TAX REFORM

Are you committed to charitable causes, but worried that you might lose your deduction?

Historically, many of our clients have claimed an "itemized deduction" on their federal tax return for charitable gifts, resulting in a lower tax bill. However, recent legislation may impact the tax benefits of charitable gifts for 2018 and beyond. Throughout our history, Mesirow has had a strong philanthropic culture, so charitable giving is a wealth planning area in which we are very experienced and eager to help our clients. This article outlines how our clients can integrate charitable giving into their financial plan and still enjoy some of the tax benefits long associated with charitable giving.

Taxpayers have the choice of electing either to (i) use the "standard deduction" (a fixed dollar amount that can be deducted by every taxpayer) or (ii) "itemize" their deductions (the value of a taxpayer's aggregate tax deductions). The percentage of households that use the standard deduction is expected to increase dramatically due to the recently passed Tax Cuts and Jobs Act of 2017 (TCJA).

Beginning in 2018, the TCJA sharply limited or eliminated several of the most widely used itemized deductions; for example, capping "state income and local property tax" deductions and eliminating the "2% miscellaneous" deduction. The TCJA also nearly doubled the standard deduction to $24,000 for married couples (from $12,700) and $12,000 for individuals (from $6,350). As a result, many taxpayers will find that in 2018 their aggregate itemized deductions will not exceed the new standard deduction.

This is a crucial change, as many new "standard deduction" taxpayers will no longer receive a direct tax benefit from any of the itemized deductions they have historically used, such as charitable donations, local property taxes, and home mortgage interest.

Here are two strategies to consider based on the new tax rules.

Strategy 1: Donor Advised Fund

One approach taxpayers can consider is to strategically "lump together" several years' of charitable donations into a single tax year by making a donation to a Donor Advised Fund (DAF).

A DAF is a vehicle for charitable giving that makes it easy for donors to dedicate funds to support their favorite nonprofit organization. It allows the donor to make a charitable contribution, receive an immediate tax benefit, and then recommend grants from the DAF to the donor's charities over time.

For the years in which the "lumped" contributions are made, it may be more beneficial to itemize the taxpayer's deductions to create tax savings (assuming those deductions exceed the $24,000 standard deduction threshold). In other years, the taxpayer would elect to use the increased standard deduction.

Federal Deduction	Change Under New TCJA Legislation
Property taxes and state and local income taxes (SALT)	Limited to an aggregate maximum deduction of $10,000
Miscellaneous itemized deductions subject to the 2%-of-AGI floor	Deduction completely eliminated
Home mortgage interest	Deduction limited to interest on no more than $750,000 of mortgage debt for newly acquired homes (interest on $1,000,000 of mortgage debt taken out before December 15, 2017 is grandfathered). Deductibility is only allowed for debt used to acquire, build, or substantially improve the residence that is secured by the loan. The structure of the debt (mortgage vs. home equity line of credit) does not impact deductibility.

This is not intended to be a comprehensive list of all possible itemized deductions.

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For example, let's assume that a married couple typically makes annual charitable donations of $12,000. In addition, their only other itemized deductions are state income taxes and local property taxes, which are now limited to a combined maximum deduction of $10,000. Due to these new limitations, their total itemized deductions would be $22,000. Since this is below the $24,000 standard deduction threshold, the taxpayer would elect the standard deduction and would not receive any direct tax benefit from the charitable donations, state income taxes, or local property taxes.

$12,000 Charitable gifts	+	**$10,000** max/year Property Tax	=	**$22,000** Total Itemized Deductions

In this instance, you would instead take the $24,000 Standard Deduction.

To produce tax savings, the couple could instead combine four years' worth of donations together and contribute to a DAF. As a result, they would receive an immediate tax deduction for the combined $48,000 donation to the DAF and would have itemized deductions well in excess of the standard deduction amount for that particular year. They could then make $12,000 grants from the DAF to their preferred charities each year for the next four years!

$12k x 4 = $48,000 Tax deductible charitable gift to a donor advised fund	+	**$10,000** max/year Property Tax	=	**$58,000** Total Itemized Deductions

In this instance, you would itemize your deductions instead of taking the $24,000 Standard Deduction.

In addition to providing a taxpayer with the opportunity to maximize their tax benefit from these charitable donations, DAFs offer the following benefits:

- When you gift appreciated stock to the DAF, you receive a charitable deduction for the full value of the stock and the full value of the stock goes into the DAF. None of the entities (you, the DAF, or the charity) will pay capital gains on the stock's past appreciation
- Once the funds are in the DAF, you can invest that money (with the support of your advisor) and any future growth will be tax free
- You control your DAF account during your lifetime, with named successors to carry on your legacy
- You control which charities the DAF will provide grants to, as well as the amount of the grants made by the DAF to those charities

Strategy 2: IRA Qualified Charitable Distributions (QCDs)

Charitable-minded investors age 70½ or older can take advantage of qualified charitable distributions (QCDs) where some or all their distribution is donated directly to a charity. In these situations, the amount donated can be used to satisfy the annual required minimum distribution (RMD) requirement, but is excluded from taxable income. This approach is limited to $100,000 per year.

In situations where the taxpayer is not going to itemize their deductions, the QCD strategy will likely be more advantageous than taking the RMD in cash and then contributing to charity (as the standard deduction taxpayer will have to include the RMD amount as income, but will not benefit from a charitable deduction). In order to order to take advantage of a QCD:

- You must be at least 70½ years old
- The charity must be a qualified charity
- The check must be made payable to the qualified charity
- Contributions to a DAF or a private foundation do not count as a QCD

These are just a couple examples to demonstrate how we can partner with you to make minor charitable giving adjustments that will allow you to continue your gifting and still enjoy the tax benefits long associated with charitable giving. Your Mesirow wealth advisor can discuss these and other options with you and your tax advisor to help determine which approaches might work best for you.

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