VERITAS

DOMINICAN FRIARS FOUNDATION

# The Tax Cuts and Jobs Act

&

# Charitable Giving

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**Introduction**

With the enactment of the **Tax Cuts and Jobs Act (TCJA)** in December 2017, many Americans are facing uncertainty as to its impact on their personal situations. The goal of this pamphlet is to simplify these recent changes so that you can begin to evaluate its potential impact and options available to improve your tax situation.

Additionally, we seek to point out opportunities for you to continue and even expand your philanthropy in a tax-advantaged way, as charitable giving remains one of the primary tools for reducing your tax burden.

Please note: this pamphlet is for informational purposes only. We have simplified a complex area of the law for a lay reader. To determine the actual impact on your specific situation, we vigorously recommend sitting down with your advisors. This booklet should in no way be viewed as replacement for consultation with your advisors.

**The New Tax Return**

It's important to first understand changes to the personal tax return to understand how the recent tax law changes may impact you.

There are many details that we are leaving out that may affect the examples – our goal is to simply give you a clear idea of how you may be impacted. The actual impact, as we have mentioned, can only be determined with your personal tax advisor reviewing your current situation.

The following chart walks you through the basics of a standard tax return.

| | |
|---|---|
| **Gross Income<br>Added up from all sources** | • Salaries<br>• Interest<br>• Gains (may be capital and taxed differently) |
| **Minus<br>"Above the Line" Deductions** | • IRA contributions<br>• Self-employed contributions to qualified plans and health ins.<br>• Student loan interest, qualified tuition |
| **Equals<br>Adjusted Gross Income (AGI)** | • Important for various gov't issues but is NOT your final taxable income |
| **Minus<br>"Below the Line" Deductions** | • Standard deduction OR Itemized deductions<br>• Charitable deduction<br>• Real estate/state/local taxes, Mortgage interest |
| **Equals<br>Taxable Income** | • Multiplied times your bracket rate **less** any "tax credits" or "taxes paid" **equals** what you owe (NOTE: your income is taxed in graduations so that initial inoome is taxed at the lowest bracket level and up until only the highest part of your income are taxed at your "bracket") |

**Tax Brackets**

Your tax bracket is perhaps the most important part of determining your tax liability. It is not as simple as multiplying your taxable income by your tax bracket (less, of course, taxes already paid through payroll deductions or tax credits). Rather, your taxable income is taxed at each tax bracket level. For example, your first $9,325 of taxable income in 2017 is taxed at 10%. The next $28,624 is taxed at 15%. And so on. This is often referred to as the *marginal tax rate*.

The new tax law for 2018 significantly reduces the tax bracket rates. While this is very important in terms of lowering your tax burden, the drop in the rates is not as dramatic as the charts indicate since only those amounts above each bracket level are taxed at the higher levels. Our examples will further show how this works and that the typical rate drop for taxpayers in 2018 will be around 2%.

The bigger question is whether other tax law changes, such as capping of the state and local income tax deduction, will raise your tax bill or not. The answer to this question depends on how other aspects of the new tax law impact your personal situation. In our examples, we will show the actual tax rate being applied to each scenario.

# Tax Brackets Single Filers

| 2017 | | 2018 | |
|---|---|---|---|
| 10% | $0 to $9,325 | 10% | $0 to $9,525 |
| 15% | $9,326 to $37,950 | 12% | $9,526 to $38,700 |
| 25% | $37,951 to $91,900 | 22% | $38,701 to $82,500 |
| 28% | $91,901 to $191,650 | 24% | $82,501 to $157,500 |
| 33% | $191,651 to $416,700 | 32% | $157,501 to $200,000 |
| 35% | $416,701 to $418,400 | 35% | $200,001 to $500,000 |
| 39.60% | $418,400+ | 37% | $500,000+ |
| Standard Deduction | $6,350 | Standard Deduction | $12,000 |
| Personal Exemption | $4,050 | Personal Exemption | Eliminated |

