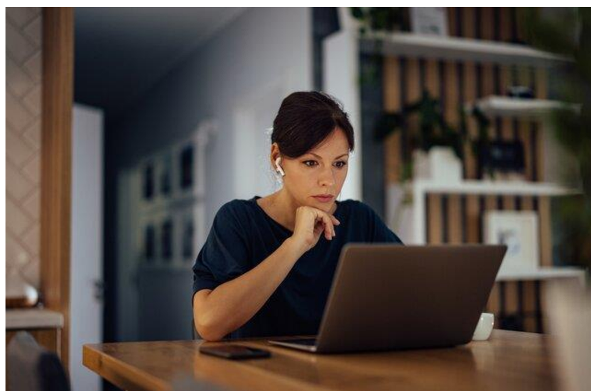
5 Strategies for Charity-Minded Clients in 2022

Advisors can use these strategies this year to help philanthropic clients.

By Debbie Carlson
Jan. 19, 2022, at 10:34 a.m.



Tax deductions are not often top of mind when charitable-minded clients donate to their favorite nonprofit organizations, but if they do it right, these clients may be able to take advantage of the tax code to make tax-efficient, practical and impactful charitable contributions.

"There are a lot of different nuances that go into what's the most tax-efficient way to accomplish philanthropic goals, and it really depends on the client's personal tax situation, their estate planning, and whatever the tax code says that year," says Chloe Wohlforth, certified financial planner and managing director at Angeles Wealth Management in New York, a firm that specializes in working with charities and philanthropic clients.

Tim Steffen, director of tax planning at Baird, concurs. "There are two variables that determine what might be the right strategy to use for charitable giving," he says. "One is,

how much does the client plan to give? The larger the gift, the (more) different the strategy. And the second is, are they going to be itemizing those deductions or not?"

The itemization question is key, Steffen says. The 2017 tax-code changes significantly increased the standard tax deduction for individuals and married couples, making it harder for people to use charitable giving to itemize their taxes. Assuming a standard deduction of roughly $25,000 for a married couple, state and local taxes apply up to the first $10,000. If there are no other deductions, such as mortgage interest, it takes $15,000 in charitable gifts just to meet the standard-deduction threshold, and it won't provide a tax benefit. If a couple in the same situation gave $20,000 in charitable donations, only $5,000 of that amount would be tax deductible.

"If they're going to be giving a small dollar amount, it's probably not going to provide them any tax benefit. If they are going to be giving a larger amount, then you can be a little bit more creative," Steffen says.

Here are five strategies financial advisors can look to for charity-minded clients in 2022:

- Qualified charitable distribution.
- Donor-advised fund.
- Charitable remainder trusts.
- Charitable lead trusts.
- Private foundations.

Clients who are 72 or older and need to make their required minimum distributions from an individual retirement account can take advantage of qualified charitable distributions, or QCDs. It's probably the easiest and the most popular way to donate to charity for this demographic, says Craig Ferrantino, founder of Craig James Financial Services in Melville, New York.

"It's probably the most tax-efficient way that I could think of to support a cause," he says.

Clients tell the advisor their preferred charity, and the financial advisor fills out an IRA distribution form. What's critical is that the money goes straight to the nonprofit organization, rather than the client taking ownership of the money and making the donation themselves, he says.

Eric Bond, wealth advisor at Bond Wealth Management in Long Beach, California, says the form needs to include information such as the charity's name, address and tax identification number.

Wohlforth says QCDs have two benefits for clients: clients get a tax deduction for charitable gifts, and they avoid paying taxes on the ordinary income they would normally pay from a required minimum distribution. The main limitation is that QCDs are capped at $100,000 in a tax year.

Donor-Advised Fund

Donor-advised funds are vehicles designated to support 501(c)3 charities approved by the IRS, Wohlforth says. They've been around since the 1990s, but they became popular following the 2017 tax code changes.

Clients who want to itemize their taxes need to have enough donations to clear the standard-deduction hurdle, Steffen says, and that often means "bunching" several years of deductions into one year. Donations go into the fund, and the donor receives an immediate tax break. However, the donor can dole out the money when he or she wants to make a gift and can make even small donations.

Clients can put up to 60% of their annual adjusted gross income, or AGI, in cash, and up to 30% of their AGI in securities, Bond says. This is an irrevocable trust, meaning once the cash or securities are in the fund, it's out of the donor's estate. Donor-advised funds are a good place to park highly appreciated assets, since the approach helps donors move those out of their estate without clients having to sell and pay taxes on the gains.

Steffen says that in addition to cash and securities, trustees or administrators managing the fund may also allow illiquid or unusual items. Whether a donor can put assets such as art, antiques or real estate in the fund depends on the trustee.

Charitable Remainder Trusts

A charitable remainder trust works well for people who want to give something to charity but also want to be able to receive income from that asset, Steffen says. Charities must wait until the end of the trust's term to receive their share of the asset in a charitable remainder trust.

These trusts are irrevocable, and the amount of money put into the trust isn't a 100% deduction since the donor still receives some of the money. For example, a donor who puts $100,000 into a charitable remainder trust doesn't get a $100,000 deduction because the donor is taking a piece of that back over time.

Advisors can set up the trust to receive a fixed percentage or fixed dollar amount every year, and the account grows or shrinks in value as the payment grows or shrinks. Remainder trusts require trustees to manage it, and the trust must file a tax return annually.

Charitable Lead Trusts

A less common strategy is a charitable lead trust, where the charity receives income from the asset in the trust, but at the end of a certain term, whatever money is left goes to another beneficiary.

"The non-charitable beneficiaries receive the remainder of the donated assets once the donor passes. It's a similar idea (to the remainder trust), but it's different in terms of when the charity versus the donor's family or beneficiaries receives the income," Wohlforth says.

Like remainder trusts, lead trusts require trustees to manage them, and the trust must file a tax return annually. Trusts are a way to get assets out of estates, but unlike donor-advised funds, the charitable trusts are a way to maintain a certain level of proximity and closeness between a family and a charity, she says.

Private Foundations

Private foundations can give clients more control than donor-advised funds.

"A donor-advised fund requires the charities that you are donating to be a 501(c)(3)–approved charity," Wohlforth says, and this isn't the case with a private foundation.

Donors can seed a private foundation with as little as about $500,000, Wohlforth says, although, given the administrative costs to having a private family foundation, it may make more sense for clients to have multiple millions to fund it. Private foundations can hold private business assets, tangible assets and other illiquid assets.

Foundations are legal entities, requiring attorneys to set them up. That makes them more costly to initially start than a donor-advised fund, although the ongoing maintenance in a private foundation could be cheaper in the long run, Steffen says. Foundations must give away 5% of their assets annually, a rule that doesn't apply to donor-advised funds. Donor-advised funds may make more sense for people with less means than ultra-high-net-worth clients.

"Donor-advised funds are like foundations for people not named Gates and Rockefeller," Steffen says.