CHAPTER 32

CHARITABLE CONTRIBUTIONS

INTRODUCTION

A charitable contribution is a gratuitous transfer of property to a charitable, religious, scientific, educational, or other specified organization. If the donee (recipient) of the gift falls within one of the categories designated in the Internal Revenue Code, a charitable deduction may be taken for income, gift, or estate tax purposes.

Charitable contributions have tax value; therefore, because they can result in a current income tax deduction, may reduce federal estate taxes, and can be made free of gift tax. From the charity’s point of view, charitable contributions are also tax favored – the charity itself pays no tax upon receipt of either a lifetime gift or a bequest and, generally, no income tax is paid by the qualified charity on income earned by the charity on donated property. (This topic is covered in more detail in *The Tools & Techniques of Charitable Planning*.)

For tax years beginning before 2015 (unless this provision is extended), taxpayers who are age 70½ or older can make tax-free distributions to a charity from an Individual Retirement Account of up to $100,000. These distributions are not subject to the charitable contribution percentage limits since they are neither included in gross income nor claimed as a deduction on the taxpayer's return.[[1]](#endnote-1)

WHEN IS USE OF SUCH A DEVICE INDICATED?

1. When the donor wishes, for non-tax reasons, to benefit one or more charities.

2. When the donor wishes to reduce income or estate taxes by taking advantage of the deductions allowed for such gifts.

3. When the donor would like to achieve certain personal objectives. These are discussed below.

WHAT ARE THE REQUIREMENTS?

1. Charitable contributions are deductible only if they are made to organizations that are “qualified.” Examples of “qualified” organizations include nonprofit schools and hospitals, churches and synagogues, the United Way, Community Chest, United Cerebral Palsy, YMCA, YMHA, The American Red Cross, the Boy Scouts, Campfire Boys and Girls, and the American Heart Association.

A donee will be considered qualified only if it meets all three of these conditions:

(1) It must be operated exclusively for religious, charitable, scientific, literary, or educational purposes; or to foster national or international amateur sports competition, or to prevent cruelty to children or animals;[[2]](#endnote-2)

(2) No part of the organization’s earnings can benefit any private shareholder or similar individual;

(3) The organization cannot be one disqualified for tax exemption because it attempts to influence legislation or participates in, publishes or distributes statements for, or intervenes in, any political campaign on behalf of any candidate seeking public office. The Internal Revenue Service publishes a list of qualified charities in IRS Publication 78, which can be viewed on the IRS Website: http://apps.irs.gov/app/pub78.

Generally, an income tax deduction is available for contributions to churches, educational organizations, hospitals and medical research organizations, governmental units, and various other organizations and support organizations described in IRC Section 170(c). To the extent that the donor receives some benefit in exchange for the contribution, only the amount in excess of the benefit received by the donor is deductible.[[3]](#endnote-3)

It is important to note that the statutory descriptions of qualified charities for federal income tax purposes are not exactly the same as the descriptions of qualified charities for federal estate or gift tax purposes. One basic distinction is that except where a tax treaty says otherwise for income tax purposes the donee must be a domestic organization, whereas the donee for estate tax charitable deduction purposes can be a foreign *or* a domestic charity. (Be certain to check the rules under all applicable Code sections.)[[4]](#endnote-4) The client or practitioner should ascertain whether a potential donee is qualified under the Code. If it is not listed in IRS Publication 78, it is wise to request a copy of a determination letter from the IRS indicating that the charity does (or does not) qualify.

If you are making a bequest to a charity in a will, and you are not sure if it will qualify for the deduction, it may be advisable to include a provision in the Will that to the extent the organization does not qualify for the charitable deduction, the bequest will be paid to an alternate charity. Of course, this is only necessary if the size of the estate is large enough where the charitable deduction is necessary.

2. The second requirement necessary for a charitable contribution deduction is that *property* must be the subject of the gift. Therefore, the value of a taxpayer’s time or services, even if contributed to a qualified charity, is not deductible. For example, if a carpenter spent ten hours building chairs for his church, he could not deduct his normal hourly wage as a charitable contribution. However, he could deduct the cost of materials he purchased and used in producing the finished product. To view this from a conceptual perspective, since the carpenter never recognized the income associated with the ten hours building chairs, he cannot deduct the value of his services. The cost of the materials purchased can be deducted since the carpenter spent money which had previously been taxed to purchase the donated materials.

Likewise, a taxpayer who donates the *use* of his property to a charity has not made a contribution of property. So the rent-free use of an office, or even an office building, no matter how valuable the rent-free use of the facility might be, will not be considered a charitable contribution any more than a contribution of personal services.

3. A third requirement for a charitable contribution deduction is that there must be a contribution to the charity in excess of the value received by the donor. In some cases the donor will receive a benefit in conjunction with his charitable gift. Such a contribution is deductible only to the extent that the value of the contributed property exceeds any consideration or benefit to the donor. For example, the individual might donate cash to a charity. The charity in turn might pay the donor (and perhaps his survivors) an annuity income for life. Only the difference between the contribution made and the value of the annuity would be deductible (see Chapter 33). What the donor receives in return must be both incidental *and* insubstantial in relation to the gift made. It is very important that the facts demonstrate the individual's intent to make a charitable gift rather than engage in an exchange or obtain a bargain, regardless of how favorable that exchange or bargain is to the charity. Charitable intent is a *sine qua non* (i.e., an indispensable condition) to deductibility.

4. The fourth requirement that must be met for a deduction to be allowed is that the gift to charity must actually be paid in cash or other property before the close of the tax year in question. Typically, therefore, even an accrual basis taxpayer must actually pay cash or contribute other property before the close of the tax year in order to receive a deduction.

5. A charitable contribution at death will be deductible regardless of whether it is made by will, by the terms of a life insurance policy, or by gift during the decedent’s lifetime in such a manner that the gift will be includable in his gross estate. But in order to be deductible by the decedent, he or she must make the gift, as distinguished from a transfer made by his estate or beneficiaries. Therefore, a deduction would not be allowed for a bequest to charity if the bequest requires the approval of a third party.

6. Where the lifetime transfer or bequest to charity is a gift of a “partial interest” (i.e., where the gift will be split between non-charitable and charitable beneficiaries), the general rule is that no deduction will be allowed – unless the strict rules in the statutory exceptions are met. Generally, if a charity’s interest in the transfer of property is a remainder interest (i.e., the charity receives what remains after the non-charitable income beneficiaries have received income for a specified time), a transfer in trust will qualify *only* if it is an annuity trust, unitrust, or a pooled income fund as these terms are defined by the Code. (These terms are defined and described in Chapter 33.)

A qualified appraisal (as required by IRS Form 8283)[[5]](#endnote-5) must accompany a tax return showing donations of property valued at over $5,000. Who can be an appraiser? An individual is qualified to be an appraiser for tax purposes only if (1) the individual has earned an appraisal designation from a recognized organization or demonstrated competency in valuing the type of property being appraised or met certain minimum education and experience requirements; (2) the individual regularly prepares appraisals for which they are paid; (3) the individual demonstrates verifiable education and experience in valuing the type of property being appraised; (4) the individual has not been prohibited from practicing before the IRS. The appraiser must also understand that an overstatement of value may lead to the imposition of penalties. The appraisal may not be made by the donor, the organization receiving the contribution, any person from whom the property was acquired, or certain related individuals or entities. Generally, a separate appraisal must be made for each item of property unless similar items are donated in the same year. Partnerships donating property valued at over $5,000 must provide a copy of the appraisal to every partner who receives a proportionate share of the deduction.

