

OBBBA and Charitable Giving

Take-Away: When it comes to encouraging charitable giving, the One Big Beautiful Bill Act (OBBBA) is, at best, a ‘mixed bag.’

Background: OBBBA, 900+ pages of turgid tax law, contains several provisions that impact charitable giving. Some of those provisions follow which focus on the tax benefits the donor hopes to derive from charitable giving. As a generalization, much of the charitable giving is by wealthy donors who look for tax incentives. Individuals who reduce or eliminate their taxable income with many of OBBBA’s new deductions may see much less benefit from planning their charitable gifts. In short, many of OBBBA’s provisions reduce the incentive for large donors to give (at a time when nonprofits are anxious about reduced government funding, and there is increased need for private support by many in society.) Consider the following:

Cash Charitable Contributions. OBBBA permanently extends the 60% of adjusted gross income (AGI) limitation (increased from 50%) for cash gifts made to public charities, an enhancement that was otherwise set to expire at the end of 2025.

Above the Line Deduction: Another positive from OBBBA is that it now gives to individuals the opportunity to claim a \$1,000 charitable gift as an ‘above the line’ deduction. That means a married couple can gift \$2,000 to a public charity as an income tax deduction and still claim the standard deduction instead of itemizing their tax deductions. However, the contribution must be made in cash and must be made directly to a qualified public charity, excluding donor advised funds or supporting charities.

0.5% Limit to Itemized Charitable Deductions: However, there is the new OBBBA provision that limits a charitable deduction for those individuals who itemize their tax deductions. OBBBA adds a 0.5%-of-adjusted-gross-income *floor* on an individual’s charitable deductions for tax years after 2025. Under this rule, charitable deductions are only allowed to the extent that donations exceed 0.5% of the donor’s contribution base. The donor’s contribution base is defined as his/her adjusted gross income (AGI) determined without regard to any net operating loss carryback to the taxable year.

Example: If Don Donor's contribution base is \$500,000, then 0.5% of that amount, or \$2,500, is not deductible by Don. Consequently, if Don makes \$10,000 in charitable donations during the year, only \$7,500 would be deductible by Don in the current year (also subject to the other percentage limitations of the Tax Code.)

If a donor's total charitable contributions do not exceed 0.5% of his/her AGI, the amount below this floor cannot even be deducted by the donor in the current year and it is not eligible to be carried over to future years by the donor. If the donor's contributions exceed the 0.5% floor but they are limited by the upper percentage charitable giving ceilings, the disallowed excess may be carried forward and potentially deducted in any of the five following tax years, subject to the same percentage limitations each year. Restated, the 0.5% floor acts as a threshold for charitable deductions, but the carryover rules continue to apply only to those charitable contributions limited by traditional AGI percentage caps, not to amounts that are disallowed solely because they fall below the new 0.5% floor.

3/37th Reduction in Itemized Deductions: Wealthy donors are charitably inclined. For those donors in the highest marginal federal income tax bracket, the total amount of itemized deductions, including charitable contributions (after applying limits on miscellaneous deductions) must be reduced by 2/37 (about 5.4%) of the lesser of: (i) the total itemized deductions, or (ii) the portion of taxable income that exceeds the threshold for the 37% tax bracket. This calculation is determined without regard to this limitation but increased by the amount of itemized deductions. The upshot of this confusing provision is that it caps the maximum tax benefit a donor can receive from itemized deductions, including his/her charitable gifts, to about 35%, rather than the full 37% marginal income tax rate. OBBBA also deleted IRC 68(e). As a result, a non-grantor trust that retains income that exceeds the \$15,650 is subject to the 2/37th reduction in itemized deductions that individual donors have to face.

Income in Respect of a Decedent: Assume a decedent dies and leaves his/her entire estate, or trust, to charity. The 2/37th deduction disallowance will cause the trust or estate to pay income tax. Rather than obtain an IRC 661 deduction for income that is paid to charities, the trust (or estate) receives an IRC 642(c) deduction for gross income paid to charity. If and to the extent the trust has unrelated business income, which includes all S corporation K-1 items regardless of nature, IRC 681 requires the trust to use instead IRC 170 to deduct the charitable distribution. IRC 67(b)(4) specifies that IRC 642(c) or IRC 170

deductions are itemized deductions, and IRC 67(e) will not protect these charitable deductions. IRC 691(c) authorizes the deduction of federal estate taxes attributable to income in respect of a decedent. The purpose of IRC 681(c) is to avoid double taxation, i.e., estate and income tax on income accrued as of the date of death. These new rules disallow the IRC 691(c) relief from double taxation. To avoid this result, if for example the decedent's IRA was made payable to the decedent's trust and out to charity, i.e., the IRA distribution is income in respect of a decedent, instead it was made payable directly by the IRA custodian to the charity (via beneficiary designation) and not 'through' the decedent's trust, that will avoid including the income in respect of a decedent in trust income, thus preventing the 2/37th disallowance from applying with regard to that income in respect of a decedent

Corporate Charitable Giving: A corporation can only deduct charitable gifts to the extent that the charitable gifts exceed 1% of the corporation's taxable income for the year.

Tax Benefits Diminished: OBBBA provides several valuable tax benefits, primarily in the form of tax deductions, that will reduce or eliminate a potential donor's taxable income. Consequently, those prospective donors may see far fewer tax benefits from tax planning with the use of charitable gifts- there is less tax incentive to make large charitable gifts. Just to identify a few of these OBBBA's provisions that conceivably negatively impact charitable gifts include:

- The lower income tax rates and broader tax brackets are made permanent.
- IRC 199A 20% Qualified Business Income Deduction was made permanent.
- IRC 1202 Qualified Small Business Stock exclusion of up to \$15 million from gain.
- Bonus Depreciation permits the deduction of up to 100% of the cost of property that is placed in service after January 19, 2025.
- Qualified Opportunity Zones are now possible on rolling 10-year increments, starting in 2027.
- Qualified Production Properties allow manufacturers to deduct 100% of the cost of new qualified property.
- The \$6,000 senior deduction for those over the age of 65.
- The tip income deduction.

- The overtime pay deduction.
- The Trump Account funding government 'seed' contribution inducement.

Conclusion: Back in 2019 after the adoption of the 2017 Tax Act with its new income tax rates and broadened tax brackets, a study by Indiana University's Charitable Giving Department projected that charitable donations were reduced by \$19.1 billion per year. What will be OBBBA's impact on philanthropy?

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