INVESTOR CHALLENGE

Client Uses Custom Core® to Increase Charitable Gifting, Reduce Tax Burden

CHALLENGE

A client usually funds charitable donations by selling stock—taking a large capital-gains hit in the process.

SOLUTION

Parametric recommended donating stock instead of cash, then repurchasing stock with an equivalent amount of newly deposited cash.

RESULTS

The client maintained her desired market exposure, increased her charitable contribution, and set herself up for a potentially lower future tax bill.

Challenge

A client makes an annual cash gift to her local food bank, funding her contribution by selling stock in her investment portfolio. While she appreciates the tax deduction for charitable giving, she's also paying taxes on capital gains incurred from selling the appreciated stock. She asks Parametric if there's a more tax-efficient way for her to make charitable donations in coordination with the tax management Parametric already performs on her Custom Core® account.

> A welcome tax deduction for charitable giving meets an unwelcome tax on capital gains.

Parametric solution

Making charitable gifts in cash is a natural instinct for many people. After all, cash gifts may lessen an investor's current tax bill by providing a charitable contribution deduction in the amount of the gift (subject to limitations, of course). But cash gifts aren't the only option. For example, when you donate stock to a charity, you may get the added benefit of receiving a tax deduction for the full fair-market value. As the below example demonstrates, this approach also represents an increase of more than 10% in the size of the gift as opposed to selling the shares and then donating the cash, since you avoid the payment of capital gains tax incurred when selling the shares.

	Selling securities and donating the cash	VS	Donating the securities themselves
Current value	$50k		$50k
Cost basis	$30k		$30k
Long-term capital gains tax paid[1]	-$4,760		$0
Resulting charitable donation	$45,240		$50,000
Additional amount available to donate to charity	$0		+$4,760

Added benefit:
The portfolio's tax position may improve depending on the size of the gift, how much cash is replenished, and the portfolio's overall appreciation.

Source: Parametric, 2020. Provided for educational purposes. No representation is made that a client will, or is likely to, achieve results similar to those presented.

[1] Assumes all realized gains are subject to the maximum federal long-term capital gains tax rate of 20% plus the 3.8% Medicare surtax, for a total rate of 23.8%. Does not take into account state and local sales tax, if any apply.

In the case of this client, Parametric suggested a two-step course of action. First, we identified suitably appreciated securities from the client's Custom Core portfolio, recommending a list of low-basis securities that, when donated, would maximize the capital gains transferred through the gifting process. Second, the client deposited cash equal to the value of stocks gifted. Parametric then used this cash to purchase stocks that allow the portfolio to maintain the client's chosen market exposure but that have a much higher cost basis than the gifted shares. This higher-basis investment increases the potential for tax-loss harvesting, which should help reduce future tax payments.

Gifting low-cost-basis securities helped the client avoid realizing capital gains.

Results

By gifting appreciated securities from her Custom Core portfolio, the client was able to donate a higher dollar amount to her favorite charity, potentially increasing her charitable tax deduction in the process. By then investing an equivalent amount of cash back into her Custom Core portfolio, she was able to purchase a number of securities with higher basis, resulting in a portfolio with a higher potential for tax-loss harvesting and reduced tracking error.

The client was able to donate a higher dollar amount to her favorite charity.

At Parametric, we manage more than $134 billion in assets in Custom Core accounts alone, with $145.5 billion in client-specified tax mandates.* Charitable gifting—and how to optimize its impact—is a critical component of our comprehensive approach to tax management.

*As of 12/31/2020

Find more insights and research at parametricportfolio.com

About

Parametric Portfolio Associates® LLC ("Parametric"), headquartered in Seattle, is registered as an investment advisor with the U.S. Securities and Exchange Commission. Registration does not imply a level of skill or training. Parametric is a leading global asset management firm, providing investment strategies and customized exposure management directly to institutional investors and indirectly to individual investors through financial intermediaries. Parametric offers a variety of rules-based investment strategies, including alpha-seeking equity, fixed-income, alternative and options strategies. Parametric also offers implementation services, including customized equity, traditional overlay and centralized portfolio management. Parametric is part of Morgan Stanley Investment Management, the asset management division of Morgan Stanley, and offers these capabilities through offices located in Seattle, Boston, Minneapolis, New York City, and Westport, Connecticut. This material may not be forwarded or reproduced, in whole or in part, without the written consent of Parametric. Parametric and its affiliates are not responsible for its use by other parties.

Disclosures

This information is intended for informational purposes and details investment strategies and opportunities identified by Parametric. Opinions and estimates offered constitute our judgment and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. We believe the information provided here is reliable, but do not warrant its accuracy or completeness. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. The views and strategies described may not be suitable for all investors. Past performance is not indicative of future results. Investing entails risks and there can be no assurance that Parametric will achieve profits or avoid incurring losses. Parametric does not provide legal, tax or accounting advice or services. Clients should consult with their own tax or legal advisor prior to entering into any transaction or strategy described herein.

This information is derived from the experiences and observations of Parametric. No representation or warranty is made as to the reasonableness of the assumptions made or that all assumptions used in achieving the results have been stated or fully considered. No representation is made that any client account will, or is likely to, achieve a successful outcome similar to the one presented. Actual results will differ and may differ substantially from the example provided. Changes in assumptions may have a material impact on the example presented. The information may not reflect the impact that material economic and market factors might have had on Parametric's decision-making.

There is no assurance that a separately managed account ("SMA") will achieve its investment objective. SMAs are subject to market risk, which is the possibility that the market values of the securities in an account will decline and that the value of the securities may therefore be less than what you paid for them. Market values can change daily due to economic and other events (for example, natural disasters, health crises, terrorism, conflicts, and social unrest) that affect markets, countries, companies, or governments. It is difficult to predict the timing, duration, and potential adverse effects (for example, portfolio liquidity) of events. Accordingly, you can lose money investing in an SMA.

Investment strategies that seek to enhance after-tax performance may be unable to fully realize strategic gains or harvest losses due to various factors. Market conditions may limit the ability to generate tax losses. Tax-loss harvesting involves the risks that the new investment could perform worse than the original investment and that transaction costs could offset the tax benefit. Also, a tax-managed strategy may cause a client portfolio to hold a security in order to achieve more favorable tax treatment or to sell a security in order to create tax losses. Prospective investors should consult with a tax or legal advisor before making any investment decision.

Parametric is located at 800 Fifth Avenue, Suite 2800, Seattle, WA 98104. For more information regarding Parametric and its investment strategies, or to request a copy of the firm's Form ADV or a list of composites, contact us at 206 694 5500 or visit www.parametricportfolio.com.

34157 | 11.10.2022