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A Guide to Gifting and Charitable Strategies

Courtesy of Vanilla, The Estate Advisory Platform

In 2023, Americans gave a whopping $557.16 billion to charities*

And that doesn't account for gifts to family and friends outside of official charity organizations. Simply put, gifting is a huge part of our economy.

*according to the Giving USA 2023 Annual Report

People choose to give for a variety of reasons, but there are two primary drivers that gifting has become such an important part of people's lives (and their financial plans). The first is altruism. Humans are a cooperative species–it's our super power–and many people give because they want to help others. There's plenty of research to suggest that giving actually has positive effects on our mental and physical health.

In addition to this spirit of good will that sparks some to give, there are also income and estate tax benefits to giving. Generally speaking, each dollar donated to a qualified charity in a year can reduce a taxpayer's income for that year by the same amount, up to 30% of adjusted gross income for non-cash assets and 60% for cash. So for someone in the top federal tax bracket paying 37% income tax, a $10,000 donation saves $3,700 in taxes. Taxpayers get to reduce their income tax and support the causes they love.

Making lifetime gifts is also one of the most common, tried-and-true strategies to reduce estate tax liability. With estate tax ranging from 18-40% over the $13.61 million per taxpayer threshold in 2024 (which is set to be cut in half in 2026), there's a lot of incentive to lower the tax burden.

There's more than one kind of gifting, however, and each type of gift or charitable strategy has a different set of requirements. Some gifts and donations are income tax deductible, while others are not, and subject to gift tax. We'll walk you through the major types of charitable and non-charitable gifts that you might want to consider, as this year draws to an end.

Quick Tip

Appreciated Assets

When choosing assets to fund gifts, you may want to consider securities that you have held for more than a year which have appreciated since their initial purchase. This will maximize the value transferred and minimize your capital gains tax exposure.

