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summaries

SIGMA INVESTMENT COUNSELORS

the official newsletter of sigma investment counselors November 2024

POPULAR CHARITABLE STRATEGIES

As the end of the year quickly approaches and the holiday season is nearly upon us, many of us feel a strong desire to give back to our communities and support causes close to our hearts. While charitable gifting often involves writing a check or making a simple donation, there are numerous financial strategies that can help maximize your contributions while also providing potential tax benefits. We have spoken on this topic in these pages in the past but given the extremely strong equity markets over the last 2 years we felt it was worthwhile to revisit.

Gifting Cash Directly to Charity

The simplest gifting method involves writing a check directly to the charity using cash you have on hand and taking an itemized deduction for the gift. When the Tax Cuts and Jobs Act was passed in 2017 the standard deduction nearly doubled from previous levels. In 2024 the standard deduction for single and married filing status is $14,600 and $29,200, respectively, with additional deductions available for each taxpayer over age 65 ($1,950 and $1,550, respectively). This makes the hurdle for itemizing deductions quite high and as a result, gifting cash to a charity may not result in a tax deduction for many individuals. There are also adjusted gross income (AGI) limitations for a cash gift where you cannot deduct more than 60% of your AGI in any given year. These details result in a scenario where a cash gift may not be the most advantageous strategy.

Gifting Appreciated Securities Directly to Charity

The stock market has been on an incredible run over the last 2 years, with the S&P 500 returning 51.95% from 10/31/2022 to 10/31/2024. Many investors may be sitting on large unrealized capital gains within their taxable brokerage accounts. Rather than selling securities in an investment account an investor can gift those securities directly to charity. By gifting appreciated securities capital gains tax is avoided on the appreciation and a deduction is received for the value of the gift. The charity then sells your security for no tax. This strategy can allow an investor to diversify their portfolio and trim profits without incurring any tax.

Similar to cash gifts, you must itemize your deductions and an AGI limitation (30%) also applies. Any gift amount exceeding the AGI limitation has the ability to be carried forward into future tax years.

Qualified Charitable Distributions (QCD)

An individual with qualified funds (pre-tax IRA) is allowed to gift the IRA funds directly to charity. You must be at least 70.5 years old to take advantage of this strategy. When funds are gifted from a pre-tax IRA the distribution is not counted as taxable income. You also do not take an itemized deduction for the gift.

This can be a worthwhile strategy for individuals who do not itemize deductions and still want to experience a tax benefit for their gift. Since the creation of the Qualified Charitable Distribution in 2006, the annual limit for QCDs has been $100,000, but the Secure Act 2.0 of 2022 introduced an annual inflation adjustment to the limit (starting in 2024). In 2024 a $105,000 limit applies to each taxpayer (a married couple could complete $210,000 annually).

In addition to the tax-free nature of a QCD, another benefit is QCDs are counted towards an individual's annual required minimum distribution, reducing the tax burden of the requirement. For individuals who are not yet subject to distribution requirements (age 73 or 75 depending on birth year) the QCD can be particularly beneficial in that a QCD will reduce the value of your pre-tax account which may later reduce the amount of your required distribution.

Donor Advised Funds

A Donor Advised Fund (DAF) is a flexible, tax-efficient way to manage your charitable gifting over time. A DAF is an account specifically set up for charitable giving and can be established though Fidelity Charitable and DAFgiving360 (previously known as Schwab Charitable). With a DAF an individual contributes highly appreciated securities into the account and immediately earns a tax deduction for the amount you contribute (subject to the same 30% AGI limitation mentioned earlier). You then gift to charities out of the DAF account instead of out of your personal accounts.

The benefit of this strategy compared to gifting appreciated securities directly to charity is a DAF provides complete flexibility in the timeline for which a charity receives the funds. There is no requirement for when you must distribute funds to charity. Meaning you could theoretically contribute to a DAF and wait years before transferring funds to a charitable beneficiary. This flexibility allows a DAF to be utilized in years where income may be abnormally high, maximizing the value of your tax deduction.

For taxpayers who are normally unable to itemize deductions, "gift bunching" can be utilized where an individual contributes multiple years' worth of donations into the account at one time to allow for itemized deductions. In future years where the standard deduction is applied charitable gifts are completed out of the DAF.

On top of all of this, funds inside of a DAF can be invested, potentially allowing for tax free growth on those assets to benefit charities even more in the future.

Additional Considerations

Charitable gifts are a great way to offset income on your tax return which may be intentionally realized for financial planning purposes. For example, if an individual is completing Roth conversions a charitable gift can be utilized to offset the effective cost of the conversion. For individuals who have inherited an IRA account since 2020, the Secure Act now requires many of those inherited IRAs to be fully distributed in 10 years as taxable income. Charitable gifting can provide tax relief during that 10-year period allowing you to distribute the inherited IRA in the most tax efficient way possible.

Please note this list is not an all-inclusive summary of the charitable strategies available but is meant to highlight some of the most popular ones. If you have questions related to these strategies, please speak with your Sigma Advisor on how to best integrate these into your financial plan. A tax professional should also be consulted before implementing any of these strategies.

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