

Creating Opportunities for Clients to Leave Social Capital

By
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In this second part of a three-part series, Janet Bandera explores tax-efficient charitable giving involving different types of assets.

Determining the most tax-efficient method to assist charitably motivated clients with diverse portfolios requires that the professional advisor be aware of how charitable deductions are calculated and what type of property to transfer. In general, the easiest assets to give are cash and securities, with life insurance and unencumbered real estate close seconds. Some assets your clients may wish to contribute require extra care. These include tangible personal property, encumbered real estate, closely held C corporation stock, restricted (Rule 144) stock, stock with a tender offer in place, sole proprietorships, partnerships and on-going businesses, and S corporation stock.

There are some assets that should generally be avoided in charitable gift planning, including property with an existing sales agreement, installment notes, stock options (both qualified ISO and nonqualified stock options), lifetime transfers of IRAs¹ and qualified plan dollars, lifetime transfers of commercial deferred annuities and lifetime transfers of savings bonds.

This article briefly highlights the issues in transferring differing types of assets and includes some twists on old favorites and a few nontraditional ideas for giving including donating vehicles, e-giving, charity shopping Web sites and affinity credit cards.

Calculating the Charitable Deduction

Generally, donors are entitled to a charitable deduction in the amount equal to the fair market value of property contributed to a charity. There are, however, cer-

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tain types of property in which the deduction is limited to the lesser of the property's fair market value on the date of contribution or the donor's adjusted cost basis. There are four types of such property as found in Code Sec. 170(e):

- Tangible personal property put to an unrelated use by the charitable donee (regardless of holding period)²
- Property that if sold would produce ordinary income³
- Long-term capital gain property (other than publicly traded securities for which market quotations are readily available)⁴ contributed to a private nonoperating foundation⁵
- Property not otherwise considered 170(e) property (e.g., long-term capital gain property) contributed to a public charity (as described in Code Sec. 170(e)(1)(B)) for which the donor makes a special election to have treated as 170(e) property⁶

Tangible Personal Property

Some clients may have personal property such as antiques or other collectibles that are highly appreciated, but do not produce income. Because of capital gains and estate taxes, a client loses much to taxes whether he or she disposes of the asset *inter vivos* or at death.

Rather than selling such property outright, the client could contribute it to a charitable remainder trust (CRT). As noted above, the charitable deduction for tangible personal property that has no "related use" is based upon the lesser of the property's fair market value or the donor's cost basis under Code Sec. 170.⁷

Despite the limited deduction, there is still an advantage to con-

tributing such assets to a charitable trust rather than an outright sale. Because the trust is income tax exempt, it may invest the gross sale amount, rather than net after tax amount after payment of capital gain. With more capital to invest, the trust will earn a higher return than the individual could expect. The income paid to the donor is taxed according to the "four-tier system."⁸

Rather than using a trust that will substantially eliminate or limit the donor's right to retain or use the property, the client could choose to donate personal property "outright" but with strings attached. In LTR 200223013,⁹ the IRS ruled that a couple making a gift of artwork to a museum, subject to a gift and loan agreement, could take a charitable deduction. The gift and loan agreement allowed, among other things, that the donors could transfer fractional interests in a given piece of art and retain possession of it for a period of time, each year commensurate with their proportionate interest in the item.¹⁰

In this case, the donors' deduction was not limited to cost basis because the personal property was not going to be put to an "unrelated use" as it was "of a general type normally retained by the museum or other museums for museum purposes."¹¹

One important consideration when transferring illiquid assets is that there is the possibility that the property will not produce sufficient income to meet the trust's payout requirement. Accordingly, advisors should consider a net income charitable remainder unitrust (NICRUT), a net income makeup charitable remainder unitrust (NIMCRUT) or a Flip NIMCRUT.¹²

Mortgaged Property

Due to the significant value of some real estate and the uncertainty of the market, both donors and charities may wish to provide for the transfer of property even if it is encumbered with a mortgage. Unfortunately, at least two obstacles stand in the way of an effective transfer: the "bargain sale" rules and the "debt-financed income" rules. If the proposed transfer is to a private foundation, the "self-dealing rules" must also be examined. The tax consequences of such a transfer must be viewed in light of the following considerations.

Under the bargain sale rules,¹³ when mortgage property is contributed to charity, the portion of the fair market value representing the debt is treated as a sale and the equity portion is treated as a donation. The adjusted cost basis of the property must be prorated between these portions.

Example. Donor has property valued at \$1 million, with an adjusted cost basis of \$400,000 and subject to a purchase money mortgage of \$300,000 placed on the property more than 10 years ago. There is no depreciation subject to recapture. Donor is entitled to a charitable tax deduction of \$700,000; however he has long-term gain of \$180,000 due to the "relief from indebtedness."¹⁴

The second issue is that of "debt-financed income," a type of unrelated business taxable income (UBTI).¹⁵ Charities (and charitable remainder trusts) must pay tax on this type of income. Thus, the rent generated from a property subject to a mortgage

would be taxable income in the proportion that the debt bears to the fair market value (if a CRT has any UBTI, the entire trust will be taxed as a complex trust under Code Sec. 661 for that year¹⁶).

