

# CHAPTER 16

## Charitable Gift Transfers

Circumstances where charitable gifts are of significant interest to clients:

- 1) Clients have no direct descendants.
- 2) Clients have substantial assets and genuine charitable objectives.
- 3) Clients have substantial antipathy to paying taxes – i.e., a desire to frustrate the tax collector at almost any cost.

IRC provisions concerning charitable gifts:

§§170, 2055, 2522, 501(c)(3), 4940, et. seq.

Issues: Income, gift & est. tax & federal tax & local law status of recipient (charitable) entity.

# **Types of Charitable Gift Transfers**

**P.3**

**Charitable contribution options:**

- Cash to charity**
- Appreciated property to charity**
- Bargain sale to charity**
- Horizontal split charitable interest gifts:**
  - (1) An income interest retained, or,**
  - (2) A remainder interest is retained (in trust or personal residence)**
- Charitable gift annuity**
- Conservation easements**
- Private foundations**

# Tax Effectiveness of Charitable Gifts P.3

- 1) Avoid inclusion in the income tax base of the accrued appreciation in the gifted property.
- 2) Complete the gifts during lifetime to (1) reduce federal income tax liability (and save income tax costs) and (2) thereby, increase the assets in the client's estate.
- 3) Coordinate family giving and gifts through entities, including (a) depleting assets of the older generation and (b) increasing the interests of younger generation members in the family wealth/business.

# Identifying an Entity as a Charity for Tax p.4-5

What is a Code §501(c)(3) organization?

How legally organize the charity:

(a) corporation or (b) trust? A state law issue (including re fiduciary risk for directors/trustees).

How qualify the entity with IRS as a §501(c)(3) organization? IRS Form 1023.

How does a potential donor verify the status of an entity as a §501(c)(3) organization donee?

Note the definition of charitable gift in §170(a) for income tax; cf., E&G tax.

# **Tax Eligibility of an Entity as a Charity p.5**

**PLR 200151045 – p.5: §501(c)(3) (& §501(e) );  
entity organized to participate in joint venture  
between various charitable hospitals to provide  
specialized health services in that venture.**

**Does this qualify for charitable tax exemption?**

**How much “charity care” must be provided?**

**What is the relevance of the “unrelated  
business income tax” rules Code §§511-513?**

**Determined in this PLR that no UBTI existed.**

# How Designate Charitable Beneficiaries? P.13

Not to individual beneficiaries – must be to a charitable entity (§501(c)(3) entity).

Local law determination may be required to determine the charitable status of a recipient entity. Note Bosch case re local law impact.

Possible estate dispute settlement can provide for a distribution to charity (eligible for a charitable deduction). Vested at death? P.13.

If a charitable gift is made by the estate's beneficiaries then individuals receive an income tax deduction.

# Percentage Limitations

## p.13

Federal income tax – limit to 50% (or 60% for cash) of a taxpayer’s “contributions base.”

Further FIT limits for gifts: 30% for capital gains property & 20% to private foundations.

No percentage limitations for estate and gift tax purposes. Why? Should the client consider a gift of his/her entire estate to a private charitable foundation? Why not a large gift before death and reduce income taxes (and (possibly) a charitable contributions deduction carryover)?

# Allocating the Tax & Expense Burden

p.14

§2055(c) requires a reduction of the charitable gift amount if the tax liability and/or expenses are allocated against this gift.

Will a state (e.g., Texas) tax apportionment statute help the resolution of this question?

If the charitable gift is burdened by expenses then an interrelated computation is required to determine the net deductible value of the gift.

Pay the administration expense from estate income? Note the marital deduction, Hubert case, and subsequent regulations.

# How Document the Fair Market Value of a Gift?

**Page 15:** Substantiation requirements are applicable, including qualified appraisals for larger gifts for FIT purposes.

