Ruminations on Charitable Giving

Many of our clients make regular charitable contributions. The tax laws can be fairly complicated in this area, but there are ways to give more efficiently that are worth knowing if you have charitable inclinations. While these strategies apply to most of our clients, please contact us or an appropriate tax professional before taking action as there may be differences in your individual situation that may limit your deduction, etc.

Gifts

Frequently the best gift to make to a charity is a donation of appreciated securities that you own in a taxable account (not a retirement account). Suppose 100 shares of stock were acquired many years ago for $5,000 and the value has subsequently grown to $50,000. The position may be transferred to a charity and (with some limitations) a deduction taken for the current value. The charity can sell the securities, and as a non-profit will pay no taxes on the appreciation. The $45,000 gain is *never* taxed in this case. This is a particularly good strategy if you have a position you would otherwise sell (for diversification perhaps), that has a very low cost basis. It is also nice for positions where you are unsure of your exact cost basis since it never needs to be determined.

Bequests

Under current law, at death most holdings will be "stepped-up" in value so heirs will have a cost basis equal to the current value. Thus, leaving a bequest of securities as in the previous paragraph doesn't have an income tax advantage. (In fact, if the estate is not large enough to be taxable, it would be better to leave the property to an heir and have them make the charitable contribution so that they can have an income tax deduction rather than wasting it by leaving the property to the charity directly.) For bequests, the best gift is generally assets in a retirement account that has only pre-tax contributions. This would include most IRAs, 401(k)s, etc. To do this, simply name the charity on the beneficiary designation for the account.

Alternatively, to maintain flexibility it is possible to name the charity as a contingent beneficiary and have the primary beneficiaries disclaim the amount they would like to go to charity at that time. Disclaimers are frequently not executed properly, so discussing the plan beforehand and involving competent advisors would be prudent.

The reason these retirement accounts are optimal for charitable bequests is that they generally have no cost basis at all, and as IRD (Income in Respect of a Decedent) property they do not receive a step-up in basis as discussed above. Thus a $50,000 traditional IRA left to someone in the 25% marginal tax bracket would only give them $37,500 after taxes if they withdrew the funds immediately. Conversely, the entire $50,000 would be available to a charity as a tax-exempt entity. This is an even better strategy than the gift of appreciated securities above because 1) rather than simply a "low" basis, these retirement accounts typically have a cost basis of zero, and 2) the taxes saved are ordinary income taxes rather than the lower capital gains taxes.

Donor Advised Funds

A Donor Advised Fund (hereafter DAF) is a charity and a gift to the DAF is a completed charitable gift that qualifies for a current tax deduction. However the account is typically invested rather than immediately disbursed, and the donor, who is no longer technically the owner of the funds, may advise the fund where and when to make contributions. It would be extremely rare for a DAF to disregard the donor's wishes in regard to gifts to a public charity. The DAF typically has a low initial minimum size of $5,000-$10,000 and successor advisors to recommend distributions may be named as well. A DAF is optimal when the ultimate recipient of the gifts has not yet been determined, or for simplicity if there are a number of charitable recipients. In other words, it would be easier to gift $50,000 worth of stocks to the DAF and then have the DAF sell the position and disburse 50 checks for $1,000 to various charities, than it would be to set up 50 individual stock transfers to 50 different charities.

Of necessity, the above discussion has been very superficial. As I noted at the beginning, before implementing these strategies it would be prudent to consult with an appropriate professional for advice and guidance.

Notes:

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