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**Conrad Teitell's
Guide to Tax Benefits
For Charitable Gifts**

The federal government helps our clients be philanthropists with tax incentives that greatly reduce the out-of-pocket cost of charitable gifts and in many instances enable donors to contribute much more than they originally imagined.

In these troubled economic times, many of our clients believe that it is more important than ever to support worthwhile causes. Charities' endowments are down and the demand for their services has increased.

But, as the great Roman playwright Publius Terentius Afer (known as Terence) said more than 2000 year ago, "Charity begins at home." So for clients who want to help others, but need income themselves, charitable remainder trusts (CRTs) and charitable gift annuities (CGAs) are now more important than ever.

For those who are still wealthy (although, perhaps, a tad less than a few years ago), a charitable lead annuity trust (CLAT) is a savvy way to provide support for favorite charities (including their own private foundations) for a term of years with a gift of the trust's assets to family members at the end of the trust term. Low asset values and low Section 7520 rates make a CLAT a perhaps once-in-a-lifetime way to benefit charities and pass megabucks on to family members at no federal gift-tax cost.

Having said this, advisers need to know every jot and tittle of the tax law to assure clients' tax benefits. So, here's a rundown of the major rules, together with the relevant Internal Revenue Code sections, Treasury regulations, revenue rulings and court cases. Unless otherwise stated, it's assumed that an individual is making the gift to a public charity (for example, to a school, church, hospital or community foundation) or a private operating foundation (for example, a museum). Currently, only itemizers can deduct their charitable gifts.

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OUTRIGHT GIFTS

GIFTS OF MONEY—Deductible up to 50 percent of donor's adjusted gross income (AGI). Internal Revenue Code Section 170(b)(1)(A) and Treasury Regulations Section 1.170A-8(b). Five-

year carryover allowed for any “excess.” IRC Section 170(d)(1) and Treas. Regs. Section 1.170A-10(b).

Caveat: When the amount of the charitable contribution exceeds 50 percent of a taxpayer’s “contribution base,” any excess contribution is to be treated as a charitable contribution paid in each of the five succeeding taxable years in order of time. The carryover is good for the five years immediately following the charitable deduction, and some portion of the deduction expires each year, whether it is actually used or not. The maximum amount of the carryover must be used in each carryover year, up to that year’s adjusted gross income. The taxpayer cannot pick and choose when to take the deduction. *See Maddux*, T.C. Summ. Op. 2009-30 (March 4, 2009).

Appreciated securities and real estate held long-term—Deductible at the full present fair market value (FMV), with no tax on appreciation. *Campbell v. Prothro*, 209 F.2d 331 (5th Cir. 1954). Deductible up to 30 percent of AGI. IRC Section 170(b)(1)(C)(i) and Treas. Regs. Section 1.170A-8(d)(1). Five-year carryover allowed for any “excess.” IRC Section 170(b)(1)(C)(ii).

DEPRECIATED IN VALUE—If capital loss deduction is available, sell the property to establish that deduction. Then contribute the sales proceeds.

CEILING ELECTION—Under an election, a donor can increase the ceiling to 50 percent of AGI (with a five-year carryover for any “excess”) by making the same gift, but:

- reducing the amount deemed contributed for all long-term property gifts during the year by 100 percent of appreciation, and
- reducing the deemed contribution for long-term property gifts being carried over from earlier years. IRC Section 170(b)(1)(C)(iii), IRC Section 170(e)(1) and Treas. Regs. Section 1.170A-8(d)(2).

SECURITIES AND REAL ESTATE HELD SHORT-TERM—Deduction is for cost basis or current FMV, whichever is lower. IRC Section 170(e)(1)(A) and Treas. Regs. Section 1.170A-4(a)(1). Deductible up to 50 percent of AGI. IRC Section 170(b)(1)(A). Five-year carryover for any “excess.” IRC Section 170(d)(1) and Treas. Regs. Section 1.170A-10.

ORDINARY INCOME PROPERTY—Sale results in ordinary income. Treas. Regs. Section 1.170A-4(b)(1). For gifts of inventory, IRC Section 306 stock, collapsible-corporation stock, crops, artworks created by the donor and other “ordinary income” property gifts, deduction is allowed for property’s cost basis or current FMV, whichever is lower. IRC Section 170(e)(1)(A) and Treas. Regs. Section 1.170A-4(a)(1). Deductible up to 50 percent of AGI. IRC Section 170(b)(1)(A). Five-year carryover allowed for any “excess.” IRC Section 170(d)(1) and Treas. Regs. Section 1.170A-10(b).