The appraisal must also meet the requirements of Regulations Sec. 1.170A-13(c)(3) and Notice 2006-96, 2006-46 I.R.B. 902. In general, the appraisal must be signed and dated by the appraiser. In addition, the appraisal must: (1) be made within sixty days prior to the date of contribution; (2) be prepared, signed and dated by a qualified appraiser; (3) include certain required information; and (4) not involve a prohibited fee. [[6]](#endnote-6)

7. In addition, in the case of charitable contributions of art valued at more than $50,000, the taxpayer may request a “Statement of Value” from the IRS to substantiate the gift for income tax purposes. The request must be accompanied by a copy of the appraisal, a completed appraisal summary, and the user fee ($2,500 for the first three pieces of art).[[7]](#endnote-7)

While the appraisal requirement does not apply to gifts of publicly traded securities, it does apply to non-publicly traded securities worth more than $10,000. Note there are severe penalties for overvaluation of charitable gifts.

In the case of all contributions, including cash, a charitable deduction is not allowed for any contribution of $250 or more unless the donor also obtains contemporaneous written acknowledgement that includes: (1) the amount of money, or a description of the property contributed; (2) whether the organization gave any goods or services to the taxpayer in return for the contribution; (3) a description and good faith estimate of the value of the goods and services; and (4) a statement that the goods and services provided consisted solely of intangible religious benefits. Canceled checks, alone, are not sufficient in such cases.

In addition, no charitable deduction is allowed for a non-cash contribution in excess of $500 unless the taxpayer attaches Form 8283 to his tax return showing the required information (on Part A). If you are donating clothing or household items worth more than $500, you must get an appraisal unless the property is in good condition or better. If the property is not in good condition or better, you can still claim the deduction so long as you get the item appraised.

Special rules also apply when donating an automobile to charity. If the motor vehicle is worth more than $500, you must attach to your tax return an acknowledgement from the organization to which you donated the vehicle. With certain exceptions, the amount of the deduction is equal to the smaller of the vehicle’s fair market value on the date of the contribution or the gross proceeds received from the sale of the vehicle. The second limitation, relating to the sales proceeds, does not apply if the charitable organization improves the vehicle, uses the vehicle, or gives/sells the vehicle to someone below fair market value in furtherance of the organizations purpose of helping out the poor.

All donors must keep canceled checks, receipts, or other reliable written records. These documents must show the name of the donee, the date of the contribution, and the amount of the gift. The safest approach is to make the records at the same time the gift is made and have the recipient charity sign a receipt.

HOW IT IS DONE – AN EXAMPLE

A direct gift to charity is probably one of the simplest estate planning techniques. During lifetime, such a gift can be accomplished merely by writing a check, assigning stock, transferring life insurance policies, signing a deed to real estate, or conveying property to charity in any other standard outright manner.

Likewise, at death, gifts to charity can be made by will, by life insurance contract, by employee benefit contract (i.e., the death benefits from a pension plan, IRA, 401(k) plan, or nonqualified deferred compensation plan can be paid to charity), or by trust. Generally, lifetime gifts to charity yield both higher tax and non-tax rewards.

TAX IMPLICATIONS

1. A charitable contribution to a qualified charity may reduce current income taxes (assuming the donor itemizes deductions).

2. No federal gift tax is payable on a gift to a qualified charity regardless of the size of the gift.

3. Gifts to qualified charities can reduce the federal estate tax, with the amount of the deduction limited only by the value of the gift (i.e., the donor’s entire estate can be left to charity and a deduction will be allowed for the entire gift).

4. The charity itself will pay no tax upon the receipt of either a lifetime gift or a bequest.

5. Generally, no income tax will be payable by a qualified charity on income earned by donated property.

6. If an otherwise deductible charitable contribution to a college or university entitles the donor to purchase tickets for athletic events, 80% of the contribution will be deductible.

1. For federal income tax purposes, there are percentage limitations on the amount that can be claimed as a charitable contribution deduction; these depend on, among other things, the type of property transferred. (The percentage limitations are discussed, below, in the Frequently Asked Questions section, and are also displayed in Figure 32.1.)

For tax purposes, potential charitable donees will be classified either as a private foundation or a public charity. The percentage limitations discussed below are those generally applicable to public charities. There are stricter percentage limitations on deductions for contributions to most private foundations.

Any organization that is classified as a charity under Internal Revenue Code Section 501(c)(3) is deemed a private foundation *unless* it is: a church; an educational organization with a regular curriculum, faculty, and student body; a hospital; a governmental unit; or certain other publicly supported institutions and support organizations.

In view of the importance of the income tax charitable contribution deduction and the percentage limitations, it is important for the advisor to determine not only whether the charitable recipient is a qualified charity, but also whether it is a private foundation – and if so, what type of private foundation.

IMPLICATIONS AND ISSUES IN COMMUNITY PROPERTY STATES

Because of the equal ownership aspect of community property between a husband and wife, care must be exercised in the creation of a charitable trust, since a taxable transfer may occur.

*Example.* If community property is used to fund a trust that benefits only one of the spouses, there has been a gift by the other spouse. Conversely, if the separate property of one of the spouses is used to fund a trust that provides for a lifetime benefit for both spouses, there is a recognized gift to the non-contributing spouse. The availability of the unlimited marital deduction for federal gift tax purposes eliminates prior concerns as to federal gift tax (see Chapter 24). However, some states still have some form of gift tax, and only some of those states have an unlimited gift tax marital deduction. Therefore, state gift tax can still be a problem in these circumstances. However, if community property is used to fund a trust that provides a lifetime benefit for *both* spouses, there will be no gift tax consequences.

It is possible for community property to be “split,” creating separate interests for each spouse, which could then be used to fund separate charitable trusts, each involving life interests of only the spouse making the gift. Or, one spouse can make a gift with her half of the “split” funds, and the other spouse can use the funds for his own purposes or to pay their joint income tax liability. In order for community property to be “split,” an agreement between the parties must be made to that effect. A “split” is essentially a transmutation of community property to separate property; such transmutations must be in writing in some states (e.g., California). If there is no written agreement requiring a particular division of the property in the community estate, the law generally requires the estate to be divided equally between the spouses.

As a general rule, no consideration is necessary to support a transmutation agreement between the spouses, and such agreements may be entered into both before and during marriage.[[8]](#endnote-8)

Under the community property laws in many states, a valid contribution of community property cannot be made to a charity by one spouse without the consent of the other spouse. This consent should be obtained before the close of the tax year for which the deduction will be claimed; otherwise the IRS may argue the contribution was not complete and is not deductible.

Generally, the same income, estate and gift tax advantages that are available for gifts of separate property will be available in situations where community property is the subject of a charitable contribution.

FREQUENTLY ASKED QUESTIONS

**Question** – How do you calculate the tax savings and after-tax cost of a charitable contribution?

*Answer* – The tax savings and after-tax cost can be found as follows:

|  |  |  |
| --- | --- | --- |
| Tax Savings | = | Amount of deductible gift x Effective tax bracket |

*Example.* A $2,000 gift by a taxpayer in a 40% (federal and state) income tax bracket equals $800 in tax savings. Stated another way, the out-of-pocket cost of the gift equals:

|  |
| --- |
| Amount contributed – Tax savings |

For instance, the $2,000 gift above less the $800 in income tax savings equals the out-of-pocket cost of the gift, $1,200.

**Question** – How do you determine the amount of an income tax charitable deduction?

*Answer* – The amount of a charitable contribution deduction that will be allowed for income tax purposes depends on the five following factors, which will be discussed in detail below:

1. *The type of property given away.*

(a) Rent-free occupancy;

(b) Cash;

(c) Long-term capital gain property;

(d) Ordinary income property;

(e) Tangible personal property where the use of that property by the donee is *related* to the exempt functions of the donee; and tangible personal property where the use of that property is *unrelated* to the exempt purposes of the donee;

(f) Future interests in property. (The various types of property listed above will be discussed in detail in the following question.)

