

4 Ways Charitable Giving Can Help Reduce Your 2020 Taxes

Entrepreneurs have unique options for tax-smart charitable giving this year.

November 24, 2020 7 min read

Opinions expressed by *Entrepreneur* contributors are their own.

This year in the U.S., we've seen truly historic levels of charitable giving in support of communities impacted by the pandemic, social unrest and natural disasters. Still, new research from the Lilly Family School of Philanthropy at Indiana University and funded by Schwab Charitable shows that many nonprofits are struggling with rising demand for their services at the same time funding has declined. Many entrepreneurs and business owners are struggling, too, but for those who have the means, this year's tax laws and election-year uncertainty may make it wise to be generous now.

Tax rules could change in 2021 with a new administration, but current annual income tax deduction limits for gifts to public charities, including donor-advised funds, are 60% of adjusted gross income (AGI) for contributions of cash. In addition, with the S&P 500® index currently trading at roughly twice the level of eight years ago, you may also want to consider donating non-cash assets, such as publicly traded stock, which have an annual AGI limit of 30%. For blended contributions of cash and non-cash assets, the limit is 50% of AGI. Donation amounts in excess of these deduction limits may be carried over up to five tax years.

As you consider how to respond to these unprecedented times, four strategies are worth considering to help make your charitable giving both tax-smart and high-impact.

1. Make the most of cash

If you plan to take the standard deduction, the Coronavirus Aid, Relief and Economic Security (CARES) Act offers the option to claim a deduction of up to \$300 for cash contributions to “operating charities.” The term is defined by Internal Revenue Code section 170(b)(1)(A) and does not include donor-advised funds, supporting organizations or private foundations.

Many sole proprietors and business owners of pass-through entities itemize deductions on their personal returns. In that case, the CARES Act also gives donors who itemize an option to elect a 100% of AGI deduction limit for cash donations to operating charities. It is important to consult a tax advisor before electing the 100% of AGI deduction because the limit on cash contributions applies to federal income taxes and may not be honored by your state. It is also unclear whether combinations of cash and non-cash assets can be used to reach or exceed the 100% of AGI deduction limit. In addition, there is uncertainty about whether taking the election when filing 2020 taxes will eliminate or reduce deductions for other charitable contributions.

2. Consider appreciated non-cash assets for extra tax benefits

If you itemize deductions, you can generally claim a deduction for the fair market value of an appreciated non-cash asset that you have held for more than one year before contributing to charity. Donors also generally do not owe the capital gains tax they would pay if they sold the asset and donated the cash proceeds. Commonly donated assets include publicly traded securities (such as stocks, exchange traded funds and mutual funds), restricted stock, and privately held business interests.

Original cost (cost basis) of XYZ stock: \$5,000 Fair market value of XYZ stock: \$50,000
 Federal long-term capital gains tax rate: 15%

