PALLAS
CAPITAL ADVISORS

Last Chance - Charitable Giving in 2021

December 2021

PUBLIC SERVICE ANNOUNCEMENT

December 23rd is usually the last day you can purchase Christmas presents online and have them shipped in time for the holiday! No one wants to be in that uncomfortable position of realizing you waited too long. Well, in similar fashion, a week and a day later - December 31st - is the last day for individuals to make tax-deductible charitable donations for 2021. Let's examine a few of the charitable gifting ideas that should be considered by individuals as they seek to benefit charity and also maximize any income or estate tax benefits.

CASH DONATIONS

Giving cash is the simplest, and most common way to benefit charity. For those who give even modest amounts of cash to charity – there can still be income tax benefits. In 2021, taxpayers who don't itemize deductions on Schedule A can deduct cash donations of up to $600 for joint filers and $300 for single filers. "Cash" includes donations made by check, credit, or debit card and electronic funds transfers.

The donations must also be made directly to a qualified charity other than a donor-advised fund.

For taxpayers who itemize their deductions, in 2021 there is no limit on the amount of adjusted gross income (AGI) that can be offset with a cash donation to charity. In future years (unless Congress extends this provision), the deductions for these cash donations will be limited to 60% of the taxpayer's AGI. Again, these donations can't be to donor-advised funds.

DONATIONS OF APPRECIATED STOCK

Nearly as easy as donating cash, contributing stocks, bonds, or mutual funds that have appreciated over time has become increasingly popular. In addition to the charitable tax deduction, this strategy can help the taxpayer avoid the capital gains tax that would otherwise be due if the appreciated security had been sold by the taxpayer.

If the appreciated security has been held for more than one year when the donation is made, donors can claim the fair market value as an itemized deduction on their federal income tax return (assuming they itemize their deductions). The amount deducted in a single year can be up to 30% of the donor's AGI for stock donations.

By way of example, say Pete is a high-earning donor who has a taxable investment account with $10,000 of long-held stock that he bought for $2,000, and he wants to donate $10,000 to a favorite charity.

If Pete sells his stock he'll owe federal tax of 23.8% on his $8,000 long-term gain, leaving him with only $8,096 to donate and deduct. If he gives the stock directly to the charity, he won't owe capital-gains tax, and he'll get a deduction for the full $10,000. The charity will typically sell the shares and pocket the $10,000.

USING AN IRA FOR DONATIONS

For some individuals, using your IRA to donate directly to charity may make sense. This strategy, called a QCD or qualified charitable distribution, permits owners of traditional IRAs who are 70½ or older to donate account assets totaling up to $100,000 a year directly to one or more charities. As an added benefit, these donations can count toward their annual required minimum distributions (RMDs) from their IRA.

QCDs may be particularly appealing if you have few other itemized deductions or if you are already close to your charitable deduction limitations. As the tax-free QCD is never reported as income or as a deduction, it is not counted against the charitable limits and does not require itemization to be effective.

Also, the use of a QCD can be combined with the ability to deduct cash donations of $300 ($600 for joint filers) for those taxpayers who do not itemize. I get this question a lot – unfortunately, QCDs may not be made to donor-advised funds. Also, a QCD must be performed before RMDs are taken – you cannot undo the RMDs otherwise.

BUNCHING DONATIONS

Since the 2017 "Tax Cuts and Jobs Act" overhaul, most taxpayers no longer itemize their income tax deductions – instead claiming the standard deduction. For those who are planning to donate significant amounts to charity, they may be able to itemize and obtain a charitable tax break by "bunching" more than one year of charitable donations.

Let's look at Jack and Jill - a married couple who typically donate $15,000 per year. State and local taxes (SALT) capped at $10,000 per return plus the $10,000 of donations—come to less than the standard deduction of $25,100 for joint filers for 2021. That means their only tax break for their charitable donation is the meager $600 allowed by Congress for 2021.

After some consideration, Jack and Jill decide they can afford to shift their donations so that they give $20,000 one year and $5,000 the next. The result is they will have a total of $30,000 in Schedule A deductions every other year. Itemizing for those years will yield a much larger charitable tax break, and they'll deduct more than $25,000 in the other years due to the standard deduction.

