Charitable Giving Opportunities Under the New Tax Law

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by Robert Huebscher

Kim Laughton is president of Schwab Charitable, a non-profit, donor-advised fund (DAF) provider established with the support of Charles Schwab & Co., Inc. to make charitable giving simpler and more tax-efficient for clients. She is responsible for the general management of Schwab Charitable and the fulfillment of its charitable mission, setting strategy and priorities and ensuring all contractual obligations and goals are met.

Prior to joining Schwab Charitable, Kim held a variety of leadership, strategy, and general management positions at Charles Schwab & Co., Inc. Earlier in her career, Kim was a vice president for Citibank-Asia/Pacific and a Consultant for Bain & Company. She also has served on the board of the Educational Foundation of Orinda and as the head of its investment committee. Kim has been recognized by the San Francisco Business Times as one of the most influential women in Bay Area business.

She holds a BA in economics and a BS in biology from Stanford University and an MBA from Harvard Business School.

I spoke with Kim at the Schwab IMPACT conference on October 29.

Tell me a little about Schwab Charitable. How do you work with advisory firms?

Schwab Charitable is a non-profit DAF provider. It was founded by Charles Schwab about 20 years ago to help its clients and the advisors that serve them give effectively to philanthropy. We want to help clients achieve more tax efficiency, and therefore allow them to be able to give more and consolidate all their giving in one place. Advisors are a big part of our business.

The majority of our assets are advisor-managed or associated with clients who have an advisor. Advisors are a big part of helping clients consolidate their financial life and their wealth-management practices. Charitable giving is increasingly a big component of that.

What is the typical profile of a client who sets up a DAF? For whom are DAFs most appropriate?

DAFs serve a wide span and a variety of types of clients and needs. The minimum to open at Schwab Charitable is $5,000. Our largest account, however, is over a billion dollars. From that, you can probably tell that we're serving both everyday donors giving maybe thousands of dollars a year to charity, all the way up to very large donors. This includes multi-generational families that are using us either instead of, or sometimes in conjunction with, a private foundation to fund very substantial gifts and complex grant agreements.

DAFs can be appropriate for both the people who are contributing and giving every year. They can use it as a “charitable checkbook” to keep track of their giving, to remind themselves of when to give and set up small recurring gifts.

It can also be appropriate for people who have windfall events, where they've sold a business or maybe have large capital gains that they are facing in a specific stock. Investors can use it to peel off some of that money, get a deduction for tax reasons, and then use the account to grant over time.

It's also used by very large donors as a way to have a vehicle for specific types of assets, to manage their taxes and manage the giving between various entities.

What makes now an ideal time for advisors to talk about philanthropy with their clients?

The fourth quarter of every calendar year is always a great time to think about philanthropy. It's when clients tend to think about it, between Thanksgiving and the various December holidays. It's on clients' minds.

Advisors are uniquely qualified to open the conversation to ensure that clients are using the right assets that are going to be most tax effective. Oftentimes advisors are going to have quarterly or annual reviews, sometime in the fourth quarter.

Adding the component around charitable giving is important as they think about rebalancing their portfolios.

Knowing that your client is philanthropically inclined and giving a certain amount either this year or into future years and being able to make those decisions, can make your clients feel smart, and therefore think that you're smart when you're keeping an eye out for ways to make their gifts go further saving on taxes.

What tips do you have for donors who want to make an impact with their charitable giving before the end of 2018?

The most important thing to consider is the charitable provisions were not touched by the recent tax reform. Almost every other deduction has either been eliminated or capped, particularly for high-net worth donors – state and local tax, property tax, and mortgage tax deductions.

Mortgage-interest tax deductions are going to be impacted to the extent that by the end of the year, people should think about what charitable gifts they want to make, either for this year or in future years.

Appreciated investments are still a good thing to give because they were not touched by the new tax law. People can give appreciated investments or assets to charity, either through a DAF or directly. The charity doesn't have to pay capital gains taxes, so before the end of the year it's really important that people think about funding gifts, so that they can get that tax deduction this year, and think about doing it with appreciated investments.

The advisor should take a look at the portfolio, figure out where they may be a little overweight given market volatility, think about the desired asset allocation, and then use their charitable account as a way to help get there.