2. *The identity of the donee.* Generally, contributions to publicly supported domestic organizations – so-called “public charities” – are more favorably treated than contributions to foreign organizations or to most private foundations. Cash contributions to public charities, for example, are fully deductible up to 50% of a donor’s contribution base (i.e., adjusted gross income computed without regard to any net operating loss carryback to the taxable year).

The deduction for an individual’s contributions to most nonpublic (private) charities, regardless of the type of property given away, is limited to the lesser of (a) 30% of the taxpayer’s contribution base, or (b) 50% of his contribution base minus the amount of charitable contribution deductions allowed for contributions to the public-type charities.[[9]](#endnote-9) For example, if a wealthy individual donates property worth 40% of his contribution base (AGI) to a public charity such as the Boy Scouts, his contributions to “30% charities” (private charities) are deductible up to only 10% of his contribution base.[[10]](#endnote-10) The limitation for gifts of capital gain property to private foundations is the lesser of 20% *or* the unused portion of the 30% limitation.

Donations to individuals or to foreign charities (except where allowed by treaty) are not deductible for income tax purposes.

3. *The identity of the donor.* Deductions for contributions made by individuals are limited to specified percentages of their contribution base. An individual must itemize deductions in order to claim an income tax charitable contribution deduction. A corporation is limited to a deduction based on a percentage of its taxable income.[[11]](#endnote-11)

4. *The amount of property given away.* Both individuals and corporations can carry over excess contributions (i.e., contributions above their deductible limit) for up to five years.[[12]](#endnote-12)

5. *The place where the contribution is to be used.* As mentioned above, gifts made to United States charities are treated more favorably than gifts to most foreign charities.

**Question** – How does the type of property interest given to charity affect the income tax limitation on deductions? What is the effect of a contribution of a partial interest in property to charity?

*Answer* – Generally, a charitable contribution of less than a donor’s entire interest in property is not deductible. Gifts of a partial (a.k.a "split") interest in property are deductible only in four very narrowly defined situations:

1. The first is a gift of an undivided portion of the donor’s entire interest in property.[[13]](#endnote-13) For example, if Jesse Torelli, a successful businesswoman, gave her original Ramlo sculpture to the Philadelphia Museum of Art, but agreed with the museum that she could keep it in her home as long as she or her husband Wayne lived, no current deduction would be allowed. However, if Jesse gave an undivided one-half interest in the sculpture (i.e., if she gave the museum an immediate, absolute, and complete right of ownership, for display purposes or otherwise, for one-half of each year), she would likely be successful in obtaining a current deduction.[[14]](#endnote-14)

2. The second situation involves a gift of a remainder interest in a personal residence or farm.[[15]](#endnote-15) If Robin Lynn Kay gives her home or her farm to a qualified organization with the stipulation that she may live there for life, she may take a current income tax deduction for the value of the future gift. This assumes, of course, that the gift is irrevocable.

3. The third circumstance in which a charitable contribution of less than the donor’s entire interest could generate a deduction is where the donor makes a gift to a qualified charitable organization of a remainder interest in real property granted solely for conservation purposes.[[16]](#endnote-16)

4. Finally, a gift of a partial interest would be deductible if transferred in trust. This exception allows a charitable deduction for transfers of property in trust even if the taxpayer transfers less than his entire interest. The deduction is allowed to the same extent that a deduction would be allowed had the same property been transferred directly to the charitable organization rather than in trust.

However, where there is a gift of a partial interest in tangible personal property to charity, it is necessary for the portion of the interest retained by the donor to be gifted within ten years of the initial contribution (or the date of death of the donor if the donor dies within the ten years). Failure to do so will result in a recapture of the tax benefits, plus interest and a ten percent penalty.[[17]](#endnote-17)

Figure 32.1 and the discussion that follows illustrate how each type of property influences the limitation on the deduction for an individual who itemizes deductions.

**Figure 32.1**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **CHARITABLE CONTRIBUTION DEDUCTION LIMITATIONS** | | | | | | | |
| ***PERCENTAGE LIMITATION*** | | | | | | | |
|  |  |  | ***INDIVIDUAL***  ***AS DONOR*** | ***CORP.***  ***AS DONOR*** |  |  |  |
|  | ***Type of Property***  **N(1)** | ***Donee†***  **(2)** | ***Adjusted Gross***  ***Income\*\****  **(3)** | ***Taxable***  ***Income***  **(4)** | ***Individual***  ***Carryover***  **(5)** | ***Corporation***  ***Carryover***  **(6)** | ***TAX***  ***TREATMENT***  **(7)** |
| (A) | Rent-Free Occupancy or Services | – | – | – | – | – | No Deduction |
| (B) | Cash | Public | 50% | 10% | 5 yrs. | 5 yrs. | Full Deduction |
| (C) | Long-Term Capital Gain Property (except for tangible personal property) | Public | 30%\* | 10% | 5 yrs. | 5 yrs. | Full Deduction for  Fair Market Value |
| (D) | Ordinary Income Property | Public | 50% | 10% | 5 yrs. | 5 yrs. | Deduction Limited  to Basis†† |
| (E) | Tangible Personal  Property  (L.T.C.G. Property) |  |  |  |  |  |  |
| (1) Use-Related | Public | 30%\* | 10% | 5 yrs. | 5 yrs. | Full Deduction for  Fair Market Value |
| (2) Use-Unrelated to Exempt Purposes of Donee | Public | 50% | 10% | 5 yrs. | 5 yrs. | Deduction Limited  to Adjusted Basis |
| (F) | Future Interests in Property\* |  |  |  |  |  |  |
| \* See detailed discussion in text.  \*\* With certain adjustments.  † Regardless of the type of property given, the deduction for an individual's contributions to private charities is limited to the lesser of (a) 30 percent of the taxpayer's “contribution base” (roughly the same as adjusted gross income) or (b) 50 percent of the contribution base less any charitable contribution deduction allowed for contributions to public-type charities.  †† There is an important exception. The deduction for corporate donors (other than S corporations) has a higher limit, basis plus one-half of appreciation in value, where the property is to be used by the donee solely for the care of the ill, the needy, or infants. (See the text below). | | | | | | | |

*(A) Rent-Free Occupancy*

Contributions of a mere right to use property (such as a rent-free lease of meeting space in a building owned by an individual to the Boy Scouts) are not deductible.[[18]](#endnote-18) This is the situation because, to be deductible, contributions must be made in cash or other property. The mere right to use property is considered neither cash nor other property. The IRS considers a contribution of the right to use property as a contribution of less than the donor’s entire interest in the property.

*(B) Cash*

Where the property is cash (as in a gift of any other type of property), it is necessary to ask, “Who is the donee?” If the donee is a publicly supported charity, the deduction ceiling (column 3) is 50% of the individual taxpayer’s contribution base (generally, adjusted gross income).[[19]](#endnote-19)

A corporation’s deduction is limited to 10% of its taxable income (with certain adjustments).[[20]](#endnote-20) Regardless of the type of property given, a corporation can always take a current deduction of up to 10% of its taxable income (column 4). Likewise, regardless of the identity of the donee, a corporation may carry over excess contributions for up to five years (column 6).

Contributions by individuals to “public” charities in excess of the deductible limit for the taxable year may also be carried over (column 5) for a period of up to five years.[[21]](#endnote-21) In other words, excess contributions are not wasted and can be used as itemized deductions in future years. For example, if Scott Jeffries contributed $20,000 in cash to a synagogue, but his contribution base was only $36,000, he could currently deduct only 50% of his contribution base, $18,000. He could, however, carry over the $2,000 excess ($20,000 contribution minus $18,000) to the following year. (A 5-year carryover is also provided for excess contributions to private foundations.)

