SMS Capital Management, Inc.

High Income Planning (HIP): Charitable Giving

CASE STUDY

Situation

Brendan and Erin Steele are on track to comfortably fund their retirement goals. With their kids out of college and financially independent, they are turning their attention to other personal pursuits including community service and philanthropy. They have a large brokerage account that includes some low basis, highly appreciated equity holdings.

STEELE FAMILY SNAPSHOT	
Brendan / Erin's Ages	60 / 58
Annual Household Income	$200,000
Investment Assets	$3,000,000
Net Worth	$5,000,000

The Steele's objectives include:

- Have ample funds for future gift-giving without impeding their lifestyle.
- Maximize the tax deductibility of future gift-giving.
- Maintain flexibility as to gift recipients.

SMS Charitable Giving Planning Process

Define Expected Charitable Giving Goals

Through some interactive goal-based retirement planning, SMS confirms that the Steeles should have adequate capacity to continue to make charitable giving as part of their retirement. They expect to make grants of at least $15,000 per year to various charities over the next several years. However, the Steeles are not entirely sure of the timing or which charities will be the recipients of their giving.

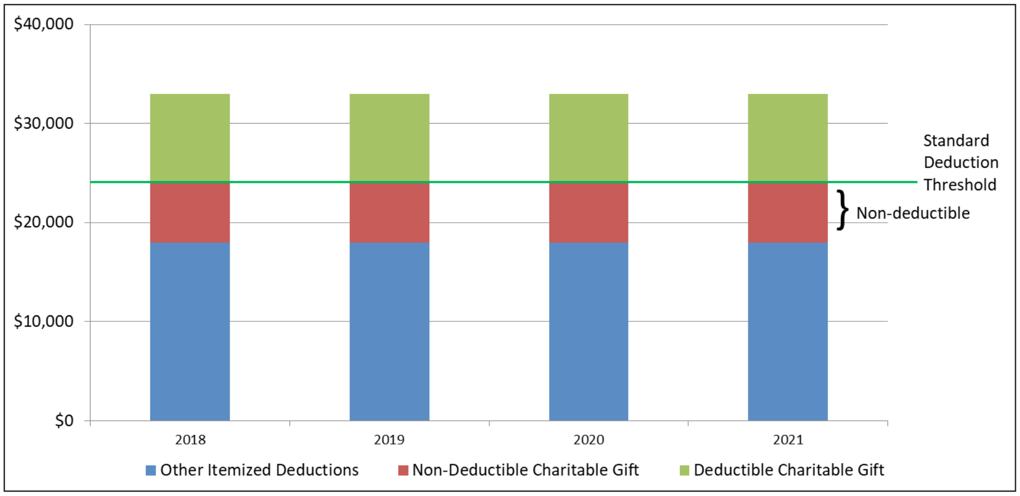
Evaluate Potential for Charitable Tax Deductions

The Tax Cut and Jobs Act of 2017 makes it more difficult for households to itemize deductions; thereby, reducing the potential for the tax deductibility of charitable contributions. The new standard deduction is $24,000 for a married couple filing jointly (under age 65), and only $10,000 in property taxes may be deducted if trying to get above that hurdle to itemize deductions.

The Steeles have qualified mortgage interest of about $8,000 each year which puts their total estimated itemized deductions at $33,000 ($10,000 property tax + $8,000 mortgage interest + $15,000 charitable), $9,000 over the standard deduction. Therefore only $9,000 or 60% of their expected $15,000 of annual charitable giving will be effectively tax deductible.

The chart below illustrates that if current deductions remain constant, the Steeles will not get the full potential deductibility of their charitable giving going forward since their itemized deductions without charitable giving are less than their standard deduction level.

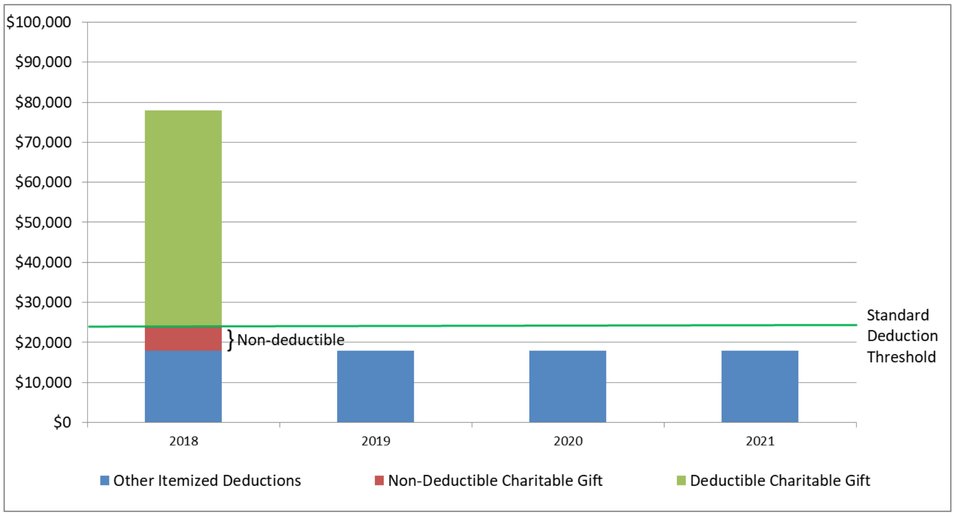
Deductions with Equal Charitable Contributions



Lumping Charitable Contributions with Donor-Advised-Fund

After reviewing the Steele's financial situation and objectives, SMS recommends that the Steeles consider establishing a Donor-Advised-Fund (DAF) and lump their next several years of expected charitable giving into the DAF in 2018. Furthermore, instead of funding the DAF with cash, the Steeles should fund the DAF with appreciated securities from their brokerage account. By doing so, they will avoid paying long term capital gains taxes on the appreciated securities while capturing more of the value of the charitable deduction.

Impact of Lumping Charitable Contributions



For example, if the Steeles were to lump four years of gifts into 2018 ($15,000 x 4), they would have a $60,000 deduction in 2018. Using this strategy, the Steeles can go from only 60% of their gift being tax deductible to 90% being tax deductible.

The other benefit the DAF provides is that the Steeles will maintain flexibility as to the future timing and recipients of their gifts. The DAF allows for the funds can be invested and then distributed to charities whenever the Steeles are ready to do so.

Planning Impact Summary

- Steeles fund a Donor Advised Fund (DAF) to use as primary vehicle for future charitable giving.
- Lumping several years of future giving into 2018, not only avoids taxation of long-term capital gains, but also captures more charitable tax deduction (90%) than if gifts were spread out evenly over the next several years.
- The Steeles preserve the flexibility as to where and when their charitable dollars will go in the future.