

Charitable Giving

A plan that works for charity, your family, and Uncle Sam.

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Starting this year, make a commitment to take more control of your charitable funds. By now, you have probably already filed your 2003 tax return and are likely considering how to make the tax bite a little less intensive next year. While you may be generally aware of what charita-

ble options exist, you may not realize how these options apply in your case. These two factors, the what and the how, can greatly influence the value of the charitable donations for your specific tax situation and the value of your charitable donation in terms of its ultimate impact. Each of the following scenarios describes a different philanthropic goal and one approach to accomplishing it in a more tax-efficient manner.

SCENARIO 1: GIFTS OF STOCK

A typical scenario includes families who make weekly charitable gifts to their local church or other non-profit, by writing a check from their checking account. Although this is a very traditional and time-honored way of giving, putting your check in each week with the rest of the congregation is probably not the most effective means of making your charitable gifts from an income tax standpoint. This is because by giving cash, you are giving up the opportunity to give other assets, such as stock.

For example, let's say you bought a stock for \$5,000 and it's now worth \$10,000. Let's further assume that you are not enamored of this stock anymore and want to take your profits. Even under the current lowered capital gains taxes, you'll end up paying 15% to Uncle Sam, and depending upon the state you live in, maybe another 5% to 7% in state taxes. Let's assume that the combined tax

rate is 20%, thus the effective tax rate you pay on this transaction is 20% of the \$5,000 capital gain, or \$1,000. (Note: Be cautious of selling appreciated assets that are held less than 12 months, as you will pay ordinary income tax rates on these short-term capital gains, up to the maximum 35%, and even more with phase-out.)

What you could do instead is add together all of the gifts you'll make to charity over the coming year; let's say that total is \$10,000. Instead of writing a check to that charity, why not gift stock to those charities and avoid having to pay tax on your \$5,000 gain? This way, you'll

save \$1,000 in capital gains income tax, plus the regular income tax deduction that comes from making a charitable gift of \$10,000. (It is important to note that the deduction here is for the full \$10,000 fair market value of the stock on the date of the gift to charity, even though you only paid \$5,000 for the stock—see *IRS Publication 526 Charitable Contributions*, for more specifics.) And,

you can always take the \$10,000 in cash that you were going to give to charity and buy another stock with these funds instead of selling your winning stock, paying capital gains taxes of \$1,000 and writing personal checks to your favorite charity. After you've done this once, you'll see how easy the process is; your charities are probably already doing this for other donors. I like to summarize it this way: You are earning \$1,000 tax-free in the form of capital gains tax savings, probably for less than an hour's worth of paperwork or phone calls.

Changing the facts just a little, let's assume all of the above, only now you want to continue owning the stock for the long term. You could still utilize the exact same process as outlined above and repurchase the stock using



the cash that you were going to give to charity. This way you have given the appreciated asset, avoided the capital gains tax, and were able to repurchase the very same stock that you wanted to own for the long-term at a higher tax basis than you had before. When you do finally sell the stock, you will likely pay less in capital gains tax because you now own something for which you paid \$10,000, and you will only pay capital gains tax on anything above that amount. In addition, if the stock goes down, you can sell it and take a tax loss on the stock and claim it on your taxes. Under the wash-sale rules, you can even claim the loss, and buy the stock back 31 days after selling it to continue to owning the stock for its long-term potential. Your primary risk here is being out of the market for the 31 days that the IRS says you must wait.

SCENARIO 2: GIFTS OF STOCK VIA A DONOR-ADVISED FUND

Does the previous example sound too complicated? It is if that \$10,000 is going to numerous charities, in which case you have to do paperwork and dole out small sums of stock to each of those different entities. However, there is another approach; utilizing a donor-advised fund will allow you to make one transaction of stock, transferring the \$10,000 of stock to the donor-advised fund. The donor-advised fund is a separately managed 501(c)(3) tax-exempt organization that can sell the stock at no taxable gain and hold the funds until you're ready to pay them out to any number of charities—typically in \$250 minimum increments. You could pay the funds out all at once, or dole them out to your favorite charities over the course of the next 1 year, 10 years, or longer. See *Endovascular Today's* February 2004 issue, page 72, for a further discussion of donor-advised funds.

In summary, Scenarios 1 and 2 are two avenues for giving your \$10,000 stock; (1) giving actual stock to the charities you want to benefit, or (2) giving the stock to a donor-advised fund and then distributing the funds from the donor-advised fund to the ultimate charity. Either way, it's a matter of doing a little paperwork and having to come to terms with not dropping that envelope in the mail each week; it's doing the same thing a little more tax efficiently, and getting used to giving on your schedule, not every time an envelope is presented to you.

In each of these first two scenarios, you've made your charitable contributions, and the entities receive \$10,000 in stock, but you save \$1,000 in capital gains tax. Plus, when you take into account the tax-saving on the \$10,000 charitable gift, assuming your combined federal and state income tax bracket is 30%, then your charitable donations saved you another \$3,000 in income tax. Thus, at a combined savings of \$4,000, your charitable contributions are

being made at an effective 40% tax savings—a fairly powerful incentive to make charitable gifts.

