An invitation to the Bunch Club

"Bunching" has always been a tax strategy, often utilized to maximize one's tax deduction. Now with the passing of the Tax Cuts and Jobs Act in December 2017, including a near doubling of the standard deduction, the strategy of bunching is gaining steam. Find out if you are among the certain taxpayers who stand to gain even greater tax benefits as we unpack the strategy of bunching.

Itemized vs. Standard deductions

Each year, you the taxpayer, can choose whether to itemize or take the standard deduction on your income tax return. If the sum of your itemized deductions is greater than the standard deduction, you itemize. If not, you go the standard deduction route.

The big four itemized deductions are:

1. SALT (State Taxes and Local Real Estate Taxes)
2. Charitable Contributions
3. Home Mortgage and Other Interest Paid
4. Unreimbursed Medical Expenses Exceeding 10% of AGI

Up until the 2017 tax reform, the standard deduction amounts were $6,350 for single filers and $12,700 for married filing joint.

So what has changed?

First, there have been changes to the itemized deduction thresholds:

1. SALT (State and Local Taxes) are now limited to $10,000.
    a. This will likely have the biggest impact on your itemized deductions, especially if you own a large house or live somewhere with state income tax.
    b. If you care to quantify, go to your 2017 tax return, Schedule A, Line 9. Any amount over $10,000 will not be eligible for deduction in 2018 and beyond.

2. Charitable contribution limits have increased to 60% of AGI from 50% for cash donations.
    a. A high threshold to start, this has added even more room to give and receive a tax benefit. This is where the bunching comes in…stay tuned.

3. Home mortgage interest is deductible, but only on the first $750,000 of mortgage debt.
    a. This has a greater impact on taxpayers in areas with high real estate prices.
    b. In addition, you can no longer deduct home equity interest NOT used for home improvements.

4. The threshold for unreimbursed medical expenses has dropped from 10% to 7.5% of AGI.

a. Unreimbursed means expenses that are not covered by insurance or an HSA account (as you have already received a deduction for those dollars).

5. The tax bill also eliminated the following deductions: theft and personal casualty losses, tax prep and investment advisory fees, and unreimbursed employee expenses.

Second, to counteract the limitations and eliminations of many itemized deductions, the new tax law expands the standard deduction to the following:

- $12,000 for single filers
- $24,000 for married filing joint

When and why to bunch charitable contributions

With the $10,000 limitation on SALT, those who are charitably inclined may have enough itemized deductions to be within earshot of the new standard deduction amount. This is the sweet spot for bunching.

Let us assume you desire to give $15,000 per year to charity, have no mortgage debt, and SALT that exceed $10,000 (thus being limited to that number). If you give $15,000 each year to charity, your itemized deductions will be greater than the standard by only $1,000 per year.

Not - Bunching					
	2018	2019	2020	2021	
Unreimbursed Medical	$0	$0	$0	$0	
SALT	$10,000	$10,000	$10,000	$10,000	
Home Mortgage Interest	$0	$0	$0	$0	
Charitable Contributions	$15,000	$15,000	$15,000	$15,000	
Itemized	$25,000	$25,000	$25,000	$25,000	
Standard	$24,000	$24,000	$24,000	$24,000	
Deduction Used	$25,000	$25,000	$25,000	$25,000	$100,000

Alternatively, you can bunch your charitable deductions using a Donor Advised Fund (DAF), which allows you to contribute highly appreciated investments and avoid capital gains taxes. The table below shows the impact of contributing $30,000 to charity in year one, netting you a greater itemized deduction. (Recall, when you contribute to a DAF you get a current year deduction and can grant the monies to charities over time.)

Continuing this example, in year two you would not make any charitable contributions to your DAF and take the standard deduction. One year on, one year off. Over four years, this amounts to an extra $28,000 you would be able to write off in deductions.

Bunching					
	2018	**2019**	**2020**	**2021**	
Unreimbursed Medical	$0	$0	$0	$0	
SALT	$10,000	$10,000	$10,000	$10,000	
Home Mortgage Interest	$0	$0	$0	$0	
Charitable Contributions	$30,000	$0	$30,000	$0	
Itemized	$40,000	$10,000	$40,000	$10,000	
Standard	$24,000	$24,000	$24,000	$24,000	
Deduction Used	$40,000	$24,000	$40,000	$24,000	**$128,000**

If you are charitably inclined and do not have a donor advised fund, we would be happy to go over the benefits they offer you. If you have a donor advised fund currently and would like to discuss this bunching strategy, let us know. You will also want to include your accountant in any discussions about bunching before taking any action.

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