Tax Reform Provisions That Could Affect Charitable Giving

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Under Republican leadership, Congress is working feverishly to complete the details of sprawling tax reform legislation, the *Tax Cuts and Jobs Act*, and have it on President Trump's desk for his signature by the end of this year. The House bill (H.R. 1) was voted on and approved on November 16. On the same day, the Senate Finance Committee approved their version of the tax package, which is substantially similar to the Chairman's Mark of the Senate bill released on November 13. The full Senate will take up consideration of the bill after Thanksgiving.

The two bills differ in some important ways and so a reconciliation process will be required before a final bill can be passed and signed by the President. Consequently, the final form of the bill is unknowable. The discussion that follows is based on provisions found in the final House bill and in the bill approved by the Senate Finance Committee. Although some specifics may be altered during the reconciliation process, it seems likely that these provisions will look substantially similar in any final bill that would be approved by both chambers.

The list below summarizes provisions in the bills that would affect charitable giving. The provisions would be effective January 1, 2018 unless otherwise noted.

- Both bills would roughly double the standard deduction to $24,000 for married taxpayers filing jointly, and $12,000 for single filers.

- Both bills would eliminate the personal exemption.

- The House bill would reduce the current seven federal income tax brackets to four - 12%, 25%, 35%, and 39.6%. The top bracket would kick in at a much higher level of taxable income than it does now. The Senate bill would maintain seven brackets. Several brackets would be at a modestly lower rate than now. The top bracket, 38.5%, would start at the same much higher income level as the top bracket in the bill approved by the House.

- The House bill would allow qualified pass-through business owners either to count 30 percent of their income as business income (rather than wage income), taxable at 25%, or set the ratio of their wage income to business income based on their capital investment. The Senate bill would provide a 17.4% deduction for non-wage income, with certain limitations for many types of service businesses.

- Both bills would eliminate the alternative minimum tax.

- Both bills would eliminate most itemized deductions. The mortgage interest and charitable deductions would be preserved, however. The House bill would allow the mortgage interest deduction on loans of up to $500,000 ($250,000 for singles). The Senate bill limit would be $1 million ($500,000 for singles), as under current law. The House bill would eliminate the deduction for state and local income taxes, but allow a property tax deduction with a cap of $10,000. The Senate bill would eliminate the deduction for all state and local taxes, including property taxes.

- Both bills would increase the 50% of AGI limit for cash charitable contributions to 60%, for the year of gift and for the 5-year carryforward. Both bills would also eliminate the Pease limitation by which taxpayers with AGI over an applicable threshold reduce their itemized deductions by 3% of the overage.

- Both bills would double the lifetime exemption from gift and estate taxes to $11.2 million per person, $22.4 million per couple and index these amounts for inflation. The lifetime exemption from generation skipping tax (GST) would also be doubled. Also, the House bill would eliminate estate and GST taxes altogether in 2024 and preserve the current step-up in basis on inherited assets; the Senate bill would not eliminate these taxes.

- The House bill would lower the top gift tax bracket from 40% to 35% in 2024. The Senate bill does not change the top gift or estate tax rate.

Income Tax Rates

The current federal income tax schedule for married filing jointly is:

Taxable Income	Tax Rate
$0 - $19,050	10%
$19,051 - $77,400	15%
$77,401 - $156,150	25%
$156,151 - $237,950	28%
$237,951 - $424,950	33%
$424,951 - $480,050	35%
$480,051 & above	39.6%

The proposed federal income tax schedule for married filing jointly in the House bill is:

Taxable Income	Tax Rate
$0 - $24,000	0%
$24,001 - $90,000	12%
$90,001 - $260,000	25%
$260,001 - $1,000,000	35%
$1,000,001 & above	39.6%

There is a complicated provision that phases out the benefits of the 12% bracket for taxpayers with adjusted gross income (AGI) over $1 million, $1.2 million if married filing jointly. Those taxpayers with AGI in the range where the 12% bracket is being phased out, roughly $1.2 million to $2.3 million if married filing jointly, could face an effective marginal tax rate of up to 45.6%.

The proposed federal income tax schedule for married filing jointly in the Senate Bill is:

Taxable Income	Tax Rate
$0 - $19,050	10%
$19,051 - $77,400	12%
$77,401 - $120,000	22.5%
$120,001 - $290,000	25%
$290,001 - $390,000	32.5%
$390,001 - $1,000,000	35%
$1,000,001 & above	38.5%

Under the House bill, most taxpayers will be in the same or a lower tax bracket under the proposed schedule, although taxpayers with $260,000 - $425,000 of taxable income will see their tax bracket increase from 33% to 35%. Under the Senate Bill, all taxpayers will be in the same or a lower bracket, including those with over $1 million in taxable income (38.5% vs. the current 39.6%). Many taxpayers who receive income from pass-through entities such as partnerships and S Corporations would pay lower rates on some or all of that income than on their wage income.

