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THE GOODMAN REPORT

Gifting Strategies to Charities and Loved Ones

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In addition to significant life events such as retirement, many people have a deep desire to provide financial support to their loved ones and to contribute to their favorite causes through charities. Strategic charitable giving and thoughtful gifting to loved ones offers opportunities to make a lasting impact on charitable causes and family legacies. If this is important to you, optimally navigating the intricacies of philanthropy is essential to ensuring that the gifts align with your financial goals and are tax efficient!

Giving to Charity

Before we get into discussing the different strategies, it is important to understand what qualifies as a gift for tax purposes. A gift only becomes a gift once the property or cash donation is delivered to the intended recipient, whether an individual or a charitable organization. Consequently, pledges and promissory notes are not typically considered gifts until they are fulfilled or paid. With this understanding, we can now proceed to discussing the first strategy, gifting to charities.

While direct cash donations are the most commonly used method for donating to charities, depending on your situation, there are other tax-advantageous strategies available that could be more beneficial. The first two charitable giving strategies that we will discuss are highly appreciated stock and donor-advised funds (DAF). These strategies will require you to itemize deductions to take advantage of the tax savings. So, the first step is to explore how to potentially itemize your deductions in a tax environment with such a large standard deduction. One way is to alternate which years you will take the standard deduction and itemized deduction by bunching itemized deductions such as property taxes, charitable donations, and health care expenses every other year. On the right, is an example of the tax benefit bunching can have for your itemized deductions. The client doubled their property tax payments and charitable donations in one year, allowing them to itemize and generate $2,486 of tax savings. Those additional dollars will allow you to give back even more in the long run!

Now that we have determined a strategy for itemizing, we can explore utilizing highly appreciated stock, DAFs, or a combination of both, for philanthropy.

Highly Appreciated Stock

A highly appreciated stock is one that has significantly increased in value over time. When you sell a highly appreciated stock, the capital gain will be subject to capital gains tax and can be a significant amount of money – eroding the value you can give away. However, there is an alternative! By donating all, or part, of the stock to a charity that accepts stock donations, you can avoid paying taxes on the gain that you would have realized if you had sold the stock. In return for your donation, you can receive an immediate income tax deduction based on the fair market value of the donated stock if the stock was held for more than one year in a taxable account, and you itemize deductions. If you donate highly appreciated stock that has been held for less than a year, the deduction will be limited to the stock's cost basis. Additionally, depending on the type of property and charity, the deduction will be capped at a percerntage of your adjusted gross income (AGI). If your donation exceeds this limit, you may carry over the excess amount for up to five years if you continue to itemize during that time. Generally, this strategy is best for people who are certain they will continue to itemize their deductions into the future.

Donor Advised Funds

Now, you may be asking yourself, what if my charity does not accept stock donations? If your charity of choice does not accept stock donations, there is another option available to you called a donor-advised fund (DAF). A DAF can also be utilized if you are not sure which charities you would like to donate to yet, or if your tax liability is expected to be high and you want to frontload your charitable donations instead of spreading them out over several years. A DAF is an investment account created specifically for the purpose of donating to your favorite

POTENTIAL TAX SAVINGS

	No Bunching	With Bunching	Tax Savings
Adjusted Gross Income	$200,000	$200,000	
Itemized/Standard Deductions			
Deductible Medical Expenses	$0	$0	
State Sales Tax	$2,000	$2,000	
Property Taxes ($10k SALT Cap)	$4,000	***$8,000***	
Mortgage Interest	$5,000	$5,000	
Charitable Contributions	$12,000	***$24,000***	
Total Itemized Deductions	$23,000	$39,000	
Standard Deduction (MFJ)	$27,700	$27,700	
Taxable Income	$172,300	$161,000	
Tax Liability	**$28,521**	**$26,035**	**$2,486**

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charities. You can fund the account using cash, securities, or other assets and receive an immediate income tax deduction in the year you make the contribution. The deduction for cash contributions is limited to 60% of your AGI, and the deduction for contributions of securities or other appreciated assets is limited to 30% of your AGI. Like the highly appreciated stock, contributions to the DAF exceeding those limits may be carried forward up to 5 years. Additionally, the assets contributed to the DAF will be removed from your estate and avoid probate. Donating highly appreciated stock and utilizing a DAF are both great strategies for those who can benefit from itemizing deductions; and if that's not you and you are at least 70 ½ years old, this next strategy may be right for you.