DEPRECIABLE PROPERTY—Deduction for depreciable real estate and/or tangible personal property is reduced by what would have been taxed as ordinary income (under IRC Sections 1245 or 1250) if property had been sold. IRC Section 170(e)(1)(A).

APPRECIATED TANGIBLE PERSONAL PROPERTY—This includes works of art, antiques and books, held long-term. Treas. Regs. Section 1.170A-4.

RELATED GIFTS—Deduction is full present FMV, with no tax on the appreciation, if use of the property is related to donee’s exempt function (for example, a gift of a painting to an art museum or to a school for its art gallery.) Deductible up to 30 percent of AGI. IRC Section 170(b)(1)(C)(i). Five-year carryover allowed for any “excess.” IRC Section 170(b)(1)(C)(ii). Deductible up to 50 percent of AGI (with five-year carryover for any “excess”) if same election made as for gift of long-term securities or real estate. *See* “ceiling election,” in this guide.

UNRELATED GIFTS—If gift is unrelated to donee’s exempt function (*See* Treas. Regs. Section 1.170A-4(b)(3) for a general definition of “unrelated use”), deduction is for the cost basis or current FMV, whichever is lower. IRC Section 170(e)(1)(B)(i). Deductible up to 50 percent of AGI. IRC Section 170(b)(1)(A). Five-year carryover allowed for any “excess.” *See* IRC Section 170(d)(1).

The IRS recaptures related use tax benefits (FMV deductibility) if the property is not put to a related use by the donee. The rule applies to property that is identified by the donee on Form 8283 as made for a use related to the donee’s exempt purpose and for which a deduction of over \$5,000 is claimed. IRC Sections 170(e)(1)(B), 170(e)(7) and 6720(B).

GIFT OF WORK OF ART WITHOUT THE COPYRIGHT—Gift or bequest of work of art qualifies for gift and estate tax charitable deductions (but not income tax deduction) even though copyright isn’t transferred to charity, when the donee is a public charity described in IRC Section 501(c)(3), that is not a private foundation (under IRC Section 509), and the use is related to the donee’s charitable purpose. IRC Section 2055(e)(4); Treas. Regs. Section 20.2055-2(e)(1)(ii), IRC Section 2522(c)(3) and Treas. Regs. Section 25.2522(c)(3)(c)(1)(ii).

TANGIBLE PERSONAL PROPERTY HELD SHORT-TERM—Same as gifts of short-term securities and real estate.

CLOTHING AND HOUSEHOLD ITEMS—No deduction is allowed for a charitable gift of clothing or household items unless the clothing or household item is in good used condition or better.

Exception: A deduction may be allowed for a gift of an item of clothing or a household item not in good used condition or better if the amount claimed is more than \$500 and the taxpayer includes a qualified appraisal with his return. IRC Section 170(f)(16).

FRACTIONAL INTEREST GIFTS OF TANGIBLE PERSONAL PROPERTY; INCOME TAX TRAPS—A gift of an undivided portion of a donor’s entire interest in property is generally deductible. That interest must consist of a fraction (or percentage) of each and every substantial interest or right owned by the donor and must extend over the entire term of the donor’s interest. A charitable deduction isn’t allowable for a gift of a future interest in tangible personal property. IRC Section 170(a)(3) and Treas. Regs. Section 1.170A-5(a)(4). However, IRC Section 170(a)(3) has no application to a transfer of an undivided present interest in property. The value of a donor’s charitable deduction for the initial contribution of a fractional interest in long-term tangible

personal property is based upon the FMV of the related-use artwork at the time of the contribution of the fractional interest.

Additional contributions: For determining the deductible amount of each additional contribution of an interest in the same property, the Pension Protection Act of 2006 added an income tax special valuation rule for treatment of contributions of fractional interests in tangible personal property. Under this rule, the FMV of the item is the lesser of the FMV used for purposes of determining the charitable deduction for the initial fractional contribution, or the FMV of the item at the time of the additional (and subsequent) contribution. IRC Section 170(o). The special valuation rule created unintended consequences under the gift and estate tax laws. The Tax Technical Corrections Act of 2007 strikes the rule for estate and gift tax purposes, but retains it for income tax purposes.

