Tax-Smart Charitable Giving

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There's a persistent misnomer in the minds of some financial consumers that charitable giving can actually benefit the giver from a tax standpoint if the gifts are carefully structured to avoid capital gains taxes and generate tax write-offs. But in fact, there are no clever strategies that make it profitable to give away money or assets.

However, there are ways to make gifts and donations less expensive on an after-tax basis, which means that people can be more generous to their charity, church or educational institution by leveraging the tax code a bit. The simplest tax-advantaged giving strategy is to give appreciated stock, real estate, or other assets from a taxable account (not a traditional or Roth IRA) instead of writing a check. This allows the donor to transfer the full value of the assets without ever having to pay capital gains taxes on the amount of appreciation. Their donation can be up to 20% higher than a cash donation, and yet come out equally on an after-tax basis.

Donors can also, of course, claim a tax write-off on their charitable contributions. For appreciated assets, this is generally limited to 30% of their adjusted gross income. A more serious write-off obstacle is the high standard deduction: currently $27,700 for married couples filing jointly. If the donation plus other deductions don't exceed that threshold, it makes more sense to simply claim the standard deduction—which means there is no tax benefit (or write-off) from the amount given.

The solution? A savvy donor could bunch multiple years of contributions into one year, putting a larger contribution into a donor-advised fund. This pushes the contribution in the current year beyond the standard deduction, recovering the tax write-off by itemizing deductions, and then the donor could make his or her usual annual charitable gifts from the donor-advised fund.

Another tax-aware giving strategy for people who are taking required minimum distributions (RMDs) from their IRAs is to make use of qualified charitable distributions (QCDs). Individuals aged 70 1/2 or older can have up to $100,000 per year go directly out of their IRA to a charitable organization, which would satisfy the RMD requirement, and never have to pay taxes on the distribution.

And then, of course, there are a variety of trust vehicles that offer tax advantages. Donating to a charitable lead trust provides income payments to a charity for a fixed term of years, and when the donor dies, whatever is left in the trust will be passed on to the heirs. This can be structured to generate an initial write-off or to eliminate estate taxes on the inheritance.

If the donation is made to a charitable remainder trust, there is an immediate tax write-off, and the trust will provide income to the donor for a fixed period of time or life, and upon death, the remaining assets will go to the charity of the donor's choice. The amount of the write-off is determined by the size of the income the donor receives. Charitable gift annuities work in a similar fashion; there is an up-front tax deduction and a lifetime stream of income payments flowing back to the donor until death, at which point the charity takes full possession of the remaining assets.

The simple point here is that the U.S. tax code encourages and even helps leverage charitable activities, even if it doesn't go so far as to make them profitable. Tax-smart donors can give more and have more impact.

Sources:

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