Charitable Contributions

SPIDELL

Tax • Analysis • Education

www.caltax.com | E-mail: CPE@spidell.com | Phone: 714-776-7850 | Fax: 714-776-9906

CHARITABLE CONTRIBUTIONS

Course objectives: This course is an up-to-date, comprehensive review and analysis of the tax treatment of qualified charitable deductions for individuals, business entities, and estates and trusts. Topics addressed include: basic rules of qualified charitable contributions; deductibility; carryovers; income limitations; noncash contributions; valuation; appraisals; substantiation; qualified charitable distributions from IRAs; donor advised funds; charitable remainder trusts; reporting requirements; and much more.

After completing this course, you will be able to:

- Recall the maximum deduction amount for charitable contributions from estates and complex trusts
- Identify when crowdfunding deductions are deductible
- Determine which factor weighs most heavily in the determination of the fair market value of real property
- Identify the carryover period for qualified conservation contributions
- Recall the tax differences between charitable remainder unitrusts and charitable remainder annuity trusts
- Identify the limitations when making a qualified charitable distribution from an IRA

Category: Taxes

Recommended CPE Hours: CPAs — 2 Tax
EAs — 2 Federal Tax
CRTPs — 2 Federal Tax

Level: Basic

Prerequisite: None

Advance Preparation: None

Expiration Date: February 2023

Table of Contents

CHARITABLE CONTRIBUTIONS

INTRODUCTION AND BASIC RULES

Taxpayers are allowed a deduction for qualified charitable contributions. (IRC §170)

A deductible charitable contribution generally is one that:

- Is made to or for the use of a qualified charitable organization;
- Is paid within the taxpayer's taxable year;
- Is within the applicable statutory income limits for individuals and corporations; and
- Meets the substantiation requirements.

For individual taxpayers, the deduction is an itemized deduction. (IRC §63(d)) For flowthrough entities such as partnerships and S corporations, the deduction is shown as a separate line item on the K-1. (Treas. Regs. §§1.170A-1(j)(7), 1.1366-1(a)(2)(iii))

Contributions may be in cash or other property. Many special rules apply to noncash donations including valuation and substantiation requirements (see "Noncash contributions" on page 18).

Taxpayers may make charitable contributions directly from their IRAs and exclude an otherwise taxable distribution from income (see "Qualified charitable distributions from IRAs" on page 43). (IRC §408(d)(8))

QUALIFIED CHARITABLE ORGANIZATIONS

A qualified charitable organization is one that fits into one of the categories specified in IRC §170 and that the IRS has ruled (or the donor establishes) is eligible to receive deductible charitable contributions. Charitable organizations described in IRC §501(c)(3) are eligible to receive tax-deductible contributions in accordance with IRC §170.

Here are some examples of qualified organizations:

- Churches, temples, synagogues, mosques (or a convention or association thereof), and other religious organizations;
- War veterans' organizations;
- Most charitable organizations, such as the Red Cross and United Way;
- Most charitable education organizations, including the Boy and Girl Scouts of America, colleges, museums, and day care centers if substantially all the child care provided is to enable individuals (the parents or other guardians) to be gainfully employed and the services are available to the general public (a contribution that is a substitute for tuition or other enrollment fee is not deductible as a charitable contribution);
- Charitable hospitals and medical research organizations;
- Utility company emergency energy programs, if the utility company is an agent for a charitable organization that assists individuals with emergency energy needs;
- Volunteer fire companies;
- Public parks and recreation facilities; and
- Civil defense organizations.

Taxpayers may ask a representative from an organization whether that organization is a qualified organization, or may use the Tax Exempt Organization Search online tool on the IRS's website to see if an organization is a qualified organization:

Website
https://apps.irs.gov/app/eos/

Crowdfunding

Donations made through a crowdfunding source will only qualify for a charitable contribution deduction if the donee organization is a qualified organization as listed above and if the taxpayer receives the substantiation documentation discussed in the chart beginning on page 40.

Donation to foreign church not deductible

Two taxpayers' donations to Catholic churches in a foreign country were nondeductible. (***Theodore R. Rolfs and Julia A. Gallagher v. Comm.*** (2010) 135 TC 24) The taxpayers argued that the Catholic church is a "universal" organization and that, as such, contributions to any Catholic church should qualify. However, the Tax Court stated that the churches to which the funds were transferred were not created or organized in the United States and were not under the laws of the United States.

Deduction allowed for direct contributions to missionaries

The Tax Court has allowed deductions for charitable contributions made to church missionaries working with domestic churches. (***Wilkes v. Comm.***, TCS 2010-53) However, no deduction was allowed for contributions to missionaries working for foreign churches, or for contributions made directly to needy families. The direct contributions to domestic missionaries were allowed because the constructive donee, the church, was a qualifying domestic charity, and the direct donee was acting in his capacity as a fiduciary of the church.

<table>
<tr><th colspan="2">Deductibility of Contributions</th></tr>
<tr><th>Deductible as charitable contributions</th><th>Not deductible as charitable contributions</th></tr>
<tr><td>Money or property given to/for:
Churches, synagogues, temples, mosques, and other religious organizations
Federal, state, and local governments, if the contribution is solely for public purposes (for example, a gift to reduce the public debt or to maintain a public park)
Nonprofit schools and hospitals
Public parks and recreation facilities
Salvation Army, Red Cross, CARE, Goodwill Industries, United Way, Boy Scouts, Girl Scouts, Boys and Girls Clubs of America, etc.
War veterans' groups
Out-of-pocket expenses when volunteering for a qualified organization
Expenses paid for a student sponsored by a qualified organization who is living with the taxpayer</td><td>Money or property given to/for:
Civic leagues, social and sports clubs, labor unions, and chambers of commerce
Foreign organizations (unless provided for under a tax treaty; contributions to Mexican, Canadian, and Israeli charities may qualify if the taxpayer has income from those countries, see IRS Publication 526)
Groups that are run for personal profit
Groups whose purpose is to lobby for changes in law
Homeowners' associations
Individuals
Political groups or candidates for public office
Cost of raffle, bingo, or lottery tickets
Dues, fees, or bills paid to country clubs, lodges, fraternal orders, or similar groups
Tuition
Value of your time or services
Value of blood given to a blood bank
Value of goods or services received from a charitable organization</td></tr>
</table>

YEAR ALLOWED

The deduction is allowed in the taxable year the contribution is made. However, accrual-basis corporations may deduct contributions made after year-end if:

- The board of directors authorizes the charitable contribution;
- The payment of the contribution is made before the 15th day of the fourth month following the end of the taxable year; and
- The taxpayer-corporation elects to treat the contribution as made in the taxable year. (IRC §170(a)(2))

To make the election, the taxpayer must attach to the return for the election year a declaration that the resolution authorizing the contribution was adopted by the board of directors during the tax year. (Treas. Regs. §1.170A-11(b)(2))

Method of payment

Generally you make a contribution at the time of its unconditional delivery:

- **Checks:** Delivered on the date of postmark;
- **Credit card:** Deductible in the year it's charged;
- **Text message:** The year the text is sent if charged to the taxpayer's telephone or wireless account;
- **Pay-by-phone:** The date the financial institution pays the amount;
- **Promissory note:** On the date the note payments are made;

- **Option to buy real estate:** The date the charity exercises the option;
- **Stock certificate:** On the date of postmark. However, if an agent or the issuing corporation makes the transfer, the date the stock is transferred on the books of the corporation;
- **Borrowed funds:** If you contribute borrowed funds, you can deduct the contribution in the year you deliver the funds to the charity, regardless of when you repay the loan; and
- **Conditional gift:** Not completed until the condition is removed, unless the chances of the condition arising are negligible at the time of transfer.
  (IRS Publication 526, Charitable Contributions)

DEDUCTION AMOUNTS AND CARRYOVERS

CONTRIBUTION AMOUNT — GENERALLY

Generally, the amount deductible is the amount of cash or the fair market value of noncash property. With regard to noncash contributions there are numerous exceptions and special rules, discussed in "Noncash contributions" on page 18.

State tax credits and charitable contributions

Under Treas. Regs. §1.170A-1(h)(3), no federal charitable contribution deductions may be claimed for payments made to charitable or governmental entities if the taxpayer claims a state or local tax credit in excess of 15% for the payments. This limitation applies to contributions made after August 27, 2018.

Comment

These regulations were promulgated to prevent early efforts by states to subvert the TCJA's $10,000 SALT deduction cap. Some states had proposed or enacted laws effectively converting state tax payments into charitable contributions as a way for taxpayers in their state to circumvent the $10,000 limitation.

When taxpayers receive or expect to receive a state or local tax credit in return for a payment or transfer to a qualified charitable or governmental entity, the tax benefit received is a nondeductible charitable contribution.

In applying the charitable contribution rules of IRC §170 and the *quid pro quo* doctrine, the regulations do not exempt state or local tax benefits from the normal rules that apply to other benefits received by a taxpayer in exchange for a contribution. Thus, the proposed regulations state the amount otherwise deductible as a charitable contribution must generally be reduced by the amount of the state or local tax credit received or expected to be received, just as it is reduced for many other benefits. (Prop. Treas. Regs. §1.170A-1(h)(3)(i))

If a taxpayer makes a charitable contribution to a qualified entity for which the taxpayer receives a state tax deduction rather than a credit, then the taxpayer is not required to reduce his or her federal charitable contribution deduction unless the state tax deduction exceeds the amount or fair market value of the taxpayer's contribution to the entity. (Prop. Treas. Regs. §1.170A-1(h)(3)(ii)(A) and (B))

The proposed regulations include a *de minimis* exception under which a taxpayer may disregard a state or local tax credit if the credit does not exceed 15% of the taxpayer's payment or 15% of the fair market value of the property transferred by the taxpayer. (Prop. Treas. Regs. §1.170A-1(h)(3)(vi))

> ***Example of de minimis exception***
>
> State X provides a 15% tax credit for contributions to a state university program. Benjamin contributes $10,000 to the program. He is entitled to a $1,500 state credit. Because the credit does not exceed the 15% *de minimis* exception, Benjamin may claim a charitable deduction of the full $10,000 amount on the federal return.

Benefit received

The deduction for a charitable contribution must be reduced by the fair market value of goods or services received. The acknowledgment of the gift from the charitable organization must set forth the nondeductible amount of the contribution. (IRC §170(f)(8))

De minimis benefit

For 2021, charitable contributions are fully deductible (without reduction for benefit received) if:

- The donor makes a minimum payment of $56.50 and receives certain benefits with a cost of not more than $11.30;
- The charity mails or otherwise distributes free unordered "low-cost articles" with a cost of not more than $11.30; or
- The benefit received by the donor is not more than the lesser of $113 or 2% of the amount of the contribution.
  (Rev. Proc. 2020-45)

Personal services

Because charitable contributions only apply to gifts of money or property, the value of personal services (including professional services) rendered are not deductible. (***C.L. Etheridge v. Comm.***, TCM 1977-175) However, taxpayers may be able to deduct some expenses paid in giving services to a qualified organization. Such expenses of $250 or more must meet substantiation requirements.

The amounts must be:

- Unreimbursed;
- Directly connected with the services;
- Expenses incurred only because of the services of the taxpayer; and
- Not personal, living, or family expenses.

Deductions for out-of-pocket expenses intended for the benefit of charity are denied if:

- The expenses are not incurred directly in connection with, and are not solely attributable to, charitable services (***Nyhus v. Comm.***, TCM 1979-519);
- A substantial, direct, personal benefit inures to the donor or someone other than a charitable organization (Letter Ruling 9540002);
- The donor does not actually render services to a charity (***Peters v. Comm.***, TCM 1976-170); or
- The services do not further the activities of a charitable organization. (***Wilhelm v. Comm.***, TCM 1978-327; ***Hamilton v. Comm.***, TCM 1979-186)

The following unreimbursed expenses can be deducted as contributions made to charity.

Conventions

A chosen representative delegate attending a convention on behalf of a qualified organization can deduct unreimbursed expenses for travel and transportation, including a reasonable amount for meals and lodging, while away from home overnight in connection with the convention. "Qualified organizations" include nonprofit groups that are religious, charitable, educational, scientific, or literary in purpose, and nonprofit groups that work to prevent cruelty to children or animals. (IRC §170(c)(2))

No deduction is allowed for personal expenses for sightseeing, fishing parties, theater tickets, or nightclubs. The representative also cannot deduct travel, meals and lodging, and other expenses for his or her spouse or children. (Rev. Rul. 71-135)

If the taxpayer attends a church convention only as a member of the church, rather than as a chosen representative, none of the expenses in attending are deductible unless they are directly connected with giving services for the church during the convention. (Rev. Rul. 61-46)

Uniforms

The cost and upkeep of uniforms that are not suitable for everyday use and that the taxpayer must wear while performing donated services for a charitable organization are deductible. An example would be troop leader uniforms. (Rev. Rul. 56-509)

Foster parents

Foster parents may be able to deduct as a charitable contribution some of the costs of being a foster care provider if they have no profit motive in providing the foster care and are not, in fact, making a profit. A qualified organization must designate the individuals that taxpayers take into their homes for foster care. (Rev. Rul. 77-280; Rev. Rul. 84-61)

Deductible expenses must be both of the following:

- Unreimbursed out-of-pocket expenses to feed, clothe, and care for the foster child; and
- Primarily to benefit the qualified organization.

Unreimbursed expenses that are not deductible as charitable contributions may be considered support provided by the taxpayer in determining whether he or she can claim the foster child as a dependent.

Example of foster child

Lauren, a foster child, lived with Mr. and Mrs. Smith for the last three months of the year. The Smiths cared for Lauren because they wanted to adopt her (although she had not been placed with them for adoption). They didn't care for her as a trade or business or to benefit the agency that placed her in their home. The Smiths' unreimbursed expenses aren't deductible as charitable contributions but are considered support they provided for Lauren.

Church deacon

Taxpayers can deduct as a charitable contribution any unreimbursed expenses while in a permanent diaconate (training) program established by a church. (Rev. Rul. 76-89) These expenses include the cost of vestments, books, and transportation required in order to serve in the program as either a deacon candidate or as an ordained deacon.

Car expenses

Unreimbursed out-of-pocket expenses such as the cost of gas and oil that are directly related to the use of a car in giving services to a charitable organization are deductible.

Of course, most people use a standard mileage rate of 14 cents a mile to figure the contribution, but don't forget that parking fees and tolls are also deductible, regardless of whether the taxpayer uses actual expenses or the standard mileage rate.

Travel

Taxpayers can claim a charitable contribution deduction for travel expenses incurred while away from home performing services for a charitable organization only if there is no significant element of personal pleasure, recreation, or vacation in the travel. (IRC §170(j))

That doesn't mean that the deduction for travel expenses will be denied simply because the taxpayer enjoyed providing services to the charitable organization. Even if he or she had fun, a charitable contribution deduction for the travel expenses is permitted if the taxpayer was on duty in a genuine and substantial sense throughout the trip.

Example of travel expenses

Gary is a troop leader for a tax-exempt youth group, and he helps take the group on a camping trip. Gary is responsible for overseeing the setup of the camp and for providing adult supervision for other activities during the entire trip. Gary participates in the activities of the group and really enjoys his time with them. He oversees the breaking of camp and helps transport the group home. Gary can deduct his travel expenses.

However, if Gary's son Harry is a member of the troop, Gary's travel expenses will not be deductible because Harry, rather than the organization, will be deemed the beneficiary of Gary's generosity.

Example of nondeductible travel expenses

Cecilia works for several hours each morning on an archeological dig sponsored by a charitable organization. The rest of the day Cecilia is free for recreation and sightseeing. She cannot take a charitable contribution deduction even though she works very hard during those few hours.

Disaster assistance

Unreimbursed expenses directly connected with providing food, lodging, clothing, or other basic necessities to hurricane or other disaster evacuees referred through an organization like the Red Cross, Civil Defense, Salvation Army, or a church are deductible. But no allocation of household costs (like rents and/or utilities) is allowed. (***Larry A. Miller v. Comm.***, TCM 1975-279)

In general, for expenses related to providing services to be deductible as a charitable contribution, the services must benefit an organization and not individuals. However, a deduction is allowed for expenses related to services provided to individuals where an organization's essential charitable purpose is to benefit individuals in a prescribed group, and the individuals benefited are selected by the organization and not the taxpayer.

Unreimbursed out-of-pocket expenses for maintaining, in a taxpayer's home, refugees referred by a qualifying charitable organization are deductible. (Rev. Rul. 66-10) These expenses are contributions or gifts for the use of the organization, within the meaning of IRC §170.

The limitation on charitable contribution deductions for corporations was temporarily increased from 25% to 100% for qualified disaster relief contributions made during the period beginning on January 1, 2020, through February 25, 2021. (TCDTRA §304(a))

Leave contributions

Employers may provide a program for their employees where the employees may forego paid vacation, sick pay, or personal leave in exchange for cash payments the employer makes to charitable organizations providing relief for the victims of the COVID-19 pandemic. Under this special relief, the donations made prior to January 1, 2022, are not included in the income or wages of the employees, and the employer will be permitted to deduct the cash payments as business expenses. (IR-2021-142; Notice 2021-42)

Volunteer Income Tax Assistance

Program volunteers' expenses such as transportation costs to and from training and tax assistance sites, paper and pencils, and newspaper advertising were deductible contributions to a charitable organization. (Rev. Rul. 80-45; Rev. Rul. 84-61)

Donation of someone else's services

A taxpayer may take a charitable deduction for contributing the right to another person's services. For example, if an individual buys dancing lessons from a dancing school and donates the lessons to charity, which in turn uses the lessons in furtherance of its charitable purposes by designating the persons who could take the lessons, the value of the dancing lessons is deductible. (Rev. Rul. 68-113)

Don't try to go too far

Although IRC §170 allows that unreimbursed expenses incurred in rendering services are contributions "made to" (rather than "for the use of") a charity and qualify for the highest possible deduction, don't let your clients try to expand the definition too much.

Certain equipment

A member of the Civil Air Patrol (CAP) was entitled to deduct most substantiated expenses incurred "for the use of" the charitable organization. Although radios purchased by the member were used almost exclusively for CAP purposes, a charitable contribution deduction for the cost of such radios was denied because the member retained title and control over the radios, and he could have converted them to other uses. (***J.F. Patterson v. Comm.***, TCM 1987-252)

This will apply to vehicles owned by volunteer firefighters, boats owned by volunteer harbor patrol members, and skis for ski patrol members. No amount for insurance covering the equipment is allowed either.

Athletic associations

A sponsor of an amateur softball team was denied a deduction for members' equipment, uniforms, trophies, medical expenses, and lodging and meals on overnight trips because the charities (the softball league and the softball association) were not the primary beneficiary of the expenses. (***J. F. Patterson v. Comm.***, TCM 1987-252)

Athletic seating rights

Under the TCJA, no charitable deduction is allowed for a payment to a college or university in exchange for receiving the right to purchase tickets or seating at an athletic event. (IRC §170(l)(1))

Under pre-TCJA law, if a taxpayer made a contribution to or for the benefit of a college or university that would have been allowable as a charitable deduction but for the fact that, as a result, the taxpayer received (directly or indirectly) the right to buy tickets for seating at an athletic event in the institution's athletic stadium, 80% of the payment was treated as a charitable contribution.

The 80% rule applied without regard to whether tickets would have been available to the taxpayer without making the payment, and applied even if the seating was in a special area such as a skybox. The 80% rule did not apply if the taxpayer received tickets or seating, rather than the right to buy tickets or seating, in return for the payment. In this case, the expense has never been deductible.

This rule was an exception to the general rule that a contribution be made not in exchange for a benefit to the donor. The TCJA eliminates this exception. Beginning in 2018, no deduction is allowed for contributions in exchange for the right to purchase tickets or seating at an athletic event.

Expenses for student living with taxpayer

A taxpayer may claim a charitable contribution deduction for certain expenses incurred in housing a student. (IRC §170(g)) The student may be foreign or American but may not be a dependent or a relative (as defined, generally under IRC §152 pertaining to definitions of relatives for dependent purposes). The student must be a full-time student in the 12th or lower grade.

The deduction is limited to $50 multiplied by the number of months during the taxable year that the student lived with the taxpayer. (IRC §170(g)(2)(A)) No deduction is allowed to the extent the taxpayer receives any compensation or reimbursement for the expenses.

Allowable expenses include books, tuition, food, clothing, transportation, medical care, entertainment, and other expenses incurred for the well-being of the student. (IRS Publication 526) Expenses such as depreciation on the home, fair market value of lodging, and general household expenses such as property taxes, insurance, repairs, etc., do not qualify.