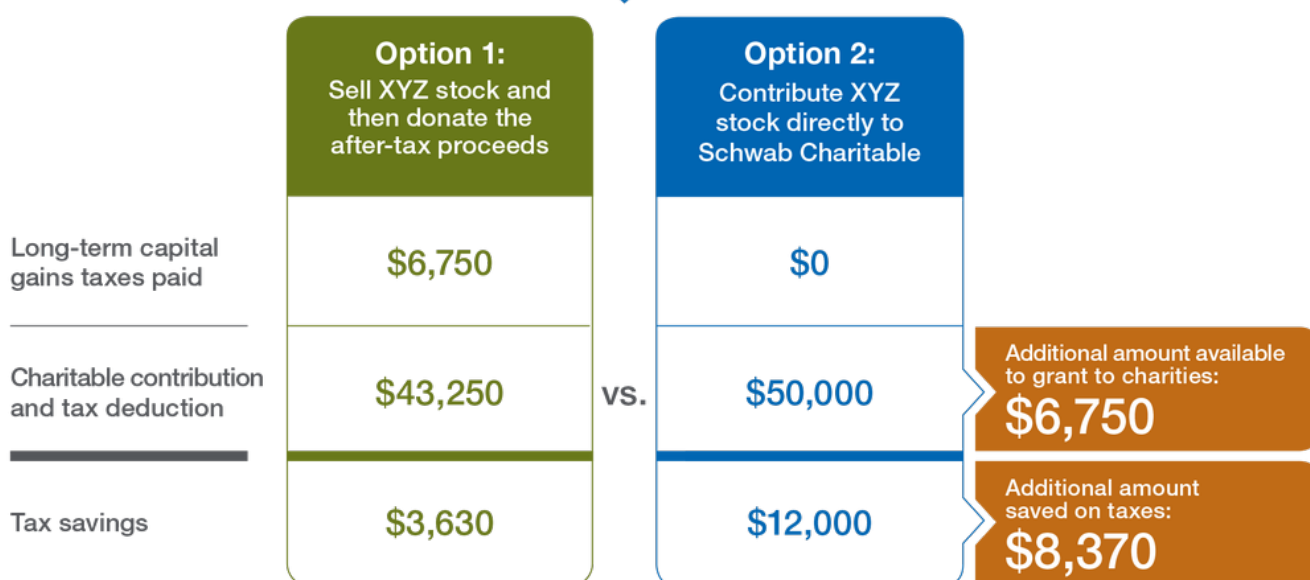


Image credit: Schwab Charitable

This hypothetical example is only for illustrative purposes and does account for state or local taxes or the Medicare net investment income surtax. The tax savings shown is the tax deduction, multiplied by the donor's income tax rate (24% in this example), minus the long-term capital gains taxes paid.

3. Take advantage of carryovers or bunching

- **Give beyond limits.** Donors who itemize deductions may give more than the 60% AGI limit for cash and 30% AGI limit for non-cash assets in 2020, and then carry over the excess deduction for up to five years.
- **Concentrate contributions.** If your total itemized deductions are a little less than the standard deduction, you may be able to have more charitable impact and a larger two-year deduction by concentrating, or bunching, 2020 and 2021 charitable contributions into one year (2020), and then itemizing deductions on your 2020 taxes. If you then take the standard deduction on

your 2021 tax return, it may result in a larger deduction over the two years, compared to two separate years of itemized charitable deductions (depending on income level, tax filing status, and giving amounts each year).

4. Offset a taxable event

- **Donate a portion of privately held business interests you plan to sell.** If you are considering a sale of an interest in a privately held company (C-Corp, S-Corp, LP, LLC), donating a portion of your long-term held interest to a donor-advised fund or other public charity before the sale can help to reduce your tax burden. Consult your tax and financial advisors to ensure you are considering all relevant requirements, which may include avoiding a pre-arranged sale, obtaining a qualified appraisal, applying SEC Rule 144, accounting for unrelated business income tax, or transfer restrictions.
- **Lower taxes on equity compensation.** The most common forms of equity compensation awards are non-qualified stock options, incentive stock options, restricted stock units and restricted stock awards. The awards themselves are generally not transferable and therefore cannot be given to charity. Once these awards are vested and/or exercised, a sale of the resulting stock may result in a large capital gains tax bill, because the awards often have a low cost basis. In order to maximize tax benefits of contributing stock received from the vested and exercised equity compensation award, the stock should be held for the required holding period to qualify as long-term capital asset, which is generally more than one year from date of vesting and exercise. For incentive stock options, stock must be held two years from grant date and more than one year from the date of exercise.
- **Contribute IPO stock to charity.** An initial public

offering (IPO) may result in substantial capital gains taxes when the IPO stock is sold. Donating a portion of your IPO stock – either during or after the lock-up period – to a donor-advised fund or other public charity may provide you with a current year, fair market value income tax deduction and potentially eliminate capital gains taxes. The issuer's counsel determines whether and how charitable gifts of IPO stock may be made during a lock-up period and a qualified appraisal may be required to substantiate fair market value.

- **Use a charitable deduction to help offset the tax liability of a retirement account withdrawal or a Roth conversion.** If you take withdrawals from a retirement plan account in 2020, you may be able to use charitable donations to help offset income tax on the withdrawals and reduce your taxable estate. Charitable deductions can also potentially offset taxes on the amount of a tax-deferred retirement account, such as a traditional IRA, that is converted to a Roth IRA.

What to do next

You may want to talk to your financial and/or tax advisor about ways to maximize your philanthropic impact and incorporate charitable planning into your overall plan. They can help guide you so that your charitable goals are funded right along with other financial objectives.

Here are a few potential starting points include the following:

- Explore charities recommended by the Center for Disaster Philanthropy for COVID-19 relief efforts
- Review this case study on the tax benefits of bunching charitable contributions
- See frequently asked questions on IRA rollovers and Roth conversions from the Internal Revenue Service

- Listen to Schwab Charitable's Giving with Impact podcast, where you'll find leading voices from the charitable ecosystem who may help you become a more effective philanthropist

But, there are also plenty of resources and tools available online to help you with your philanthropic journey. You can find guidance on everything from defining a charitable mission to making tax-smart account contributions and researching charities to support.

<https://www.entrepreneur.com/article/359676>