

# COMMON CHARITABLE GIVING STRATEGIES AND TAX CONSIDERATIONS

As we move throughout the second half of the year, tax planning becomes a key focus for our firm and for many of our clients. Tax planning discussions often include required minimum distributions (for those who are over age 70 ½), maximizing retirement account contributions (for those who are still working), considering Roth IRA conversions, harvesting available losses in taxable accounts, and in many cases charitable giving.

Charitable giving is most commonly addressed around the holidays and at year-end, but considering the best mode for effecting gifts throughout the year can be beneficial.

There are several ways that clients can structure charitable gifts. While a reduction in taxes is not the primary driver behind charitable giving, a thoughtful approach to how one's giving is structured can lead to the IRS getting less of the overall pot. When it comes to charitable giving, the most efficient process is a function of each client's unique situation. The balance of this article will give an overview of the most common gifting strategies that we see across our client base.

## Writing a Check

For many clients, charitable giving has historically taken place in the form of writing a check to a qualified charity and receiving a current year tax deduction for the amount of the gift. This is a simple, straightforward way to give and it can work well when the donor wants to make an immediate gift to a predetermined charity. Generally, deductions for gifts of cash to qualified public charitable organizations are limited to 50% of a taxpayer's adjusted gross income. As an example, a taxpayer with \$80,000 of adjusted gross income would be limited to deducting \$40,000 of charitable giving in a single year.

While writing a check is the simplest way to give, the ability to realize a tax benefit is dependent upon being able to itemize one's deductions on their federal tax return.

With the most recent tax reform legislation that went into effect on January 1, 2018, the standard deduction was nearly doubled. The standard deduction currently stands at \$24,400 for married couples filing jointly and \$12,200 for single filers compared to \$12,700 and \$6,350 respectively in 2017. Further, deductions for state and local property, income and sales taxes, which were often a material contributor to itemized deductions have been capped at \$10,000.

As a result, fewer taxpayers are reaching the necessary deduction threshold for itemization and writing a check to a charity, while simple, may not reduce one's tax bill.

## Gifting Appreciated Securities

For clients who own appreciated securities, Sigma can assist in transferring those appreciated securities directly to one or more charitable organizations. As an example, let's assume that a client invested \$1,000 in Amazon stock that is now worth \$10,000. An outright sale of this stock would result in capital gains taxes on the \$9,000 of appreciation. However, if the stock is transferred directly to a qualified charitable organization, the donor can receive a tax deduction on the full \$10,000 gift, while avoiding tax on the \$9,000 gain. The charity is then able to liquidate the security without creating a taxable event. Generally, deductions for gifts of appreciated securities to qualified public charitable organizations are limited to 30% of a taxpayer's adjusted gross income.

Gifting securities directly to a charity can make sense when trying to reduce a concentrated position in the portfolio without selling shares and paying the resulting taxes. It can also make sense if the price that was originally paid for the shares is unknown, and/or if the stock being gifted no longer fits within the client's ideal portfolio structure.

The tax-related drawback of gifting appreciated securities directly to a charity is that any tax deduction for the donor is limited to those who itemize deductions on their federal tax return.

## Using a Donor-Advised Fund

A donor-advised fund is a charitable giving vehicle sponsored by a public charity that allows a donor to make a contribution to that charity, which qualifies for an immediate tax deduction. The donor is then eligible to recommend grants over time that flow out of the donor-advised fund to any IRS-qualified public charity.

The key differentiator from writing a check or giving securities directly to a specific charity is that the donor-advised fund structure allows for the separation of the initial tax deduction for the donor from the ultimate release of funds to the end charity. In other words, the donor can take a charitable deduction in a high tax year and subsequently distribute grants to charities in future years.

When a donor makes a contribution to a donor-advised fund,

local independent personal accessible  
interactive creative local independent personal  
knowledgeable thoughtful ethical experienced

they are making a tax-deductible donation to the organization sponsoring the fund. Because the account is “donor-advised”, the donor is able to advise the organization on how to grant the money out to charities of their choice over time. The donation is invested based upon the donor’s preferences, so it has the potential to grow tax-free while the donor is deciding which charities to support.

