CHARITABLE DONATIONS: MAXIMIZE HOLIDAY SPIRIT, MINIMIZE TAXES

By: Tiffany Lam-Balfour - December 8, 2021

As the year draws to a close, some questions may come to mind. How do I give back to my community, how do I tie up loose ends for this year and how do I plan for the coming year? Coincidentally, the generous holiday season makes charitable giving a win-win. It combines the joy of helping others with a potential tax break perk.

There are many different charitable donation strategies to consider alongside your financial situation. While some techniques may have certain restrictions to keep in mind, making a move in 2021 could set you up with compelling benefits when tax day rolls around in 2022.

Contribute cash to qualified charitable organizations

The Taxpayer Certainty and Disaster Tax Relief Act of 2020 has extended several tax provisions from the Coronavirus Aid, Relief, and Economic Security, or CARES, Act through the end of 2021.

The IRS has reminded taxpayers of a special tax provision that permits you to deduct up to $300 ($600 for a married couple) in cash donations given to a qualified charity, even if you're taking the standard deduction. Usually, you cannot claim a deduction unless you itemize.

If you plan on itemizing, there's an increased limit for qualified cash contributions made in 2021 of up to 100% of adjusted gross income. Typically, you can only claim deductions ranging from 20% to 60% of AGI, depending on the type of contribution and where it's going — this can help those wanting to offset more taxable income this year. However, note that you'll need to make an election when filing your taxes to take advantage of the higher limit.

However, cash donations are not the only way to give.

"Often, donors will just write checks to support their favorite charities and not consider other balance sheet assets that may be more beneficial to gift," says Margot Bunn, certified financial planner and vice president of RMB Capital, based in Chicago.

Gift highly appreciated assets from your portfolio

Instead of cash, donating highly appreciated assets (stocks, bonds, mutual funds, real estate, etc.) can help you achieve high-impact, tax-smart philanthropy, according to Philip Herzberg, certified financial planner and lead financial advisor at Team Hewins LLC, a wealth management firm in Miami.

When donating long-term appreciated securities (assets held for over a year), you benefit by avoiding capital gains taxes, he says.

Not only will you likely get a deduction based on the appreciated market value of the assets, but you maximize your philanthropic impact since the charity won't be responsible for paying capital gains tax.

Bunch charitable donations into a donor-advised fund

Bunn suggests opening a donor-advised fund instead of donating cash contributions to various charitable organizations every year if you're looking to take your charitable giving up a notch.

"By making a single charitable contribution to a DAF, donors are able to receive an immediate tax deduction and can make distributions to charities on their own timetables," she says.

Especially if your taxable income will be higher this year, pre-funding or bunching several years' worth of donations into a DAF means you can itemize and benefit from a larger tax deduction today while still being in charge of your philanthropic giving. Your donor-advised fund will be invested and grow tax-free, but you can dole out distributions to charities on an ongoing basis at your discretion.

Donate retirement distributions directly to charity

If you have funds socked away in a traditional IRA, the IRS forces you to take withdrawals, called required minimum distributions, or RMDs, usually once you hit age 72. Using a qualified charitable distribution strategy can make sense if you don't need any additional income. You can direct up to $100,000 a year to charity through a QCD while fulfilling your required minimum distribution.

Unlike itemized charitable deductions, QCDs differ by reducing the modified adjusted gross income subject to taxation, Herzberg says. One benefit of lowering your MAGI is avoiding premium increases for Medicare. You're also able to retain flexibility with your giving since you can donate to different charities with this technique, he says.

Set up charitable trusts

If you have the means to give more, establishing a charitable trust allows you to make a donation, benefit from a tax deduction and still keep some strings attached.

"Charitable lead trusts may give you a deduction today while leaving assets for family members in the future. In contrast, a charitable remainder trust may provide for family members initially, leaving assets to charities afterward," says Neel Shah, certified financial planner and estate planning attorney at Beacon Wealth Solutions in Jamesburg, New Jersey.

While there are many different types of trusts to choose from, charitable trusts can help you minimize taxes and maximize giving.

Make every contribution count

When it comes to philanthropy, all donations are welcome.

"Don't underestimate the benefit of matching gifts if you have an employer or are part of an organization that will match your goals," says Shah.

You can also purposely select holiday gifts with charitable intentions.

"Combine the best of both worlds by buying gift cards that provide a percentage to the charity of your intentions. You can also purchase gift certificates redeemable by recipients at the charities of their choice," says Herzberg of Team Hewins.

No matter what you give or how you give it, if you plan to make a charitable donation, it's a good time of year to spread goodwill and make a difference — for others as well as for yourself.

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