WRMarketplace

An AALU/GAMA Washington Report

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TOPIC: Some Good News in 2020: This is the Year for Charitable Contributions

MARKET TREND: New incentives encourage philanthropy in 2020, just when charitable organizations advancing health and social justice causes need significant support. Record-low interest rates and the availability of the IRA charitable rollover also create a tremendous opportunity for donors to leverage existing charitable giving techniques.

SYNOPSIS: Americans are seeing the convergence of a public health crisis, downward economic trends, and heightened social tensions. The Coronavirus Aid, Relief, and Economic Security (CARES) Act not only provides federally funded support for Americans, but also encourages public support of charitable causes by purposefully incentivizing philanthropy in 2020.

TAKEAWAYS: Charitably inclined individuals should consider taking advantage of increased opportunities to enhance philanthropic endeavors in 2020. The CARES Act allows both itemizing and non-itemizing taxpayers to deduct qualifying cash contributions made this year. Previous limitations imposed by the Tax Cuts and Jobs Act of 2017 ("**TCJA**") have encouraged many individuals to "bunch" charitable donations into a single tax year to utilize itemized deduction rules, and 2020 may be the optimal year to implement that technique. Other planning opportunities include designating charities as beneficiaries of retirement assets or as recipients of required minimum distributions ("**RMDs**") from individual retirement arrangements (“**IRAs**”), which may provide benefits for taxpayers regardless of whether they itemize. Finally, life insurance is an invaluable tool for individuals looking to replenish wealth devoted to a philanthropic legacy.

CHARITABLE GIVING INCENTIVES UNDER THE CARES ACT

Industry coverage of the economic impact caused by the COVID-19 pandemic has focused largely on asset values, interest rates, and potential intra-family wealth planning approaches. Additional coverage has focused on the economic relief offered by the CARES Act, including stimulus payments, small business loans, and the suspension of RMDs. One aspect of increasing importance is the Act’s incentives for charitable giving.

Millions of Americans have been unemployed during the second quarter of 2020 as a result of mandated business closures to slow the spread of COVID-19 causing a surge of demand at foodbanks and similar organizations. At the same time, organizations supporting racial and social justice efforts have ramped up fundraising efforts.

Current events have inspired many taxpayers to give generously to charitable causes. Several CARES Act provisions are specifically designed to incentivize charitable giving in 2020:

CARES Act Provision:	Summary of Incentive
Sec. 2104: Allowance of Partial Above the Line Deduction for Charitable Contributions	Beginning in 2020, individual taxpayers who do not elect to itemize deductions may deduct up to $300 of their “qualified charitable contributions.” A “qualified charitable contribution” is defined as a charitable contribution of cash made to a charitable organization other than a supporting organization, private non-operating foundation, or regulated donor-advised funds.
Sec. 2105(a)(2)(A): Modification of Limitations on Charitable Contributions by Individuals	In 2020, for taxpayers who elect to itemize deductions, any “qualified contribution” is deductible to the extent that the total contributions do not exceed the taxpayers adjusted gross income (“**AGI**”). Excess qualified contributions may be carried over for five years. A “Qualified contribution” is defined as a charitable contribution of cash

	made during 2020 that the taxpayer elects to deduct.
Sec. 2105(a)(2)(B): Modification of Limitations on Charitable Contributions by Corporations	In 2020, a corporation may deduct any "qualified contribution" to the extent that the total contributions do not exceed 25 percent (up from 15 percent pre-CARES Act) of its taxable income. "Qualified contribution" is defined as a charitable contribution of cash made during 2020 that the taxpayer elects to deduct.
Sec. 2105(b): Increased Cap for Contributions of Food Inventory	In 2020, the cap applicable to contributions of food inventory under Code § 170(e)(3)(c) is increased from 15 percent to 25 percent.
Sec. 2103: Special Rules for Use of Retirement Funds	Notably, the provisions of the CARES Act relating to retirement funds did not change the rules permitting a charitable rollover from an IRA.

Cash is King. It is important to note that most of the CARES Act charitable giving incentives relate to gifts of *cash*. Thus, gifts of tangible personal property (such as vehicles or artwork), marketable securities, real property, or any other non-cash property will not qualify for the increased charitable deductions noted above.

Not All Charities Are Alike. The overall policy of the CARES Act provisions supporting charities is focused on organizations providing direct support to the public. Accordingly, the CARES Act encourages gifts to public charities, such as churches, hospitals, colleges and universities, and organizations deriving nearly all of their support from the general public. Private operating foundations also qualify, as these organizations typically deliver charitable services directly to the public (as opposed to making grants) despite receiving significant private funding. As a result, most gifts to donor-advised funds, supporting organizations, and nonoperating private foundations will not qualify for the CARES Act incentives, as these organizations most often function by implementing grants to other exempt organizations. Nevertheless, contributions to many popular charitable organizations in 2020, including many of the organizations providing goods and services to needy individuals and organizations engaged in coronavirus relief and social justice efforts, will qualify for these incentives.

Maximize Charitable Giving in 2020. The TCJA made sweeping changes to the Internal Revenue Code, eliminating or drastically limiting the availability of most itemized deductions in favor of a doubled standard income tax deduction. As a result, there has been a significant reduction in the number of individuals who elect to itemize, limiting the potential tax incentives for making charitable donations. Since the enactment of the TCJA, individuals have been advised to take a more thoughtful approach to charitable giving to take advantage of the charitable income tax deduction. Many advisors suggest "bunching" charitable contributions into a single year every few years, rather than making smaller, annual gifts. Taxpayers can then elect to itemize deductions in the years when they make larger charitable gifts and take the standard deduction in years when no charitable gifts are made.