There are several exceptions to the definition of “debt-financed income.” One such exception is that the property subject to the mortgage be used at least 85 percent in the exempt function of the charity.¹⁷ A second exception applies to property acquired by gift.¹⁸ If the mortgage was placed on the property more than five years prior to the date of the gift and the donor owned the property more than five years prior to the gift, the mortgage will not be considered “acquisition indebtedness” during the 10 years after the donation. Because the mortgage is not considered “acquisition indebtedness,” the property is not considered “debt-financed” and none of the income is subject to the unrelated business income tax during this 10-year period. The exception does not apply, however, if the donee assumes the mortgage rather than taking the property subject to the mortgage or pays the donor anything for his equity in the property.¹⁹

Restricted Stock

In general, a contribution of stock to a charity is deemed made at the time delivery is affected.²⁰ Delivery of a gift of stock, including restricted stock, is considered complete when the stock has been placed “beyond the control of the donor” so that the donor has no legal right to recall the gift.²¹

Generally, if restricted stock, transferred to a charity, has been held by the donor as a capital asset for more than one year, he is entitled to a charitable income tax deduction equal to the fair mar-

ket value of the stock on the date the contribution is made.²²

What Is the Fair Market Value of Restricted Stock? Valuing restricted stock is more complicated than valuing publicly traded stock. There is no one source that provides the answer. Generally, the fair market value of a charitable contribution of property other than money is the price at which the property would change hands between a willing buyer and a willing seller.²³ But, if a donor makes a charitable contribution of property at a time when the donor could not reasonably have been expected to realize its usual selling price, the value of the gift is not the usual selling price, but is the amount for which the quantity of property contributed would have been sold by the donor at the time of contribution.²⁴

Rev. Rul. 59-60 sets out several factors to be used in valuing closely held stock for estate and gift tax purposes including: (1) the nature of the business of the issuing corporation and the history of the enterprise from its inception; (2) the book value of the stock and the financial condition of the issuing corporation; (3) the earning capacity and dividend-paying capacity of the issuing corporation; (4) sales of the stock and the size of the block of stock to be valued; and (5) the market price of stocks of corporations engaged in the same or a similar line of business, where the stocks are actively traded on an exchange or over-the-counter.²⁵

There are special rules to follow when closely held stock is contributed to a private foundation. The

IRS in various rulings has stated that in such a case, the stock would be treated as “qualified appreciated stock”²⁶ and that a donor is allowed to claim a full fair market value deduction for a contribution of restricted stock.²⁷

Following these rulings, it seems that a donor may be able to deduct the full fair market value of restricted stock to a public charity or a private foundation, if (1) the donor and the charity or foundation, as the case may be, have entered into a contractual arrangement pursuant

In general, the easiest assets to give are cash and securities, with life insurance and unencumbered real estate close seconds.

to which the charity or foundation is effectively not restricted from freely transferring the contributed stock, despite the aggregate volume limitation contained in Rule 144 of the Securities Act, and (2) no other resale restrictions apply.²⁸

S Corporation Stock

In 1996, Congress enacted the Small Business Job Protection Act of 1996²⁹ and permitted a charity (but *not* a charitable remainder trust) to be an eligible shareholder of an S corporation beginning January 1, 1998. As S corporation stock is often the most valuable asset owned by a potential donor, this offers many opportunities. The primary tax concerns that both the donor and the charity should be aware of before a gift of S corporation stock is made are as follows³⁰:

- The donor’s tax deduction will likely be less than the appraised value of the stock.³¹
- The charity will be subject to UBTI on its portion of the S

corporation's accounting income for every day that it owns the S corporation stock. If the business is profitable, the charity will need cash to pay the UBTI. The most likely source will be distributions from the S corporation.³²

- Unlike virtually every other asset that a charity might own, the gain from the sale of S corporation stock will be subject to UBTI.³³
- A charity that is a trust under state law will generally pay more UBTI on an S corporation's ordinary income than a charity that is a corporation. However, a charitable trust will generally pay less UBTI on a large long-term capital gain, such as from the sale of S corporation stock than a charitable corporation. To the extent that a charity consists of a combination of trusts and corporations (for example, a community foundation or a university with several supporting organizations), the charity should adopt a policy that S corporation stock will be contributed to the type of charitable organization that will pay the least amount of UBTI based on the anticipated income that will be generated from the S corporation stock.³⁴

Partnerships, Sole Proprietorships and Ongoing Business Interests

All such business interests may be used to fund outright gifts or, in certain cases, life-income arrangements such as charitable remainder trusts. They can be given during lifetime or at death. Generally, a partnership interest qualifies for a charitable deduction based on (but not necessarily equal to) the difference between the donor's share of

the fair market value of the partnership's assets and his share of the partnership's liabilities.

Gifts of any such interests involve issues of valuation, suitability of the donee as partner, transfer restrictions, unrelated business income and the tax consequences to the donor.

