

THE Good Advisor

Beyond Vanilla: Choosing the Right Asset to Give

Imagine walking into a local shop on a hot summer day and agonizing over a tantalizing variety of frozen treats. Dying for some chocolate? How about rocky road or double fudge cookies and cream? You might rationalize concerns about your waistline by leaning toward something light and fruity—maybe a lemon-lime or orange sorbet. Suppose you want to throw caution to the wind with an ultra-decadent coconut milk frozen delight? Or perhaps you are a diehard who, despite a dizzying array of enticing choices, always opts for plain vanilla. No question, vanilla is good, but by picking it every single time, diehards miss an almost limitless variety of delicious choices.

Likewise, when our clients think about making gifts, their first thought is often vanilla—a generous gift of cash. But clients who own a variety of assets have a number of gift possibilities. Financial professionals advising clients on gift planning need to understand the implications of how each asset class is treated in a charitable giving context. To help you assist your clients in choosing their “personal best” gift assets, this issue of *Good Advisor* is devoted to some of the most attractive giving options:

- **Cash: Still Favored After All These Years**
- **Securities: An Alternative with Benefits**
- **Retirement Assets: Advanced Giving at an Advancing Age**

CASH: Still Favored After All These Years

Vanilla is the most popular ice cream—its all-American taste makes it both delicious and compatible with any other flavor. In much the same way,

gifts of cash are the simplest to execute and also the most common. As a consequence, most people have a basic understanding of how the federal income tax will impact gifts of cash. Still, you may have to review additional considerations.

Documentation Requirements

For a donor to receive an income tax charitable deduction for a cash gift, the Internal Revenue Code (IRC) requires contemporaneous written acknowledgement from the charity of any gift of \$250 or more.¹ This acknowledgement must show the name of the organization plus the date and amount of the contribution.² For smaller gifts, a bank record is sufficient. Either way, it is up to the individual to maintain appropriate records of any cash gifts in order to secure the deduction.

Adjusted Gross Income Limitation

As with all charitable gifts, any income tax deduction is limited to a percentage of the donor’s adjusted gross income (AGI) for that tax year.³ It is important to remember that this is for income tax purposes only and does not apply to the gift or estate tax charitable deduction. The IRC provides that the aggregate income tax charitable deduction cannot exceed 50% of the taxpayer’s contribution base for the year that gifts are made to a public charity, government or operating private foundation.⁴

If a donor has substantial assets but little income (perhaps an individual who retired after an exceedingly successful career), a large charitable gift of cash is more likely to result in the individual being affected by the 50%-of-AGI limitation. If the donor cannot deduct the full amount of a charitable contribution in the initial tax year, any excess can be carried over and

used for up to five subsequent years.⁵

Why Give Cash?

Cash is the easiest gift for donors and charities; it is typically the most accessible asset for donors and is immediately beneficial to the charitable organization that receives it. Also, a cash gift may be particularly well suited for an individual who has received an unusually large cash influx during the year (such as the sale of a business, an inheritance, or a performance bonus).

SECURITIES: An Alternative with Benefits

Believe it or not, ice cream is not for everyone. Some may prefer the Italian *sorbetto* or *granita*—delicious non-dairy alternatives that have the flexibility to appear after a meal, between courses, or even at the breakfast table. Likewise, donors looking for a good alternative to cash usually think about making a charitable gift with securities. Stock in a publicly traded company is typical, but donors may also give bonds, mutual fund shares and closely held stock.

Securities are a good gift option when a client is reallocating assets within a portfolio of investments, or when the donor wants to make use of a capital gain from a highly appreciated stock without paying the capital gains tax on the appreciation.

Limits on Charitable Deductions

The charitable deduction for a gift of securities depends on the length of time the donor owned the securities:⁶

- A gift of short-term securities (held for one year or less) to a public charity cannot exceed 50% of the donor's AGI in the year the gift is made.⁷
- A gift of long-term securities (held for more than one year) made to a public charity cannot exceed 30% of the donor's AGI in the year the gift is made.⁸

As with cash gifts, any excess charitable contribution that cannot be deducted due to AGI limitations can be deducted in up to five subsequent years.

A gift of short-term securities made to a public charity must be reduced by the amount of ordinary income that would have been realized if the owner had sold the securities rather than donating them.⁹ A gift of long-term securities made to a public charity, however, can be deducted for the full fair market

value of the securities on the date of the gift.¹⁰ If the security is listed on a market exchange (e.g., on the NASDAQ®), the gifted security requires no qualified appraisal. The mean price on the date of the gift is the value of the gifted security.¹¹

Why Give Appreciated Stock?

A gift of appreciated stock allows the donor to make a valuable charitable gift while avoiding the capital gains tax that would have been imposed if the appreciated stock had been sold and the cash proceeds donated—a “win-win” situation for the charity and the individual.

