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Four Often Overlooked Tax Strategies for Charitable Contributions

An Exclusive Special Report from
BradfordTaxInstitute.com

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Make the RMD from Your Traditional IRA Tax-Free

Traditional IRAs offer a number of appealing benefits, including a tax deduction when you put your money in.

But once you reach a certain age, starting from the following April 1st, it’s time to pay the piper in the form of required minimum distributions (RMDs).

The chart below gives you the age when you have to start taking RMDs[1]

Your Birth Year	Your Mandatory RMD Age
1950 or earlier	72 (70.5 for those who turned 70.5 before 2020)
1951-1959	73
1960 or later	75

Whether or not you want or need the money right then, the law requires you to take out a certain amount each year and pay taxes on it.

To make sure you honor your RMD requirement, the tax law levies a 50 percent penalty on the amount you were required to withdraw but failed to withdraw. That’s an attention-getting penalty.

Escape Route

After you reach the RMD age, the tax code allows you to donate directly from your IRA account up to $100,000 per year in qualified charitable distributions (QCDs).

- The QCD donated money escapes income taxes and also does not count as adjusted gross income (AGI).[2]
- The QCDs can satisfy all or part of your RMD requirement.[3]
- The QCD doesn’t bump up against the 50-percent-of-AGI ceiling[4] that applies to cash donations.[5]

Planning 101 for RMDs

You likely will want to use the plan in this article if you donate money to your church, a school, or some other 501(c)(3) organization, such as the Red Cross or American Cancer Society.

Rule 1. You must make your QCD donation to a qualifying 501(c)(3) organization, such as your church, a school, or the Red Cross.[6] Your QCD cannot go to a private foundation, a donor-advised fund, or a charitable supporting organization.[7]

Rule 2. Don't touch the money. The trustee must make the check or transfer payable to the charity (not to you).[8]

Big Benefits

Double dip. You get a double-dip benefit when you don't itemize deductions and you contribute directly from your IRA to a charity.

- First, you get the benefit of the standard deduction.
- Second, you get the benefit of the direct charitable contribution deduction because it cancels your RMD income, making the RMD tax-free.

To put this another way, with the IRA-to-charity contribution, you (the non-itemizing taxpayer) create a deduction where none existed before. And because of the Tax Cuts and Jobs Act, you are less likely to itemize these days.

Save on Medicare premiums. The government bases the Medicare premiums that you pay on the AGI reported on your tax returns two years ago (e.g., your 2023 payments are based on your 2021 tax return). To see how you can save, consider this:

- If you take the IRA money directly, it adds to your AGI, which can increase your Medicare premium costs in 2023.
- If you use the QCD method, you add nothing to your AGI.

Pay less tax on your Social Security benefits. Before 1984, you paid no income taxes on your Social Security benefits. Today, you have to add together your AGI, your tax-exempt income, and half of your Social Security benefits, and then pay taxes at your regular tax rate on:[9]

- 50 percent of the Social Security benefit on the computed amount if that computed amount is between $25,000 and $34,000 ($32,000 and $44,000 on joint returns), and
- 85 percent of the Social Security benefit on the computed amount that exceeds $34,000 ($44,000 for joint returns).

The taxable RMD adds to your AGI and can make more of your Social Security benefits taxable.

Solution. Avoid the RMD taxable income inclusion with the direct IRA-to-charity donation, and that, in turn, can cut the taxes you are paying on your Social Security benefits.

Shrink the net investment income tax (NIIT). You pay the 3.8 percent NIIT on investment income when your modified AGI is greater than $200,000 ($250,000 for joint returns).[10]

Would your required IRA RMD make you subject to this tax? If so, consider making the RMD disappear with the direct IRA-to-charity strategy.

Don't Do the QCD with a Roth IRA

There is no legal prohibition on funneling Roth IRA amounts to a charity, but there's no tax advantage for doing so.

You have no tax-law reason to take the money. For example, the Roth IRA has no RMD requirement.[11]

But you also have no reason not to take the money. You put the money into the Roth IRA post-tax. The rules of the Roth IRA allow you to withdraw the money tax-free when you are over age 59 1/2 and satisfy the five-year waiting period.[12]

Takeaways

As you see in this article, the RMD that arrives as taxable income on your Form 1040 can do more tax damage than you would first think.

