Taking Advantage of the 100% Limit on Deductions for Gifts of Cash in 2020

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The Coronavirus Aid, Relief, and Economic Security Act, better known as the CARES Act, became law in late March. The Act includes several provisions of interest to gift planners. Arguably the most significant of these is the ability to waive the usual 60%-of-adjusted-gross-income limit on deductions for gifts of cash made to public charities in 2020. This change creates several gift opportunities that will appeal to some donors.

How the AGI Limit Waiver Works

For the 2020 tax year only, donors may elect to have a new 100% of adjusted gross income (AGI) limit apply to cash gifts to public charities. The election is available separately for each cash contribution. Whether a donor would want to make the election for some gifts and not for others will depend on the donor's specific tax situation. Gifts to donor advised funds (DAFs) or supporting organizations (SOs) are not eligible for this special election. The 100% limit is reduced dollar-for-dollar by other itemized charitable deductions. This means that in 2020, a donor who deducts 30% of her AGI in long term appreciated property gifts and elects the 100% of AGI limit for qualified cash contributions will also be able to deduct up to 70% of her AGI for qualified cash gifts, a total deduction of up to 100% of AGI. If this donor uses all her available deduction for qualified cash gifts, she will pay no federal income tax in 2020. Ordinarily, this donor’s total deduction would be limited to 60% of AGI and she would have to carry forward the rest. If she makes more than 70% of her AGI in qualified cash gifts in 2020, the qualified cash gift deductions she must carry forward to 2021 or beyond will be subject to the usual 60%-of-AGI limit.

Are Planned Gifts Eligible?

The Act is silent on this question. A Joint Committee on Taxation report released after the CARES Act states that cash gifts to fund a charitable remainder trust are not eligible for the 100% election unless the remainder is distributed in cash to charity during 2020 (see p. 26 of the report: [Description Of The Tax Provisions Of Public Law 116-136]. While not necessarily the last word on this question, the JCT report increases the likelihood the IRS will adopt the same interpretation. The JCT does not mention gift annuities, which can be viewed as an encouraging sign that the JCT agrees with the many commentators who have opined that cash gifts to fund gift annuities are eligible for the 100% election. Our best advice is to advise your donors to consult their own tax counsel on this question.

Leveraging the Temporary 100% Limit on Deductions for Gifts of Cash

The temporary availability of a 100% of AGI limit on gifts of cash presents an opportunity for donors to make large gifts from their retirement plans. This includes not only IRAs, but also 401(k)s, 403(b)s, and other defined contribution plans.

Give From a Retirement Plan

Ordinarily, donors are advised against withdrawing funds from their retirement account and then giving them to charity because they must declare the withdrawal as income and limits on taking an offsetting deduction and other tax effects may result in their gift increasing their income tax.

Imagine Joanne, who has $1 million accumulated in her IRA. She has been using her IRA funds to make charitable gifts but has been limiting herself to making QCDs equal to her RMD each year. Last year that was a little over $43,000. She is a major donor to your organization and would like to make a $250,000 gift to its capital campaign. Her advisor reminds her that the maximum she can give using a QCD is $100,000. The advisor notes, however, that she could withdraw $250,000 from her IRA, then give the $250,000 in cash to your organization. She would have to declare the $250,000 withdrawal as income but could make the 100% election and deduct the entire $250,000 from her taxes. She has enough other income that even if she makes other gifts using appreciated stock, she will have ample adjusted gross income to use all $250,000 of her deduction. Her advisor has determined that the additional $250,000 in adjusted gross income won't otherwise affect her taxes or costs. The result is that she will pay no net tax on her withdrawal, she will make the gift she wants to make, and she will expedite the use of her IRA to make charitable gifts.

Unlike with the QCD, this strategy is open to donors with other types of defined contribution plans. As long as the donor is over 59½ and therefore not subject to the 10% penalty tax on early withdrawals, taking advantage of the 100% election presents an opportunity to make large tax-free charitable gifts from retirement assets in 2020.

If Joanne is over 70½, an alternative would be for her to make a $100,000 QCD and withdraw another $150,000 from her IRA to give to the charity. This approach would result in a smaller increase in her AGI and possibly reduce any adverse tax consequences. Another option is to combine a QCD with a gift of appreciated stock . In this case, Joanne and her advisors would need to weigh the benefit of avoiding capital gain on the appreciated stock against the 30% of AGI limit that would apply to that part of her gift.

