Clients want to know: What's deductible and what's not?

Whether you are an estate planning attorney, financial advisor, or accountant, you've probably seen an uptick in client questions about tax deductions–and tax rules in general–over the last few years. Tax law changes at the end of 2017 have caused a lot of ongoing taxpayer confusion.

To be sure, your clients will be asking about charitable tax deductions as year-end rolls around. As an advisor, you're already working with clients on financial and tax planning all year long, but fall is the time when many clients buckle down. Whether it's the change in the weather or the imminent end of the calendar or tax year, autumn is a time to reassess things like tax loss harvesting and charitable giving. These are just two of many types of transactions that result in deductions when tax returns are filed in the spring.

Charitable giving may be especially high on the planning radar right now because of the many national fundraising initiatives that kick into gear this time of year. You (and your clients) have probably noticed that many different types of causes are celebrated each and every month. October, in health-related charities alone, is National ADHD Awareness Month, National Down Syndrome Awareness Month, Pregnancy and Infant Loss Awareness Month, Spina Bifida Awareness Month, National Physical Therapy Month, and likely many more.

Make sure your clients are aware that there are specific parameters around tax deductibility before they respond to requests from organizations and even their friends and family members who support these organizations. Your clients are relying on you as an advisor to stay on top of the rules, including:

–Section 501(c) of the Internal Revenue Code lays out the requirements for organizations to be considered tax-exempt--a status for which an organization must seek IRS approval.

–Tax exemptions apply to certain types of nonprofit organizations, but status as a nonprofit (which is a state law construct) does not necessarily mean that the organization will be exempt from Federal income taxes.

–Furthermore, even under Section 501(c), there are different types of nonprofits that are recognized by the IRS as tax-exempt.

–To qualify under the Internal Revenue Code Section 170 charitable deduction for gifts to Section 501(c)(3) organizations, for example, the recipient must be organized and operated exclusively for “charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and the prevention of cruelty to children or animals.” “Charitable,” according to the IRS, has a very narrow definition.

–No doubt, many of your clients not only support 501(c)(3) charities, but also social welfare groups organized under Section 501(c)(4). Examples of social welfare groups include neighborhood associations, veterans organizations, volunteer fire departments, and other civic groups whose net earnings are used to promote the common good. Donations to social welfare groups are tax deductible in only certain cases (*e.g.*, gifts to volunteer fire departments and veterans organizations).

–Chambers of commerce and other business leagues fall under Section 501(c)(6); donations to these entities are not tax deductible.

If you have any questions about the tax deductibility of your clients’ contributions to various organizations, please reach out to the team at the Community Foundation. We are immersed in the world of Section 501(c) every single day and are happy to help you navigate the rules.