

## Why Cash Isn't Always The Best Donation

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Whether it's your time, money or a box of things from your garage - giving feels good. Donating cash or writing a check to your favorite charity is an amazing way to give back. It's also fairly easy and the most obvious method for charitable donations, but it may not be the best strategy. So, before you reach for your check book, make sure you understand your options.



One of the problems with donating cash at the bank is that for many people, there's no Federal tax advantage. That's because the IRS doubled the standard tax deduction in 2018 and limited certain deductions we used to be able to itemize. Depending on how you file and how old you are, the 2021 deduction is now between \$12,550 for a single filer under age 65 and \$27,800 for joint filers over the age of 65. Therefore, if all your allowable deductions (including your charitable contribution) are less than this amount in a given tax year, you will not save any money in federal taxes by giving cash. In 2021, there is one exception to this that allows single filers to deduct up to \$300 in charitable donations and joint filers to deduct up to \$600, while taking the standard deduction.

The good news is, there are some options that can save you on taxes and allow you to direct more dollars to the non-profit close to your heart.

### Qualified Charitable Distribution (QCD)

Once you reach age 72, you will be required to start distributing a certain percentage from your pre-tax retirement accounts, such as IRAs and 401(k) plans. These required distributions are taxable as ordinary income, unless they are given directly to a charity as a Qualified Charitable Distribution (QCD). This is an excellent strategy for many people, even when giving smaller amounts. By giving directly from your IRA, you eliminate taxes on the amount given (up to \$100,000 annually) regardless of whether you itemize or take the standard deduction. Unlike other charitable deductions, QCDs also reduce your Adjusted Gross Income (AGI). This is important because your AGI is a factor in many other tax calculations, so reducing it can also reduce your Social Security taxes and Medicare premiums, increase your medical expense deductions, and help you qualify for certain tax credits.

To highlight the effectiveness of this strategy, here is an example where a couple wants to donate \$10,000.

Scenario 1: They Give Cash	Scenario 2: They do a QCD
They pull \$ out of an IRA to donate	Donate \$10,000 directly from the IRA
Distribution pushes them into 22% Federal tax bracket	No taxes are owed
9% Oregon tax bracket	Only \$10,000 comes out of the IRA
Withdraw \$14,493 from IRA to cover donation & taxes	Still get to take \$27,800 standard deduction
Pay \$4,493 in taxes	Reduces their AGI so they may see other benefits as well
Donate \$10,000	
Take \$27,800 standard deduction without seeing a Federal tax benefit	

## Clustering Contributions

If you tend to give every year and your itemized deductions are close to the standard deduction amount, clustering your contributions can be very beneficial. For example, if you give \$20,000 every year you might instead give \$40,000 this year and nothing the following year. This would allow you to itemize in the year you donated \$40,000 and take the standard deduction the following year. Even if you itemize, if your itemizations don't exceed the standard deduction by the amount of your charitable contributions, clustering your contributions can increase your total deductions over a multiple year period. This strategy is particularly useful if you have unusually high income one year from the sale property, a business sale, a large bonus or vesting employee stock. If you are able to cluster your contributions using a cash donation, this year may be particularly beneficial for some people since the IRS has waived the usual 50% of income deduction limitation for 2021.

## Donor Advised Fund

Many people want to take advantage of the clustering strategy, but feel an obligation to give to a certain organization every year, don't want to give it all away at one time, or are not ready to decide which charities to donate to. In this case, using a Donor Advised Fund may be appropriate. These funds allow you to cluster several years of contributions for an immediate tax deduction and then to donate them over time. Until the funds are donated, they can be invested and grown tax deferred.

## IRA Designated Funds

While the IRS does not allow QCDs from IRA accounts to Donor Advised Funds, you are permitted to make a QCD to a Designated Funds. Unlike Donor Advised Funds, Designated Funds have predetermined charitable beneficiaries, so they do not give you the flexibility to determine the organizations at a later date. They do offer an immediate tax deduction and allow for flexibility on the timing the organization receives the funds.

