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A Refresher on Charitable Giving

As we near the end of September and the beginning of the fourth quarter, many of our conversations with clients involve a fair amount of tax planning. This can include items such as required minimum distributions, maximizing retirement plan contributions, harvesting available losses in taxable accounts, and in many cases charitable giving.

There are several ways that we've seen clients structure their charitable gifts including writing checks directly to charities, gifting appreciated securities, making qualified charitable distributions from an IRA, or setting up a donor-advised fund. The balance of this article will look to give an overview of these four different gifting strategies.

For many clients, charitable giving generally takes place in the form of writing a check to a qualified charity and receiving a tax deduction for the amount of the gift in the year that it is given. 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.

For clients that 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 Apple stock that is now worth $10,000. If they were to sell this stock, they would owe capital gains tax on the $9,000 of realized gains. 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. Generally, deductions for gifts of appreciated securities to qualified public charitable organizations are limited to 30% of a taxpayer's adjusted gross income.

For clients that are over age 70 ½ and are required to take minimum distributions from their IRA accounts, using required distributions to fund charitable giving is a common strategy. 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. While this was a temporary bill that was extended multiple times, President Obama made it permanent in December of 2015. These "qualified charitable distributions" satisfy required minimum distribution requirements, 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.

Sometimes clients have a desire to be charitable over several years and they are dealing with an anticipated level of taxable income that may be higher than usual (i.e. sale of their business or practice, vesting of company stock and/or options, etc.). At the same time, 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. For clients in these situations, a contribution to a donor-advised fund can be a great solution.

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 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 distribute grants to charities in future years.

When a donor makes a contribution to a donor-advised fund, they're 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 their favorite charities. The donation is also 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.

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 can be below 0.15% for indexed options. For balances over $250,000, donors can have their portfolio managed professionally by an advisor.

Donor-advised funds are able to accept a number of different 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). Donors are also able to name successor account holders to oversee the fund after their passing, or specify that the remaining balance be transferred to one or more predetermined charities.

In short, a donor advised fund can be used to accomplish many of the charity-related goals that were previously done through more complex, expensive planning tools, such as private family foundations.

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. We look forward to hearing from you and would like to take the opportunity to wish everyone a happy fall!

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