INCOME LIMITATIONS — INDIVIDUALS

CARES Act changes extended

For the year 2021, the Taxpayer Certainty and Disaster Tax Relief Act (TCDTRA; P.L. 116-260) extended, with modification, the following CARES Act provisions:

- An individual, who does not itemize deductions, may claim a maximum $300 ”below-the-line” deduction for 2021 charitable contributions ($600 for married taxpayers filing jointly). The deduction is claimed on line 12b of the Form 1040 (TCDTRA §212; IRC §§63(b), 170(p)); and
- An individual who does itemize may deduct a charitable contribution up to 100% of their adjusted gross income. The contribution must be in cash or cash equivalent such as a credit card charge. The 100% contribution limit is referred to as a “qualified cash contribution.” Taxpayers must “affirmatively elect” the 100% limit, by including the 100% deduction on line 11 of the Schedule A, and also listing each qualified cash contribution for which the election is made on the dotted line next to the line 11 entry space. For donations made by S corporations and partnerships, the election is made at the partner/shareholder level. Donor advised fund contributions and those to supporting organizations do not qualify for either deduction. See page 15 for ordering rules for carryover contributions. (TCDTRA §213)

Income limitation, generally

An individual can’t deduct more than a specified percentage of his or her “contribution base” (generally adjusted gross income computed without regard to net operating loss carrybacks). (IRC §170(b)(1)(G)) If an individual’s total charitable contributions exceed the applicable income limitation, the excess may be carried over and deducted for five years (see page 14).

Generally, the percentage limitation is 50% (60% for cash contributions made after December 31, 2017, and before January 1, 2026, increased to 100% for the 2020 and 2021 tax years) of the contribution base for contributions "to" a 50% charity (discussed below) as opposed to "for the use of" the organization. However, this limitation doesn't apply to contributions of "certain capital gain property" unless the election is made to reduce the amount of contribution (in which case, the 50% ceiling applies) (see page 11). Special rules apply to qualified conservation contributions (see page 36).

The 50%/60%/100% ceiling applies only to contributions *to* 50% charities of:

- Cash (60%/100%);
- Property that isn't certain capital gain property (50%); and
- Certain capital gain property for which the taxpayer has made the election to reduce the amount considered contributed (50%).

A 30% ceiling applies to other contributions that are:

- Indirect (that is, *for the use of*, rather than *to*) a qualifying organization;
- 30% charities (discussed below); or
- Spent on behalf of a qualifying student living with a taxpayer.

Contributing "to" versus "for the use of"

A contribution is "for the use of" a qualified organization when it is held in a legally enforceable trust for the organization or in a similar legal arrangement. (IRS Publication 526)

A contribution of an income interest in property is considered as made "for the use of" rather than "to" the charitable organization. A contribution of a remainder interest in property is considered as made "to" the charitable organization; there is an exception if the interest is held in trust for the benefit of the organization, in which case the contribution is considered as made "for the use of" the organization. (Treas. Regs. §1.170A-8(a)(2))

More than one category

If a taxpayer makes contributions in multiple percentage categories, the higher percentage categories are generally deemed to be contributed first. IRS Publication 526 contains worksheets to figure the deduction when multiple categories are involved.

If the aggregate of the 60% limit contributions are greater than 30% of the taxpayer's contribution base (AGI less any NOL carrybacks to the taxable year), then all 30% limit contributions are carried over. (IRC §170(b)(1)(G)(iii)(I) and (II))

Example of more than one category

Dale has an AGI of $50,000. Over the course of the year, he contributes $18,000 to 30% charities. He doesn't make any contributions to 50% charities. He can deduct $15,000 (30% × $50,000).

Sara has an AGI of $50,000. She makes cash contributions, which she elects not to treat as qualified charitable contributions, of $22,000 to 50% charities and $10,000 to 30% charities. She can deduct the $22,000 contributed to the 50% charities. However, she can only deduct $8,000 of her contributions to the 30% charities. This is calculated as the excess of 60% of her AGI ($30,000), over her allowable contributions to 50% charities ($22,000). She may carry the remaining $2,000 from her donations to the 30% charities to the following year.

50% and 30% charities

50% charities are those listed at IRC §170(b)(1)(A):

- Churches, or conventions or associations of churches;
- Educational organizations including foundations for the benefit of state colleges;
- Hospitals and medical research organizations;
- Governmental bodies;
- Government-supported organizations;
- IRC §509(a)(2) and (a)(3) organizations; and
- Private foundations that meet the strict requirements of IRC §170(b)(1)(F), including:
    - Private operating foundations as defined in IRC §4942(j)(3) (generally, those that actively conduct charitable activities and meet annual charitable distribution requirements);
    - Conduit foundations; and
    - Common fund private foundations.

30% charities are defined as charitable organizations that are not 50% charities. (IRC §170(b)(1)(B)) These would include certain war veterans organizations, organizations testing for public safety, fraternal orders, cemetery companies, and private foundations that don't meet the requirements of IRC §170(b)(1)(F) to qualify a private foundation as a 50% charity. It also includes contributions for the use of any qualified organization, including amounts spent on a student living with you (see page 9). (IRS Publication 526)

A contribution to a 30% charity is allowed to the extent that it doesn't exceed the lesser of:

- 30% of the taxpayer's AGI; or
- The excess of:
    - 50%/60%/100% of the taxpayer's AGI; over
    - The amount of allowable contributions to 50% charities.

(IRC §170(b)(1)(B))

20% limitation

A 20% limit applies to capital gain property donated to a 30% organization. (IRC §170(b)(1)(D)) The deduction ceiling for contributions of capital gain property by individuals to 30% charities is the lesser of:

- 20% of the taxpayer's AGI for the tax year; or
- The excess of:
    - 30% of the taxpayer's AGI; over
    - The amount of allowable contributions of certain capital gain property to 50% charities.

(IRC §170(b)(1)(D)(i)(I) and (II))

Certain capital gain property election

The 50% limitation doesn't apply to contributions of certain capital gain property unless the election is made to reduce the amount of contribution (in which case, the 50% ceiling applies).

An individual who makes a charitable contribution of certain capital gain property may elect the 50% ceiling if he or she is willing to reduce the amount of the contribution to the property's basis. (IRC §170(b)(1)(C)(iii); Treas. Regs. §1.170A-8(d)(2)) If made, the election applies to all contributions of certain capital gain property made during the year.

Capital gain property is any capital asset, the sale of which at its fair market value at the time of donation would have generated long-term capital gain.

For purposes of the 30%/50% distinction, "certain capital gain property" is all capital gain property other than:

- Tangible personal property donated for unrelated function use;
- Contributions to nonqualifying private foundations;
- Contributions of intellectual property; and
- Taxidermy property.
  (IRC §170(b)(1)(C)(i); IRS Publication 526)

There is no election available to reduce the amount of the contribution of capital gain property to a 30% charity.

Comment

The election is most beneficial when the amount of appreciation is minimal.

The election is made by attaching to the original electing year return, or to an amended return filed by the due date for filing the original return, a statement that the election is being made.

Election statement

I elect under IRC §170(b)(1)(C)(iii) and Treas. Regs. §1.170A-8(d)(2) to have the reduction rule of IRC §170(e)(1)(B) apply to my capital gain property contributions.

Carryovers

In applying the 50% carryover for any year in which this election is made, contributions of capital gain property in any prior year for which the election was not made are reduced as if they were subject to the reduced contribution rule when made. (IRC §170(b)(1)(C)(iii)) Carryovers already used in intervening years need not be adjusted. Thus, the recomputed carryover is the amount that the taxpayer's carryover would have been if he or she had elected to reduce the amount of the contribution that gave rise to the carryover, minus the amount that has already been deducted for the contribution, including any part of the carryover already deducted in previous years.

If a carryover recomputation is required, the election statement must include a schedule setting forth the recomputation of the carryover. It must also provide sufficient information to enable the IRS to identify the returns for the previous year(s), and indicate whether the return(s) were joint or separate return(s).

Example of carryover

In year 1, Eddie donates his collection of guitars to a county museum (a 50% charity). The guitars have a fair market value of $25,000 and a basis of $20,000. His adjusted gross income is $40,000 and he does not make the election. His deduction is limited to $12,000 (30% × $40,000), and he has a carryover of $13,000 ($25,000 - $12,000).

In year 2, Eddie donates his collection of amplifiers to the same museum. They have a fair market value of $15,000 and a basis of $10,000. His adjusted gross income is $40,000. He makes the election.

Recomputed deduction for year 1 (lesser of basis or 50% of AGI)	$20,000
Deduction taken in year 1	(12,000)
Recomputed carryover to year 2	8,000
Deductible amount for year 2	10,000
Total deductible amount for year 2	$18,000
Maximum deduction (50% × $40,000)	$20,000
Deduction	$18,000
Carryover to year 3	$ 0

Had Eddie not made the election, his deduction would have been limited to $12,000 (30% of AGI). His excess contribution of $3,000 plus his carryover from year 1 (of $13,000) would have given him a carryover to year 3 of $16,000.

INCOME LIMITATIONS — CORPORATIONS

Generally, the charitable contribution deduction for corporations cannot exceed 10% of their taxable income, as specially defined. (IRC §170(b)(2)(A)) This amount was increased to 25% for 2020 and 2021 under the CARES Act and Taxpayer Certainty and Disaster Tax Relief Act (TCDTRA). Contributions to supporting organizations or donor advised funds do not qualify for the higher limitation. The percentage for applicable certain food inventory donations made in 2020 and 2021 also increased from 15% to 25% of taxable income. (CARES Act §2205) Excess amounts may be carried over.

For this purpose, taxable income is computed without regard to:

- IRC §170 (the charitable contribution itself);
- IRC §199A (the qualified business income deduction);
- IRC §§241–247 (dividends received deductions);
- IRC §249 (deduction of premium on repurchase of convertible debt);
- IRC §250 (foreign-derived intangible income and global intangible low-taxed income deduction);
- Any net operating loss (NOL) carryback to the tax year; and
- Any capital loss carryback to the tax year.
  (IRC §170(b)(2)(D)

See page 36 for the limitations on qualified conservation contributions.

See page 33 for the food inventory contribution calculation.

Flowthrough entities

The charitable contributions paid by an S corporation or partnership are passed through to, and taken into account by, the shareholders or partners who must apply any limitations at their level. Schedule K-1 separately codes different categories of contributions (cash 60%, noncash 30%, etc.).

Personal holding companies

In computing undistributed personal holding company income, the corporate charitable contribution percentage limitation is based on ceilings that normally apply only to individuals. IRC §170(b)(2)(A), which normally imposes a 10%-of-taxable-income ceiling on corporate charitable contribution deductions, is disregarded, and excess contribution carryovers from other years—either of individuals or of corporations—aren't allowed. (IRC §545(b)(2))

INCOME LIMITATIONS — ESTATES AND TRUSTS

Estates and complex trusts may deduct any amount of income which under the terms of the governing instrument is paid for the purpose of making a charitable deduction. (IRC §642(c)(1)) This deduction is in lieu of the deduction allowed by IRC §170. It is allowed without limitation; that is, there is no deduction ceiling on the amount of charitable deduction allowed. Nor is the deduction subject to the 2% of adjusted gross income (AGI) floor.

CARRYOVERS

Five-year carryover

Individuals

If an individual's charitable contributions exceed the applicable percentage-of-AGI limitation, the excess may be carried over and deducted for five years. (IRC §170(d)(1)(A)) Extended carryover is available for qualified conservation contributions (see page 36). Any contribution carried to a future year remains in its percentage limitation category and can only be deducted after any contributions made in that category in that future year, subject to the limitations applicable to that year. However, a carryover of a 50%/60% limited contribution must be used before 20% or 30% limited contributions in the current year. (IRS Publication 526, Charitable Contributions) The 100% cash contribution limit available in 2020 and 2021 is not subject to this ordering rule. Rather, 100% cash contributions are taken after all other current contributions and carryovers in the other categories are applied first.

Example of ordering rules under the CARES Act

Molly's 2021 AGI is $50,000, and she has a $35,000 60% cash contribution carryover from 2020. Molly makes another $24,000 cash contribution in 2021. She may claim a $50,000 deduction computed as follows:

Carryover from 2020 ($50,000 2021 AGI × 60%)	$30,000
Qualified contribution from 2020 ($50,000 - $30,000 prior year carryover allowed)	20,000
	$50,000

She may carry over $9,000 in unclaimed deductions ($5,000 from pre-2020 carryovers + $4,000 of unused qualified contributions from 2021). The $9,000 will be subject to the 60% AGI limit in 2022.

Example of lost carryover

If Molly's $35,000 carryover in the previous example was from 2016, under the standard ordering rules she would have deducted the 2021 contribution first and would have only been able to claim $6,000 of the carryover.

Qualified contribution from 2021	$24,000
Carryover from 2016 (because her 2016 contribution deduction may not bring her total deduction to more than 50% of 2021 AGI)	6,000
	$30,000

The remaining $29,000 ($35,000 - $6,000) of carryover would have been lost because the five-year carryover period expires at the end of 2021.

Any carryover attributable to a deceased taxpayer that isn't used in the deceased taxpayer's final return is lost.

A taxpayer who claims a deduction for the carryover of an excess charitable contribution must attach to his or her return for the deduction year a statement showing the contribution year and any other items affecting the current-year deduction including capital gain property and any election pertaining to it, and the elements of the carryover including different percentage limitation property.

Ordering

☑ Planning Pointer

The provisions that increase the charitable contribution limitation for the 2020 and 2021 tax years only applies to cash contributions made during 2020 and 2021. Taxpayers with charitable contribution carryovers from taxable years prior to 2020 cannot increase their charitable contribution carryover to 100% in 2020 and 2021. (CARES Act §2205(a)(2)(A)(ii))

Example of contribution carryovers into 2021

Melinda has $40,000 of charitable contribution carryovers from 2016, which means they will expire if she does not use them in 2021. In 2021, Melinda's AGI is $70,000 and she has $5,000 of cash contributions.

Even though the CARES Act increases the contribution deduction from 60% to 100% of a taxpayer's AGI in 2021, it does not apply for contribution carryovers. Because Melinda's 2021 cash contributions are below 60% of her AGI, her overall charitable contribution deduction will be limited to 60% of her AGI, unless she elects to treat her $5,000 2021 contribution as a qualified cash charitable contribution.

Melinda will calculate her charitable contribution deduction as follows:

	2021 AGI	$70,000
×	AGI limitation	60%
=	Maximum charitable contribution deduction	$42,000
-	2021 contributions	(5,000)
=	2016 contributions used in 2020	$36,000

Melinda will permanently lose $4,000 of her 2016 contribution carryovers ($40,000 carried over into 2021 - $36,000 used in 2021).

However, if Melinda elects to treat her $5,000 2021 cash contribution as a qualified cash contribution, the standard ordering rules do not apply. She will be able to claim the $40,000 2016 carryover first and because her $5,000 qualified cash contribution plus the $40,000 carryover is still below her $70,000 AGI limitation, she may claim the full $5,000 2021 cash contribution deduction on her 2021 return.

Contribution carryovers when standard deduction is used

Taxpayers with excess charitable contributions and who utilize the standard deduction must reduce their charitable contribution carryover to the following year as if they had itemized. (Treas. Regs. §1.170A-10(a)(2))

Example of contribution carryovers and the standard deduction

Caroline and Joe are married taxpayers who file jointly. Caroline and Joe own a restaurant and their AGI typically hovers around $150,000 per year. However, their business was affected by the ongoing COVID-19 pandemic.

Their 2021 AGI is only $10,000, but they had charitable contributions of $7,000. They also took the standard deduction in 2021.

Even though Caroline and Joe took the standard deduction, they still must calculate their charitable contribution carryover as if they had itemized their deduction. Their charitable contribution carryover to 2022 is calculated as follows:

Contributions made in 2021		$7,000
AGI	$10,000	
Limitation %	60%	
Contributions allowable in 2021		(6,000)
Contribution carryover to 2022		$1,000

Corporations

If corporate charitable contributions for a year exceed the 10%-of-taxable-income limit (25% for 2020 and 2021), the excess may be carried over and deducted for up to five future years, to the extent the sum of carryovers and contributions for each of those years doesn't exceed 10% (25% for 2020 and 2021). Excess contribution carryovers are deducted after current year contributions. (IRC §170(d)(2)(A)) Carryover contributions cannot be deducted to the extent they increase an NOL carryover. (IRC §170(d)(2)(B))

Extended carryover is available for qualified conservation contributions (see page 36).

Intersection of NOL and charitable contribution carryovers

A charitable contribution carryover is reduced and an NOL carryover is increased by the amount that a charitable contribution would have been allowed without regard to the NOL. (IRC §170(d)(1)(B) and (d)(2)(B))

Example from Treas. Regs. §1.170A-10(d)(1)

The taxpayer has $50,000 of AGI, a $35,000 charitable contribution, and a $50,000 NOL carryover from prior years. Because the NOL wipes out AGI, no charitable contribution is used due to the percentage limitation. However, when computing the amounts of the NOL and charitable contribution carryovers to subsequent years, there is a "swap." The charitable contributions are used up to the extent they would have been used if not for the presence of the NOL, and the remainder is carried forward.

The NOL is computed as if the charitable contributions are deducted. As such, instead of a $35,000 charitable contribution carryover and zero NOL carryover, the actual result is a charitable contribution carryover of $5,000 ($35,000 - ($50,000 × 60%) and an NOL carryover of $20,000. The result is generally favorable to taxpayers because the NOL carryover period is longer than the charitable contributions carryover period.

Aggregation not allowed

Taxpayers who have both NOLs and charitable contribution deductions must follow specific ordering rules to avoid a double tax benefit. Chief Counsel Advice 201928014 tackles the issue of utilizing corporate NOLs, charitable contribution carryovers, and current-year charitable contributions in the same tax year.

Pursuant to an audit, the IRS determined the aggregate method used by the taxpayer to calculate the allowable NOL carryover and subsequent charitable contribution deduction was not accurate.

The taxpayer had several years of NOLs, as well as charitable contribution carryovers. Some of the charitable contribution carryovers were set to expire. In addition, the benevolent taxpayer not only had taxable income in the year examined, it made current-year charitable contributions.

The taxpayer tried to aggregate its NOL carryovers instead of using a year-by-year computation for purposes of calculating its charitable contribution carryover under IRC §170. The Chief Counsel ruled that the IRC §170(d)(2)(B) adjustment had to be calculated for each tax year an NOL carryover is utilized beginning with the earliest one available for that tax year.

Carryover incident to divorce

If a husband and wife file a joint return for a contribution year and compute an excess charitable contribution, and they file separate returns for one or more of the five carryforward years, the carryforward amount must be allocated between the spouses. (Treas. Regs. §1.170A-10(d)(4))

The carryforward is allocated to each spouse in proportion to the amount of carryforward that each spouse would have had if they had each filed separate returns in the contribution year.

If all items of income and deduction are community property, then the carryforward will be allocated 50/50, and you can save yourself the exercise of doing the computation. However, if the contribution was made from separate property or if any item of income or deduction was separate on the joint return, it will be necessary to run the computations.

Example of carryover incident to divorce

Mickey and Sylvia have decided that love is *too* strange, so they get divorced. In the prior year, they filed a joint return and reported AGI of $100,000. They took a charitable contribution deduction of 50% property of $70,000. As such, they were only allowed to deduct $50,000, and they have a carryover of $20,000.

All items of income and deduction were community, except for $10,000 of dividends generated by stock Mickey inherited and which are separate property. Both Mickey and Sylvia will have to recompute their prior-year returns as if they had filed separately.

	Mickey AGI	**Sylvia AGI**
Separate property	$10,000	$ 0
Community property	45,000	45,000
Total	$55,000	$45,000
Charitable contribution	$35,000	$35,000
Deduction	$27,500	$22,500
Carryover	$ 7,500	$12,500

When they do, they find that Mickey would have an excess contribution of $7,500 and Sylvia an excess contribution of $12,500. Each may carry over those amounts.

NONCASH CONTRIBUTIONS

Generally, the charitable contribution amount of a noncash contribution is its fair market value. (Treas. Regs. §1.170A-1(c)(1)) Numerous exceptions apply depending on the type of property. In addition, there are valuation requirements that vary depending on the type and value of the property and substantiation requirements that vary, again, depending on the type and value of the property. Substantiation requirements are discussed on page 39.

Special rules are in place for:

- Motor vehicles, boats, and airplanes;
- Certain appreciated property;
- Property subject to a liability;
- Partial and fractional interests;
- Inventory; and
- Patents and other intellectual property.

REVIEW QUESTIONS

Under the NASBA-AICPA self-study standards, self-study sponsors are required to present review questions intermittently throughout each self-study course. Additionally, feedback must be given to the course participant in the form of answers to the review questions and the reason why answers are correct or incorrect.

