RESEARCH MEMO

Charitable Gifting as a Rebalancing Lever

Why lowest basis may be the wrong screen for selecting gift lots

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Modeled scenario. All figures hypothetical.

1 · SUMMARY OF CONCLUSIONS

Most charitable gifting programs run a single screen: find the lowest-basis lot and give it away. That screen is incomplete in two ways. It ignores holding period, and it ignores what the gift does to the rest of the portfolio. Correcting for both changes the recommendation materially in a realistic case.

> Screen candidate lots on three dimensions in sequence: holding period as a gate, tax avoided per dollar gifted as the ranking, and drift-versus-target as the constraint. Evaluate each candidate against the client's full transaction plan for the year, never as a standalone decision.

Findings

1 · Gifting a short-term appreciated security is always dominated. Because the deduction is capped at basis while the avoided gain is taxed at ordinary rates, the benefit collapses to the marginal rate alone, independent of basis. Every long-term appreciated position does strictly better. This is provable, not situational. (§4)

2 · The remedy is timing, and it is worth $17,200 here. The sample position crosses into long-term treatment in six weeks, inside the same tax year. Waiting raises the benefit from $62,900 to $80,100. The position would need to fall 17.8%, about 1.5 standard deviations, before waiting became the wrong call, roughly a 5% probability. (§4.1–4.3)

3 · The commitment structure matters more than any market assumption. Gifting a position exposes the client to $0.57 per dollar of price decline, because the asset was leaving either way. Gifting a fixed dollar amount exposes them to $1.20, because a shortfall must be funded from assets they intended to keep. That single distinction moves the probability of a wrong call from 5% to 23%, a larger swing than any volatility or tax-rate assumption tested. (§4.4)

4 · Overfunding the donor advised fund resolves this. The pledge is to the charity, not to the fund. Contributing above the grant commitment creates a buffer that absorbs declines; above roughly an 18% buffer the commitment stops binding entirely and the analysis reverts to the position case. This costs nothing, since the surplus remains available for future grants. (§4.5)

5 · The gift should be scored against the year's full transaction plan. In the worked example, the naive lowest-basis pick wins by $3,846 on the gift transaction itself, and loses by $13,354 once the sale the client was making anyway is brought inside the analysis. The naive pick also drives a position 5 percentage points below target, requiring repurchase. (§5)

Three standing rules

RULE	WHY
6.1 Never gift a loss position	Sell it, harvest the loss, gift the proceeds. Same deduction, loss preserved
6.2 Never gift cash while appreciated securities are available	Gift the security and repurchase; identical outcome plus a basis reset. Bounded at zero downside, so it holds even for positions never intended for sale
6.3 Always transact at the lot level	Average-cost accounting discards every attribute the analysis depends on. Round contributions to lot boundaries, upward

What would change these conclusions

A client near the 30%-of-AGI deduction limit may do better gifting cash than securities, the one case where 6.2 reverses. A book containing positions that liquidate outside the standard long-term rate (collectibles at 28%, PFICs, partnership recapture) breaks the equivalence between basis-ordering and tax-ordering noted in §3. And a client who is genuinely committed to a fixed dollar figure with no overfunding flexibility faces a materially closer timing decision than Finding 2 suggests.

2 · THE SAMPLE PORTFOLIO

A taxable account of $2.96M. The client is in the top federal bracket (37% ordinary, 20% long-term capital gains) and makes an annual contribution to a donor advised fund. Two positions carry a standing instruction to exit: a regional bank holding and a defense contractor the client wishes to divest on ESG grounds.

Total value $2,960,000 · Total basis $1,754,000 · Embedded gain $1,206,000 · Active share 33.8%

POSITION	VALUE	COST BASIS	GAIN	GAIN %	HOLD	ACTUAL	TARGET	DRIFT
NVDX (employer stock)	$780,000	$95,000	$685,000	87.8%	LT	26.4%	5%	+21.4%
Large-cap index fund	$640,000	$410,000	$230,000	35.9%	LT	21.6%	27%	−5.4%
Mid-cap growth fund	$310,000	$118,000	$192,000	61.9%	LT	10.5%	10%	+0.5%
Developed intl fund	$295,000	$265,000	$30,000	10.2%	LT	10.0%	16%	−6.0%
Regional bank stock	$185,000	$210,000	−$25,000	−13.5%	LT	6.3%	0%	+6.3%
Defense contractor	$170,000	$84,000	$86,000	50.6%	ST	5.7%	0%	+5.7%
Core bond fund	$580,000	$572,000	$8,000	1.4%	LT	19.6%	42%	−22.4%