A full deduction, up to 50% of the contribution base of individuals who itemize deductions, or 10% of taxable income for corporations, is allowed for gifts of cash (column 7).[[22]](#endnote-22)

*(C) Long-Term Capital Gain Property*

“Long-term capital gain property” is property that would have produced a long-term capital gain (held for more than one year) on the date of the gift had it been sold rather than donated to charity.

Long-term capital gain property can be divided into two types:

(1) The first type consists of intangible personal property and all real property. A gift of Xerox stock purchased 11 years ago at $100 a share, now worth $400 a share, would be considered intangible personal long-term capital gain property. Appreciated land held the requisite “long-term” period would be an example of real property that is properly classified as long-term capital gain property.

(2) The second type of long-term capital gain property is tangible personal property, such as a car, a painting, sculpture, an antique, or jewelry. Tangible personal property will be discussed in Section E.

Where intangible long-term capital gain property, such as stock held for the requisite period, is given to a “public” donee (column 2), an individual’s deduction may not exceed 30% of his contribution base (column 3).[[23]](#endnote-23) If his gift exceeds this percentage limitation, he may carry over the disallowed portion of the deduction for up to five succeeding years (column 5). The full fair market value of the gift is deductible (column 7).[[24]](#endnote-24)

*Example.* Suppose Nick Catrini donates stock worth $25,000 to the United Way. The stock cost $12,000 when he purchased it four years ago. If his adjusted gross income is $50,000, his maximum deduction for the contribution is $15,000 (30% of $50,000). He will be able to carry over the $10,000 balance and apply that as a 30%-type deduction against future years’ income.

The deduction for contributions of long-term capital gain property is doubly advantageous. First, a person saves the taxes on his potential profit; in the above example, Nick saves the tax on a $13,000 long-term capital gain. Second, he gets a deduction for the full fair market value of the gift; here it will be $25,000.

Contributions of certain publicly traded stock to private foundations share the same advantages as similar gifts to public charities. Generally, a gift of publicly traded stock (which if sold, would result in a long-term capital gain) made to a private foundation is deductible at its full fair market value provided that the amount of stock does not exceed 10% in value of all the outstanding stock of the corporation.[[25]](#endnote-25)

There is an election the taxpayer may want to make in certain situations. The 30% limitation can be increased to 50% if the donor is willing to reduce the value of his gift by the amount of his potential gain.[[26]](#endnote-26) The election can be extremely important for a taxpayer whose income fluctuates widely from year to year. It is of particular value when the amount of appreciation is small. For example, the value of a gift of long-term capital gain property with a basis of $980 and a fair market value of $1,000 would be reduced by only $20. In this way, the taxpayer could qualify for the higher 50% limitation at the expense of losing only a very small portion of his deduction.

*(D) Ordinary Income Property*

“Ordinary income property” is an asset that would have generated ordinary income (rather than capital gain) on the date of contribution had it been sold at its fair market value rather than contributed.[[27]](#endnote-27) Ordinary income property includes: (a) capital assets held less than the requisite long-term period at the time contributed; (b) Section 306 stock (i.e., stock acquired in a nontaxable corporate transaction that is treated as ordinary income if sold); (c) works of art, books, letters, and musical compositions, but only if given by the person who created or prepared them or for whom they were prepared; and (d) a taxpayer’s stock in trade and inventory (which would result in ordinary income if sold).[[28]](#endnote-28)

Ordinary income property given to a public charity (column 2) by an individual is deductible subject to a 50% of contribution base ceiling. However, a taxpayer’s deduction is generally limited to his basis (cost) for the property (column 7).[[29]](#endnote-29) For example, if a famous painter donated one of his paintings worth $25,000 to an art museum, his deduction would be limited to his cost for producing the painting. This means that only the cost for canvas, paint, etc., would be deductible. No deduction would be allowed for the value of his time and talent.

A similar situation occurs in the case of Tony Molino, who owned his National Motors stock for 4 months (i.e., a sale would have resulted in short-term capital gain). He purchased the stock at a cost of $12,000 and gave it to Villanova Law School when it was worth $25,000. Therefore, since the property is considered ordinary income property, only his cost (basis) is deductible. Tony will be limited to a charitable deduction of $12,000 even though the property had a fair market value of $25,000 at the time of the gift. Had Tony waited until the sale of the stock would have generated long term capital gain; he would be entitled to the deduction for the full fair market value of the stock.

An exception to this rule is provided for certain ordinary income property, such as inventory, given by a corporation to a public charity, or a private operating foundation for use in its exempt purpose for the care of the ill, the needy, or infants (e.g., a contribution of medical supplies to the Red Cross).[[30]](#endnote-30) In situations where this requirement can be met, the allowable deduction for contributions of appreciated ordinary income property is limited to (a) the donor’s basis plus (b) one-half the potential gain in the property (but in no event can this deduction exceed twice the basis).[[31]](#endnote-31)

*Example.* Assume a pharmaceutical corporation donates $11,000 worth of medicine (inventory) to a charity that performs services for ill and infirm individuals. If the basis to the corporation was $5,000, it may deduct $8,000 – its $5,000 basis plus one-half of the $6,000 potential gain.

Gifts of substantially appreciated ordinary income property should be avoided if possible. Capital assets should be held for the requisite long-term period if that will make it long-term capital gain property (i.e., deductible at full fair market value), or left to charity by will so that a full estate tax deduction can be obtained. Alternatively, ordinary income property could be left to the donor’s children by will. The stepped-up basis the children would receive in the property after the donor’s death would enable them to obtain a larger income tax deduction then if they were to give the property to charity.[[32]](#endnote-32)

*(E) Tangible Personal Property*

Tangible personal property (which would have produced capital gain if sold) includes cars, jewelry, sculpture, art works, books, etc., but only if created or produced by a person other than the donor.[[33]](#endnote-33) With respect to this type of property, a distinction must be made between (a) gifts that will be used by the donee charity in such a manner that the use of the gift is related to the exempt purposes of the donee (“use related” gifts), and (b) gifts that will not be used by the charity in a manner related to the exempt purposes of the donee (“use unrelated” gifts).

An example might be the contribution of a stamp collection to an educational institution. If the stamp collection is placed in the donee organization’s library for display and study by students, the use of the donated property is related to the educational purposes constituting the basis of the charitable organization’s tax exemption. However, if the stamps were sold, even if the proceeds were used by the organization for educational purposes, the use of the property would be an unrelated use.

*Example.* Elwood Chester has a $10,000 contribution base. He contributes a collection of whaling harpoons to the Cape May County Historical Museum for display purposes. The collection cost him $2,000, but on the date of contribution it was worth $10,000. The type of property contributed is tangible personal property. The donee is a public charity and the gift is “use related” to the exempt purposes of the Museum. Therefore, for the year of contribution, he can deduct up to 30% of his contribution base (AGI), $10,000. This figure is $3,000. In addition, because the full $10,000 contribution is deductible, he will be able to carry over the remaining $7,000 for up to five years (subject to the 30% rule each year).

If the gift is “use unrelated” (i.e., made to a donee whose direct use of the asset is unrelated to the charitable function of the donee), the deductible amount is limited to the donor’s basis in the property. This is true for corporations as well as individuals.[[34]](#endnote-34)

*(F) Future Interests in Property*

A “future interest” is any interest or right that will vest in possession or enjoyment at some time in the future. The term “future interest” includes situations where a donor purports to give tangible personal property to a charitable organization, but has made a written or oral agreement with the organization reserving to a non-charitable beneficiary (himself or a member of his immediate family) the right to use, possess, or enjoy the property. For example, suppose Robin Lynn donates a genuine Douglas W. Mellor photograph to an art museum, but arranges with the museum to keep the photograph in her home as long as she lives. The museum has a future interest in the photograph.