If you currently give money to a church, a school, or other 501(c)(3) charity, use a QCD donation from your traditional IRA to

- make your RMD tax-free,
- avoid the 50 percent limit on donating to charities,
- reduce your Medicare premiums,
- cut the income taxes you pay on your Social Security benefits, and
- shrink your NIIT taxes.

In many of these circumstances, your wallet is talking to you and telling you to use the QCD donation strategy.

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[1] Pub. L. No. 117-328, SECURE 2.0 Act of 2022, Section 302(b), p. 831.

[2] IRC Section 408(d)(8).

[3] https://www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-iras-distributions-withdrawals

[4] IRC Section 170(b)(1)(A).

[5] IRC Section 408(d)(8).

[6] Id.; IRC Section 170(b)(1)(A).

[7] Id.

[8] Notice 2007-7, Q&A 41; IRC Section 408(d)(8)(B)(i).

[9] IRC Section 86.

[10] IRC Section 1411(b).

[11] Reg. Section 1.408A-6 (Q&A 14).

[12] IRC Section 408A(d)(2)(B) 2018.

Don’t Waste Donations on Your Church or Charity; Use Your Business

The Tax Cuts and Jobs Act (TCJA) made it harder to benefit from your donations.

Let’s say you donate $10,000 to a church, school, or other 501(c)(3) charity:

1. Will you get a tax deduction—in other words, will you itemize?
2. Will you benefit from the entire $10,000 as an itemized deduction? In other words, did the $10,000 simply put you over the hump that beat the standard deduction?
3. Say you can deduct all $10,000 as an itemized deduction. Would making it a business deduction increase the tax benefit value to you?

The TCJA made two big changes that make it less likely that you will itemize. First, the TCJA set a $10,000 limit on your state and local income and property tax deductions. Second, it increased the 2023 standard deductions (adjusted for inflation) to[1]

- $13,850 for individuals, and
- $27,700 for married couples filing jointly.

Even if you make a big donation, think about the problem this creates—suppose you are married and donate $17,000 to charity. If this is your only itemized deduction, your donation does you no good because it’s less than $27,700.

Fortunately, there’s a much more tax savvy way to give.

As a business owner, you can make a few modifications and convert your church, school, and other 501(c)(3) donations to a different type of deduction—an ordinary business expense—which, as you’ll see below, increases the tax savings that land in your pocket year after year.

Why the Business Deduction Is Better

When you deduct a contribution to charity as a business expense, the deduction goes on your Form 1040, Schedule C, or corporate tax return (if you operate your business as a corporation).

Let’s say you operate as a Schedule C taxpayer and the business expense goes on your Form 1040, Schedule C. This is nice because:

- It reduces both (a) self-employment and (b) income taxes. (If you itemize, personal charitable deductions reduce only income tax.)

- It reduces your adjusted gross income (AGI). This is important because the more you reduce your AGI, the more you benefit from other non-business tax deductions and credits you might be able to utilize.

Example. Suppose you earn $115,000 and you give $10,000 to charity as a business deduction. This reduces both your

- self-employment tax, and
- income tax.

In addition, the reduction in your AGI could increase your tax savings for other deductions and credits, depending on your family size and investment strategies.

You also achieve superior results if you operate as a C corporation or an S corporation and claim a business deduction for the money given to charity.

Business Deductions for Charitable Contributions

Now that you've had a glimpse at the tax savings you can generate through this strategy, it's time to find out how it works.

You convert a charitable contribution into a business expense by making the contribution a promotion or advertisement for your business.

You might think—wait, that sounds a little tacky. Don't worry. If you would prefer not to call attention to yourself when you give to charity, there are ways you can use this strategy and still donate fairly discreetly.

Here's how tax law states the rule: Treat a contribution to a charitable organization as a business expense if the contribution is both[2]

1. directly related to your business, and
2. made with a reasonable expectation of a commensurate economic return. In other words, if you contribute $10,000 to a charity, you expect to generate at least $10,000 of business because of this contribution.

Note. Your donations to charity don't have to actually generate that much revenue—but you must have a reasonable expectation that they will generate that much revenue for you.

Strategy 1—Use the Donation as an Advertisement

One strategy is to use your donation as a way to attract customers to come to your business in the future.

For example, in the *Marcell* case, the owner of a trucking company contributed cash to a hospital because he wanted to impress the chairman of the charity drive, who was a potential customer.

The court found that Philip Marcell had a reasonable expectation for a commensurate return on his donation and treated the contribution as a business expense.[3]

Example. You hold a fundraiser for a charity. You pay for the location, food, and print materials. During the event, you make it known that you are a sponsor and you give a short talk about how your services can benefit the attendees of the event. This is a business expense and you can deduct the costs of holding the fundraiser.

