Impact to Charitable Organizations under the Tax Cuts and Jobs Act

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05/01/2018

While many businesses and individuals will see a lower tax bill as a result of the 2017 Tax Cuts and Jobs Act, charitable organizations may ultimately be the biggest losers from the sweeping tax reform. The Tax Act includes several changes that eliminate the tax savings incentives for charitable giving for many households. As a result, charities can expect to see a decrease in charitable giving in 2018 and beyond.

The 2017 Tax Cuts and Jobs Act (the "Tax Act") makes four changes that are likely to discourage charitable giving: (1) it increases the standard deduction for individuals and married filers, (2) it caps the state and local tax deduction, (3) it generally lowers individual income tax rates, and (4) it roughly doubles the estate and gift tax lifetime exemption amounts.

Increased Standard Deduction and Limited State and Local Tax Deduction

Under the law prior to the Tax Act, the standard deduction amounts were to be: $13,000 for married individuals filing jointly (including surviving spouses), $9,550 for heads of household, and $6,500 for single individuals and married individuals filing separately. Under the Tax Act, the standard deduction is increased to $24,000 for married individuals filing a joint return, $18,000 for head-of-household filers, and $12,000 for all other taxpayers, adjusted for inflation.

In addition, the Tax Act enacted a new limitation for the state and local tax deduction – an itemized deduction allowed for the amount of state and local income, property and sales taxes paid by individuals. The previously unlimited deduction is now limited to $10,000 for married individuals and $5,000 for non-married or married filing separately.

These two changes will significantly reduce the number of taxpayers who will have enough deductions to benefit from taking itemized deductions rather than the standard deduction. Because charitable donations are an itemized deduction, these changes will significantly reduce the number of households who would receive a tax benefit for making a charitable donation.

According to estimates from the Urban-Brookings Institution Tax Policy Center, these changes in the itemized deduction rules will shrink the number of households claiming an itemized deduction for their charitable gifts from about 37 million to about 16 million in 2018. The effect will be even greater for middle and upper-middle income families. As noted by Howard Gleckman of the Tax Policy Center's blog, TaxVox, the share of middle-income households claiming the charitable deduction will fall by two-thirds, from about 17 percent to just 5.5 percent. Among those making between $86,000 and $150,000, the percentage of taxpayers itemizing their charitable gifts will drop from about 39 percent to 15 percent.

Change in Individual Tax Rates

The Tax Act's changes to individual income tax rates will generally benefit lower to middle income taxpayers more than the highest earners, which means the tax benefit of charitable giving will also decline significantly for low- and moderate-income taxpayers. As Gleckman notes, the marginal tax benefit for middle-income taxpayers will fall from 8.1 percent to 3.3 percent. By contrast, for those in the top 1 percent, it will fall from 30.5 percent to 28.9 percent.

The Tax Act does, however, include one positive change with respect to charitable giving. For contributions made in tax years beginning in 2018, the 50% limitation for cash contributions under Code Sec. 170(b) is increased to 60%, meaning those taxpayers who are able to take a deduction for their charitable donations will be allowed to deduct a slightly larger portion of their donation.

Estate and Gift Tax Exemptions Increased

Generally, a gift tax is imposed on lifetime gifts to family and friends, and an estate tax is imposed on transfers at death. However, prior to the Tax Act, the first $5 million of transferred property is exempt from estate and gift tax, or $10 million for a married couple. That amount is indexed for inflation, was and set to be approximately $5.6 million per individual and $11.2 million per couple in 2018. Further, because gifts to charitable organizations are typically exempt from gift and estate tax, making gifts or estate bequests to charities is a common strategy for reducing an individual's potential estate tax liability at death.

For estates of decedents dying and gifts made in tax years 2018 through 2025, the Tax Act doubles the estate and gift tax exemption amount from $5.6 million to roughly $11.2 million per individual, or $22.4 million per married couple. By doubling the estate and gift tax exemption, the Tax Act effectively allows individuals to leave more assets to their decedent's children or other beneficiaries, and reduces the need to make gifts to charity to avoid estate tax on the individual's estate.

Estimated Impact

Of course, the tax benefit of charitable giving for many people is merely an incidental benefit for supporting a worthy cause, and is not the primary motivation. As Howard Gleckman notes, "not everyone gives to charity just to get a tax deduction. Millions of non-itemizers contributed each year under the old tax law and many will continue to do so under the [Tax Act]." Nonetheless, the Tax Policy Center estimates that the Tax Act is "likely to reduce charitable giving by somewhere in the neighborhood of 5 percent. And those gifts will come from fewer—and richer--givers."