## Donating Appreciated Assets

For anyone who owns appreciated assets outside of qualified retirement accounts, donating these assets without selling them first can be a great strategy. It's particularly useful for people that have a highly concentrated stock positions and want to reduce their risk by selling some of the stock. I think seeing a simple example highlights the tax benefits best.

- An Oregon couple purchases stock for \$10,000. Years later the stock is worth \$50,000.
- If sold, they would have a \$40,000 taxable gain. The couple has \$200,000 of other taxable income, so they would owe 15% in Federal long-term capital gains taxes, 3.8% in Net Investment Income tax and 9.9% state income tax – totaling \$11,480 in taxes. This reduces their donation and possible deduction to \$38,520.
- If they instead donate the stock directly, they avoid the federal and state taxes on the sale, the charity receives a larger donation, and they receive a larger deduction.

## Estate Planning

You can also incorporate charitable giving into your estate plan by naming a charity as a beneficiary on an investment account or in your trust or will. This is often utilized by people who want to leave a legacy behind. Since you receive a tax deduction on your estate taxes, this is a particularly good strategy for people who have a taxable estate and want to have access to funds during their lifetime.

When incorporating charitable giving into your estate plan, it's important to consider how assets are taxed depending on who they are left to. For example: an IRA that is left to individuals will be taxable as ordinary income to your heirs, non-retirement accounts may receive a step-up in cost basis (basically forgiving the tax on investment gains) and Roth IRAs are passed tax-free. It's therefore advisable to leave IRAs to charity and leave your non-retirement accounts and Roths to your friends and family.

## State Programs

For my fellow Oregonians, The Oregon Cultural Trust is an underutilized resource that can allow you to double your impact when donating to one of 1,400 different Oregon non-profits. You can see which organizations

qualify on their website: [www.culturaltrust.org](http://www.culturaltrust.org). By making a matching donation of up to \$500 per person you will effectively have your match refunded to you in the form of a tax credit, which reduces your tax due dollar for dollar. The matched amount is then granted to cultural nonprofits across Oregon. Residents of other states may have access to similar programs.

### **Charitable Gift Annuity**

For people who need additional income a charitable gift annuity can be a good option to consider. In exchange for the donation, the charity provides an income stream for your life, or some other set period of time, and you receive an immediate partial tax deduction.

### **Charitable Trusts**

If you have significant assets that you would like to donate during your lifetime, you might also want to consider a charitable trust or a foundation.

Charitable trusts are irrevocable, so once assets are put into the trust you cannot use them for any reason not specifically outlined in the trust. The benefit is that you are able to donate appreciated property, receive an immediate tax deduction, and avoid capital gains on the sale. There are two main types. A Charitable Remainder Trust provides income to the charitable donor for life or some other specified period and at the end of the period the remaining assets go to the designated charity. A Charitable Lead Trust is the opposite. Income goes to the charity for a specified period and the remaining assets revert back to the donor or another named beneficiary. You will need an attorney to draw up the trust and having a professional trustee is often recommended, so this is best for more complex assets and larger donations. If this sounds appropriate for you, you may need to act fast. There is a tax proposal to tax the gains for the non-charitable portion of the trust, notably reducing the tax benefit of this type of donation.

### **Foundations**

A family foundation or private foundation can be appropriate for individuals who would like their charitable work to continue long after they are gone, by passing the torch to future generations. The donated funds are invested tax-deferred. Unlike other options you have the ability to hire staff, including your own family, to operate the foundation. Foundations are highly regulated and can be expensive to administer, so they are usually only pursued by families with significant assets.

Not all of these strategies will be appropriate for everyone and what makes sense for you one year may not be best the following year, so it's important to work with your professional team on an ongoing basis. Talk with your financial planner about how this fits into your overall financial plan, to ensure you are balancing your generosity with your ability to achieve your other financial goals. Your planner can also help you narrow down your options, coordinate with your accountant and estate planning attorney, and consider options for taking advantage of higher deductions, such as Roth conversions or realizing investment gains in a lower tax bracket. If you are not currently working with a financial planner, you can learn about the advisors at Merriman at [www.merriman.com/advisors](http://www.merriman.com/advisors).

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