If a partnership or a sole proprietorship has debt, the charitable contribution is treated as part contribution and part sale.³⁵ The charitable deduction is the excess of the fair market value of the property over the debt to which it is subject. The sale portion is determined by the amount of debt on the property. The seller/contributor is deemed to have realized an amount equal to any debt assumed by the donee or subject to which the donee takes the property. In addition, the seller's basis must be allocated between the sale and the contribution as per the amount of debt relieved versus the total value of the contribution.³⁶

Most charities will evaluate whether they wish to accept a gift of business interests based upon, among other things, the ultimate financial liability of the charity (a general partnership interest will subject the charity to the debts and expenses of the business), the amount of management attention required, the restriction on a subsequent sale or transfer and the amount or likelihood of additional capital contributions that will be demanded from the charity.

Property Transfers to Avoid

Transfers to charity that should generally be avoided include lifetime transfers of IRAs and qualified plan dollars (but see the exception be-

low), property that has an existing sales contract and savings bonds.

Lifetime Transfers of IRAs

Income taxation of distributions from qualified retirement plans is governed by Code Sec. 402(a). This section provides that "except as otherwise provided in §402, any amount actually distributed to any distributee by an employees' trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to the distributee, in the taxable year of the distributee in which distributed, under section 72." Code Sec. 72 is complicated, but generally all distributions from a qualified retirement plan are includible in the distributee's gross income as ordinary income unless an exception applies.

A donor who contributes any qualified retirement asset will be subject to income taxes on the entire amount and possibly penalty taxes.³⁷ Thus, qualified retirement assets are particularly undesirable for lifetime transfers.³⁸

Exception for Lifetime Transfer of a Lump-Sum Distribution from Pension Plan to a CRT

One exception found in Code Sec. 402 is for a lump-sum distributions, paid out in kind with the employing corporation's securities. Typically, such lump-sum distributions are excluded from the gross income of a taxpayer in the amount of the entire "net unrealized appreciation." The "net unrealized appreciation" is the difference between the cost basis and the fair market value of the stock on the distribution date.³⁹

In LTR 200215032,⁴⁰ a taxpayer proposed to take a qualifying lump-sum distribution consisting of securities of his employing cor-

poration. He proposed that a portion of the stock would be rolled over to an IRA, another portion sold and the balance contributed to a trust qualifying under Code Sec. 664. The IRS approved the plan and stated that the taxpayer will not include the net unrealized appreciation in his taxable income for that year; he will not recognize gain upon the contribution of the appreciated stock to charity (a CRUT); and that the amount of the gift tax charitable deduction will be the fair market value of the stock at the time of the transfer less the present value of the taxpayer's retained unitrust interest.

Property with an Existing Sale Contract

The IRS will not allow a donor to avoid paying capital gains tax where the transfer to a charity is for this sole purpose rather than with charitable intent. Where a donor contributes property with a sales contract already in place, the IRS may assume that income tax avoidance was the sole purpose.

In general, donors can avoid gain on a sale of contributed property only as long as the donee is not obligated to enter into a transaction that benefits the donor⁴¹ or as long as the gift occurs before the sale becomes legally enforceable. The IRS and the Tax Court analyze the property on the basis of two doctrines: the assignment-of-income doctrine and the step-transaction doctrine.⁴²

Under the assignment-of-income doctrine, where there is evidence that a taxpayer's right to proceeds from the disposition of property has matured at the time of a donation, the transfer is an "anticipatory assignment of income" for which the donor realizes income from the sale pro-

ceeds regardless of the purported transfer of the property.⁴³ On the other hand, if there is merely anticipation or expectation (rather than a certainty) of income, there is no assignment of income.⁴⁴

The second test to determine charitable intent or lack thereof is through the step-transaction doctrine. Like the assignment-of-income doctrine, the step-transaction doctrine focuses on the reality and substance of events to determine the incidence of taxation, rather than formalities and remote hypothetical possibilities.⁴⁵ There are several tests that are used in applying the step-transaction doctrine: the binding commitment test, the end-result test and the interdependence test. Under the binding commitment test—the narrowest test—the transactions are compressed if, when the first step is taken, there was a binding commitment to enter into the later step.⁴⁶ Under the end-result test—the broadest tests—the step-transaction doctrine will apply if a series of steps are prearranged parts of one transaction which are intended to reach an ultimate result.⁴⁷ The interdependence test examines whether a series of formally separate steps were, in substance, so integrated, interdependent and focused on one result, they should be treated as one transaction.

In applying the binding commitment test or interdependence test, the IRS looks to whether there was a prearranged plan by which a taxpayer used the donee merely to avoid recognizing long-term gain.⁴⁸

Thus, "charitable gifts" of property subject to an existing sales contract should be generally avoided and if done, carefully undertaken. At the very least, the contract should give the transferee the ability to alter or revoke the contract.⁴⁹

Savings Bonds

Series EE savings bonds (formerly Series E) are the most common variety of savings bonds. They are usually issued at a discount price of half of the bond's stated maturity value (e.g., a savings bond with a stated maturity value of \$100 usually is purchased at a discount price of \$50). Each bond grows in value because of the accumulated interest. It can be redeemed at the maturity date for the stated value, but often the owner continues to hold the bonds and interest continues to accumulate. Series EE bonds accumulate interest for up to 30 years after the issue date (40 years for Series E bonds issued before November 1965).⁵⁰

Unless the owner filed a Code Sec. 454(a) election to recognize taxable income as the interest accrues (something rarely done), the owner of the bond is usually not taxed until he or she redeems the bond. The amount of interest income that the owner must eventually report is the difference between the bond's redemption amount and the original purchase price.⁵¹

Series HH savings bonds (formerly Series H) are issued at their face amount (minimum \$500 per bond) and pay interest twice each year.