What are the benefits of donating appreciated assets to charity? What are the tradeoffs when donating to a DAF versus directly to the charity?

The big benefit of donating any appreciated asset or investment that's been held for a year or more is that the charity doesn't have to pay capital gains tax and the client can avoid the capital gains tax. That allows you to effectively give up to 20% more than you otherwise would be able to if you sold it and then took the gain – that is a real benefit. Now, those investments can be made directly to charity or to any 501©(3), which can be a public charity. That includes most operating charities, but it also includes DAFs.

Some clients will say, "I'll give two shares of this stock to this charity, five shares of this stock to that charity." The benefit of a DAF is that, if you are giving to a variety of charities and figuring out how many shares to give to each charity, you can instruct your advisor to do that. Your advisor can instruct the custodian, in this case, Schwab, to do that. Otherwise, there's a lot of friction in that system. It's a pain, especially at the end of the year when people are celebrating the holidays.

The simpler use case is to say, "I want to give $30,000 to these different charities, but I'm not going to worry at the end of the year to get them all to those charities. I'm just going to go ahead and give this many shares of these stocks directly from my investment account to my charitable account. I'll get the tax deduction and then when it's convenient, I can grant them out." The charities will receive the cash, but it's literally a few clicks of the button that your advisor makes from their system or that the client can make directly from their system that makes that happen. The client gets the tax deduction and then they can grant at their leisure. The charity then receives cash, which is a much simpler thing for them to manage.

Many small charities, when they receive donations of shares, oftentimes can't tell who it is from. They are on vacation at the end of the year and so they don't get to liquidating it for weeks. There's volatility in the market, so it can be a cumbersome process to donate directly to charities.

How can advisors help clients increase tax-efficiency under the new tax law?

We talked a bit about donating appreciated investments. For any client, that makes tons of sense. Approximately74%% of our contributions over the past year have been appreciated investments. In general, advisors get that.

The second thing would be deciding whether clients are going to be itemizing in the future under the new tax bill. There's some research to suggest that many clients, and maybe their advisors, don't quite understand yet how they're going to be impacted by the new tax bill. They probably won't get it until they actually go do their taxes.

Why is now a good time for some donors to consider concentrating, or “bunching,” charitable contributions?

Advisors can help clients ask, "Do you think you're going to be itemizing or not?" If you are going to be itemizing, the charitable deduction is the most flexible deduction you can take. It wasn't capped or eliminated, so consider how a charitable deduction can be used and make sure that they know that. If they think they might take the standard deduction or maybe members of their family – next-gen members – would be, there is this strategy called “bunching” or “concentrating of contributions,” if someone is just below the level that they would be itemizing. For a couple, that's $24,000 of deductions a year. Let's say they have $22,000 and they're charitably inclined. They can go ahead and take the standard deduction, but they're not getting the full tax benefit of their charitable contributions. Instead, they could say, "You know, what I'm going to is I'm going to go ahead and contribute a larger amount this year" – say $15,000 to a DAF. Go ahead and itemize, get the tax benefit and then maybe for the next two or three years they can take the standard deduction, but they could be granting to the charities out of their DAF.

It helps them make sure that they're getting full tax advantages from the great giving that they're already doing.

What trends are you seeing with respect to the usage of socially responsible (ESG/SRI) funds within DAFs and more broadly across the charitable investing industry?

The trend definitely continues. Socially responsible funds increasingly are being demanded by clients and advisors.

We have, in our core offering, two socially responsible pools that we're very proud of and there’s an increasing interest in them. One of the great things about it is advisors can pick and choose among any investment that's available on the Schwab platform, which includes a lot of socially responsible investments, and we're seeing that happen. It's a constant trend; it's one that we're very excited to be supporting. In the ultra-high net worth space, there's also some interesting private equity-type structures that are socially responsible. For our largest clients, that's something that we work with advisors on, to make sure that they can do it in their charitable accounts as well.

Are there any other considerations to keep in mind when thinking about end-of-year charitable giving?

Just make sure that people know that timing is important. To the extent that people want to donate appreciated investments, it's good to do so early.

If clients want to be granting out to charities at the end of the year, make sure they schedule those grants and get those in early.

We have more and more that people are able to donate online and electronically, so that makes it more convenient. But it's always good for people to try to act early and not be rushing to do this at the very end of the year, in the last week or so.