**See (1) Code §170(f)(11) concerning appraisals, & (2) Code §170(f)(12) concerning contributions of used motor vehicles, boats and airplanes. Subsequent sale by the charity of the gifted property as relevant for determining gift values?**

**See Rev. Proc. 96-15 (p.15) re art valuations.**

# Appreciated Capital Asset Property p.16

What is the enhanced after (income) tax cost to the donor of a charitable gift of appreciated property (as contrasted with a charitable transfer of cash)?

Transfer to pay a charitable pledge/debt? Fn.22.

But, what about the potential for accrued appreciation disappearing at death (under Code §1014)? But, note prior possible carryover basis regime - Code §1022 (only for tax year 2010).

# Charitable Gifts of Ordinary Income Property

Code §170(e)(1)(A).

P.17-18

No “tax arbitraging” for ordinary income property for FIT purposes (p.18):

- Inventory.
- Self-created art, or a manuscript for a book.
- Assets held for less than 12 months (STCG).
- Section 306 stock (preferred stock bail-out).

Make a charitable transfer of IRD items at death (e.g., IRA balances)? Why? P.18, fn 26.

# **Appreciated Tangible Personal Property p.18**

**Deduction for the full fair market value of the donated tangible personal property (e.g., a work of art) (except ordinary income property)?**

**An income tax charitable deduction limit applies where the gift is not for the use of the charitable recipient: See Code §170(e)(1)(B)(i).**

**How make the charitable gift of tangible personal property for “the use by” the charity?**

# Remainder in Tangible Personal Property P.19

Code §170(a)(3) provides a deduction for a charitable gift of a future interest in tangible personal property only when (1) all intervening interests have expired, or (2) the interests are held by non-related parties. A timing limitation. Why? Do “paintings have legs”?

Cf., gift of a 1/2 interest (i.e., a vertical interest). See §170(o) – must contribute the remaining vertical interest within ten years or by death or a recapture of the earlier deduction results.

# Bargain Sales to Charity

## p.20

Code §1011(b): adjusted tax basis is allocated proportionately to (1) the portion deemed sold and (2) the portion donated to charity.

Cf., treatment of a bargain sale (e.g., net gift) in the intra-family context. No basis allocation.

PLR 9329017, p. 21: Charitable contribution of a remainder interest in a mortgaged farm. §170(f)(3)(A) & (B)(i).

Holding that mortgage debt is treated as an amount realized for bargain sale to charity (although donor remains liable on mortgage).

# Personal Residence & Bargain Sale to Charity

p. 22 – Accomplished in conjunction with the use of the Code §121 gross income exclusion. Up to \$250,000 (\$500,000 on joint return) of realized gain can be excluded from gross income upon the sale of the principal residence (without regard to whether the sale is to charity, but possibly including a sale to charity).

# **Gift of Vertically Divided Interests**

**p.23**

**Examples: gift of part of shares of corporation; part of farm acreage; gift of mineral rights; gift of an easement (what type of easement? P.25).**

**Note (earlier) vertical interest in painting.**

**Cf., gift of a license to use a patent – donor can not retain any substantial rights in the patent.**

**Notice 2004-7, p. 23, re gifts of intellectual property (no income tax charitable deduction if a retained right).**

# **Gifts of Easements**

## **p.25**

**Code §170(f)(3)(B)(ii) & Code §170(h).**

**Gift must be a contribution of a “qualified conservation easement.”**

**I.e., for a conservation purpose, or for “certified historical structures”.**

**Golf courses?**

# **Gift of Corporate Stock to Private Foundation p.26**

Code §170(e)(1)(B)(ii) reduces the amount of the charitable contribution deduction when the gift is to a private charitable foundation.

However, Code §170(e)(5) provides an exception from this rule for a gift of “qualified appreciated stock.”