To obtain the maximum benefit from this course, we recommend that you complete each of the following questions, and then compare your answers with the solutions that immediately follow. *These questions and related suggested solutions are not part of the final examination and will not be graded by the sponsor.*

1. Taxpayers are allowed a deduction for qualified charitable contributions. In particular:
   a) For partnerships, the deduction is itemized when computing the partnership's taxable income
   b) Donations made through crowdfunding are deductible
   c) Out-of-pocket expenses when volunteering for a qualified organization are deductible as charitable contributions
   d) Charitable contributions may not be made directly from an IRA without a taxable distribution from income

2. Which of the following would constitute a deductible expense related to a charitable contribution?
   a) The cost and upkeep of a hospital volunteer's uniform that is not suitable for everyday wear
   b) Costs incurred by a taxpayer attending a church convention as a church member
   c) The clothing expenses of a foster child that is going to be adopted by the caregiver
   d) A designated representative's unreimbursed expenses for travel and transportation and those of their spouse when attending a convention on behalf of a qualified organization

3. When it comes to the deductibility of car or travel expenses incurred in giving services to a charitable organization, which of the following applies?
   a) The cost of gas and oil consumed while giving services to a charitable organization are deductible
   b) The standard mileage rate for calculating the deduction for services to a charitable organization is 17 cents per mile
   c) Taxpayers may always claim a deduction for travel expenses for a trip that involves providing services to a charitable organization
   d) In cases where a taxpayer combines a recreational trip with time spent providing charitable services, the taxpayer must keep a log to separate deductible and nondeductible travel expenses

4. A taxpayer may claim a charitable contribution deduction for certain expenses incurred in housing a student. Specifically:

    a) The student may be foreign or American, and may be a relative
    b) The student must be a full-time college student
    c) Allowable expenses include food, clothing, and entertainment
    d) The deduction is limited to $75 multiplied by the number of full calendar months that the student lived with the taxpayer during the year

5. Which of the following is a 30% charity?

    a) Church
    b) Medical research organization
    c) War veterans organization
    d) Educational organization including foundations for the benefit of state colleges

6. Estates and complex trusts may deduct ________, which under the terms of the governing instrument is paid for the purpose of making a charitable deduction.

    a) 2% of AGI
    b) Up to $100,000
    c) Any amount of income
    d) A maximum of $150,000

SOLUTIONS TO REVIEW QUESTIONS

1. Taxpayers are allowed a deduction for qualified charitable contributions. In particular: **(Page 3)**

   a) Incorrect. For individual taxpayers, the deduction is an itemized deduction. For partnerships, the deduction is shown as a separate line item on the K-1 to the partner indicating their distributive share of the contribution.
   b) Incorrect. They will qualify for a deduction only if the donee organization is a qualified one.
   c) Correct. This is true, although the value of your time or services is not deductible.
   d) Incorrect. Charitable contributions may come for qualified distributions from IRAs.

2. Which of the following would constitute a deductible expense related to a charitable contribution? **(Page 6)**

   a) Correct. A hospital volunteer's uniform would be an example of a uniform that would not be suitable for everyday use in which case it is a deductible charitable expense.
   b) Incorrect. Unless the attendant is a chosen representative, none of the expenses are deductible unless they are directly related to giving services to the church at the convention.
   c) Incorrect. Such expenses are considered support for the child so there is no deduction as a charitable contribution.
   d) Incorrect. The representative may deduct their expenses, but expenses for the spouse or children are not deductible.

3. When it comes to the deductibility of car or travel expenses incurred in giving services to a charitable organization, which of the following applies? **(Page 6)**

   a) Correct. The cost of oil and gas, if directly related to the use of the car for the purpose of donating services to a charitable organization, are deductible, as are tolls and parking.
   b) Incorrect. The rate is 14 cents per mile.
   c) Incorrect. A deduction is only allowed if there is no significant element of personal pleasure or recreation associated with the trip.
   d) Incorrect. Unless the recreational time is minimal and the taxpayer was predominantly involved in providing charitable services, the travel expenses will be nondeductible.

4. A taxpayer may claim a charitable contribution deduction for certain expenses incurred in housing a student. Specifically: **(Page 9)**

   a) Incorrect. The student may be foreign or American, but may not be a relative or a dependent.
   b) Incorrect. The student must be a full-time student in the 12th grade or lower.
   c) Correct. Allowable expenses include books, tuition, food, clothing, transportation, medical care, entertainment, and other expenses incurred for the student's general well-being.
   d) Incorrect. The deduction is limited to $50 multiplied as noted.

5. Which of the following is a 30% charity? **(Page 11)**
    a) Incorrect. A church is a 50% charity under IRC §170(b)(1)(A).
    b) Incorrect. Medical research organizations are listed as 50% charities.
    c) Correct. 30% charities are defined as charitable organizations that are not 50% charities, including, for example, war veterans organizations, cemetery companies, organizations that are testing for public safety, and more.
    d) Incorrect. This qualifies as a 50% charity.
6. Estates and complex trusts may deduct _______, which under the terms of the governing instrument is paid for the purpose of making a charitable deduction. **(Page 14)**
    a) Incorrect. Estates and complex trusts are not subject to the 2% of adjusted gross income floor.
    b) Incorrect. There is no dollar limit on the amount of deduction that may be taken.
    c) Correct. This is true under IRC §642(c)(1).
    d) Incorrect. The deduction amount is allowed without limitation.

VALUATION — GENERALLY

Determining the deductible amount of a noncash contribution begins with fair market value, but fair market value is often only the starting point. For example, in the case of ordinary income property, the deduction is the fair market value reduced by the amount that would have been recognized as gain other than long-term capital gain if the property had been sold by the donor at the time of contribution.

Nonetheless, the deductible amount always revolves around fair market value. Two questions emerge:

- How do you determine fair market value?
- How do you prove it?

Because fair market values may change rapidly, time is of the essence. Generally, fair market value is determined as of the date that the transfer of the property takes place. (Treas. Regs. §170A-1(b)) If mailed, the donation is effective on the date of mailing.

In the case of a donation of stock, if the donor delivers the stock certificate to his or her bank or broker as the donor's agent, or to the issuing corporation or its agent, for transfer into the name of the donee, the gift is completed on the date the stock is transferred on the books of the corporation.

An individual who grants an option on real property to a charitable organization is allowed a charitable deduction for the year in which the organization exercises the option, not in the year the option is granted. (Rev. Rul. 82-197) The fair market value is computed as of the date the option is exercised.

Determining fair market value

The value of property is a question of fact to be determined from all competent evidence. (Treas. Regs. §1.1001-1(a); ***James Couzens v. Comm.*** (1928) 11 BTA 1040) While no one factor is determinative, the following factors weigh most heavily, in order of priority:

- The cost or selling price of the item;
- Sales of comparable properties; and
- Replacement cost.

Cost or selling price

The cost of the property to the donor or the actual selling price received by the donee charity may be the best indication of fair market value if the terms of purchase or sale are bona fide; i.e., at arm's length and without unusual restrictions. However, because conditions in the market change, the cost or selling price of the property may have less weight if the property was not bought or sold reasonably close to the date of contribution. (***Hemmings v. Comm.***, TCM 1997-121)

In lieu of an actual purchase or sale, an arm's-length offer to buy the property close to the valuation date may help prove its value if the person making the offer was willing and able to complete the transaction. (IRS Publication 561, Determining the Value of Donated Property)

Sales of comparable properties

The sales prices of properties similar to the donated property are often important in determining fair market value. The key factors are:

- The degree of similarity between the comparable property and the donated property;
- The time of the sale — whether it was close to the valuation date;
- Whether the sale was at arm's length; and
- The conditions of the market — whether it was stable or unusually inflated or deflated.

It's important to note that comparable sales must be based on actual sales. An appraisal based on list prices of comparable products will be rejected. (***Viea M. Taylor, et al. v. United States*** (September 9, 1991) United States District Court, S.D. Ohio, W.D., Case No. C-1-90-202) However, for items not requiring an appraisal (see below), trade publications and well-respected trade catalogs may provide supporting evidence for fair market value (for example, the Kelley Blue Book value for cars or the Scott stamp catalog for stamp collections).

Replacement cost

While replacement cost of an item is not normally equivalent to the fair market value of the item (Rev. Rul. 68-69), replacement cost may be used in unusual situations in which comparable sales are not available.

Replacement cost is the amount it would cost to replace the donated item on the valuation date. To determine replacement cost, find the cost of purchasing the item new. From that figure, subtract an amount for depreciation. You must be able to show how you arrived at the purchase price figure and the amount of depreciation.

Opinion of experts

Generally, the weight given to an expert's opinion on matters such as the authenticity of, for example, a coin or a work of art depends on the knowledge and competence of the expert. The thoroughness of the opinion and the experience and facts on which it is based will also weigh heavily. For example, more weight will be given to an appraisal by an individual specializing in the kind and price range of the piece being appraised than would an opinion by a more generalized appraiser.

Factors that Affect Fair Market Value	
Reliance on:	**Relevant questions:**
Cost or selling price	• Was the date of purchase or sale of the property reasonably close to the date of contribution? • Was any increase in value, as compared to cost, at a reasonable rate? • Were there any restrictions on the purchase or sale that would affect value? • Was there any arm's-length offer to purchase the property close to the valuation date?
Comparable properties	• How similar is the comparable property to the property donated? • How close is the date of sale of the comparable property to the date of donation, and have market conditions changed significantly in the interim? • Was the sale at arm's length?
Replacement cost	• What would it cost to replace the donated property? • Is there an imbalance between supply and demand for the donated property?
Opinion of experts	• Is the expert knowledgeable and competent? • Is the opinion thorough and supported by facts and experience?

So many skulls and hooves, so little space

A big-game hunter was denied a charitable contribution deduction and carryovers of $1,425,900 for 177 taxidermy specimens he donated to an ecological foundation after his trophy room became "too cluttered." (***Gardner v. Comm.***, TCM 2017-165)

The taxpayer's appraiser estimated the replacement cost of each item by totaling the costs to travel to the hunting site, safari costs, and taxidermy and shipping costs. The appraisal report listed all specimens as being in excellent condition and provided no provenance for any of them. The taxpayer also relied on the opinions of two experts, one who was neither an appraiser nor a taxidermist, and both had no expertise in hunting.

The issue came down to whether the appraiser's replacement cost method of valuation was appropriate versus using a market price approach (which the IRS used). The court found that the market price was more appropriate and accepted a revised charitable donation amount of $163,045, which wiped out most of the deduction plus the carryover and left the taxpayer holding the bag for $411,875.

Bargain sales

A taxpayer who sells property for less than the property's fair market value (i.e., makes a "bargain sale") to a charity is generally entitled to a charitable contribution deduction equal to the difference between the fair market value of the property and the amount realized from the sale. (See ***Stark v. Comm.*** (1986) 86 TC 243; ***Knott v. Comm***. (1977) 67 TC 681; ***Waller v. Comm.*** (1963) 39 TC 665; Treas. Regs. §1.170A-4(c)(2))

In order to qualify for a bargain sale to constitute a charitable contribution, the seller must make the sale with the requisite charitable intent, and the fair market value of the property on the date of the sale must in fact exceed the selling price. (See ***U.S. v. Am. Bar Endowment*** (1986) 477 US 105)

Additionally, the contribution is not deductible unless it constitutes a completed gift, meaning the donor "must do everything reasonably permitted by the nature of the property and the circumstances of the transaction in parting with all incidences of ownership." (***Coffey v. Comm.*** (1944) 141 F.2d 204) This means that the donor must completely relinquish "dominion and control" over the contributed property; the donor may not retain any right to direct the disposition or manner of enjoyment of the subject of the gift. (See ***Rosano v. U.S.*** (2001) 245 F.3d 212)

However, if a condition is placed on the contribution that may otherwise invalidate the contribution, and the condition is so remote as to be negligible, the charitable contribution deduction will be allowed. (Treas. Regs. §1.170A-1(e))

No deduction where conditions are placed on noncash charitable contributions

A taxpayer-LLC sold property to a charity in a bargain sale transaction but placed restrictions on the charity's ability to transfer the property that invalidated the charitable contribution. (***Fakiris v. Comm.*** (TCM 2017-126))

Grou Development, LLC (Grou), a real estate developer, purchased the St. George Theatre in Staten Island, New York for $700,000. Grou decided to divest the theatre from its portfolio by donating it to Richmond Dance Ensemble, Inc. (Richmond Dance) through a bargain sale. Richmond Dance agreed to purchase the theatre for $470,000 at a time when its appraised value was $5 million. Richmond dance was newly incorporated, and its tax-exempt status with the IRS was pending.

Richmond Dance's incorporators had a relationship with another tax-exempt entity, WEMGO Charitable Trust, Inc. (WEMGO), and WEMGO agreed to receive the theatre on Richmond Dance's behalf.

The contract of sale between Grou and WEMGO imposed two significant conditions on the transfer of the theatre to WEMGO:

- WEMGO was prohibited from selling the theatre during the five-year period following delivery of the deed to it; and
- Grou retained the right during that period to transfer the theatre to Richmond Dance once the IRS recognized it as tax-exempt under IRC §501(c)(3).

The Tax Court sided with the IRS and held that Grou did not make a complete gift because the two conditions outlined in the sale agreement allowed Grou to retain dominion and control over the theatre after its transfer to WEMGO.

APPRAISALS

Generally, an appraisal is: (1) not required for items for which you claim a deduction of $5,000 or less, and (2) required for $5,000 or more. (Treas. Regs. §1.170A-16(d)(1)(ii)) There are exceptions to both. An appraisal is required for a deduction of $5,000 or less if you donate an item of clothing or household item that is not in good used condition or better and for which you deduct more than $500. (IRC §170(f)(16)(C); Prop. Treas. Regs. §1.170A-18(b))

Comment

It’s commonly, and correctly, understood that no deduction is allowed for clothing or household items that aren’t in good used condition or better. That rule is clearly spelled out in IRC §170(f)(16)(A). However, just two lines down, subparagraph C states that you can take a deduction for such items if the deduction is more than $500 and you attach a qualified appraisal. In other words, you can’t deduct junk unless it’s expensive junk (but you must get it appraised)!

The term “items” means a single item or group of similar items. The phrase “similar items” means property of the same generic category or type (whether or not donated to the same donee), such as stamp collections, lithographs, land, buildings, etc. (Treas. Regs. §1.170A-13(c)(7)(iii)) For example, if you give books to three schools and you deduct $2,000, $1,000, and $3,000, respectively, the claimed deduction is more than $5,000. You must get a qualified appraisal.

Taxpayers argued that they were unaware of the requirement regarding aggregating similar items of property for determining the $500 and $5,000 thresholds, which apply to each category of property. (***Kunkel v. Comm.***, TCM 2015-71) At trial, the taxpayers argued unsuccessfully against the aggregation of certain items, specifically regarding the $8,000 they claimed for donated books, stating not all textbooks should be aggregated because “a Pharmacology textbook is not similar to a Spanish textbook.”

Example of appraisal of goods

Mabel donated clothing and household goods to ten different organizations with each contribution valued at $750. She also donated books to her church with a fair market value of $1,000. Mabel must obtain a qualified appraisal for the clothing and household goods because the total contributed was $7,500 (more than $5,000). However, she does not need a qualified appraisal for the books as the total of those similar items does not exceed $5,000

An appraisal is not required if the property is:

- Publicly traded stock of any amount;
- Nonpublicly traded stock of $10,000 or less;
- A vehicle for which the deduction is limited to the gross proceeds from the sale;
- Qualified intellectual property, such as a patent; or
- Stock in trade, inventory, or property held primarily for sale to customers in the ordinary course of a trade or business.
  (Treas. Regs. §1.170A-16(d)(2))

Qualifications for an appraisal

Prop. Treas. Regs. §1.170A-17 generally controls the requirements pertaining to an appraisal including:

- The qualifications of the appraiser;
- The applicable professional standards under which the appraisal must be performed; and
- The contents of the appraisal.

To be considered a qualified appraisal, the appraisal must meet the conditions outlined in Treas. Regs. §1.170A-13(c)(3), including:

- The appraisal must be obtained prior to the due date (including) extensions of the return on which the deduction is first claimed;
- It must be made no earlier than 60 days before the date of contribution of the appraised property; and
- It must include a description of the donated property in sufficient detail to ascertain that the property that was appraised is the property that was contributed.
  (***Platts v. Comm.***, TCM 2018-31)

Appraisers are not generally licensed or credentialed by state or other governments, although there are exceptions (California, for example, licenses real estate appraisers). However, the regulations spell out certain criteria for a qualified appraiser:

- The appraiser must either:
  - Have an appraisal designation from a recognized professional appraiser organization; or
  - Have met certain minimum education requirements;
- The individual regularly prepares appraisals for which he or she is paid;
- The individual has demonstrated knowledge of the type of property appraised;
- The individual has not been barred from practicing before the IRS; and
- The individual is not an excluded individual (i.e., the donor, the donee, a related party to either the donor or donee, or any individual preparing the appraisal under a contingent fee arrangement such as a percentage of appraised value).
  (Prop. Treas. Regs. §1.170A-17(b))

The appraisal must be performed under generally accepted appraisal standards under the principles of the Uniform Standards of Professional Appraisal Practice as developed by the Appraisal Standards Board of the Appraisal Foundation.

The contents of the appraisal must include all of the following:

- A detailed description of the property, including condition;
- Date, or expected date, of the contribution;
- The appraised FMV of the property on the date of transfer;

- The method used for valuing the property (i.e., the comparable sales approach), plus the basis for the valuation and justification for the method used;
- Any terms, including restrictions, attached to the property;
- Detailed information about the appraiser, including qualifications; and
- A statement that the appraisal was performed for income tax purposes.
(Prop. Treas. Regs. §1.170A-17(a)(3))

The appraisal must be signed by the appraiser no earlier than 60 days before the date of the contribution and no later than the due date (including extensions) of the return on which the deduction is first claimed, or in the case of an amended return, the date on which the amended return is filed. (Prop. Treas. Regs. §1.170A-17(a)(4))

A copy of the appraisal must be retained by the donor and made available upon request by the IRS. However, a complete copy of the appraisal must be attached to the return in the following four instances:

- Any deduction of $500,000 or more (Treas. Regs. §1.170A-16(e)(1)(iv));
- A deduction of $20,000 or more for art (IRS Ann. 90-25);
- A deduction of $500 or more for clothing or a household item that is not in good used condition or better (IRC §170(f)(16)(C)); or
- Any deduction for an easement or other restriction on the exterior of a building in a historic district. (IRC §170(h)(4)(B)(iii))

Art valued at $50,000 or more

Taxpayers donating an item of art appraised at $50,000 or more can request a Statement of Value for that item from the IRS prior to filing the return. The request must include:

- A copy of the qualified appraisal;
- A check or money order for $2,500 (an additional $250 for each item in excess of three items);
- A completed Form 8283, Noncash Charitable Contributions; and
- The location of the IRS territory responsible for examining the taxpayer's return.
(IRS Publication 561)

Dueling appraisers value Old Master paintings very differently

Two Old Master paintings were revalued by the IRS for estate tax purposes after the estate's appraiser failed to provide convincing proof to support his low valuation of the paintings, which later sold at auction for five times the appraised value. **(*Estate of E. F. Kollsman, Jeffrey Hyland, Executor v. Comm.*** (June 21, 2019) United States Court of Appeals, Ninth Circuit, Case No. 18-70565, affirming ***Estate of E.F. Kollsman v. Comm.***, TCM 2017-40**)** The revaluation created an estate tax deficiency and the case hinged on the type of evidence the appraiser provided to support their very different valuations.

The two paintings, referred to as "Maypole" and "Orpheus," were both 17th century Dutch Old Master paintings. On the estate tax return, the paintings were valued at $500,000 and $100,000, respectively.

Maypole, the painting with the higher value, sold at auction a few years after the decedent's death for $2.43 million. Orpheus was not sold, and there was some question regarding which artist it was attributable to, making valuation difficult.

The estate's appraiser

The estate used an appraiser who was a close friend of the family who also proposed to sell the paintings at Sotheby's, where he was vice president of the auction house's North American and South American operations.

The court found that he exaggerated the dirtiness of the paintings and the risk involved in cleaning them for the purpose of discounting their values, didn't use comparable sales, and was unable to definitely attribute the painting to one artist over the other.

The IRS's appraiser

The IRS's appraiser, on the other hand, suggested values of $2.1 million for Maypole and $500,000 for Orpheus. He based these figures on comparative market data for paintings featuring the same subject and composition as well as a discount for the condition of the paintings.

He provided evidence that Orpheus was painted by Jan Brueghel the Elder, rather than Jan Brueghel the Younger, which increased the value of the painting. However, he also provided comparable sales for Orpheus if it were to be attributed to Jan Brueghel the Younger, and even these figures were much higher than the estate's original value.

