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Subject: To Itemize or Not to Itemize, that appears to be the Big Question!

The changes in the New Tax Act has confused many people. A common question appears itemizations. Let me attempt to clear up some of the confusion. Under the new tax act, the Standard Deduction has been raised to $24,000 (MFJ) (1/2 for everyone else) from $12,700 (MFJ). In effect, it is not worth itemizing unless your itemization list is over $24,000. Now what does that mean to most of our clients?

There are basically 4 groupings of itemization:

1. Medical (the amount over 7.5% of AGI (Adjusted Gross Income) can be itemized
2. State and Local Taxes (SALT) – Capped at $10,000
3. Mortgage Interest Deduction (limited to interest on the first $750K of Mortgage Asset)
4. Contributions

For many of our clients the calculation might be:

- Medical Itemization over 7.5% of AGI = $-0-
- Property Tax and State Income Tax = $10K Max
- Mortgage interest (It Ranges from -0- (We encourage our clients to be debt-free) to say $12K. ($300K Mortgage Debt X 4% Interest Rate)).
- Contributions between $5K to $15K.

Based on the above Itemized deductions would be between $15K and $37K. Obviously the people above $24K should itemize and the ones below should not; they would use the standard deduction of $24K.

Strategy: Many of our clients have giver-hearts and give substantial amounts but not enough to be over the $24K, especially if they are debt free and have their mortgage paid off. Therefore, a strategy we encourage many of our clients to adopt is that of the Donor Fund, in that you group your contributions in one year for a large deduction, so that you can itemize, and then give out of the Donor fund in future years and use the “standard” deduction in the future years. An example would be as follows:

Strategy Example: Bunch giving first year, give out in future years.

Year 1. Contribute $30K to donor fund, plus $10K SALT =$40K of itemized deduction, able to take advantage of **additional $16K**) additional Itemization (Over the $24 Standard Deduction.)

Year 2-4. Give $10K from Donor Fund to Charity of your choice, have $10K of SALT. Take Standard deduction of $24K and take advantage of **additional $14K ($24K-$10K).**

Strategy Conclusion: Due to the Donor fund there was an advantage of an additional $58K ($16+ (14X3)) of deductions. If the taxpayer was in the 22% tax rate this would be about a $13K impact.

Without Donor fund:

Year 1-4: Contribute $10K plus $10K SALT =$20K of itemized deduction, use standard deduction of $24K, take advantage of **additional $4K ($24K-$10K).**

Standard Strategy Conclusion: Without using the Donor fund strategy and just using the standard deduction of $24K, there is a pick-up of $16K ($4K x 4). Compared to the Donor Strategy in which there was an additional advantage of $58K. Therefore, the additional cost of not using the Donor Fund Strategy would be $42K ($58K-$16K) X 22% (Assumed tax rate) or a bottom-line opportunity loss of about $9K. Which is more than one year of contributions.

Bottom Line: The $9K savings would be in effect, Tax-Free additional earnings just due to timing structure and a little planning.

Other Factors to consider:

- In addition, hopefully the Donor Fund grew during this time allowing you to give more to the Charity of your choice.
- If the contribution numbers were higher and the Donor Contribution was equally increased, the increased savings would be increased.
- If the taxpayer was in a higher tax rate the increased savings would be increased.
- The larger Donor Fund Contribution in the first year and the more spread years of giving, the larger the savings gain.
- The Donor Fund Strategy is dependent upon the tax payer having the cash flow to fund the strategy in the first year. Vanguard Minimum is $25K, Fidelity is $5K.

Additional Thought: Even if you do not itemize, we do need the amount of Property Tax Paid, because this is used for a Tax Credit on the Illinois Tax Return.

Hopefully the above was understandable, you might want to read it a couple of times and work out your own numbers for a better understanding. We would encourage you to consider this tax planning in your situation and feel free to discuss with us further.