ParsecFinancial
WEALTH MANAGEMENT

Charitable Gifting Strategies to Maximize Income Tax Benefits

The 2017 Tax Cuts and Jobs Act materially changed charitable giving for many Americans by doubling the standard deduction and limiting available itemized deductions.

The three most notable changes included:

1. Doubling of the standard deduction: The standard deduction for a "Married Filing Jointly" (MFJ) status is $25,100 in 2021 compared to $12,700 in 2017. For a single taxpayer, the standard deduction rose to $12,550 in 2021 vs. $6,350 in 2017.

2. New limitations were placed on certain itemized deductions: Home interest mortgage, state/local and property tax deductions were materially reduced. Home equity loan interest is now only deductible when used to acquire or improve a home, while state and local taxes (SALT) are only deductible up to $10,000. Mortgage interest expense is only deductible on new mortgage amounts up to $750,000.

3. Elimination of miscellaneous itemized deductions: The most pertinent to our clients are unreimbursed job expenses, investment expenses and tax preparation fees.

Due to these changes to Schedule A, many clients who historically itemized deductions are now no longer able to itemize and deduct their charitable gifts. With proper income tax planning, clients can work around the TCJA changes to maximize the tax benefits of their annual charitable contributions.

1 Donate via an IRA using qualified charitable distributions

The qualified charitable distribution (QCD) survived the 2017 Tax Cuts and Jobs Act but was modified by the 2019 SECURE Act.

A QCD allows taxpayers over age 70½ to make tax-free distributions directly to a qualified charity. Most 501(c)(3) organizations qualify as eligible recipients. However, donor-advised-fund sponsors, private foundations and supporting organizations are ineligible. Annual donations to a church or house of worship, support of a favorite college or university as well as contributions to local charitable organizations can generally be funded through QCDs.

Distributions from IRAs to fulfill required minimum distributions (RMDs) are taxed as ordinary income. When fulfilling the RMD, a client can choose to direct some or all of his/her RMD to one or more eligible charities through a QCD. In doing so, the portion donated is tax free. (Note: the SECURE Act pushed back the RMD age from 70½ to 72; however, QCDs may still be made beginning at age 70½.)

For example, a 75-year-old client with an IRA is required to take a $20,000 RMD in 2021. The client directs $7,000 to an eligible charity via a QCD. The $7,000 is distributed tax-free while the remaining $13,000 distribution is treated as taxable income. The annual limit for QCDs is $100k per individual, so a couple can gift up to $200k in QCDs every year.

A QCD reduces IRA income, which in turn reduces a taxpayer's MAGI (Modified Adjusted Gross Income). Here are a few examples of when QCDs should be considered::

- An IRA owner is no longer able to itemize as a result of the changes in Schedule A. So, his or her charitable contributions are no longer deductible.
- An IRA owner whose RMD is pushing up his or her MAGI into a higher premium bracket for Medicare Part B and D (IRMAA).
- An IRA owner has medical expenses that would be eligible to itemize with a lower AGI. Medical expenses exceeding 7.5% of AGI are able to be deducted on Schedule A.

2 Donate appreciated securities to avoid taxes on unrealized capital gains

Another tax efficient strategy for charitable giving is donating highly appreciated securities. Specifically, securities held in a taxable (non-IRA) brokerage or trust account with significant long-term gains (a holding period of at least 1 year). A donation of appreciated securities (generally individual stocks, ETFs or mutual funds), triggers an eligible tax deduction for the market value of the gift. The donor also avoids paying capital gains tax on the unrealized gain.

Donations of appreciated stock are limited to 30% of AGI. Unused charitable deductions will be carried forward for 5 years. The donor must itemize in these years in order to use the charitable deduction.

Securities with the most unrealized gain are the best candidates for charitable gifts given more opportunity to forgo capital gains tax.

If you are a Parsec client, We will identify the best candidates within your portfolio for gifting and help facilitate the transfer of the holdings to your specified charity.

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3 Maintain ongoing charitable giving with a donor-advised fund

A donor advised fund (DAF) is a charitable savings account. We work with many clients who've established a donor advised fund at a local community foundation or through the non-profit arm of a national brokerage firm like Charles Schwab or Fidelity. Qualified Charitable Distributions (QCD) cannot be contributed to a DAF.

For example, a donor pledged $30,000 to a charity over three years. This donor's Schedule A deductions ($10,000 of income and property tax plus $10,000 of the multi-year pledge) do not exceed the higher standard deduction. Instead of taking the standard deduction for the next three years, the donor could transfer $30,000 of highly appreciated securities into a DAF, which along with the $10,000 of income and property taxes would allow the donor to itemize and receive a charitable deduction for the pledge in one year.

Although the deduction is taken in year one, the donor can decide the timing of when gifts are made out of the DAF.

DAFs are most often funded with appreciated securities. Once the securities are sold within the DAF, capital gains are not realized. Funding a DAF with appreciated securities is an efficient way to trim a concentrated position within a portfolio without realizing capital gains. The charity also benefits from a larger gift.

A donor advised fund is an excellent way to teach the younger generation principles of financial stewardship by engaging them in philanthropy. It can unite family members to make meaningful impact decisions together and to pass on charitable giving experiences from one generation to the next. Often the older generation will earmark a percentage of the family's annual gifting to be directed by the younger generation. This not only teaches principles of financial stewardship, but also allows the younger generation to engage on a deeper level and continue the family's charitable giving legacy.

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Next steps to fulfilling your philanthropic goals:

Discuss your charitable intentions with your advisor. Your advisor will make recommendations for the most appropriate charitable giving strategy each year. For families wishing to educate the younger generations, speak with your advisor about facilitating a family meeting.

About Parsec Financial:

Parsec is a fee-only Registered Investment Advisor (RIA) with $3.95 billion in assets under management as of September 30, 2021. Parsec provides investment management, financial planning, tax planning, trust services and business retirement services to more than 1,925 families and businesses in six offices across North Carolina.

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