The court accepted the IRS's appraiser's values. However, the court found that the paintings were in fact dirty and there was some risk inherent in their cleaning, and allowed a 5% discount for both paintings. For Orpheus, the court allowed an additional 10% discount because the painting was bowed, plus another 10% discount in value for the attribution issue because while the IRS's appraiser had compelling evidence that Orpheus was the work of Brueghel the Elder, an attribution dispute nevertheless existed.

Finding an appraiser

As noted, the expertise of the appraiser is critical. The IRS makes clear that "the opinion of a person claiming to be an expert is not binding on the Internal Revenue Service." The following are links to appraiser associations that provide services to help find an appraiser and allow you to search by location and specialties.

American Society of Appraisers®: www.appraisers.org/find-an-appraiser
International Society of Appraisers: www.isa-appraisers.org/find-an-appraiser
Appraisers Association of America: www.appraisersassoc.org
Appraisal Institute®: www.appraisalinstitute.org/about

You may even find appraiser associations by specialty. For example:

American Association of Equine Appraisers: www.equineappraiser.com

Deducting appraisal fees

Appraisal fees are not deductible as charitable contributions. Prior to 2018, they were deductible as miscellaneous itemized deduction subject to the 2% limit. (IRS Publication 526)

VALUATION — CLOTHING AND HOUSEHOLD ITEMS

No deduction is allowed for clothing or household items unless they're in good used condition or better. (IRC §170(f)(16)) However, see the comment on page 22.

Value calculators

The IRS notes that there is no exact means of valuing clothing and household items, but they also note that the fair market value of these items is "usually far less than the price you paid for them." (IRS Publication 526) Nonetheless, there are some aids that can help.

Both the Salvation Army and Goodwill also provide lists:

- **Salvation Army:** Go to https://satruck.org/Home/DonationValueGuide; and
- **Goodwill:** Goodwill offers valuation guides based on region, so find your regional Goodwill website and look there for a donation valuation guide.

Value seems too low?

Your client may be shocked at the low values listed for the clothing and furniture they are contributing. The charts provide high and low values. For example, the Salvation Army's website lists a woman's blouse value from $3 to $12. The blouse's original cost may have been $200, and if it's only a year old, the client may balk at the value listed. However, these values are based on the price the organization will charge in its store.

There are higher-end thrift shops where designer clothing is sold at reduced prices. A client with expensive and relatively new items may want to donate to one of these charitable organizations. Although most of these higher-end thrift stores do not have valuation charts, your client can get values based on prices charged.

Most of these organizations will require that the clothing be brought in on hangers and in dry cleaners' bags, not in a garbage bag. However, this might be a way to justify a higher value.

Real-life cases

Shopaholic contributor

Christiana Stamoulis claimed a $55,764 charitable contribution deduction on her 2002 return. The Tax Court recomputed her allowable deduction as $8,949. (***Stamoulis v. Comm.***, TCS 2007-38)

Ms. Stamoulis described herself as an "impulsive buyer" whose annual expenditures for clothing and shoes might be deemed by some to be rather extravagant. However, she claimed she had a shopping problem, and that many of the designer clothes that she contributed had only been worn once.

The court noted that the inventory list presented a fairly accurate description of the items donated but the court had "severe reservations regarding the fair market values that the taxpayer assigned to those items." The court stated that determination of the fair market value of an item involves an approximation, and is, at best, an inexact science. (***Works v. Comm.*** (1986) 87 TC 389, 407–408)

Shopping for deductions

According to a Tax Court case, a retired grandmother loved to shop, and "[s]eeking to combine her love of shopping with a desire for a tax cut, she developed [her own] personal tax shelter." (***Grainger v. Comm.***, TCM 2018-117)

She shopped all the bargain racks at Talbots and purchased items that had been heavily discounted using both cash and accumulated store loyalty points. For example, between the discounts and her points she could purchase items for $10 that had originally been priced at $99. She would then donate the item to Goodwill and claim a charitable contribution of $99.

For the tax year at issue, she claimed $34,401 of charitable contributions, but the court upheld the lower value applied by the IRS, which set the deduction at $6,117, which was just a little above the amount of the taxpayer's cash outlay and points.

(continued)

Real life cases (continued)

Curbside donations

A professor with a J.D. degree was unable to substantiate noncash contributions of $79,000 and $90,000 in 2010 and 2011 respectively. (***Payne, et ux. v. Comm.***, TCS 2016-30)

First, the taxpayers argued that the aggregation rules should not apply because sellers such as Amazon use categories more specific than those used by the IRS. Therefore, no appraisal was required.

Second, the taxpayers claimed they did not have receipts for many of the items because the professor regularly found property that had been placed on the curb as unwanted. He took it to his home and/or to the charities. The IRS stated that he did not report the income as required when he found the property. In addition, the taxpayers valued most of the donations at 50% of cost and, at court, listed them as "antiques."

Finally, the taxpayers argued that "congressional intent was to incentivize citizens to actually donate … Congress sets the limit pretty high [permitting] donations that reach up to 50% of your adjusted gross income." They further contended that congressional intent is a strong incentive to reach that 50% level.

He not only lost but was subject to penalties.

VALUATION — VEHICLES, BOATS, AND AIRPLANES

We've all heard the radio ads and seen the billboards with ads extolling the benefits of donating a used car to charity. The problem is the IRS is paying attention, too, especially after a study by the Government Accountability Office found that, in 2000, taxpayers claimed $654 million in deductions for car donations, but charities reported getting just $32.7 million from sales of those cars.

Congress responded by limiting the deduction for a vehicle to the lesser of its fair market value or the amount the charity receives from its sale if the claimed deduction is more than $500. (IRC §170(f)(12)(A))

Comment

"Vehicles," for this purpose, is defined to include cars or other motor vehicles, boats, and airplanes.

There are two exceptions to the general limitation:

- The donee significantly uses the vehicle or materially improves it before selling; and
- The donee gives the vehicle to a needy person or sells it to a needy person at a price substantially below fair market value in furtherance of the donee's charitable purpose. (Notice 2005-44)

Claimed value under $500

These rules do not apply if the claimed value of the vehicle is under $500. In that case, the deduction is the lesser of the fair market value or $500. (IRS Publication 526)

Donee sells qualified vehicle without using it or improving it

If a donee organization sells a qualified vehicle without any significant intervening use or material improvement by the donee organization, the deduction allowed under IRC §170(a) may not exceed the gross proceeds received from the sale, which will be reported on Form 1098-C, Contributions of Motor Vehicles, Boats, and Airplanes.

Example of qualified vehicle

On October 1, Sherri contributed a qualified vehicle with a fair market value of $1,300 to the Salvation Army, an IRC §170(c) organization. On December 1 of the same year, the qualified vehicle was sold without any significant intervening use or material improvement. Gross proceeds from the sale were $1,000. Sherri's deduction is limited to $1,000.

Donee makes significant intervening use or materially improves the qualified vehicle

If the donee organization makes a significant intervening use of or material improvement to a qualified vehicle, the donor is not subject to the gross proceeds limitation. However, the deduction claimed by the donor may not exceed the fair market value of the qualified vehicle. The donor must obtain an acknowledgment from the donee organization, but only the donor must substantiate the fair market value of the vehicle.

Whether the donee's use of the vehicle is significant depends on the nature, extent, frequency, and duration of the use. For example, use of the vehicle only a few times is not significant.

A material improvement is a major repair or upgrade that improves the condition of the qualified vehicle such that the vehicle significantly increases in value. Material improvements do not include finish work (such as paint, rust proofing, or wax), removal of dents or scratches, cleaning or repair of upholstery, and installation of theft deterrent devices. In addition, major repairs will not be considered to be material improvements if they are funded by additional payments to the donee organization by the donor of the qualified vehicle.

Vehicle donated or sold significantly below fair market value to a needy individual

The gross proceeds limitation also does not apply to a sale of a qualified vehicle to a needy individual at a price significantly below fair market value or a gratuitous transfer of a qualified vehicle to a needy individual in direct furtherance of a charitable purpose of the donee organization of relieving the poor and distressed or the underprivileged who are in need of a means of transportation.

Getting maximum value

As noted, the default deduction for a contribution of a vehicle is the lesser of its fair market value or the amount the charity receives from its sale if the claimed deduction is more than $500. Because charities generally sell vehicles at auctions or in bulk sales, this provision usually limits the donor's deduction to an amount far below Blue Book value.

Organizations have sprung up that make it convenient for individuals to make such qualifying contributions. For example, 1-800-CharityCars (www.800charitycars.org) is a well-known §501(c)(3) organization that accepts auto donations and will pick them up anywhere in the U.S. The organization refurbishes the car, if necessary, and donates it to a needy family. As such, a donor qualifies to deduct the full fair market value.

VALUATION — OTHER ITEMS

Appreciated property

As noted, generally the amount deductible for a charitable contribution of property is the fair market value of the property. However, this rule does not apply to contributions of the following types of property:

- Ordinary income property; that is, property that if sold would generate ordinary income or short-term capital gain; and
- Tangible personal property, if the use by the donee is unrelated to its exempt purposes. (IRC §170(e)(1))

In the case of ordinary income property, the deduction is the fair market value reduced by the amount which would have been recognized as gain other than long-term capital gain if the property had been sold by the donor at the time of contribution. Generally, this rule limits the deduction to the taxpayer's basis in the property. (IRS Publication 526)

The most common examples of ordinary income property include:

- Inventory or other property held for sale to customers;
- Property used in a trade or business but only to the extent that gain on its sale would have been recognized as ordinary income (e.g., IRC §1245(a) or §1250 for depreciation recapture); and
- Capital assets held for less than the long-term holding period.

Example of deductible contribution

Paul contributed stock worth $5,000 to a charitable organization. He purchased it three months prior for $2,000. His deduction is limited to $2,000 because if he had sold the stock on the same date, there would have been $3,000 of short-term capital gain on the sale.

Had he held the stock for more than one year, he would be allowed to deduct $5,000.

Example of nondeductible contribution

George donates a truck used in his business that is fully depreciated and has a fair market value of $2,000. Had he sold the truck for $2,000, the gain would have been entirely ordinary income because of depreciation recapture. As such, he gets no deduction for the contribution.

When computing your deduction for a gift of capital gain property, you can generally use the fair market value of the property. However, this is not the case if the donation is tangible personal property that:

- Is put to an unrelated use by the charity; or
- Meets these three tests:
  - The property has a claimed value of more than $5,000;
  - The charity sells, trades, or disposes of the property during the year in which the contribution is made; and
  - The charity has not made the required certification of exempt use. (IRC §170(e)(1)(B))

If the disposition occurs after the last day of the donor's tax year in which the property was contributed and before the last day of the three-year period commencing with the date of contribution, the donor must recapture the amount allowed as a charitable contribution in excess of the donor's basis at the time of contribution. (IRC §170(e)(7))

The certification by which a donor of applicable property may avoid the reduction rule and the recapture rule discussed above is a written statement that either:

- Certifies that the donee's use of the property was substantial and related to the purpose or function that is the basis for the donee's exemption under IRC §501, and describes how the property was used and how that use furthered the exempt purpose or function; or
- States the intended use of the property by the donee at the time of the contribution, and certifies that the intended use has become impossible or not feasible to implement.

The certification is reported on Form 8282, Donee Information Return (Sale, Exchange, or Other Disposition of Donated Property). A copy must be supplied to the donor. When working with a client that is a public charity and donee of property, it is important to ensure that the charity has the donor's tax identification number. Without it, the charity will not be able to accurately file the Form 8282 and will be subject to penalties.

The ceiling for contributions of capital gain property to 50% organizations is 30% of the taxpayer's contribution base (generally, AGI). (IRC §170(b)(1)(C)) However, the taxpayer may elect the 50% ceiling if the taxpayer agrees to reduce the amount of the contribution to his or her basis in the property (see page 11 for more information on donating capital gain property and the effect of electing the 50% ceiling on carryovers).

Example of property donation

George has AGI of $60,000. In the current year, he gave land worth $50,000 to a 50% charitable organization that will immediately resell it. His basis in the property is $40,000. George may only deduct $18,000 (30% × $60,000). However, if George elects to deduct basis, he may deduct $30,000 (50% × $60,000).

Property subject to a liability

If contributed property is subject to a debt, you must reduce the fair market value of the property by the amount of the liability. (Treas. Regs. §1.170A-3(d)) This is true even when the donor made a promise, enforceable under state law, to pay the liability. (***Douglas v. Comm.***, TCM 1989-592) As the taxpayer pays off the liability, each additional payment constitutes a further charitable donation.

However, in the case of a charitable contribution in which a liability is assumed by the recipient or in which the property contributed is subject to a liability, the contribution is reduced to the extent necessary to avoid duplication of amounts; i.e., the deduction of the same payment as both an interest expense and a charitable contribution. (IRC §170(f)(5); Treas. Regs. §1.170A-3(a))

Partial or fractional interests

Generally, you may not deduct contributions of partial interests in property. (IRC §170(f)(3)(A)) Exceptions exist for:

- Contributions made to a trust which satisfies specified requirements;
- A remainder interest in a personal residence or farm;
- An undivided (fractional) portion of a taxpayer's entire interest in property; and
- A qualified conservation contribution.
  (IRC §170(f)(2) and (3)(B))

In the case of a fractional contribution of an undivided interest in tangible personal property, you may not take a charitable contribution deduction unless immediately before the contribution all interests in the property are held by the contributor or the contributor and the qualifying organization receiving the contribution. (IRC §170(o)(2))

After making an "initial fractional contribution," the taxpayer must follow with one or more "additional contributions" so that his or her entire interest in the property is transferred by the earlier of 10 years after the date of the initial contribution or the date of the donor's death. (IRC §170(o)(3)) In the event such complete transfer does not take place, the donor is subject to recapture of the deduction plus a 10% penalty and interest.

The property is valued for contribution purposes based on the property's value at the time of the initial fractional contribution. For additional contributions, the fair market value is the lesser of:

- The fair market value at the time of the initial fractional contribution; or
- The fair market value at the time of the additional contribution.
  (IRC §170(o)(2))

Example of fractional contribution

Fred owns the original masterpiece Cats Playing Parcheesi, which is now worth $40,000. On July 1 of year 1, he makes an initial fractional contribution of an undivided one-quarter interest in the painting to the Museum of Atrocious Art. The museum is entitled to possession of the painting for one-quarter of the year. Fred is entitled to a deduction of $10,000 in year 1.

In year 2, the value of the painting has appreciated to $100,000 when he makes an additional contribution of an undivided one-quarter interest. His deduction is limited to $10,000.

Fred must contribute the balance of his interest in the painting to the museum before July 1 of year 10, or he must recapture his contributions plus pay interest and a penalty equal to 10% of the recaptured amount.

Charitable demolition of home is a bust

Taxpayers were denied a charitable contribution deduction for a house and its contents because under state law, the taxpayers had not properly conveyed the home to the charitable organization. (***Mann v. U.S.*** (January 31, 2019) U.S. District Court, Dist. of Maryland, Civil Action No. TDC-17-0200) The taxpayers bought a parcel of land with an existing house which they wanted to demolish. First, they contracted with a 501(c)(3) charity to "deconstruct" the house; the charity would salvage as much of the materials and contents of the house as possible, and the taxpayers would be able to take that amount as a charitable deduction.

On their tax return for the year the house was demolished, the taxpayers claimed a charitable deduction of $675,000 for the donation of the house and its contents, plus the $10,000 cash donation they provided to the charity. The IRS disallowed the deduction, claiming the taxpayers had donated only a partial interest in their property: the house. The court agreed with the IRS's determination.

In Maryland, where the property is located, recorded ownership rather than contractual ownership demonstrates ownership on improvements to land for the purposes of real property tax. (Md. Code Ann. Tax Property §1-101(gg)(I); ***Supervisor of Assessments of Baltimore County v. Greater Baltimore Medical Center, Inc.*** (2011) 202 Md. App. 282) Because the taxpayers had not recorded the transaction with the charity in the land records, which would have severed the house from the land, the donation of the house for deconstruction was a partial-interest gift.

Timeshares

The tax deduction for a donation of a timeshare is the fair market value. (Treas. Regs. §1.170A-1(c)(1)) Fair market value is not what the taxpayer paid for the week, nor is it the price at which developers are currently selling weeks. Because the marketplace is the resale market, the going price on that market is the best indicator of fair market value. The prices of other resales at the property are generally the best evidence of the approximate fair market value of a week.

If the donee organization sells the property within three years of contribution, the organization must file Form 8282, Donee Information Return, and send a copy to the donor. If the sale happens soon after the contribution, the sales price would, presumptively, be the best evidence of value. However, if the sale takes place more than a reasonable period of time after the contribution, the Form 8282 amount may not reflect fair market value for the time the timeshare was originally donated. (Instructions to Form 8282) If the amount on the 8282 differs substantially from the claimed amount, it may alert the IRS to a possible valuation overstatement.

If the claimed value is $500 or more, the taxpayer must file Form 8283, Noncash Charitable Contributions. If the claimed value is $5,000 or more, the taxpayer must obtain a qualified appraisal for the property. (Treas. Regs. §1.170A-16(d)(1)(ii))

Auction donations

Taxpayers donated a one-week use of their three-week timeshare in the Caribbean in a charity auction. (***Van der Lee v. Comm.***, TCM 2011-234) They deducted the fair rental value of the residence for one week plus one-third of their annual maintenance fees. The taxpayers reasoned that because they were contributing one-third of their annual usage, they should get to deduct one-third of their annual costs. The court denied the deduction because, generally, no deduction is allowed for partial interests in property. (IRC §170(f)(3)(A))

The issue here is that they donated a one-time, one-week use of the property. The result would have been the same even if they had donated use of all three weeks of their three-week ownership. A donation of a timeshare is a deductible charitable contribution only if you donate the ownership of the property and only to the extent of the fair market value.

Inventory

The deductible amount for inventory is generally the lesser of basis or fair market value. (IRC §170(e)(3)) A C corporation may be able to claim a deduction equal to (a) the lesser of the basis of the donated property plus half of the appreciated gain, or (b) twice the basis of the donated inventory or property.

These special rules apply to:

- Contributions by C corporations to §501(c)(3) organizations that use the property for the care of the ill, the needy, or infants; and
- Certain donations of food inventory.
  (IRC §170(e)(3)(C))

> ***Care of the ill, needy, or infants***
>
> The enhanced deduction available for contributions of property for the care of the ill, the needy, or infants is limited to those items used to care for the necessities of life. Therefore, contributions of grooming items such as wrinkle creams, hair gels, perfumes, curling irons, etc., did not qualify for the special treatment. (CCA 201414014)

The Internal Revenue Code also provides an enhanced deduction for C corporations that are not personal holding companies or service corporations that donate qualified research equipment (IRC §170(e)(4)) to colleges that use the equipment in carrying on research activities, including research training. The enhanced deduction is calculated the same as for inventory.

Food inventory

Taxpayers, other than C corporations, are ordinarily allowed a deduction for charitable contributions of food inventory up to 15% of the taxpayer's aggregate net income from all trades or businesses that donated food inventory for the year, computed without regard to the deduction. (IRC §170(e)(3)(C)(ii)(I))

For taxpayers other than C corporations, the CARES Act and the Consolidated Appropriations Act of 2021 increased the contribution limit from 15% of the taxpayer's aggregate net income to 25% for the 2020 and 2021 tax years. (CARES Act §2205; TCDTRA §213)

For C corporations, the deduction is ordinarily 15% of *taxable* income. (IRC §170(e)(3)(C)(ii)(II)) C corporations must make numerous adjustments to their taxable income to arrive at "taxable income" for charitable contribution purposes. (IRC §170(b)(2)(D))

Food inventory contribution calculation

Businesses are permitted a deduction for food inventory of the lesser of:

- The basis of the food inventory, plus one-half of the ordinary income that the C corporation would have recognized if the property were sold at fair market value; or
- Twice the basis of the property.
  (IRC §170(e)(3)(B))

Example of food inventory contribution deduction

Farm-It, Inc., a C corporation had taxable income without regard to its food inventory charitable contribution deduction of $500,000 in 2021. Farm-It made food inventory contributions as follows in 2021:

		2021
(a)	Basis of donated food inventory	$70,000
(b)	Twice basis of donated food inventory ((a) × 2)	$140,000
(c)	Ordinary income that would have been earned if donated food inventory was sold	$68,000
(d)	One-half of ordinary income ((c) × 50%))	$34,000
(e)	Basis of donated food inventory + one-half of ordinary income ((a) + (d))	$104,000
(e)	Lesser of (b) or (e)	$104,000
(f)	Taxable income without regard to food inventory charitable contribution deduction	$500,000
(g)	Limitation (percentage)	25%
(h)	Limitation (dollar amount)	$125,000
(i)	Disallowed deduction – carried over to next year ((e) – (h), but not less than zero)	$0

If Farm-It was a taxpayer other than C corporation, then it would use aggregate net income on line (f) instead of taxable income to calculate its limitation.