# Tax Brackets for Married Joint Filers

| 2017 | | 2018 | |
|---|---|---|---|
| 10% | $0 to $18,650 | 10% | $0 to $19,050 |
| 15% | $18,651 to $75,900 | 12% | $19,051 to $77,400 |
| 25% | $75,901 to $153,100 | 22% | $77,401 to $165,000 |
| 28% | $153,101 to $233,350 | 24% | $165,001 to $315,000 |
| 33% | $233,351 to $416,700 | 32% | $315,001 to $400,000 |
| 35% | $416,701 to $470,700 | 35% | $400,001 to $600,000 |
| 39.60% | $470,700+ | 37% | $600,000+ |
| Standard Deduction | $12,700 | Standard Deduction | $24,000 |
| Personal Exemption | $8,100 | Personal Exemption | Eliminated |

**Major Differences Between 2017 and 2018**

It is important to understand how the "Standard Deduction" and "Personal Exemption" work - through 2017 and from 2018 going forward.

After subtracting "above the line deductions" from your gross income from all sources, you have your "Adjusted Gross Income" or AGI.

Then, you deduct from your AGI either the "standard deduction" or your itemized deductions (including charitable giving, state income taxes, etc.), whichever is higher. This applies to both 2017, 2018 and beyond.

Additionally, only through 2017, you were able deduct a "personal exemption" per member of your household (children up to age 24) of $4,050 per person. Both of these sets of deductions (the standard/itemized and personal exemptions) reduced your AGI to bring you to your "taxable income." Your taxable income applied to the tax brackets at each level, your marginal rate, brings you to the final amount owed in taxes. Note: the personal exemption deduction phased out for higher AGI levels at around $300,000 to $350,000.

The "standard deduction" was essentially doubled under the new law but the personal exemption deduction was eliminated. Below we will discuss more about these changes to "below the line" deductions.

**Above the Line Deduction Changes**

- Alimony payers will no longer be able to shift taxable income to their former spouses for divorce agreements entered into or modified after 12/31/18.
- Moving expenses are no longer a deduction.
- IRA contributions, self-employment health or retirement costs, student loan interest and qualified tuition and related expenses **remain unchanged**.

While changes to "above the line" deductions may not affect very many people, changes to "below the line" deductions may negatively impact a lot Americans.

**Below the Line Deductions Changes**

- The standard deduction is doubled.
- Personal exemptions are eliminated.
- Deductions for state/local taxes are capped at $10,000.
- Mortgage interest deduction is now limited to mortgages of up to $750,000.

**Plan for Retirement and Reduce Your Taxes**

Contributions to IRAs and qualified retirement plans like 401(k) or 403(b) plans reduce your AGI and thereby reduce your taxes.

If you are concerned about your taxable income increasing due to the new tax law, consult with your tax advisor about whether to increase your contributions to these retirement vehicles.

As our examples show, these changes could mean significant gains or losses to you, depending on your unique situation. **You should consider meeting with your accountant to begin estimating how the new tax law impacts you and what steps you can take to improve your tax situation.**

**The Standard Deduction**

The standard deduction is essentially doubled. This will benefit some taxpayers as it may increase your total “below the line” deductions.

The Act increases the standard deduction to $24,000 for married individuals filing jointly, $18,000 for head-of-household filers, and $12,000 for all other individuals, close to double the 2017 amounts.

While this change may in some cases lesson your taxes if the rest of your “below the line” deductions won’t exceed the standard deduction, there are several other changes to this part of your tax return that may in fact raise your total tax burden even though your tax rate went down and your standard deduction doubled.

**Personal Exemptions**

One of the most prominent “hits” taxpayers face is the loss of the personal exemption.

This “below the line” deduction from your taxable income was $4,050 per person in 2017 (including children up to age 24).

Its replacement in the law – the doubling of the “Child Tax Credit” from $1,000 to $2,000 – assists fewer people, phases out at lower AGIs, and applies only to children under age 17 (not yourself, your spouse or children ages 17-24). See examples.

**Deduction for State and Local Taxes**

The next most prominent “hit” taxpayers may face is the loss of “below the line” deductions for state and local income taxes (“SALT”) in excess of $10,000.

The Act limits the deduction for SALT to $10,000 ($5,000 for married filing separately)

This will significantly affect many taxpayers who reside in high-tax jurisdictions such as New York, New Jersey, and California.

