A tax strategy for givers

The new tax laws make it worth reconsidering how you give gifts to charity.

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Idea Generation Exchange-Traded Funds

The tax code has long held an incentive for charitable gifts: the potential for a deduction whenever you give to qualified charities. But the tax reform law signed in 2017 changed the math for charitable givers—and many taxpayers may lose the tax benefits of giving. If you typically make charitable gifts or plan to do so, this a good time to consider some new charitable giving strategies to make sure you take advantage of the tax breaks that do exist. A tax-savvy giving strategy may help preserve or potentially increase the tax benefits of charitable gifts, even under the new rules.

What changed

Under the old tax law, taxpayers who itemized could deduct the value of their gift to charity from their taxable income, up to certain limits. It generally made sense to itemize if you had deductions worth more than the standard deduction, which was $6,350 for single filers and $12,500 for couples.

From 2018 through 2025, the tax reform law increased the standard deduction to $12,000 for single filers and $24,000 for married couples filing jointly. The law also introduced new limits—or tightened up old ones—for many itemized deductions, including the deductions for mortgage interest and state and local taxes. Those changes may mean lower taxes and simpler filing for many, but they also make it harder to reach the threshold for itemizing. For anyone who stops itemizing, it also means the end of the tax benefits for charitable gifts. On the other hand, for those who still itemize, the tax law increased the adjusted gross income (AGI) limit for the deduction, up to 60% for cash contributions.

There are still a few ways to help maximize tax advantages from charitable gifts.

Tax-savvy giving strategies

Being strategic about what you give and when you give may help you take advantage of the tax breaks that do exist.

Strategy A: Donating appreciated securities
Instead of selling investments (held for a year or more) that have gone up in value—which means paying capital gains taxes—and then donating the remainder, you can donate the appreciated stock or other securities directly to charity. That way you can minimize the capital gains tax, and qualify for a charitable gift deduction.

Strategy B: Bunching gifts with a donor-advised fund
The new tax law made it harder to accumulate enough deductions to reach the point where itemizing makes sense—but it didn't make it impossible. Taxpayers with deductions in excess of the standard deduction may still benefit from the tax write-off for charitable gifts. For taxpayers who make annual charitable gifts, that could provide an incentive to bunch your gifts—pull forward several years' worth of gifts into one tax year.

A donor-advised fund, or DAF, sponsored by a public charity may provide help here. A DAF is like a charitable investment account. When you contribute cash, securities, or other assets to a DAF you are generally eligible to take an immediate tax deduction. Then those funds can be invested for tax-free growth and you can recommend grants to virtually any IRS-qualified public charity at any point in time in the future.

Consider bunching several years of gifts to a DAF. You have the potential to maximize the tax deduction and at the same time allow your assets to grow in a tax-free account.

Say you normally give $10,000 per year to charity. Instead, you fund the DAF with $20,000, $30,000, or $50,000 in a single year and then make no further donations to the DAF for 2, 3, or 5 years. That may allow you to get a deduction in year 1, and then you can recommend grants to your favorite charity or charities over the next several years. During the "skip" years, when you do not make additional grants to the DAF but you do make grant recommendations from the DAF to the charities, you can still take advantage of the new higher standard deduction.

Strategy A & B: Donating appreciated securities, with bunching, to a DAF

If you have investments that will cover several years of charitable gifts and you keep them in your brokerage account, consider moving the appreciated securities to a DAF. There are a couple of potential benefits:

- Capture a larger tax deduction
- Minimize capital gains taxes on your securities

How it plays out

Let's take a look at a hypothetical case study to see how this would play out. Let's say Matt and his wife Lisa are planning to donate $10,000 each year to charity—a mix of their alma maters, a local hospital, and a religious organization. Let's assume they are in the 37% tax bracket and pay the 3.8% Medicare surtax on high earners. In addition, we'll say that their itemized deductions before charity (e.g., mortgage interest, state and local tax) total $12,000, meaning that they don't itemize and instead take the standard deduction of $24,000.

We will assume their savings are invested in a taxable brokerage account and earn 6% annually pre-tax (or 5.35% after tax), and that their investments have roughly doubled since they purchased them—meaning when they sell them they pay capital gains tax of 20%, plus the 3.8% Medicare surcharge, on half the value of the sale.

In a simple approach, Matt and Lisa sell securities from their portfolio, pay the capital gains tax, and then donate the $10,000 to charity. Note that even when this $10,000 is added to their other deductions, their itemized total ($12,000 + $10,000 = $22,000) is still below the standard deduction, so they will not get any tax deduction on their gifts. Worse, because they pay effectively 23.8% capital gains tax, they need to sell about $11,351 worth of investments each year to fund the gifts. As a result, even earning 6% annually, they would need about $48,666 at the outset to cover 5 years of $10,000 gifts.

