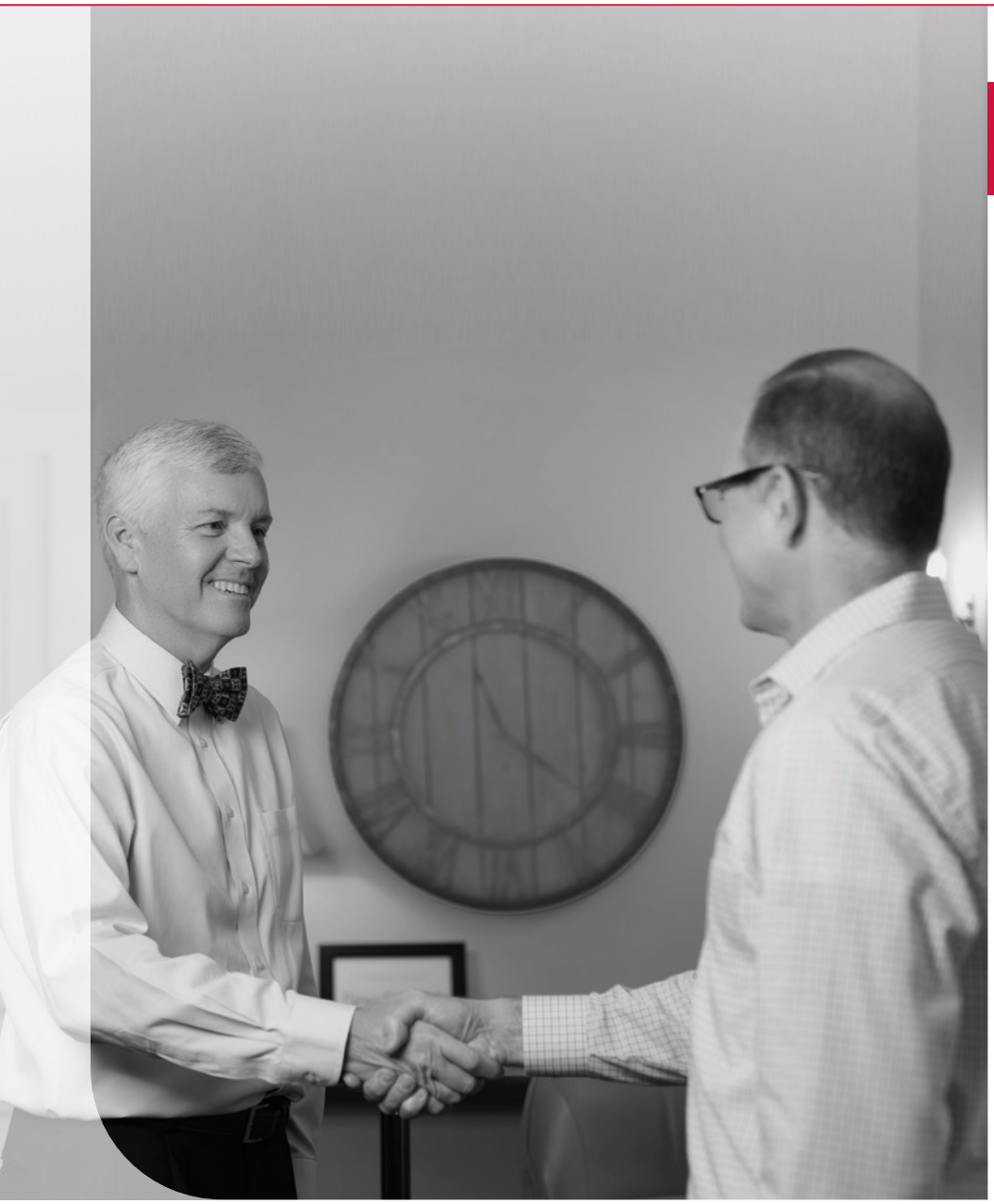
ParsecFinancial
WEALTH MANAGEMENT

Four Strategies to Help Maximize Charitable Deduction Contributions

The 2018 Tax Cuts and Jobs Act materially changed charitable giving for many Americans by modifying the rules around standard and itemized deductions.



The three most notable changes included:

1. Doubling of the standard deduction: A couple with a "Married Filing Jointly" (MFJ) filing status will see their standard deduction rise to $24,400 in 2019 (compared to $12,000 in 2017). The 2019 standard deduction for a single taxpayer will be $12,200.

2. New limitations on itemized deductions: The most impactful limitations are related to home mortgage interest and state and local income taxes. 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: Unreimbursed job expenses, investment expenses and tax preparation fees are some of the expenses that are no longer deductible.

Due to these changes, many clients who historically itemized deductions may instead choose to take the enhanced standard deduction. If so, some or all of the tax benefits of their charitable contributions could be lost without proper planning.

1 Donate via an IRA using qualified charitable distributions

The qualified charitable distribution (QCD) survived the 2018 Tax Cut and Jobs Act but was modified as a result of the 2019 SECURE Act.

The QCD allows taxpayers over age 70½ to make tax-free distributions directly to the qualified charity by the IRA custodian. 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 considered ordinary income and taxed accordingly. When fulfilling the RMD, a client can choose to direct some or all the RMD to one or more eligible charities by way of a QCD. In doing so, the portion donated is free from taxes. (Note that the SECURE Act of 2019 pushed back the age for required minimum distributions from 70½ to 72; however, QCDs may still be distributed starting at age 70½.)