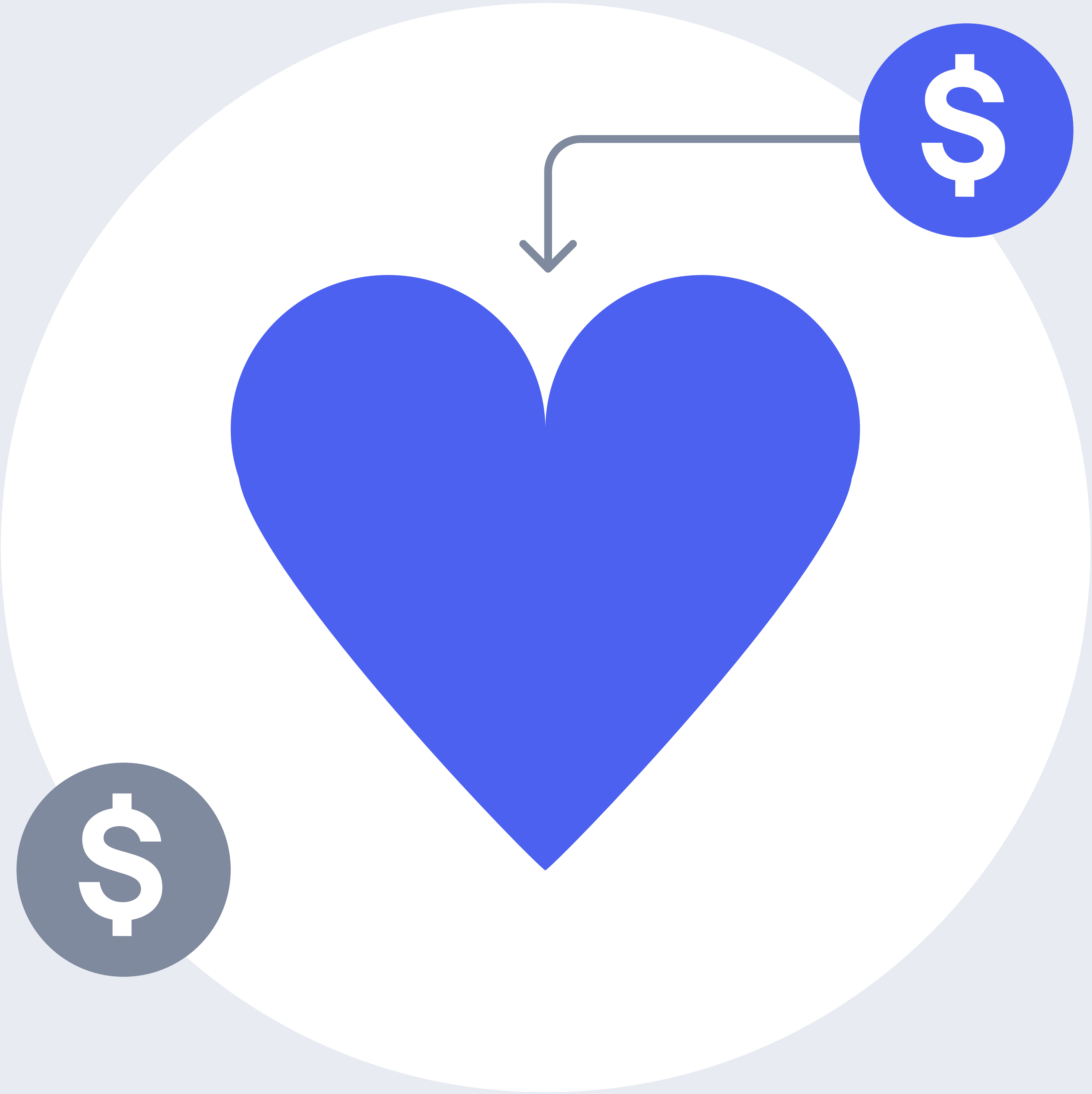
Charitable Giving

One of the biggest debates when it comes to charitable giving is whether to donate to a charity directly, or a donor-advised fund (DAF). There are advantages to both, however.

The DAF allows the donor to make an immediate charitable gift to the fund (and realize the income tax deduction), while also retaining control over the timing and amount of grants to the ultimate charitable organizations that the donor wishes to support. The DAF also allows donors to gift assets such as stocks without having to sell them and deal with the capital gains tax or reporting to the IRS.

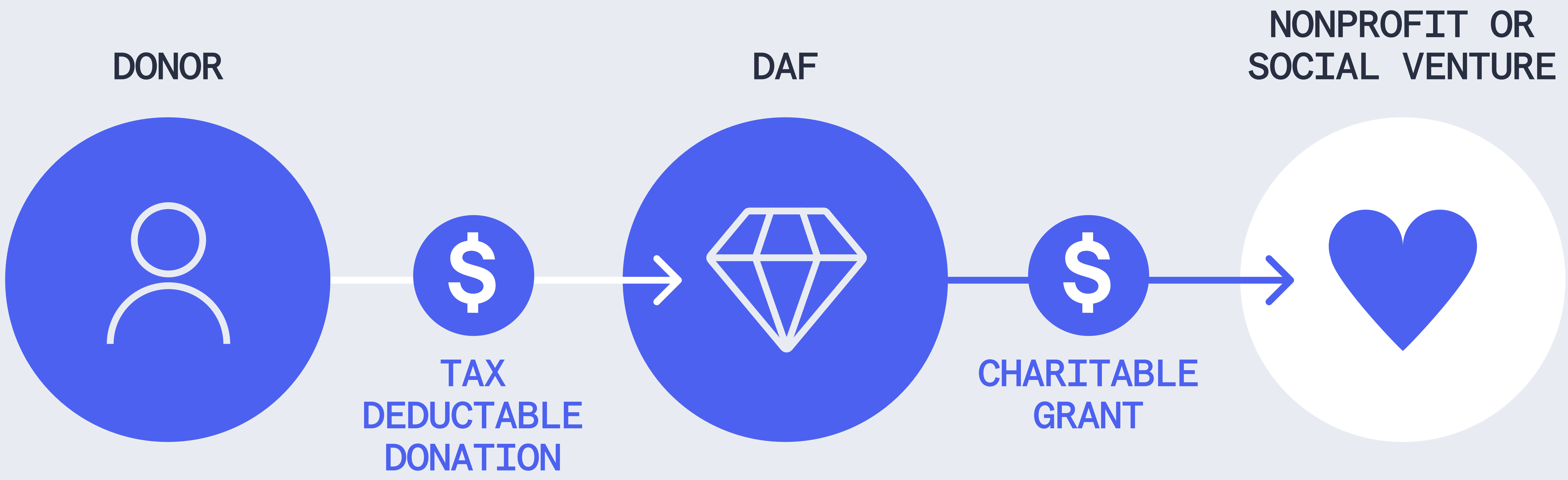
Direct Gifting

Giving directly to a qualified charitable organization enables the donor to receive an income tax deduction (as well as lowering their overall taxable estate). However, if the donor liquidates assets, such as stocks, they are responsible for taxes related to the capital gains. The donor is also responsible for the records and reporting to the IRS.