Patents and other intellectual property

The charitable deduction for most intellectual property is limited to the lesser of the taxpayer's basis in the property or the property's fair market value of any patent or other intellectual property, plus an additional deduction based on income. (IRC §170(e)(1)(B)) However, copyrights described in IRC §1221(a)(3) or §1231(b)(1)(C) are excluded from that rule (copyrights held by the taxpayer who created it or by a transferee whose basis is determined by reference to the creator's basis), and contributions of such property are limited to the donor's basis.

Intellectual property means:

- Patents;
- Copyrights (other than those discussed above);
- Trademarks;
- Tradenames;
- Trade secrets;
- Know-how;
- Software (other than software described in IRC §197(e)(3)(A)(i); and
- Other similar property or applications or registrations of such property.

The taxpayer may be able to claim additional charitable contribution deductions in the year of the contribution and years following based on the income from the donated property. (IRC §170(m)(1)) The taxpayer may deduct an applicable percentage of the income derived from that property for up to 12 years after the date of donation. The applicable percentage is a declining amount. (IRC §170(m)(7))

Taxable year of donor ending on or after date of contribution	**Applicable percentage**
1st	100
2nd	100
3rd	90
4th	80
5th	70
6th	60
7th	50
8th	40
9th	30
10th	20
11th	10
12th	10

The increased deductible contribution kicks in once the cumulative amount based on the applicable percentage exceeds the initial contribution amount.

The donor is required to inform the donee at the time of contribution, in writing, that the donor intends to treat the contribution as subject to the additional charitable deduction provision. (Notice 2005-41) The donee organization is required to report to the donor the amount of income derived from the property using Form 8899, Notice of Income From Donated Intellectual Property. (IRS Publication 526)

Example of additional deductions not allowed

In Year 1, Frank donates a patent to a qualifying charity. His basis is $30,000. As such, his initial contribution amount is $30,000. In ensuing years, the income, applicable percentages, and deductible amounts are as follows:

Year	**Income**	**Statutory %**	**Tentative deduction**	**Cumulative amount**
1	$ 5,000	100%	$ 5,000	$ 5,000
2	$15,000	100%	$15,000	$20,000
3	$10,000	90%	$ 9,000	$29,000
4	$10,000	80%	$ 8,000	$37,000
5	$ 3,000	70%	$ 2,100	$39,100

Frank is not allowed additional deductions until Year 4, when the cumulative amount exceeds his initial deduction. In Year 4, he is allowed a deduction of $7,000. In Year 5, he is allowed a deduction of $2,100.

Timothy McVeigh attorney denied charitable deduction

Described by a former law partner in a 1997 article in People magazine as "the most dishonest person I've ever met, including all the criminals I've defended" (Hewitt, Bill (March 31, 1997) "Humble? Forget It" *People Magazine*), Stephen Jones was denied a charitable deduction of documents pertaining to the Timothy McVeigh Oklahoma City bombing case, in which he was the defense attorney. (***Jones v. Comm.*** (2007) 129 TC 146; ***Jones v. Comm.*** (March 27, 2009) United States Court of Appeals, Tenth Circuit, Case No. 08-9001)

Jones donated 171 boxes containing hundreds of thousands of items pertaining to the case to the University of Texas. The items included letters, memoranda, photos, lab reports, and computer discs. Jones obtained an appraisal of the items and claimed a charitable contribution deduction of $294,877.

First, the court noted that the appraiser Jones hired spent only one day reviewing the materials, and he reviewed only a small percentage of them. He based his valuations on comparable collections, but the collections to which he made the comparisons consisted primarily of original documents while the taxpayer's consisted entirely of copies.

The court denied any deduction because the amount of any charitable contribution of property must be reduced by the amount of gain that would not have been long-term capital gain if the property contributed had been sold by Jones at its fair market value. (IRC §170(e)(1)(A)) The materials were specifically excluded from the definition of capital asset under IRC §1221(a)(3) as in effect during the tax year at issue:

> *(3) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property held by-*
>
> > *(A) a taxpayer whose personal efforts created such property, [or]*
> > *(B) in the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced*

Because the materials fell under the exclusion of letters, memoranda, or similar property produced by Jones's own efforts, they were ordinary assets. As such, the deduction was limited to Jones's basis, which was zero.

Qualified conservation contributions

Although charitable deductions are generally not allowed for donations of partial interests, an exception is made for a "qualified conservation contribution." (IRC §170(f)(3)(B)(iii); Treas. Regs. §1.170A-14(a)) This is a contribution of a qualified real property interest, including easements, to a qualified organization exclusively for conservation purposes. The donee must be prohibited from making certain transfers, and the conservation purpose must be protected in perpetuity.

Conservation purposes include protecting a natural habitat, or preserving a land area, open space (including farmland and forest land), or a historically important land area or certified historic structure.

In perpetuity

Pay special attention to the "in perpetuity" traps that may arise when donating an easement.

An easement that may be extinguished, in whole or in part, by mutual consent of the parties does not satisfy the "in perpetuity" requirement. (***Carpenter et al. v. Comm.***, TCM 2012-1)

A North Dakota law that limited real property easements to 99 years meant that a donor could not meet the requirement under IRC §170(h) that a conservation easement must be granted in perpetuity, even though the donor's remaining interest was negligible. (***Wachter v. Comm.*** (2014) 142 TC 7)

An easement is not considered protected "in perpetuity" until it is recorded. In ***Zarlengo v. Comm.***, TCM 2014-161, taxpayers were denied a charitable contribution deduction in the year the easement was donated because the easement had not been recorded until the following year.

In addition, because a taxpayer, who retained the right to build a single family home on each of 11 building areas located on the donated 500 acres, failed to identify the 11 building areas prior to the date of the contribution, was denied the claimed contribution because it violated the perpetuity requirement under IRC §170(h)(2)(c). (***Carter v. Comm.***, TCM 2020-21)

A charitable deduction cannot be claimed if the donation has no material effect on the real property's FMV or enhances rather than reduces its FMV. For example, little or no deduction may be allowed if the property's use is already restricted by zoning laws or by contract, and the donation does not further restrict how the property can be used (see ***Chandler v. Comm.*** (2014) 142 TC 16).

Enhanced income limits

Even if the property is capital gain property, it receives 50% treatment under IRC §170(b)(1)(E)(i) (see the discussion of AGI percentage limitations on page 9). Certain contributions of qualified conservation property by farmers and ranchers get 100% treatment. (IRC §170(b)(1)(E)(iv)(I))

Enhanced carryovers

Qualified conservation contributions are allowed a 15-year carryover period instead of the usual five years. (IRC §170(b)(1)(E)(ii))

$500 filing fee

In the case of a qualified conservation contribution that is a restriction relating to the exterior of a building located in a registered historic district for which a deduction of more than $10,000 is claimed, no deduction will be allowed unless the taxpayer includes a $500 filing fee with the return for the tax year of the contribution. (IRC §170(f)(13)) The payment is made by filing Form 8283-V, Payment Voucher for Filing Fee Under Section 170(f)(13).

Does a developer's donation of land qualify as a deductible conservation easement?

A taxpayer granted a perpetual conservation easement covering a golf course that the donee (i.e., the North American Land Trust) owned and which resulted in a charitable contribution of approximately $30 million (the IRS auditors initially disallowed the entire deduction). The course was surrounded by a residential development, and the easement's value was determined by subtracting the value of the property being used for the golf course from the value of the land if it had instead been used as part of the residential development. (***Kiva Dunes Conservation v. Comm.***, TCM 2009-145)

Consider, for a moment, what is going on here from a tax planning standpoint. The taxpayer probably never had any intent except to have a golf course on this property (because it was a widely advertised amenity for this community). Yet, by granting an easement to the local land trust, the taxpayer was able to create a charitable contribution deduction which flowed through from the partnership tax return to his personal return for more than $30 million.

It's this type of double benefit that resulted in the Tax Court disallowing charitable contribution deduction of a conservation easement sold by a land developer for less than its appraised value to the local county government. (***Wendell Falls Development, LLC v. Comm.***, TCM 2018-45)

The land developer purchased 1,280 acres of land to build a master planned community. The planned community included a 125-acre park that would be connected to all of the roughly 4,000 planned homes through a system of greenways. The developer appraised the 125-acre park at $4.8 million, sold it to the county for $3 million, and claimed a charitable contribution deduction for the difference of $1.8 million.

The Tax Court held that the external features of the overall transaction supported the IRS's denial of the charitable contribution deduction. The park was part of the master planned community, it was situated in a way that all the homes in the community would have direct access to it (and thus would increase their value to the developer), and the purpose of the conservation easement was so that the 125 acres would be restricted to use as a park.

Taxidermy property

The deduction for taxidermy property is limited to the lesser of basis or fair market value. (IRC §170(e)(1)(B)(iv)) Basis includes only the cost of preparing, stuffing, and mounting the property. It does not include transportation or travel costs, or the direct or indirect costs of killing the animal, or the value of the taxpayer's time. (IRS Publication 526) See page 20 for a discussion of ***Gardner v. Comm.***, TCM 2017-165, which covers the replacement cost method of valuation for taxidermy property.

Donations of cryptocurrency

A charitable contribution deduction is generally equal to the fair market value of the virtual currency at the time of the donation if the virtual currency was held for more than one year. If the virtual currency was held for one year or less at the time of the donation, the deduction is the lesser of the basis in the virtual currency or the virtual currency's fair market value at the time of the contribution.

The charitable organization will need to provide the contemporaneous written acknowledgment to the donor if the donor is claiming a deduction of $250 or more for the virtual currency donation. If the donor is claiming a deduction of more than $5,000 and the donor presents Form 8283, Noncash Charitable Contributions, to the organization for signature to substantiate the tax deduction, the organization is required to sign.

A charitable organization that receives virtual currency should treat the donation as a noncash contribution. Charities must file Form 8282, Donee Information Return, if they sell, exchange, or otherwise dispose of charitable deduction property (or any portion thereof) for real currency within three years after the date they originally received the property. This includes the sale of virtual currency. The charity also must give the original donor a copy of the Form 8282.

SUBSTANTIATION REQUIREMENTS

In addition to the general rules regarding documenting a deduction, the Code provides additional requirements to document and substantiate charitable contributions. (IRC §170(f)(8)) They are summarized in the following chart. In addition to what is noted below, written acknowledgements from donee organizations must provide a good faith estimate of the value of any goods or services, if any, given in exchange, or a statement that no benefit was received (other than an intangible religious benefit).

REGULATIONS

Some of the highlights from the final substantiation regulations adopted in 2018 include, but are not limited to:

- A blank pledge card provided by the donee organization does not constitute adequate substantiation for cash, check, or other monetary gifts because it does not show the information required under IRC §170(f)(17) (Treas. Regs. §1.170A-15(b)(2));
- There is no specific reasonable cause exception to the various substantiation/reporting rules for certain noncash contributions because such an exception is based on the taxpayer's facts and circumstances. This reflects the Tax Court's conclusion in ***Crimi v. Comm.***, TCM 2013-51;
- A fully completed Form 8283, Non-Cash Charitable Contributions, alone does not meet the substantiation requirements of IRC §170(f)(8) regarding contemporaneous written acknowledgement for donations of $250 or more because the form only contains some of the information required by the Code. See the chart below for more complete information on the substantiation required for various charitable donations (TD 9836);
- The IRS valuation tables are not acceptable substitutes for qualified appraisals. The tables may be used to value property in other than charitable contribution contexts, but do not give adequate fair market value for charitable substantiation purposes (TD 9836); and
- Regarding appraisals and appraisers:
  - If an appraisal is required in the year of contribution, a copy of the appraisal must be attached to returns for any carryover years (Treas. Regs. §1.170A-16(f)(3)); and
  - The final regulations make clarifications regarding the education requirements for appraisers. (Treas. Regs. §1.170A-17)

Substantiation Requirements		
Contribution	**Documentation**	**Substantiation**
Cash contributions of less than $250	Bank record	Includes cancelled check; bank, credit union, credit card statement showing name; and transaction posting date (credit card)
	Written communication from charity	Name of charity, date, and amount of contribution (if separate payments made, an acknowledgement is required for each payment)
	Payroll deduction	Pledge card and pay stub, W-2 wage statement, or other document furnished by employer including total amount withheld for charity
Cash donations of $250 or more	Written acknowledgment from the charity for each donation	Name of charity, date, amount paid, description, and estimate of value of goods or services provided by the charity
Noncash contributions of less than $250	Receipt from donee or reliable records	Name of charity, date and location of contribution, and reasonably detailed property description
Property donations greater than $250 and not more than $500	Contemporaneous written acknowledgment	Name of charity; date, amount paid, and description (but not necessarily value) of property contributed; whether the charity gave goods or services in return and the description and value of those goods or services
Property donations greater than $500 and not more than $5,000 (**Note:** To determine whether $500 threshold has been met, combine all claimed deductions of similar items of property donated to any charitable organization during the year)	Written acknowledgement	Same as above, plus: • How you got the property; • Approximate date you got or created the property; and • Cost or other basis for property other than public securities. Must file Form 8283, Noncash Charitable Contributions, Section A (**Note:** C corporations other than personal service corporations and closely held corporations are not required to file Form 8283)
Donations of $5,000 or more excluding stock, certain works of art, and autos	Qualified appraisal	Attach appraisal to return and complete Form 8283, Section B for year of contribution and all carryover years C corporations required to file Form 8283
Qualified conservation property	Information above, as applicable	Information listed above, as applicable, plus the property's FMV before and after the contribution; identification of the conservation purpose. If easement on building in historic district must have qualified appraisal, photographs of building's exterior, and description of all restrictions on building's development
		(continued)

<table>
<tr><th colspan="3">Substantiation Requirements (continued)</th></tr>
<tr><th>Contribution</th><th>Documentation</th><th>Substantiation</th></tr>
<tr><td>Donations of art valued at $20,000 or more</td><td>Signed appraisal for each object</td><td>Attach signed appraisal to return and provide photograph of sufficient quality and size to fully show object if requested by the IRS</td></tr>
<tr><td>Stock of publicly traded corporation</td><td>Contemporaneous written acknowledgement from donee organization. No appraisal required if as of date of the contribution market quotations are readily available on an established securities market</td><td>Attach Form 8283 to return</td></tr>
<tr><td rowspan="2">Nonpublicly traded stock</td><td>Contributions greater than $5,000 and less than or equal to $10,000</td><td>Contemporaneous written acknowledgement from donee organization. A partially completed appraisal summary; complete Form 8283, Part I</td></tr>
<tr><td>Contributions greater than $10,000</td><td>Attach qualified appraisal to return</td></tr>
<tr><td>Vehicle, boat, or airplane with value of more than $500</td><td>Value is the lesser of the gross sales proceeds or the FMV of the vehicle if no “significant use or material improvement”</td><td>Taxpayer needs contemporaneous written acknowledgement from donee organization; donee organization must use Form 1098-C to report value of vehicle donations if vehicle is sold; this can be used to provide acknowledgement to the donor</td></tr>
<tr><td colspan="3">These rules apply to individuals making qualified contributions to §501(c)(3) organizations. Additional rules apply when gifting a partial or restricted interest, gifts via trusts, and gifts with a remainder interest. Where an appraisal is required to be submitted with a return, it is also required to be submitted with the return for any carryover years.</td></tr>
</table>

☑ Planning Pointer

Inform your clients that they need to prove “good used condition or better” of their donated items. A detailed statement, complete with pictures, will better represent the item gifted. Receipts from the Salvation Army or Goodwill with vague descriptions will not be enough substantiation for a $1,000 or $2,000 (for example) noncash contribution. And these organizations are not allowed to value donated goods. Generally they will only list number of boxes, bags, or items you requested to be picked up.

CONTRIBUTION REPORTED ON FORM 990 IS NOT AN ACKNOWLEDGEMENT

A charitable contribution deduction was denied because an amended Form 990 containing a statement highlighting details of the donation did not satisfy the requirement for a written contemporaneous acknowledgement of the donation. (CCA 201120022) The Chief Council Advice notes that the IRS has not provided any forms for donees to use in connection with the requirement for a contemporaneous acknowledgement. While initially implying that the taxpayer was denied the deduction because the Form 990 was amended (and therefore, not contemporaneous), the CCA goes on to state that taxpayers cannot satisfy the requirement with a Form 990 or any other form filed by the donee.

ACKNOWLEDGEMENT FROM ONESELF IS NOT SUFFICIENT

A taxpayer was denied charitable contribution deductions where the substantiation for the amounts donated was in the form of a letter from the taxpayer himself. The donations were made to the church where the taxpayer was both president and minister, and other than the letter (which was not contemporaneous), he did not have proper records of the donations. (***Davis v. Comm.***, TCM 2018-56)

PROFESSOR FLUNKS CHARITABLE DEDUCTION RULES

The Tax Court denied a professor and his contract-specialist wife deductions of $79,000 and $90,000 in noncash charitable contributions. (***Payne, et ux. v. Comm.***, TCS 2016-30) The court also imposed accuracy penalties under IRC §6662(a) for the 2010 and 2011 years. The amount deducted was approximately 46% and 47% of the taxpayers' 2010 and 2011 income, respectively.

In 2011, the taxpayers submitted receipts to support their claimed charitable deductions with either generic or no descriptions of donated items. The Form 8283 contained no specific information about the individual items of property, the cost basis, the valuation method, or the date of acquisition. Similar inadequate documentation was provided for 2010.

The IRS argued that the taxpayers did not meet the following substantiation requirements:

- Contemporaneous written acknowledgment: Of the receipts attached, only three of the 53 acknowledgments for both tax years contained specific itemization. None of the receipts included a description of the property written by the donee organization; and
- An appraisal for items donated valued at $5,000 or more: The IRS argued that the aggregation rule of IRC §170(f)(11) must be applied.

Interestingly, the court noted that the taxpayers had also claimed noncash charitable contribution deductions in amounts exceeding $25,000 for the years 2006 through 2009, and they claimed $80,000, $36,000, and $52,000 for 2012, 2013, and 2014, respectively. The property contributed was similar to those in this case.

Example of insufficient substantiation

In ***Kunkel v. Comm.***, TCM 2015-71, the IRS disallowed $37,315 in charitable deductions claimed due to lack of substantiation resulting in a deficiency assessment of $12,338 and an accuracy-related penalty of $2,468.

The taxpayers claimed that they were not required to provide in-depth documentation because they made all of their donations in batches that were valued at less than $250. Needless to say, the court had difficulty believing that, because the taxpayers donated over $13,000 of goods to their church's annual flea market event, and the remaining $24,000 of items would have required over 92 trips to the various charities over the course of the year.

However, even if the court had believed their claim, the taxpayers still failed to meet the contemporaneous written acknowledgement substantiation requirement. Doorknob hangers left by charities that pick up donated goods are insufficient substantiation as they are undated, not specific to the taxpayers, do not describe the property contributed, and fail to indicate whether any goods or services were received in exchange for the donation.

QUALIFIED CHARITABLE DISTRIBUTIONS FROM IRAs

Taxpayers may exclude up to $100,000 in "qualified charitable distributions" (QCD) from their AGI. The distributions may be made from a traditional IRA or from a Roth IRA. (IRC §408(d)(8)) QCDs may also be made from SEP and SIMPLE IRAs, but only if the participant is no longer working and receiving contributions into the plan. (IRS Notice 2007-07, Q&A #36)

> ***Comment***
>
> Even though the SECURE Act increased the age at which RMDs must begin from age 70½ to age 72, taxpayers can still make qualified charitable distributions starting at age 70½.

Qualified charitable distributions are:

- Made directly by the IRA trustee to a charitable organization; and
- Made on or after the date the taxpayer reaches age 70½.

Distributions may not be made to a:

- Private foundation;
- Donor-advised fund;
- Charitable remainder trust; or
- Charitable annuity trust.

QCD LIMITATION WHERE IRA CONTRIBUTIONS ARE MADE AFTER AGE 70½

Taxpayers who make deductible IRA contributions after age 70½ face a limitation if they later make direct IRA-to-charity contributions (QCDs).

A taxpayer's annual qualified charitable distribution is reduced (but not below zero) by the excess of:

- All aggregate deductible IRA contributions made for years on or after the year the taxpayer reaches age 70½; over
- The aggregate amount of those contributions that have previously reduced QCDs for all years prior to the tax year at issue.
  (IRC §408(d)(8)(A))

This means that each post-age-70½ deductible IRA contribution will reduce a taxpayer's QCD, even if the QCD is in a later year. However, the QCD will only be reduced up to the amount of each post-age-70½ deductible contribution.