For example, a 75-year-old client and owner of an IRA is required to take a $20,000 RMD in 2019. In doing so, 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 becomes taxable income. Note that the total amount donated by way of a QCD in any given tax year is limited to the total amount of the RMD or $100,000, whichever is less. As in the example above, the IRA owner would be limited to $20,000 in donations via QCDs.

The QCD technique is useful in several circumstances, such as:

- An eligible IRA owner who is over age 70½ and has historically itemized but is now better served to take the standard deduction;
- An eligible IRA owner whose RMDs are pushing up his or her adjusted gross income (AGI) to the point where more of his or her Social Security benefits are taxable;
- An eligible IRA owner who itemizes deductions but would have a portion of his or her charitable deduction carried forward because the total charitable gifts exceed a certain portion of his or her AGI. (This is less common.)

2 Donate appreciated securities to avoid taxes on unrealized capital gains

Another effective strategy for making charitable contributions is the gifting of appreciated securities. Specifically, these are securities held in a taxable (non-IRA) brokerage account in which the owner has significant long-term gains (a holding period of at least 1 year). With a donation of appreciated securities (generally individual stocks, ETFs or mutual funds), the donor receives a tax deduction for the market value of the gift while also avoiding paying taxes on all of the unrealized capital gain. It is a double win and a highly attractive way to give charitably.

Limitations do apply. Donations of appreciated stock more than 30% of your AGI are not allowed as an itemized deduction in the year of the donation. The excess must be carried forward and is available to be used in future years. If unused after 5 years, the deductibility expires. To get the benefit, the client must itemize deductions.

Mathematically, clients are better off gifting the stock that is the most highly appreciated. However, at Parsec, we review the client's portfolio to ensure that the donation will not adversely affect their overall portfolio diversification.

Appreciated stock donations are generally better for larger donations. Given the process, it is inefficient to do them for small dollar charitable donations. For each appreciated stock donation, a donor would contact the receiving charity to obtain their delivery instructions (investment account number and brokerage firm's DTC number and address). Then, he or she would sign a letter of authorization for each charity and their custodian would send the shares to the charity electronically. It is helpful to let the charity know the specifics of the donation so that they can prepare an appropriate receipt. If you are a Parsec client, your Client Service Specialist will assist you with this process.

3 "Bunch" charitable contributions to hit the increased standard deduction

The "bunching" concept is simple: Group your charitable contributions into those years where you will itemize deductions to maximize the full benefit. For example, for a couple who historically makes charitable contributions of $15,000 annually, they would be unlikely to itemize deductions at this level of giving. As an alternative, the couple could make 2 years' worth (or $30,000) of charitable contributions in one year to make itemizing possible and enhance deductibility. The next year, they would skip making charitable contributions and take the standard deduction. The couple would also want to coordinate any non-cash donations in years when they are itemizing deductions.

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4 Maintain ongoing charitable giving with a donor-advised fund

The issue with bunching is that some people have regular annual commitments or prefer to give every year. One potential solution is to use a Donor-Advised Fund (DAF).

A DAF is administered either at a custodian (such as Fidelity or Schwab) or at a local Community Foundation. After establishing an account, the donor transfers appreciated stock into the DAF account. In doing so, the donor gives up ownership of the shares but receives a tax deduction (provided that he or she itemizes deductions and the donation satisfies the 30% of AGI limitation detailed above). Once the funds are in the DAF, the donor can direct the distribution of the funds to qualified charities at his or her discretion. Note that certain foreign charities are ineligible and a Qualified Charitable Distribution (QCD) cannot be used to fund a DAF.

For example, a donor has pledged $30,000 to a charity over multiple years. The donor could put the entire $30,000 into a DAF upfront and get the full tax deduction in the first year but distribute it out to the charity at $10,000 per year over multiple years.

Another advantage to a DAF is that it can easily be used for smaller donations (usually there is a minimum of around $250). You get the tax benefits of being able to use appreciated stock without having to get delivery instructions for each charity. If the DAF is at the same custodian as your brokerage account, you can even fund the account by making the transfers online.

Finally, a DAF can be a great way to introduce children to philanthropy. For example, parents could establish a DAF account and organize a family meeting. In the meeting, they can share their philosophy and expectations on the family's charitable giving. Each child could be asked to research and select a couple of eligible organizations to receive grants from the family's DAF. Through this process, the parents can pass on a legacy of charitable giving that reinforces their family's core values and shared beliefs.

> "A DAF can be a great way to introduce children to philanthropy."

NEXT STEPS TO FULFILLING YOUR PHILANTHROPIC GOALS:

Charitable giving is alive and well. Given the tax law changes, it just makes sense to do a little more planning to ensure you get the maximum possible benefit. Keep in mind that these techniques are not all or nothing. You can combine any or all of the above strategies.

We are here to help, so please feel free to reach out with any questions relevant to your individual situation.

About Parsec Financial:

Parsec Financial is a registered fee-only financial advisory firm with $2.99 billion in assets under management as of December 31, 2019. Parsec provides investment management, financial planning, tax planning, trust services and business retirement services to more than 1,700 individuals and businesses in six offices across North Carolina.

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