Strategy 2—Give a Portion of the Sales Proceeds to Charity

A second strategy is to tell customers that you will donate a portion of your sales proceeds to charity. This encourages customers to buy your products because they know they are supporting a good cause.

Example. ABC Company attaches rebate slips to some of its products that it sells to customers. The customers can then present the rebate slips to the charity, at which point ABC Company pays the charity the amount listed on the slip.

In a revenue ruling, the IRS held that the payments from ABC Company to the charities in this example are business expenses.[4]

Strategy 3—Follow the Stockbroker Strategy

In Revenue Ruling 72-314, the IRS ruled that the stockbroker corporation that paid 6 percent of its brokerage commissions to the neighborhood charity could deduct the payments as business expenses because

- its office was located in the neighborhood;
- it made the payments to promote its brokerage, which was located in the neighborhood; and
- it made the payments to separate itself from and compete with brokerage firms located in more established financial neighborhoods of the city.

The neighborhood charity's purpose was to reduce neighborhood tensions and combat neighborhood deterioration.

The stockbroker operated as a corporation and wanted to avoid the 5 percent limit on corporate charitable deductions. With this ruling, the IRS declared all of the stockbroker's payments to the charity were deductible as advertising expenses.

In this ruling, the IRS emphasized the promotion aspects of the payments, including the following:

- The brokerage got the charity to agree to advertise the arrangement.
- The advertisements told prospects that doing business with the brokerage put money into the neighborhood at no cost to the customer.

- There was a reasonable expectation that the arrangement with the charity would direct new business to the brokerage and help retain existing business.

Strategy 4—Coupons

The strategy here is different from Strategy 2 but along the same lines.

To stimulate business, the sole owner of a corporation attached a coupon to his corporation's products. The coupon stipulated that the customer could trigger a contribution to one of the listed charities by buying the product and sending the coupon to the charity.

When the charity received the coupon, it contacted the owner, who then wrote a check to the charity to redeem the coupon.

In Revenue Ruling 55-514, the IRS ruled that this owner could deduct as business expenses the monies he paid to charities to redeem the coupons issued by his corporation on the sale of its products.[5]

Planning note. Make sure that the business is writing the checks directly to the charities.[6]

Building better records. If you operate your business as a proprietorship, you should have a separate business checking account for the proprietorship. You are best served with the separate account even when you operate the proprietorship in your personal name.

Consider the IRS. A separate checking account makes your business feel and look like a separate entity from you, the individual.

Strategy 5—Rebate Strategy

Sarah Marquis, a sole-proprietor travel agent, made payments to charities on the basis of business they did with her. She had 30 charities as clients, and those 30 charities accounted for 57 percent of her business.

Rather than promote the business using salespeople, as her competitors did, Marquis used a cash rebate that she arranged either in person or over the phone. The rebate was tied to the business or expected business from the charity. In deciding on the amount of the rebate, Marquis considered

- the type and amount of travel business from the client;
- the nature of the recipient (i.e., group, conference, referral source);
- the profitability of the business; and
- the likelihood of ongoing business with the recipient.

Marquis wrote the check from her business account and enclosed a message to the effect that the payment was in lieu of a salesperson's visit and that Marquis appreciated the business.

With one exception, the religious organizations were denominations different than Marquis' own. Further, Marquis made charitable-deduction payments to her church separate and apart from the business payments.

In this case, the court ruled that Marquis could deduct the payments that she made to the religious organizations as business expenses.[7]

More Things to Know

The IRS says that you can deduct payments to charity as[8]

- **charitable contributions** if they are completely gratuitous, or
- **business expenses** if they bear a direct relationship to your business and you make them with a reasonable expectation of financial return commensurate with the amount paid.

Definition of charitable contribution. According to the IRS, a "charitable contribution" is a voluntary transfer of money or property made by the transferor without receipt or expectation of financial or economic benefit.[9]

If the transferor receives, or can reasonably expect to receive, sufficiently substantial financial or economic benefits in excess of those that would accrue to the general public, the transfer is not a charitable deduction.[10]

Be Overt

Here's a failure.

Closely held Hartless Linen Service Co. sent checks to 86 Christian Science churches with a note that stated the following:

- Use this money to give more lectures.
- We advertise in the Christian Science Monitor.
- We would appreciate being informed of any prospects in your area who would be interested in our services.

