Tax Aware

Levering Up to Do Good

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Donating appreciated stock, instead of cash, may help amplify the benefits of charitable giving. The charity gets the full market value of the appreciated securities — as opposed to the after-tax value (that is, the value reduced by liquidation tax) — and the donor receives a tax deduction for the full amount gifted while potentially avoiding liquidation tax.[1] In other words, gifting appreciated stock allows a donor to do good while managing taxes at the same time.

But it doesn't end there. Charitable giving programs implemented on top of tax-loss harvesting strategies, like direct indexing, can potentially be even more effective for the donor. As the strategy's most appreciated positions are donated, its ongoing tax benefits typically increase, and expected future tax liability typically declines. This can be especially true if new capital is added to replace donated positions.

Our latest paper finds investors who want to "do good" may be able do even better.

We've written before that long/short strategies may outperform traditional approaches, both before and after taxes. So, it shouldn't come as a surprise that they can also be a game-changer for charitable giving. Our new paper covers four distinct advantages for long/short investment strategies over direct indexing, but for brevity (this is a blog, after all) here are two big ones.[2]

- **For the charity:** Greater donation amount. As a strategy's leverage increases, so does the value of the long positions relative to invested capital. As a result, the value of positions that can be donated increases as well. For example, compare a long-only portfolio to one that is 200 long and 100 short. In the latter case, the value of long positions that can be candidates for donation increases by a factor of 2.
- **For the donor:** Greater donation "efficiency." Because levered strategies have larger positions than unlevered strategies, they can also accumulate larger amounts of unrealized gains. This means that for a given donation amount, the levered portfolio will tend to have more unrealized gain to dispose of. Said another way, long/short levered strategies can allow for more efficient reduction in an investor's future tax liability per dollar donated.

Taken together, long/short tax aware strategies can be a win-win for the charitably inclined: larger donations for the charity and larger tax benefits for the donor. Therefore, the paper concludes: "Families planning on doing good should consider levering up."

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[1] Assuming that the gifted position is a long-term position, held for more than one year. Deductions for short-term positions, held for one year or less, are only allowed up to the cost basis.

[2] Very briefly, the other two: levered long/short strategies can have achieve greater capital loss realizations, and as leverage increases (e.g., from 150/50 to 250/150), donations offer the investor more flexibility to modify the levered strategy to a long-only portfolio.