Charitable Giving 101: 4 Key Considerations

By Andrew Harvey

With the holiday season close at hand, this time of year often brings a bevy of worthy causes to your doorstep and social media feed asking you help as they pursue their mission. Giving back to the community is something I feel strongly about—this year I helped organize a "Community Goals" campaign as part of Ballard FC's championship-winning season in USL League Two. We raised money for one of the club's nonprofit partners, the Ballard Food Bank, for every goal the club scored this season. I'm very much looking forward to expanding the program in 2024.

But while our primary motivation to support charitable causes is altruistic, it is important to clarify the benefits and ramifications in making donations to charities. In this article, we'll explore four key considerations to bear in mind when determining when and where to make a gift.

1) **Standard vs. Itemized Deductions**

Charitable gifts reduce your taxes by offering a tax deduction—that is to say, lowering your income by the amount of your donation, subject to limitations. Those limitations can be broadly broken down into two primary categories: the type of property being donated, and the type of organization receiving the donation. These limitations allow a donor to reduce their Adjusted Gross Income (AGI) by 60%, 50%, 30%, or 20% depending on what was given and to whom. Unused deductions from gifts exceeding these limits may be carried forward up to five subsequent tax years.

It is critical to note, however, that tax deductions on charitable gifts can only be claimed by those who itemize their tax returns, rather than take the standard deduction. Following the Tax Cuts and Jobs Act (TCJA) in 2017, the standard deduction increased dramatically. In 2023, the standard deduction reduces a single filer's income by $13,850 and $27,700 for those who are married filing jointly. Married couples who file separately are not eligible to claim the standard deduction on their taxes. While we would never discourage anyone to avoid giving to charity, it is important to ensure you understand the rules and whether they will allow you to enjoy a tax deduction for your gift.

Example: Michael, who is single and makes $100,000 a year, donates $50 per month to a local charity that provides after-school programming for children. He will not be able to deduct his $600 donation over the course of the year from his AGI unless he has other deductions that will add up to greater than $13,850, the standard deduction for a single filer in 2023.

Example 2: Sally, who is single and makes $200,000 a year, decides feels she is living comfortably and wants to make a sizeable donation to ABC Charity, a public foundation that performs children's cancer research. She makes a sizeable $20,000 donation before the end of the calendar year and receives a receipt from ABC Charity. When she files her taxes next year, (barring no other deductions), she will reduce her AGI from $200,000 to $180,000. Since this $20,000 deduction eclipses the standard deduction, in this example it makes sense for Sally to itemize her return. Based on 2023 standard tax brackets, Sally's gift will have the effect of reducing her federal taxes by roughly $1,800.*

Clearly, a gift of $20,000 shouldn't be given solely to reduce taxes by less than $2,000, but if Sally had already planned to give that much, she should be sure to make use of the charitable deduction come tax time.

2) Know the Deductibility Limits of Your Cash Gift

There are many subcategories for what qualifies as a tax-exempt organization, but the most practical way for an individual to check is with the IRS itself using its [Tax Exempt Organization Search]. For the purposes of deductibility limits, we can broadly divide charities into "public" and "private" charities. Public organizations include churches, educational institutions, hospitals, and organizations that receive a substantial portion of their funding from the public or from state and local government. Private charities include private foundations (so called "non-operating" foundations) and veterans' groups, fraternal societies, and nonprofit cemeteries. More specific distinctions exist, but they are beyond the scope of this article.

For public charities, the deductibility of donations is up to 60% of AGI for gifts of cash or cash equivalents. For private charities, the limit is reduced to 30%.

Example 3: Sally, from our previous example, could theoretically donate $120,000 of cash in a single year to ABC Charity and deduct the entire amount from her AGI, bringing her from $200,000 down to $80,000 for tax year 2023. If she made the same $120,000 donation to the XYZ Foundation, a private, non-operating charity, she could only reduce her AGI by a maximum of 30% down to $140,000. Luckily for Sally, the tax code currently allows her to carry the remaining $60,000 tax deduction from her donation to the XYZ Foundation forward for up to five years, offsetting her AGI in the years to come.

3) Gifts of Appreciated Stock

The old saw goes that "cash is king," but that's not always the case in the world of charitable giving. Gifts of property that would be subject to long-term capital gains tax if sold can also be donated to reduce your AGI within a given tax-year. This includes things like stock, corporate bonds, and treasury bonds. For gifts to public charities, the deduction limit is 30% of AGI. For gifts to private charities, it is 20%. To be subject to long-term capital gains tax, the donor must have owned the asset for more than one year. Currently, the long-term capital gains tax rate is 15%, or 20% for high earners.