Qualified Charitable Distributions

Once you are 70 ½ or older, you are eligible to make Qualified Charitable Distributions (QCDs) from your IRA. QCDs are IRA distributions that are paid directly to a 501(c)3 organization of your choice. You are not allowed to make QCDs from employer plans such as 401(k)s or 403(b)s. Typically, distributions from Traditional/Rollover IRAs are taxable income and taxed at ordinary tax rates. However, if distributions are sent in the form of a QCD, the distribution will not be counted as taxable income and not taxed. Keep in mind that because the distribution is excluded from your taxable income, you will not receive an itemized deduction for your QCD. The 2023 annual QCD limit is $100,000. If you are married, each spouse can distribute up to $100,000 in QCDs from their respective IRAs. One benefit of making QCDs prior to Required Minimum Distribution (RMD) age is that you satisfy your charitable intent while lowering the balance of your IRA, which could lower your RMDs in the future. Once RMDs have started, QCDs may be used to offset your RMD.

Other Strategies

For more complex financial situations, it may be beneficial to consider establishing charitable trusts or a foundation to fulfill your charitable and legacy planning goals, but these do come with a higher cost. While providing an in-depth discussion is beyond the scope of this article, we will offer some information on these strategies. Let's start with charitable remainder trusts (CRTs). These are tax-exempt irrevocable trusts designed to receive a tax deduction in the year of funding. CRTs distribute income to the beneficiaries for a specific period and then donate the remaining trust amount to a designated charity or charities. Next, we have charitable lead trusts (CLTs). In contrast to CRTs, CLTs donate income from the trust to the designated charity or charities for a specified period. Afterward, the remaining balance is distributed to a non-charitable beneficiary, often a family member. Another option is a private foundation, which is a nonprofit organization established by an individual, family, or corporation. You can have an operating foundation, which runs the charitable activities or organizations, or a non-operating foundation, that simply disburses funds to other charitable organizations. Now that we have fully discussed multiple ways to meet your gifting goals for charities, we will discuss your options for gifting to loved ones during your lifetime.

Giving to Loved Ones During your Lifetime

The easiest and most common way to make a tax-free gift to loved ones during your lifetime is to utilize the annual federal gift tax exclusion amount. In 2023, the federal gift tax exclusion is $17,000 per individual and $34,000 per married couple. This amount may be gifted to an unlimited number of individuals each year. Another great way to help support loved ones is through direct payments for medical or education expenses. If the payments are made directly to the institution or provider, an unlimited amount may be paid on another's behalf and be considered a tax-free gift. If you want to make larger gifts beyond the annual exclusion, you will need to file a gift tax return (Form 709). Currently, the estate and gift tax unified exemption in 2023 is $12.92M per person. This exemption may be utilized during life by gifting above the annual exclusion or at death through your estate. Note, if gifting highly appreciated stock to an individual the cost basis and related tax implications carry over to that recipient. Instead, if they inherited those assets at death, they would receive a step up in basis, which can save a significant amount in capital gains taxes.

Giving from Your Estate

Lastly, we will discuss a few strategies for gifting to your loved ones and your favorite charities through your estate. The simplest way to leave assets to loved ones from your estate is by creating bequests in your will that detail who should receive specific assets and by naming those close to you as the beneficiary of your accounts and insurance policies. If you would like to have more control over the assets after death and provide potential protection from creditors, you can create a trust for your loved ones during your life or at death. Similarly, you can leave assets in your estate to a charity by designating a charitable donation in your will or living trust or naming a charity as the beneficiary of an account. Your estate is eligible to receive an estate tax reduction for this charitable gift. When leaving assets through your estate, you will want to make sure you consider your heirs' personal and financial situations when creating your estate plan. An example would be leaving more of the tax-advantageous assets to an heir that is in a higher tax bracket and the less tax-advantageous assets, like Traditional/ Rollover IRA assets, to heirs in lower tax brackets. Your estate is eligible to receive an estate tax reduction for this charitable gift. Another tax rule to be aware of is the Generation Skipping Transfer Tax. This tax may be due in addition to estate or gift tax when transferring assets to someone who is two or more generations from you.

In Closing

Effective charitable giving and gifting to loved ones requires careful consideration and strategic planning. From direct donations to advanced trust structures, financial advisors provide a wealth of expertise to guide individuals toward making meaningful contributions. By aligning philanthropic endeavors with overall financial goals, individuals can create a legacy that extends far beyond their lifetime, leaving a lasting impact on both charitable causes and their cherished loved ones. If you are interested in learning more about any of these strategies or would like to explore additional options, please reach out to your financial advisor.