Series EE and Series HH savings bonds are not particularly attractive sources of charitable gifts while the owner is alive. Any attempt to transfer ownership of the bonds will usually trigger all of the untaxed interest income that had accumulated. A living donor is generally better off making charitable contributions of appreciated stock or real estate since he or she can usually deduct the entire value of the gift without recognizing any long-term capital gain from the property's appreciation in value.⁵²

New Ideas for Income-Generating Transfers

Although transfers to a charity or a charitable giving vehicle, such as a remainder or lead trust, should be motivated primarily by charitable intent, many clients will want to structure the gift so that they or some one else receives income in return. There are many

Because there is no “typical” American philanthropist, a charitable giving plan must take into consideration the unique personalities, dreams, desires, families and assets of each individual.

opportunities ranging from transferring real estate in exchange for an annuity, structuring an annuity (through a charitable gift annuity or a trust) to provide protection for a disabled individual or making a testamentary devise of an IRA in exchange for a gift annuity for another individual.

Retained Life Estate with Remainder Interest to Charity in Exchange for a Charitable Gift Annuity

Some clients who are “house rich, income poor” would like to convert equity in their personal residences to an income stream without giving up their homes.⁵³ The first step is finding an organization that participates in such plans. This may be difficult because the plan requires the charitable organization to advance annuity payments from sources other than the contributed property and the parties must de-

termine who is to be responsible for maintaining the premises, insuring the property against loss and liability and repairing the premises in the event of damage.

Once a participating organization is located, the parties prepare a life estate agreement. Generally, a life estate agreement is an arrangement in which a property owner retains the right to occupy and enjoy the beneficial rights of ownership in his personal residence for the balance of his lifetime (or the lifetime of he and another, such as a spouse) and transfers the remaining interest to a charitable organization.

When the life tenant(s) dies, the organization takes possession of the property. The donor receives a current income tax deduction for the present value of the remainder interest based upon the number of life tenants, their ages, the appraised fair market value of the property, assumptions regarding depreciation and current interest rates.

To generate an income stream, the donor exchanges the remainder interest for a charitable gift annuity. There are two primary tax considerations in this transaction: capital gain and the charitable income tax deduction. Ordinarily, when a donor transfers a remainder interest in a residence to a charity in exchange for life annuity payments, the transaction is considered a “bargain sale” requiring recognition of capital gain. However, the sale of a remainder interest is included in the \$250,000 exclusion from capital gains attributable to sales of a per-

sonal residence.⁵⁴ If the donor qualifies, capital gain up to \$250,000 will be offset by the exclusion and no tax will be due. In addition to receiving life annuity payments, the donor also receives a current income tax charitable deduction because a charitable gift annuity contains a charitable gift component.

Installment Bargain Sales

Installment bargain sales are an alternative to charitable trusts or gift annuities. Installment bargain sales are a combination of traditional bargain sale arrangements and an installment payment schedule. They are, from a technical standpoint, the purchase by the charity of an asset for less than its fair market value, with payments made over a period of time.⁵⁵

Installment bargain sales can be structured to provide a regular stream of income as a charitable trust would with a portion of the payment taxed at capital gains rates rather than ordinary income rates. The donor receives a charitable deduction of approximately the same amount as a gift to a trust and avoids part of the capital gains tax. The income to the donor may result in less tax than would be the case with a traditional charitable trust.⁵⁶

As long as the sale is to a public charity, thus no prohibition against self-dealing, a donor may live on a piece of property for a period of time after the transaction is complete as long as a fair market rent is assessed.

Installment bargain sales can be put together much as any sales transaction, using a wide variety of terms.⁵⁷ Taxpayers must be aware that if a sale of property, exclusive of a bargain to charity, would not qualify for installment sale reporting, neither

will a bargain installment sale of such property to charity. Furthermore, if the sales contract does not carry a sufficient amount of interest, as described in Code Sec. 483, a portion of the sales price may be recharacterized as unstated interest thereby reducing both the amount of the charitable contribution deduction and the amount of gain that may otherwise qualify for reporting as long-term capital gain.⁵⁸

CRT with Annuity Payment to Another Trust for the Life of a Disabled Individual

The IRS has ruled that a charitable remainder unitrust may pay the unitrust amounts to a second trust for the life of a disabled individual.⁵⁹ Code Sec. 664(d)(2)(A) requires that the unitrust amount be a fixed percentage (not less than five percent and not more than 50 percent) of the net fair market value of the trust assets, valued annually. It is to be paid to one or more persons (at least one of which is not an organization described in Code Sec. 170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of the individual or individuals.