Convention. Gain percentages are expressed as a share of current market value, not of basis. This is the correct denominator for gift selection, because the decision variable is dollars of fair market value transferred. The defense contractor has doubled in a year, a 102% gain on basis, but that is 50.6% of its market value, and the market-value figure determines how much tax the gift avoids.

3 · THE RANKING METRIC

For a long-term appreciated security, gifting $1 of market value produces two benefits:

- Deduction: $1 × 37% marginal rate = $0.37
- Avoided capital gains tax: g · r, where g is gain share and r the applicable rate

Total = 0.37 + g · r. The first term is constant across long-term positions, so the ranking is driven entirely by g · r.

POSITION	BASIS % OF VALUE	G · R PER $1	DRIFT
1 · NVDX	12.2%	$0.1756	+21.4%
3 · Mid-cap growth	38.1%	$0.1239	+0.5%
7 · Defense contractor	49.4%	$0.1012 (if LT)	+5.7%
2 · Large-cap index	64.1%	$0.0719	−5.4%
4 · Developed intl	89.8%	$0.0203	−6.0%
8 · Core bond	98.6%	$0.0028	−22.4%
6 · Regional bank	113.5%	negative, see §6	+6.3%

With a uniform 20% rate across the book, g · r is a monotonic transformation of basis: the two screens produce identical orderings. The naive screen is not wrong here, it is insufficient, because the ordering is not what determines the right answer. The gate (§4) and the constraint (§5) do.

Where the ordering genuinely diverges is when rates differ across the book: collectibles-backed funds at 28%, PFICs at ordinary rates with an interest charge, partnership structures throwing off ordinary recapture. A 28%-rate position outranks a 20%-rate position whenever its gain share exceeds 71.4% of the comparator's. That case is not present in this portfolio; §7 treats it as a screening condition worth running annually rather than a live consideration here.

4 · THE HOLDING-PERIOD GATE

Before any ranking is applied, candidate lots must clear a holding-period test, and a position that looks attractive on basis can fail it outright. The defense contractor ranks third on basis. Gifted today, it is the worst candidate in the portfolio.

Short-term appreciated securities are deductible at the lesser of cost basis or fair market value. Gifting it in kind yields an $84,000 deduction on a $170,000 transfer.

Formally, for a short-term position with basis share b, gain share g = 1 − b, at ordinary rate m:

	SHORT-TERM GIFT	LONG-TERM GIFT
Deduction value	b · m = $31,080	1 · m = $62,900
Avoided gain tax	g · m = $31,820	g · r = $17,200
Total	**m = $62,900**	**0.37 + g · r = $80,100**

The short-term benefit collapses to m(b + g) = m, the marginal rate alone, independent of basis. Since every long-term appreciated position returns 0.37 + g · r > 0.37, gifting a short-term appreciated security is dominated by gifting any long-term appreciated security.

A corollary worth stating: for short-term stock, gifting in kind and selling-then-gifting-cash are exactly tax-equivalent, both returning m. There is no in-kind advantage to preserve, so if an exit cannot wait, sell and gift cash. Nothing is lost by doing so.

4.1 The timing decision

The actionable consequence is timing, not exclusion. The position crosses into long-term treatment in approximately six weeks, comfortably inside the same tax year, so the deduction is still recognized where the client wants it. Waiting converts a $62,900 benefit into $80,100.

The value of waiting is $17,200, which is exactly g · r · V: the entire benefit of the delay is the capital gains tax that long-term treatment avoids.

4.2 Pricing the cost of waiting

The obvious objection is six weeks of continued exposure to a position the client has decided to exit. The correct way to price that is less punitive than it first appears, and the distinction matters.

At 35% annualized volatility, a six-week one-standard-deviation move on $170,000 is 11.9%, or roughly $20,200. It is tempting to set that against the $17,200 benefit and conclude the decision is a coin flip. That comparison is wrong, for two reasons.