One of the basic general rules governing charitable deductions is that contributions must be: (a) actually paid; (b) paid in cash or other property; and (c) paid before the close of the tax year. Furthermore, generally no deductions are allowed for an outright contribution of less than the donor’s entire interest in property.

Since the benefit to the museum – and consequently to the public – was deferred in the gift of the D. W. Mellor photograph, no current tax deduction would be allowed. The implication is that a deduction will not be allowed until the charity receives actual possession or enjoyment of the work of art. The gift of tangible personal property must be complete in the sense that all interests and rights to the possession and enjoyment of the property must “vest” in the charity. This means that a transfer of a future interest in property to a charity is not deductible until all intervening interests in and rights to possession held by the donor or certain related persons or organizations have expired, or unless the gift is in the form of a future interest in trust that meets the requirements discussed in Chapter 33.

Charitable remainder interests are a form of future interest in which an income interest is either retained by the donor or is given by the donor to another person. At the death of the income beneficiary, the principal goes to a designated charity. An example would be a gift to X for life where the “remainder” (i.e., the principal at the death of X) goes to charity (the “remainder person”) upon the death of X (the income beneficiary). A gift “to X for life, remainder to Villanova School of Law” would be considered a gift of a future interest to the law school. Charitable remainder trusts are discussed in more depth in Chapter 33.

**Question** – Why are stocks and bonds often used for charitable gifts?

*Answer* – Securities such as listed stocks, mutual funds, or bonds are often selected as the subject of a charitable gift because:

(1) They are transferable with minimal cost or delay;

(2) As mentioned above, appreciated securities can often be transferred without causing the donor to realize gain on the appreciation and still yield a current deduction measured by the fair market value of the gift;

(3) If securities selling below their cost are sold, the net proceeds can be donated; this “sale-gift” procedure can lower the donor’s tax;

(4) The donor’s spendable income is often increased, rather than decreased, by the contribution;

(5) A lifetime gift removes appreciating property from an individual’s estate and, thus, may lower death taxes and administration expenses; and

(6) The gift is easily valued and documented.

**Question** – What is a bargain sale and how is it used for charitable purposes?

*Answer* – The bargain sale is a device used to minimize the out-of-pocket cost of a charitable gift. At one time, an individual could sell appreciated property to a charity at his cost. The donor would receive an amount equal to his investment. In addition, he would obtain a charitable deduction for the appreciation in the property with no tax on his portion. That's no longer possible.

Under current law, a taxpayer may have to recognize a taxable gain on the bargain sale because he must allocate his cost basis between the part of the property he sold to the charity and the part he donated.[[35]](#endnote-35) This means the donor pays tax on his pro rata share of the appreciation. In other words he's treated as if he engaged in two transactions – one a sale to the charity, and the other a gift. He'll be required to pay income tax on any gain realized in the "sale" portion of the transaction, but will receive a deduction for the portion considered to be his charitable gift.

*Example.* Suppose a donor sells property he has owned for several years to his favorite charity. On the date of the sale the property was worth $10,000. The sale price is the same as the donor’s cost, $4,000. So 4/10ths of the transaction is the sale portion. The gift portion amounts to the remaining 6/10 (60%) of the property, so he is deemed to have made a gift to the charity equal to 60% of his $4,000 cost basis, $2,400. This leaves the donor only the difference, $1,600 of cost basis, to apply against the $4,000 he is deemed to have realized in the “sale.” His long-term capital gain is therefore $2,400 ($4,000 amount realized - $1,600 basis).

The $6,000 gift ($10,000 - $4,000) saves the donor $2,100 in taxes if he is in a 35% marginal tax bracket. He also has recovered his $4,000 investment, so his total “recovery” is $6,100 ($2,100 + $4,000). Since the maximum capital gain rate for capital assets held more than 12 months is 15%, his tax will be $360, 15% of his capital gain, $2,400. His net return, $5,740 ($6,100 - $360), is the sum of (a) his tax savings plus (b) the amount he realized in the sale less (c) the tax he had to pay on the sale, and the charity is enriched by $6,000.It is important to keep in mind that the documentation requirements still apply in the case of bargain sale gifts. With a bargain sale, the donor is receiving some type of benefit in exchange for the contribution. The requirements associated with gifts of property apply to these benefits received by the donor. One court disallowed a deduction because the taxpayer failed to disclose consideration received by the donor in exchange for the contribution.[[36]](#endnote-36)

**Question** – How can a gift of closely held stock be used to generate a charitable contribution deduction?

*Answer* – Several court decisions opened the door to another charitable contribution deduction tool: the use of closely held stock. The idea is to enable the owner of a closely-held corporation to siphon funds from his business free of income tax by making a charitable contribution of his personally owned stock, followed by an unrelated redemption of that stock by the corporation.[[37]](#endnote-37) If used properly, the technique may reduce or eliminate the threat of an accumulated earnings tax problem, generate a current income tax deduction for the donor (with no loss of control), and provide cash for the donor’s favorite charity with no out-of-pocket outlay.

It works like this. First, the stockholder donates some of his stock to the charitable organization. He receives a charitable deduction measured by the present value of the stock contributed. Then, at some future date, the corporation redeems (i.e., buys back) the stock from the charity. (Had the corporation redeemed the stock directly from the donor, dividend treatment would probably have resulted.)

One use of this device involved a closely held corporation whose controlling shareholder gave a school about 200 shares of his corporation’s stock each year. He took an annual deduction for the present value of the gifts, about $25,000.

The terms of the gift provided that the university could not dispose of the shares without first offering them to the corporation at their book value. The corporation was not required to purchase the stock, but did have 60 days in which to purchase any stock offered to it. Within a year or two after the shares were received by the school, they were offered to the corporation, which always purchased them – even though it was not legally bound in any way to do so. The proceeds of these redemptions were then invested by the school.

It appears that the key elements to the success of this device are the fact that the gifts were, in fact, complete and irrevocable, and that there was no formal or informal agreement that the university would offer the stock for redemption or that the corporation would purchase the stock from the school. This avoided the obvious IRS attack that the corporation’s redemptions from the charity were in essence indirect redemptions from the donor and, thus, should have been taxed as ordinary income to the donor.[[38]](#endnote-38)

A donor's retention of substantial rights in the stock given to charity, such as voting rights, will result in disallowance of the deduction because the entire interest in the property will not have been transferred.[[39]](#endnote-39) Furthermore, the stock will be included in the gross estate of the donor because of the retention for life of the right to vote the stock.

**Question** – Why is life insurance a good way to make charitable contributions?

*Answer* – Life insurance, like any other type of property, can be, and often is, the subject of a gift. In fact, life insurance is a favored means of making charitable contributions for a number of reasons.[[40]](#endnote-40)

First, the death benefit going to charity is guaranteed as long as premiums are paid. This means that the charity will receive an amount that is fixed in value and not subject to the potential downside risks of securities.

Second, life insurance provides an “amplified” gift that can be purchased on the installment plan. Through a relatively small annual cost (premium), a large benefit can be provided for the charity. A large gift can be made without impairing or diluting the control of a family business interest or other investments. Assets earmarked for the donor-insured’s family can thus be kept intact.

