TAX SMART GIVING STRATEGIES

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Since 2017, fewer people find it beneficial to itemize deductions on their individual income tax return. Why? The standard deduction for married couples increased dramatically from $12,700 in 2017 to $26,600 in 2018 if over 65 (and to $28,700 in 2022), and some previously significant itemized deductions are no longer allowed. Therefore, looking at new ways to give to charities in a tax smart manner may be worthwhile.

In this article, we will consider the tax impact of four giving strategies, two of which (#3 and #4) may be less familiar to you but may have significant advantages under current tax laws. We will apply each of these strategies to the same donation plan to illustrate the wide range of tax consequences. There are links to background information for strategies 3 and 4 that may also be helpful.

In the four examples below, the donors are a couple in their early 70's who are in the 25% income tax bracket and who plan to give $10,000 each year for the next three years to various charities. The couple has a stock portfolio that includes 300 shares of XYZ stock purchased for $20/share ten years ago that is now worth $100/share. The couple also has an IRA that requires a minimum distribution (RMD) each year of approximately $10,000, since both persons are over age 73. Finally, the couple can claim about $15,000 in itemized deductions (state taxes, property taxes, mortgage payments, medical expenses, etc.), plus any charitable donations. In each case, the couple plans to sell $10,000 of XYZ stock each year and is required to take an RMD of $10,000 each year. This will allow them to give $10,000 to charities and to have $10,000 to use for other purposes. There are several ways they can structure their giving with very different tax treatment, although they use the same assets in each case.

Bottom line: For these four examples, the tax consequences of different giving strategies vary over three-fold, making it very worthwhile to carefully consider how to structure your giving.

1. Appreciated Stock Sale Followed by Cash Giving

The most common way that most people give to charities is by making cash donations. In this example, the couple sells 100 shares of their XYZ stock to raise $10,000 and gives that money to the various charities they wish to support. They also receive $10,000 from their IRA RMD, with a taxable rate of 25% (resulting in $2500 tax). They pay taxes of $1200 on the sale of stock (100 shares of stock with a basis of $20/share, sold for $100/share, with a 15% capital gains tax rate =100 x (100-20) x 15% = $1200). Since the $10,000 in donations plus their other itemized deductions ($15,000) are less than the standard deduction of $28,700, they take the standard deduction. <u>The total tax consequence each year for the sale of XYZ and the RMD would be $3700 ($1200 + $2500).</u>

2. Appreciated Stock Given Directly to Charities

A second popular way to make charitable gifts is to donate appreciated property directly to charities. In this example, the couple directs their stock broker to transfer 100 shares of XYZ stock worth $10,000 to various charities each year (donation, with no taxes due) and also takes the RMD of $10,000, paying a tax of $2500. Since the total of all itemized deductions each year is again less than the standard deduction, the couple takes the standard deduction. <u>The total tax consequence each year is $2500.</u>

3. Giving from an IRA using a Qualified Charitable Distribution (QCD)

A third giving strategy is to make a Qualified Charitable Distribution (QCD) from an IRA account. Required Minimum Distributions (RMDs) from IRAs are mandatory each year after age 73 but the taxable amount of the RMD can be reduced by giving directly to qualified charities using a QCD.

For our couple, who have an RMD of $10,000/year, they could choose to give a QCD of $10,000/year donations (with no taxes due) and sell their 100 shares of XYZ stock to raise an additional $10,000 for other purposes. <u>The tax consequences each year would then be $1200, the tax on the sale of XYZ stock.</u>

4. Giving from a Donor Advised Fund (DAF)

A fourth, somewhat different, giving strategy is for the couple to create a Donor Advised Fund (DAF) through their brokerage (essentially a personally-managed trust fund) and make their charitable contributions from this DAF. The amount of money or other assets deposited into the fund is tax deductible <u>in the year the deposit is made,</u> but the charitable giving from the fund can be spread out over time, as the couple chooses.

In this example, the couple transfers all 300 shares of XYZ to their DAF in the first year, providing $30,000 funding that can then be used to make charitable gifts at a rate of $10,000/year for three years. For tax purposes in the first year, the $30,000 donation can be added to the $15,000 in other itemized deductions to create an itemized deduction total of $45,000 for that year. The reduction in taxable income (compared to the standard deduction) would be $16,300 ($45,000-$28,700), reducing taxes by $16,300 x 25% =$4075 for that year. In the two remaining years of the three-year plan, the couple would take the standard deduction. They would take the RMD of $10,000/year with tax consequences of $2500/year for all three years. <u>The average tax consequences for the three years would then be ($7500-$4075)/3 or $1141/year.</u>

Conclusion

There are many tax smart giving strategies that can be considered, and each person or couple must choose the best strategy based on their own particular needs. The examples given above are for illustrative purposes only and should not be considered tax advice. The three-year planning period in the example is also just one possibility among many that might be most appropriate for different individuals. As examples 3 and 4 indicate, it may be possible to achieve significant tax savings by using a QCD to give from your IRA, or by using a DAF to manage your giving. You may wish to consult a tax professional to get detailed advice on a strategy that best meets your needs.

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