**What stock is eligible for this treatment?**

**Publicly traded stock? Mutual fund shares?**

**ETFs?**

**Gifts by insiders? See p. 26, fn. 33.**

# **Gift & Redemption of Closely Held Stock p.27-8**

**Structure: (1) Gift of stock to public charity;  
(2) charity then redeems this stock;  
(3) reduction of earnings and profits of corp.;  
(4) increase in the percentage interest of other shareholders (e.g., children).**

**Tax issue: Whether (1) the gift and (2) the redemption transactions are to be collapsed for federal income tax purposes, with ordinary dividend treatment attributed to the donor.**

# **Charitable Gift of a Life Insurance Policy p.29**

**Can an individual give a life insurance policy (on that individual's life) to a charity & obtain a charitable deduction?**

**Does the charity have an insurable interest?**

**What is the amount of the deduction?**

**See PLR 200209020, p. 29, charitable deduction is allowable after the expiration of the 30-day cancellation period for the single premium whole life policy. But, "title" is not transferred.**

**No "split dollar" insurance – Code §170(o)(10).**

# Charitable Gift Annuity

## p.32

Charity promises to make annuity payments for life in exchange for donor's transfer of cash or appreciated property.

If appreciated property is transferred :

- 1) bargain sale to charity rules are applicable,
- 2) charitable gift of the excess value, and
- 3) income when annuity payments received.

How determine the annuity amount?

Cf., private annuity treatment (& timing rule).

# Charitable Remainder Trusts

p.32

Code §170(f)(2)(A) specifies no income tax deduction for remainder gift (in intangibles) unless to a trust which is a CRAT or CRUT. Similarly, Code §2055(e)(2) (estate tax) and §2522(c)(2) (gift tax).

Minimum charitable gift of 10% of total (cf., zero-out GRATs) & not + 50%.

See Rev. Proc. 2003-53, p. 34, including other Rev. Procs. re various alternatives.

CRATs & CRUTs are defined in Code §664(d).

# Charitable Remainder Unitrust – CRUT

p.43

§664(d)(2) – charitable annuity based on a specified percentage of the value as determined on a specified date each year.

See §664(d)(3) re a NIMCRUT or “net income makeup unitrust.” Only actual income is paid but subject to a recapture/subsequent make-up provision.

# **Rev. Rul. 2002-20**

## **p.44**

**CRUT benefits paid from CRUT to a separate trust for life of an individual who is financially disabled (i.e., unable to manage financial affairs). I.e., “special needs trust.”**

**CRUT qualifies under §664 if funds are payable to a 2<sup>nd</sup> trust for the life of individual and, on death, remaining funds are payable to the estate of the beneficiary. Trust is used to make necessary distributions and to avoid supplanting government benefits.**

# **Pooled Income Funds**

## **p.46**

**Code §642(c)(5).**

**A mutual fund (in equivalence) is managed by the charity itself, rather by than a private (corporate?) trustee, with proportionate amount of income currently distributable to the life beneficiary.**

# Personal Residence Remainder Interest Gift

P. 47 Code §170(f)(3)(B)(i) provides an exception from charitable remainder trust rules for a gift of a remainder interest in a family residence. Why?

What is a family residence for this purpose?  
Including furniture and furnishings?

Similarity to a QPRT in tax approach?

# **Defective Charitable Remainder Trusts p.47**

**How deal with defective charitable remainder trusts?**

**See Zella Hall decision, p. 48.**

**See the trust “qualified reformation” provisions at Code §2055(e)(3). No more than a 5% variance from “before to after.”**

**And, see PLR 201125007 (p. 56) re IRS agreeing that a qualified reformation occurred (after trust reformation in state law proceeding).**

# **Charitable Lead Trusts**

## **p.60**

**Code §§170(f)(2)(B), 2055(e)(2)(B) and 2522(c)(2)(B).**

**Lead interest for charity and remainder for private beneficiary.**

**Grantor must be the owner of the income under the grantor trust rules.**

**Charitable deduction for the discounted present value of the income stream payable to charity.**

# Use of a “Private Foundation”

p.62

Purpose for using a “private charitable foundation” as qualified under §501(c)(3)?

Who controls?

Monitoring also by state’s Attorney General (or other official) to assure charitable purposes are fulfilled for state law requirements?

