Key Wealth Institute

2021 Charitable Giving Strategies

August 23, 2021

Gretchen Miller, MBA, CFP®, Senior Client Experience Manager

One of the most meaningful aspects of accumulating wealth is the ability to give back in significant, influential ways. Families and individuals donate for a whole host of reasons and taking advantage of tax breaks is low on the list of motivations. Still, tax benefits are an important secondary consideration when giving, one that requires a closer look, especially with recent changes to the tax laws. Make the most of your giving this year including some unique considerations created by the Coronavirus Aid, Relief and Economic Security (CARES) Act passed in 2020 and modified or extended by the Taxpayer Certainty and Disaster Relief Act of 2020 (TCDTRA), a part of the Consolidated Appropriations Act, 2021 (CAA, 2021). These strategies should be evaluated by taking into consideration your personal goals and circumstances and in consultation with your Key Private Bank advisor and your tax advisor.

Since 1917, individual taxpayers who itemized have been able to receive a tax break on their charitable gifts. However, the enactment of the Tax Cuts and Jobs Act in 2017 has reduced the federal tax benefit for many households. Beginning in 2018, the standard deduction nearly doubled. As a result, far fewer taxpayers are itemizing and receiving an actual tax break for their charitable gifts.

Understanding the factors impacting tax benefits

For itemizing taxpayers, the tax benefits of charitable giving will depend on factors that include:

- The type of asset contributed
  (e.g., cash, long-term capital gain property, short-term property, tangible personal property, self-created property).
- The basis and fair market value of the assets donated.
- The type of charity to which the gift is donated – a public charity or a private foundation.
- The income level and tax bracket of the taxpayer.
  As a rule, an individual cannot offset their entire income in a year with a sufficiently large charitable gift. The amount you can deduct for charitable contributions is generally limited to no more than 60% of your adjusted gross income (AGI). Your deduction may be further limited to 50%, 30% or 20% of your AGI limit depending on the type of property you give and the type of organization you give it to. A higher limit applies to certain qualified conservation contributions and qualified cash contributions for 2020 and 2021 only. For large charitable gifts, amounts in excess of those limits can be carried forward for five more years.

Donating securities or cash in 2021?

This is an opportunity that may be contrary to prior advice that the gifting of appreciated securities directly to charity is the best option for low basis stock. With the temporarily increased AGI limitation for cash contributions made to public charities from a maximum of 60% of AGI to a maximum of 100% of AGI, this may warrant a review of your charitable planning choices for 2021. In this year, it may be preferrable to donate cash.

2021 planning under the current law changes

The CARES Act was signed into law on March 27, 2020, to lessen the financial impact of COVID-19 on individuals and businesses. To encourage charitable giving during this time, the legislation included provisions that created some attractive opportunities for individuals making charitable contributions in 2020. The Consolidated Appropriations Act, 2021 (CAA) signed into law on December 28, 2020 maintains and expands the charitable contribution incentives originally enacted by the CARES Act and extends certain provisions through 2021.

100% charitable deduction

Current law provides a one-time unlimited cap on certain cash donations for 2021. Individuals who itemize their deductions (total itemized deductions greater than $12,550 for individuals and $25,100 for married filing jointly) can deduct up to 100% (as compared with the previous limit of 60%) of their adjusted gross income for certain cash contributions made to a public charity or certain foundations. Donations to nonoperating private foundations, supporting organizations, or donor advised funds (DAFs) do not qualify for this increased deduction amount. Any charitable contributions made in excess of adjusted gross income (AGI) limitations in 2021 will be carried forward for five years, subject to the standard AGI limitations.

Above-line deduction

Current law also allows individuals who do not itemize their deductions the ability to deduct up to $300 ($600 married filing jointly) of cash contributions made to a public charity or certain foundations. Donations to non-operating private foundations, supporting organizations, or donor-advised funds do not qualify for this above-line deduction amount.