2020 is an opportunity for individuals who are looking to bunch their charitable contributions to make an especially significant charitable gift. Before the CARES Act, the annual limitation on cash gifts to public charities and private operating foundations for itemizing taxpayers was 60 percent of the taxpayer's AGI. For example, a taxpayer with AGI of $1,000,000 could deduct up to $600,000 of cash gifts.[1] In 2020, an itemizing taxpayer can deduct up to 100 percent of AGI. Thus, the same taxpayer could obtain a charitable income tax deduction of up to $1,000,000 for qualified contributions made in 2020. Donors who give more than 100 percent of their AGI can carryforward their excess deductions for a period of five years.

Additionally, beginning in 2020, individuals who are not positioned to make significant gifts may nevertheless obtain a tax benefit by deducting up to $300 of qualified charitable contributions.

OTHER CHARITABLE GIVING OPPORTUNITIES IN 2020

In addition to the CARES Act incentives, historically low interest rates and the continuation of the IRA charitable rollover rules can provide additional benefits to individuals wishing to make larger charitable gifts.

Charitable Lead Annuity Trusts. Each month, the IRS publishes the "7520" rate, which serves as the hurdle rate for a charitable lead annuity trust ("**CLAT**"). The 7520 rate for the month of July is 0.6% (as in June[2]), down from 0.8% in May.[3] The record-low 7520 rates in 2020 continue to provide a tremendous opportunity for charitably inclined clients to leverage the benefits of CLATs.

As described in WRMarketplace No. 2020-09, a CLAT is a charitable split-interest trust that creates a "lead" charitable interest in the form of an annuity payable to one or more charitable organizations for a fixed term of years. A gift to the CLAT is composed of two parts: (i) the charitable lead interest (structured as an annuity) and (ii) the non-charitable remainder interest (the assets remaining at the expiration of the charitable lead term). If a CLAT is treated as a grantor trust, the grantor will receive an immediate charitable contribution income tax deduction in the year the CLAT is funded in an amount equal to the present value of the charitable lead interest. The CLAT can be "zeroed-out" such that the value of the charitable lead interest is equal to the value of the assets contributed to the CLAT. Thus, the value of the charitable lead interest is nearly 100 percent of the total value of the gift, and the remainder interest has little to no value. Upon the conclusion of the annuity term, the remainder interest can be distributed outright to non-charitable beneficiaries or held in one or more continuing trusts for their benefit.

Accordingly, a CLAT will be successful if the CLAT assets appreciate at a rate exceeding the 7520 rate. Designing a CLAT also presents a fairly unique opportunity for taxpayers to monitor the 7520 rate over the course of three months and select the lowest rate published during that period.

Direct IRA RMDs to Charities. The IRA charitable rollover permits an individual to direct transfers of up to $100,000 of taxable RMDs from an IRA to a charity. This concept became permanent in December 2015. The IRA charitable rollover can provide several benefits for individuals age 70½ or over who are receiving RMDs. The transfer can have the same effect as a charitable contribution deduction since the transferred amount is excluded from the donor's AGI for income tax purposes. The transfer is also excluded from a donor's modified AGI in calculating the thresholds for application of the 3.8% net investment income tax. Note, however, that state and local income tax rules should be reviewed for any specific client situation, as not all tax authorities follow the federal paradigm.

WEALTH REPLACEMENT WITH INSURANCE

Charitable giving, even if furthering an individual's philanthropic goals or providing a tax-deductible benefit, reduces the potential legacy left for family members. By using life insurance, the family can replace donated assets. For example, life insurance can provide a guaranteed death benefit in an amount sufficient to replace family wealth expected to pass to a charitable organization at death or amounts that passed to charity through lifetime gifts, essentially leaving the donor's heirs in the same place as if charitable gifts were not made. Life insurance also can be used to partially supplement a donor's estate where retirement benefits are left to charity. Unlike the retirement benefits, life insurance death benefits paid to non-charitable beneficiaries generally are not subject to income tax. If desired, the life insurance can be held in an irrevocable life insurance trust to provide stewardship and creditor and marital protection for the beneficiaries without increasing the estate tax obligations of the insured's estate.

TAKEAWAYS: Charitably inclined individuals should consider taking advantage of increased opportunities to enhance philanthropic endeavors in 2020. The CARES Act allows both itemizing and non-itemizing taxpayers to deduct qualifying cash contributions made this year. Previous limitations imposed by the TCJA have encouraged many individuals to "bunch" charitable donations into a single tax year to utilize itemized deduction rules, and 2020 may be the optimal year to implement that technique. Other planning opportunities include designating charities as beneficiaries of retirement assets or as recipients of RMDs from IRAs, which may provide benefits for taxpayers regardless of whether they itemize. Finally, life insurance is an invaluable tool for individuals looking to replenish wealth devoted to a philanthropic legacy.

NOTES

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[1] Lower limitations (20% and 30%) apply to gifts to private foundations and gifts of certain types of property.

[2] *See* Revenue Ruling 2020-12.

[3] *See* Revenue Ruling 2020-11.