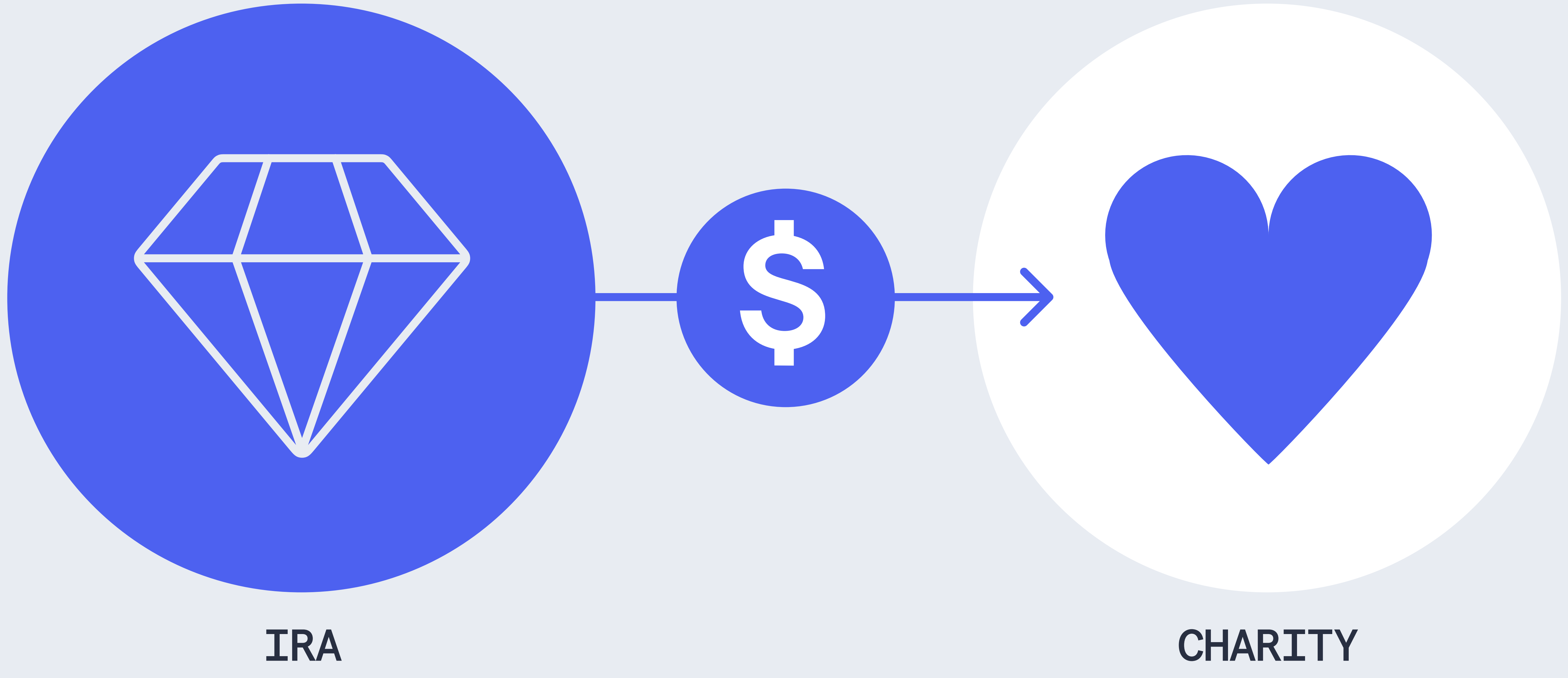
Donor-Advised Funds (DAF)

Donor-advised funds are typically operated by 501(c)③ organizations (called "sponsoring organizations"), and allow multiple parties to contribute to the fund or account. Once a donation has been made, though, the organization has legal control over it. The donor (or their representative) will retain advisory rights, however, and grant recommendations are generally followed. DAFs allow donors to receive an immediate tax deduction without having to choose which charity the assets will go to, and shift responsibility of reporting to the IRS to the sponsoring organization.



Qualified Charitable Distribution (QCD)

A qualified charitable distribution allows those who are 70 ½ or older to make charitable contributions of up to $100,000 from a traditional IRA. A QCD can satisfy a required minimum distribution (in whole or in part). This is an income tax-efficient technique that also reduces a person's estate for estate tax purposes. Note: SEPs and SIMPLE IRAs are not eligible for the QCD.