In general, charitable gift donors who itemize their deductions would save the same amount or a little less in taxes under both of the proposed income tax schedules than they do under the current schedule. Tax savings may go up for donors who have been subject to the about-to-be-repealed alternative minimum tax or who reside in high income tax states.

The Standard Deduction

About 69% of taxpayers currently take the standard deduction. It has been estimated that the combination of a much higher standard deduction amount and the elimination of most itemized deductions would increase this percentage to about 95%. This would mean that despite the retention of the charitable deduction in the House and Senate bills, about 95% of potential donors would derive no tax benefit from the charitable deduction because they wouldn't itemize their deductions.

An Indiana University Lilly Family School of Philanthropy Study (http://independentsector.org/wp-content/uploads/2017/05/tax-policy-charitable-giving-finalmay2017-1.pdf) conducted in May 2017 found that the reduced tax benefit that would result from an increase in the standard deduction and the reduction in income tax rates would reduce charitable giving by 1.7% - 4.6%. The study assumed a slightly smaller increase in the standard deduction than is proposed ($11,000/$22,000 vs. $12,000/$24,000), so its model might predict a slightly greater negative effect using the more current proposed figures.

Deduction Limitations

Some apparent good news for charities is that both bills would keep the charitable deduction, increase the limit on charitable deductions for gifts of cash from 50% of adjusted gross income (AGI) to 60% of AGI and eliminate the Pease limitation. These changes, of course, would affect only the estimated 5% of donors who would actually itemize their deductions if tax reform passes, and of those, likely only a small fraction would have bumped up against the 50% AGI limitation or have lost charitable deductions due to the Pease limitation. But higher-income planned gift and major gift donors could be in that group.

CGP Proposes a Universal Charitable Deduction

The National Association of Charitable Gift Planners (CGP), along with other advocates for the charitable sector, is encouraging Senators and Representatives to support the addition of a universal charitable deduction to their tax reform bills. This would be an above-the-line deduction, meaning that all taxpayers would be able to reduce their taxable income by making gifts to charity, not just the small fraction who itemize their deductions.

Rep. Mark Walker (R-NC) introduced H.R. 3988 in October of this year, which would allow exactly this treatment for taxpayers who take the standard deduction, albeit only up to one-third of their standard deduction. Senators Debbie Stabenow (D-MI) and Ron Wyden (D-OR) have introduced Amendment #9 to the Chairman's Mark of the Senate bill, which would allow an above-the-line charitable deduction up to 60% of modified AGI and reduce the deduction allowed in a way similar to the current Pease limitation. As we write this, CGP is marshalling support for this amendment. If successful, and this provision is preserved in the final bill, it would encourage all donors to make charitable gifts, including the 69% today who take the standard deduction.

Possible Effect on Testamentary Charitable Giving

The reality is that even without tax reform, very few donors are affected by federal estate tax. In 2018, a single person will be able to give $5.6 million away over her lifetime (indexed for inflation) without paying estate tax. A married couple will be able to give twice that much: $11.2 million. The Joint Committee on Taxation estimates that only 0.2% of taxpayers who die in 2017 will owe any estate tax. So, for 99.8% of taxpayers, doubling of the federal estate tax exemption in 2018 would have no effect, nor would eliminating it in 2024 as the House bill proposes.

As a result of the doubling of the estate tax exemption in 2018, the slice of the 0.2% sliver of taxpayers whose estates are over $5.6 million but under $11.2 million (or over $11.2 million but under $22.4 million for married couples) would no longer save 40% of every dollar they give away to charity. Under the House bill (but not the Senate bill), the estates that are even larger would see the same loss of tax benefits starting in 2024. The very largest charitable bequests naturally come from the very largest estates, so it is possible that the number and size of these bequests will decline as a result of these changes. Funding for private family foundations may also decline. The counter-argument is that as a result of the reduction, and then elimination, of the estate tax, these large estates will have more assets available to transfer to charity and therefore will tend to give more to them.

Summary

In general, these developments will reduce the tax benefits of making a charitable gift. For the many more taxpayers who will take the standard deduction rather than itemize, the charitable deduction will be of no value. Most of those who still itemize will save less from deductions because their tax rate will be lower. The doubling of the gift and estate tax deductions will remove federal estate tax savings as an incentive for all but the wealthiest donors (although state estate taxes will remain a consideration). Even the wealthiest donors will lose this incentive if the House bill’s proposed elimination of the estate tax in 2024 is adopted.

While lower taxes will translate into donors keeping more of their wealth and income, research suggests the many reductions in tax incentives will discourage charitable giving of all kinds, including planned gifts. In the long term, gift planners will be wise to put less focus on the tax benefits of a planned gift and more focus on the other ways the gift will benefit the donor and the charity.