Third, life insurance is a self-completing gift. If the donor lives, cash values, which can be used by the charity currently, grow constantly from year to year. If the donor becomes disabled and the policy contains a waiver-of-premium feature, the policy will remain in full force, guaranteeing the ultimate death benefit to the charity as well as the same cash values and dividend build-up that would have been earned had the insured not become disabled. Even if death occurs after only one deposit, the charity is assured of its full gift.

Fourth, the death proceeds can be received by the designated charity free of federal income and estate taxes, probate and administrative costs and delays, brokerage fees, and other transfer costs. Thus, the charity, in fact, receives “one hundred cent” dollars. This prompt cash payment should be compared with the payment of a gift to a selected charity under the terms of an individual’s will. In that case, probate delays of up to several years are not uncommon.

Fifth, because of the contractual nature of the life insurance policy, large gifts to charity are not subject to attack by disgruntled heirs.

Finally, a substantial gift may be made with no attendant publicity (i.e., confidentially) because the life insurance proceeds to be paid to charity can be arranged so that they will not be part of the decedent’s probate estate. Of course, publicity may be given if desired.

*Warning:* In Private Letter Ruling 9110016, the Service denied a charitable deduction for premiums paid on a life insurance policy assigned to a charity on the grounds that since the charity had no insurable interest (under New York law) in the insured, payment of the proceeds to the charity could violate state law. If so, it was determined that the proceeds would be included in the insured’s estate and, thus, subject to federal estate tax. Subsequent to the Service’s treatment of the matter, New York amended its insurable interest statute to give charities an insurable interest in donors’ lives. The Service responded to New York’s amendment by issuing Letter Ruling 9147040, which revoked Letter Ruling 9110016. Most states now have insurable interest statutes giving charities an insurable interest in the lives of their contributors. Some states require the charity to be the owner and irrevocable beneficiary while others allow the insured to be the initial owner if a subsequent transfer to the charity is made. A complete list of every state’s insurable interest law with respect to charities is available at http://www.leimbergservices.com.

**Question** – How is the gift of a life insurance policy valued?

*Answer* – Since the bundle of rights in a life insurance policy can be considered equivalent to property, a gift of a life insurance policy is valued according to the same general tax rules as any other gift of property.

If a life insurance policy were sold at a gain, the gain would be taxed at ordinary income rates; to the extent the cash surrender value exceeds premiums paid and capital gain for any excess value over the cash surrender value; therefore, a gift of life insurance is at least partially a gift of ordinary income property. Assuming the value of the policy (i.e., the interpolated terminal reserve plus unearned premium on the date of the sale) exceeds the policyholder’s net premium payments, the deduction for a gift of a policy is generally limited to the policyholder’s basis (cost) – in other words, his net premium payments (plus by capital gain if the policy was held more than 1 year).

*Example.* Suppose an individual assigns a policy on his life to the American Heart Association. His charitable contribution deduction is limited to his basis (i.e., his cost in the contract) or the value of the policy, if lower. If the individual paid net premiums of $15,000, but the policy had a value of $18,000, his charitable contribution deduction would be limited to $15,000 if the value of the policy is its cash surrender value.

If there had been no gain upon a sale of the policy, the value of the donated policy would then be equal to its replacement cost at the date of the gift. In other words, if the total net premiums paid exceed the value of the policy when the individual assigns it (i.e., the policy would not give rise to a gain if sold), the deduction would be limited to the lower of the two, its replacement cost.

The amount of the deduction is dependent on the replacement cost of the policy. This differs depending on whether the policy in question is (1) a single premium or paid-up policy, (2) a premium-paying policy, or (3) a newly issued policy. The insurance company in question will generally calculate the exact value on IRS Form 712 upon request. One concern is that a gift of an insurance policy valued in excess of $5,000 must be accompanied by an appraisal. Generally the issuing insurance company will value the policy but there is a question as to whether it may be a qualified appraiser.

The replacement cost of a single premium or paid-up policy is the single premium the same insurer would charge for a policy of the same amount at the insured’s attained age (increased by the value of any dividend credits and reduced by the amount of any loans outstanding).

The replacement cost of a premium-paying policy is the policy’s interpolated terminal reserve plus any unearned premium at the date of the gift (again, taking into consideration any dividend credits and outstanding loans).

The replacement cost of a newly issued policy is the gross premium paid by the insured.

A gift of a life insurance policy to charity must, of course, satisfy local requisites of a valid gift. In most states, this means that the donor must have intended to make a present gift of the policy and that he delivered it, actually or constructively, to the charitable donee. An absolute assignment is the most straightforward way of effectuating the transfer.

**Question** – Is it possible to obtain a charitable deduction for premium payments if a charity owns a life insurance policy on the donor’s life?

*Answer* – Premium payments are considered gifts of cash and are, therefore, fully and currently deductible as charitable contributions if the charity owns the policy outright.

The donor should send his check directly to the charity and have it pay the premium to the life insurance company in order to assure the most favorable tax results. The canceled check will serve as proof of (1) the fact that a gift was made to the charity, (2) the date the gift was made, and (3) the amount of the gift. It will also assure the donor of a full deduction up to 50% of his contribution base.

When an “indirect” gift is made to a charity, the annual deduction limit is lowered to 30% of the taxpayer’s contribution base. A gift in trust is one such example. Another example of an indirect gift is where premiums on a policy owned by a charity are remitted directly to the life insurance company instead of to the charity itself.

If the gift to the charity exceeds $250, a statement will be required from the charitable organization showing the amount of money contributed and whether the charity gave any goods or services in return for the contribution.

**Question** – How could life insurance enable a charity to convince a donor to make an immediate gift of land or other property?

*Answer* – Life insurance can serve as a means of enabling a donor to make a large current gift. For example, assume that an individual is 50 years old, a widower, and has three children. His gross estate is about $6 million. One of his assets is a parcel of land with a basis and fair market value of about $200,000. He wants to perpetuate the memory of his late wife through a memorial scholarship fund, but at the same time he does not want to deprive his children of a significant part of his estate.

He can satisfy his overall objective through an immediate gift coupled with the purchase of life insurance to replace the gifted property. Assuming his income is taxed at a marginal combined federal and state rate of 40%, the arrangement would work like this:

He would contribute the $200,000 parcel of land to his favorite charity immediately. Since the gift is an outright contribution, it will be currently deductible up to 30% of his contribution base. (If his income is not high enough to allow him to deduct the entire $200,000 in one year, he could carry over the excess and deduct it against his next five years’ income.) The $200,000 charitable contribution would result in $80,000 of tax savings, since he is in a 40% combined federal and state income tax bracket. He can take this $80,000 that otherwise would have been used to pay taxes and instead make annual gifts of up to $14,000 each to his children. They in turn could purchase a policy on his life and name themselves as owners and beneficiaries.

Figure 32.2 compares a charitable bequest of the $200,000 parcel of land by will to an immediate lifetime charitable gift of the property coupled with the purchase of life insurance to replace the gifted land. Although the federal estate tax is the same in either situation, the heirs receive $100,000 more by the lifetime gift/insurance purchase technique. Assume death occurs in 2013.