TEN-YEAR OR EARLIER YEAR DEATH—If a donor makes an initial fractional contribution, then fails to contribute all of his remaining interest in the property to the same donee before the earlier of 10 years from the initial fractional contribution or the donor’s death, the donor’s income and gift tax charitable deductions for all previous contributions of interests in the item will be recaptured, plus interest. IRC Section 2522(e).

AUTOS WHEN CLAIMED VALUE EXCEEDS \$500—If a charity sells an auto worth more than \$500 without “any significant intervening use or material improvement by the charity,” the deduction can’t exceed the gross proceeds received from the sale. Under an exception, a donor may claim a FMV deduction if the vehicle is sold at a price significantly below FMV to a needy individual in direct furtherance of the donee’s charitable purpose of relieving the poor and distressed or the underprivileged who are in need of a means of transportation.

The deduction is not allowed unless the taxpayer substantiates the contribution by contemporaneous written acknowledgment by the charity. See IRC Section 170(f)(12). The charity may use a completed IRS Form 1098-C to comply with this requirement. The charity must also report the information in the acknowledgment to the IRS by filing Copy A of Form 1098-C.

GIFTS OF TAXIDERMY—The charitable deduction for gifts of taxidermy property contributed by the person who prepared, stuffed or mounted the property—or by any person who paid for those services—is the lesser of the taxpayer’s basis or the FMV. IRC Sections 170(e)(1) and 170(f)(15).

PATENTS—Initial deduction is limited to the lesser of the taxpayer’s basis in the patent or its FMV. An additional charitable deduction allowed in year of contribution and subsequent years based on a specified percentage ranging from 100 percent and reduced to 10 percent over a 12-year period of the “qualified donee (charity) income” received or accrued by the charity on the patent. IRC Section 170(e)(1)(m).

BARGAIN SALES—Charitable contribution is the difference between FMV and sale price of long-term securities and real estate. IRC Section 170(e)(2); *Magnolia Dev. Corp.*, 19 T.C. Memo 934; *Waller v. Commissioner*, 39 T.C. 665 (1963); *Gladstein v. Comm’r*, 68-1 USTC (D.C. Cir. 1968), para. 9197; and *Gamble v. Comm’r*, 681 USTC 9393 (D.C. Cir. 1968), para. 9393.

CAPITAL GAIN IMPLICATIONS—Cost basis of property must be allocated between portion of property “sold” and portion of property “given” to charity, based on the FMV of each. Appreciation allocable to sale is subject to capital gains tax; appreciation allocable to gift is not. See IRC Section 1011(b), Treas. Regs. Sections 1.1011-2 and 1.170A-4(c)(2).

Caveat: Outright gift of mortgaged property is considered a bargain sale. Treas. Regs. Section 1.1011-2(a)(3) and *Guest v. Comm’r*, 77 T.C. 9 (1981).

PARTNERSHIP GIFTS—Contributions are not deductible on partnership return, but are deductible by individual partners. IRC Section 702(a)(4) and Treas. Regs. Section 1.170A-1(h)(7).

CORPORATE GIFTS—Ceiling on deductibility is 10 percent of corporation’s taxable income. IRC Section 170(b)(2). Five-year carryover for any “excess.” IRC Section 170(d)(2).

A corporation on accrual basis may elect to deduct a gift on this year’s tax return even though the payment is to be made in the next tax year, if the gift is authorized by the board this tax year and payment made within two and a half months of the close of this tax year. IRC Section 170(a)(2) and Treas. Regs. Section 1.170A-11(b).

Corporations meeting certain tests get enhanced deductions for gifts of inventory (used by charity for the ill, needy or minors), or scientific equipment (used by colleges, universities or qualified scientific research organizations for research, experimentation or research training.) The deduction is for the property’s basis plus half of the appreciation, or twice the property’s basis, whichever is lower. IRC Sections 170(e)(3), (4) and Treas. Regs. Section 1.170A-4A.

Gifts of computer technology and equipment for educational purposes from kindergarten through 12th grade and for public libraries can qualify for the enhanced deduction (when tests are met), provided the gifts are made before the end of 2009.

FOOD INVENTORY GIFTS—For 2009, any taxpayer (not solely C corporations) engaged in trade or business is eligible to claim an enhanced deduction for donations of food inventory. IRC Section 170(e)(3)(C).

BOOK INVENTORY GIFTS—For 2009, a C corporation is entitled to an enhanced deduction for a gift of books to a public school that provides elementary education or secondary education (kindergarten through 12th grade) and is an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on. IRC Section 170(e)(3)(D).

