Becoming a Benefactor Does Wonders for Your Health and Your Tax Status

Giving to Charity Is Good for You

by Alexandra Armstrong, CFP, and Kelly Wright, CFP

Mahatma Gandhi said, "The best way to find yourself is to lose yourself in the service of others." A 2008 study by Harvard Business School found that giving money to someone else lifted participants' happiness more than spending it on themselves. These good feelings are reflected in our biology. In a 2006 study, the National Institutes of Health found that when people give to charities, it activates regions of the brain associated with pleasure, social connection and trust, creating a "warm glow" effect. Scientists also believe that altruistic behavior releases endorphins in the brain, producing the positive feeling known as the "helper's high."

A December 2014 study in the *Journal of Economic Psychology* showed that giving to others reduces stress and strengthens the immune system and that tax subsidies for charitable giving may have positive spillover effects on health. So why not try to help the world and your own well-being in the most tax-efficient manner possible? The tax laws are written so that we get a tax deduction when we give money to charities we support, so it makes sense to plan accordingly.

Giving Cash

The easiest way to give monetarily is to write checks to the charities of your choice. As long as you itemize your deductions, these amounts are subtracted from your taxable income, up to a maximum of 50 percent of your adjusted gross income. Thus, if you're in the 28 percent federal tax bracket, for a donation of $10,000, you save $2,800 in federal taxes so that your actual out-of-pocket cost is $7,200. Of course, if you live in a state with income tax, the out-of-pocket cost is even less, since you save state income tax as well. Although the easiest, this method is the least tax-efficient way to make a charitable gift.

Giving Shares of Stock or Mutual Funds

Besides gifts of cash, there are several other ways to give to charity. From a tax-efficiency standpoint, gifting appreciated securities is far more advantageous. Let's say you invested $2,000 in a stock several years ago and it's now worth $10,000. If you sell it, you'd owe $1,200 in capital gains tax, netting $8,800 after tax. You could then give the $8,800 to charity and get a $2,464 deduction.

Instead, if you give the shares directly to charity, you'll receive a $10,000 tax deduction, which will save you $2,800 in federal income tax and save the $1,200 in capital gains tax, assuming a 28 percent tax bracket. You're saving the world and $1,536 by giving shares rather than cash. Everyone comes out ahead!

It's important to note the maximum deduction for giving appreciated securities is 30 percent of your AGI versus 50 percent for cash in any one year. If your gift of stock exceeds this limitation, the excess amount can be carried forward for up to five more years. If you own an appreciated security and still feel it has upside potential, you can buy more of it and then gift the older appreciated shares. But be very careful doing this — it's crucial in this and other gifting strategies that you identify which shares you're giving to charity.

If giving appreciated shares, it's important to identify the shares with the lowest cost basis so that you're removing the maximum in capital gains from your portfolio. Broker/dealer firms don't do this by default, so we recommend you instruct them in writing, as they may not even have a place on their forms for it. Also, the shares you give must be held for more than one year or you get credit only for your cost basis of the security rather than for the appreciated amount. For example, if you bought a stock that went from $2,000 to $10,000 in less than a year (kudos!) and gave that stock to charity, you would only get a $2,000 deduction.

Donor-Advised Funds

What if you have an appreciated stock, are worried about it going down from current levels, want to give to charities, but don't want to decide which charities to give to at this time? Here you can give your stock to a **donor-advised fund**, which qualifies as an intermediary charity. You'll receive a full market value deduction in the year that you give the stock to the DAF. The DAF establishes a fund in your name. Thereafter, the DAF makes gifts to charities from your fund. Legally, you cannot control these distributions, since you gave the stock permanently and irrevocably to the charity. But you retain the right to make "suggestions" as to who receives the distributions.

The DAF is entitled to accept or reject those suggestions, but in practice it won't usually reject proper and reasonable suggestions. As always, investigate and compare before selecting a donor-advised fund. Generally, DAFs are established with gifts of $5,000 and more.

Split Gifting

As charitably inclined as you might be, you may not be able to afford to give away stock or cash to charity. Instead, there are various ways you can give to charities and let them provide you with lifetime income. Included in this group are a **pooled income fund**, a **charitable gift annuity** and a **charitable remainder trust**.