In court, Robert B. Hartless, the sole owner of the corporation, testified that he could not demonstrate that his new Christian Science customers were the result of his donation letter or that they came to his corporation as a result of the advertisements in the Christian Science Monitor. On the basis of this testimony, the court ruled that the payments to the 86 churches were charitable contributions and not business expenses.[11]

Hartless Linen failed to qualify the payments as business expenses for two reasons. First, the corporation did not make clear to the churches that it wanted business. Second, the corporation got business but could not prove where the business came from.

Hartless may have fared better had it used the coupon strategy and reimbursed the 86 churches for each referral. The coupon would help prove commercial intent and would allow tracking to the referring church and perhaps even the name of the church member who made the referral.

If you decide to make business contributions to charity, make sure your proof will stand up to scrutiny. With the knowledge you have gained here, you know how to do this and you know it's not difficult.

Takeaways

It's a win-win situation when you qualify to treat your monies paid to a church, school, or other 501(c)(3) charity as a business expense: the charity gets the money and you increase your tax savings over what you achieve with a personal, itemized charitable deduction.

The additional tax breaks give you a bigger incentive to help the church, school, or other 501(c)(3) charity. In fact, you can contribute more to such institutions without hurting yourself financially.

To turn a charitable donation into a business expense, you have to promote your business. In one way or another, you need to prove that your strategy has as its purpose attracting customers and revenue for your business.

The tax law rule is that your donation must

- have a direct relationship to your business, and
- create a reasonable expectation for a commensurate economic return.

Make a record that shows the activity and monies spent, and document why you expect the expenditures to create and sustain business. For good measure, include dollar estimates that show your estimated return on investment.

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[1] Rev. Proc. 2019-44.

[2] Reg. Section 1.170A-1(j)(4); *United States v The Jefferson Mills, Inc.*, 367 F.2d 392.

[3] *Marcell v United States*, 8 AFTR 2d 5344.

[4] Rev. Rul. 72-314.

[5] Rev. Rul. 55-514.

[6] Rev. Rul. 63-73.

[7] Sarah Marquis, 49 T.C. 695 (1968).

[8] Rev. Rul. 77-124 explanation of Rev. Rul. 72-314; IRC § 162(a); IRC § 170; Reg. §§ 1.170A-1(c)(5), (h)(4).

[9] Rev. Rul. 76-257.

[10] United States v Transamerica Corp., 392 F. 2d 522 (9th Cir. 1968); Singer Co. v. United States, 449 F. 2d 413 (Ct. Cl. 1971). See also Rev. Rul. 68-607 and Rev. Rul. 73-113.

[11] Hartless Linen Service Co., 32 T.C. 1026.

Donor-Advised Funds: A Tax Planning Tool for Church and Charity Donations

Do you give money to your church?

Do you get a tax benefit from those donations?

How about your donations to other charities?

Recent changes in the tax code have done much to destroy your benefits from church and other tax-deductible 501(c)(3) donations. But there's a way to donate the way you want, get revenge on the tax code, and realize the tax benefits you deserve.

This get-even tool is the donor-advised fund, an increasingly popular way to donate to your church and other 501(c)(3) organizations. Indeed, donor-advised funds have exploded over the past few years, with over one million donor-advised fund accounts in existence as of 2020.[1]

If you're charitably inclined, there are many benefits to donor-advised funds and few drawbacks, as you will see in this article.

What Is a Donor-Advised Fund?

A donor-advised fund is not a separate charitable entity. It is a charitable giving account you establish with a "sponsoring organization," which must be a Section 501(c)(3) organization.[2] (This differs from a private foundation, which is a separate legal entity established and controlled by its founders—and is much more complex and expensive to establish and administer.)

With a donor-advised fund, you make a charitable gift of cash or property to an account maintained by the fund. The fund—not you—owns and controls the assets in the account. But you control to whom and when the fund disburses the money.

Big picture. You donate $100,000 to the fund today. You get the $100,000 deduction now. From the fund, you donate $10,000 a year to your church (probably more as your money in the fund grows tax-free).

You Don't Need to be Rich to Have a Donor-Advised Fund Account

Anyone can open a donor-advised fund account, and you don't have to be rich to do so. Depending on the sponsor, the required minimum initial contribution to establish a donor-advised fund account typically ranges from $1,000 to $25,000. But some donor-advised funds—including Fidelity Charitable, the nation's largest donor-advised fund—have no minimum initial contribution requirement at all.