This possible “below the line” deduction loss, coupled with the loss of the personal exemption deduction, could cause an increase in taxable income. See examples and suggestions for improving your tax situation.

**Mortgage Interest Deduction**

Another change to this part of your tax return is the loss of the mortgage interest deduction on any portion of interest from a pre-existing loan exceeding $1 million or interest on the portion exceeding $750,000 on home loans going forward.

You will still be able to deduct all mortgage interest for loans up to those amounts. If your mortgage exceeds these amounts, the interest on the portions above $1 million for pre-existing mortgages or $750,000 for mortgages created after 12/31/2017 will no longer be deductible.

In other words, very few people will be affected by this change and those looking to obtain mortgages in excess of $750,000 in the future can plan accordingly.

**Miscellaneous Deduction Changes**

- The Act eliminates the deduction of interest on home equity loans, regardless of when the home equity loan originated.
- Individuals may no longer deduct "excess business losses" or advisor/tax preparation fees.
- Student loan interest and qualified tuition and related expenses is not affected.
- Phase-out (Pease) of a portion of itemized deductions for higher income taxpayers is eliminated.
- Medical expenses exceeding 7.5% of your AGI are deductible (down from 10% - applies only to 2017 and 2018).
- **Cash contributions to charitable organizations may now offset up to 60% of your AGI (up from 50%).**

**Alternative Minimum Tax**

While addressing the Alternative Minimum Tax (AMT) is beyond the scope of this pamphlet, there is good news for those previously impacted by this tax.

According to the Tax Foundation (https://taxfoundation.org/), the changes to AMT in the new tax law will dramatically limit the number of individuals impacted by the AMT over the next decade.

Changing provisions, such as the increased standard deduction, new rate schedules, and limitations on itemized deductions including mortgage interest and state and local property or income and sales tax will all reduce the number of taxpayers affected by AMT.

**Examples of Tax Outcomes**

The examples on the following pages are designed to provide a general idea as to how the new tax law impacts different basic situations. We have used very simple examples just for illustration purposes. **To estimate how the new tax law impacts you, we strongly recommend meeting with your accountant and/or tax advisor who knows your personal situation and can give you a more accurate estimate.**

# Example Single Standard Deduction

| Single | 2017 | 2018 |
|---|---|---|
| AGI | $100,000 | $100,000 |
| SD + PE | $10,400 | $12,000 |
| Taxable Income | $89,600 | $88,000 |
| **Actual Tax Rate*** | 20% | 17.4% |
| Taxes Owed | $18,139 | $15,300 |
| **Net Tax Savings in 2018: $2,839** | | |

*Actual Tax Rate is computed by taxing income at each level of the brackets, referred commonly as the marginal tax rate

**SD – Standard Deduction**
**PE – Personal Exemption**
**ID – Itemized Deductions**

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# Example Married No Children Standard Deduction

| Married | 2017 | 2018 |
|---|---|---|
| AGI | $150,000 | $150,000 |
| SD + PE | $20,800 | $24,000 |
| Taxable Income | $129,200 | $126,000 |
| Actual Tax Rate | 18% | 16% |
| Taxes Owed | $23,778 | $19,599 |
| **Net Tax Savings in 2018: $4,179** | | |

**SD – Standard Deduction**
**PE – Personal Exemption**
**ID – Itemized Deductions**

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# Example Single Itemizer

| Single | 2017 | 2018 |
|---|---|---|
| AGI | $100,000 | $100,000 |
| ID* + PE | $24,050 | $20,000 |
| Taxable Income | $75,950 | $80,000 |
| Actual Tax Rate | 19% | 17% |
| Taxes Owed | $14,726 | $13,540 |
| **Net Tax Savings in 2018: $1,187** | | |

*Itemized Deductions assumed to be $20,000 in both 2017 and 2018

**SD – Standard Deduction**
**PE – Personal Exemption**
**ID – Itemized Deductions**

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# Example Married With 2 Children Itemizer

| Married | 2017 | 2018 |
|---|---|---|
| AGI | $150,000 | $150,000 |
| ID* + PE | $46,200 | $30,000 |
| Taxable Income | $103,800 | $120,000 |
| Actual Tax Rate | 15% | 12% |
| Taxes Owed | $17,428 | $18,279 |
| Child Tax Credit | $2,000 | $4,000 |
| Total Owed | $15,428 | $14,279 |
| **Net Tax Savings in 2018: $1,149** | | |

