Spring 2021 Charitable Giving Update

April 6, 2021

As spring arrives, it is time for a look at the latest tax changes and their effects on individuals and nonprofits making gifts and receiving contributions. 2021 presents an opportunity to take advantage of increased incentives for charitable giving and some well-established strategies.

1. The high standard deduction continues to alter the traditional tax incentive for charitable giving

Tax changes enacted in 2017 significantly raised the standard deduction.[1] The following are the standard deductions for 2021:

Single: $12,550

Head of Household: $18,800

Married filing jointly: $25,100

With these higher standard deductions, fewer individuals will have sufficient itemized deductions to have an incentive to claim them (as opposed to taking the standard deduction). This means most individuals will not claim a federal charitable contribution deduction for gifts to charity (other than the above-the-line deduction described below). In addition, state and local taxes (SALT) deductions, including state income taxes and property taxes, remain limited by a $10,000 annual cap (until 2026).[2] For individuals living in Minnesota and other high tax states, this limit substantially affects their incentive to itemize.

2. Universal Charitable Deduction: $600 for married-filing-jointly filers in 2021

In light of the changes to the standard deduction, and to spur charitable giving, the CARES Act instituted a $300 above-the-line deduction for non-itemizing individuals (also limited to $300 per married couple) for cash gifts made in 2020 to most public charities (and not to donor advised funds, private foundations or supporting organizations).

The "Consolidated Appropriations Act, 2021" extended and enhanced this benefit so that individuals who make cash contributions to eligible charities in 2021 may take a $300 above-the-line deduction (or $600 per married couple).[3] This benefit allows these filers to take the standard deduction and also take that above-the-line charitable deduction.

3. Increased "Percentage Limitations" for Cash Gifts

Generally, there are limits on the percentage of a taxpayer's adjusted gross income (AGI) that the taxpayer can offset with a charitable contribution deduction. The CARES Act raised the applicable limit for cash gifts to public charities. Previously the limit for deducting such gifts was 60% of AGI. This was raised to 100% of AGI in 2020, and this provision was extended to 2021.[4] Many donors made large cash gifts in 2020, and they can do so again in 2021.

In addition, the provision of the CARES Act that raises the limit for corporations making cash gifts was also extended to 2021. The limit is normally 10% of the corporation's taxable income, but it has been raised to 25% for 2020 and 2021.

4. "Bunching" charitable gifts remains a potential tax strategy

As noted, the high standard deductions in place through at least 2025 makes it harder to claim a federal charitable contribution deduction. One way to blunt the impact of this is for donors to "prepay" gifts that they would have made in later years. Some donors bunch their gifts using donor advised funds that yield a deduction now, but the gifts can be made to charities from the fund in future years.

5. Making planned gifts while interest rates are low

Certain charitable "planned gifts" may be attractive to donors when interest rates are low. Planned gifts usually involve structures under which individual noncharitable persons and charity share the benefits of the gift but at different times. The valuation of the present and future interests uses a rate based on prevailing market interest rates in the month of the gift.[5]

One type of planned gift structure particularly attractive while Section 7520 rates are low, such as now when the April 2021 rate is 1%, is a gift to charity of a remainder interest in a personal residence or farm while the donor retains a life estate in the property. The donor may occupy the property and collect its income during the donor's lifetime, and the donor may share in the proceeds if the property is sold during his or her life. Although the charity will not receive the property until the donor's death (or prior sale), the charitable deduction is available currently, based on the actuarial value of the charity's right to receive the property after the donor's life expectancy. Thus, as a rough example, if a 65-year-old donor gifts a home or farm valued at $1,000,000 while the Section 7520 rate is 8.0%, the charitable deduction is approximately $284,140, whereas if the Section 7520 rate is 1.0%, the charitable deduction is valued at approximately $714,040 (factoring in depreciation). This is because the present value of an asset to be received at a later date is larger when interest rates are low, given that one would have to invest a larger amount — at today's rates — in order to have an asset of that value at the future date. This larger deduction may incentivize donors to give remainder interests in personal residences and farms to charity during these economic times.

Charities that accept these gifts will want to evaluate the property prior to acceptance and enter an agreement with the donor regarding maintenance obligations.

6. Keep an eye on future changes

Congress and state legislatures are considering a variety of legislative changes that could affect charitable giving. It is too early to tell whether any of the proposed changes will become law.

Some proposals include:

- Making the universal charitable deduction (described above) permanent.
- Increasing the income tax rate for the higher-income individuals. Since 2017, the top marginal rate has been 37 percent, and there are proposals to raise it to 39.6 percent.
- Increasing the corporate income tax rate. The current rate is 21 percent. There are proposals to raise it to between 25 and 28 percent.
- Reducing exemptions from estate tax. The federal gift and estate tax rates are currently 40% with an exemption in 2021 of $11.7 million per taxpayer ($23.4 million for a married couple with portability). Those changes are scheduled to sunset in 2025 and revert back to $5 million as adjusted by inflation, but there have been proposals to modify these provisions earlier. Those proposals would seek to raise the tax rates and lower the exemptions.

For more information, please contact Sheryl Morrison, Wade Hauser, Nonprofit Practice Leader Sarah Duniway or your regular Lathrop GPM contact.

[1] *See* I.R.C. § 63(c). Under current law, these changes expire in 2025. At that time, the standard deduction will once again be a smaller amount.

[2] I.R.C. § 164(b)(6).

[3] *See* Section 212 of Division EE (Taxpayer Certainty and Disaster Tax Relief Act of 20202) of the Consolidated Appropriations Act, 2021, H.R. 133 (enrolled bill), P.L. 116-260, available here.

[4] *See id.* § 213.

[5] Treas. Reg. § 1.170A-7(c). This rate is known as the 7520 rate, which is available at https://www.irs.gov/businesses/small-businesses-self-employed/section-7520-interest-rates.