Give a Valuable Collectible

The 100% election may also be an opportunity for a donor to give valuable collectibles, such as artwork, antiques, or rare coins, to charity. If the donor were to give the property itself to charity, the donor's deduction would be limited to his cost basis in the property unless the charity kept the property and put it to a use related to its mission. Also, his deduction would be limited to 30% of his adjusted gross income. If the charity intends to sell the donated property and use the proceeds, the donor likely will be better off selling the property himself, realizing the capital gain, then giving the cash proceeds from the sale to the charity and taking the resulting deduction. With the availability of the 100% election in 2020 for cash gifts, the donor should be able to more than offset the reportable gain from the sale by itemizing the deduction for the gift.

Imagine Mr. Jackson, age 78, owns a valuable painting worth $500,000 that he inherited several decades ago when it was worth $200,000. Assuming the charity will not put the painting to a related use, here is how his tax benefits will work out if he gives the painting outright to a charity versus selling the painting himself and giving the proceeds.

	Give Painting	**Sell Painting, Give Proceeds**
Painting FMV	$500,000	$500,000
Painting cost basis	$200,000	$200,000
Realized gain	$0	$300,000
Capital gain tax (@ 28%)	$0	$84,000
Charitable deduction	$200,000	$500,000
Income tax savings (@ 35%)	$70,000	$175,000
Capital gain tax	- $0	- $84,000
Net tax savings	$70,000	$91,000

Mr. Jackson has a unique opportunity in 2020 to save $21,000 more in income tax by selling the painting and giving the proceeds than by giving the painting itself.

If the charity plans to put the painting to a related use, the conventional advice to give the painting itself to the charity will likely provide the most tax benefit to Mr. Jackson. In this case, he would be able to take the entire $500,000 fair market value of the painting as a deduction, which will save him $175,000 in income tax, assuming he is able to use the entire deduction in the year of the gift plus five additional tax years. He will not owe any capital gain tax, either.

Windfall Income in 2020

Because federal income tax rates are progressive, the 100% election offers the potential of considerable tax savings for a donor who has the good fortune to receive a windfall of income in 2020 - for example, a big bonus or the proceeds from selling a business - and wants to give much or all of it to charity.

Example: Henry ordinarily has an adjusted gross income of $200,000/year. A big deal he worked on pans out and he receives a $1 million bonus in 2020, so his AGI in 2020 will be $1.2 million.

If he gives $1 million in cash to public charities in 2020 and elects to waive the %-of-AGI limit on each of his cash gifts, he will save $363,412 in federal income tax in 2020. That is the difference between the federal income tax on $1.2 million and the federal income tax on $200,000.

If he does not elect the limit waiver, on the other hand, he will be limited to deducting $720,000 in 2020 (60% of his AGI) and will have to carry forward the remaining $280,000. He will need another three years to use all of it, assuming his AGI is once again $200,000 each year after 2020 and the federal income tax schedule does not change. The total of his federal income tax savings over the four years will be $296,404.

Henry will save about $67,000 more in federal income tax by waiving the 60%-of-AGI limit. The difference arises because Henry can deduct more of his gift from income that is in a higher tax bracket when he takes all of the deduction in 2020 than when he takes some of it in years when his income is in a lower bracket.

The 100% Election May Not Always Be the Tax-Wise Choice

It is not a given that it will be to a donor’s advantage to make the 100% of AGI election.

Example: Neena, a single donor, has taxable income of $200,000, putting her in the 32% federal income tax bracket. If she makes $200,000 in qualified cash contributions, makes the 100% of AGI election, and itemizes no other deductions, she will pay no federal income tax in 2020, saving $45,016 in tax. However, if Neena does not make the election, she will deduct $120,000 and carry forward $80,000 to 2021. Assuming she can deduct the remaining $80,000 in 2021 and again has taxable income of $200,000, she will save $31,625 in federal income tax in 2020 and another $22,136 in 2021, a total tax savings over the two years of $53,761. Spreading the deduction over two years by using the 60% of AGI limit saves Neena an additional $8,745 ($53,761 - $45,016) over using the 100% of AGI election and taking the whole deduction in 2020.

Summary

The option to waive the 60%-of-AGI limit on gifts of cash made to public charities in 2020 creates some interesting gift opportunities. Each donor’s tax situation is unique, however, so making the election may or may not maximize the donor’s tax benefit from a cash gift. When the question comes up, gift planners should encourage their donors to consult their tax advisors about whether to waive the 60%-of-AGI limit on their gifts of cash in 2020.