*Itemized Deductions assumed to be $30,000 in both 2017 and 2018

**SD – Standard Deduction**
**PE – Personal Exemption**
**ID – Itemized Deductions**

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# Example Married With 2 Children Itemizer in High State Tax Area

| Married | 2017 | 2018 |
|---|---|---|
| AGI | $150,000 | $150,000 |
| ID* + PE | $41,200 | $24,000 |
| Taxable Income | $108,800 | $126,000 |
| Actual Tax Rate | 15% | 12% |
| Taxes Owed | $18,678 | $19,599 |
| Child Tax Credit | $2,000 | $4,000 |
| Total Owed | $16,678 | $15,599 |
| **Net Tax Savings in 2018: $1,079** | | |

*Itemized Deductions assumed to be $25,000 in 2017 and but now taking Standard Deduction in 2018 due to loss of local/state tax deduction over $10,000

**SD – Standard Deduction**
**PE – Personal Exemption**
**ID – Itemized Deductions**

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# Example Married With 4 Children Itemizer in High State Tax Area

| Married | 2017 | 2018 |
|---|---|---|
| AGI | $150,000 | $150,000 |
| ID* + PE** | $58,300 | $24,000 |
| Taxable Income | $91,700 | $126,000 |
| Actual Tax Rate | 14% | 12% |
| Taxes Owed | $14,403 | $19,599 |
| Child Tax Credit** | $2,000 | $4,000 |
| Total Owed | $12,403 | $15,599 |
| **Net Tax Cost in 2018: $3,197** | | |

**SD – Standard Deduction**
**PE – Personal Exemption**
**ID – Itemized Deductions**

*Itemized Deductions assumed to be $35,000 in 2017 and but now taking Standard Deduction in 2018 due to loss of local/state tax deduction over $10,000
**Assume two children are between ages 17 and 24 which don't qualify for child tax credit for both years

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# Example Married High Earning Itemizer

| Married | 2017 | 2018 |
|---|---|---|
| AGI | $350,000 | $350,000 |
| ID* + PE | $58,100 | $34,000 |
| Taxable Income | $291,000 | $316,000 |
| Actual Tax Rate | 24% | 20% |
| Taxes Owed | $71,247 | $64,499 |
| **Net Tax Savings in 2018: $6,748** | | |

*Itemized deductions in 2017 include mostly state taxes of $50,000

**SD – Standard Deduction**
**PE – Personal Exemption**
**ID – Itemized Deductions**

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# Example Married Very High Earning Itemizer

| Married | 2017 | 2018 |
|---|---|---|
| AGI | $650,000 | $650,000 |
| ID* + PE | $72,100 | $34,000 |
| Taxable Income | $577,900 | $616,000 |
| Actual Tax Rate | 30% | 27% |
| Taxes Owed | $174,079 | $167,299 |
| **Net Tax SAVINGS in 2018: $6,780** | | |

*Itemized deductions in 2017 include mostly state taxes of $64,000

**SD – Standard Deduction**
**PE – Personal Exemption**
**ID – Itemized Deductions**

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## Example Married Very High Earning Itemizer

| Married | 2017 | 2018 |
|---|---|---|
| AGI | $650,000 | $650,000 |
| ID* + PE | $72,100 | $54,000** |
| Taxable Income | $577,900 | $596,000 |
| Actual Tax Rate | 30% | 27% |
| Taxes Owed | $174,079 | $159,979 |
| **Net Tax SAVINGS in 2018: $14,100**** | | |

*Itemized deductions in 2017 include mostly state taxes of $64,000
**Add additional $20,000 in charitable giving in 2018 to bring down taxable income

**SD – Standard Deduction**
**PE – Personal Exemption**
**ID – Itemized Deductions**

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### Tax on Appreciated Assets

An important point regarding the new tax laws is that the capital gains tax remains unchanged.

