Independent Investor

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Making a Charitable Choice

The greatest benefit of charitable giving is the knowledge that you've made a positive contribution to others. At the same time, charitable giving can also provide tax breaks so long as you are aware of some rules and keep track of what you've donated.

Choosing a Charity

The first step is to identify an organization you wish to support. There are thousands of charitable organizations to choose from, supporting such causes as environmental protection, curing illness or improving the lives of children. Start by identifying what is most important to you.

Next, you will want to do some research. If you want to claim a tax deduction for your gift, you'll need to make sure that you are dealing with a registered charity to satisfy IRS rules. Your local Better Business Bureau (BBB) can provide information on charities.

Once you have a short list of registered organizations, contact each one and ask for a copy of its annual report. This report explains the charity's mission, lists its key personnel, and provides a breakdown of how donations are spent. Pay careful attention to marketing and administrative expenses, which can vary widely among organizations. You will probably want the majority of your money to go to those who need it. Keep in mind, however, that high expenses related to awareness campaigns are designed to educate the public and increase donations, so they might not be cause for concern.

The BBB Wise Giving Alliance also provides independent evaluations of popular charities. These reports are available online at www.give.org. You can also request written reports by writing to BBB Wise Giving Alliance, 4200 Wilson Boulevard, Suite 800, Arlington, VA 22203.

IRS Rules for Giving

You are free to give as much to charity as you like. However, you will need to follow IRS rules and keep records of your gifts to claim tax deductions. Monetary contributions are the easiest to report. Always pay by check and make the check payable directly to the charity. Ask for a receipt and save it along with your canceled check and your bank account statements.

A deduction is no longer allowed for monetary gifts unless accompanied by a bank record or a written receipt from the charity indicating the amount of the contribution, date of the donation and name of the charity. If your contribution exceeds $250, either in cash, certain property or out-of-pocket expenses that are attributable to volunteer work, you will also need to obtain a written description of your gift. This description must contain an acknowledgement from the charity of your contribution, a description of noncash items donated, a statement of whether the charity provided goods or services in exchange for the donation and—if goods or services were provided—a good-faith estimate of their value.

The IRS has ruled that the fair market value of goods and services should be deducted from any charitable contributions used to offset taxes. Keep in mind that fair market value may differ from what you pay for the goods or services offered. A good example of this is the popular practice of selling candy bars. As an example, say that you pay $2 for a candy bar to benefit a local school. The fair market value of the candy is actually $1 were you to purchase it at a local store. That $1 is deducted from your contribution, leaving you with a deduction of $1. To simplify your tax reporting, it might be best to turn down any goods or services of more than nominal value that a charity offers in exchange for your gift.

Noncash Gifts

To declare charitable gifts of certain noncash items worth more than $500 (such as used clothing or furniture), you must supply cost and acquisition information for the items given. When claiming single noncash gifts worth more than $5,000 (excluding publicly traded stock), you must include an appraisal of the gift's value with your tax return.

Two such gifts to carefully consider are used items and time. Items such as computers and clothing are subject to depreciation over time, so you won't be able to declare your purchase price as a deduction. Time spent volunteering typically isn't deductible; however, expenses associated with volunteering, such as transportation and materials, are deductible.

Appreciable Gifts Are Best

Items with the potential for appreciation are the best gifts for tax-conscious charitable givers. You can avoid capital gains taxes by donating assets that have appreciated in value. Outside of a charitable trust or foundation, this is one of the most effective ways to reduce taxes through charitable contributions. You can donate appreciated stock, artwork, antiques, collectibles or other noncash items as long as you have owned them for at least one year. You can deduct the full fair market value of the gift from your taxes, and any appreciation will escape taxation.

Consider selling appreciable assets you have owned for a year that have lost value, with the proceeds of the sale donated to charity. This allows you to remove the full fair market value of the assets from your taxes while still claiming a capital loss on the depreciation.

In addition to direct gifts to charity, other options include a charitable remainder or charitable lead trust or setting up a private foundation. However, complex rules govern the creation and maintenance of these vehicles. Thus, tax and legal advisors are necessary to determine if a trust or foundation is appropriate for your situation.

Charitable donations are an excellent way to reduce your taxes and make a difference in the lives of others. And while it's natural to consider charitable giving during the holidays or at tax time, it's also important to remember that the need to help others lasts year round.