Charitable Contribution Complexity

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If you donate money to somebody in need, you can write off that gift on your tax returns, right?

Would the charitable contribution laws be that simple? The actual rules say that you can itemize your charitable donations on Schedule A of IRS Form 1040. But (and these are enormous 'buts') only if you're giving to a registered charitable organization, and only if that contribution plus your other deductions exceeds the standard deduction ($13,850 for single filers; $27,770 for joint filers). If, say, your donation plus other deductions come to less than the standard deduction, then it's better, tax-wise, to simply take the standard deduction, and get no tax benefits for your contribution.

One simple way to overcome this standard deduction hurdle is to make five years' (or more) worth of charitable contributions to a charitable trust, take the larger (5 years' worth) deduction in the current year, and overcome the standard deduction limit. Then the actual donations can be made out of the charitable trust on a yearly basis.

There are other complications as well. If you donated to a registered 501(c)(3) charitable organization, you are allowed to deduct no more than 60% of your adjusted gross income in any one year. If you contribute investment securities, property, or things like artwork instead of cash, the amount of the donation should be reported as the fair market value of what you donated at the time it passed to the charity. There may be an extra benefit if the item that is contributed has appreciated in value; by giving it away (think: stock that has risen in value), the donor avoids having to pay capital gains that would otherwise be owed when the item is sold.

If the donation was made to certain private foundations or fraternal societies, then the tax write-off is subject to a limit of 30% of your adjusted gross income. The Internal Revenue Service has created a search tool that lets you determine which organizations qualify for which sorts of tax exemptions: https://www.irs.gov/charities-non-profits/tax-exempt-organization-search.

Many donors prefer to create trusts that will offer more complicated gifting strategies, which create a combination of a tax write-off and either future income or the reduction of estate taxes for their heirs. The list includes charitable gift annuities where the donor would make an irrevocable gift of cash or securities to a nonprofit in exchange for a fixed income payment for a set term, or for life. (Think: a retirement income stream.) Charitable remainder annuity trusts work similarly; the donor contributes cash or securities and receives a fixed income that is calculated as a percentage of the assets in the trust at the time of the donation. Donations to a charitable remainder unitrust would result in the donor receiving a fixed percentage of the trust's assets, recalculated each year. Pooled-income funds work similarly.

In each of these cases, when the term is up or the donor dies, the remaining amount in the trust goes to the charitable organization. And the up-front tax deduction is calculated based on the amount donated and the net present value of the expected income that the donor would receive. It could be very low if the donor ops to receive significant income from the trust.

Charitable lead trusts work kind of in the opposite way. The gift goes into the trust, and the designated nonprofit would receive an income stream from the investments in the trust. Often, the heirs are listed as the beneficiaries, and when the donor dies, the trust assets would then pass to the heirs either free or nearly free of estate taxes. (These vehicles have become a bit less attractive now that the estate and gift tax exemption is nearly $13 million for individuals, and $26 million for couples, making estate taxes less of a problem for most Americans.)

Yes, one would think that giving generously would be less complicated. But that means one does not understand that we have a tax code that is currently (including regulations and IRS guidance) about 75,000 pages long.

Sources:

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https://www.irs.gov/charities-non-profits/charitable-organizations/charitable-contribution-deductions

https://resources.freewill.com/types-of-planned-gifts

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