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Tax Reform and Philanthropy: Exploring Why and How You Give

The new tax law will have sweeping implications on charitable giving, creating a greater urgency to examine what motivates your philanthropy and to review your personal approach.

For the majority of Americans, the tax overhaul has altered or reduced many of the financial incentives for making charitable donations. But charitable giving is rarely driven solely by the desire to trim tax bills. In fact, most individuals and families give for a variety of reasons and support organizations in whose missions they believe.[1] Still, 18% of donors primarily make gifts to receive tax benefits. As this new tax era ushers in, we believe it is an ideal time to examine why you give as well as the vehicles you use to give.

Why You Give

A key factor to determining the impact of the new tax legislation on your charitable giving and the means you use to make donations is to understand why you give. Below are some questions to review with your family and your advisors to help clarify your motivations.

- What drives you to support specific causes and organizations?
- Do you have an overarching reason for being philanthropic in general?
- Do you have both long- and short-term goals you are trying to achieve?
- Are you seeking to engage family members to help generations develop wealth management skills?
- Are you seeking opportunities to discuss and share family values and legacy?
- Are you seeking a tax deduction?
- Do you make charitable contributions for a combination of reasons?

The Tax Implications

Simply put, the Tax Act and Jobs Act[2] is anticipated to result in the elimination of the charitable deduction for approximately 90% of U.S. taxpayers, who will likely choose to take the standard deduction. The Tax Policy Center estimates 91-95% of taxpayers will take the standard deduction while the Joint Committee on Taxation estimates over 90% will.

Many families of wealth will, however, likely continue to itemize. For donors who do itemize, the tax rules for charitable giving remain complicated. Tax benefits vary depending on the form of contribution. For example, cash, appreciated stock, or artwork come

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[1] 2016 U.S. Trust Study of High Net Worth Philanthropy *http://www.ustrust.com/publish/content/application/pdf/GWMOL/USTp_ARMCGDN7_oct_2017.pdf*

[2] Officially titled "*To provide for the Reconciliation pursuant to titles II and V of the concurrent resolution on the budget for the fiscal year 2018.*"

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with their own set of rules, which vary based on the organization donated to. (For details on the specific changes in the tax code, please see chart on page 4.) Additionally, there are limits to how much is tax deductible in a given year. To gain a clear understanding of how the new tax laws affect your specific situations, we recommend you speak with your tax advisor.

Itemizers May Benefit from New Provisions

The act contains a few provisions that may encourage charitable giving by individuals who itemize. It raises the limit on cash contributions for those who itemize from 50% of adjusted gross income (AGI) to 60% of AGI. This benefit expires after 2025. There is no change for noncash gifts.

Additionally, the Pease limitation on itemized deductions for higher income individuals has been repealed. The Pease limitation reduced the value of most itemized deductions when a taxpayer's AGI reached a certain point.

Those with estates in excess of the new estate tax exemptions of $11.2 million for individuals and $22.4 million for couples may continue to benefit from strategies maximizing estate tax deductions and minimizing the value of their estate. Those with estates that fall within the exemptions should note this provision expires after 2025 and that the estate tax could be amended again prior to 2025. Since 2001, the estate tax has been amended over 30 times.

Weighing Gifting Vehicles

There are a number of strategies and vehicles that can be employed to make charitable gifts. Below, we review eight of the most common methods of donating. Changes to the tax laws do not affect any of the nontax reasons for using these strategies.

- **Donor-advised funds** (DAFs) are a low-cost, simple method to administer your charitable giving. DAFs provide the opportunity to engage family members who may serve as advisors and successor advisors. Advisors can recommend grants when they choose, in the amount they choose, to qualified charities from a DAF. For those who itemize, DAFs may provide an immediate tax deduction.
- **Charitable lead trusts** allow a donor to make charitable gifts during their lifetime by providing a charity of the donor's choice with an income stream. These trusts are frequently used as a technique to delay gifts to family members. They are also used to shelter appreciation and capital gains. Depending on the donor's unique financial situation, use of charitable lead trusts may reduce the donor's estate and gift taxes.
- **Charitable remainder trusts** allow a donor to receive an income stream and make a charitable gift when the trust term ends. These trusts are frequently used for highly appreciated assets to shelter appreciation. They are also commonly used to minimize capital gains. Depending on the donor's financial circumstances, the donor may receive an estate deduction as well as reduced estate and capital gains taxes.
- **Private foundations** are tax-exempt entities that fulfill a charitable purpose by making grants to

Charitable Deductions May be Back

The Universal Charitable Giving Act (H.R. 3988/S. 2123) is pending legislation that would allow non-itemizers to claim a charitable deduction of up to one-third of their standard deduction, or $4,000 for individuals/$8,000 for couples.