The Act preserves the 0%, 15%, and 20% tax brackets for long-term capital gains and qualified dividend income based on the same breakpoints as under pre-Act law. For joint filers in 2018, the 15% bracket begins at $77,200 and the 20% bracket at $479,000 ($38,600 and $425,800 for single taxpayers, respectively).

The Act did not eliminate or modify the 3.8% net investment income tax! Highest earners still face a 23.8% maximum effective Federal capital gain tax rate in addition to any state level taxes on capital gains!

The Act also did not adopt the Senate bill’s requirement that taxpayers use the “first-in, first-out” rule in determining which securities have been sold. Thus, taxpayers will still be able to identify specific blocks of securities being sold or gifted (and may, e.g., elect to sell high-basis securities or contribute low-basis securities to charity).

### New Planning Opportunities for Parents or Grandparents of Private Elementary and Secondary Students

Tax-advantaged accounts designed to encourage saving for future college costs, so-called 529 plans, are now expanded to include savings for elementary and secondary school expenses.

Taxpayers will be able to withdraw up to $10,000 per year tax-free for elementary and high school expenses, such as tuition and books.

Another potential advantage applies to taxpayers living in states that allow state level income tax deductions for 529 plan contributions. Approximately 35 states give a full or partial deduction against ***state*** income taxes for contributions to their state's section 529 plans. In Michigan, for example, up to $10,000 in 529 plan contributions can be deducted from taxable state income.

Note: be sure to discuss this provision with your advisors ***prior*** to making any 529 contributions or withdrawals as each state creates its own rules regarding 529 plans and states may eliminate the deductions mentioned above and/or may limit the use toward elementary or secondary schools.

**Estate Tax Changes**

The changes to the estate tax offer significant planning opportunities.

The new law doubles the maximum gift/estate tax exemption, as well as the Generation Skipping Transfer Tax (GSTT) exemption. Thus, as of January 1, 2018, the maximum estate/gift and GSTT exemption amounts which had been scheduled to rise to $5,600,000 under prior law will be now be double that amount -- $11,200,000 per person. That means a married couple pooling their exemptions will be able to shelter up to $22,400,000 from gift, estate, and generation skipping taxes.

That also means that an individual who had previously used all his or her estate/ gift and GSTT exemptions will have an additional $5,600,000 of exemptions with which to plan.

Additionally, the gift tax annual exclusion, which allows you to gift to as many people as you wish without requiring a gift tax filing, will increase from $14,000 to $15,000.

**Charitable Trusts as a Planning Option**

If carefully designed, a **charitable lead trust** – which creates a fixed stream of payments to charities for a term of years – can provide a donor with immediate income and estate/gift tax deductions, as well as significant wealth transfers to children or grandchildren.

Or, a **charitable remainder trust** can be used to bypass capital gains, receive a partial income tax deduction and create a stream of income for yourself or a loved one.

**Contact your estate planning attorney to find out more about these and other sophisticated giving vehicles.**

**Watch Your Home State's Estate Taxes**

Many states have already eliminated, or are in the process of eliminating, their state level estate tax. Nevertheless, it is important to check with your estate planning attorney and other advisors as on this issue rather than just relying on being below the new Federal estate tax levels.

Those states that still have their own estate tax often tax estates up to 16% above the state exemption levels.  Additionally, several states maintain an inheritance tax, taxing recipients of your estate depending on the familial relationship involved.

**Opportunities for Donors Who are No Longer Itemizing**

- Many more Americans will no longer itemize on their tax returns. This is a positive if it lowers your tax costs, but it also effectively removes the value of the charitable income tax deduction for newly non-itemizers. To be clear, when you claim the standard deduction, you get no financial benefit for any of your itemized deductions, including your charitable donations. However, if you are taking required minimum distributions (RMDs) from your traditional IRA, there is a smart strategy (see below) that will still allow you to obtain a financial benefit from your charitable donations, even if you're still claiming the standard deduction.

**Americans Give Regardless of Tax Benefits**

Only around 30% of American Taxpayers itemize on their returns – and this percentage will drop with the new law.

Yet, approximately 67% of American Households give to charity.

This means that the overwhelming majority of charitable gifts in America are made regardless of tax benefits. In other words, passion outweighs tax consideration.