In contrast, given the costs involved, experts say you need at least a $10 million to $15 million contribution to make a family charitable foundation worthwhile.

It's Easy

It's easy to establish a donor-advised fund account. You choose a charitable sponsor, complete an application (ordinarily online), and make your initial contribution. You also get to name your donor-advised fund account.

The donor-advised fund sponsor takes care of all the recordkeeping and account administration. Most donor-advised fund sponsors charge nothing to set up your donor-advised fund account, but they do charge administrative and money management fees.

There are hundreds of public charities, including some churches, that sponsor donor-advised funds.

National investment firms such as Fidelity, Schwab, and Vanguard have all created donor-advised funds. These "commercial" donor-advised funds hire an affiliated for-profit investment firm to manage the assets in the accounts for a fee that varies based on the account balance.

You can also establish a donor-advised fund account with a community foundation that has a local orientation; a single-issue non-profit, such as a university or an environmental charity like the Sierra Club; or an independent, non-commercial organization such as the American Endowment Foundation, National Philanthropic Trust, or United Charitable.

Donor-advised fund sponsors have differing policies as to what type of property they accept, how they will invest it, and how they will distribute it. Their fees differ as well. It pays to shop around.

You Can Contribute Money or Property to a Donor-Advised Fund

You can always donate cash, including money in IRAs and 401(k)s, to your donor-advised fund account. But many donor-advised funds also accept non-cash donations, including

- stocks, bonds, and mutual fund shares,
- real estate,
- privately owned company stock,
- LLC and limited partnership interests,
- Bitcoin and other cryptocurrency, and
- life insurance.

Whether you contribute money or property to a donor-advised fund, your contribution is an irrevocable charitable gift. The sponsoring charity now owns the gifted assets, and you can never get them back. The donor-advised fund must give you written acknowledgment of this fact.[3]

If you donate property such as private company stock, real estate, or Bitcoin with a value over $5,000, you need to get an appraisal. This is not required for publicly traded stock or other securities.[4]

Donating stock or mutual fund shares that have appreciated is a great tax strategy. Here's why:

- If you owned the stock for more than one year, you get a deduction equal to its fair market value at the time of the donation.
- And you don't pay any capital gains tax on the appreciated value of the stock.[5]

The donor-advised fund will never owe that capital gains tax either, if it later sells the stock.

Example 1. Darius owns $1,000 shares of Evergreen stock that's publicly traded on NASDAQ. He paid $10,000 for the stock back in 2010, and the shares are worth $100,000 today.

He establishes a donor-advised fund in 2022 and donates the stock.

- He gets a $100,000 charitable deduction for 2022.
- He pays no federal tax on his $90,000 gain.

Contributing stock to donor-advised funds is very popular. Fidelity Charitable reports that 57 percent of all contributions to its donor-advised fund accounts in 2020 were in the form of publicly traded securities.[6]

Donor-Advised Fund Contributions Are Flexible

After making the initial contribution, you have near total flexibility on how much to contribute to your donor-advised fund in future years. There is no legal requirement that you make any additional donations after you establish a donor-advised fund. You can donate as much or as little as you want each year. Most donor-advised funds do not have annual minimum contribution requirements.

Donor-Advised Fund Contributions Are Fully Deductible the Year They Are Made

A contribution to a donor-advised fund account is treated much the same as a donation to your church, a school, or other 501(c)(3) organizations. It is deductible in the year made.[7]

But there is an annual limit on how much you can deduct for all your contributions to charity, whether through a donor-advised fund or otherwise. For 2022, the limits are as follows:[8]

- For **cash contributions**, the limit is 60 percent of your adjusted gross income.
- For **property contributions**, such as corporate stock, it's 30 percent of your adjusted gross income.

You may carry excess contributions forward until they're used, but not for longer than five years.

Donor-Advised Funds Can Help You Bunch Your Charitable Contributions

You are able to deduct your charitable contributions only if you itemize your personal deductions on your tax return instead of taking the standard deduction. The Tax Cuts and Jobs Act roughly doubled the standard deduction in 2018.

For 2022, the standard deduction stands at $25,900 for marrieds and $12,950 for singles.[9] As a result, few taxpayers itemize—only about 11 percent. Thus, few taxpayers are able to deduct their charitable deductions.

One way to deduct charitable contributions if you don't have a lot of other personal deductions is to bunch them into a single year instead of making them over several years. This will give you enough personal deductions to itemize in the bunch year. You don't need a donor-advised fund account to do this, but the fund certainly makes it easier.