Charitable Gift Annuity

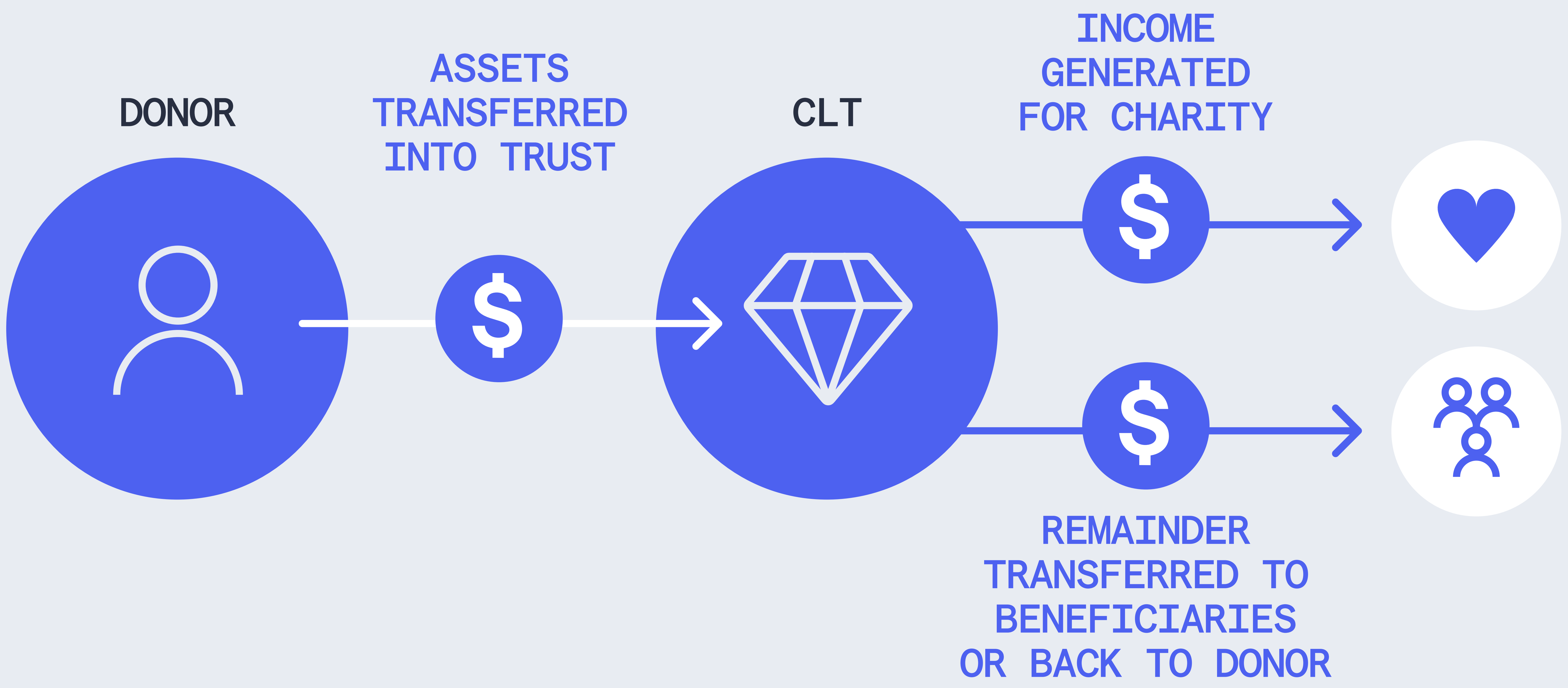
The donor gives assets or cash to a sponsoring charity, and the charity then pays the donor an annuity payment. When the donor dies, the charity retains whatever is left over. This strategy is sometimes used instead of a charitable remainder trust if the amount of the donation is insufficient to warrant a charitable remainder trust.

A charitable gift annuity is established with a single charity, so it can't support multiple causes at once. The size of the annuity payment is based on numerous factors, including age of donor.
There is an immediate tax deduction, but annuity payments are often less than what is available from commercial annuity products.

Charitable Lead Trust (CLT)

A charitable lead trust (CLT) is a type of trust established by an individual to provide regular payments to one or more charities for a specified period.

