Season 1 – Episode 21 – Maximizing Philanthropy & Minimizing Taxes: A Deep Dive into Donor-Advised Funds and Charitable Bunching

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Host: Daniel J. Rohr, CPA/PFS, EA, M.S. Tax

Welcome to Tax Blueprints, a Rohr CPAs podcast. I'm Daniel Rohr, the managing shareholder of Rohr and Associates, a premier CPA firm based in California. I'm a CPA, Personal Financial Specialist and Enrolled Agent. I have extensive experience advising individuals and business owners with tax minimization and personal financial planning strategies. On each episode of Tax Blueprints, I delve into the intricacies of tax laws, explain the subtleties of business tax planning, and guide individuals towards a path of financial stability. Whether you're a business owner navigating the murky waters of taxation or an individual planning for a worry-free retirement, Tax Blueprints will provide you with the tools and knowledge you need. I hope you enjoy this episode.

Today we'll discuss two sophisticated but commonly utilized charitable giving strategies donor advice Funds and charitable bunching. A Donor Advice Fund, commonly referred to as a DAF, is a philanthropic vehicle that allows taxpayers to contribute to the fund and be eligible for an immediate federal income tax deduction after the initial contribution. The DAF can then be used to make contributions to the charities of your choice over any time period, even over many years. It's important to note that contributions to the DAF are irrevocable, and you are only allowed to take a charitable donation deduction for the contribution to the DAF, not for any future contributions that are made using DAF funds. To illustrate the utility of the Donor Advice Fund for high income earners, let's consider a hypothetical example. Assume that Jane, a successful business owner, has just sold her business for $2 million. The sale has increased her into the highest federal tax bracket of 37%.

If Jane doesn't take any tax mitigating action, her tax liability on this 2 million, ignoring other income and deductions for simplicity, would be around $740,000. Now, let's say Jane is philanthropically inclined and plans on donating 50,000 annually to various charities over the next ten years. Instead of making these annual donations directly to the charities, jane could opt to contribute a lump sum of 500,000 to the Donor Advice Fund in the same year she sells her business. And by doing this, Jane would be eligible for a tax deduction of 500,000, effectively reducing her taxable income from the sale to 1.5 million. Consequently, her federal tax liability would now be calculated as 37% of 1.5 million, which amounts to 555,000, which is a tax savings of $185,000. Now, what's more, this strategy allows Jane the flexibility to direct grants from her Donor Advice Fund to her chosen charities over the next ten years, which is aligning her with her initial philanthropic intentions.

Now, there are limitations imposed by the IRS regarding the amount you may contribute to a DAF that are based on your income and the type of contribution. So for cash contributions, the cap is set at 60% of your adjusted gross income, and for contributions of appreciated assets, the limit is 30%. So, to illustrate, imagine that Sarah, a high-income individual, has an adjusted gross income AGI of a million dollars for the year. She also holds shares of a publicly traded company that have appreciated significantly since she purchased them. If Sarah wanted to contribute cash to her DAF, the max she could contribute is 60% of her $1 million adjusted gross income, meaning she could contribute up to 600,000 in cash to the DAF and take the full deduction in the current year. If Sarah were to want to contribute the appreciated stock, she could deduct 30% of her 1 million AGI, which would be 300,000.

She could therefore contribute up to 300,000 worth of appreciated stock to the DAF and be eligible for a full tax deduction. Importantly, donating appreciated stock also allows Sarah to avoid capital gains tax on the appreciated amount, which provides an additional layer of tax efficiency. It's also worth noting that if Sarah exceeds these contribution limits, the IRS does allow for a five-year carryover for the unused portion of the deduction. So if she were to have contributed $700,000 of cash on her $1 million of adjusted gross income, she would only get the 600,000 as a current year deduction. And 100,000 would then go to the next year, where she could then utilize that 100,000 against her income in the following year. So let's move on now to discussing the bunching strategy. Charitable bunching is a strategy employed to maximize tax efficiency, and this involves consolidating multiple years of charitable contributions into a single tax year.

This, of course, then is designed to exceed the standard deduction threshold for that year. So let's consider john is a married individual and usually donates $6,000 annually to various charities. And for simplicity's sake, let's assume the standard deduction for married filing jointly in the current tax year is 25,000. In a typical year, let's say John and his spouse have other deductions like mortgage, interest and state taxes, that total $20,000. Adding his standard annual charity donation of 6000 would make his total deductions 26,000. And since there's just 1000 more than the standard deduction, john is receiving only marginal tax benefits from his charitable giving when he itemizes. So let's consider bunching. Instead of giving 6000 annually, john decides to bunch two years' worth of charitable donations into a single year. He contributes 12,000 to his chosen charities in one year and zero in the next. In the year he bunches, his total itemized deductions would be 32,000, which is the 20,000 from other deductions, plus the 12,000 from charitable contributions.

This $7,000 more than the standard deduction of 25,000. And in the following year, John would revert back to taking the standard deduction since he wouldn't make any charitable contributions. By doing this, John increases the total deductions he can claim, thus reducing his taxable income more substantially than if he were to distribute the donations evenly across years. And depending on his tax bracket, this could result in significant tax savings. In summary, today we've delved deeply into two high impact charitable giving strategies, the donor advised funds and charitable bunching. Each of these mechanisms offer a unique pathway for enhancing your philanthropic impact while optimizing your tax position. The financial complexities of these advanced charitable giving strategies necessitate careful planning and competent advice. While we've provided you with a foundational, understanding the nuances of each individual's financial situation can make a significant difference in the optimal approach. Therefore, it's imperative to consult a qualified tax professional to ensure these strategies align well with your broader financial plan and charitable intentions.

That's all for this episode of Tax Blueprints of Rohr CPAs podcast. You can find us online at Rohrcpas.com/podcast and don't forget to subscribe on Apple podcasts or Spotify. If you enjoy the show, please consider rating or reviewing us wherever you listen. I'm your host, Daniel Rohr. Thanks for listening.

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