Example of SECURE Act's IRA-to-charity limitation

Jane is age 73 in 2020. Jane is still working and makes a $6,000 deductible traditional IRA contribution in 2020, 2021, and 2022, for a total of $18,000 over the three years. In 2023 she begins making annual $10,000 QCDs from her IRA. Jane's QCDs are reduced as follows:

2023 QCD		$10,000
Minus:		
2020, 2021, and 2022 deductible IRA contributions	18,000	
Prior QCD reductions	- 0	
Total current year QCD reductions	18,000	(18,000)
Jane's QCD for 2023		$ 0[1]

[1] The QCD cannot be reduced below zero; further reductions will happen in future years. In this example, $8,000 of IRA contributions for years on or after age 70½ will carry over to Jane's next taxable year.

2024 QCD		$10,000
Minus:		
2020, 2021, and 2022 deductible IRA contributions	18,000	
Prior QCD reductions	- 10,000	
Total current year QCD reductions	8,000	(8,000)
Jane's QCD for 2024		$ 2,000

2025 QCD		$10,000
Minus:		
2020, 2021, and 2022 deductible IRA contributions	18,000	
Prior QCD reductions	- 18,000	
Total current year QCD reductions	0	(0)
Jane's QCD for 2025		$10,000

These qualified charitable distributions are ignored for tax purposes; that is, they are not included in gross income but also are not deductible as a charitable contribution.

Because an IRA distribution made to a charity is not included in taxable income, the many AGI-related phaseouts are minimized and Social Security taxation may be decreased. Also, because the contribution is excluded from income rather than deducted as a charitable contribution, taxpayers who don't itemize get the full benefit of the contribution.

These charitable distributions are treated as distributions for required minimum distribution (RMD) purposes.

Example of charitable distributions

Joan is 72 years old and has an IRA consisting solely of deductible contributions and earnings. Her RMD from her IRA is $6,000. She wants to contribute $1,000 to Meals on Wheels. She directs the IRA trustee to send $1,000 to Meals and $5,000 to her. She will include $5,000 in her AGI, and she has met her RMD for the year.

Vito is 71 years old and has an IRA consisting solely of deductible contributions and earnings. He contributes $5,000 each year to his church, but because he and his wife take the standard deduction he gets no tax benefit. Vito's RMD is $5,000. Assuming he is in the 22% tax bracket, if he takes the $5,000 out of his IRA and writes a check to his church, he will pay $1,100 in tax ($5,000 × 22%) but will have no charitable deduction because he doesn't itemize. By requesting that the IRA trustee send a check directly from his IRA to his church, he saves $1,100 in tax.

Laura, age 72, has a traditional IRA with a balance of $100,000 consisting solely of deductible contributions and earnings. Laura has no other IRAs. The entire IRA balance is distributed to the YMCA building fund. The entire distribution of $100,000 is a qualified charitable distribution. No amount is included in Laura's income as a result of the distribution, and the distribution is not taken into account in determining the amount of Laura's charitable deduction for the year.

The normal distribution ordering rules are ignored, and basis is not distributed on a *pro rata* basis. Instead, basis is distributed last. As such, a taxpayer who has basis in his or her IRA and makes charitable distributions in the current year will have a higher percentage of basis and a lower taxable amount in future distributions including RMD.

Example of charitable distribution from nondeductible account

Bob, age 81, has a traditional IRA with a balance of $100,000, consisting of $20,000 of nondeductible contributions and $80,000 of deductible contributions and earnings. Bob has no other IRAs. Bob directs his IRA trustee to contribute $80,000 to Habitat for Humanity.

If Bob took a distribution from his IRA and then made a contribution, a portion of the distribution from the income would be treated as a nontaxable return of nondeductible contributions under the ordering rules. The nontaxable portion of the distribution would be $16,000. The amount of the distribution is multiplied by the ratio of the nondeductible contributions to the account balance ($80,000 × ($20,000 ÷ $100,000)). Thus, $64,000 of the distribution ($80,000 - $16,000) would be includable in Bob's income.

When the IRA trustee makes the contribution, the total amount that would be includable in income if all amounts were distributed from the IRA is $80,000. The entire $80,000 distributed to the charitable organization is treated as coming from the taxable portion of the distribution.

No amount is included in Bob's income, and the distribution is not taken into account in determining the amount of Bob's charitable deduction for the year.

Bob's remaining $20,000 is treated as nondeductible contributions with basis.

Example of multiple accounts

Janet has two IRA accounts. One has a balance of $100,000 with a $20,000 basis in nondeductible contributions. The other has a balance of $30,000, consisting of $10,000 of nondeductible contributions and $20,000 of deductible contributions and earnings.

Janet directs the IRA trustee to contribute the full amount of the $100,000 IRA to the Girl Scouts of America. The IRA accounts are aggregated, and the distribution is deemed to have come from the $100,000 taxable amount. The remaining $30,000 in her IRA is treated as a nondeductible contribution with basis.

CLIENT LETTER

Download a customizable client letter on making charitable donations from an IRA directly to a charity at:

💻 **Website**
www.caltax.com/files/2021/cl-iracharity.doc

DONOR-ADVISED FUNDS AND CHARITABLE TRUSTS

DONOR-ADVISED FUNDS

Need a big charitable contribution deduction but don’t know who to give it to? A donor-advised fund may be your answer. The client can amass years’ worth of donations into a deduction in one year.

Donor-advised funds are easy to establish. Many mutual fund companies offer a donor-advised fund. The taxpayer contributes assets to the fund: either cash or securities. The funds are invested, and the taxpayer does not pay tax on the income and gains in the fund. The sponsoring organization receives and retains exclusive ownership and legal control over investment returns and the amounts contributed to the fund, and they also have the ultimate responsibility for making the gift.

A donor-advised fund is a fund or account that is:

- Separately identified by reference to contributions of a donor or donors;
- Owned and controlled by a sponsoring organization; and
- Structured such that the donor or any person appointed or designated by the donor (a “donor advisor”) has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in the separately identified fund or account by reason of the donor’s status as a donor.
  (IRC §170(f)(18))

Example of donor-advised fund

The Bosses, a married couple, sold their business in year 1 for a $3 million profit in addition to their other income. They wanted to reduce their tax liability in year 1 by making charitable contributions. However, with the work involved in the sale of the business and liquidation of the corporation, they did not have time to thoroughly investigate which causes they wanted to support. The Bosses and their CPA, Ralph, determined that the Bosses would contribute $1 million.

Ralph recommended that the Bosses contribute the $1 million to a donor-advised fund. Between federal and state tax, they saved approximately $400,000 for year 1. If they waited until a later year, their tax savings would be only half that amount because their taxable income would drop to around $100,000.

By making the contribution in year 1, they received the best tax savings and postponed the decision as to how they wanted to make the contributions. In year 2, they contributed $800,000 from the fund to establish a computer learning center at their alma mater. They retained the balance in the fund for future contributions.

Restrictions

A taxpayer may not claim a charitable deduction for donations made to a donor-advised fund if:

- The qualified organization that sponsors the fund is a war veterans' organization, a fraternal society, or a nonprofit cemetery company; or
- The taxpayer does not receive a written acknowledgment from the sponsoring organization that it has exclusive legal control over the assets contributed.
  (IRC §170(f)(18))

A donor-advised fund may not distribute to a donor or a person that is related to the donor or donor advisor. (IRC §4958(c)(2)) These distributions are treated as excess benefit transactions and are subject to an excise tax.

A taxpayer may not make a tax-free transfer from an IRA to a donor-advised fund. (IRC §408(d)(8)(B)(1))

The increased 100% AGI limitation for the 2020 and 2021 tax year does not apply to contributions to donor advised funds.

Donor-advised fund deduction denied

The Tax Court denied a deduction for a charitable gift to an organization maintaining donor-advised funds for doctors. (***Viralam v. Comm***. (2011) 136 TC 8) The fund made distributions to the University of Pennsylvania in payment of the taxpayer's son's tuition. The payments were ostensibly categorized as loans that must be repaid. Because most of what the doctor contributed to the fund was used for his son's education, he never truly gave up control over the donations. In addition to not receiving the charitable deduction, the doctor was subject to capital gains tax on sale of the stock and an accuracy-related penalty.

Example of taxable distribution and deductible charitable contribution

Janet must take a $10,000 required minimum distribution from her IRA. She has a donor-advised fund established. She may not make a direct transfer from her IRA to the donor-advised fund. She may, however, take a taxable distribution of $10,000 from her IRA and make a deductible charitable contribution to the donor-advised fund.

Instead, Janet should direct the IRA trustee to transfer the $10,000 directly to a §501(c)(3) charity as a qualified charitable distribution (discussed above). She will not report the $10,000 as income and will not take a charitable deduction.

Some websites for donor-advised funds

Fidelity Charitable Gift Fund℠: www.fidelitycharitable.org/
National Philanthropic Trust: www.nptrust.org
Vanguard® Charitable Endowment Program: www.vanguardcharitable.org
FJC Foundation of Philanthropic Funds: www.fjc.org

Benefits to donors

The donor receives several tax benefits for the contribution:

- A tax deduction for the charitable gift under IRC §170;
- Avoidance of capital gains taxes if the gift is appreciated property; and
- Reduction of the gross estate by the amount of any contributed assets.

The beauty of the donor-advised fund is that the taxpayer gets the full charitable contribution deduction in the year the assets are contributed to the fund, but the taxpayer can spread his or her gifts to the charities over any number of years. This is especially beneficial for taxpayers who are retiring and expect their income to decrease.

Donor-advised funds versus private foundations

Here are some of the advantages to using donor-advised funds:

- Donor-advised funds are easy to set up. Unlike a private foundation, no complicated legal documents are required. Typically, a short fill-in-the-blank form is all the donor must complete;
- The contribution minimums are low;
- Administration fees are low, unlike private foundations, which are expensive to administer; and
- If a donor wants complete anonymity, the sponsoring organization is not required to reveal his or her identity. This is not possible with a private foundation, where grants are public record.

Some of the disadvantages are:

- **Lack of control over distributions:** Though the sponsoring organization has the final say regarding distributions, the donor has some influence in this area. Generally, though, if the donor chooses a valid charity, his or her recommendations will be followed;
- **Lack of control over investment:** Investment choices vary greatly among funds. Some funds allow the donor's investment advisor to manage the fund, or allow the donor to choose from a list of investment options. However, other funds don't give donors any choice regarding investments;
- **Donors may not receive income from the fund**; and
- **Donors may not hire themselves or family members** to do work for the fund, contrary to a private foundation.

Questions to ask

Keep in mind that not all donor-advised funds operate in the same way. Here are some questions to ask when considering what is the best choice for your client:

- What assets are accepted?
- What fees are charged?
- What restrictions are placed on grants?
    - Are there geographic restrictions?
    - What is the minimum grant amount?
    - What input does the donor have with regard to investments?
    - Does the fund allow contributions to the specific 501(c)(3) charities the donor wants to support?
- Are outside investment advisors permitted?
- What services are offered?
    - Is there staff available to help the donor decide where to give?
- Does the fund continue in perpetuity, or does it stop at the donor's or spouse's death?

CHARITABLE REMAINDER TRUSTS

Charitable remainder trusts are popular because of the charitable, financial, retirement, and estate-planning opportunities they afford taxpayers. In brief, a qualifying trust can provide an income stream for the beneficiary (who may be the grantor) and an upfront charitable contribution deduction for the amount of the remainder, even though the actual transfer to the charity may be many years away. See page 54 for an example of how to calculate the deduction.

A charitable remainder trust may be especially useful for highly appreciated assets because once they're in the trust, they can be sold tax-free. (IRC §664(c)) They may also provide an easy vehicle for converting non-income-producing assets into income-producing assets without dilution by income tax on the sale.

Background

A charitable remainder trust must have at least one noncharitable income beneficiary (this could be the grantor) and at least one qualified charitable organization (called the remainderman). (IRC §664) The income beneficiary receives an income stream from the trust for life or for a specified term of years, with the remaining assets going to the charitable remainderman.

In addition, the grantor gets a charitable contribution deduction equal to the value of the remainder interest at the time the assets are placed in the trust. The grantor may reserve the right to change beneficiaries or change the charitable remainderman to another qualified charity, but the gift to the trust is irrevocable.

There are two basic types of charitable remainder trusts:

- **Charitable remainder annuity trust (CRAT):** Pays to the beneficiary a fixed percentage of the initial value of trust assets periodically (monthly, quarterly, etc.); and
- **Charitable remainder unitrust (CRUT):** Pays to the beneficiary a fixed percentage of the revalued trust assets (as revalued annually).

> ***Example of CRAT versus CRUT***
>
> Herman created a CRAT, to which he contributed $500,000 of his highly appreciated General Motors stock. The CRAT will pay him $35,000 (7% of $500,000) annually.
>
> Betty established a CRUT that pays out 7% of the fair market value annually. If the assets were valued at $500,000, she will receive $35,000 that year (7% of $500,000). If the assets are valued at $600,000 the next year, she will receive $42,000 (7% of $600,000).

Charitable remainder annuity trust

A CRAT makes annual payments of a fixed dollar amount to the noncharitable beneficiaries, subject to percentage restrictions (5% to 50%). (IRC §§664(d), 2055(e)) These trusts are often referred to as "annuity trusts" because the amount of the annual payment does not change.

In order to qualify for income, estate, and gift-tax deductions, a CRAT must meet the following requirements:

- A fixed amount ("annuity percentage") must be payable to the noncharitable beneficiary;
- The annuity percentage must not be less than 5% and not more than 50% of the initial fair market value of all property transferred into the trust;
- The specified amount must be paid at least annually to the noncharitable beneficiary out of income and/or principal;
- The trust must be irrevocable and not subject to the power of invasion, alteration, or amendment by the donor, the trustee, or the beneficiary;
- The trust must be for the benefit of one or more persons (at least one of which is not an organization described in IRC §170(c)) who must be living at the time of the transfer in trust and whose interests must consist of either a life estate or a term of not more than 20 years;
- The entire remainder must go to charity; and
- The present value of the amount expected to pass to charity must equal at least 10% of the initial fair market value of all assets transferred to the trust. The present value of the remainder interest in a CRAT is the fair market value of the property placed in the trust, less the present value of the annuity under Treas. Regs. §§1.664-2 and 20.2031-7(d).
  (IRC §§170(f)(2), 664(d))

> ***Example of CRAT***
>
> George created a CRAT, to which he contributed highly appreciated stock with a value of $500,000. The CRAT will pay him $25,000 (5% of $500,000) annually. When he contributes the stock to the trust, George will receive a charitable contribution deduction of an amount determined using the annuity tables in Treas. Regs. §§1.664-2 and 20.2031-7(d). At George's death, the assets remaining in the trust will be paid to his church.
>
> If the CRAT's investments earn exactly $25,000 each year, and the trust distributes $25,000 each year, at George's death the church will receive $500,000. If the investments earn $50,000 each year, the CRAT will retain the $25,000 annual excess to reinvest, and the church will receive more than $500,000 at George's death. However, if the investments earn less than $25,000 in a year, the difference will be made up out of trust principal, and the church may receive less than $500,000.

Once a CRAT is funded, additional assets may not be contributed later. (IRC §§170(f), 664(d)) However, the annuity amount is fixed, so the income beneficiaries are protected from a decrease in the value of the trust assets. It is the charity that will receive less if the assets decrease in value.

Charitable remainder unitrust

A CRUT pays a fixed percentage of trust assets valued annually. (IRC §664(d)) This means that the actual dollar amount that the beneficiaries receive is adjusted annually to reflect the increase or decrease in the value of the trust's assets.

If the CRUT doesn't earn any income or appreciate in value in the first year, the trustee must use principal to pay the income beneficiary. This would reduce the value of the trust principal in the next year, resulting in a lower payment. Conversely, if the value of the trust assets increases, so will the income beneficiaries' payments.

Example of CRUT

If George from the previous example had contributed his stock to a CRUT with a 5% income stream, the amount of his annual income would not be fixed. If the value of the trust assets increased to $600,000, George's income for that year would increase to $30,000. However, if the value of the trust assets dropped to $400,000 George's income for that year would only be $20,000.

A CRUT must meet all of the following requirements:

- A fixed percentage of the net fair market value of the principal, revalued annually, must be payable to the noncharitable beneficiary;
- The percentage payable to the noncharitable beneficiary must not be less than 5% and not more than 50% of the annual value of the trust assets;
- The unitrust may provide that the noncharitable beneficiary receive the lesser of:
  - The specified fixed percentage noted above; or
  - The trust income for the year, plus any excess trust income to the extent of any deficiency in the prior years (by reason of the distribution being limited to the amount of trust income in such years).
- The noncharitable income beneficiaries must be living at the time of transfer in trust, and their interests must be for a life estate or a term of not more than 20 years;
- The entire remainder must go to charity; and
- The present value of the amount expected to pass to charity must equal at least 10% of the net fair market value of the assets transferred to the trust. (The present value of the remainder interest in a CRUT is determined using the tables in Treas. Regs. §1.664-4.)

Unlike the CRAT, if the CRUT's assets are not performing sufficiently, additional assets may be contributed to the trust.

Basics of Charitable Remainder Trusts		
	CRAT	**CRUT**
Payout rate requirements	5% minimum 50% maximum	5% minimum 50% maximum
Remainder value must equal at least 10% of the initial value of property transferred to the trust	Yes	Yes
Additional contributions allowed	No	Yes
Payment amount based on annual value of property	No	Yes
Calculation of payment	Fixed amount (annuity) calculated originally on value of property when transferred to the trust	Calculated annually based on annual value of trust assets
Deficiency between required payment and trust income made up with trust principal	Yes	Yes
Comments	Payment amount never changes. If the trust earns more or less than payout rate, income beneficiary does not participate in the increase/decrease	Payment amount fluctuates based on growth/decline of trust assets
See IRC §§170(f) and 664(d)		

Computing the remainder

The key to maximizing benefit to the client is to "play with the numbers" given the above parameters. Keep in mind that the key numbers are set as of the date of contribution even though many of the numbers are variable including the assumed inflation rate, earnings rate, longevity, etc.

To determine the charitable deduction, the fair market value is diminished by two factors. First, it's reduced by payments to the beneficiary. What's left is the future value. Second, because the future value is diminished by inflation, you must derive the present value of that amount. Thus, you can say that the charitable deduction is the present value of the future value of the amount contributed to the trust.

The contribution amount

Determining the fair market value of the contribution is easy if the contribution is in cash. It becomes more difficult if the contribution is in unmarketable assets or appreciated property.

In the case of unmarketable assets, no deduction is allowed unless a valuation is performed by either:

- An independent trustee; or
- A qualified appraiser.
  (Treas. Regs. §1.664-1(a)(7))

"Unmarketable assets" are all assets other than cash, cash equivalents, or securities such as publicly traded stock — the value of which are readily determinable by established markets. (Treas. Regs. §1.664-1(a)(7)(ii))

An independent trustee is a person who is not the grantor or noncharitable beneficiary and is not related to either. (Treas. Regs. §1.664-1(a)(7)(iii))

The usual charitable contribution appreciated property rules apply. As such, the fair market value is reduced by specified amounts in the case of:

- Ordinary income property (property that would generate short-term capital gain or ordinary income);
- Tangible personal property if the use by the donee is unrelated to its exempt purposes; and
- Patents and other intellectual property.
  (IRC §170(e)(1))

Payout percentage and contribution calculation

A charitable remainder trust must pay at least a 5% annual return — either a 5% annuity for a CRAT under IRC §664(d)(1)(A) or an annual payout equal to 5% of the value of the trust assets for a CRUT — but not more than 50%. (IRC §664(d)(2)(A))

A CRAT must make payments at least annually of a specified sum certain. (IRC §664(d)(1)(A)) The amount may be altered in limited circumstances.

A CRAT's governing instrument must provide that, for a short tax year, the annuity amount is prorated on the basis of days (Treas. Regs. §1.664-2(a)(1)(iv)(a)), except that no proration is necessary if a trust terminates on the date of death of the beneficiary. (Rev. Rul. 74-386)

A CRUT must pay a fixed percentage of its assets at net fair market value as valued annually. (IRC §664(d)(2)(A)) The values may be determined on any one date during the trust's tax year or by taking the average of valuations made on more than one date during the year. (Treas. Regs. §1.664-3(a)(1)(iv)) If the valuation method is not specified in the governing instrument, the trustee must select the valuation date or dates and indicate the choice on the first return. Generally, the valuation date is the last day of the trust's tax year for a short year. (Treas. Regs. §1.664-3(a)(1)(v)(a)(3))

The term

The payout must begin with the first year of the trust and continue either for:

- A named individual's or individuals' life or lives; or
- A term not in excess of 20 years.
  (IRC §664(d)(1)(A); Treas. Regs. §1.664-2(a)(5)(i))

In the case of a term for a life or lives, the actuarial factors are provided by the IRS. Publications 1457, 1458, and 1459 provide the methods for using the tables. The publications and tables are available at:

Website
www.irs.gov/forms-pubs/about-publication-561

The discount rate

The Applicable Federal Rate, or AFR, is the IRS discount rate that is part of the calculation used to determine the charitable deduction for many types of planned gifts, including charitable remainder trusts. The rate equals 120% of the annual midterm rate, rounded to the nearest 0.2%.

