Feeling generous at year end? Strategies for donating to charity or gifting to loved ones

As we approach the holidays, many people plan to donate to their favorite charities or give money or assets to their loved ones. Here are the basic tax rules involved in these transactions.

Donating to charity

Normally, if you take the standard deduction and don't itemize, you can't claim a deduction for charitable contributions. But for 2021 under a COVID-19 relief law, you're allowed to claim a limited deduction on your tax return for cash contributions made to qualifying charitable organizations. You can claim a deduction of up to $300 for cash contributions made during this year. This deduction increases to $600 for a married couple filing jointly in 2021.

What if you want to give gifts of investments to your favorite charities? There are a couple of points to keep in mind.

First, don't give away investments in taxable brokerage accounts that are currently worth less than what you paid for them. Instead, sell the shares and claim the resulting capital loss on your tax return. Then, give the cash proceeds from the sale to charity. In addition, if you itemize, you can claim a full tax-saving charitable deduction.

The second point applies to securities that have appreciated in value. These should be donated directly to charity. The reason: If you itemize, donations of publicly traded shares that you've owned for over a year result in charitable deductions equal to the full current market value of the shares at the time the gift is made. In addition, if you donate appreciated stock, you escape any capital gains tax on those shares. Meanwhile, the tax-exempt charity can sell the donated shares without owing any federal income tax.

Donating from your IRA

IRA owners and beneficiaries who've reached age 70½ are allowed to make cash donations of up to $100,000 a year to qualified charities directly out of their IRAs. You don't owe income tax on these qualified charitable distributions (QCDs), but you also don't receive an itemized charitable contribution deduction. Contact your tax advisor if you're interested in this type of gift.

Gifting assets to family and other loved ones

The principles for tax-smart gifts to charities also apply to gifts to relatives. That is, you should sell investments that are currently worth less than what you paid for them and claim the resulting tax-saving capital losses. Then, give the cash proceeds from the sale to your children, grandchildren or other loved ones.

Likewise, you should give appreciated stock directly to those to whom you want to give gifts. When they sell the shares, they’ll pay a lower tax rate than you would if they’re in a lower tax bracket.

In 2021, the amount you can give to one person without gift tax implications is $15,000 per recipient. The annual gift exclusion is available to each taxpayer. So if you’re married and make a joint gift with your spouse, the exclusion amount is doubled to $30,000 per recipient for 2021.

Make gifts wisely

Whether you’re giving to charity or loved ones this holiday season (or both), it’s important to understand the tax implications of gifts.