Remember Receipts

In order to claim a tax deduction for a charitable gift of $250 or more in cash or property, the donor must obtain a written acknowledgment from the charity and maintain a copy of the transaction. In addition, volunteers who itemize are entitled to a tax deduction for non-reimbursed volunteer expenses of $250 or more, and must obtain an acknowledgement letter from the charitable organization containing a description of the services provided. The lack of proper supporting documentation can cause your charitable deduction to be rejected by the Internal Revenue Service (IRS).[3]

charitable organizations. Family foundations are typically classified as private foundations. They provide the directors/trustees with flexibility and control of the foundation, its investments, and grant distributions. A private foundation can potentially exist in perpetuity, helping to achieve family legacy. For those who itemize, donations to a private foundation may provide an immediate tax deduction.

- **Bequests** are a provision in a donor's will providing for a specific dollar amount, item of property, or share, fraction, or percentage of the donor's estate to be distributed to a named charitable beneficiary. The full amount of the charitable gift, at death, may be deducted from a donor's estate. Leaving a bequest to a charity fulfills the donor's philanthropic wishes by directing the charity/charities of the donor's choice to receive a gift upon their death. This may provide a benefit depending on the estate size.
- **Charitable beneficiary designations** may be bestowed on organizations, naming them as beneficiaries of various types of accounts, including retirement plans, life insurance policies, and other assets that may pass by contract. Naming a charity as a beneficiary allows for the charity to receive the gift. The donor's estate is reduced, which may be beneficial depending on the estate tax exposure.
- **Charitable gift annuities** serve as an agreement between a donor and a nonprofit organization, where the donor contributes assets to a charity, which in turn pays a lifetime income stream to the donor or an individual selected by the donor. This allows a donor to support a charity while receiving an income

The Philanthropy Impact

There is tremendous concern in the nonprofit community that the new tax law will result in a sharp reduction of contributions in 2018. In our opinion, the verdict is still out.

The Tax Policy Center (TPC) sees a reduction in charitable giving of $16-24 billion annually due to fewer taxpayers itemizing,[4] while The Joint Committee on Taxation (JCT) predicts a decline of at least $13 billion annually.[5] JCT anticipates an additional $4 billion decrease in charitable giving due to the increase in the federal estate tax exemption. It's important to note that since 1976, charitable giving increased in current dollars every year except 1987, 2008, and 2009.[6]

[3] See IRS Publication 1771 *Charitable Contributions: Substantiation and Disclosure Requirements* and IRS Publication 526 *Charitable Contribution* for detailed substantiation requirements.

[4] http://www.taxpolicycenter.org/taxvox/house-tax-bill-not-very-charitable-nonprofits

[5] https://independentsector.org/news-post/new-analysis-house-tax-bill-decrease-giving/

[6] Giving USA Foundation, *Giving USA 2017.*

stream. Donors who itemize may receive an income tax deduction. Those with estate tax exposure may receive a deduction.

- **IRA charitable rollovers** permit individuals aged 70 ½ and older to make qualified distributions up to $100,000 annually from the donor's IRA to qualified charities. Rollover distributions must be made directly from the IRA to the charity. These distributions are not taxable income for the donor and count toward the IRA's annual minimum required distribution. This provision allows IRA holders to make charitable gifts and support causes and organizations they believe in without increasing their taxable income.

Tax reform, for many, has far-reaching financial implications. Now is an ideal time to discuss and discover your philanthropic goals and motivations to determine how best to support causes and organizations meaningful to you and your family.