How much the discount rate affects the charitable contribution deduction depends upon the type of charitable remainder trust, with the variance affecting CRATs more than CRUTs. In either case, the higher the rate the higher the deduction (because the higher rate assumes higher earnings in the account, therefore diluting the remainder by a smaller factor).

Donors do, in fact, have some choices. They may use the discount rate for either the month of the gift or for either of the two months prior to the gift.

Example of calculating charitable contribution deduction

In April year 1, George created a CRAT and contributed $500,000 cash. The CRAT will pay him $25,000 annually for his life. On the date of contribution, George was nearest age 72. Here is how his charitable contribution is calculated.

Because the contribution was cash, the fair market value is $500,000; i.e., the contribution amount. The annual payout amount is $25,000, which at 5% of the contribution amount meets the requirement for a minimum 5% annual payout.

The Applicable Federal Rates were:

April year 1	3.0%
March year 2	3.0%
February year 1	2.8%

George selects 3.0%, the highest of the rates.

He then refers to Publication 1457, Table S. Under the 3% table, age 72, the annuity factor is 10.0854. As such, the present value of George's future annuity payments is $247,883 ($25,000 ÷ .100854).

The present value of the remainder is $252,117 ($500,000 - $247,883). If all other requirements are met, his charitable contribution deduction is $252,117.

Surviving spouses

A safe-harbor procedure designed to protect the tax-exempt status of CRATs or CRUTs requires a surviving spouse to waive his or her right to receive an elective share of the grantor's estate. The IRS created the safe harbor, which requires a waiver for trusts created after June 28, 2005, for purposes of determining whether a CRAT or CRUT is a qualified trust under IRC §664(d)(1)(B) or (2)(B). (Rev. Proc. 2005-44)

Waiver requirements

A grantor's spouse must complete the waiver on or before the date that is six months after the due date (excluding extensions of time to file actually granted) of IRS Form 5227, Split-Interest Trust Information Return, for the year in which the latter of the following occurs:

- The date of the creation of the trust;
- The date of the grantor's marriage to the spouse;

- The date the grantor first becomes a resident or is domiciled in a jurisdiction whose law provides a right of election that could be satisfied from the assets of the trust; or
- June 28, 2005 (the effective date of Rev Proc. 2005-24).

No waiver is required if state law does not give the spouse an elective share, or if the elective share cannot include assets of the charitable remainder trust. However, a change in the taxpayer's circumstances could cause the trust to be subject to an elective share any time after it is created. For example, a charitable remainder trust may lose its tax exemption years after it is established merely because the grantor moves to another state or remarries. So, trustees must remain diligent to be sure that their clients do not run afoul of this requirement.

Example of waiver requirements

John is a single man who lives in a separate-property state. In 2018, he established a charitable remainder trust benefiting his church. When John's trust was created it was not subject to an elective share, so no waiver was required.

In 2021, John met Marissa and they got married. John's trust is now subject to a potential elective share. Because the trust was created after June 28, 2005, Marissa must sign a waiver before October 15, 2022 (six months after the due date of Form 5227 for the year in which John married Marissa).

Splitting charitable remainder trusts

Revenue Ruling 2008-41 clarifies that a charitable remainder trust can be divided into two or more separate charitable remainder trusts without adverse tax consequences. (Rev. Rul. 2008-41) The ruling addresses two specific situations in which, if completed properly, the separate trusts will continue to qualify as charitable remainder trusts, the division won't be a sale, and no excise taxes will be imposed.

Dividing the trusts allows for different trustees and separate management of each trust, which can be very helpful when you have conflicts between beneficiaries.

In both situations addressed in the ruling, a CRAT or a CRUT was divided on a *pro rata* basis into individual trusts for each of the original trust's life beneficiaries.

IRC §199A deduction

The IRS's position is that because charitable remainder trusts are subject to an excise tax but not an income tax, then these trusts neither have nor calculate an IRC §199A deduction.

However, any taxable recipient of a unitrust or annuity amount from the trust must determine and apply the recipient's own threshold amount for purposes of IRC §199A, taking into account any annuity or unitrust amounts received from the trust.

Therefore, a taxable recipient of a unitrust or annuity amount from a charitable remainder trust may take into account qualified business income, qualified REIT dividends, and qualified PTP income for purposes of determining the recipient's IRC §199A deduction for the taxable year to the extent that the unitrust or annuity amount distributed to such recipient consists of such IRC §199A items under Treas. Regs. §1.664-1(d).

Split-interest trusts

The IRS has determined that special rules for split-interest trusts other than charitable remainder trusts, such as nongrantor charitable lead trusts or pooled income funds, are not necessary, despite public comment from the August regulations to the contrary.

Put simply, split-interest trusts apply the rules for nongrantor trusts and estates set forth in Treas. Regs. §1.199A-6(d)(3) to determine any applicable IRC §199A deduction for the trust or its taxable beneficiaries.

Separate shares within a trust

Separate shares within a trust are not treated as separate trusts for purposes of applying the threshold amount. Instead, the trust will be treated as a single trust for purposes of determining whether the taxable income of the trust exceeds the threshold amount.

Only trusts with retained DNI will be eligible for the IRC §199A deduction. The following rules apply:

- A trust, regardless of the number of separate shares it has for its beneficiaries under the separate share rule of IRC §663(c), will be treated as a single trust for purposes of applying the threshold amount under IRC §199A; and
- To the extent that a taxable beneficiary of a trust receives a distribution of DNI from the beneficiary's separate share of the trust which includes IRC §199A items, the beneficiary would apply its own threshold amount to those IRC §199A items in computing its IRC §199A deduction in accordance with the rules of Treas. Regs. §1.199A-6(d).

CHARITABLE LEAD TRUSTS

Charitable lead trusts work in reverse from charitable remainder trusts. The current beneficiary is the charity and the remainder goes to the noncharitable beneficiaries. Like charitable remainder trusts, there are annuity trusts (charitable lead annuity trusts, or CLATs) and CLUTs (charitable lead unitrusts). Many of the same rules apply.

In a charitable lead trust, the amount of distributions is not constrained by minimum or maximum payout restrictions. There is no specified limit for the charitable term, and the grantor receives a current gift or estate tax charitable deduction and possibly an income tax deduction for the value of the interest received by the charity.

The charitable income, estate, or gift tax deduction is equivalent to the present fair market value of the guaranteed annuity or unitrust interest. The longer the charitable term and the higher the rate of the guaranteed annuity or unitrust interest, the greater the value of the charitable interest and the lower the value of the remainder interest will be.

These trusts are excellent planning tools for clients with large estates who are interested in making delayed gifts to their beneficiaries while taking current advantage of a charitable deduction.

Invalid deathbed strategy

A Tax Court case highlights the downside of undertaking an aggressive deathbed planning strategy during a decedent's final weeks of life.

A decedent's son undertook a complex plan of forming a family limited partnership, transferring his mother's assets to the partnership in exchange for a 99% limited partner interest, and then gifting her partnership interest to a charitable lead annuity trust (CLAT), all while his mother lay on her deathbed. (***Estate of Powell*** (May 18, 2017) 148 TC 18)

The CLAT would provide an annuity to a charitable organization for the life of the mother. Because the assets were "gifted" to the CLAT, the assets were reported on the decedent's gift tax return and not her estate tax return. Rather than being valued at the full $10 million on the gift tax return, the assets were discounted by 25% due to the lack of control and marketability as a result of being transferred to the limited partnership.

Invalid/revocable gift

The Tax Court ruled that the son's gift to the CLAT was invalid and/or revocable because the POA did not expressly authorize the son to make gifts of his mother's property other than those specifically authorized in the POA.

Under state (in this case, California) law, the general authority provided in a POA to convey or otherwise deal in a decedent's property does not authorize the POA to make gifts. (California Probate Code §4264(c)) The general ratification provision in the POA also did not authorize the gift because it only ratified acts done "by virtue" of the POA.

Value of the assets

The court determined that the value of the assets included in the estate pursuant to either IRC §2035(a) or §2036(a) is determined under IRC §2043(a) rather than the automatic date-of-death value. IRC §2043(a) only requires that the excess amount of the assets' fair market value at the time of the decedent's death over the value of the 99% interest be included in the estate.

But because there was only one week between the time the assets were transferred to the partnership and the decedent's death, these values were one and the same, and the full value was required to be included in the estate.

CHARITABLE CONTRIBUTIONS MUST BE PURSUANT TO TRUST INSTRUMENT

A trust was denied a deduction for charitable contributions of $64,279 for 2009 because the contributions were not made pursuant to the terms of the trust. (***Harvey C. Hubbell Trust v. Comm.***, TCS 2016-67) Trusts are permitted to deduct charitable contributions under IRC §170, the same as individual taxpayers, but only if such contributions are specifically permitted by the terms of the trust. (IRC §642(c))

The Harvey C. Hubbell Trust was created upon the death of Mr. Hubbell. The trust provided for specific income amounts to its beneficiaries and granted the trustees broad power to control the trust's assets to carry out Mr. Hubbell's intent. The trust did not specifically allow for the trust to make charitable contributions, but Mr. Hubbell's attorney and trustees who knew him never had any reason to question that he intended the trust to make charitable contributions. The trust was well-funded and generated many times the income necessary to provide for the beneficiaries and make charitable contributions for many years.

Probate court's interpretation favors trust

After the inception of the Tax Court case for the disallowance of the charitable contributions, the trustees sought declaratory relief in the probate court for an official interpretation of the terms of the trust. The probate court judge declared that the trust authorized the trustees to make charitable contributions, and such interpretation was valid from the trust's inception.

Tax Court's interpretation does not favor trust

Despite a local probate court ruling in favor of the trustees' interpretation of the trust, and that courts are permitted to go beyond the provisions of a trust to determine the grantor's intent when the trust is unclear, the Tax Court ruled in favor of the IRS. (See ***Conkle v. Conkle*** (1972) 285 N.E.2d 883) The court held that the trust did not contain any unclear language, so it would not look beyond the language in the trust.

The trust instrument must authorize the fiduciary to make charitable contributions in order for a court to find that the charitable contributions were made "pursuant to" the terms of the trust. (***Old Colony Tr. Co. v. Comm.*** (1937) 301 U.S. 379) A trust does not need to require a trustee to make charitable contributions; merely authorizing the contributions and leaving them up to the discretion of the trustee is sufficient. (***Old Colony Tr. Co. v. Comm.***, supra.)

REPORTING REQUIREMENTS

For individual taxpayers, the charitable deduction is generally an itemized deduction reported on Schedule A. (IRC §63(d)) However, for the 2020 tax year, taxpayers could claim an above-the-line deduction of $300 and on the 2021 tax return non-itemizers may claim a $300 ($600 for MFJ) "below-the-line" deduction on Line 12b of the 1040.

On Schedule A, there are separate lines for the total amounts of gifts by cash or check, noncash, and carryovers from prior years. Out-of-pocket expenses incurred for charitable work are treated as cash expenses.

The instructions for Schedule A have been updated to reflect the charitable deduction limitation that applies if a taxpayer received a state or local tax credit in return for a charitable contribution.

For C corporations, the deduction is taken on Form 1120.

For flowthrough entities such as partnerships and S corporations, the deduction is shown as a separate line item on the K-1. (Treas. Regs. §§1.170A-1(j)(7), 1.1366-1(a)(2)(iii)) The K-1 is coded to let the partner or shareholder know the category of contribution (cash, noncash, percentage type, etc.).

FORM 8283

Filing requirements, generally

Taxpayers must generally use Form 8283, Noncash Charitable Contributions, if the amount of noncash gifts is more than $500. (Form 8283 Instructions)

C corporations

C corporations, other than personal service corporations and closely held corporations, must file Form 8283 only if the amount claimed as a deduction is more than $5,000.

A special rule applies to determine Form 8283 requirements for C corporations that donate inventory or scientific equipment. To determine if the corporation must file Form 8283 (or to determine which section to complete), a C corporation uses the difference between the amount claimed as a deduction and the amount that would have been claimed as costs of goods sold had the corporation sold the property instead.

This rule is only for purposes of Form 8283. It does not change the amount or method of computing the contribution deduction.

If the corporation does not have to file Form 8283 because of this rule, they must attach a statement to the return detailing the information described in the following example:

Example of inventory donation by C corporation

Ocean Atlantic Sportswear donates clothing from its inventory for the care of the needy (inventory donations and the exception for donations for the care of the needy are discussed beginning on page 32). The fair market value, and therefore the contribution deduction amount, is $8,000. If they had sold the property, the cost of goods sold amount would have been $5,000.

Contribution deduction	$8,000
Cost of goods (if sold, not donated)	(5,000)
Form 8283 reported amount	$3,000

Because its noncash charitable contribution amount ($8,000) is more than the $5,000 threshold for C corporations, it must file Form 8283. However, because the Form 8283 amount is under $5,000, they only must complete Section A and are not required to complete Section B. They must attach a statement to their return.

Sample statement

Statement with regard to inventory under Treas. Regs. §1.170A-13(c)(1)(ii)

Ocean Atlantic Sportswear
EIN 12-3456789
Form 1120, Tax Year Ending 12/31/20XX

This attachment to Form 8283 is made in support of the charitable contribution deduction shown on Schedule A for clothing taken from the corporation's inventory. It is based on the following amounts:

Contribution deduction: $8,000
Less: Cost of goods sold (if sold, not donated) $5,000
Amount for Form 8283 filing purposes: $3,000

Partnerships and S corporations

The contribution-level requirements are applied at the entity level, not at the partner or shareholder level. For example, a partnership must complete Section B of the Form 8283 if the deduction for a certain item or group of similar items is more than $5,000 even if the amount allocated to each partner is $5,000 or less.

The partnership or S corporation must give a completed copy of Form 8283 to each partner or shareholder receiving an allocation of a contribution deduction shown in Section B of the Form 8283 (i.e., the partnership or S corporation must supply a copy of Form 8283 if the entity completes Section B, generally meaning that the entity takes a charitable contribution deduction for noncash property of more than $5,000).

A partner or shareholder must combine the allocable amounts from a K-1 or K-1s with other noncash contributions made by the partner or shareholder to determine whether they must file a Form 8283 with their own return.

Section A

Donated items or groups of similar items with claimed values of $5,000 or less and certain publicly traded stock are listed in Section A. The property should be described in detail, and the greater the value of the property, the greater the detail.

Similar items of property are items of the same generic category or type such as coin collections, paintings, books, clothing, jewelry, etc.

> ***Example of similar items***
>
> Walter claims a deduction of $400 for clothing, $7,000 for publicly traded securities and $6,000 for a collection of 15 books ($400 each). He reports the clothing and securities in Section A and the books (a group of similar items) in Section B (for more than $5,000).

Section B

Generally, you will list items or similar groups of items valued at more than $5,000 in Section B. In addition, you will list any item requiring an appraisal (see appraisal requirements on page 22).

If an appraisal is required, Section B must also be signed by the appraiser and the donee organization.

Attachments

Appraisal

Generally you do not need to attach appraisals to the return, but you should keep them for your records. However, appraisals must be attached for:

- Art valued at $20,000 or more;
- Clothing and household items not in good used condition if the claimed deduction is more than $500;
- Easements on buildings in historic districts; and
- Deductions of more than $500,000 for individual items or groups of similar items.

Art valued at more than $20,000

If the total deduction for art is $20,000 or more, attach a complete copy of the signed appraisal. For individual objects valued at $20,000 or more, a photograph of sufficient quality and size to fully show the object must be provided upon request.

Easements on building in historic districts

In addition to attaching an appraisal, you must also attach photographs of the entire exterior of the building and a description of all restrictions on the development of the building.

Form 1098-C

If you donate a qualified vehicle with a claimed value of more than $500, you cannot claim a deduction unless you attach to your return a copy of the contemporaneous written acknowledgment you received from the donee organization. The donee organization may use Copy B of Form 1098-C, Contributions of Motor Vehicles, Boats, and Airplanes, as the acknowledgment and it may be attached to the return as the acknowledgment.

You should receive the 1098-C within 30 days of the sale of the vehicle.

If you e-file your return, attach a PDF of the 1098-C to the electronic record with your tax software if supported. If not, send the 1098-C with a Form 8453. (IRS Publication 526)

FORM 8283-V

In the case of a qualified conservation contribution that is a restriction relating to the exterior of a building located in a registered historic district for which a deduction of more than $10,000 is claimed, no deduction will be allowed unless the taxpayer includes a $500 filing fee with the return for the tax year of the contribution. (IRC §170(f)(13)(B)) The payment is made by filing Form 8283-V, Payment Voucher for Filing Fee Under Section 170(f)(13).

There is a separate $500 filing fee for each contribution that meets the requirements.

The Form 8283-V is not mailed with the individual's or entity's income tax return. It is mailed separately to a different address.

IRA-TO-CHARITY RULES

There are no special reporting requirements for qualified charitable distributions. (Instructions to Forms 1099-R and 5498) This means that your clients who made a qualified charitable distribution from their IRA account will receive a 1099-R listing all distributions made from the account during the year (including the qualified charitable distribution). This is not a problem because you will report the qualified charitable distribution amount on the client's 1040.

To report a qualified charitable distribution, list the total IRA distributions on Line 4a of the 1040. If the total amount distributed was a qualified charitable distribution, enter zero on Line 4b, and enter "QCD" (for "qualified charitable distribution") next to Line 4. If only part of the distribution amount was a qualified charitable distribution, you will need to calculate the correct taxable amount to enter on Line 4b and still enter "QCD" next to Line 4.

Your tax software should allow you to enter the amount of the IRA distribution that was a qualified charitable distribution, and then make the necessary adjustments and notations for you.

The Setting Every Community Up for Retirement (SECURE) Act, effective for tax years beginning January 1, 2020, raised the age for RMDs from 70½ to 72. The new rule does not apply to individuals who turned 70½ prior to the effective date.

The CARES Act enabled any taxpayer with an RMD due in 2020 from a defined-contribution retirement plan, including a 401(k) or 403(b) plan or an IRA, to skip those RMDs in 2020. This included anyone who turned age 70½ in 2019 and would have had to take the first RMD by April 1, 2020. This waiver did not apply to defined-benefit plans. The suspension did not affect the ability to make QCDs in 2020.

Individuals who are at least 70½ years old may exclude from gross income QCDs made directly from IRAs of up to $100,000 per year. (IRC §408(d)(8)(F)) These distributions are treated as distributions for RMD purposes. No charitable contribution deduction is allowed for these contributions, but they are excluded from income, so it is like an above-the-line deduction. See page 43 for more details.

Practice Pointer

Taxpayers must keep acknowledgement letters for charitable contributions even where the contributions were made directly from an IRA.

IRA-TO-CHARITY LIMITATION

Taxpayers who choose to make deductible IRA contributions after age 70½ will face a new limitation if they later make direct IRA-to-charity contributions, also known as qualified charitable distributions.

A taxpayer's annual qualified charitable distribution is reduced (but not below zero) by the excess of:

- All aggregate deductible IRA contributions made for years on or after the year the taxpayer reaches age 70½; over
- The aggregate amount of those contributions that have previously reduced QCDs for all years prior to the tax year at issue.
  (SECURE Act §107; IRC §408(d)(8)(A))

This means that each post-age-70½ deductible IRA contribution will reduce a taxpayer's qualified charitable distribution, even if the qualified charitable distribution is in a later year. However, the qualified charitable distribution will only be reduced up to the amount of each post-age-70½ deductible contribution.

For taxable years beginning after December 31, 2019, the IRA-to-charity contribution is reduced when a taxpayer makes a deductible IRA contribution after age 70½.

Example of SECURE Act's IRA-to-charity limitation

Jane is age 73 in 2020. Jane is still working and makes a $6,000 deductible traditional IRA contribution in 2020, 2021, and 2022, for a total of $18,000 over the three years. In 2023, she stops working and starts making annual $10,000 qualified charitable distributions from her IRA. Jane's qualified charitable distributions are reduced as follows:

2023 qualified charitable distribution		$10,000
Minus:		
2020, 2021 and 2022 deductible IRA contributions	18,000	
Prior QCD reductions	- 0	
Total current year QCD reductions	18,000	(18,000)
Jane's QCD for 2023		$ 0[1]

[1] The qualified charitable distribution cannot be reduced below zero; further reductions will happen in future years. In this example, $8,000 of post-age-70½ traditional IRA contributions will carry over to Jane's next taxable year.