Gift appreciated securities

Some of the most tax-efficient assets to give to charity are marketable securities held 12 months or longer that have appreciated with unrealized capital gains. By donating these directly to the charity, you receive a deduction based on the fair market value of the property, and neither you nor the charity pays a tax on the capital gains if the asset is subsequently sold by the charity.

Making a gift of highly appreciated stock may enable you to automatically increase your gift and tax deduction and save on capital gains taxes. This is how it works: When you donate appreciated assets to charity, you generally take a tax deduction for the full fair market value of the asset rather than your basis. As a result, the value of your gift and the amount of your tax deduction increase, and you eliminate your capital gains tax exposure. When the charity later sells the stock, it pays no tax on the gain. Even if you take the standard deduction this year and don't use your charitable deduction, you still benefit by eliminating the capital gains tax. This is a win for your favorite charity and a win for you.

Contribute to a donor-advised fund

A donor-advised fund (DAF) is a contractual arrangement that a donor enters into with a sponsoring charity to establish an account to benefit the donor's chosen charities. If you are charitably inclined, you might consider a contribution to a DAF to offset unexpectedly high earnings and year-end bonuses. The basic concept of a DAF is straightforward:

- You contribute to the fund and subsequently recommend specific grants to favorite charities when you are ready.
- You can claim a tax deduction for the year in which you put assets into a DAF; the amount and timing of any actual grant has no bearing on the tax deduction.
- DAFs are typically invested and grow tax-free. Donor-advised funds also enhance giving flexibility. You do not have to identify nonprofit beneficiaries when you make tax-deductible contributions to your donor-advised fund, and you can distribute your contributions and investment gains to recipients over as long a period as you wish.

Private foundations also use DAFs to fulfill their 5% mandatory annual distribution requirement when the foundation is not ready to make a final decision about where to make their grants at the end of the year.

Legislative alert

On June 9, 2021, the Accelerating Charitable Efforts (ACE) Act was introduced. If enacted, the legislation would heighten transparency and expedite the pace of resources flowing from donor advised funds (DAFs) and private foundations to working charities.

The DAF changes would attempt to address a timing mismatch perceived between the income tax deduction and the production of charitable good and services. As an example, contributions to a nonqualified DAF would not allow a charitable deduction until the sponsoring organization sells the donated property, cash contributions or proceeds from the sale of donated property are distributed to charities, and the amount of the deduction matches that of the distribution.

If enacted, the proposed legislation would go into effect after December 31, 2021, and would introduce several changes that would also affect private foundations. This includes changes relating to calculating compliance with the 5% annual payout requirement and calculating excise tax obligations among other details.

We will continue to monitor legislative developments.

Offsetting the tax costs of a Roth IRA conversion

A charitable gift could save you taxes on a Roth conversion. Roth IRAs offer two important tax advantages: (1) Unlike traditional IRAs and employer sponsored plans distributions, qualified Roth IRA distributions are tax free; and (2) Unlike traditional IRAs and employer sponsored plans, Roth IRAs are not subject to required minimum distribution (RMD) rules that must begin at age 72. A change in the tax law and political developments could result in higher future taxes. If you believe your current tax rate is lower than it will be in the years you will be taking distributions from your retirement assets, a Roth conversion can be viewed as insurance against future tax rate increases that would otherwise apply. As a result, more retirement dollars will be available as a tax-free source of income and available to pass to beneficiaries. The bad news is the amount you convert from a traditional IRA to a Roth IRA is taxed as ordinary income in the year of conversion and may push you into a higher marginal federal income tax bracket. Keep in mind that not all states tax distributions from retirement accounts (check with your tax preparer to see if state income taxes will apply to your Roth conversion). If you are charitably inclined and plan to do a Roth conversion before the end of the year, a large itemized charitable tax deduction can help offset the taxes due to the Roth conversion.