First, $20,200 is a dispersion measure, not an expected loss. The move is symmetric, and roughly 68% of outcomes fall within ±$20,200.

Second and more importantly, the client does not bear the full price move. The position is being given away in either scenario. A decline does not cost them the asset's value; it costs them the tax benefits computed on that value. Both benefits scale with price:

SENSITIVITY TO A $1 PRICE DECLINE	
Reduced deduction	$0.37
Reduced avoided gain tax	$0.20
Total economic exposure	**$0.57**

So the benefit at any future price V is 0.57·V − $16,800. Note that the multiplier is constant at 0.57 across the relevant range. The gain percentage fluctuates as the price moves, but cost basis is a fixed dollar amount, so the dollar sensitivity does not. Linearity only fails if the position falls below its $84,000 basis, at which point §6 governs and the position should be sold rather than gifted.

At a one-sigma adverse move, the foregone benefit is $20,200 × 0.57 = $11,520, against a certain $17,200. Waiting still wins comfortably.

4.3 Breakeven and probability

Setting 0.57·V − $16,800 equal to the $62,900 available today gives a breakeven price of $139,825, a decline of 17.8%, or 1.49 standard deviations over six weeks.

Probability the decline exceeds breakeven, lognormal, zero drift.

WAIT	30% VOL	35% VOL	45% VOL	55% VOL

WAIT	30% VOL	35% VOL	45% VOL	55% VOL
2 weeks	0.0%	0.2%	1.3%	3.5%
3 weeks	0.3%	1.0%	3.5%	7.0%
4 weeks	0.9%	2.2%	5.9%	10.0%
6 weeks	2.8%	5.0%	10.1%	14.8%
8 weeks	4.8%	7.7%	13.4%	18.3%

Even at 45% volatility, plausible for a single stock that has just doubled, a six-week wait carries roughly a 10% chance of leaving the client worse off. Recommendation: wait.

4.4 Where this reverses

The analysis above holds because the client is gifting the entire position. A different commitment produces a different answer, and the distinction is not cosmetic.

If the client has instead committed to a fixed dollar contribution, $170,000 funded however necessary, a price decline no longer reduces the gift. It reduces the position's ability to fund the gift, and the shortfall must be met from assets the client would otherwise have kept. The client therefore absorbs the full dollar of decline, plus the avoided gain tax that would have accompanied it:

SENSITIVITY TO A $1 PRICE DECLINE	GIFT THE POSITION	GIFT A FIXED $170,000
Reduced deduction	$0.37	– (deduction fixed)
Reduced avoided gain tax on the position	$0.20	$0.20
Shortfall funded from retained assets	–	$1.00
Avoided gain tax on the top-up asset	–	$-(r \cdot g_a)$
Total economic exposure	**$0.57**	**$1.20 − $r \cdot g_a$**

The final term matters and is easy to miss. The shortfall is itself a charitable transfer, so if it is funded with appreciated stock rather than cash, the client avoids gain tax on those shares too. The deduction is unaffected either way, it is fixed by the pledge amount, but the gain-tax shield is not.

The offset is real and bounded. Funding the shortfall from the most appreciated position available recovers at most r per dollar, or 20 cents against a $1.20 exposure:

35% annualized volatility, six-week horizon.

SHORTFALL FUNDED FROM	GAIN SHARE	EXPOSURE	BREAKEVEN DECLINE	P(WAITING LOSES)
Whole position, no shortfall arises	–	$0.570	17.8%	5.0%
Cash / money market	0.0%	$1.200	8.4%	22.9%
Developed intl fund	10.2%	$1.180	8.6%	22.5%
Large-cap index fund	35.9%	$1.128	9.0%	21.5%
Mid-cap growth fund	61.9%	$1.076	9.4%	20.3%
NVDX employer stock	87.8%	$1.024	9.9%	19.1%

Funding the shortfall well does not rescue the fixed-dollar case. Across every available source, the probability of waiting being the wrong call sits near 20%, against 5% when the whole position is gifted. The choice of top-up asset is a second-order optimization within a first-order structural difference.

> The commitment structure should be established before the timing analysis is run, not after.

4.5 Why the donor advised fund mostly resolves this

The fixed-dollar problem above assumes the contribution amount is rigid. In a program running through a donor advised fund, it generally is not, and the reason is structural rather than incidental.