For food and book inventory gifts, the property must be inventory contributed to an IRC Section 501(c)(3) charity (except for private non-operating foundations) and the donee must use the property consistent with the donor’s exempt purpose solely for the care of the ill, the needy or minors; not transfer the property in exchange for money, other property or services; and provide the taxpayer a written statement that the donee’s use of the property will be consistent with those requirements.

CONSERVATION GIFTS

Qualified conservation contributions aren't subject to the rules that generally bar deductions for gifts of partial interests in property. A qualified conservation contribution is a gift of a qualified real property interest to a qualified organization exclusively for conservation purposes. IRC Section 170(b)(E). A qualified real property interest is: the entire interest of the donor other than a qualified mineral interest; a remainder interest; or a restriction, granted in perpetuity, on the use that may be made of the real property.

Qualified organizations include public charities, governmental units and certain supporting organizations (an organization created and operated exclusively for the benefit of, to perform the functions of, or carry out the purposes of a charity.)

Conservation purposes include:

- the preservation of land areas for outdoor recreation by, or for the education of, the general public;
- the protection of a relatively natural habitat of fish, wildlife, plants, or similar ecosystem;
- the preservation of open space (including farmland and forest land) where that preservation will yield a significant public benefit and is either for the scenic enjoyment of the general public or under a clearly delineated federal, state or local governmental conservation policy; and
- the preservation of an historically important land area or a certified historic structure.

For 2009, the usual 30 percent AGI ceiling on deductibility for individuals doesn't apply to qualified conservation contributions. Instead, individuals may deduct the FMV of any qualified conservation contribution to a charity described in IRC Section 170(b)(1)(A) to the extent of the excess of 50 percent of AGI over the amount of all other allowable charitable contributions. These contributions aren't taken into account in determining the amount of other allowable charitable contributions. Individuals are allowed to carry over any qualified conservation contributions that exceed the 50 percent of AGI limit for up to 15 years instead of the usual five-year period. *See* IRC Section 170(b)(E)(i), (ii).

For an individual who is a qualified farmer or rancher for the taxable year in which the contribution is made, a deduction for a qualified conservation contribution is allowable for up to 100 percent of the excess of the taxpayer's AGI over the amount of all other allowable charitable deductions. IRC Section 170(b)(E)(iv).

IRA ROLLOVERS

For 2009, an individual age 70 1/2 or older can make direct charitable gifts from a traditional or Roth IRA—including required minimum distributions (RMDs)—of up to \$100,000 to qualified public charities (other than donor-advised funds and supporting organizations) and to operating and

pass-through foundations, and not have to report the IRA distributions as taxable income on his federal income tax return. This is for outright gifts only—not life-income gifts. There is no charitable deduction for the distributions. However, not paying tax on otherwise taxable income is the equivalent of a charitable deduction. IRC Section 408(d)(8).

Waiver of RMD for 2009. The Worker, Retiree, and Employer Recovery Act of 2008 waives any RMDs for 2009 from retirement plans that hold a participant’s benefit in an individual account such as 401(k) and 403(b) plans, certain 457(b) plans and IRAs. As a result, most participants and beneficiaries who might otherwise be required to take minimum distributions from such accounts are not required to withdraw any amount in 2009. If they do make a withdrawal in 2009, they might be able to roll over the withdrawn amount into another eligible retirement plan. However, any previously untaxed portion of the withdrawal that is not rolled over must be included in their gross income.

Distributions from a qualified IRA must be made directly by the IRA’s administrator or trustee to a qualified charity. A payment to the donor who then one second later gives it to the charity doesn’t qualify.

The exclusion won’t be available if the IRA distribution to the charity isn’t sufficiently substantiated. The charity must give the donor a written acknowledgment that it has received the IRA distribution and that no goods or services were given in connection with the IRA distribution. *See* IRS Notice 2007-7.

The entire distribution must be paid to the charity with no quid pro quo. The exclusion applies only if a charitable deduction for the entire distribution would have been allowable (determined without regard to the generally applicable percentage limitations.) Thus, if the donor receives (or is entitled to receive) a rubber chicken dinner in connection with the transfer to the charity from the IRA, the exclusion isn’t available for any part of the IRA distribution. That’s a “quid pro crow!”

PRIVATE FOUNDATIONS

For outright gifts to private foundations (other than private operating foundations):

SECURITIES, REAL ESTATE AND TANGIBLE PERSONAL PROPERTY HELD LONG-TERM—Deduction is for cost basis or current FMV, whichever is lower. IRC Section 170(e)(1)(B)(ii).