Example 2. Doug and Darla are a married couple who ordinarily take the standard deduction because their total personal deductions (mortgage interest, state taxes, medical expenses) are no more than $20,000 per year.

They plan to donate $5,000 to their church each year over the next five years. If they do so, they won't be able to deduct their contributions because their personal deductions will amount to less than the standard deduction.

Instead, they establish a donor-advised fund account and donate $25,000 in 2022, and then plan to donate nothing to the fund for the next four years.

Their 2022 personal deductions are now $45,000, and they are able to itemize and deduct their charitable contribution. They need not choose in 2022 how to gift the $25,000 they contributed to their donor-advised fund account. They can take their time and decide how to donate the money over the next one, five, or more years.

Donor-Advised Funds Help with Economic Windfalls

A donor-advised fund account can be very helpful if you come into a large sum of taxable money in a single year and enter an especially high tax bracket—for example, when you sell your business or enjoy substantial investment returns. You can establish a donor-advised fund, deduct the full amount of your contribution that year at your high tax rate, and then distribute the money to charity over any number of future years.

Example 3. Andrew and Alicia, a married couple, sell their business for a $1 million profit in 2022.

They establish a donor-advised fund account and contribute $200,000. They deduct the full $200,000 in 2022, saving them about $90,000 in federal and state income tax.

They plan to use the money in their donor-advised fund account to give $20,000 to charity each year over the next 10 years.

You and Your Sponsor Make Investment and Grant Decisions

The assets in a donor-advised fund account are owned and controlled by the charitable sponsor, who makes the final decision on how they are invested and distributed as grants to charity.

But you have advisory privileges over the investment and distribution of the account assets. The charitable sponsor will usually honor your grant recommendations so long as the grants are given to qualified 501(c)(3) charities.

You can use your donor-advised fund account to contribute to any number of charities each year, or to make recurring grants to a single charity over multiple years. Your donor-advised fund sponsor can help advise you about how best to utilize the assets in your account.

As you would expect, you can’t use the assets in a donor-advised fund account to benefit you or your relatives personally.

For example, you can’t use money in your account to pay for tickets to attend a charity-sponsored event.[10] If you want to receive goods or services (such as tickets) offered by a charity in exchange for a contribution, you should make the contribution from other funds.

Donor-Advised Fund Assets Need Not be Distributed Each Year

There is no legal requirement to distribute to charity any of the money or other property held in a donor-advised fund account. Theoretically, you can donate money to a donor-advised fund account and never distribute it to any charity.

But some charitable sponsors do require a minimum amount to be distributed over a specified number of years. Fidelity Charitable reports that three-quarters of contributions placed in its donor-advised fund accounts are distributed as grants within five years.[11]

Donor-Advised Funds Are Not Subject to Estate Tax

Assets in a donor-advised fund account are not subject to estate tax. This is because your estate doesn’t own them—they are owned by the sponsoring charity. Of course, this is important only if your estate is large enough to be subject to estate tax. For 2022, the federal estate tax applies only to estates over $12.06 million.[12] A few states impose taxes on smaller estates.

Donor-advised fund accounts can continue perpetually.

When you establish your donor-advised fund account (or after you have created it), you can name a successor who will take over making grant recommendations after you die.

Takeaways

Here are four takeaways from this article.

1. A donor-advised fund is a charitable giving account established with a tax-defined charitable sponsor. You find such funds at Fidelity, Schwab, and other investment houses, along with some national Section 501(c)(3) organizations such as the Red Cross.
2. The money or property donated to a donor-advised fund account is owned and controlled by the charitable sponsor, not you (the giver). But you generally direct the distribution of the funds from general accounts such as those at Fidelity to your church, a school, or other local or national 501(c)(3) organizations.
3. Donor-advised fund account contributions are deductible in the year they're made, up to annual charitable contribution limits. There is no legal requirement to donate a minimum amount to a donor-advised fund in any year after the account is established.
4. The assets in a donor-advised fund account grow tax-free until they are distributed as grants to charity, but there is no legal requirement that a minimum amount be distributed in any year. This enables you to obtain an immediate tax deduction for your donor-advised fund contributions while spreading your gifts to your church and other 501(c)(3) charities over many years.

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[1] National Philanthropic Trust, *The 2021 Donor Advised Fund Report*.

[2] IRC Section 4966(d)(1).