SCENARIO 3: GIFTS OF STOCK OR CASH IN ALTERNATING YEARS

Let's say your income is a modest \$50,000 a year, but you have significant assets and you continue to give \$5,000 a year to charity. If you have no mortgage and pay low state income taxes (or you are fortunate enough to live in a state with no income taxes), you may not even meet the threshold of being able to itemize your deductions each year. However, the federal government gives you a nice benefit of the standard deduction, if your total itemized deductions are not over certain thresholds. For a married couple in 2003, that threshold is \$9,500. Thus, if your itemized deductions are not over \$9,500, you're not getting any benefit from your charitable contributions of \$5,000. In this case, you could make 2 years worth of your \$5,000 annual charitable contributions in 1 year. This would then allow you to itemize your deductions for that year by allowing you to overcome the itemized deduction threshold in that year, and make all of your other itemized deductions eligible to be deducted as well. These may include your charitable non-cash donations, charitable mileage or other expenses, vehicle licensing fees, real estate taxes, state taxes, investment expenses, and so forth. This is because as a cash basis tax payer, you have the control over how and when you time these charitable contributions, and thus by making a lump sum of 2 years worth of charitable contributions in 1 year, you may be able to get a significant tax benefit by doing so.

To use this strategy and itemize your tax deductions in alternating years, you could simply make the gifts to your specific charity in alternating years, then contribute nothing for a year or two, and then make the gift again. However, if there's one thing I've found with charitable organizations, it's that no matter what you give, they continue to want you to give the following year. A donor-advised fund is a good solution because you don't need to dole out the funds to the specific charities all at once. The donor-advised fund can help you space out the timing of your contribution to meet your tax purposes by allowing you to deduct the full value of the gift in one year, then you can make the gifts to the ultimate charity over time.

SCENARIO 4: MAKE CHARITABLE GIFTS IN A WINDFALL YEAR

You may have a significant one-time event causing a large portion of your income to be taxed at much higher rates, such as the sale of a business or the exercise of stock options. Since nearly all of us are cash-basis taxpayers, you can elect to make larger contributions in these high tax

years, and no contributions in other years, to take advantage of your tax differential in your higher tax year (eg, if you were taxed at an assumed 45% combined federal and state tax rate, rather than just the 30% tax rate that you face in normal years). What you may wish to consider is to make several year's worth of your charitable tax deductions into the donor-advised fund in that year, so that you're reducing income that would otherwise be taxed at 45%, instead of your standard 30% rate. The impact is the differential in your regular yearly tax rate of 30% versus the rate you'd be taxed at this year, which is 45%. Thus, on a \$50,000 contribution to a donor-advised fund, you're saving an extra 15% in taxes by making that contribution this year, or \$7,500 in tax savings over your typical tax year, and \$22,500 in total tax savings. Now we're talking about real dollars that might make a difference in your charitable giving. Once the money is in your donor-advised fund, you can dole it out to the charities of your choice over time.

Some of the more common donor-advised funds will only accept gifts of cash or publicly traded securities; however, there are donor-advised funds that will accept other assets, such as artwork or real property. Of course, with any gift of hard-to-value assets, the donor-advised fund will have to consider its expertise and ability to be effective stewards of such assets, as well as the liability that the fund may be exposed to by accepting certain assets such as real property.

When considering these larger gifts, keep in mind there are some limitations in your ability to write off the entire contribution in the first year. For instance, you should pay attention to deductions limitations that limit your charitable deductions to a percentage of your Adjusted Gross Income, depending on the type of asset donated, and the charity to which it is donated. For gifts of common stock to a public charity, that deduction limitation is generally 30% of your Adjusted Gross Income. Charitable deductions beyond this amount can be carried forward for 5 additional tax years. Also, at higher income and deduction levels be aware of itemized deduction phaseouts, and the Alternative Minimum Tax, which can reduce some of these benefits.

SCENARIO 5: GIFTS OF REMAINDER INTERESTS

Let's take charitable plan concepts to a whole new level. All of the gifts that we have discussed so far are "completed gifts" (ie, you are not retaining any interest in the property given to charity). Gifts of Remainder Interests, commonly called planned gifts, are gifts from which you may receive income (the Income Interest) from the designated assets for a period of time (often you and your spouse's lifetimes), and then when you are gone, the assets pass to

charity; this is referred to as the Remainder Interest. This splitting of the Income Interest from the Remainder Interest is a helpful concept, especially for those looking to both help plan their income tax scenarios as well as their estate.

Gifts of Remainder Interests involve calculations that take into account the value of both the Income and Remainder Interests because your designated charities will often just be receiving the Remainder Interest, and thus the tax deduction is limited to calculating the present value of the Remainder Interest. For example, say you are contributing a stock to a charity valued at \$300,000, and will reserve the right to draw an income from that value for the lifetime of you and your spouse. Depending on your ages and other factors, you may receive a charitable deduction for only \$100,000; however, at the same time, the tax-exempt organization has the ability to sell the stock, pay no capital gains, and reinvest the proceeds to pay you an income of say 6% per year on the full \$300,000 value, or \$18,000 per year.

Charitable Gift Annuities, Pooled Income Funds, and a variety of Charitable Remainder Trusts formats can all be excellent methods to accomplish both your charitable goals, as well as tax and estate planning benefits. These advanced planning techniques, including giving gifts of Remainder Interests, will be explored in detail in next month's column.

A BENEFIT FOR ALL

You might well ask, why does Uncle Sam allow such varied and effective means for making charitable gifts if these options in effect reduce your tax bill? The answer lies in the fundamental notion that the government seems to understand that private charity reduces demand for government services; if not directly, then with a fairly high degree of correlation. Suffice it to say, the government realizes that your private charitable contributions to organizations that you feel are effective are an attractive proposition to all involved, including Uncle Sam, your charities, and you. ■

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