As we approach year end and review our annual giving, learn how to avoid capital gains tax with charitable giving. This can make a far greater impact than simply writing a check. If you own stocks, mutual funds, or other investments that have increased substantially in value, giving appreciated securities directly to charity may provide significantly greater tax benefits than making the same gift in cash.

How to Avoid Capital Gains Tax with Charitable Giving

If you sell appreciated securities, the difference between the sale price and your cost basis is generally subject to capital gains tax. Depending upon your circumstances, the gain may also be subject to the 3.8% net investment income tax and applicable state income taxes.

By contrast, when you donate appreciated securities that have been held for more than one year directly to a qualifying public charity, you generally do not recognize the capital gain. In addition, subject to the applicable charitable deduction limitations, you may generally claim an income-tax deduction based upon the fair market value of the securities on the date of the gift.

Simple Steps to Avoid Capital Gains Tax with Charitable Giving

Consider a simple example. Mary purchased stock several years ago for $20,000. The stock is now worth $100,000, meaning that it contains $80,000 of unrealized appreciation. Mary would like to make a $100,000 charitable gift.

If Mary sells the stock and contributes the resulting cash, the sale generally triggers recognition of the $80,000 capital gain. Part of the value of the investment may therefore be lost to federal and possibly state taxes before the charitable gift is made.

Instead, Mary could transfer the stock directly to the charity. Mary generally recognizes no capital gain on the transfer (assuming the applicable requirements are satisfied). Generally, she will be entitled to a charitable deduction based upon the stock's $100,000 fair market value. The charity, because of its tax-exempt status, can generally sell the securities without incurring the capital gains tax that Mary would have incurred. Thus, the full $100,000 value can be devoted to the charitable purpose.

Strategic Benefits: Portfolio Diversification and Donor-Advised Funds

Gifting appreciated securities can also be an effective investment-planning technique. An investor with a concentrated position in highly appreciated stock can use charitable giving to reduce that concentration without first recognizing the embedded capital gain. Cash that otherwise would have been given to charity can then remain available for investment in a more diversified portfolio, potentially with a higher cost basis.

A donor-advised fund can provide additional flexibility. You may contribute appreciated securities to the fund, potentially receive the charitable deduction in the year of contribution, and then recommend grants to individual charities over a period of years.

Before making a significant charitable gift in cash, it is worth considering whether appreciated securities might be a more tax-efficient source for the gift. The precise tax consequences depend upon your particular circumstances. This includes holding period, adjusted gross income, the type of property contributed, and the organization receiving the gift. For donors over age 701/2 with funds in an IRA, a Qualified Charitable Distribution (QCD) may also present an

attractive gifting vehicle. Coordinate significant gifts with your tax, financial, and legal advisors.

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