Reg. §1.664-3(a)(5)(i) provides that the period for which the unitrust amount is payable begins with the first year of the charitable remainder trust and continues either for the life or lives of a named individual or individuals or for a term of years not to exceed 20 years and that only an individual or an organization described in Code Sec. 170(c) may receive an amount for the life of an individual.

Under this regulation, generally, a charitable remainder unitrust would only be able to pay unitrust amounts to a second trust for a term of 20 years or less. The IRS has, however, approved payment of such amounts to a second trust for the life of an individual when the sole function of the second trust is to receive and administer unitrust amounts for the benefit of an individual who is unable to manage his own financial affairs by reason of a medically determinable mental or physical impairment.⁶⁰

Charitable Gift Annuity in Exchange for Testamentary Bequest of an IRA

The IRS recently ruled that a charity could accept IRA proceeds at a participant's death in exchange for an annuity payable to another person. This ruling allows a donor to provide for another and relieves the charity of the worry that it will recognize unrelated business taxable income as a result of its receipt of the proceeds from the IRA on the individual's death in exchange for the annuity payable to another person or that the charity's tax-exempt status will be adversely affected.⁶¹

To accomplish this result, an IRA participant enters into a gift annuity agreement with a charity agreeing to make a testamentary gift of his IRA to be deposited in the charity's general fund. In consideration of the testamentary gift, the charity will pay to another individual, if surviving, an annuity based upon the amount in the IRA at the participant's death, the recipient's age at that time and the gift annuity rates in effect at the participant's death.

The value of the IRA at the participant's death will be included in his gross estate, and an estate tax charitable deduction will be allowed equal to the value of the IRA on the date of death less the present value, determined as of the date of death, of the annuity payable to the third party. The proceeds distributed to the charity from the IRA will be income in respect of a decedent to the charity when distributed and will not be income in respect of a decedent to the individual's estate.⁶²

The annuity must qualify as a charitable gift annuity under Code Sec. 514(c)(5). In order to qualify as a charitable gift annuity, the annuity must have a value that is less than 90 percent of the value of the property received in exchange by the charity, the annuity must be payable over the life of the annuitant, the annuity contract must not guarantee a minimum amount of payments or specify a maximum amount of payments and does not provide for an adjustment which references the amount of income generated by the transferred property. Additionally, if the proposed recipient predeceases the participant, the IRA proceeds will be transferred to the charity without any obligation on the charity's part. The annuity is irrevocable and nonassignable, cannot be commuted and is to be paid from the charity's general fund.

The IRS did not rule upon the characterization of the payment to the annuitant despite the taxpayer's request (the taxpayer asked the IRS to rule that for purposes of determining the character of the annuity payments received by the annuitant, the annuitant's "investment in the contract" is equal to the IRA

proceeds transferred to the charity in exchange for the annuity less the estate tax charitable contribution deduction.⁶³

Deferred Gift Annuities

A donor who wishes to supplement his or her retirement income or provide for delayed gratification of an inheritance might choose an annuity that begins some time in the future. In LTR 9743054,⁶⁴ the IRS approved a deferred annuity in which the donor does not have to choose the starting date for payments in advance. Depending upon the circumstances, the decision can be made later.

Example. On July 1, 1999, David Gould, whose birth date is March 23, 1949, contributes \$25,000 for a flexible deferred gift annuity. The gift annuity agreement allows him to start his quarterly payments on March 31 of any year not earlier than 2010 or later than 2020. The amount of payments is based on the year in which payments begin.

The IRS ruled that such a contract meets the definition of a gift annuity as described in Code Sec. 501(m)(5), that issuance of gift annuities of this type will not result in income from an unrelated trade or business as defined in Code Secs. 511–513, and that the investment of annuity funds will not be unrelated debt-financed income under Code Sec. 514.⁶⁵

One question raised is whether the right to receive payments as of a certain date results in constructive receipt of income as of that date. In the opinion of sev-

eral commentators—including Frank Minton,⁶⁶ in his article *Twelve Uncommon Things You Can Do With a Gift Annuity*—it does not.⁶⁷

Multiple Life NIMCRUT

Pursuant to Rev. Proc. 2001-3,⁶⁸ the IRS had ceased ruling on whether a proposed charitable remainder trust for multiple lives qualified under Code Sec. 664 therefore entitling a donor to a charitable tax deduction. Although the IRS declined to express an opinion on whether a trust qualified under Code Sec. 664, in LTR 200150019, it approved a five-life NIMCRUT and at the request of the taxpayer provided the deduction factor.⁶⁹

Converting a Remainder Interest in a Charitable Remainder Trust to a Gift Annuity

Charitable remainder trusts have been utilized for many years. Thus, many donors are now older and are locked into distribution payouts (such as a five-percent unitrust amount) that are much lower than the return that could be achieved from a charitable gift annuity.