The pledge is made to the charity, not to the fund. The fund is an intermediary, and contributions into it need not match grants out of it. A client committed to granting $150,000 can contribute $170,000, make the grant, and leave the surplus invested for future years. Overfunding creates a buffer that absorbs price declines, and the $1.20 exposure applies only to a shortfall beyond that buffer.

Cash-funded shortfall, 35% annualized volatility, six-week horizon.

GRANT COMMITMENT	BUFFER	BREAKEVEN DECLINE	P(WAITING LOSES)
None, gift the whole position	n/a	17.8%	5.0%
$130,000	23.5%	17.8%	5.0%
$140,000	17.6%	17.7%	5.1%
$150,000	11.8%	14.6%	9.2%
$160,000	5.9%	11.5%	15.2%
$170,000	no buffer	8.4%	22.9%

Above roughly an 18% buffer the commitment stops binding altogether: the surplus absorbs any decline large enough to have changed the decision, and the analysis reverts exactly to the whole-position case. Deliberate overfunding is therefore the practical answer to §4.4. It converts a fixed-dollar commitment back into a position gift at no cost, since the surplus remains available for future grants and continues to compound inside the fund.

This is not a workaround. It reflects what the fund is for: decoupling the timing of the contribution, which is tax-driven, from the timing of the grant, which is not.

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5 · WORKED EXAMPLE: A $170,000 CONTRIBUTION

Assume the employer stock is subject to a trading window and is being unwound separately under a scheduled plan. The client wishes to contribute $170,000 to their donor advised fund this year, and independently wishes to be out of the defense contractor position.

NAIVE PATH — GIFT THE MID-CAP FUND	
Deduction benefit	$62,900
Avoided gain tax ($170,000 × 61.9% × 20%)	$21,046
Gift subtotal	$83,946
Defense position must still be sold: $86,000 × 20%	−$17,200
Net	**$66,746**

The mid-cap position also falls from 10.5% to 5.0% against a 10% target, requiring roughly $140,000 of repurchase to restore.

FRAMEWORK PATH — WAIT SIX WEEKS, GIFT THE DEFENSE POSITION	
Deduction benefit	$62,900
Avoided gain tax ($86,000 × 20%)	$17,200
Net	**$80,100**

The defense position is fully exited, mid-cap remains at target, and active share improves. Framework advantage: $13,354.

Note what produces it. On the gift transaction alone, the naive pick wins by $3,846: it has the larger gain share, and that is real. The framework wins only once the defense sale the client was making regardless is brought inside the analysis. The gift should be evaluated against the client's full transaction plan for the year, not as a standalone decision. That is the argument this memo exists to make.

6 · THREE STANDING RULES

6.1 Never gift a loss position

The regional bank sits at a $25,000 unrealized loss. Gifting it produces a full fair market value deduction of $185,000, which looks acceptable in isolation and is why it occasionally happens.

But the loss is an asset. Sold, it generates $25,000 of harvestable loss worth $5,000 against long-term gains, or up to $9,250 against ordinary income within the $3,000 annual limit. Gifted, that value is destroyed: the charity inherits the position and the loss is never realized by anyone.

Correct treatment: sell the position, harvest the loss, gift the cash proceeds. The deduction is identical and the harvest is preserved. Small in dollars, but a reliable separator between practitioners who run gifting programs and those who have read about them.

6.2 Never gift cash while appreciated securities are available

The mirror-image error is more common and more costly. A client with cash on hand will often simply write the check, on the reasoning that the securities they hold are ones they want to keep.

That reasoning is incomplete, because the position can be replaced. Gift the appreciated shares in kind, then repurchase the same position with the cash that would have funded the contribution. The client ends with the same holding at the same market value, the charity receives the same amount, the deduction is identical, and the repurchase establishes a new cost basis at current market value, permanently eliminating the embedded gain on the shares transferred.

$170,000 CONTRIBUTION	DEDUCTION	EMBEDDED GAIN WASHED OUT	VALUE AT 20%
Cash	$62,900	–	–
Gift + repurchase mid-cap growth	$62,900	$105,230	$21,046
Gift + repurchase large-cap index	$62,900	$61,030	$12,206
Gift + repurchase developed intl	$62,900	$17,340	$3,468

The wash sale rules do not apply, they govern losses, not gains, so the repurchase can be immediate. The default should therefore be that cash is the funding source of last resort, used only when no appreciated position is available or none can be transferred.

