Charitable Giving Strategies

The American public continues to be generous to their favorite causes. It is estimated that over $335 billion was given to charities in 2013 according to the Giving USA Foundation. Along with enabling their favorite charities to continue their good works, many include charitable giving as part of their overall income tax and estate planning strategy. This article identifies some of the issues you may want to consider as you plan your charitable giving activities. You should always make sure the charities you are considering are legitimate and you should consult with your financial or tax advisor to better understand how the tax laws apply to your situation.

Income Tax Deductions

If you itemize your deductions, contributions to qualified charitable organizations can be claimed as deductions. There has been considerable discussion as part of many tax law changes about enabling non-itemizers to also get tax relief from charitable contributions. However, at this time, only taxpayers claiming itemized deductions get this benefit.

The amount you can deduct for charitable contributions is generally the fair market value (FMV) of what you give. For cash contributions, it is simple. Your deduction is just how much you gave. If you give other property (like stocks, real estate, art or other items), determining fair market value can be more difficult. For publicly traded securities, FMV is calculated as the average of the high and low prices for that security on the date it was transferred to the charity. For illiquid or non-publicly traded securities, you may need to get an appraisal to determine the FMV. In addition, the property (or securities) must have been held for more than a year.

Limits on Deductions

The tax laws do place some limits on the total amount of charitable contributions that may be claimed on individual tax returns. For contributions of cash to public charities (not private foundations), you may claim deductions up to 50% of adjusted gross income. If appreciated securities are given, there is a limitation of 30% of adjusted gross income. Deductions in excess of these limitations can be carried forward and used over a five year period.

Why give appreciated securities?

Donating stocks (or other capital items) that have risen in value since they were acquired offers two tax benefits. As long as you have held the securities for more than a year, you can claim a deduction for the appreciated value and you avoid paying tax on the capital gain. If you have held the stock for less than a year, your deduction is limited to your cost basis. If you donate a stock that has fallen in value, your deduction is limited to the fair market value.

Consider the following:

You bought 100 shares of XYZ stock several years ago for $25 per share and it has now risen to $60 per share. In other words, your $2500 investment is now worth $6000 and you wish to give $6000 to your favorite charity.

If you donate the shares to a charity, you get a deduction for $6000 and pay no income tax on the gain. If you sell the shares, you would pay tax on the capital gain of $3500 (probably 15% of $3500 or $525) leaving you only $5475 to donate. By giving the shares you avoid the capital gains tax and the charity gets the full $6000 value. The charity could then sell the shares and have the proceeds to use.

Other Alternatives

There are more sophisticated trust strategies that some individuals use – charitable remainder trusts and charitable lead trusts. With a charitable remainder trust, a donor contributes property (usually money, securities or real estate) to a special form of trust. During the donor's lifetime or some period, the income from that property is distributed to the donor. On the donor's death or at the end of the specified period, the remainder goes to the charity.

With a charitable lead trust, the effect is the opposite. The charity gets the income for the lifetime of the donor (or some period) and the remainder goes to the donor's estate or some other beneficiary at the end. These types of trusts are complicated to set up and administer and are usually only used as part of a sophisticated estate plan by wealthier individuals. Qualified legal and tax assistance is a must.

Another contribution vehicle that has become popular in the past few years is the donor advised fund. These funds have been established by many mutual fund companies and function like this:

- A person donates cash or appreciated securities to the "donor advised fund." Usually, these funds require a minimum of at least $10,000. The contribution is irrevocable.
- The donor gets a tax deduction for the contribution in the year it is made.
- The fund invests and manages the contribution along with the rest of the monies within the fund.
- The donor recommends which charities are to receive the contributions.
- The "donor advised fund" evaluates the recommendation and makes the contribution.

The benefits of this approach include the ability to get an immediate deduction while the contributions are made later. In addition, the fund professionally manages the monies and handles much of the paperwork. Be sure to thoroughly investigate any organization offering donor advised funds before enrolling.

Summary
Charitable contributions enable many worthwhile organizations to carry out their missions. Donors can get emotional satisfaction and tax benefits through their giving. The tax laws are structured to encourage giving and there are ways to maximize the tax benefits of giving. Using some of the more sophisticated ways of giving can get complicated and it is always advisable to use professional help in evaluating them.