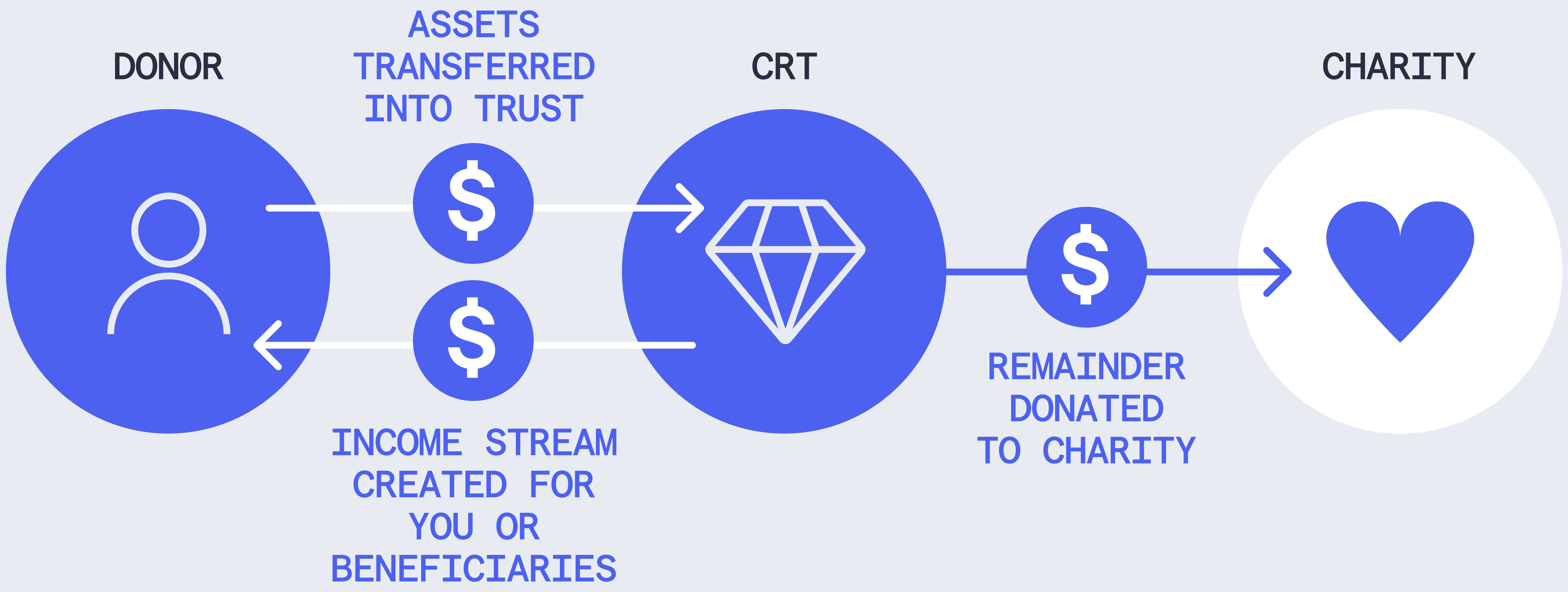
At the end of that period, the remaining assets in the trust either revert to the settlor or pass to non-charitable beneficiaries, such as family members or other individuals named by the donor. In a charitable lead trust, the charity has a primary or "lead" interest in the trust assets before anything is passed down to other beneficiaries.



Charitable Remainder Trust (CRT)

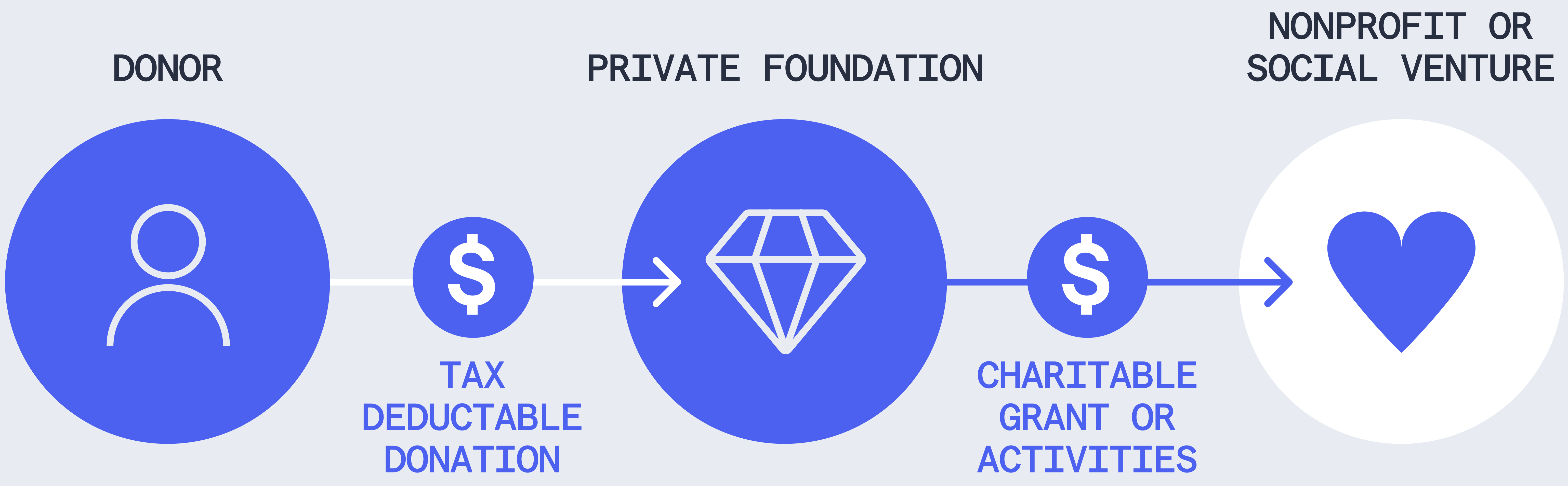
The donor funds the CRT with certain assets, and the donor or other non-charitable beneficiaries, such as the family members or other individual named by the donor, is entitled to draw an annual payment over the lifetime of the trust. When the income recipient dies (or the trust term ends), anything that remains in the trust immediately goes to a charity.