The rule does not depend on an intention to sell. It is tempting to qualify this by saying the basis reset is only worth $21,046 if the position is eventually liquidated, and worthless for assets held to death and stepped up. That framing sets up the wrong comparison. The client has already decided to contribute $170,000; the only question is what funds it. Gifting the security and repurchasing leaves them holding the same position at the same value with a higher basis, an end state identical to the cash gift in every respect but one, and better in that one. The downside is bounded at zero. What varies with liquidation probability is the size of the benefit, never its sign, so the rule holds unconditionally even for positions the client intends to hold indefinitely.

Never selling is not a real category, and the benefit accrues at the lot level. Positions intended for perpetuity get sold anyway: a wedding, a grandchild, a medical event, a property purchase. Liquidity needs arrive on their own schedule and outrank tax planning when they do. The repurchase therefore does more than reduce a hypothetical future gain. It leaves the client holding recently established lots near basis, which are precisely what an unplanned liquidation should draw on first. A $50,000 emergency sale from a reset lot realizes essentially no gain; the same sale from the original mid-cap lot realizes $30,950 and costs $6,190. Basis diversity across lots is itself a liquidity asset, and gifting-and-repurchasing builds it as a byproduct.

AGI limits cut the other way. Appreciated securities are deductible to 30% of AGI against 60% for cash: a $170,000 contribution requires $566,667 of AGI as securities versus $283,333 as cash. A client near the threshold may deduct more in-year by gifting cash, and the comparison then turns on carryforward timing rather than basis. This is the one circumstance in which the cash gift can genuinely win.

Specify lots, and rotate the source. Repurchased shares are short-term for twelve months and unavailable for gifting during that window under §4. In practice this is a lot-selection question rather than a constraint: gift the oldest long-term lots and leave the newly established ones alone, and the position continues to carry gift-eligible lots indefinitely. Two further reasons it rarely binds: a full position is seldom gifted in a single year, particularly a large concentrated one, and where a small position is exhausted the program can simply rotate to a different holding the following year. Any portfolio with more than a handful of positions has ample rotation capacity.

Execution risk. The transfer and repurchase are not simultaneous. In-kind transfers to a sponsor typically settle over several days, during which the client is out of the market on that value. Repurchasing before the transfer settles is the alternative, which eliminates the out-of-market gap but substitutes a sizing problem: the exact share count leaving the account is not fixed until settlement, so the repurchase is made against an estimate. Either way the exposure is imperfect. The point is that this should be a conscious choice rather than an accident of paperwork.

6.3 Always transact at the lot level

Everything in §3 through §6.2 assumes the unit of decision is a tax lot, not a position. Where a position is being exited in full, lot identification is moot. Wherever a position is gifted in part, which is the normal case, average-cost accounting discards the entire basis of the analysis. The ranking metric, the holding-period gate, and the basis-reset argument all operate on lot-level attributes that an averaged position does not have.

Specific identification must be elected and documented. The default treatment at many custodians is average cost for funds and FIFO for equities, neither of which will reliably select the lot the analysis identifies. This is a standing account configuration, not a per-transaction decision, and it should be verified before a gifting program is designed around lot selection.

Contributions become lumpy, and that is correct. Lots do not divide evenly into round numbers. A client asking to move $150,000 may find that three specific lots total $152,375, and forcing the contribution to exactly $150,000 means either splitting a lot or selecting a worse one. The lot boundary should govern and the contribution amount should round to it, upward by preference.

This connects directly to §4.5. Rounding up produces exactly the overfunding buffer that neutralizes fixed-dollar exposure, so the two practices reinforce each other: gift whole lots, let the total land where it lands, and grant the committed amount out of a fund balance that comfortably exceeds it. The lumpy contribution figure is a feature of a correctly run program, not a rounding error in it.