2024 qualified charitable distribution		$10,000
Minus:		
2020, 2021 and 2022 deductible IRA contributions	18,000	
Prior QCD reductions	- 10,000	
Total current year QCD reductions	8,000	(8,000)
Jane's QCD for 2024		$ 2,000

2025 qualified charitable distributions		$10,000
Minus:		
2020, 2021 and 2022 deductible IRA contributions	18,000	
Prior QCD reductions	- 18,000	
Total current year QCD reductions	0	(0)
Jane's QCD for 2025		$10,000

Comment

We believe the disallowed qualified charitable distributions will qualify for charitable contribution deductions on Schedule A, because those amounts will be included in the taxpayer's taxable income. However, we will need clarification on this issue.

✐ **Practice Pointer**

For clients who make deductible IRA contributions after age 70½, practitioners should notify them that those cumulative contributions will reduce later qualified charitable distributions.

How to avoid this limitation

You could avoid the later limitation on qualified charitable distributions by contributing to a Roth IRA. The other option for taxpayers with no employees is to make a contribution to a SEP, a 401(k), or a profit sharing plan. Taxpayers who are still working can make contributions to these plans after age 70½, and though these contributions are deductible, they do not reduce future qualified charitable distributions if subsequently rolled into an IRA.

✐ **Practice Pointer**

The 1099-R should list the total distributions in Box 1 (Gross distribution), leave Box 2a (Taxable amount) blank, and check Box 2b (Taxable amount not determined). However, if there is an amount listed in Box 2a, this is not a problem because you will enter the correct taxable amount on Line 15b of the 1040.

CHARITABLE TRUSTS — FORM 5227

Charitable lead trusts and charitable remainder trusts do not file Form 1041 unless there is unrelated business taxable income. Instead, they file Form 5227, Split-Interest Trust Information Return, reporting items of income, deduction, distributions and other information.

The return is due April 15 for calendar-year taxpayers. You may request an automatic three-month extension to file using Form 8868. You may request an additional (not automatic) three-month extension also using Form 8868.

REVIEW QUESTIONS

Under the NASBA-AICPA self-study standards, self-study sponsors are required to present review questions intermittently throughout each self-study course. Additionally, feedback must be given to the course participant in the form of answers to the review questions and the reason why answers are correct or incorrect.

To obtain the maximum benefit from this course, we recommend that you complete each of the following questions, and then compare your answers with the solutions that immediately follow. *These questions and related suggested solutions are not part of the final examination and will not be graded by the sponsor.*

7. Qualifications for an appraisal include:
    a) The appraisal must be performed by a licensed appraiser with an official designation from a professional appraiser organization
    b) Appraisals can widely vary because there are no published standards on which appraisers can rely
    c) The appraisal must be signed by the appraiser no earlier than 60 days before the date of the contribution
    d) A complete copy of the appraisal must be attached to the return

8. Although charitable deductions are generally not allowed for donations of partial interests, there is an exception for a qualified conservation contribution. In addition:
    a) Capital gain property receives 30% treatment under IRC §170(b)(1)(E)(i)
    b) Qualified conservation contributions are allowed a five-year carryover period
    c) All qualified conservation contributions for which a deduction of more than $10,000 is claimed must pay a $500 filing fee with the return for the year of the contribution
    d) The conservation purpose must be protected in perpetuity

9. Qualified charitable distributions from IRAs:
    a) Must be made on or after the date the taxpayer reaches age 66
    b) May not be made to a private foundation
    c) Are included in taxable income
    d) Are deductible as charitable contributions

10. A charitable remainder unitrust differs from a charitable remainder annuity trust in which of the following ways?
    a) Additional assets may be contributed to a CRUT but not to a CRAT
    b) The annual payout must be at least 5% of the value of the trust assets for a CRUT but not for a CRAT
    c) The CRUT makes annual payments of a fixed dollar amount
    d) Only with a CRAT must the deficiency between the required payment and the trust income be made up with trust principal

SOLUTIONS TO REVIEW QUESTIONS

7. Qualifications for an appraisal include: **(Page 23)**

    a) Incorrect. Appraisers are not generally licensed or credentialed by the state or other governments (California is an exception). If the appraiser does not have a designation from a recognized organization, then they should have met certain minimum education requirements.
    b) Incorrect. Appraisals are required to be performed under the accepted appraisal standards under the Uniform Standards of Professional Appraisal Practice developed by the Appraisal Standards Board of the Appraisal Foundation.
    c) Correct. The appraisal must be signed by the appraiser no earlier than 60 days before the date of the contribution and not later than the due date of the return claiming the deduction, or the date on which an amended return is filed.
    d) Incorrect. A copy of the appraisal must be retained by the donor and made available upon request by the IRS. A complete copy of the appraisal must be attached to the return only in specific instances, for example, if there is a deduction of $500,000 or more.

8. Although charitable deductions are generally not allowed for donations of partial interests, there is an exception for a qualified conservation contribution. In addition: **(Page 36)**

    a) Incorrect. Capital gain property receives 50% treatment under this regulation.
    b) Incorrect. These contributions are allowed a 15-year carryover instead of the typical five years.
    c) Incorrect. This fee specifically applies to qualified conservation contributions with a restriction relating to the exterior of buildings located in registered historic districts.
    d) Correct. Also, an easement must be recorded before it can be considered protected in perpetuity.

9. Qualified charitable distributions from IRAs: **(Page 43)**

    a) Incorrect. In order to be a qualified charitable distribution, the distribution must be made on or after the date the taxpayer reaches age 70½.
    b) Correct. The distribution may not be made to a private foundation, donor-advised fund, charitable remainder trust, or charitable annuity trust.
    c) Incorrect. These distributions are not included in taxable income.
    d) Incorrect. These distributions are not deductible as charitable contributions.

10. A charitable remainder unitrust differs from a charitable remainder annuity trust in which of the following ways? **(Page 51)**

    a) Correct. This is true for a CRUT and is a benefit if the assets are not performing as expected.
    b) Incorrect. The payout rate is a minimum of 5% and a maximum of 50% for both a CRAT and a CRUT.
    c) Incorrect. This is true for a CRAT. For a CRUT, the payment is adjusted annually.
    d) Incorrect. The deficiency must be made up for both CRATs and CRUTs.

GLOSSARY

Adjusted gross income (AGI): income calculated from an individual's gross income (all income earned in the tax year) and used to determine what amount is taxable. The modifications to gross income are all above-the-line deductions and include, but are not limited to, medical expenses, unreimbursed business expenses, retirement plan contributions, alimony, and loss from the sale or exchange of property

Applicable federal rate (AFR): the IRS discount rate that is part of the calculation used to determine the charitable deduction for many types of planned gifts, including charitable remainder trusts. The rate equals 120% of the annual midterm rate, rounded to the nearest 0.2%

Coronavirus Aid, Relief, and Economic Security (CARES) Act: signed into law on March 27,2020, provides economic impact payments to qualified individuals, low-interest Payroll Protection loans for business with fewer than 500 employees per location, Employer Retention Credits, delays payroll tax payments, provides retirement plan benefits, expands unemployment insurance coverage for those impacted by COVID-19, and more tax relief for individuals and businesses

Charitable lead trust (CLT): works in reverse from charitable remainder trusts. In this case, the current beneficiary is the charity, and the remainder goes to the noncharitable beneficiaries. These trusts include charitable lead annuity trusts (CLATs) and charitable lead unitrusts (CLUTs)

Charitable remainder annuity trust (CRAT): a type of CRT that pays to the beneficiary a fixed percentage of the initial value of trust assets periodically (monthly, quarterly, etc.). The annuity amount must be at least 5%, but not more than 50%, of the initial net fair market value of all property contributed to the trust

Charitable remainder trust (CRT): a trust in which the noncharitable beneficiaries are the current beneficiaries, and the remainder interest goes to charity

Charitable remainder unitrust (CRUT): a type of CRT that pays to the beneficiary a fixed percentage of the revalued trust assets (as revalued annually) (not less than 5%, but not more than 50%)

Contribution base: generally adjusted gross income computed without regard to net operating loss carrybacks

Donor advised fund: a philanthropic vehicle administered by a public charity for the purpose of managing charitable donations from individuals, families, or organizations. The donor surrenders ownership of what is donated to the fund but may advise on how the account should be invested

Fair market value (FMV): the market value of property whereby an asset would be sold in a voluntary transaction between a willing buyer and a willing seller, both of whom are unrelated and under no obligation to buy or sell

IRA: individual retirement account that allows a person to save for retirement on a tax-deferred basis. With a traditional IRA, contributions may be able to be deducted on an individual tax return, and earnings grow tax-deferred until they are withdrawn. With a Roth IRA, after-tax contributions are made that may be withdrawn at retirement tax-free

IRC §199A deduction: a small business tax deduction under the TCJA. With respect to a trade or business, it is the actual deduction after subjecting the combined tentative deduction to the taxable income limitation and adding in any deductible amount with respect to co-ops, REITs, and PTPs

Net operating loss (NOL): a period when a company's allowable tax deductions are more than the company's taxable income with negative taxable income as a result. Prior to the TCJA, the loss could be carried back against income in prior years or carried forward as a deduction against future income. Under the TCJA, however, NOL carrybacks are largely repealed with limited exceptions. For losses arising in tax years beginning after December 31, 2017, the NOL deductions are limited to 80% of the taxpayer's taxable income for the year of the claimed deduction, but carryovers are allowed indefinitely. **New under the CARES Act:** NOLs are allowed to be carried back five years if they arose in the 2018, 2019, and 2020 taxable years for all taxpayers. The two-year carrybacks for farming losses and insurance company losses do not apply during this period. For taxable years beginning before January 1, 2021, the 80% taxable income limit for NOLs is repealed

Ordinary income property: property that would generate ordinary income, not capital gain, if sold rather than donated to charity, such as inventory held for sale to customers

Private foundation: a legal, nonprofit organization that qualifies for a tax exemption under IRC §501(c)(3) set up by an individual, family, or group of individuals and whose funds are managed by its own trustees

Qualified conservation contribution: a contribution of a qualified real property interest, including easements, to a qualified organization exclusively for conservation purposes. The conservation purpose must be protected in perpetuity

RMD: required minimum distribution, which is the minimum amount a taxpayer must withdraw from their retirement account every year by April 1 following the year they reach age 70½. This includes withdrawals from an IRA, SEP IRA, SIMPLE IRA, or retirement plan account. Roth IRAs do not require withdrawals until after the owner dies. Penalties apply if RMD is not taken. The Setting Every Community Up for Retirement (SECURE) Act, effective for tax years beginning January 1, 2020, raised the age for RMDs from 70½ to 72. The new rule does not apply to individuals who turned age 70½ prior to the effective date

Roth IRAs: a special retirement account where taxes are paid on money going into the account, but all future withdrawals are tax free

SECURE Act: Setting Every Community Up for Retirement Enhancement Act of 2019 enacted to impact almost all types of employer and retirement plans

SEP IRA: Simplified Employee Pension Plan, which allows self-employed individuals and small employers to contribute to retirement plans on behalf of themselves and their employees without the complexities of a qualified plan. All contributions are funded by the employer. Withdrawals are taxed as ordinary income

SIMPLE IRA: Savings Incentive Match Plan for Employees, a savings incentive match plan that allows employees and small employers to contribute to a traditional IRA. An eligible employer must have employed 100 or fewer employees who earned a minimum of $5,000 during the previous year.

An eligible employee is one who received at least $5,000 as compensation during any two years prior to the current calendar year and who is reasonably expected to receive at least $5,000 in the current calendar year. Employers cannot maintain any other qualified plan

50% charity: includes churches, education organizations, hospitals and medical research organizations, governmental bodies, and specific private foundations. Generally, taxpayers may deduct up to 50% of their adjusted gross income. The 50% ceiling applies only to contributions to 50% charities of cash, property that isn't certain capital gain property, and certain capital gain property for which the taxpayer has made the election to reduce the amount considered contributed. Under the TCJA, the 50% limitation is raised to 60% for cash contributions to 50% charities made after December 31, 2017, and before January 1, 2026

30% charity: includes charitable organizations that are not 50% charities such as war veterans organizations, organizations testing for public safety, fraternal orders, cemetery companies, and private foundations not meeting the requirements to qualify as 50% charities

INDEX

CHARITABLE CONTRIBUTIONS
Course description and study guide

Course objectives: This course is an up-to-date, comprehensive review and analysis of the tax treatment of qualified charitable deductions for individuals, business entities, and estates and trusts. Topics addressed include: basic rules of qualified charitable contributions; deductibility; carryovers; income limitations; noncash contributions; valuation; appraisals; substantiation; qualified charitable distributions from IRAs; donor advised funds; charitable remainder trusts; reporting requirements; and much more.

Completion deadline and exam: This course, including the examination, must be completed within one year of the date of purchase. In addition, unless otherwise indicated, no correct or incorrect feedback for any exam question will be provided.

Category: Taxes

Recommended CPE Hours: CPAs — 2 Tax
EAs — 2 Federal Tax
CRTPs — 2 Federal Tax

Level: Basic

Prerequisite: None

Advance Preparation: None

Course qualification: Qualifies for QAS and NASBA Registry CPE credit based on a 50-minute per CPE hour measurement

CPE sponsor information: Spidell Publishing, Inc. (Registry ID: 104931)

Expiration Date: February 2023*

*Exam must be completed within one year of the date of purchase

Learning assignment and objectives

As a result of studying the assigned materials, you should be able to meet the objectives listed below.

Assignment:

At the start of the materials, participants should identify the following topics for study:

- Deduction amounts and carryovers
- Noncash contributions
- Substantiation requirements
- Qualified charitable distributions from IRAs

Learning Objectives:

After completing this course, you will be able to:

- Recall the maximum deduction amount for charitable contributions from estates and complex trusts
- Identify when crowdfunding deductions are deductible
- Determine which factor weighs most heavily in the determination of the fair market value of real property
- Identify the carryover period for qualified conservation contributions
- Recall the tax differences between charitable remainder unitrusts and charitable remainder annuity trusts
- Identify the limitations when making a qualified charitable distribution from an IRA

After studying the materials, please answer exam questions 1-10.

Course Evaluation for Spidell Publishing, Inc.

Program title: **Charitable Contributions**

If applicable, program instructor: ______________________________

Program date: _______________ Participant name (optional): ______________________

Instructions: Please comment on all of the following evaluation points for this program and assign a number grade, using a 1-5 scale, with 5 as the highest rating.

1. Were the stated learning objectives met? _______________
2. If applicable, were prerequisite requirements appropriate and sufficient? _______________
3. Were the program materials accurate? _______________
4. Were program materials relevant, and did they contribute to the achievement of the learning objectives? _______________
5. Was the time allotted to the learning activity appropriate? _______________
6. If applicable, were the individual instructors knowledgeable and effective? ______________
7. Were the facilities and/or technological equipment appropriate? _______________
8. Were the handout and/or advanced preparation materials satisfactory? _______________
9. Were the audio and visual materials effective? _______________

IRS Course Number (if applicable): CRA7E-T-00560-22-S

TTP (CTEC) Course Number (if applicable): 1019-CE-1135

Date course completed: _______________

Number of hours it took to complete the course: _______________

SPIDELL
Spidell Publishing, Inc.®

Examination for Spidell's Charitable Contributions

PLEASE: Place the correct response for each question on the attached answer sheet and retain this examination for your records. If you purchased the online version, or would like to complete your exam online, please log-in to your SpidellCPE online account to submit your answers to the exam. 70% or more (7 of 10) correct responses are necessary to receive credit for this course. This course must be completed within one year of the date of purchase.

<u>Final Exam Questions</u>

1. A contribution given to a _______ is not deductible as a charitable contribution.
   a) School
   b) Public park
   c) War veterans' group
   d) Labor union

2. A contribution is made at the time of its delivery, which means:
   a) For a check: on the date on the face of the check
   b) For a text message: the year the text is sent if charged to the phone or wireless account
   c) For a promissory note: on the date the note is signed
   d) For pay-by-phone: on the date the call is made

3. Charitable contributions do not apply to which of the following?
   a) Gift of money
   b) Gift of property
   c) Value of personal services
   d) All of the above apply

4. The 60% limitation on the contribution base for contributions to "50% charities" made after December 31, 2017, and before January 1, 2026, applies to which of the following?
   a) Contributions for the use of a qualifying organization
   b) Property that isn't certain capital gain property
   c) Certain capital gain property for which the taxpayer has made the election to reduce the amount considered contributed
   d) Cash

5. The charitable contribution deduction for corporations cannot exceed _______ of its taxable income.
   a) 10%
   b) 15%
   c) 20%
   d) 30%

6. If corporate charitable contributions for a year exceed the percentage of taxable income limit, the excess may be carried over and deducted for up to _______ future years as long as the sum of carryovers and contributions for each of those years does not exceed the corporate taxable income limit.
   a) 3
   b) 5
   c) 7
   d) 10

Spidell Publishing, Inc.®

P. O. Box 61044 • Anaheim, California
***Phone:* (714) 776-7850 • *Fax:* (714)**
http://www.caltax.com

92803-6144 • *E-Mail:* cpe@spidell.com
776-9906 • *Website:*

7. Several factors are used in determining the fair market value of property. Which of the following factors weighs most heavily in this determination?

   a) Replacement cost
   b) Sales of comparable properties
   c) The cost or selling price of the item
   d) Expert opinions

8. For the purpose of donating a used car to charity, Congress has limited the deduction to the lesser of its fair market value or the amount the charity receives from its sale if the deduction claimed is more than _______.

   a) $1,500
   b) $1,000
   c) $750
   d) $500

9. When making a qualified charitable distribution from an IRA, taxpayers are allowed to exclude up to _______ from their AGI.

   a) $10,000
   b) $50,000
   c) $75,000
   d) $100,000

10. When evaluating the advantages and/or disadvantages of donor advised funds, which of the following is true?

   a) Donors may make a tax-free transfer to a donor advised fund from their IRA
   b) Donors may not hire themselves to do work for the fund
   c) The administration fees are comparatively high
   d) Donor advised funds require complicated legal documents when being set up

Name ____

Answer Sheet for Spidell's Charitable Contributions

Name: ________________________________ Signature: ______________________________

Company: _____________________________ No. of Hours to Complete (Max. 2): _________

Address: ____

City/State/ZIP: ____

Phone: _______________________________ Fax: ______________________________

E-mail: ____

License/Registration No.: ____________ ☐ CPA ☐ EA ☐ CRTP (CTEC) ☐ Atty

PTIN: ___________

If you are an EA or CRTP (CTEC), we must have your PTIN in order to report your hours to the IRS.

Deadline to Complete the Course: *In accordance with NASBA and IRS requirements, you have one year from the date of purchase to complete the examination and submit it to our office for grading.*

This examination is designed to test your knowledge on the content of **Spidell's Charitable Contributions**. We will grade the answer sheet, and if you answer 70% or more of the questions correctly you will be sent a certificate of completion. Passing CPAs will be recommended for two hours of continuing education credit, and passing EAs and CRTPs will be recommended for two federal tax hours of continuing education.

* Attorneys will be recommended for 1.5 hours of General MCLE/Tax Specialization credit.

Mail or fax this Answer Sheet to:

Spidell Publishing, Inc.
P.O. Box 61044
Anaheim, CA 92803-6144
Fax: (714) 776-9906

Name ____________________

Final Exam Questions

1. ☐ **a)** School
   ☐ **b)** Public park
   ☐ **c)** War veterans' group
   ☐ **d)** Labor union

2. ☐ **a)** For a check: on the date on the face of the check
   ☐ **b)** For a text message: the year the text is sent if charged to the phone or wireless account
   ☐ **c)** For a promissory note: on the date the note is signed
   ☐ **d)** For pay-by-phone: on the date the call is made

3. ☐ **a)** Gift of money
   ☐ **b)** Gift of property
   ☐ **c)** Value of personal services
   ☐ **d)** All of the above apply

4. ☐ **a)** Contributions for the use of a qualifying organization
   ☐ **b)** Property that isn't certain capital gain property
   ☐ **c)** Certain capital gain property for which the taxpayer has made the election to reduce the amount considered contributed
   ☐ **d)** Cash

5. ☐ **a)** 10%
   ☐ **b)** 15%
   ☐ **c)** 20%
   ☐ **d)** 30%

6. ☐ **a)** 3
   ☐ **b)** 5
   ☐ **c)** 7
   ☐ **d)** 10

7. ☐ **a)** Replacement cost
   ☐ **b)** Sales of comparable properties
   ☐ **c)** The cost or selling price of the item
   ☐ **d)** Expert opinions

8. ☐ **a)** $1,500
   ☐ **b)** $1,000
   ☐ **c)** $750
   ☐ **d)** $500

9. ☐ **a)** $10,000
   ☐ **b)** $50,000
   ☐ **c)** $75,000
   ☐ **d)** $100,000

10. ☐ **a)** Donors may make a tax-free transfer to a donor advised fund from their IRA
    ☐ **b)** Donors may not hire themselves to do work for the fund
    ☐ **c)** The administration fees are comparatively high
    ☐ **d)** Donor advised funds require complicated legal documents when being set up