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Why To Give Generously Before December 31

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Are you charitably-minded but not sure what charity you want to benefit from your largesse? Then consider putting money into a donor-advised fund by December 31. You get a charitable deduction upfront to offset your 2011 income (you'll see the benefit on the tax return you file April 2012), and you get to dole out the money you stashed in the fund to operating charities of your choice later.

Here's an extreme example. A widow recently got the big news that she got $500,000 in royalties for the rights to make a movie out of a book written by her late husband. That was a huge unexpected spike in income, so she went to her advisor, Ronald Finkelstein, a CPA with Marcum in Melville, N.Y. to talk tax. Her idea was to make a charitable contribution of $50,000 to $75,000 to set up a donor-advised fund at the Berkshire-Taconic Community Foundation in Sheffield, Mass., near where she keeps a second home. His answer: "This would be the year to do it." She'll get a much better tax benefit making the gift this year because she's in a higher tax bracket than usual. That's the key.

Move up Move down

There's nothing wrong with timing gifts to charity to maximize your tax benefit. If you time your gift right so that you save on income taxes with the charitable contribution deduction, you can divert even more dollars away from Uncle Sam and to your favorite charity.

Donor-advised funds, both those run by community foundations (there are 700 throughout the U.S.) like the Berkshire-Taconic Foundation and those affiliated with investment firms, such as the Fidelity Charitable Gift Fund, the Vanguard Charitable Endowment Program, and the Schwab Charitable Fund, are a fine way for folks to funnel money over time to their favorite charities. The umbrella charity–the community foundation or the brokerage affiliate–invests and administers your fund for an annual fee. Typically you need just $5,000 to set up a fund. If your combined federal and state income tax rate is 40%, that's $2,000 off that you can spend, save or donate.

Folks with bigger charitable kitties, even those who are rich enough to set up their own private foundations, use these funds too. "There is a focus on funding foundations and donor-advised funds in a year where it still might be safe to allow for the maximization of income tax benefits," Janine Racanelli, head of JP Morgan's Advice Lab. There is continued worry that the deductibility of charitable gifts will be limited in the future (President Barack Obama has proposed limiting the deduction to 28%, instead of the current 35% top federal income tax rate).

Racinelli is working with a family able to give away $60 million this year through a combination of increasing the size of an exisiting family foundation, funding a donor-advised fund at the National Philanthropic Trust and making outright gifts to favorite operating charities. "It pays to do the math around this," she says, adding, "If you're otherwise inclined to be generous, given our uncertain future, it may pay to be generous now."