Case Study: Roth conversion with a charitable offset strategy

Establish a Giving Account® and potentially offset the taxes due to an IRA Roth conversion

Working with their advisor on estate planning, Marco and Tamara's primary concern as a couple in their mid-50s was the inheritance they would leave for their two children and ensuring they didn't also burden them with estate and income taxes.

After reviewing the couple's retirement and non-retirement accounts, the advisor suggested a Roth individual retirement account (IRA) conversion, which increases the assets that will be considered tax-free, as opposed to a traditional IRA with taxed distributions. Marco and Tamara were open to carrying out a Roth conversion, but they expressed hesitation with the increase in taxes they would incur this year as a result. The couple was interested in offsetting these taxes so that funds were available in case unexpected expenses came up.

Their advisor then shared the advantageous charitable offset strategy that can be used with a Roth conversion. The clients were pleased to learn that a charitable gift could decrease their taxable income by the amount they would contribute.[1] Marco and Tamara valued giving back to those less fortunate in their community, so they were very open to this strategy. With this approach, the couple started to build their charitable legacy by opening a Giving Account®, or donor-advised fund, with $100K to offset the $100K being converted to a Roth IRA. Opening a Giving Account in the same year as performing a Roth conversion could mitigate most of the taxes that would be charged for the Roth IRA, allowing them to keep cash on hand for emergencies and living expenses.

Marco and Tamara can support the charities they care about by making grant recommendations with their Giving Account when convenient, and over a span of several years as a ready reserve. To continue their charitable legacy after their passing, the couple established their children as Giving Account successors.

	Without Roth conversion	With Roth conversion
Current year adjusted gross income for the couple	$240,000 *(married filing jointly, ages 52 and 55)*	$340,000
Ordinary income tax bracket	24%	24%
Itemized deductions in 2023[2]	$30,000	$30,000
Taxable income	$210,000	$310,000
Tax amount owed	$37,200[3]	$61,200

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Roth conversion + charitable contribution:

With the couple already locking in their decision to convert $100K to a Roth account, they also decided to maximize their tax efficiency by front-loading their charitable giving in the same tax year.

$61,200 Taxes owed without charitable contribution

$37,200[3] Taxes owed after donating $100K

$24,000
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By funding their Giving Account with $100K, they net an additional $24,000 in federal tax savings and offset the taxes owed due to the Roth conversion.

The power of giving long-term appreciated assets

Rather than using cash, Marco and Tamara could also donate long-term appreciated securities, such as stocks, mutual funds, bonds, and exchange-traded funds (ETFs), to minimize paying taxes on the capital gains for their most efficient, lowest basis shares. In addition, when giving long-term appreciated securities in an after-tax brokerage account, they should also be eligible for a fair market value deduction.

Tamara, who works for a public company, has been paid in various forms of equity compensation over the years and has built up 40% of her total portfolio in company stock. The couple's financial advisor has encouraged Tamara to consider divesting in the past, but she has been hesitant due to the capital gains that she'd have to pay, causing her to delay this strategy year after year.

To amplify the impact of their newly opened Giving Account, the advisor suggests that Tamara consider donating her most appreciated company stock that is held in her brokerage account, thereby minimizing the capital gains liability, and then use the cash that she was going to donate to her Giving Account to reinvest in different securities to further diversify her holdings. Tamara is excited to learn that donating these long-term assets will provide considerable tax efficiencies, versus selling the stock and donating the after-tax cash proceeds. Ultimately, this strategy will have a greater impact on the charities Marco and Tamara choose to support, while also helping them manage their new tax liabilities as a result of the Roth conversion.

Of the stock that was donated, $65,000 was unrealized capital gains. The couple decided to donate the $100K from company stock held in Tamara's brokerage account, helping to eliminate $9,750 worth of capital gains tax.

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This hypothetical case study is provided for illustrative purposes only. It does not represent an actual donor, but is meant to provide an example of how a donor-advised fund can help individuals give significantly more for the causes they care about.

Consult with your tax advisor to plan your charitable strategy the same year as performing a Roth conversion.

[1] Clients exceeded the standard deduction with other itemized deductions.

[2] Itemized deductions prior to the $100K charitable donation.

[3] Tax amount owed, rounded up from $37,199.76.

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