**Figure 32.2**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **BEQUEST OF**  **PROPERTY**  **BY WILL** |  | **LIFETIME**  **GIFT OF**  **PROPERTY** |  | **BEQUEST OF**  **PROPERTY**  **BY WILL** |  | **LIFETIME**  **GIFT OF**  **PROPERTY** |
|  |  |  |  |  |  |  |  |
| Gross Estate | $6,000,000 |  | $5,800,000 | Gross Estate | $6,000,000 |  | 5,800,000 |
|  |  | less |  | Estate Tax (after unified credit) |  | less | 220,000 |
| Charitable Bequest by Will | 200,000 |  | 0 |  | 6,000,000 |  | 5,580,000 |
|  |  |  |  |  |  |  |  |
| Taxable Estate (Tentative Tax Base) | $5,800,000 |  | $5,800,000 | Charitable Bequest by Will | 200,000 | less | 0 |
|  |  |  |  |  | 5,800,000 |  | 5,580,000 |
|  |  |  |  | Estate Tax (after  Unified credit) | 220,000 | plus |  |
|  |  |  |  | New Life Insurance | 0 |  | 100,000 |
|  |  |  |  | Passing to Heirs | 5,580,000 |  | 5,680,000 |
|  |  |  |  | Advantage of Lifetime Gift | | $100,000 | |

The premium on a $100,000 whole life policy for a male age 50 is only about $3,000 a year, so it will take about 27 years before the premiums equal his $80,000 of income tax savings. Meanwhile, the charity owns the land immediately, and he has provided his children with everything they would have received even if he made no gift. In fact, properly arranged, the policy proceeds will be received free of income tax, estate tax, inheritance tax, and probate costs. Thus, his children could be in better financial condition than if he had waited to make the gift.

**Question** – Can a donor obtain a charitable deduction if he splits policy death benefits between a charity and a family member?

*Answer* – A life insurance policy can be split into two parts, the protection element and the policy cash value. The protection element, often called the net amount at risk, is the difference between the face amount of the policy and its cash (surrender) value. By splitting the proceeds of a policy between a donor’s family and a charity, a donor can provide additional protection for the benefit of his family and at the same time make a meaningful gift to charity.

Note that if a donor attempts to “split dollar” the charitable gift (i.e., to name his personal beneficiary as the recipient of the policy’s pure death benefit (the amount at risk), but make the charity the owner of the cash value), the Service will disallow a deduction for the gift.[[41]](#endnote-41)

**Question** – Can group term life insurance be used for charitable contributions?

*Answer* – Currently, employees must include the cost of group term life insurance coverage over $50,000 in their taxable income. The tax on this economic benefit must be paid with after-tax dollars, which has the effect of reducing the spendable income of the employee.

However, by naming a charity as the beneficiary of group insurance coverage over $50,000, the employee can provide for a gift to charity and at the same time avoid the tax on the economic benefit.

*Example.* A 63-year-old executive who is taxed at a combined federal and state marginal rate of 40% who had $140,000 of coverage would save 40% of $59.40 per month ($712.80) annually, or $285.12 annually (based on $140,000 of coverage *minus* $50,000 tax-free coverage, resulting in $90,000 taxable coverage; and 90 (per $1,000 of coverage) x .66 (cost of $1,000 of protection for a 1-month period for an individual aged 63) equals $59.40). See Chapter 30.

**Question** – Aside from tax savings, why do people make charitable contributions?

*Answer* – There are many reasons why, aside from tax savings, people (and their businesses) make gifts to charities.Thesenon-tax motives include situations where there was “no one else to leave it to,” the desire to “ransom the donor’s reputation,” a feeling that the charity's mission expressed and furthered the donor’s own values, passion, and interest, and the donor wanted to help assure the continuation of that mission. Gifts to charity are also made because the donor strongly relates to the needs of others or perhaps because the donor sees giving as a moral imperative. Sometimes, charitable gifts are made because the donors want to transfer values to their children and grandchildren, and to help their children and grandchildren grow and enhance their family values (or protect them from the problems unearned wealth often creates). Charitable gifts are sometimes made as part of a donor's desire to find meaning in abundance, or to “make a mark,” (i.e., to have significance and to obtain a measure of immortality). Charitable gifts bring honor to both the giver and the giver's family.

Sometimes charitable gifts fulfill a sense of debt while other cases represent the donor's desire to share good fortune, to enhance the family's image and access, or out of a sense of competitiveness. Some people give to encourage and inspire others, while many give because it is part of their religious/ethical/social/family/cultural upbringing ("It's what we do.”) Yet others give to charity because they are, or desire to become, distinguished human beings, because they feel wealth is a responsibility and that they possess wealth as stewards. To some, charitable gifts are a “means of fighting back” (e.g. against cancer or bigotry or ignorance). Some see charitable giving as a way to determine the future and to assure a higher quality of life for future generations. Charitable gifts are made by others to honor the charity for its efficiency, because it "makes me happy," and as an important step in the search for meaning. In all probability, most charitable gifts are motivated for more than one reason and in many cases the donor is not fully conscious of all the reasons he or she is giving.

**Question** –What is a donor advised fund?

*Answer* – In general, a donor advised fund is a charitable plan where the donor makes a gift to a public charity or community foundation, which sets up a sub-account or fund in the donor’s name. The donor, or a person appointed by the donor, then makes recommendations of grants to be paid from that fund to selected charitable beneficiaries. For charitable deduction purposes, the sponsoring organization must provide a contemporaneous, written acknowledgement substantiating the gift. One of the key benefits of the donor advised fund is that the donor obtains a current income tax deduction even though the selection of the charity to receive the donation may not happen for some time. This is accomplished by having the property contributed to the donor advised fund remain within the fund and be invested. The donor has the ability to make *suggestions t*o the donor advised fund as to which charities which shall receive distributions. While the donor cannot require the recommendations be followed; the suggestions are typically are followed. This allows the for the current charitable deduction followed by the future benefit to the charities

**Question** – May a donor gift a fractional interest in tangible personal property to a charity and claim an income tax deduction?

*Answer –* Yes, but special rules apply under IRC Sec. 170(o). These rules typically are applied with respect to fractional gifts of artwork. In these situations, no deduction is allowed unless all interests in the property are held immediately before the contribution by the donor, or the donor and the charity. Also, the charitable deduction will be subject to recapture if the donor fails to transfer the entire property within the earlier of: ten years of the initial donation; or the donor’s death. The tax which is recaptured is accompanied with a 10 percent penalty. Finally, the amount of the deduction is based upon the value at the time of the initial contribution. Therefore, the donor does not get an additional deduction if the value of the property increases.

**Question** *–* May a donor gift assets from an IRA, and is it advantageous to do so and if so, how is it done?

*Answer* – If a donor wishes to make a charitable gift, the most tax efficient way to do so is to donate IRA money. IRA money will be estate taxed in the estate of a decedent whose assets are valuable enough to cause tax and will be income taxed to the recipient as IRD (less the estate tax on the IRA). See Chapter 51. A direct donation at death avoids the income tax to the beneficiaries and so, is a more tax efficient way to donate to charity. A donation during lifetime not only avoids income tax on the distribution but has the effect of boosting the tax effect of the donation, especially in states that do not permit itemized deductions such as Ohio. Lifetime gifts to charity from an IRA however are limited to persons over 70 ½ making the donation directly from the IRA to a public charity, not including donor advised funds, supporting organizations, private foundations, charitable remainder trusts, or charitable gift annuities. The donation may be used to satisfy the donor’s required minimum distribution and is limited to $100,000 annually. As currently written, the provision expires after 2013 unless extended.[[42]](#endnote-42)

