Pittenger & Anderson, Inc.
REGISTERED INVESTMENT ADVISOR

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Bunching to reduce taxes

"Bunching" is a strategy utilized to maximize a taxpayer's itemized deduction, and with the passing of the Tax Cuts and Jobs Act in December 2017, this strategy is even more useful. 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:

- State and local taxes (SALT)
- Charitable contributions
- Home mortgage interest
- Unreimbursed medical expenses

Up until the 2017 tax reform, the standard deduction amounts were $6,350 for single filers and $12,700 for married filing joint. For 2020, those amounts are now $12,400 for single filers and $24,800 for joint filers. Below are additional changes made under the tax reform bill of 2017:

1. State and local taxes (SALT) are limited to $10,000: This has the biggest impact on your itemized deductions, especially if you own a large house or live somewhere with state income tax.
2. The 2017 tax reform modified the allowable charitable contribution limits from 50% of AGI to 60% of AGI for cash donations. (The CARES Act of 2020 temporarily increased this limit to 100% of AGI for cash donations). This where the "bunching" comes in…stay tuned.
3. Home mortgage interest is deductible, but only on the first $750,000 of mortgage debt: This has a greater impact on taxpayers in areas with high real estate prices. Additionally, you can't 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: Unreimbursed means expenses that are not covered by insurance or an HSA account (as you have already received a deduction for those dollars.
5. As a reminder, the tax bill also eliminated the following deductions: theft and personal casualty losses, tax prep and investment advisory fees, and unreimbursed employee expenses.

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 exceeds $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 deduction by only $200 for 2020.

Without bunching

	2020	2021	2022	2023	
Unreimbursed medical	$ -	$ -	$ -	$ -	
State and local taxes (SALT)	$ 10,000	$ 10,000	$ 10,000	$ 10,000	
Home mortgage interest	$ -	$ -	$ -	$ -	
Charitable contributions	$ 15,000	$ 15,000	$ 15,000	$ 15,000	
Itemized deduction amount	$ 25,000	$ 25,000	$ 25,000	$ 25,000	
Standard deduction amount*	$ 24,800	*$ 24,800*	*$ 24,800*	*$ 24,800*	
Deduction used	$ 25,000	$ 25,000	$ 25,000	$ 25,000	$100,000

*future standard deductions will likely be higher than 2020's amount; for comparison purposes we are showing it to be the same

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 $29,600 you would be able to write off in deductions.

Using a bunching strategy					
	2020	2021	2022	2023	
Unreimbursed medical	$ -	$ -	$ -	$ -	
State and local taxes (SALT)	$ 10,000	$ 10,000	$ 10,000	$ 10,000	
Home mortgage interest	$ -	$ -	$ -	$ -	
Charitable contributions	$ 30,000	$ -	$ 30,000	$ -	
Itemized deduction amount	$ 40,000	$ 10,000	$ 40,000	$ 10,000	
Standard deduction amount*	$ 24,800	$ *24,800*	$ *24,800*	$ *24,800*	
Deduction used	$ 40,000	$ 24,800	$ 40,000	$ 24,800	$129,600

*future standard deductions will likely be higher than 2020's amount; for comparison purposes we are showing it to be the same

If you are charitably inclined and do not have a donor-advised fund, here are some things to consider:

1. Once monies go into a DAF, the only way they can come out is to be gifted to a 501(c)3 charitable organization.
2. Fidelity Charitable is our DAF of choice. P&A will assist you in all aspects of opening, funding, and gifting from the account.
3. Fidelity charges 0.60% per year on the assets in your account, up to $500,000, then their fee drops to 0.30% (still a modest fee in our estimation).
4. P&A does not charge a fee or benefit from you using a regular Fidelity DAF. However, P&A recently joined the Charitable Investment Advisor Program (CIAP) at Fidelity. This program allows us to manage DAF's valued over $250,000 with our own investment management strategies. We assess our management fee on top of Fidelity's fee listed above for those who want a truly custom approach to the management of their donor-advised fund.
5. Appreciated publicly traded securities can certainly be a great asset to donate to a DAF, but some people also have non-cash assets as part of their balance sheet with even greater unrecognized appreciation that could be used. Examples include ownership shares in their company, real estate, or other capital gain investments.

As year-end approaches, there's still time to act on some of these tax savings opportunities, but you'll want to act fast. Please contact us if you are interested in starting a DAF. 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.