Exception: For pass-through foundations, deduction allowed for full present FMV when the private foundation, within two and a half months after the year of receipt, gives an amount equal to all gifts to public charities (schools, churches, etc.) or private operating foundations. IRC Sections 170(b)(1)(A)(vii), (E)(ii) and (iii) and Treas. Regs. Section 1.170A-9(g)(2)(iv), (v).

Note: Unless tangible personal property is put to a “related” use, deduction is limited to the lesser of current FMV and cost basis. IRC Section 170(e)(1)(B)(i).

LONG-TERM APPRECIATED PUBLICLY TRADED SECURITIES (SPECIAL RULE)—A deduction for the full FMV is allowable for contributions of stock for which, as of the contribution date, market quotations are readily available on an established securities market. This special treatment is available to the extent that the contribution—along with all prior contributions of stock in the same corporation by the donor and the donor’s family—do not exceed 10 percent of the value of the corporation’s outstanding stock.

Caution: Appreciated publicly traded stock subject to Securities and Exchange Commission Rule 144 is deductible at cost basis. Private Letter Rulings 9247018, 9320016, 9734034 and 9746050. But SEC Rule 145(e) stock (allowed to be sold under that rule) is deductible at present market value. PLR 9320007.

ORDINARY INCOME AND SHORT-TERM PROPERTY GIFTS—Deduction is for the lesser of cost basis and current FMV. IRC Section 170(e)(1)(A).

CEILINGS ON DEDUCTIBILITY—Thirty percent of AGI for cash and ordinary income property. IRC Section 170(b)(1)(B). Twenty percent of AGI for gifts of capital gain property. *See* IRC Section 170(b)(1)(D)(i).

EXCEPTION FOR PASS-THROUGH FOUNDATIONS—If certain distribution requirements are met, ceiling may be 30 percent or 50 percent of AGI, with five-year carryover for any “excess.” IRC Sections 170(b)(1)(A)(vii), (C)(iii).

CARRYOVER—Five-year carryover for “excess” gifts. IRC Section 170(b)(1)(B).

REDUCTION FOR SOME ITEMIZERS

Taxpayers must reduce their itemized deductions (except medical expenses, casualty and theft losses, and investment interest) by 1 percent of AGI over \$166,800 (over \$83,400 if married, filing separately) in 2009. This amount is adjusted annually for inflation. In any event, the 1 percent rule won’t take away more than 80 percent of the itemized deductions subject to that rule.

DELIVERY DATE

The delivery date determines valuation and year of deduction. Treas. Regs. Section 1.170A-1(b). Here are the rules:

SECURITIES—If mailed by U.S. mail, date of mailing is the delivery date; if delivered by other means (including private delivery services, such as FedEx) or if hand-delivered, date received by charity is the delivery date. To be effective, the delivery must be unconditional and the stock certificate must be properly endorsed. If the stock certificate is not endorsed, the donor should give the charity a properly endorsed power and the stock certificate. If securities are delivered to the donor’s bank or broker (as donor’s agent) or to the issuing corporation (or its agent) instructing the corporation to reissue in charity’s name, the delivery date is the date securities transferred to the charity on the corporation’s books (date on new stock certificate having charity’s name.)

For Depository Trust Company electronic transfers, the gift is “delivered” when the transfer to the charity’s account is completed.

CHECKS—If mailed by U.S. mail, date of mailing is delivery date; if delivered by other means (including private delivery services, such as FedEx), date received by charity is delivery date.

ARTWORK AND OTHER TANGIBLE PERSONAL PROPERTY—Date charity receives the property (and a deed of gift, if required by state law) is the delivery date.

REAL ESTATE—Date charity receives the properly executed deed is the delivery date (unless state law requires the deed to be recorded for title to pass; in that case, recording date is delivery date.)

PLEDGES—Deduction is taken in year fulfilled—not when made. IRC Section 170(a)(1). Satisfying pledge with property does not give rise to taxable gain or deductible loss. Revenue Ruling 55-410, 1955-1 C.B. 297.

FAIR MARKET VALUE

SECURITIES—When there is a market for securities on a stock exchange or over the counter, FMV is the mean between high and low on date of delivery (bid and asked prices on date of delivery if quoted selling prices not available.) Treas. Regs. Section 20.2031-2. Same rule for closed-end investment company shares.