Make qualified charitable distributions

A charitable rollover, also known as a qualified charitable distribution (QCD), can be an effective vehicle for charitable giving. QCDs enable an individual over age 70½ to make tax-advantaged charitable donations of up to $100,000 per year from their IRAs during their lifetime if the distribution is made directly to a charity. QCDs are only allowed from traditional IRAs; they are not allowed from employer sponsored retirement plans. QCDs are not included in adjusted gross income and for those over age 72, the distribution will satisfy or help satisfy your required minimum distribution from an IRA. Any potential income taxes owed on these distributions are eliminated which makes QCDs beneficial for standard deduction filers.

If you have IRAs with nondeductible contributions or multiple IRAs, there are special rules in determining what portion of deductible and nondeductible contributions has been distributed as a QCD and what portion of the remaining IRA is treated as including nondeductible contributions.

Be aware some states may not follow federal tax law and will not allow an exclusion of the QCD from state taxable income. The IRA owner should consult with their tax preparer regarding state taxability of QCDs.

Use employer sponsored retirement accounts to donate to charity

As outlined, QCDs are only available to IRA owners and IRA beneficiaries who are age 70½ or older and they are limited to $100,000 per person per year. QCDs are not permitted from employer sponsored retirement plans like 401(k)s or 403(b)s. In 2021, thanks to current law changes, the AGI limit on tax deductions for cash gifts to charity is currently 100%. This provides an opportunity to take distributions from any retirement account (not just IRAs), donate the cash to a charity, and completely offset the income on the entire distribution with a 100% tax deduction, effectively creating an unlimited QCD.

A large charitable deduction also allows the taxpayer to take advantage of itemizing deductions if the itemized deductions exceed the standard deduction. Deductions such as state and local taxes and mortgage interest would be more apt to be claimed, which increases the taxpayer's overall tax benefit.

Individuals who have large retirement account balances and will be subject to large RMDs at age 72 may want to take advantage of this limited window of opportunity to donate some of their retirement money to a qualified charity. RMDs force annual distributions in a potentially higher tax environment that may not be wanted or needed. Reducing potential RMD amounts allows you more control over your tax liability in the future.

Caution, the downside of this strategy is that like a Roth conversion, you will temporarily increase AGI which could reduce or eliminate certain AGI-based tax deductions, credits, or other benefits, e.g., an increase in Medicare IRMAA surcharges for parts B and D and reduced deductibility for medical expenses (deductions are limited to amounts in excess of 7.5% of AGI). For wealthier taxpayers, these consequences may be insignificant to their overall tax planning strategy.

Legislative alert

In May 2021, the White House released the Biden Administration's proposed budget for federal spending in fiscal year 2022. Included is a provision that would significantly reduce the benefit of split-interest gifts for taxpayers. Specifically, the proposal would treat transfers of appreciated assets – including donations to a split-interest trust – as "realization events." Under current law, donors of transfers of appreciated assets are not taxed on the appreciation at the time of the transfer. The proposal, however, would tax the difference between the asset's fair market value on the date of the transfer and the asset's adjusted basis. Any appreciation of the asset over its basis would be treated as a taxable gain. While there is an exclusion allowed for the charity's share of the gain, the gain allocable to the non-charitable portion would be taxed to the donor at the time of the transfer. The proposed effective date is January 1, 2022, so there is a window of opportunity for donors to make split-interest gifts in 2021 before any potential new rules take effect.

We will keep you apprised of any future developments in this area.

Utilize split-interest charitable trusts

Split-interest trusts are popular due to their dual beneficial interests: They can benefit a qualified charity and a noncharitable beneficiary. For individuals with taxable estates (assets exceeding $11.7 million per individual, $23.4 million per married couple), historically low interest rates and lower asset values create a unique opportunity to plan with charitable lead annuity trusts (CLATs). A CLAT is an irrevocable trust that distributes a predetermined amount to a charitable beneficiary for a term of years; the amount remaining at the end of the term is distributed to noncharitable beneficiaries, such as your children. You receive a current charitable income tax deduction to offset the taxable transfer to your beneficiaries, which is sensitive to the IRS interest rate (Section 7520 rate). The lower the interest rate (1.0 percent in September 2021), the higher the deduction. The greater the difference between the projected average rate of return of CLAT assets over the trust term and the Section 7520 rate, the greater the potential tax-free wealth transfer to the younger generation. CLTs have been particularly useful for assets that generate substantial income each year that isn't needed and where the donor wants to eventually pass the asset to heirs.

