation, please reach out to your Kovitz advisor.