VALUATION OF MUTUAL FUND SHARES (OPEN-END INVESTMENT COMPANIES)—FMV is the redemption price (bid). *See U.S. v. Cartwright*, 411 U.S. 546 (1973).

REAL ESTATE, WORKS OF ART AND OTHER PROPERTY NOT TRADED ON AN EXCHANGE OR OVER THE COUNTER—FMV is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. Treas. Regs. Section 1.170A-1(c)(2). Valuation is substantiated by expert appraisals. (*See* “Substantiating Deductions,” below.) Cost of appraisal is an IRC Section 212(3) deduction (subject to 2 percent floor on miscellaneous itemized deductions.) Percent of AGI ceiling on charitable contributions is inapplicable. Rev. Rul. 67-461, 1967-2 C.B. 125. For guidelines on appraisals, *see* Rev. Proc. 66-49, 1966-2 C.B. 1257 and Treas. Regs. Section 1.170A-13(c). *See Wortman v. Comm’r*, T.C. Memo. 2005-227, for an excellent primer on valuing real estate.

SUBSTANTIATING DEDUCTIONS

To deduct any gift of \$250 or more, a donor must have contemporaneous written substantiation from the charity (including a good faith estimate of the value of any goods or services given to the donor in exchange for the gift.) IRC Section 170(f)(8). If no goods or services were provided, the acknowledgment must so state. IRC Section 170(f)(8) and Treas. Regs. Section 1.170A-13(f)(2). The substantiation rules don’t apply, however, to charitable remainder unitrusts (CRUTs) or charitable remainder annuity trusts (CRATs). A contemporaneous written acknowledgment means

that the donor must have the receipt in hand *before* filing his or her timely income tax return. A letter to donors from a church in January 2008 stating that it had received donations in 2005 was not contemporaneous and the donors could not deduct the amounts claimed for 2005. *Gomez*, T.C. Summ. Op. 2008-93 (July 30, 2009).

Strict appraisal, appraisal summary (Section B to IRS Form 8283) and information reporting requirements are imposed when property gifts (other than marketable securities) are claimed as income tax charitable deductions. The rules apply to property contributions claimed at over \$5,000 per item or group of similar items, whether or not donated to the same charity (\$10,000 for closely held stock, but appraisal summary is required if claimed value is over \$5,000.)

Completed Form 8283 (Section B). A completed Form 8283 (Section B) includes: (1) the donor's name and taxpayer identification number (social security number if the donor is an individual or employer identification number if the donor is a partnership or corporation); (2) the donee's name, address, taxpayer identification number, and signature, the date signed by the donee, and the date the donee received the property; (3) the appraiser's name, address, taxpayer identification number, appraiser declaration, signature, and the date signed by the appraiser; (4) the following information about the contributed property: (a) the fair market value on the valuation effective date (as defined in Treas. Regs. Section 1.170A-17(a)(5)(i)); (b) a description in sufficient detail under the circumstances (taking into account the value of the property) for a person who is not generally familiar with the type of property to ascertain that the described property is the contributed property; (c) in the case of real or tangible personal property, the condition of the property; (5) the manner of acquisition (for example, by purchase, gift, bequest, inheritance, or exchange), and the approximate date of acquisition of the property by the donor, or, if the property was created, produced, or manufactured by or for the donor, the approximate date the property was substantially completed; (6) the cost or other basis, adjusted as provided by IRC Section 1016; (7) a statement explaining whether the charitable contribution was made by means of a bargain sale and, if so, the amount of any consideration received from the donee for the contribution; and (8) any other information required by Form 8283 (Section B) or the instructions to Form 8283 (Section B).

Substantiation of noncash charitable contributions of more than \$500,000. Generally, no income tax charitable deduction is allowed for a noncash charitable contribution of more than \$500,000 unless the donor: (1) substantiates the contribution with a contemporaneous written acknowledgment (as described in IRC Section 170(f)(8) and Treas. Regs. Section 1.170A-13(f)); (2) obtains a qualified appraisal (as defined in Treas. Regs. Section 1.170A-17(a)(1)) prepared by a qualified appraiser (as defined in Treas. Regs. Section 1.170A-17(b)(1)); (3) completes Form 8283 (Section B) and files it with the return on which the deduction is claimed; and (4) attaches the qualified appraisal of the property to the return on which the deduction is claimed.

