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Impact of Tax Reform on Charitable Donations

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After passage of the Tax Cuts and Jobs Act of 2017 (TCJA) on December 22, 2017, many nonprofits have been left wondering what the impact will be on charitable donations received and individuals are trying to determine how to maximize their tax benefit from donations.

Impact of Changes to Standard and Itemized Deductions

Each tax year individuals are allowed to reduce their Adjusted Gross Income by the greater of their itemized deductions or the standard deduction. TCJA nearly doubled the standard deduction starting in 2018—$12,000 for single filers; $24,000 for married filing joint; $18,000 for head of household. At the same time TCJA made changes to the itemized deductions, which may limit these deductions for some individuals.

The combination of these changes will mean that some individuals that had previously itemized deductions will now be taking the standard deduction. Tax Policy Center is projecting that about 11% of households will be itemizing deductions on their individual tax return under the new tax law, which is down from approximately 26% under prior law.

This means that one of the potential side effects under the tax reform is that some individuals may choose to reduce donations to charities because they are no longer receiving a tax benefit. The Joint Committee on Taxation estimates that individuals may reduce charitable giving by $13 billion annually as a result of this tax law change.

"Bunching" as a Strategy to Receive Tax Benefits from Charitable Donations

With proper tax planning some individuals may be able to continue receiving a tax benefit for the donations they make through a technique called "bunching." An individual that uses this technique will combine and make multiple years of normal annual charitable donations in a single year in order to increase the likelihood that itemized deductions will exceed the standard deduction and provide additional tax savings.

Let's look at the following example to put this into perspective: Betty is a single filer and she typically donates $3,000 per year to PPFF. Her other annual itemized deductions total $8,000. Without bunching donations, Betty's itemized deductions ($11,000) would be lower than her $12,000 standard deduction so she would take the standard deduction each year. If Betty were to bunch 3 years' worth of annual donations
($9,000) into Year 1 her itemized deductions would be $17,000 which exceeds the standard deduction in Year 1 by $5,000 resulting in a tax benefit for the donations. Then in Year 2 and 3 Betty would reduce her donations to a lower level and would take the standard deduction.

Donor-Advised Funds as a Method of Receiving Tax Benefits from Donations

Another method for achieving this same result is through the use of a donor-advised fund (DAF). A DAF is essentially a charitable savings account that allows donors to make a charitable donation, receive an immediate tax deduction and then recommend grants from the fund over time. At any time the individual may direct funds to be granted from the account to their favorite qualified charity.

Using the previous example, in Year 1 Betty could establish DAF and decide to contribute the $9,000 (3 years of annual donations) in order to receive the immediate tax deduction in Year 1 even if she only distributes $3,000 to PPFF through the DAF in the first year. In Year 2 and 3 Betty could continue to distribute $3,000 from the DAF in order to even out her donations to PPFF while still receiving the tax benefit in Year 1.

Please discuss these tax and investment planning opportunities with your tax and investment advisors in order to determine the impact on your specific facts and circumstances.