A charitable remainder trust (CRT) provides non-charitable beneficiaries with exclusive rights to distributions until their interests terminate; at that time, charitable beneficiaries receive the assets left over in the trust. CRTs have been particularly useful for investors who want to diversify highly appreciated assets but have been concerned about incurring the capital gains tax. The deferral or avoidance of capital gains tax has been a popular feature for funding CRTs with appreciated assets.

Individuals with large retirement accounts should consider naming a CRT as beneficiary, particularly in light of a recent law (The SECURE Act, 2019) that requires retirement account benefits to be distributed within 10 years after the year of the retirement account owner's death. In general, a CRT provides a current income tax charitable deduction and a stream of income to noncharitable beneficiaries, such as your children, for a term of no more than 20 years or the life of one or more of the noncharitable beneficiaries. By using a longer payout term, a CRT can potentially avoid subjecting a beneficiary to a higher tax bracket and the 3.8% surtax on net investment income. When the trust term ends, the remainder passes to a charity or charities.

If you are considering making gifts to your favorite charities this year, consult your Key Private Bank Advisor and your legal or tax advisor to determine which strategy could help maximize the benefit for you, your family, and your chosen charitable causes.

For more information, please contact your advisor.

About the Author

As a Senior Client Experience Manager for Key Private Bank, Gretchen Miller focuses on ensuring her clients' wealth management plans are carried through to meet their unique financial objectives and grow and preserve wealth.

Partnering closely with the Relationship Manager, Gretchen coordinates the implementation of wealth management strategies with the relationship team and ensures clients have the tools and information to keep track of their financial situation and make informed decisions. She also synchronizes regular communications and updates with the team, and proactively delivers the latest insights and advice to benefit clients' particular situations.

Gretchen has more than 25 years of experience in financial services and is well qualified to help clients implement strategies to achieve their goals. Most recently, prior to joining Key, Gretchen served as Director of Advanced Planning for Prudential Financial where she was a subject matter expert on financial and estate planning, and on retirement topics such as Social Security and Medicare.

Gretchen earned a Bachelor's Degree in Management from Springfield College and an MBA from the University of Phoenix. Gretchen also obtained her certification as a Certified Financial Planner®. She is a member of the Financial Planning Association, the Investments & Wealth Institute and the Key Wealth Institute.

The Key Wealth Institute is comprised of a collection of financial professionals representing Key entities including Key Private Bank, KeyBank Institutional Advisors, and Key Investment Services. Any opinions, projections, or recommendations contained herein are subject to change without notice and are not intended as individual investment advice. This material is presented for informational purposes only and should not be construed as individual tax or financial advice.

Bank and trust products are provided by KeyBank National Association (KeyBank), Member FDIC and Equal Housing Lender. Key Private Bank and KeyBank Institutional Advisors are part of KeyBank. Investment products, brokerage and investment advisory services are offered through Key Investment Services LLC (KIS), member FINRA/SIPC and SEC-registered investment advisor. Insurance products are offered through KeyCorp Insurance Agency USA, Inc. (KIA). KIS and KIA are affiliated with KeyBank.

Investment and insurance products are:

NOT FDIC INSURED • NOT BANK GUARANTEED • MAY LOSE VALUE • NOT A DEPOSIT • NOT INSURED BY ANY FEDERAL OR STATE GOVERNMENT AGENCY

KeyBank and its affiliates do not provide tax or legal advice. Individuals should consult their personal tax advisor before making any tax-related investment decisions.

©2021 KeyCorp.

210823-1208299