One strategy that has become more popular since the standard deduction was increased in 2018 is to “bunch” several years’ worth of charitable giving into a donor advised fund during a single year in order to itemize deductions in that year. In subsequent years when contributions are not made into the donor advised fund, the client is able to take the standard deduction on their federal tax return. This strategy of alternating between itemizing and taking the standard deduction can improve the overall tax efficiency of one’s giving strategy.

There are numerous sponsoring organizations for donor-advised funds. At Sigma, both of our primary custodians, Charles Schwab and Fidelity Investments sponsor donor-advised funds. Schwab Charitable™ and Fidelity Charitable™ are independent 501(c)(3) organizations, both of which allow for accounts to be opened with an minimum initial gift of \$5,000. Administrative fees are 0.60% of the assets annually for balances below \$500,000, with that amount trending downward for larger balances. Underlying mutual fund investment options carry additional management fees, which are less than 0.10% annually for index fund options. For balances over \$250,000, donors can have their portfolio managed professionally by an advisor.

Donor-advised funds are able to accept various types of assets as gifts including cash, publicly traded securities, certain restricted stock shares, mutual fund shares, private equity and hedge fund interests, real estate, and even certain privately held C-corp and S-corp shares.

The sponsoring entities, such as Schwab Charitable™ and Fidelity Charitable™ are able to take care of all of the administration including receiving contributions, investing the contributions, distributing grants, sending grant letters to the receiving charitable organizations and providing a single tax form to the donor at the end of the year.

When a donor sets up their donor-advised fund, they are able to name their fund (i.e. The Smith Family Charitable Fund) so that end beneficiary knows who the money is from. Donors are able to name successor account holders to oversee the fund after their passing or they can specify that the remaining balance be transferred to one or

more predetermined charities upon their passing.

Sometimes clients have a desire to be charitable over several years and they are dealing with an anticipated level of taxable income in the current year that may be higher than usual (i.e. sale of their business or vesting of company stock and/or options, etc.). They would like to receive a tax deduction in the current year, but may not want to make large outright gifts to one or more charities all at once. There may also be a desire to avoid the cost and complexity of more involved entities, such as private family foundations. For clients in these situations, a contribution to a donor-advised fund can be a great solution.

### Qualified Charitable Distributions

For clients who are over the age of 70 ½, IRS rules require that distributions be taken from tax-deferred retirement accounts. These distributions result in taxable income in the year that they are taken.

The Pension Protection Act of 2006 allowed for individuals to begin rolling over up to \$100,000 of required distributions annually from an IRA directly to qualifying public charities. The Protecting Americans from Tax Hikes Act of 2015 made this provision permanent. These “qualified charitable distributions”, or QCD’s count towards the account owner’s required distribution, while allowing the account owner to avoid paying taxes on the gifted amount. At the same time, the charity receives a gift of pre-tax dollars that will never be subject to taxes.

The QCD has one key added benefit vs. the other gifting strategies listed above, which is the ability for the income associated with an IRA distribution to avoid inclusion in one’s gross income altogether. This can help with qualifying for various tax deductions and credits while avoiding certain income-driven events like higher Medicare premiums in retirement.

While this article has touched on a few of the most common ways that Sigma has helped clients to facilitate charitable giving, it is not all inclusive. Further, it should also be noted that Sigma will often coordinate with a client’s tax professional to ensure that the client is able to structure their charitable giving in a manner that is most effective, given their own unique tax situation.

If you have questions relating to any of the strategies that have been outlined above, or on any other giving strategies, please feel free to reach out to us directly.

Christopher W. Frayne, CFA, CFP®

The views in this publication are as of August 2019 and are for informational purposes only and do not represent any recommendation of any particular security or strategy and should not be considered investment advice. The publication is prepared for educational purposes and the information presented has been gathered from sources believed to be reliable.

Please remember to contact Sigma Investment Counselors if there are any changes in your financial situation or investment objectives