[3] IRC Section 170(f)(18)(B).

[4] IRS Publication 526, Charitable Contributions (2021), dated Feb. 24, 2022, p. 21.

[5] Ibid., p. 12.

[6] Fidelity Charitable, *2021 Giving Report*, p. 5.

[7] IRC Section 170(f)(18).

[8] IRC Section 170(b); IRS Publication 526, Charitable Contributions (2021), dated Feb. 24, 2022, ps. 15-16.

[9] Rev. Proc. 2021-45.

[10] IRS Notice 2017-73.

[11] Fidelity Charitable, *2021 Giving Report*, p. 5.

[12] Ibid.

Use a Conservation Easement Donation to Create a Big 199A Deduction

Does your out-of-favor specified service business give you a zero Section 199A tax deduction because your taxable income is more than[1]

- $464,200 on a joint return or
- $232,100 on all other returns?

Whether or not you have an out-of-favor business, you qualify for the full 20 percent Section 199A deduction if your taxable income is equal to or less than[2]

- $364,200 on a joint return or
- $182,100 on all other returns.

Example. You are in an out-of-favor specified service business. You are married and have taxable income after itemized deductions of $600,000.

You invest $120,000 in a qualified conservation easement that produces a charitable tax deduction of $285,000. Now your taxable income is $315,000 and your 20 percent Section 199A tax deduction is $63,000.

Observations

You likely noticed that you invested $120,000 to create a $285,000 tax deduction. Here's why that can work: When you donate a conservation easement to a qualified charity or government entity, you deduct "fair market value," not the amount you paid for the property.

To measure fair market value of a conservation easement, you generally compare the fair market value of the property before and after the granting of the easement.[3] The deduction for the fair market value is what makes the $120,000 investment produce a $285,000 tax deduction.

To put this in context, think of a charitable donation of publicly traded stock. Say you paid $1,000 for the stock several years ago and now donate it to a qualified charity when it trades on the stock exchange for $25,000. You have a $25,000 tax deduction.[4]

Conservation Easement 101

Lawmakers created a provision in the tax law allowing property owners to donate their development rights in property in exchange for a calculated fair market value charitable contribution deduction.[5]

The conservation easement is a land-preservation agreement between a landowner and a qualified land protection organization. The conservation easement is recorded on the property's deed, which provides for permanent preservation of the property through a development restriction.

To qualify for the tax deduction, the conservation easement must be exclusively for conservation purposes, which include[6]

- preservation of the land areas for outdoor recreation by or for the education of the general public;
- protection of a relatively natural habitat of fish, wildlife, or plants or a similar ecosystem;
- preservation of open space (including farmland and forest land) where the preservation is for the scenic enjoyment of the general public or pursuant to a governmental conservation policy and will yield a significant public benefit; or
- preservation of a historically important land area or a certified historic structure.

The conservation easement terms can include reservation of certain rights, provided they don't impair the conservation purposes. These can include recreation, hunting, timbering, and traditional agricultural uses.

The law limits your conservation easement charitable deduction to 50 percent of your adjusted gross income, but you can carry forward any unused amounts for up to 15 years.[7]

Your Options

You generally have three ways to get your conservation easement charitable deduction:

- You own a parcel of land and donate the development rights to that land to a qualified organization.
- You live in a historic district and donate the rights to alter the building façade to a qualified organization.[8]
- You invest in a real estate partnership that acquires land and donates the development rights to that land to a qualified organization.

For the real estate partnership strategy, you don't need the land or the building, you simply need the cash to invest. It works like this:

1. You invest cash in a partnership.
2. The partnership buys property.
3. The partnership donates the property's development rights.
4. The partnership passes the conservation easement charitable deduction to the partners on their Schedule K-1s.

Many reputable firms and conservation organizations facilitate these real estate partnerships so that investors can use their cash to both

- help preserve open space and
- gain a tax benefit from doing so.

Example

Let's walk through an example where the conservation easement strategy has a great outcome.

Paul and Sarah, a married couple, will have the following items on their 2022 tax return:

- Paul is an attorney with an S corporation. His reasonable compensation wage is $150,000 with pass-through income of $300,000.
- Sarah is an employee with wages of $100,000.
- They pay $30,000 in state and local taxes as well as $20,000 in mortgage interest.

Since Paul is an attorney (an out-of-favor specified service business), married, and will have taxable income above $464,200, he will lose his Section 199A deduction in full.

Based on this information and before they implement their conservation easement strategy, their total federal tax is $129,506, as shown below.

