



## Donor Decisions Affected by Itemizing

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Since the Tax Cuts and Jobs Act of 2017 was signed into law, much has been written about its effect on the number of U.S. taxpayers who will itemize their deductions. The new law, which became effective on January 1, 2018, made several changes that have greatly reduced the number of taxpayers who itemize. Among the most significant of these changes are a near doubling of the standard deduction, which is \$24,400 for a married couple in 2019 (add another \$2,600 if both spouses are over 65), and the limitation of the deduction for state and local taxes (SALT) to \$10,000. Estimates are that the number of itemizers for 2018 declined from 30% of taxpayers to just 12% of taxpayers.

A donor's deductions save the donor income taxes only if the donor itemizes the deductions. It makes sense for a donor to itemize deductions only if the total of those deductions exceeds the standard deduction. For a married couple who file jointly and are both over 65, that means they would need itemized deductions of more than \$27,000 for itemization to make sense (half that, \$13,500, if single or filing separately). Hence, a couple who fund a gift annuity and earn a deduction well under \$27,000 may very well be better off taking the standard deduction rather than itemizing.

### Donor Does Not Expect to Itemize

When a gift annuity donor does not expect to itemize, and therefore will derive no benefit from the charitable deduction, it is to her advantage to choose the lowest available IRS discount rate when computing her deduction. Why does it matter, you might ask, if the donor is not going to itemize? Because choosing the lowest IRS discount rate will maximize the annuitant's tax-free income.

- Using the **lowest** available IRS discount rate maximizes the portion of the annuity payments that are tax-free and minimizes the donor's income tax charitable deduction.
- Using the **highest** available discount rate maximizes the donor's income tax charitable deduction and minimizes the portion of the annuity payments that are tax-free.

## Donor Expects to Itemize

Despite the changes wrought by the 2017 Tax Act, many planned gift donors will still be itemizing their deductions. For example, any donor who makes a planned gift that produces a charitable deduction over \$27,000 in 2019 will want to itemize. If the donor has \$10,000 of SALT deductions and a mortgage interest deduction, a charitable deduction of even a few thousand dollars may put her into itemization territory. Some donors may be in itemization territory without any charitable deductions at all.

If a gift annuity donor expects to itemize, then offer the donor the choice of using any of the three available IRS discount rates in the month of gift. The highest available will maximize the donor's deduction and the lowest available will maximize the annuitant's tax-free income. The one in the middle, if there is one, will strike a compromise between the two extremes. Note that in *Planned Giving Manager*, you can show all three results on the Summary of Benefits chart by marking *Yes to Compare gift annuity benefits on Summary of Benefits chart under all 3 available rates?* in the Gift Date – IRS Discount Rate window.

If the IRS discount rate used to compute the deduction is not the rate for the month of gift, make sure the annuitant knows that she must include with her income tax return an explicit election of the rate used. Both *Planned Giving Manager* and *PGM Anywhere* can produce this election statement: choose the IRS Discount Rate Election Statement narrative in Presentations.

## Election to Limit Deduction to Cost Basis

Normally, a charitable contribution of long-term capital gain property (property held more than one year) is measured by its fair market value on the date of gift. However, a donor can elect to limit her charitable deduction to what she paid for the property (the cost basis) and use the 50% of adjusted gross income (AGI) limitation rather than the usual 30% limitation for charitable gifts of long-term capital gain property.

Why would a donor ever consider reducing the deductible amount from fair market value to cost basis? A donor might use this election if she is unable to use all of her income tax charitable deduction in the year of the gift because the deduction exceeds 30% of her AGI, but is less than 50% of her AGI. The donor may then be able to take the entire deduction in the year of the gift instead of having to carry forward her unused deduction.

For example, suppose a donor has an adjusted gross income of \$200,000 and funds a charitable remainder unitrust with long term appreciated stock that has an 80% cost basis. The gift earns the donor an income tax charitable deduction of \$100,000. Without the election, the donor can use just \$60,000 of the deduction and would have to carry forward the other \$40,000. With the election, the donor's deduction would be reduced to \$80,000, but she could take all \$80,000 in the year of the gift.

When a donor makes an election to use the 50% limitation for gifts of appreciated property, the election applies to the deductions for ALL the donor's gifts of long-term appreciated property, including carryforward from prior years. Note that in the case of a gift annuity, making this election affects the donor's deduction only. It does not affect the taxation of the gift annuity payments.

As you can see, there are a lot of tax considerations that go into the decision to make the 50% election. A donor should do so only in close consultation with her tax advisor. Nevertheless, when you have a donor who is planning to fund with long-term appreciated property (e.g., stock) a charitable remainder trust, gift annuity, or other planned gift that will generate an income tax charitable deduction, consider suggesting to the donor that she consult with her tax advisor about whether making the 50% election would be wise tax planning.

## **Summary**

When working with your donors, find a moment in your conversation with them to ask whether they expect to itemize their deductions. Their response will help you guide them to the best IRS discount rate for computing their deduction and help you determine whether the 50% election is something they should consider with the aid of their tax advisor.