Use Appreciated Assets for Charitable Donations

Writing a check is the easiest way to make charitable contributions. However, donating appreciated assets can be more tax-efficient. That's true if the donated assets have been held longer than one year and, thus, would qualify for long-term capital gains tax treatment on a sale.

Example: Mark Parker wants to donate $5,000 to a local animal shelter. If he writes a check for $5,000, he'll get a $5,000 tax deduction. Mark's cost for this deduction is $5,000, after-tax.

Instead, Mark goes through his portfolio and finds a stock he bought in 2009 for $3,000 and, thus, would qualify for long-term capital gains treatment. That stock now sells for $5,000. Mark decides to donate the stock to the animal shelter. With this approach, Mark gives a donation of $5,000, the fair market value of the donated assets. However, those shares are really not worth $5,000 to Mark. To cash them in, he would owe tax on a $2,000 long-term capital gain. At a 15% tax rate, Mark would owe $300. Therefore, by donating the shares, Mark gets a $5,000 tax deduction by relinquishing an asset that would be worth only $4,700 to him after-tax.

After the contribution, the animal shelter can sell the donated shares.

As a charitable organization, the shelter owes no tax on the sale. Consequently, the charity gets the same $5,000 contribution with this strategy, and Mark is better off than he would have been writing a check.

To implement this strategy, you can call the charity and get its brokerage account number. Then, call your own broker or mutual fund company and explain what you want to do and provide the charity's account number. If you wish to donate part of a position, specify the shares you wish to contribute. Follow up by sending an e-mail to your broker or fund company and eventually check with the charity to confirm the transaction,

Note: Different rules apply to contributions of tangible personal property, patents and other intellectual property, and property contributed to certain private foundations. In most cases, the deduction for a property in one of these categories will be limited to the property's fair market value less the long-term capital gain that would have been recognized if the property had been sold for fair market value at the time of contribution.

Spreading the wealth

The procedure described in the previous paragraph can work well if you are making one or two relatively large charitable contributions. However, if you plan to make $500 contributions to each of 20 charities, the process may get cumbersome. Instead, consider donating through a donor-advised fund (DAF).

Many financial firms and local community foundations offer a DAF. You make donations directly to the funds; the minimum initial contribution might be a lump sum donation of $10,000. You'd get a charitable deduction for the year the assets go into the DAF. If you donate appreciated assets held longer than one year, your deduction usually will be the assets' fair market value.

The DAF typically will create an account in your name after it has received your initial contribution. Then, the DAF will sell the donated assets, owe no tax, and put the cash into your account. Subsequently, you can request the DAF to make "grants" to specified charities from your account. For multiple donations of appreciated securities, using a DAF will simplify the process