DONOR-ADVISED FUNDS

A donor-advised fund offers an easier way for you to make a significant gift to charity over a long period of time. A Donor-Advised Fund (DAF) is a charitable investment account that provides simple, flexible, and efficient ways to manage charitable giving. The money that goes into a Donor Advised Fund becomes an irrevocable transfer to a public charity with the specific intent of funding charitable gifts. This public charity serves as the administrator of the DAF. The donor may be an individual, family, trust, Private Foundation, or corporation.

DAFs are useful tools for donors who are also trying to bunch deductions. The DAF allows them to combine gifting into a single year for the tax benefit, and then use multiple years to distribute funds to charity as they had originally intended.

CHARITABLE REMAINDER TRUST

A Charitable Remainder Trust (CRT) is a "split-interest" trust. This means it includes both charitable and non-charitable beneficiaries. A form of a CRT called a Charitable Remainder Unitrust (CRUT) distributes a fixed percentage of the trust's assets to the beneficiaries each year. At the end of the trust distribution period (for up to 20 years, or the donors' lifetimes), any remaining trust assets go to charity. This may be a good option for individuals who want an immediate charitable deduction and need an income stream during their lifetime.

What about using your IRA and a CRT to accomplish testamentary charitable objectives? Well, the SECURE Act of 2019 eliminated the stretch IRA for most non-spouse beneficiaries, and thus a Charitable Remainder Trust (CRT) is one of the few remaining vehicles to provide a tax-advantaged stream of income to heirs over a long period of time, and ultimately benefiting charity.

Currently, the low interest rate environment favors another type of split-interest trust known as a charitable lead trust. It makes sense to discuss both of these trust options with your financial and estate planning advisors to determine which, if any, best meet your objectives.

PRIVATE FOUNDATION

A Private Foundation is a tax-exempt organization (a trust, corporation, or hybrid) which a donor creates, funds, and controls for the primary purpose of making grants to charities and/or individuals. A Private Foundation funded during the donor's lifetime can provide philanthropic recognition to the donor and family. Through the management of the foundation, it can instill in the donor's heirs a sense of social awareness and responsibility that might not otherwise be present, while allowing them to be paid for their work on the governing board.

Along with providing a vehicle for your client's philanthropic impact for generations, private foundations can offer significant income and estate tax savings. One immediate benefit is that a donor will receive an income tax deduction for any amount they contribute to a private foundation up to 30% of the donor's AGI. The client can also choose to take the deductions over time.

After their first year of existence, a private foundation is required by law to give away at least 5% of the value of its assets annually.

GIFTS OF ARTWORK

While not as common, the donation of artwork that has significant value may also be considered by individuals. There are several tax-planning issues that should be considered before giving artwork to charity. Those considerations include determining the value of the artwork, the amount of the deduction, how the recipient intends to use the artwork, etc. It is very important to talk with a qualified professional with experience in this area when considering donations of artwork in exchange for a charitable income or estate tax deduction.

IMPORTANT REMINDERS

There is still a possibility that Congress may raise the $10,000 limit on the State and Local Tax (SALT) deduction that is available on the federal income tax return. If so, that may mean that thousands of taxpayers go back to itemizing their charitable deductions again.

Remember that donations must be made to a qualified charity, and donors can't deduct the portion of a contribution that provides a benefit to them, such as the donation to a university that provides the donor with tickets to team's football games.

Make sure to retain proper substantiation of your charitable contributions. To claim a charitable deduction for any contribution of cash, a check, or other monetary gift, you must maintain a record of such contributions through a bank record or a written communication (such as a receipt or letter) from the charity showing the name of the charity, the date of the contribution, and the amount of the contribution.

CONCLUSION

Don't wait until it's too late – either for your charitable giving or your holiday shopping! If you are considering ways to make a significant tax-deductible contribution in 2021, you still have time...but it's running out.

Sincerely,

James Landry, ChFC
Chief Operating Officer, Director of Planning
Pallas Capital Advisors