Basis diversity is a byproduct worth managing deliberately. Because §6.2's repurchase establishes a new lot at current market value, a gifting program run at the lot level steadily builds a ladder of lots at varying bases within the same position. That ladder is what makes an unplanned liquidation cheaper: it gives the seller lots to choose among rather than a single blended basis, so the highest-basis lot can be sold and the gain recognized is lower than it would otherwise be. A program that gifts oldest-lot-first and repurchases annually maintains this ladder as a matter of course; one that transacts at the position level destroys it.

7 · IMPLEMENTATION NOTES

Holding-period calendar as a standing input. The §4 result is only actionable if lot acquisition dates are surfaced before the gift decision, not checked afterward. A gifting program should carry a forward calendar of positions approaching their one-year mark, reviewed against the contribution schedule. The single highest-value operational change most programs can make is moving this from a validation step to a planning input.

Annual rate screening. Identify holdings that liquidate outside the standard long-term rate: collectibles-backed funds at 28%, PFICs at ordinary rates with an interest charge, partnership structures with ordinary recapture. These break the basis-ordering equivalence noted in §3 and are the cases where a naive screen produces genuinely wrong rankings rather than merely incomplete ones.

AGI limitation. Contributions of appreciated securities are deductible up to 30% of AGI, versus 60% for cash. A $170,000 gift of appreciated stock therefore requires approximately $566,667 of AGI to deduct fully in-year; excess carries forward five years.

For clients with consistently high income this rarely binds, and gifting is often deliberately timed to coincide with large realization events, a property sale or a carried-interest distribution, where AGI is elevated well beyond the threshold. But the limit deserves active monitoring rather than assumption, particularly for clients with lumpy or episodic income. A contribution sized against a normal year can strand a deduction in a light one, and the carryforward, while usable, defers the benefit and interacts with the timing logic in §4. There is limited value in accelerating a deduction into a year where it cannot be absorbed.

Timing across the year. Where a client has a known realization event, funding the contribution against it directly is cleaner than year-end batching: the offset is explicit and the amount can be sized to the gain. For clients paying quarterly estimates, spreading contributions smooths the payment schedule and avoids a single large true-up or refund.

Market-level triggers. Gifting after a run-up maximizes deduction per share transferred. A strong year is a legitimate trigger independent of any tax event, and the reverse is worth stating explicitly: contributing into a drawdown transfers more shares for the same deduction, which is the opposite of what a gifting program should do.

Family governance. For many clients the year-end contribution is also a family event, with children participating in grant decisions from the accumulated fund balance. Advice that optimizes purely on tax and ignores this misses why the client does it. Where the two conflict, the governance calendar usually should win; the tax difference between a November and a January contribution is rarely large enough to justify overriding it.

Sponsor acceptance. Not every asset can be transferred in kind. Restricted stock, thinly traded securities, and partnership interests are frequently declined or require pre-approval and independent valuation. Confirm acceptance before building a recommendation around a position, and hold a liquid fallback.

8 · APPENDIX: SENSITIVITY OF THE §4 RECOMMENDATION

The §4 analysis uses a 20% long-term rate. Higher applicable rates strengthen the case for waiting, because the entire benefit of the delay is the rate spread between ordinary and long-term treatment.

Probabilities assume 35% annualized volatility over six weeks.

RATE ASSUMPTION	MARGINAL EXPOSURE	VALUE OF WAITING	BREAKEVEN PRICE	DECLINE REQUIRED	P(WAITING LOSES)
20% LTCG	$0.570	$17,200	$139,825	17.8% (1.49σ)	5.0%
23.8% incl. NIIT	$0.608	$20,468	$136,336	19.8% (1.67σ)	3.2%
23.8% + 2.5% state	$0.633	$22,618	$134,269	21.0% (1.77σ)	2.4%

The recommendation is robust across all three. A client subject to NIIT and state capital gains tax, the common case at this asset level, faces a stronger case for waiting than the base analysis suggests, not a weaker one.

Volatility sensitivity is given in the §4.3 table. The recommendation survives to approximately 55% annualized volatility at a six-week horizon before the probability of an adverse outcome exceeds 15%.

The dominant assumption is structural rather than statistical, specifically whether the client is gifting a position or a dollar amount (§4.4). Across the ranges tested here, that distinction moves the breakeven more than any rate or volatility assumption, and it should be confirmed before the framework is applied.

Modeled scenario prepared for illustrative purposes. All figures hypothetical. Not tax advice.