In this situation or where a donor/beneficiary of a charitable remainder trust is unhappy with decreasing distributions or where the administrative costs of continuing a charitable remainder trust are not justified by the amount of the remaining trust assets, the donor/beneficiary could transfer the income interest in the remainder trust to the charitable organization in exchange for a gift annuity.⁷⁰ Effective January 2003, the recommended gift annuity rate for a two-life joint and survivor annuity for a couple, one age 72 and the other

age 78 to 80 is 6.5 percent.⁷¹ This may be substantially higher than the return currently generated by the trust.

Nontraditional Ways of Giving

Donation of Vehicles

Donors may choose to make a donation of a motor vehicle or boat.⁷² Many charities, including the American Cancer Society, will accept donations of a car, truck, newer RV or boat. The IRS has ruled that a transfer of a car to a dealership that administers a charity's car donation program is a valid transfer if the parties have established a valid agency relationship under state law.⁷³ In this same ruling, the IRS also concluded that the donor may use an established used car pricing guide to determine the fair market value of a donated car.⁷⁴ The charity typically requires that vehicles have keys and at least be in fair condition. Tax information is provided after the vehicle is picked up by the charity's representative.

Due to the popularity of car donation programs, the IRS and state charity officials issued a consumer alert to help taxpayers avoid potential pitfalls when donating automobiles to charities. The National Association of State Charity Officials (NASCO) urges potential donors to do the following prior to donating a vehicle:

- Ensure that the organization is qualified. A donation is only deductible if the organization is qualified. To check that an organization is qualified, search IRS Publication 78 at apps.irs.gov/search/eosearch.html or call the IRS

Tax Exempt/Government Entities Customer Service at (877) 829-5500. Note, however, that churches, synagogues, temples, mosques and governments are not required to apply for this exemption in order to be qualified.

- Determine how the donation will benefit the charity's beneficiaries. If the donor wants to ensure that a contribution will be used for an intended charitable purpose, he or she should check to see if the vehicle will be given to the needy directly or resold with the cash being used for the charity's direct beneficiaries.
- Determine the "fair market value" of the vehicle.
- Determine record-keeping requirements. For vehicle donations, taxpayers must document the car donation and its fair market value. Record-keeping requirements vary depending on the amount of the contribution and the total amount of the charitable deduction (consult IRS Publication 526 for details of the types of receipts taxpayers must obtain and the forms to file).

E-Giving

Many online donor services are designed to facilitate donations to charity and to educate donors. According to NetAction Notes, a listserv designed to promote effective grassroots organizing on the Internet, "online fundraising" or "e-philanthropy" can come in three varieties.⁷⁵

The first category, "charity portals," is portal sites that list nonprofits and encourage dona-

tions to those organizations listed. These sites may list a nonprofit on their site for no charge or they may charge a small fee. Most often, they obtain revenue through the sale of advertising space. A second category is "payment service providers." Such companies are set for nonprofits to conduct secure credit card transactions. Once a user decides to make a donation, he or she is taken to the "payment service provider's" site where the transaction takes place. Usually, the provider establishes a fee structure with participating nonprofits based on contributions received. The third category, "e-commerce commission portals," is e-commerce sites that donate a portion of their sales to a nonprofit of the customer's choice.⁷⁶

Charity Shopping Sites

Through these sites, an individual can purchase items and the site will give a small percentage of the purchase price to charity—one the site has sponsored or one the purchaser chooses, depending upon the set up of the particular site. A list of charity shopping sites may be found at www.baltimoregivingproject.org. Reviews of many of these Web sites and others can be found online at the FORBES magazine Web site.⁷⁷

Charity Affinity Credit Cards

Many banks and credit card companies are working out agreements with charities to offer an affinity credit card bearing the charity's name and logo. The cards are just like other credit cards, but the specified charity gets a financial benefit. However, all affinity credit cards are not

created equal. Check carefully because the benefits to the charity as well as the terms of the credit agreement vary.

The specific terms of the credit card offer must be examined as any other credit card would be—the amount of the interest rate/finance charges, the amount of the annual fee, if any, the amount of late fees and over-the-limit fees, if any, and the length of the grace period, or amount of time after which finance charges begin to accrue on any unpaid balance, should be considered.

Additionally, the promotional literature should state exactly how the charity benefits. For example, one affinity card offer declared that a specified national charity would receive half of one percent of all transactions made with the card (that works out to five cents for every \$10 worth of purchases). If the financial benefit for the charity is not spelled out, the applicant should ask.

Contributions made by a bank and/or credit card company through the use of an affinity credit card are not deductible to the consumer as a charitable donation for federal income tax purposes.

Conclusion

Because there is no "typical" American philanthropist, a charitable giving plan must take into consideration the unique personalities, dreams, desires, families and assets of each individual. There is no one-size-fits-all plan, but I hope that the ideas put forth in this article point the readers toward a plan that may fit their clients as well as the needs of nonprofit organizations in our communities.

