'Tis Better to Give—and Here's How

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Charitable giving seems to be in the American DNA. In recent years, Charitable Gift Funds, also known as Donor-Advised Funds, have become an increasingly popular gifting vehicle. Fidelity's charitable gift fund is now the second-largest public charity in the U.S., after the United Way. Still, only about five percent of all charitable giving takes place through a gift fund. Take a look and see if they're right for you.

Charitable Gift Funds are typically sponsored by big brokerage firms, such as Fidelity, Schwab, and Vanguard. They are also sponsored by community funds, and sometimes by special interest groups. A donor can establish an account, transfer cash or assets into it, and get an immediate tax deduction. The gifts to charity can come over time. Let's unpack this.

After the donor sets up an account (minimum account size can vary, typically $5,000 on up), he can fund it with cash, with appreciated stock, or sometimes with non-traditional assets. These can range from gold coins to closely-held stock, depending on what the brokerage firm is willing to accept. For most donors, the best bet is to donate appreciated stock. Not only can you deduct the value of what you donate, but you totally avoid paying tax on the stock's appreciation. That transfer is irrevocable—you cannot change your mind and get your money back.

Typically, the assets are sold and the account invested in mutual funds of the donor's choosing. Any post-donation growth is totally tax-free, albeit not deductible by the donor (or taxable to him). The donor then advises the fund to make cash gifts to charity. Legally, the donor cannot mandate a gift, but so long as the recipient is a recognized charity, the brokerage firm will make it. There is no additional deduction when the gift is made to charity; most charities' thank you letters make it clear the gift is from a gift fund.

Making gifts this way has multiple benefits. First, your accountant will love you. With a gift fund, you can have as little as one charitable deduction a year; the record-keeping is far simpler. Second, many smaller charities cannot accept stock donations; the gift fund turns your stock donation into the charity's cash gift. Third, you can make gifts as small as $50 (many brokerage firms have a higher minimum gift). This makes gift funds ideal for those numerous, smaller gifts where a stock transfer would simply be unworkable. Fourth, if you manage your gift fund online, it knows what charities you give to—and when. You won't be scratching your head wondering if this is the third time in a year you gave to the same charity, or if you haven't given in 18 months. Finally, gifts can be anonymous if you choose. This cuts down on repeat solicitations for charities you intend to give to only once.

Alternatively, you can name your gift fund after your family and have the gifts so designated, much as private family foundations do.

Gift funds are also useful if you have a big income spike. You can transfer stock to the fund to reduce your income without making direct charitable gifts so large you won't be able to repeat them.

There are a few basic guidelines to keep in mind when using a gift fund. First, if you donate appreciated stock, you must have held it for more than a year to be able to deduct the fair market value. If you have held the stock less than a year, you can only deduct your cost basis. It makes no sense to donate stock that has depreciated in value—instead, sell it, take the capital loss, and donate the cash (or some other appreciated stock).

Gifts out to charity must be outright gifts—you can't use a gift fund to buy tickets to a fundraiser, or for any other transfer where you receive some benefit in return.

If you give stock rather than cash, your tax donation is capped at 30 percent of your adjusted gross income. Admittedly, that isn't an issue for most of us. If the value of your gift exceeds that amount, the unused charitable deduction carries forward to future years.

Be aware that the ability of certain, higher-income taxpayers to take that charitable deduction is reduced. Once a married couple has income exceeding $305,050[1], or a single taxpayer has income exceeding $254,200, itemized deductions are reduced by three percent of the excess over that base. This reduction has no effect on the amount of capital gains tax avoided by donating appreciated stock to a gift fund. In fact, it makes the stock donation more compelling, because by avoiding capital gains tax, the donor effectively reduces his income. Additionally compelling, donors with this level of income are also subject to the Obamacare 2.9 percent surcharge on capital gains; stock gifts to a gift fund (or to any charity) avoid that as well.

Before you open up that Charitable Gift Fund, do read the fine print. Different sponsors have different internal rules—the minimum account size can differ, the minimum charitable gift can differ, the number of gifts a donor designates each year can differ, and of course, the internal fees on the funds will definitely differ. The rules will also likely differ as to what happens to your gift fund when you die. Typically, you can choose between making final gifts that empty the fund, appointing successor owners (a way to involve your children), or some combination of the two. Be certain your gift fund sponsor fits your charitable giving style.

The ability to designate family members as successor owners can make the gift fund function much like a private foundation. However, a private foundation comes with significant expenses and regulatory oversight. Most trusts and estates attorney don't recommend setting one up for less than $5 million—some set the threshold as high as $20 million. Using a Charitable Gift Fund gets you most of the advantage of a private foundation at a far smaller cost.

[1] These dollar amounts adjust each year by inflation.