CHAPTER ENDNOTES

1. . For 2012, the rules only apply for distributions that were made in December of 2012 and contributed to a charity in January of 2013. [↑](#endnote-ref-1)
2. . IRC Sec. 170(c) for definition of charitable contribution. See also IRS Publication 526, Charitable Contributions. [↑](#endnote-ref-2)
3. . Rev. Proc. 90-12, 1990-1, CB 471 [↑](#endnote-ref-3)
4. . IRC Sec. 2055 sets forth the rules associated with claiming a charitable deduction for estate tax purposes. The amount of the deduction is limited to the value of the property included within the gross estate. See 2055(d). Therefore no deduction is permitted if property is directed to a charity pursuant to the exercise of a limited power of appointment. Also, if the property to be donated appreciates during the period of estate administration, the amount of the deduction is limited to the amount included within the gross estate. The amount of the estate tax charitable deduction is also limited to the extent that taxes or administrative expenses are to be paid out of the funds otherwise passing to a charity. See Sec. 2055(c) and Treas. Reg. Sec. 20.2055-3. This will often become an issue if there is a residuary bequest to a charity. [↑](#endnote-ref-4)
5. . Instruction for Form 8283. *See also* 1.170A-13(c)(5) which further clarifies the requirements. Under the Regulations, the term “qualified appraiser” means an individual (other than certain excluded parties as identified in the Regulations) who hold themselves out to the public as an appraiser or performs appraisals on a regular basis; have appropriate qualifications; and is not a disqualified person. A disqualified person is generally someone who has some type of connection with the transaction. The IRS has also issued a draft of a new Form 8283 which requires additional information for donated vehicles. [↑](#endnote-ref-5)
6. . See Treas. Reg. Sec. 1.170A-13(c)(3). [↑](#endnote-ref-6)
7. . Rev. Proc. 96-15, 199601 CB 627, 12/28/1995 sets forth the requirements for obtaining a Statement of Value from the IRS. [↑](#endnote-ref-7)
8. . See for example California Family Code § 850. [↑](#endnote-ref-8)
9. . IRC Sec. 170(b)(1)(B). [↑](#endnote-ref-9)
10. . Treas. Reg. §1.170A-8(f). [↑](#endnote-ref-10)
11. . IRC Secs. 170(b)(2), 170(d)(2)(A); Treas. Reg. §1.170A-11. [↑](#endnote-ref-11)
12. . IRC Sec. 170(b)(1)(B). [↑](#endnote-ref-12)
13. . IRC Sec. 170(f)(3)(B)(ii). *See also,* Rev. Rul. 58-260, 1958-1 CB 126; Treas. Reg. §1.170A-7(a). [↑](#endnote-ref-13)
14. . Treas. Reg. §1.170A-7(b)(1). [↑](#endnote-ref-14)
15. . IRC Sec. 170(f)(3)(B)(i). [↑](#endnote-ref-15)
16. . IRC Secs. 170(f)(3)(B)(iii), 170(h); Treas. Reg. §1.170A-7(b)(5). [↑](#endnote-ref-16)
17. . IRC Sec. 170(o)(3). [↑](#endnote-ref-17)
18. . IRC Sec. 170(f)(3)(A); Treas. Reg. §1.170A-7(a). [↑](#endnote-ref-18)
19. . IRC Sec. 170(b)(1)(A). [↑](#endnote-ref-19)
20. . IRC Secs. 170(b)(2), 170(d)(2). [↑](#endnote-ref-20)
21. . IRC Secs. 170(d)(1), 170(b)(1)(B), 170(b)(1)(D)(ii); Treas. Reg. §1.170A-10(a). [↑](#endnote-ref-21)
22. . IRC Secs. 170(b)(1), 170(b)(2); Treas. Regs. §§1.170A-8(b), 1.170A-11. [↑](#endnote-ref-22)
23. . IRC Sec. 170(b)(1)(C)(i). [↑](#endnote-ref-23)
24. . IRC Sec. 170(b)(1)(C)(ii). [↑](#endnote-ref-24)
25. . IRC Sec. 170(e)(5). [↑](#endnote-ref-25)
26. . IRC Sec. 170(b)(1)(C)(iii); Treas. Reg. §1.170A-8(d)(2). [↑](#endnote-ref-26)
27. . IRC Sec. 170(e)(i). [↑](#endnote-ref-27)
28. . IRC Sec. 1221. [↑](#endnote-ref-28)
29. . IRC Sec. 170(e)(1)(A); Sen. Rep. P.L. 91-171 (12060). [↑](#endnote-ref-29)
30. . IRC Sec. 170(e)(3). [↑](#endnote-ref-30)
31. . IRC Sec. 170(e)(3)(B). [↑](#endnote-ref-31)
32. . Under EGTRRA 2001, a modified carryover basis regime replaces stepped-up basis for one year for property acquired from a decedent dying in 2010. [↑](#endnote-ref-32)
33. . IRC Sec. 170(e)(1)(B)(i); Treas. Reg. §1.170A-4. [↑](#endnote-ref-33)
34. . IRC Sec. 170(e)(1)(B)(i). [↑](#endnote-ref-34)
35. . Treas. Reg. §1.1011-2. [↑](#endnote-ref-35)
36. . *Marshall Cohan, et ux., et al. v. Commissioner*, TC Memo 2012-8. [↑](#endnote-ref-36)
37. . Note that the basic planning principle in these cases (i.e., that the redemption by a corporation of closely-held stock from a charity will not be considered a dividend to the individual who donated the stock to the charity in the absence of a prearranged plan) is still useful. *Grove v. Comm.,* 490 F.2d 241 (2nd Cir. 1973); *Dewitt v. U.S.,* 503 F.2d 1406 (Ct. Cl. 1974); *Carrington v. Comm.,* 476 F.2d 704 (5th Cir. 1973). Although both *Grove* and *Carrington* were decided after 1969, they were decided on the basis of pre-1969 Tax Reform Act law. This is why the retention of a life income by the donor did not cause a loss of the charitable deduction. But under present law, a retention of the life income produced by the donated stock or by the proceeds of a sale of such stock would make the contribution a gift of “less than the donor’s entire interest in the contributed property.” Such a gift would not qualify for a charitable deduction. See Letter Ruling 8123069 where the Service held that appreciated securities used for the redemption of all stock held by the charity would not cause dividend consequences. [↑](#endnote-ref-37)
38. . *Palmer v. Comm*., 62 TC 684 (1974), *aff’d on other grounds*, 523 F.2d 1308 (8th Cir. 1975), *acq.* 1978-1 CB 2. *See also* TAM 8623007, reaching the same conclusion as *Palmer* on “materially identical” facts. *But see* TAM 8552009, where controlling shareholders, H and W, gave nonvoting common stock shares in a family corporation to a qualified charitable trust. The shares were subject to a stock restriction agreement that would not allow the trust to sell the stock to anyone outside the stockholder group without first offering it to the corporation and the other authorized shareholders at a value contained in the agreement. The donors claimed a fair market value for the stock on their income tax return for the year of the gift of $18 million, and later had the corporation redeem the stock from the trust for the same amount. The IRS refused to apply the rationale of the *Palmer* case, above, claiming that the fair market value of the stock at the time of the gift was $32 million and at the time of the redemption was $36 million, and that the gift and the redemption were part of the taxpayers’ plan to use the trust as a conduit to make a gift to the remaining stockholders, their descendants, by increasing the value of their descendants’ shares and correspondingly decreasing the value of H’s and W’s shares. The Service characterized the transaction as redemption by the corporation from H and W of all the ostensibly donated stock, followed by a gift of the proceeds to their descendants. [↑](#endnote-ref-38)
39. . Rev. Rul. 81-282, 1981-2 CB 78. [↑](#endnote-ref-39)
40. . See S. Leimberg, “Life Insurance as a Charitable Planning Tool: Part I,” *Estate Planning*, March 2002, Vol. 29, No. 3, Pg. 132; “Life Insurance as a Charitable Planning Tool: Part II,” *Estate Planning*, April 2002, Vol. 29, No. 4, Pg. 196; and *Tools and Techniques of Charitable Planning* (800 543 0874). [↑](#endnote-ref-40)
41. . IRC Sec. 170(f)(10). [↑](#endnote-ref-41)
42. . IRC Sec. 408(d)(8). [↑](#endnote-ref-42)