

Sharing the Pain of Charitable Giving with Uncle Sam

In last month's article, I introduced the idea of decreasing the pain of charitable giving by sharing the pain with the federal government. Recall that the federal government will reward you by decreasing your federal income tax if you contribute to YOUR favorite charity. A contribution of \$100 will be rewarded with a \$35 income tax savings if you are in the 35% federal income tax bracket. Thus, for roughly every \$2 you contribute to your favorite charity, the federal government will contribute \$1. Two to one is pretty good leverage, but there are creative ways to further increase this leverage, thus sharing more of the pain of charitable giving with the federal government.

The leverage can be increased by avoiding taxes that would have been incurred if the charitable contribution had not been made. The first and easiest is to avoid the tax that would be triggered on the capital gain had the property been sold. Mrs. Smith has 100 shares of ABC Company stock. It is worth \$100,000 and was given to her by her grandfather who paid \$10,000 for it. If she sold the stock, she would generate a gain of \$90,000 which would cost \$13,500 in tax. If she contributes the net proceeds, \$86,500, the federal government would reward her with a tax break of \$30,275. The cost to her would be \$100,000 less the tax break of \$30,275, or \$69,725.

Conversely, if Mrs. Smith contributed the stock itself to the charity she would be entitled to a deduction based on the fair market value of the stock, \$100,000, which would reward her with a tax savings of 35% thereof or \$35,000. Consequently, the pain of donating the stock prior to its sale would simply be \$100,000 less the tax benefit of the \$35,000 or \$65,000. The pain has been reduced by almost \$5,000 by contributing the stock instead of contributing the proceeds. The result is that for every dollar received by the charity, Mrs. Smith contributed only sixty cents and the federal government contributed forty cents. Moreover, Mrs. Smith chose the charity.

The reduction in pain is significant enough to make it worthwhile to contribute appreciated capital assets. Almost all reasonably sophisticated charities can accept contributions of appreciated securities. As for other appreciated capital assets, you may need the intervention of a tax attorney to assist you and/or the charity to obtain the desired results. Depending on the type of property to be contributed, the leverage between the income tax avoided by not selling an item of property and the income tax saved by a contribution can increase the amount of the pain shared with the government. However, even greater leverage can be achieved in the estate tax arena because the tax rates are so much higher, currently the highest estate tax rate is about 45%.

In this case, Mrs. Smith wants to contribute the \$100,000 worth of ABC stock to her almer mater. She initially wants to contribute it at her death by way of a bequest in her will. The pain felt by her family of not receiving the stock is calculated by examining what the family would have received had Mrs. Smith left the stock to them. At her death, the stock would have been included in Mrs. Smith's estate at its fair market value of \$100,000 and assuming that she had an estate in excess of the "exemption" amount, currently \$2.0 million, it would have generated estate tax of about \$45,000; thus the kids would receive \$55,000. Consequently, the pain to the family of a bequest to charity of the stock would be \$55,000. Stated differently, for every 55 cents that Mrs. Smith contributed to HER FAVORITE charity, the government contributed 45 cents.

Let's contrast the charitable bequest of the stock with an inter vivos contribution of the stock. Based on the above example, we know that Mrs. Smith's contribution would save her \$35,000 in federal income tax. This sum would be subject to estate tax at her death and her family will receive 55% thereof after tax, or \$19,250. The pain to the family of the contribution is the amount they would have received had they gotten the stock, \$55,000, less the amount that they actually received, \$19,250, or \$35,750. Consequently, for roughly every \$1 Mrs. Smith contributed to her favorite charity, the federal government contributed \$2. Again, Mrs. Smith selected the charity.

Combining the income tax and estate tax benefits can shift a substantial portion of the pain of charitable giving to Uncle Sam. Before commencing any such gifting program however, you should evaluate your current and future projected needs. Recall that when you give, it hurts because you lose the

enjoyment and control of the property. I strongly advise that you seek the assistance of a tax and estate planning attorney to assess your financial circumstances and to evaluate alternative gifting techniques for you.

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