10.04.24 | FINANCIAL PLANNING

I Want To Make A Gift To Charity. What Is The Best Way To Do So?

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Charitable giving isn't just about making a difference in the world—it can also be a smart way to manage your tax liability. If you're holding stock in a taxable account that has increased in value, you may wonder how to realize these gains without getting hit by a tax bill. At Grimes, we get this question a lot. Good news! There are ways to give generously and keep your tax burden down at the same time. This blog outlines what you need to be aware of if you find yourself in this situation. If you would like to learn more about donating from an IRA, please refer to this blog post.

INCOME LIMITATIONS

If you are inclined to make a charitable gift and you also own stock with significant appreciation you should consider gifting the stock directly to the charity. When donating appreciated stocks to public charities [1], taxpayers can deduct up to 30% of their Adjusted Gross Income (AGI). If your donation exceeds that 30% threshold each year, don't worry! You can carry the excess forward for up to five years. But here's the catch, after five years, any unused deduction disappears.

WHAT IS MY ADJUSTED GROSS INCOME?

Your Adjusted Gross Income (AGI) is essentially your gross income (all the money you make from wages, dividends, interest, rental properties, and more) minus certain deductions. You'll find your AGI on line 11 of your IRS Form 1040–it's a number worth knowing, especially when it comes to tax planning.

WHAT HAPPENS IF I SELL MY STOCK AND DONATE CASH?

Let's say you purchased a stock position with a $100,000 cost basis years ago, and that stock is now worth $600,000. If you sell the stock outright, you'll realize long term capital gains of $500,000. For those in the highest tax bracket, that could mean a $100,000 federal tax bill, not to mention state taxes and an additional 3.8% Net Investment Income Tax (NIIT) for high earners. While you could still donate the cash from the sale and deduct a portion annually, your AGI would spike from the capital gain, potentially raising your Medicare premiums, thanks to the Income-Related Monthly Adjustment Amount (IRMAA).

WHAT HAPPENS WHEN I DONATE APPRECIATED STOCK TO A SPECIFIC CHARITY?

When you donate appreciated stock directly to a qualified charity, the charity gets the full value of the stock, and you avoid capital gains tax allowing you to deduct for the stock's current market value (subject to the 30% AGI limit discussed above). It is important to remember to donate stock that you have held for at least one year to get the most value out of this strategy. If you donate stock that you purchased less than one year ago, only the cost basis of the stock will be deductible.

NO CHARITY IN MIND YET? NO PROBLEM, USE A DONOR-ADVISED FUND!

If you haven't picked a specific charity to donate to, a Donor-Advised Fund (DAF) might be appropriate. A DAF allows you to donate appreciated stock and receive the same tax benefits as a direct donation–no capital gains tax and a charitable deduction for the stock's full value. Your donation sits in an investment account potentially growing more over time and you can make grants to different charities whenever you're ready, giving you flexibility to plan your donations while your assets potentially increase due to market exposure. Just remember that the gift to the DAF is irrevocable, meaning you cannot move these assets back into your estate once the transaction is completed.

IN CONCLUSION:

For charitably inclined individuals with low basis investments in a taxable account, donating the stocks directly to charity is a powerful strategy to align philanthropic goals with smart tax planning. Whether you donate directly to a charity or establish a Donor-Advised Fund, the advisors at Grimes are here to help you navigate the process, making sure your generosity stretches as far as possible–benefiting both your favorite causes and your financial future.

[1] To qualify, your donation must go to a public charity–think religious groups, schools, hospitals, or nonprofit volunteer groups. Private foundations also count if they operate for charitable purposes. However, donations to political organizations or individuals won't make the cut with the IRS. Make sure your chosen charity is on the list to get those tax benefits.

*Grimes & Company would like to thank Lucy McHugh, one of our Summer 2024 interns, for her assistance in researching and helping to write this blog.

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