The ultimate amount that the charity will receive will depend on how much the assets inside the CRT have appreciated, the payments to the donor over the trust term, and, in some cases, how long the donor lives.



Private Foundations

The donor contributes money or assets to the private foundation. The foundation then uses this endowment to operate charitable programs or make grants to other charities. It's important to remember, many records and tax returns are public when giving to private foundations. It also requires an annual federal and often state filing. The foundation must distribute a minimum percentage (typically 5%) to charitable causes or organizations, so it can't endlessly accumulate. Strict regulations over business relationships with the donor and donor's family must be observed to avoid penalties.



Non-charitable giving

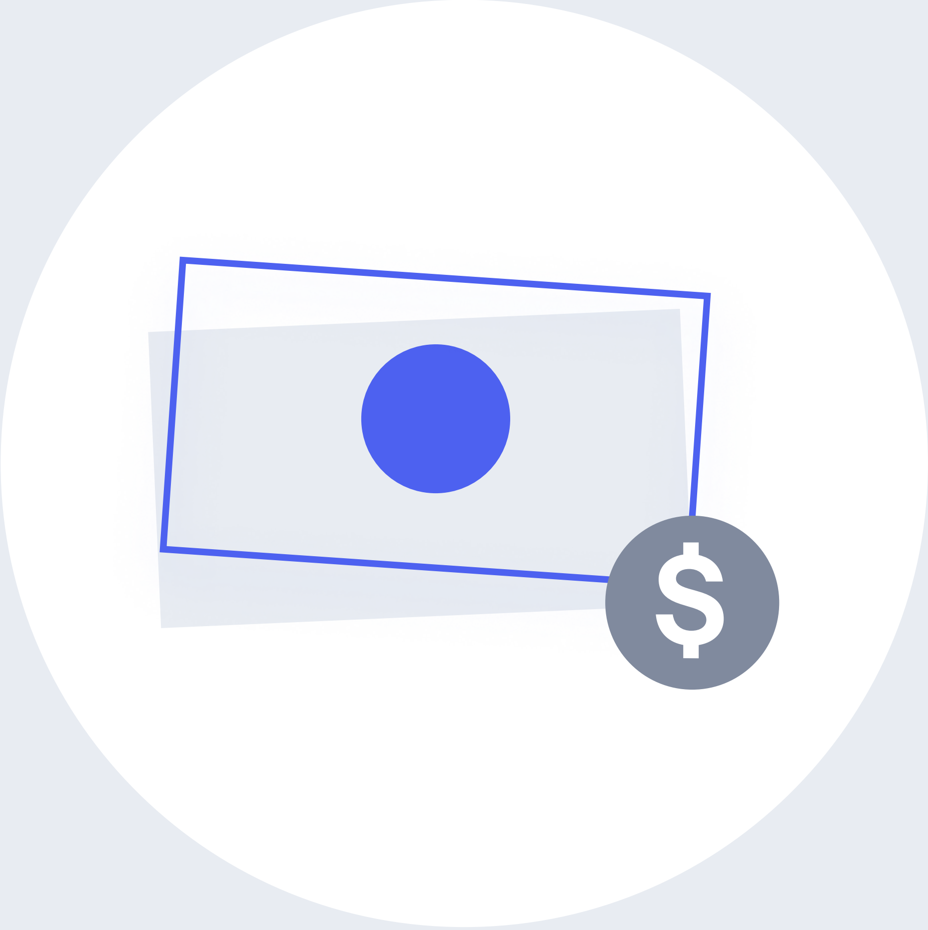
There are many types of giving that are considered “non-charitable,” but can still have a big impact on a taxable estate – as well as on those people or organizations the assets are given to. Next, is a rundown of some of the most common types of non-charitable giving, and what you need to keep in mind for each.