Wages - Sarah	$100,000
Wages - Paul	$150,000
Pass-Through Income	$300,000
Total Income	**$550,000**
Adjusted Gross Income	$550,000
Itemized Deductions	$30,000
Tentative Taxable Income	**$520,000**
Section 199A Deduction	$0
Taxable Income	**$520,000**
Tax	$129,506
AMT	$0
Total Income Tax	**$129,506**

Assume Paul and Sarah invest $50,000 cash in a conservation partnership and will receive a pass-through $220,000 conservation easement charitable deduction in 2022.

The conservation easement deduction reduces their total tax to $84,235, as shown below.

Wages - Sarah	$100,000
Wages - Paul	$150,000
Pass-Through Income	$300,000
Total Income	**$550,000**
Adjusted Gross Income	$550,000
Itemized Deductions	$250,000
Tentative Taxable Income	**$300,000**
Section 199A Deduction	$60,000
Taxable Income	**$240,000**
Tax	$45,271
AMT	$0
Total Income Tax	**$45,271**

Let's summarize Paul and Sarah's results from the conservation easement strategy:

- 100 percent restoration of their Section 199A deduction
- $84,225 total federal tax savings (cash in their pockets)
- 68.47 percent return on investment[9]

Don't Forget State Taxes

If your state provides a deduction for your conservation easement charitable contribution, then you'll have an even better outcome and a much higher return on investment.

Let's assume Paul and Sarah live in Montgomery County, Maryland, which allows the deduction:

- They'll have a state income tax reduction of $19,687.[10]
- Their return on investment will increase to 107.8 percent.[11]

Compliance Issues

The IRS recently made the use of a real estate partnership to facilitate a conservation easement charitable deduction a listed transaction in certain circumstances.[12] This requires:

- Filing of Form 8886, Reportable Transaction Disclosure Statement with the tax return.
- Full disclosure of the transaction details on the tax return.

You're probably concerned now that there's something wrong with this strategy because the IRS appears to be targeting it.

Don't worry—the strategy is sound if properly administered.

Certain promoters were not acting properly, causing some taxpayers to ultimately lose the deduction or get a substantially reduced deduction upon examination or litigation.

Key Point. Work only with reputable organizations that have a history of successful and legally proper conservation easement donations.

Takeaways

If you are in one of the out-of-favor specified service businesses, don't just give away your Section 199A pass-through deduction.

Take it back and get a huge tax reduction with a conservation easement charitable donation.

You can get your deduction by

- donating the development rights to land you own to a qualified organization,
- donating the rights to alter your building façade to a qualified organization, or
- investing in a real estate partnership that acquires land and donates the development rights to that land to a qualified organization.

And remember, if you work with a third party to facilitate your conservation easement donation, be sure that third party follows the law to the letter and that you are working only with a third party that has a solid track record in successful easement donations.

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[1] IRC Section 199A(d)(3).

[2] Ibid.

[3] Reg. Section 1.170A-14(h)(3).

[4] IRC Section 170(b).

[5] IRC Section 170(h).
[6] IRC Section 170(h)(4).

[7] IRC Section 170(b)(1)(E).

[8] IRC Section 170(h)(4)(B).

[9] The return on investment is $34,235 ($84,235 less $50,000 investment), and the return on investment percentage is 78.47% ($34,235 return over $50,000 investment).

[10] Assumes 5.75% state income tax rate and 3.2% local income tax rate on the $220,000 conservation easement charitable deduction.

[11] The return on investment is $53,922 ($103,922 less $50,000 investment), and the return on investment percentage is 107.8% ($53,922 return over $50,000 investment).

[12] IRS Notice 2017-10. The notice states that a listed transaction occurs when an investor receives promotional materials that offer prospective investors in a pass-through entity the possibility of a charitable contribution deduction that equals or exceeds an amount that is two and one-half times the amount of the investor's investment—that's 250 percent.

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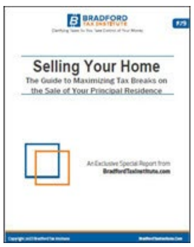

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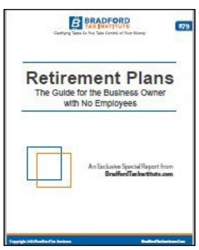

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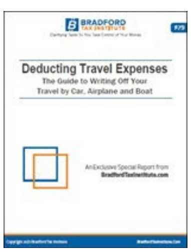

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