Strategy A: Donating appreciated securities

What if they donated appreciated securities to charity instead of selling and donating cash? That would avoid the capital gains tax. Instead of selling $11,351 worth of securities to fund a $10,000 donation, they could simply donate $10,000 worth of securities. If Matt and Lisa started with the same $48,666 and made the same $10,000 gifts each year, but avoided capital gains taxes, they would end up with a balance of about $7,515 in their taxable account at the end of 5 years.

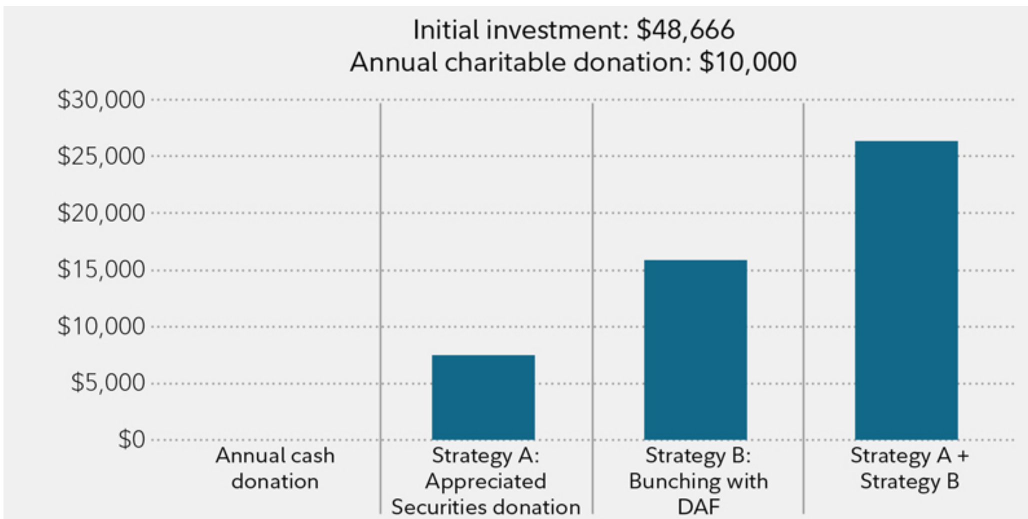
Strategy B: Bunching gifts with a donor-advised fund

Instead of leaving their money in a brokerage account, they could bunch their gifts by selling the same $48,666 worth of stock to fund a donor-advised fund. After paying the capital gains tax, they would have about $42,874 to fund the DAF. Bunching the gifts into a single year in this way would push their itemized deduction total up to about $54,874, which is easily over the $24,000 standard deduction. This would let them deduct most of the gift, and produce $11,424 in tax savings. Those savings would grow to about $14,827 by the end of the 5 years if invested at 6% (5.35% after tax) in their taxable brokerage account (that accounts for taxes along the way, but not for capital gains on liquidation). Meanwhile, after paying out $10,000 a year, the DAF would still have about $1,005 left at the end of 5 years, because the investments in the DAF grow tax-free, at a rate of 6% per year. So in total, Strategy B generates a benefit for Matt and Lisa that is $15,832 greater than the simple approach of selling securities and donating the proceeds, and about $8,315 greater than Strategy A.

Strategy A & B: Bunching and donating appreciated securities to a donor-advised fund

Finally, what if Matt and Lisa put these strategies together? Instead of selling, they donate $48,666 worth of appreciated securities directly to the DAF. Now they have avoided capital gains taxes and get total itemized deductions of $60,666, yielding a tax benefit of about $13,566. Over 5 years invested in their brokerage account, that would grow to about $17,608. In addition, after making $10,000 donations each year for 5 years, the DAF would still have a balance of about $8,755. In addition, after making $10,000 donations each year for 5 years, the DAF would still have a balance of about $8,755, thanks, once again, to the tax advantages of investing in the DAF. So the total financial advantage over cash donations would be about $26,363, the advantage over Strategy A alone would be about $18,846, and the advantage over Strategy B alone would be about $10,531.

Financial benefits of various giving strategies over 5 years



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The bottom line

There are plenty of reasons to make charitable gifts that go way beyond taxes. But if you do plan to give, and you have a portfolio, it makes sense to be strategic about how and what you give. Consult your tax advisor: It may save you on taxes, give you more money to donate, or both.

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