Tax Changes

Summary of Provisions Affecting Philanthropy

	Tax Changes	
Provision	**Tax Cuts and Jobs Act**	**Impact**
Standard Deduction Increase	▪ The standard deductions are increased for individuals from $6,500 to $12,000; for couples from $13,000 to $24,000; and heads of households from $9,350 to $18,000. ▪ There was no change for noncash gifts. ▪ Limitations on itemized deductions for higher-income individuals (Pease limitations) are repealed. ▪ Raises the limit on cash donations for those who itemize deductions to 60% of AGI from the current 50% of AGI. ▪ Expires after 2025.	▪ The Joint Committee on Taxation (JCT) estimates less than 10% of taxpayers will itemize going forward, reducing charitable giving at least $13 billion annually. The JCT also estimates this reduction in charitable giving would cost 220,000 to 264,000 nonprofit jobs. ▪ Impact limited to taxpayers who itemize.
Deductions for Charitable Contributions	▪ No provision to extend charitable giving deduction to taxpayers who do not itemize. ▪ Repeals the Pease Amendment, which imposed limits on itemized deductions.	▪ The Universal Charitable Giving Act (H.R. 3988/S.2123) is pending, which would allow non-itemizers to deduct up to one-third of their standard deduction ($4,000 for individuals, $8,000 for couples). ▪ Eliminates limits on itemized deductions for higher-income taxpayers.

Provision	Tax Changes	
	Tax Cuts and Jobs Act	**Impact**
Federal Estate Tax	▪ Doubles the exemption from $5.6 million to $11.2 million for individuals and $22.4 million for couples. ▪ Expires after 2025.	▪ The JCT estimates doubling the exemption will reduce federal revenues by nearly $100 billion over 10 years and lower charitable giving by $4 billion annually. ▪ Could affect planned giving vehicles including charitable trusts, charitable gift annuities, bequests, and beneficiary designations.
Unrelated Business Income Tax (UBIT)	▪ UBIT will be calculated on each UBIT generating activity, not aggregated.	▪ The first $1,000 of UBIT is exempt from taxation under current law. ▪ The change could result in increased taxes on nonprofits.
Donor Substantiation Requirements	▪ Repeals an unused regulation allowing the IRS to create an optional tax return that nonprofits could file in lieu of providing donors with a written acknowledgment of contributions.	▪ IRS substantiation rules for donors and volunteers still apply. ▪ Rule repealed would have shifted the burden of substantiating a charitable donation from the donor to nonprofits.
Nonprofit Colleges and University Endowments	▪ Places a new 1.4% excise tax on net investment income of nonprofit colleges and universities with assets of at least $500,000 per full-time student and more than 500 full-time students; half of the students must be U.S based. ▪ Donors to colleges and universities can no longer receive a charitable deduction for any payment made in exchange for the right to purchase tickets or seating for athletic events.	▪ Estimates this will affect a small number of schools.
Highly-Compensated Nonprofit Employees	▪ Imposes a new 21% excise tax on nonprofits that pay compensation of $1 million or more to any of a company's five highest-paid employees.	

Pending Legislation

The following provisions are under consideration

Provision	Pending Legislation: Tax Cuts and Jobs Act	Pending Legislation: Impact
Johnson Amendment	▪ Adopted in 1954, the Johnson Amendment (also known as "preaching from the pulpit") prohibits charities and churches from "directly or indirectly participating in, or intervening in, any political campaign on behalf of (or in opposition to) any candidate for elective public office." ▪ The House bill contained provisions weakening this law.	▪ Changes were excluded from the conference report due to procedural requirements. ▪ On May 4, 2017, the president signed an Executive Order instructing the Treasury not to enforce the Johnson Amendment against religious organizations. ▪ It is likely there will be additional attempts to repeal and/or weaken this law.
Donor-Advised Funds	▪ A minimum required distribution was not included in either the House or Senate bill.	▪ In December, the IRS issued Notice 2017-73 Proposed New Rules for Donor-Advised Funds, seeking comments on proposed rules relating to use of DAFs to satisfy donor's pledges, applying private foundation bifurcation rules and public support treatment of DAF distributions. Although it is not likely the current version of the proposal will be implemented, concern over the increasing balances and lack of oversight will lead to greater regulation at some point in the future. ▪ A minimum required distribution is not mentioned in this notice.

College Sports Benched

Donors to colleges and universities can no longer receive a charitable deduction for any payment made in exchange for the right to purchase tickets or seating for athletic events. Previously, donors could take a charitable deduction of 80% of the amount paid for the right to purchase the tickets.

Proposals that Missed the Cut

- The House bill proposed a 1.4% standard private foundation excise tax.
- The House bill prohibited tax-exempt organizations from issuing private activity bonds.
- The House bill required art museums that are private operating foundations to be open to the public for at least 1,000 hours per year.
- The House bill allowed the volunteer mileage rate to be adjusted for inflation.
- The Senate bill imposed excess benefits penalties, reduced executive compensation safe harbors, and repealed a provision implementing intermediate sanctions against nonprofit boards in certain circumstances.

For more information, please contact your Wealth Management advisor.