Gifts of \$5,000 or less. Easier (but still detailed) reporting rules apply for property gifts valued at \$5,000 or less. *See* Treas. Regs. Section 1.170A-13 and Form 8283. No deduction is allowed for a noncash charitable contribution of more than \$500 but not more than \$5,000 unless the donor: (1) substantiates the contribution with a contemporaneous written acknowledgment; and (2) completes Form 8283 (Section A), "Noncash Charitable Contributions", or a successor form, and files it with the return on which the deduction is claimed. A completed Form 8283 (Section A) includes: (1) the donor's name and taxpayer identification number (social security number if the donor is an

individual or employer identification number if the donor is a partnership or corporation); (2) the name and address of the donee; (3) the date of the contribution; and (4) the following information about the contributed property: a description of the property in sufficient detail under the circumstances (taking into account the value of the property) for a person who is not generally familiar with the type of property to ascertain that the described property is the contributed property; in the case of real or personal property, the condition of the property; in the case of securities, the name of the issuer, the type of security, and whether the securities are publicly traded securities within the meaning of Treas. Regs. Section 1.170A-13(c)(7)(xi); and the fair market value of the property on the date the contribution was made and the method used in determining the fair market value.

C corporations must now meet the substantiation requirements that have long been required of individuals, closely held corporations, personal service corporations, partnerships and S corporations. IRC Section 170(f)(11). For quid pro quo gifts over \$75, the charity must inform donor that gift deduction is limited to excess of amount (or value of property transferred) over value received by donor. IRC Section 6115, Treas. Regs. Sections 1.170A-1(h)-13(f), 1.6115-1 and IRS Pub. No. 1771.

For cash gifts, regardless of the amount, recordkeeping requirements are now satisfied only if the donor maintains as a record of the contribution, a bank record (such as a cancelled check, bank or credit union statements and credit card statements) or a written communication from the donee showing the name of the donee and the date and amount of the contribution. The recordkeeping requirements will not be satisfied by maintaining other written records. Effective for contributions made in taxable years beginning after Aug. 17, 2006. For calendar year taxpayers, this means starting in 2007. IRC Section 170(f)(17). *See also* IRS news release IR 2006-192.

CASH CONTRIBUTIONS MADE BY PAYROLL DEDUCTION—A charitable deduction will not be allowed unless the donor receives a “written communication from the donee organization.” That communication includes a pay stub, Form W-2 or other document furnished by the employer that states the amount withheld during a taxable year by the employer for the purpose of payment to a donee organization, together with a pledge card or other document prepared by or at the direction of the donee organization that shows the name of the donee organization. An organization described in IRC Section 170(c), or an organization described in 5 CFR 950.105 (a Principal Combined Fund Organization for purposes of the Combined Federal Campaign), and acting in that capacity, that receives a payment made as a contribution will be treated as a donee organization for purposes of IRC Section 170(f)(17). *See also* IRS Notice 2006-110, 2006-151 IRB 1127.

APPRAISALS

QUALIFIED APPRAISER—A “qualified appraiser” is an individual with verifiable education and experience in valuing the relevant type of property for which the appraisal is performed. IRC Section 170(f)(11); Treas. Regs. Sections 1.170A-16(d)(1)(ii), 1.170A-16(e)(1)(ii). An individual is treated as having education and experience in valuing the relevant type of property, as of the date the individual signs the appraisal, if the individual has: successfully completed (for example, received a passing grade on a final examination) professional or college-level coursework in valuing the relevant type of property, and has two or more years of experience in valuing the

relevant type of property; or earned a recognized appraisal designation for the relevant type of property. The coursework must be obtained from: a professional or college-level educational organization described in IRC Section 170(b)(1)(A)(ii); a generally recognized professional appraisal organization that regularly offers educational programs in the principles of valuation; or an employer as part of an employee apprenticeship or educational program. A recognized appraisal designation is a designation awarded by a recognized professional appraiser organization on the basis of demonstrated competency. For example, an appraiser who has earned a designation similar to the Member of the Appraisal Institute (MAI), Senior Residential Appraiser (SRA), Senior Real Estate Appraiser (SREA), or Senior Real Property Appraiser (SRPA) membership designation has earned a recognized appraisal designation. The relevant type of property means the category of property customary in the appraisal field for an appraiser to value. Education and experience in valuing the relevant type of property are verifiable if the appraiser specifies in the appraisal the appraiser's education and experience in valuing the relevant type of property, and the appraiser makes a declaration in the appraisal that, because of the appraiser's education and experience, the appraiser is qualified to make appraisals of the relevant type of property being valued.