- ¹ At the time of publication, H.R. 7, the CARE Act, which includes a provision to allow individuals to make lifetime charitable gifts of retirement assets without first recognizing the income tax is being debated in Congress.
- ² Code Sec. 170(e)(1)(B)(i).
- ³ Code Sec. 170(e)(1)(A).
- ⁴ Code Sec. 170(e)(5).
- ⁵ Code Sec. 170(e)(1)(B)(ii).
- ⁶ Code Sec. 170(e)(1)(C)(iii).
- ⁷ Reg. §1.170A-4(b)(3)(i).
- ⁸ Ordinary income (current year as well as any past year carryover); Capital gains (short-term then long-term); Other income (normally tax-exempt income); then Corpus.
- ⁹ LTR 200223013 (Mar. 11, 2002).
- ¹⁰ The gift and loan agreement also committed the taxpayer to transferring his interest in the artwork either during his lifetime or at death, but pursuant to state law governing the transfer during the donor's lifetime, the artwork was still subject to the claims of his creditors. Due to this, under Rev. Rul. 76-103, 1976-1 CB 293, the gift is not a completed gift and therefore not subject to gift tax.
- ¹¹ Reg. §1.170A-4(b)(3)(ii)(b) applicable to "unrelated use."
- ¹² See the definitions in the first article of this series, Janet Nava Bandera, *Philanthropy and the Professional Advisor*, J. PRACTICAL ESTATE PLANNING, Dec. 2002-Jan. 2003, at 28.
- ¹³ Reg. §1.1011-2.
- ¹⁴ Reg. §1.1011-2(b); the \$400,000 of basis is allocated 30 percent to the "sale" portion \$300,000 (debt)/\$1 million (FMV) = 30% and 70 percent to the donation portion (there is no tax benefit from the 70 percent of the basis allocation to the donation) \$300,000 (debt) - \$120,000 (basis) = \$180,000 ordinary income (long-term gain).
- ¹⁵ Code Sec. 514.
- ¹⁶ LTR 9015049 (Jan. 16, 1990).
- ¹⁷ Reg. §1.514(b)-1(b)(1)(ii).
- ¹⁸ Reg. §1.514(c)-1(b)(3)(ii).
- ¹⁹ Laura H. Peebles, *Contributing Mortgaged Property to Charity*, at www.pgdc.net, under "Gift Planner's Digest," May 2001.
- ²⁰ Reg. §1.170A-1(b).
- ²¹ *W.B. Neville*, 26 TCM 452, Dec. 28, 448(M), TC Memo. 1967-95.
- ²² Code Sec. 170(e)(1).
- ²³ Reg. §1.170A-1(c)(2).
- ²⁴ Reg. §1.170A-1(c)(3).
- ²⁵ Rev. Rul. 59-60, 1959-1 CB 237.
- ²⁶ LTR 9825031 (Mar. 24, 1998); LTR 9734034 (May 22, 1997); LTR 9441032 (July 13, 1994). A negative result was reached in LTR 9247018 (Aug. 24, 1992).
- ²⁷ Such stock is subject to Rule 144 of the Securities Act of 1933 (available among other places at www.law.uc.edu/CCL/33ActRls/rule144.html).
- ²⁸ Jennifer L. Franklin and David A. Shevlin, *Issues to Consider When Making and Ac-*
- cepting Gifts of Restricted Stock*, at www.pgdc.net, under "Gift Planner's Digest," Dec. 2002.
- ²⁹ Small Business Job Protection Act of 1996 (SBJPA) (P.L. 104-188).
- ³⁰ Christopher Hoyt, *Charitable Gifts of Subchapter S Stock: How to Solve the Practical Legal Problems*, at www.pgdc.net, under "Gift Planner's Digest," Sept. 1998, originally appearing at J. GIFT PLANNING, Jan. 1998, at 5 (entire section and accompanying cites found therein).
- ³¹ *Id.*, at note 64 and accompanying text.
- ³² *Id.*, at note 89 and accompanying text.
- ³³ *Id.*, at note 90 and accompanying text.
- ³⁴ *Id.*, at note 42 and accompanying text.
- ³⁵ Rev. Rul. 75-194, 1975-1 CB 80.
- ³⁶ Code Sec. 1011(b) and Reg. §1.1011-2.
- ³⁷ Code Sec. 72(t).
- ³⁸ *Supra* note 1, as an exception for charitable giving may also be implemented by Congress.
- ³⁹ Code Sec. 402(e)(4)(B); Reg. §1.402(a)-1(b)(i)(a).
- ⁴⁰ LTR 200215032 (Jan. 10, 2002).
- ⁴¹ See *S.P. Blake*, CA-2, 83-1 USTC ¶9121, 697 F2d 473, *aff'g*, 42 TCM 1336, Dec. 28, 324(M), TC Memo. 1891-579 (donee obligated to sell appreciated stock received from the donor and use the proceeds to buy donor's yacht at an inflated price).
- ⁴² Both of these doctrines are discussed extensively with reference to the court cases that employed them in the IRS's FSA 200149007 (Aug. 10, 2001).
- ⁴³ *Humacid Co.*, 42 TC 894, 913, Dec. 26, 927 (1964) (gift of appreciated property does not result in income to donor as long as he gives property away absolutely and parts with title thereto before property gives rise to income through a sale).
