How Bunching Expenses Can Enable Taxpayers to Continue to Itemize

In response to the significant changes to the tax deduction rules under the Tax Cuts and Jobs Act (TCJA), many taxpayers are searching for ways to recover some of the tax benefits associated with itemizing deductible expenses that have been eliminated. Taxpayers who were previously able to lower their tax bills by itemizing may want to consider using a “bunching” strategy, which generally means either accelerating or deferring deductible expenses so that more of these expenses fall in a single tax year rather than in multiple tax years.

While the TCJA lowered individual income tax rates and raised the child tax credit, it nearly doubled the standard deduction from $6,350 to $12,000 for individuals and $12,700 to $24,000 for married couples, and it suspended personal exemption deductions and limited or repealed many commonly used itemized deductions. The legislation capped the deduction for state income and property taxes (SALT) at $10,000, and limited the mortgage interest deduction. In addition, miscellaneous deductions were completely repealed, and casualty loss deductions were greatly reduced.

These changes are currently set to expire at the end of 2025, but Republicans in the House have already introduced a bill that would make many of the individual provisions in the TCJA permanent.

In light of these changes, it has been projected that the percentage of individual taxpayers who will use the standard deduction rather than itemizing will rise from around 70% in 2016 to around 90% in 2018. Yet by bunching their deductible expenses into every second or third tax year, taxpayers who might not otherwise have sufficient itemized deductions to exceed the standard deduction in every tax year may be able to lower their tax liabilities over time. As taxpayers in high-tax, high-income states like New York, New Jersey, and California are most affected by the new limits on the deductibility of SALT, they may be especially likely to consider bunching their deductions over the next several tax years.

Whether it is feasible for taxpayers to bunch or lump together itemized deductions depends on whether the expenses can be timed. In some cases, it may be possible to time state estimated taxes or property taxes by paying them in the year before they are due. In addition, taxpayers who have significant medical expenses may be able to shift those expenses to reach or exceed the threshold for claiming the medical expense deduction. Because the TCJA temporarily enhanced the medical expense deduction by lowering the AGI threshold from 10% to 7.5% for 2017 and 2018 only, some taxpayers might benefit from accelerating their deductible medical expenses into 2018.

One of the most promising approaches to bunching itemized deductions is to shift the timing of gifts to charity. Under the TCJA, the charitable deduction has been slightly enhanced: for those taxpayers who are able to itemize, gifts of cash are now deductible up to 60% of adjusted gross income (AGI), up from 50% previously; while gifts of appreciated securities remain deductible up to 30% of AGI. If donations exceed these limitations, the excess can be deducted over the next five years.

Moreover, the so-called Pease limitation, which reduced the value of a taxpayer's itemized deductions by 3% for every dollar of taxable income above a certain threshold (in 2017, $261,500 for single filers and $313,800 for joint filers) up to 80% of all itemized deductions, was suspended under the TCJA. Thus, there is currently no limit on the total charitable deductions higher-income taxpayers can take.

By contributing multiple years of what were previously annual charitable gifts in a single year, the likelihood that a taxpayer will be able to exceed the standard deduction increases. If taxpayers want to continue to space their charitable contributions across years, they should consider making a large contribution in a single tax year to a donor-advised fund administered by a charity or a financial services provider. If the gift is of sufficient size, the taxpayer will be able to itemize deductions in the year the contribution is made. The taxpayer can then instruct the fund to make charitable gifts of the same amount each year, including in years when the donor does not itemize deductions.

Taxpayers who have relatively large amounts to give may want to think about establishing a charitable gift annuity or a charitable remainder trust, which can generate an income stream for the donor or other beneficiaries. Because these giving vehicles require significant amounts of funding in the form of cash, securities, or real estate, a taxpayer may be able to itemize in the year the trust is funded. However, only a portion of the contribution is deductible.

To maximize their savings, taxpayers may want to consider making gifts of long-term appreciated securities, as the donor can avoid owing capital gains tax on the appreciation while claiming the full value of the assets as a charitable contribution. When used to fund an income-returning vehicle, the recognition of the capital gain is deferred, and is generally paid in smaller amounts over a period of years.