The Benefits of Giving Appreciated Stock: An Example

Cherie is a successful business owner who wants to make a charitable donation of \$50,000. She has significant assets and plans to write a check for the donation. In reviewing her portfolio, Cherie determines that she has appreciated stock in the same amount. She could write a check for \$50,000 or sell the stock and give the charity the \$50,000 value of the appreciated stock. With either gift, Cherie would be allowed to claim the \$50,000 as a charitable contribution if she itemizes deductions on her federal income tax return.

The advantage of giving securities rather than cash is the avoidance of the imposition of capital gains tax. Ten years ago, Cherie purchased the stock for \$10,000. If she sells the stock, she will have to pay a capital gains tax of approximately \$8,000 (a gain of \$40,000 taxed at the 2017 capital gains tax rate of 20%). Cherie is a single filer and has a modified adjusted gross income above \$200,000, so she has to include the net investment income tax of 3.8% that is due on capital gains for taxpayers in her bracket. That would be an additional \$1,520 in tax due on the sale of the securities. Thus, the real after-tax value if Cherie sells the stock to make the donation is only \$40,480.

Instead of selling the stock, Cherie can give the long-term appreciated stock to the qualified charity, incurring no capital gains tax. This would result in a capital gains tax savings of \$9,520 for Cherie.

RETIREMENT ASSETS: Advanced Giving at an Advancing Age

Gelato comes in traditional flavors (*bacio*, *mandorla*, *zabaione*, or *fico*) as well as more modern creations (pear ginger, for example). In spite of the variety available, children still tend to prefer ice cream, as gelato's denser consistency and more complex flavors appeal more to adults.

In much the same fashion, gifts of retirement assets appeal more to those who are older—particularly those who are already subject to required minimum distribution requirements. For these donors, a charitable gift of retirement assets might be the best option. After all, when an individual retires, income from wages drops, but income from retirement assets (pensions, investment accounts, or retirement accounts) may be significant.

Qualified Charitable Distributions

The primary benefit of IRAs and qualified retirement plans is the tax deferral available on contributions and earnings inside the account.¹² However, while this is a clear benefit during the accumulation years, it may create an income tax problem once the owner needs to take distributions. Owners typically rely on the accounts to provide retirement income and expect to pass on what they don't use to loved ones. However, for many donors, drawing on these assets for charitable gifts may be a tax-efficient option.

A qualified charitable distribution (QCD) allows an IRA owner to make a distribution of up to \$100,000 directly from the IRA to a qualified charity. This distribution is not considered income to the donor, but does count toward the donor's required minimum distribution (RMD).¹³ This lets high-income individuals take an annual RMD and use it to make a charitable contribution without subjecting the distribution to the individual's higher tax rate.

Why Give IRA Distributions?

Let's look at the benefits of this gift through an example. John and Maureen, both 72, were successful medical technology entrepreneurs who sold their business five years ago. Both still work as highly paid consultants. Their success allowed them to accumulate significant assets while also building solid retirement accounts, and their current employment provides a continuing source of high income. Since John and Maureen are over 70½, they are each

required to take minimum distributions from their retirement accounts. However, they do not need the distributions, nor do they want to pay income tax at their current rate on the distributions.

John and Maureen are excellent candidates to use a QCD (otherwise known as an IRA charitable rollover) allowed under the Internal Revenue Code. The qualified charitable distribution would allow John and Maureen to direct the amount of their RMD from each of their accounts straight to a qualified charity. Since neither distribution would be considered as income, no tax would be due on the RMDs.

I Scream, You Scream, We All Scream...for the Best Asset for a Charitable Donation

Sorbet, frozen yogurt, gelato, ice cream—the bounty of frozen desserts allows everyone to make the best selection for their respective tastes. The same bounty exists in charitable giving opportunities for clients with significant assets. Understanding the asset options and opportunities available for each client allows a financial professional to provide the best possible advice—good service that serves as the proverbial “cherry on top.”

ENDNOTES

- 1 IRC 170(f)(8)(A).
- 2 IRC 170(f)(17).
- 3 IRC Sec. 170(b)(1)(B).
- 4 IRC Sec. 170(b)(1)(A).
- 5 IRC Sec. 170(d)(1); Reg. Secs. 1.170A-8, 1.170A-10.
- 6 IRC Sec. 1222.
- 7 IRC Sec. 170(b)(1)(A).
- 8 IRC Sec. 170(b)(1)(C)(i).
- 9 IRC Sec. 170(e)(1)(A).
- 10 Ibid.
- 11 Reg. Secs. 25.2512(b)(1), 20.2031-2(b)(1).
- 12 <https://www.irs.gov/retirement-plans/plan-sponsor/types-of-retirement-plans-1>
- 13 IRC 408.

Access more information now!

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CATHOLIC
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12222 Merit Drive, Suite 850 • Dallas, TX 75251 • Phone 972-661-9792 • Fax 972-661-0140

www.catholicfoundation.com