- ⁴⁴ *L. Greene*, DC NY, 93-1 USTC ¶50,033, 806 FSupp 1165, 1169 (fact that taxpayer could reasonably anticipate at the time of the contribution that donee would immediately sell donated property does not necessarily convert donation into anticipatory assignment of income).
- ⁴⁵ *M. Ferguson*, 108 TC 244, 257, Dec. 52, 007 (1997); *L.B. Sheppard*, CtCls, 66-1 USTC ¶9461, 176 CtCls 244, 361 F2d 972, 973.
- ⁴⁶ *R.A. Penrod*, 88 TC 1415, 1429, Dec. 43, 941 (1987).
- ⁴⁷ *Id.*; *L. Greene*, CA-2, 94-1 USTC ¶50,022, 13 F3d 577, 583.
- ⁴⁸ FSA 200149007, *supra* note 42.
- ⁴⁹ See *Ferguson*, *supra* note 45, *aff'd*, CA-9, 99-1 USTC ¶50,412, 174 F3d 997.
- ⁵⁰ Christopher R. Hoyt, *Transferring U.S. Savings Bonds to Charities*, at www.pgdc.net, under "Gift Planner's Digest," Oct. 1998.
- ⁵¹ *Id.*
- ⁵² *Id.*
- ⁵³ Some states, including New York, prohibit the funding of a gift annuity with real estate.
- ⁵⁴ Code Sec. 121.
- ⁵⁵ Bruce E. Bigelow, Ph.D., *Gifts of Real Estate*, at www.pgdc.net, under "Gift Planner's Digest," Jan. 1999.
- ⁵⁶ *Id.*
- ⁵⁷ *Id.*
- ⁵⁸ *Bargain Sale*, at www.pgdc.net, under "Gift Vehicle Review."
- ⁵⁹ Rev. Rul. 2002-20, IRB 2002-17, 794.
- ⁶⁰ *Id.*
- ⁶¹ LTR 200230018 (Apr. 22, 2002).
- ⁶² *Id.*
- ⁶³ *Id.* (The IRS stated that to issue a ruling on this topic, it would have to assume that the annuitant will survive the taxpayer and that such assumption would involve a hypothetical situation, since both the annuitant and the taxpayer were presently living. Pursuant to §8.02 of Rev. Proc. 2001-4, 2001-1 CB 121, the IRS declines to issue rulings on hypotheticals.)
- ⁶⁴ LTR 9743054 (Aug. 1, 1997).
- ⁶⁵ Frank Minton, *Twelve Uncommon Things You Can Do With a Gift Annuity*, at www.pgdc.net, under "Gift Planner's Digest," Mar. 2000.
- ⁶⁶ Frank Minton is president of Planned Giving Services, Inc., of Seattle, Washington, a planned giving consulting firm serving clients in the United States and Canada. He has served as the senior estate planner in Northwestern University's planned giving program and as director of planned giving for the University of Washington. Minton is a past NCPG President, a recipient of NCPG's Distinguished Service Award. He is a director and past program chair of the American Council on Gift Annuities and chairs its rates committee. He is also vice president of and past ethics program chair for NCPG.
- ⁶⁷ *Id.*
- ⁶⁸ Rev. Proc. 2001-3, 2001-1 CB 111.
- ⁶⁹ LTR 200150019 (Sept. 13, 2001).
- ⁷⁰ LTR 200152018 (Sept. 26, 2001).
- ⁷¹ American Council on Gift Annuities, www.acga-web.org.
- ⁷² LTR 200230007 (Apr. 11, 2002).
- ⁷³ Rev. Rul. 2002-67, IRB 2002-47, 873.
- ⁷⁴ *Id.*
- ⁷⁵ <http://netaction.org/notes/>.
- ⁷⁶ *Id.* In LTR 200142019 (July 24, 2001), the IRS ruled that a taxpayer who elects to contribute a rebate from the purchase of products from an e-commerce Web site to a charity can deduct the contribution and will not realize income in the amount of the rebate. The IRS ruled as follows: (1) The contribution of the rebate is deductible under Code Sec. 170. Distinguishing this transaction from those in *American Bar Endowment*, SCt, 86-1 USTC ¶9482, 477 US 105, 106 SCt 2426, in which, as a condition of participating in a group insurance program, members were required to assign

ENDNOTES

refunds from their premiums to the American Bar Endowment, the IRS noted that in the present case, the donation of rebates was voluntary. (2) The charitable contribution is deductible in the year the company transmits the rebate to charity. The regulations provide that a charitable contribution paid to an agent of a charitable

organization is deductible when paid to the agent. However, in this case, the company is not acting as the charity's agent but, rather, the customer's; therefore, delivery does not occur until the rebate is actually transferred to charity. (3) The rebate is not includible in the customer's income. Citing Rev. Rul. 76-96, 1976-1 CB

23 and Rev. Rul. 84-41, 1984-1 CB 130, the IRS stated a rebate "is a reduction in the purchase price of the item; it is not an accession to wealth and is not includible in the buyer's gross income."

⁷⁷ *Best of the Web Charitable Giving*, at www.forbes.com/bow/b2c/category.jhtml?id=74.

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