KOVITZ INVESTMENT GROUP
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Financial Planning Corner
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From time to time, we will add this section to our newsletter. In it, we will discuss a wide variety of financial planning and wealth management topics, including estate planning and wealth transfer strategies, income-tax-saving strategies, social security and retirement planning ideas, charitable giving, insurance planning and beyond. Our hope for these pages is that you will periodically find something interesting (and profitable) that touches a current or future need of yours which causes you to pick up the phone and call your Kovitz Advisor to start a conversation.

Charitable Giving and Donor-Advised Funds

Each December, consumers of financial media are bombarded with articles singing the praises of year-end tax strategies with the most common format being of the "Top 12 Year-End Tax Tips" variety. Much of the information contained therein is sound advice, but the trouble is that many of these tactics become dramatically less useful when the clock strikes midnight on New Year's. So instead of focusing on the Ghosts of Tax Strategies Past, we believe it is more beneficial to channel our energies into potential tax-saving strategies we can use now that 2017 is upon us. One such strategy is planning charitable giving that capitalizes on the benefit of donating shares of stock as opposed to the typical cash donation.

In lieu of cash donations, many charitable organizations have the ability to take receipt of securities (stocks, bonds, etc.). If an organization can facilitate this, an individual may be able to donate highly appreciated securities from a taxable account, thus entitling the owner to a tax deduction in a similar manner to making a cash contribution. The main advantage of this form of donation is that the donor forever avoids paying tax on the future capital gains embedded in those appreciated securities.

For example[1], if an individual in the 39.6% federal tax bracket makes a $50,000 cash donation to a tax-exempt charitable organization, this results in federal income tax savings of $19,800 ($50,000 x 39.6%). However, if this same individual donates the same $50,000 in the form of appreciated securities that were purchased many years ago for, say, $10,000, the tax savings rise to $29,320. The additional $9,520 in tax savings in this example arises from the avoidance of paying capital gains taxes (at a 23.8% rate) on the $40,000 capital gain embedded in the donated shares.

[1] State income taxes are ignored in this example for the sake of simplicity, but there would be additional tax savings generated at the state level using the same strategy.

For those organizations that can't take possession of securities or for smaller contributions where a stock transfer is overly complicated, there is a better solution. Over the last 20+ years, the use of donor-advised funds (or "DAFs") has been steadily rising. A DAF is an account opened through a DAF provider (such as Fidelity, Charles Schwab, Vanguard, AEF, etc.) for the purpose of making distributions to charitable organizations. Similar to making a contribution of appreciated stock directly to charity, an individual would instead make an irrevocable transfer of securities to the DAF, which qualifies for the same charitable tax deduction as a direct donation to charity.

A main contributor to the growing popularity of DAFs is the flexibility they provide after the contribution has been made. Depending on the desires of the account owner, the fund can immediately forward all proceeds to a 501(c)(3) charity of the owner's choice or the proceeds of the donation can be invested in one of the DAF's investment options until a later date. The latter option provides the potential to grow the account's balance on a tax-free basis to facilitate even greater charitable giving down the road. Many donors hold a significant balance in their DAF and gradually peel off donations over many years. This "slow-burn" feature allows donors to front-load their contributions to a DAF in years with especially high taxable income, maximizing the tax benefit received in the year of the contribution.

As always, there are numerous caveats and limitations that may inhibit any particular individual's ability to take full advantage of the tax benefits described here, not to mention the potential changes to the tax code that may encourage/discourage taking action this year. Regardless, our team of financial advisors at Kovitz is committed to staying abreast of any new developments on this topic and many others. As always, please feel free to reach out to your Kovitz advisor to discuss the extent to which this or any other financial planning strategy could take a bite out of next year's tax bill.