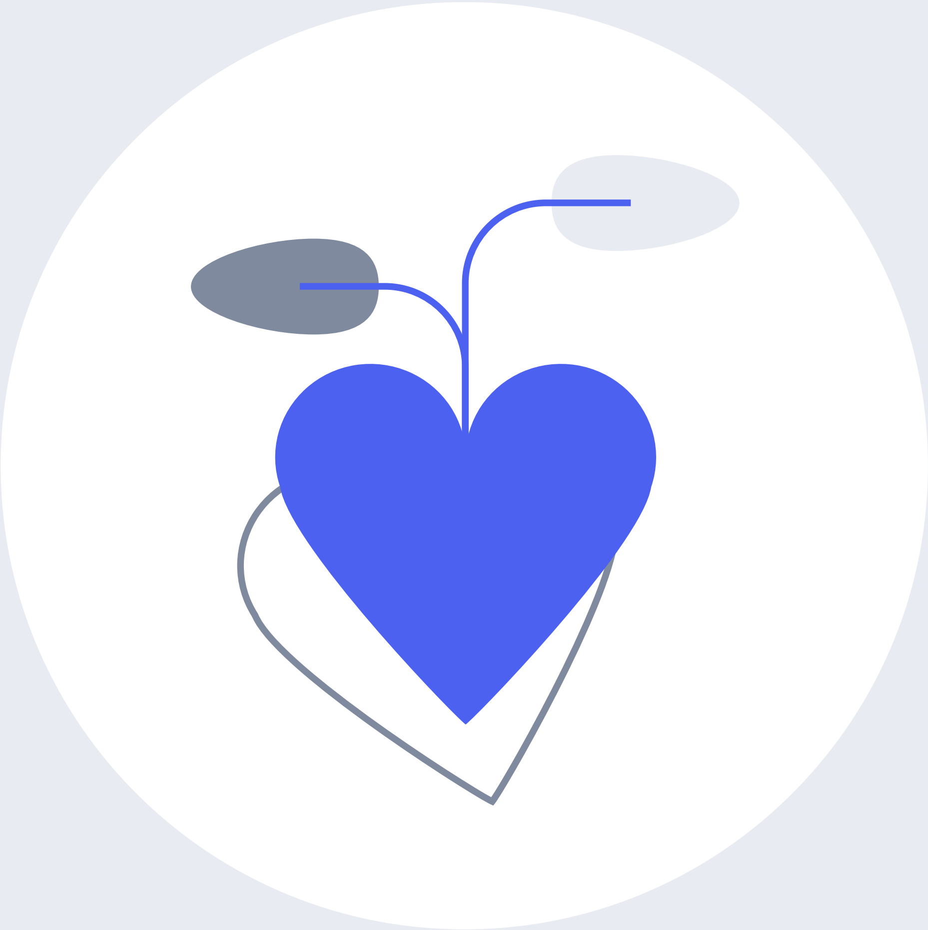
Federal annual gift exclusion

Every year, each person can give a certain amount to a non-charitable donee without triggering the federal gift tax. In 2024, individuals can give $18,000 (spouses can jointly give $36,000). The cap is per recipient, meaning you can give $18k gifts to multiple recipients without triggering a gift tax. These non-charitable gifts will reduce your taxable estate, but will not impact your yearly taxable income in the form of a deduction.

Lifetime gifting exemption

In addition to the annual gift exclusion, every individual is able to give a cumulative amount up to $13.61 million in 2024, free of the federal gift and estate tax. This is on top of the annual gift exclusion, meaning that if, for example, someone gives $25,000 in 2024, he or she could cover $18,000 with their annual gift exclusion and use their lifetime exemption to cover the other $7,000 (provided it had not been used up) and still not pay any gift tax. The maximum federal gift and estate tax rate is currently 40%.





Qualified education and medical expenses

There is no limit to the amount an individual can contribute, tax-free to qualified education expenses. This includes "amounts paid for tuition, fees and other related expenses for an eligible student that are required for enrollment or attendance at an eligible educational institution." A similar rule applies for qualified medical expenses. When structured properly, direct payments of education and medical expenses allow support for family members that can far exceed the annual gift exclusion amount. These expenses cannot be deducted in respect to yearly income tax, but will reduce the total estate without consuming exemption.

529 plan

The qualified tuition program is also known as a 529 plan. It allows the contributor to pay for educational expenses at a qualified institution or to contribute to an account dedicated to paying those expenses. It's limited to the gift cap ($18,000/year in 2024) unless it's part of a superfund. A superfund allows you to make five times the annual gift exclusion, spread over five years (allowing you to invest a larger sum of money, tax deferred, sooner.) Some 529s allow a limited state income tax deduction to the donor, in certain circumstances.
Are 529s worth it?

529s are a promising tax vehicle for many Americans who plan to send their children to college. However, there are circumstances when you want to skip a 529. If, for example, a couple does not have a taxable estate today, but they likely will in the future (especially in lieu of the 2026 exemption sunsetting), it could make sense to pay for the children's college expenses directly (using the qualified education expense) to reduce their taxable estate.

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Thank you.