Developing Distress in Private Lending

By: Chris A. Matlock, CPA, CFA
Chief Investment Officer

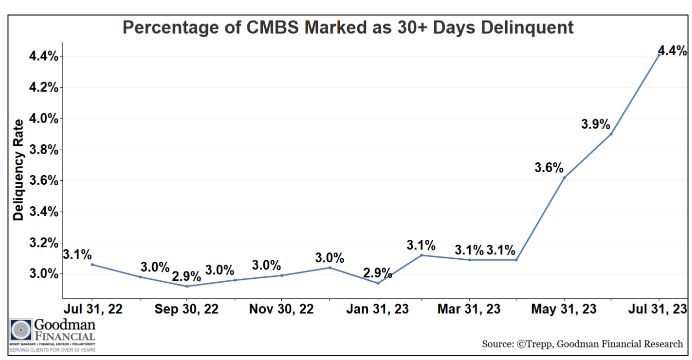
Investors like to focus on and talk about parts of the markets that are public and have easy to obtain price data – things like stocks and bonds and various mutual funds or exchange traded funds (ETFs). There is another very large part of financial markets that gets much less attention but deserves more, and that involves the domain of private lending. By private lending, we are referring specifically to various loans that include commercial real estate (CRE) and leveraged lending. These types of loans have a few things in common: (1) the loans are usually variable rate loans that float based upon the overnight Federal Funds rate or prime rate, and then include some additional interest rate on top of that rate; (2) the loans are typically given to companies that are incurring high levels of debt relative to their underlying assets or cash flows; (3) most of these loans were originated when interest rates were at historically low levels; and (4) the loans are typically held by institutions and various private funds and rarely have a publicly stated price, such that any loan distress is largely hidden from view by most investors.

So, why are we writing about this part of the market? As mentioned above, almost all these types of loans carry a floating interest rate. Given the significant increase in the Federal Funds rate in the past year or so (increased from 0.5% to 5.5% now), the cost of this debt to the borrowers has sky-rocketed. Some of these borrowers might have interest rate hedges in place that protected them from this rise in short-term interest rates, but unfortunately, those hedges last only so long and are beginning to roll off for those borrowers. In some cases, loans have stated maturities that will need to be refinanced over the next few years – in a market where lenders of all sorts have tightened their lending standards significantly.

We are just now beginning to see the impact of the distress this is causing borrowers. It is first seen in CRE lending, where some very high-profile borrowers have defaulted on their loans and given the properties back to the lenders. This is especially true for office properties and to a lesser extent, apartments and hotels. In one recent example, Applesway Investment Group defaulted on a $230 million loan that resulted in over 3,000 apartments in Houston being taken over by their lenders. Many of these CRE loans are packaged into securities called Commercial Mortgage-Backed Securities (CMBS). According to **MSCI**, the amount of CMBS loans that are in distress has tripled over the past few years to nearly $75 billion and looks to meaningfully increase from here as higher interest rates come home to roost. This distress can also be seen in the nearby chart which shows the recent rapid increase in the rate of CMBS loans that are more than 30 days delinquent.

The leveraged lending market is made up of loans to mostly private companies, typically owned by private equity firms, where they are borrowing relatively high amounts of debt relative to their underlying cash flows (thus "leveraged"). The rising interest cost of this debt is consuming ever larger amounts of that cash flow, causing increasing distress in this market too. This also has the potential to get much worse should the economy slow down, as we expect it will over the next year, and which will negatively impact a company's cash flow. A useful metric for these loans is something called the "interest coverage" ratio (cash flow divided by interest costs), a measure of a company's ability to service its debt. Coverage ratios for leveraged loans have been declining the past couple of years from a high of nearly 6.0x in 2021 to a more recent 4.5x measure according to **Pitchbook**.

The increasing distress we described above is one of the reasons we have grown more cautious in our economic outlook for the coming year, causing us to take a more defensive posture with our investments. Of course, while most individual investors don't own any of these loans directly, they may unknowingly own them in funds they are invested in, whether private funds or publicly traded ones like closed-end funds or Business Development Companies (BDCs). It is important as ever to know what you own in this regard. Finally, many pension plans, foundations and endowments have significantly increased their exposure in recent years to private debt funds that own these types of loans. We would not be surprised to see their future returns come under pressure should things get as bad as we believe they might. Stay tuned!



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Thursday, September 21, 2023 (8am – 11am)
Financial Planning Roadmap – Course Correction (2 CPE hours)
Charitable Gifting & Giving Strategies (1 CPE hour)

Thursday, September 28, 2023 (11:30am – 1:30pm)
Market Update (1 CPE hour)
Investment & Tax Planning from ages 55 – RMD Age (1 CPE hour)

NOVEMBER 2023

Wednesday, November 8, 2023 (8am – 4pm)
Financial Planning A to Z (8 CPE hours)

DECEMBER 2023

Tuesday, December 5, 2023 (9am – 12pm)
Equity Compensation: Taxation and Planning (1 CPE hour)
Tax Efficient Investing (2 CPE hours)

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