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Understanding CARES Act changes to charitable giving

The CARES Act of 2020 made several changes to the tax rules for charitable gifts. Generally these changes are supportive of taxpayers who make charitable gifts and the organizations that rely on those donations. The key changes shown here are worth noting for tax planning and charitable giving purposes.

A SIMPLE DEDUCTION FOR SMALL DONATIONS

Most American taxpayers do not see any tax benefit for routine charitable giving because the standard deduction outweighs their total itemized deduction, even more so after the Tax Cuts and Jobs Act of 2017 doubled the standard deduction.

But the 2020 CARES Act creates a new incentive to make charitable gifts by allowing up to $300 in “above the line” deductions, meaning taxpayers who do not itemize deductions can benefit from giving. To claim the deduction, gifts must be made in cash to qualified charities. The deduction is only available to those who take the standard deduction, not taxpayers who itemize their deductions.

For many taxpayers, this will be a somewhat modest benefit. For those in the 22% marginal tax bracket, this would provide a $66 federal tax savings. For those in the highest marginal bracket (37%), this would provide a $111 federal tax savings. There is no difference in the deduction regardless of filing status, that is, whether single, married filing together or separately, head of household, or a qualified widow or widower. State tax treatments may differ.

Based on an interpretation of the bill, this appears to be a permanent new provision to the tax code, not just a change for 2020, though Congress may provide additional guidance later.

Which charities do not qualify?

Gifts to donor advised funds and 509(a)(3) supporting organizations do not qualify for the CARES Act provisions.

CASH GIFTS IGNORE THE DEDUCTION LIMIT IN 2020

Under the new rule, the deduction limit of 60% of a taxpayer's adjusted gross income (AGI) is waived for cash gifts made to a qualified charity in 2020. Deductions from gifts of appreciated property are still limited to 30% of AGI. For taxpayers wishing to maximize charitable gifts, a combination of both cash and appreciated property gifts may be an effective strategy.

THERE ARE SOME LIMITATIONS:

- It only applies to 2020 tax returns.
- Charitable gifts exceeding 100% of your 2020 AGI will be carried forward for up to five years.
- Charitable deductions carried forward from prior tax years are excluded from the 2020 increased AGI limit and are still subject to the old rules.

From a purely tax planning perspective, families in a high tax bracket year after year may not want to offset 100% of AGI in a single year, as realizing some income and paying a low federal income tax rate – 12%, 22%, 24% – may be preferential. Even though it's good to be charitable during this unprecedented time of need, providing additional gifts may be more effective as a tax strategy in future years, owing to the complexity of charitable gift tax rules. Your advisor can provide guidance relevant to your specific circumstances.

When did the charitable deduction limit increase?

The Tax Cuts and Jobs Act of 2017 raised the limit on charitable deductions on cash gifts to 60% of adjusted gross income from the previous limit of 50% of adjusted gross income.

HIGHER CORPORATE CHARITABLE DEDUCTION LIMITS

Corporations that make charitable gifts are normally limited to a deduction of no more than 10% of taxable income. For 2020 only, this limit is raised to 25% of taxable income for qualifying charitable gifts. Gifts must be made in cash and must be made to qualifying charities.

The act also raised the limit for gifts of "food inventory" up to 25% from 15%. Additional rules limiting deductions for gifts of food inventory still apply, so you should consult your tax preparer.

For S-corporations, this election is made at the individual shareholder level and the treatment may differ among individual shareholders. Consult your corporate tax advisor for application of these rules to your business.

NO CHANGES TO QUALIFIED CHARITABLE DISTRIBUTIONS FROM IRAS

Qualified charitable distributions, also known as QCDs, allows an IRA owner (or the beneficiary of a decedents IRA) over age 70 1/2 to distribute up to $100,000 the IRA to a qualified charity while excluding that distribution from income for the purposes of federal tax. This income exclusion does not require a taxpayer to itemize deductions.

This strategy is effective for those who do not itemize and for those who may have exceeded the adjusted gross income limits for charitable deductions. While qualified charitable distributions are not taxable, it does count toward satisfying a required minimum distribution, or RMD.

The SECURE Act of 2019 changed the age to begin taking RMDs from age 70½ to 72. The CARES Act of 2020 then eliminated all RMDs for 2020. However, neither law changed the qualified charitable distribution rule. This means that in 2020, IRA owners and beneficiaries of a decedent's IRA may still make a qualified charitable distribution from an IRA to a qualified charity while excluding it from income, even though they do not have an RMD for the year.

To see how these changes affect your tax or charitable giving strategy, talk to your financial advisor and tax professional.

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