Despite the lower deduction limit, the advantage of donating appreciated assets is that it allows the donor to avoid paying capital gains tax on significantly appreciated property. Assets held less than one year that are donated have their deductibility limited to the donor's cost basis (what they paid for the asset).

Example 4: Let's say Sally decides to give a gift of her stock in VeryGood Corp (VGC), a company she has owned for a long period of time that is currently valued at $60,000 against her cost basis (purchase price) of $10,000. Sally could theoretically donate her entire position in VGC to ABC Charity and deduct $60,000 from her AGI this year, since the fair-market value of her shares is exactly 30% of her AGI. Sally has reduced her AGI from $200,000 to $140,000, saving herself roughly $11,400 in income tax (based on 2023 tax brackets), but she has also managed to avoid paying $7,500 in capital gains tax that she would have incurred if she had sold her VGC shares, rather than donating them.

As we can see, the avoidance of the capital gains tax for the potential sale of the VGC stock has meaningfully impacted Sally's tax burden in 2023. What's more, having donated her VGC shares to a tax-exempt entity, her charity of choice will be able to make full use of the $60,000 value of the stock as they do not pay capital gains tax. If Sally had sold the stock and then donated the proceeds less her capital gains tax obligations, ABC Charity would have only received $52,500. Despite their lower deductibility limits, gifts of appreciated stock can be an effective way of reducing potential capital gains taxation, while still providing a great benefit to a cause you support.

4) **Consider a Donor-Advised Fund**

What if you're not certain which cause you'd like to donate money to, but still want to take advantage of a tax deduction this year? Perhaps you'd like to give money to several different causes, but are concerned about keeping track of all of the receipts for your tax professional? Maybe you have stock that you believe has a large potential for future appreciation that you'd like to donate to charity, but you don't want to donate it just yet?

Enter the Donor-Advised Fund (DAF).

Donor-Advised Funds are an increasingly popular way for charitably minded investors to give gifts of cash or appreciated assets to charity, while easing the administrative costs of those gifts. A DAF allows you to donate into a fund that is held on your behalf, which then disburses gifts to charities of your choice at a time and date of your choosing.

There are three powerful characteristics that make DAFs so appealing. First, you receive the tax benefit of your donation immediately, even if the grant is not made in the same year. Second, your donated assets may realize further tax-free growth (subject to market returns) and will not be subject to capital gains when they are sold to fund a distribution. Third, DAFs are considered public charities for the purposes of deductibility and are subject to the 60% rule for cash gifts and 30% rule for long-term appreciated assets.

Example 5: Instead of giving either her cash gift outlined in Example 3 or her appreciated VeryGood Corp stock shown in Example 4, Sally instead establishes a Donor-Advised Fund with an organization she has researched extensively. Her prior gift in either example would still be fully deductible from her AGI of $200,000 in 2023, but her investments can continue to grow, further increasing the magnitude of her gift when she decides to make a distribution years from now.

The DAF offers Sally a great degree of flexibility over the timing and growth potential of her gift, while still affording her control over when she receives the tax benefit for her distribution. It is important to remember that different Donor-Advised Fund organizations have different rules about how and when gifts may be given, as well as account minimums for opening and maintaining a DAF. Be sure to consult with your advisor with further questions and to help find the DAF organization that best fits your needs.

Closing Thoughts

With the right strategy, charitable giving can be a great way to manage your tax liability and support a cause you believe in strongly. While these are general principles, much more complicated strategies involving charitable trusts, gift annuities, and Qualified Charitable Distributions (QCDs) exist and are commonly used by our team to help our clients both manage their tax burden and leave an impact on organizations they care about. Please reach out to me or a member of my team if you have any questions or would like to learn more about how to best achieve your philanthropic goals within your portfolio.

*Please note that the examples within this article utilize standard federal tax brackets and do not account for the alternative minimum tax (AMT) – a separate form of tax calculation that charges different tax rates and disallows certain types of tax deductions (but not deductions for charitable gifts).

This article is for the purpose of general education and should not be considered as financial, legal, or tax advice. As always with tax-related matters, be sure to consult your tax professional when determining the best path for you. The information in this article is based off federal tax rates and charitable deduction limitations—individual states may set more stringent limits.