*Source: The Tax Foundation and The Nonprofit Almanac*

**Opportunities**

- **Make an IRA Rollover gift**. If you are taking an RMD, you can get a tax break even without itemizing by making a charitable gift from your IRA via a Qualified Charitable Distribution (QCD).

  A QCD, also referred to as a "Charitable IRA Rollover," is a direct transfer of funds from your IRA custodian to a qualified charity. QCDs can be counted toward satisfying your required minimum distributions (RMDs) for the year. This option allows you to transfer up to $100,000 a year from your Individual Retirement Account (IRA) to charity with no taxable income.

  For example, if you direct a gift to charity of, say, $10,000 or $25,000 as an IRA Rollover gift, your taxable income will be reduced by the same amount, again, up to $100,000 per year. In some instances, this may result in lowering your tax bracket.

- **Accelerate charitable contributions.** For those younger than age 70 ½, consider combining the charitable contributions you might make over several years into a gift made in one year by using a Donor Advised Fund or prepaying pledges. This could result in an itemized tax return that might otherwise not qualify for itemization or it could lower your taxes on higher bracket income.

**Need to Replace Lost Deductions**

For those who itemize deductions, particularly those living in higher tax states, the elimination of some deductions may prompt taxpayers to find other deductions to lessen taxes paid to the IRS.

**Opportunities**

- Increase direct charitable giving or giving to donor advised funds.
- Give appreciated securities or real estate, which also enables you to avoid capital gains taxes.
- Accelerate payments on multi-year pledges.

**Maximizing Your Charitable Deductions**

The new tax law allows an individual to take an income tax deduction for up to 60% of one's AGI for cash gifts (up from 50% in 2017).

Additionally, half of those gifts (up to 30% of your AGI) can be made with appreciated securities (avoiding capital gains as well).

**Consider meeting with your advisors if you have outstanding pledges and/or highly appreciated assets to discuss whether bundling your charitable giving into one tax year is appropriate for your circumstances.**

**Capital Gains Avoidance Relevant Again**

Those earning well over $200,000 a year face a capital gains tax rate of upwards of 23.8% or more depending on the state lived in. Coupled with the need for additional deductions to reduce taxable income, many donors may start considering charitable gifts of appreciated assets.

**Opportunities**

- Make gifts of appreciated securities or real estate to avoid capital gains and increase your deductions.
- Consider creating a charitable remainder trust funded with appreciated securities or real estate.
- Explore estate planning techniques such as charitable lead trusts which can provide an immediate income tax deduction and tax-efficient wealth transfer to heirs while creating very significant gifts to charity.

**New Estate Gifting Ability**

Many people maxed out their lifetime gifting to family in 2010 to avoid what some feared would be a return to a 55% estate tax rate and $1 million exemption. Those donors now enjoy the possibility of gifting an additional $5.6 million per person to children or grandchildren and/or leveraging this gifting ability with a charitable vehicle.

**Opportunities**

- Explore estate planning techniques such as charitable lead trusts which can provide an immediate income tax deduction and tax-efficient wealth transfer to heirs while creating very significant gifts to charity.
- The new tax law changes are significant enough that estate plans should be reviewed in any case with estate planning counsel.

**Takeaways**

- The new tax plan may in fact benefit most donors once all is said and done.
- Individuals should meet with their tax advisors early enough in the year to project the potential impact of the new law and evaluate their options for taking advantage of opportunities created by the law. (Note: the charitable giving deadline is December 31st, not April 15th).
- Individuals should meet with estate planning counsel as well, to evaluate whether there are opportunities to use additional lifetime gifting, increase charitable deductions and avoid capital gains through more sophisticated estate planning vehicles.
- Those with outstanding pledges or those considering campaign gifts should meet with charity representatives to review gift options.
- Non-itemizers over age 70½ should evaluate giving directly from an IRA.

**About the author - Jonathan Gudema, Esq.** has been a practicing attorney since 1994 and a member of the New York and New Jersey Bars. Throughout his career, he has worked on over $500 million dollars in family wealth transfers and charitable giving structures either with individual clients or representing nonprofit institutions assisting their supporters. In 2011, Jonathan launched his own consulting firm dedicated to assisting individuals and nonprofits with charitable estate planning and planned giving programs.