5 Year-End Strategies for Charitable Giving

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With these year-end giving strategies, you can make charitable donations in ways that are most beneficial to your financial situation.

Many people have charitable inclinations, however, they do not realize the variety of ways they can donate or that through donating they can receive significant tax breaks. Even though fewer people will be itemizing deductions as a result of the Tax Cuts and Jobs Act, there are still many ways to realize tax savings from your charitable giving.

Typically, people think of donating to charity by check or cash, but that is not always the most effective way to go about it. These five giving strategies combine the desire to support good causes with the possibility of saving significant money through tax breaks.

1. GIVE SECURITIES RATHER THAN CASH

If you've held stocks, mutual funds, or bonds for more than one year, you can donate the appreciated securities and receive more income-tax savings than you would if you donated the cash. Moreover, donating securities is convenient because all you need to do is transfer them—you should not sell the securities first in order to donate them.

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Donating securities rather than contributing cash saves you more in taxes because donated securities do not face a capital gains tax when they are given to a nonprofit. For example, if you make a $10,000 cash donation, you could save $4,500 in taxes. However, if you make a $10,000 donation in stocks that have doubled in value, you would save $5,990 in taxes, including the $1,490 in saved future capital gains taxes.

2. DONATE AN RMD TAX-FREE TO CHARITY

If you are 70½ or older, you can transfer your required minimum distribution (RMD) to charity; it will count as your RMD without increasing your adjusted gross income. (Note: RMDs start at age 73.) However, the money must be transferred straight from the IRA to the charity for it to be considered tax-free.

To get the tax-free benefit, you cannot first withdraw the RMD from the IRA and then donate it to charity. If you first withdraw the money from your IRA and then donate it to charity, you can still deduct the donation as a charitable contribution, but the withdrawal will be included in your adjusted gross income, which is typically not as beneficial as the direct contribution method.

3. UTILIZE A CHARITABLE DONATION TO BALANCE THE TAX COSTS OF CONVERTING A TRADITIONAL IRA TO A ROTH IRA

The biggest difference between a traditional IRA and a Roth IRA is that contributions to a traditional IRA are often tax deductible for both state and federal tax returns in their year of creation and can grow tax deferred within the account. The trade-off for a traditional IRA is that the contributions and earnings are then taxed at ordinary income tax rates upon withdrawal, and you are required to start taking minimum distributions (RMDs) from your funds at age 73 or 75. In comparison, contributions to a Roth IRA are not tax-deductible, but the following growth and withdrawals are tax-free. In short, traditional IRAs allow you to avoid taxes when you put money in, and Roth IRAs allow you to avoid taxes when you take the money out in retirement. For both types of IRAs, you will not pay any taxes on the growth of the funds while they stay in the account.

Roth accounts make sense for those who think that their current tax rate is lower than it will be when they make withdrawals, or if they are considering estate planning and legacy benefits associated with it. The problem with converting a traditional IRA into a Roth IRA is that you will owe taxes on any pretax converted funds at the time of conversion, based on your tax rate and the amount converted. However, if you convert in a year when you can claim a large charitable tax deduction, the charitable deduction can help to offset the conversion taxes. Under these circumstances, giving to charity can be a great opportunity to both give back and reduce taxes.

4. CREATE A DONOR ADVISED FUND

With a donor advised fund (DAF), you make a donation to an organization sponsoring the fund, get the immediate tax deduction, and then can decide later, at your convenience, how to grant out the money to your preferred charities. To open a donor advised fund, you must make at least one contribution of money or assets to the organization, which will establish the DAF. You may then want to add to that fund in subsequent years.

Creating a DAF is an effective year-end strategy for charitable gifting because it enables you to immediately take a tax deduction once you have gifted, but you don't have to decide which charities to aid right away. Using a DAF is an excellent way to minimize the tax implications of year-end bonuses, or counterbalance a year of unforeseen high earnings.

5. CREATE A CHARITABLE REMAINDER TRUST

A charitable remainder trust (CRT) allows you to convert cash or property into lifetime income while providing you and your heirs a large tax break. What essentially happens is that you set up a trust, and transfer to it cash or property that you want donated to an IRS-approved charity. The charity will then serve

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as the trustee, and it is charged with managing and investing the trust funds. Then the charity pays you, or someone you name, a portion of income the trust accumulates for a certain number of years or your whole life (you specify the payment period in the trust document).

You can choose to either receive fixed annuity payments or percentage payments from the trust. If you choose to receive fixed annuity payments—where you get a fixed dollar amount from the trust each year regardless of whether the trust has a bad or good investment year—you have selected a charitable remainder annuity trust. If you choose to receive percentage payments—where you get the same percentage share each year regardless of how much the trust lost or made in that year—you have chosen a charitable remainder unitrust. Finally, at the end of the payment period you set, the remainder of the property goes to the charity, which is why it is called a charitable "remainder" trust.

A charitable remainder trust provides you with tax savings in three main ways:

- A tax deduction spread out over several years for the value of your gift to the charity minus what you can expect to receive as a return through interest payments.
- An estate tax deduction on the trust property you donated to the charity (as it's no longer in your estate, so it isn't subject to federal estate tax).
- A capital gains tax deduction, as a charitable trust enables the charity to turn property that isn't producing income into cash without having to pay a tax on profits gained. For example, if John held 1,000 shares of a stock that had appreciated in value from $1 per share to $10 per share while he held it, he could not sell the stock without having to pay a capital gains tax on it. However, if John donates the stock to a charitable remainder trust, then the trust can sell the stock without having to pay a tax on the sale, and pay John interest from this fund for the rest of his life without ever having to pay a capital gains tax.

In conclusion, there are many ways to give back while receiving valuable tax breaks, and your financial professional can provide a great service by helping you discover what's most beneficial for your unique financial situation.

Debra Taylor, CPA/PFS, JD, CDFA, writes on tax and retirement planning for Horsesmouth, an independent organization providing insight into the critical issues facing financial professionals and their clients.