

Stay Within Charitable Deduction Boundaries

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As a general rule, you can deduct all of your charitable contributions made to qualified organizations (but not contributions for “the use of” qualified organizations). However, deductions for charitable donations may be limited if you give extra-generous gifts or you donate appreciated property. Here’s a brief summary of the main rules.

When you donate cash to charity (or a cash equivalent such as a credit card charge), you may deduct the full amount of the cash donation. If you donate property, the deduction is generally limited to your “basis” in the property, which is usually the cost. However, if the property would have produced a long-term capital gain had you sold it instead of donating it; you may deduct the property’s fair-market value (FMV). Therefore, if you owned the property for more than one year, you can deduct its FMV if you donate it to charity.

Other special rules for donated property may come into play. To realize the full tax benefit, the charity must use the property to further its tax-exempt function.

But not all charitable organizations are created equal. Some charities are treated as “50% charities.” As the name implies, contributions to these charities are limited to 50% of your adjusted gross income (AGI) for the year. The list of 50% charities includes educational institutions, most religious groups, hospitals and public charitable organizations. In contrast, contributions to “30% charities”—such as veterans’ associations and certain private foundations—are limited to 30% of your annual AGI.

This is where things can get really complicated. If you donate long-term capital gain property to a 50% charity, your deduction is limited to 30% of your AGI. Conversely, if you donate the property to a 30% charity, the deduction cannot exceed 20% of your AGI.

Simplified example: Alex Ajax has an annual AGI of \$100,000. He donates \$10,000 to his alma mater this year. Also, he gives to his church stock that he acquired for \$25,000 ten years ago that is now worth \$50,000. Finally, Alex donates \$5,000 to a 30% charity.

The deduction limits for Alex’s contributions are applied as follows:

- The \$10,000 cash donation to his alma mater is fully deductible.
- A deduction equal to FMV for the gift of stock is allowed, but it is limited to 30% of Alex's AGI. Therefore, the maximum deduction is \$30,000 (30% of \$100,000).
- Normally, Alex could deduct the entire \$5,000 donated to the 30% charity. However, he has already reached the 30% limit, so the deduction is zero.

The result is that the total deduction is reduced to \$40,000 even though Alex donated cash and property worth \$65,000 (\$10,000 plus \$50,000 plus \$5,000).

In this situation, Alex may shift his gift-giving pattern to stay within the limits or decide to postpone certain gifts until the following year. If charitable donations exceed the deduction ceiling for the current year, the remainder may be carried forward for up to five years.

Astute tax planning can maximize the charitable deductions on your return. Be sure to contact your Henry & Horne professional for assistance in this area.

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