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Charitable Giving to Reduce Income Taxes

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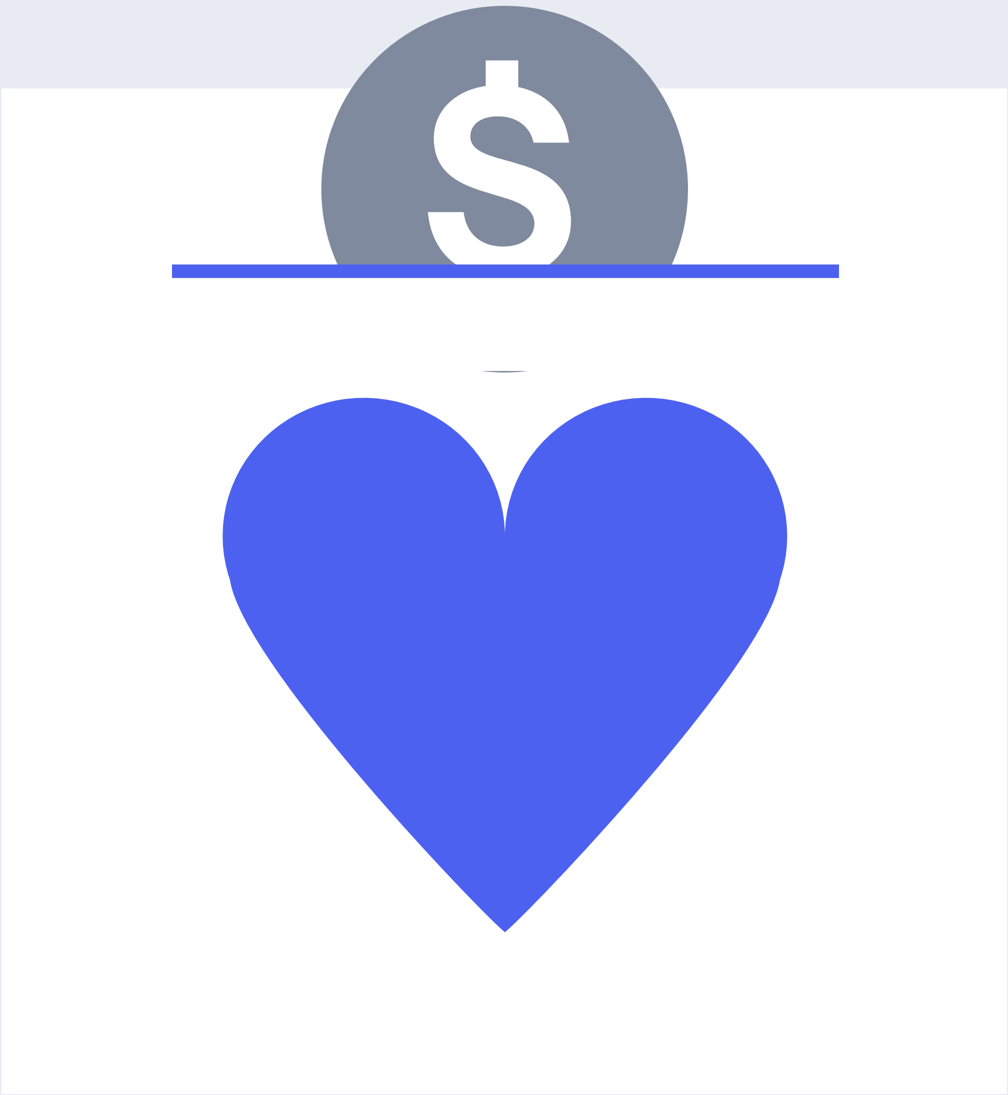

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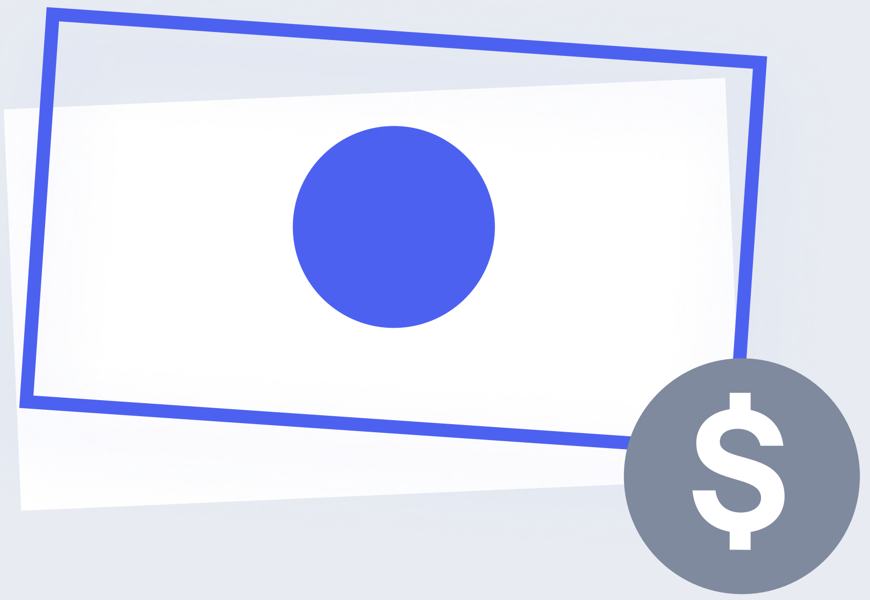

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