Pooled income funds usually are for gifts of $20,000 and up. Charitable gift annuities are generally used for gifts above $10,000. Charitable remainder trusts are typically for larger gifts of $200,000 or more and are the only choice where the person giving wants to continue to control the investments.

There are differences between these gifting devices, but the basic principle governing each is the same. In each case, you give your shares to a recognized charity and, in return, you receive income of at least 5 percent of the value of the trust each year for life and possibly for the life of your spouse or beneficiary. In the year you give your shares, you'll be entitled to an income tax deduction. The amount of the deduction is determined by your age, if the income is for your life and the life of your spouse, and the amount or percentage of income you're projected to receive. After you — or you and a designated beneficiary, such as your spouse — die, the remaining principal goes to the designated charity. The tax deduction is determined on this remainder.

In the case of the pooled income fund and charitable gift annuity, you give the shares to a specific charity. It's important to realize all charitable gifts are irrevocable — that is, you can't change your mind as to the gift or the recipient. With a charitable remainder trust, however, you can have the flexibility to designate the charities you want to benefit from your gift and can reserve the right to change the beneficiaries at a later date.

Pooled Income Fund

With a pooled income fund, you give the shares to the charity, and it places them in a "pool" with other gifted money. The sponsoring charity manages the money in the fund for you and the other beneficiaries and pays you monthly or quarterly income. The level of income you receive will change periodically based on the income that the assets in the pooled income fund are earning.

Charitable Gift Annuity

With the charitable gift annuity, you give the shares to the charity, and in exchange it provides you with fixed income based on actuarial tables. The older you are when you give to the charity, the higher your income will be.

Charitable Remainder Trust

The charitable remainder trust is a more complex way to gift and is really more suitable for larger gifts of $200,000 or more. If you want to give the money to just one charity and don't want to reserve the right to change your mind as to the beneficiary, the charity often will help by providing you with sample documentation and may even serve as trustee of the trust. If you want more than one charity to benefit or if you want to retain the right to change the charities at a later date, you'll need a lawyer to draw up the document for you. It's important to consult a lawyer skilled in charitable tax planning matters, as this is a complex area.

The CRT will pay you income for your lifetime, plus that of another beneficiary, if you so wish, or for a specified period up to 20 years. At the end of this period, the CRT terminates and the assets go to the named charity or charities. Under a 1997 law change, the charitable interest must have a value equal to at least 10 percent of the amount placed in the trust. Once the CRT has been established, you can give either appreciated property or cash to the CRT.

There are two types of CRTs: the unitrust and the annuity trust. The unitrust pays you a percentage of the annual appraised value of the account. The annuity trust pays a fixed dollar amount or a fixed percentage of the amount given. This amount wouldn't change annually.

Once the CRT is set up, you must name a trustee. You may be your own trustee, but if so you must name a successor trustee for the disposition of your assets after your death or in the event of your disability. Of course, if you choose to serve as your own trustee, you'll be subject to fiduciary limitations in investing and otherwise managing the trust, with potential liability for mistakes. The CRT must file a tax return each year and this, too, is the trustee's responsibility.

If you exchange your shares for an interest in a pooled income fund or a charitable gift annuity, you've given up control over the investments. The same is true if you give your money to a CRT run by a charity. Your gift is irrevocable. If you're the trustee of your CRT, you must supervise the investments.

A Great, But Complicated, Strategy

Using one of these planned giving techniques is an excellent financial planning strategy. You can avoid paying capital gains on a stock gain, receive a current tax deduction, obtain regular income — usually at a higher rate than your investment is currently paying — and benefit your favorite charities.

Gifting your securities isn't a simple matter, particularly since once you've given the money away you can't take it back. Therefore, it's mandatory that you seek independent professional advice before giving to charity.

Also, remember to identify which shares are to be gifted without exception and that any gifted security has been held for more than a year.

Your financial planner, working with your estate-planning lawyer as well as your charity, should be able to provide you with the necessary specific advice. ■

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