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Charitable Giving Before Tax Law Changes Under the New Administration

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Significant changes are expected to U.S. tax laws following the election of Donald Trump as the next President of the United States and the Republican Party's retention of control over both houses of Congress. The details of any legislation are far from settled, but early indications suggest that charitably-minded individuals who have the means to do so may be wise to make larger donations in 2016, possibly accelerating expected 2017 charitable gifts to this year.

This analysis is based upon two elements of Mr. Trump's proposed tax plan. First, he has proposed lowering federal income tax rates. Under Mr. Trump's plan, the top federal income tax rate would drop to 33% from a current high of 39.6%. Second, Mr. Trump proposes capping itemized deductions (which include the charitable deduction) at $100,000 for single taxpayers and $200,000 for married taxpayers filing jointly. House Speaker Paul Ryan's current tax plan would eliminate itemized deductions other than the charitable deduction and the mortgage interest deduction, so it is not clear how these proposals would be reconciled.

These proposed changes suggest that charitable gifts may be more valuable for some taxpayers in 2016 than in 2017, assuming that any changes to the law would be implemented next year. A deduction is generally more valuable when tax rates are higher than when they are lower. Thus, a $1,000,000 charitable gift could save $396,000 of tax at a current 39.6% marginal rate, but only $330,000 of tax at the highest proposed 33% marginal rate for a difference of $66,000.

If enacted, Mr. Trump's cap on itemized deductions could also significantly reduce the tax benefits of charitable giving. Under current law, the maximum amount of a charitable gift that a person may deduct each year is expressed essentially as a percentage of the person's adjusted gross income (AGI) and is not capped at any set dollar amount. For example, gifts of cash to publicly-supported charities are deductible up to 50% of an individual's AGI, while gifts of appreciated stocks are deductible up to 30% of AGI. The current limits for deductions to private foundations are lower – 30% of AGI for cash gifts and 20% of AGI for publicly-traded stock – but still valuable. (Other existing laws, such as the Pease limitation, further influence the deduction that an individual may claim.) If the Trump proposal were enacted, the total of all itemized deductions, including the charitable deduction, could not exceed $200,000 for a married couple. Individuals who already claim itemized deductions for non-discretionary items such as property taxes, mortgage interest, state and local income taxes and medical expenses may find that they have little room left over for charity within the cap.

If a charitable gift is too large to be deducted fully in the year that it is made, current law allows the donor to carry forward the excess portion of the gift for up to five additional years and apply it against income during that time. It is unclear whether any new tax legislation would change or eliminate the charitable carry forward.

All of this suggests that individuals contemplating large charitable gifts should consider making them in 2016, so as to (a) offset the current higher tax rates and (b) avoid any dollar amount cap on the deduction taken. Individuals may consider making gifts to a private foundation or a donor advised fund, each of which allows a donor to make a contribution that is deductible in the year of the gift, but also allows the donor to select the ultimate charitable beneficiaries later. Donors also may consider taking advantage of other sophisticated strategies that can be beneficial in a time of declining tax rates.

Individuals with questions should contact their Goulston & Storrs attorney or any member of the Private Client & Trust or Tax Group.

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