QUALIFIED APPRAISAL—An appraisal is qualified if it is prepared by a qualified appraiser (as defined above) following generally accepted appraisal standards and Treas. Regs. Section 1.170A-17(a). Generally accepted appraisal standards comply with the substance and principles of the Uniform Standards of Professional Appraisal Practice, as developed by the Appraisal Standards Board of the Appraisal Foundation are followed. A qualified appraisal is one that, among other things: is made not earlier than 60 days before the date of contribution and not later than the due date (including extensions) of the return on which an income tax charitable deduction is first claimed; is prepared, signed, and dated by a qualified appraiser.

A qualified appraisal must include the following information about the contributed property: a description in sufficient detail under the circumstances (taking into account the value of the property) for a person who is not generally familiar with the type of property to ascertain that the appraised property is the contributed property; for real or tangible personal property, the condition of the property; the valuation effective date; and the fair market value (within the meaning of Treas. Regs. Section 1.170A-1(c)(2)) of the contributed property on the valuation effective date.

A qualified appraisal must also include: (a) the terms of any agreement or understanding by or on behalf of the donor and donee that relates to the use, sale, or other disposition of the contributed property, including, for example, the terms of any agreement or understanding that: restricts temporarily or permanently a donee's right to use or dispose of the contributed property; reserves to, or confers upon, anyone (other than a donee or an organization participating with a donee in cooperative fundraising) any right to the income from the contributed property or to the possession of the property, including the right to vote contributed securities, to acquire the property by purchase or otherwise, or to designate the person having income, possession, or right to acquire; or earmarks contributed property for a particular use; (b) the date (or expected date) of the contribution to the donee; (c) the following information about the appraiser: name, address, and taxpayer identification number; qualifications to value the type of property being valued, including the appraiser's education and experience; if the appraiser is acting in his or her capacity as a partner in a partnership, an employee of any person (whether an individual, corporation, or partnership), or an independent contractor engaged by a person other than the donor, the name address, and

taxpayer identification number of the partnership or the person who employs or engages the qualified appraiser; (d) the signature of the appraiser and the date signed by the appraiser (appraisal report date); (e) the following declaration by the appraiser: “I understand that my appraisal will be used in connection with a return or claim for refund. I also understand that, if a substantial or gross valuation misstatement of the value of the property claimed on the return or claim for refund results from my appraisal, I may be subject to a penalty under section 6695A of the Internal Revenue Code, as well as other applicable penalties. I affirm that I have not been barred from presenting evidence or testimony before the Department of the Treasury or the Internal Revenue Service pursuant to 31 U.S.C. section 330(c);” (f) a statement that the appraisal was prepared for income tax purposes; (g) the method of valuation used to determine the fair market value, such as the income approach, the market data approach, or the replacement-cost-less-depreciation approach; and (h) the specific basis for the valuation, such as specific comparable sales transactions or statistical sampling, including a justification for using sampling and an explanation of the sampling procedure employed.

PROHIBITED APPRAISAL FEES—The fee for a qualified appraisal cannot be based to any extent on the appraised value of the property.

APPRAISER PENALTIES—A civil penalty is imposed on any person who prepares an appraisal that is to be used to support a tax position if the appraisal results in a substantial or gross valuation misstatement. The penalty is equal to the greater of \$1,000 or 10 percent of the understatement of tax resulting from a substantial or gross valuation misstatement—up to a maximum of 125 percent of the gross income derived from the appraisal. The penalty doesn’t apply if the appraiser establishes that it was “more likely than not” that the appraisal was correct. IRC Section 6695A.

SUBSTANTIAL AND GROSS OVERSTATEMENT OF PROPERTY VALUATIONS—Accuracy-related penalties are imposed on a taxpayer for substantial or gross valuation misstatements relating to an underpayment of income, gift and estate taxes. IRC Sections 6662, 6695A.

INCOME TAX—A substantial valuation misstatement exists when the claimed value of any property is 150 percent or more of the amount determined to be the correct value. A gross valuation misstatement occurs when the claimed value of any property is 200 percent or more of the amount determined to be the correct value.

ESTATE AND GIFT TAXES—A substantial estate or gift tax valuation misstatement exists when the claimed value of any property is 65 percent or less of the amount determined to be the correct value. A gross estate or gift tax valuation misstatement exists when the claimed value of any property is 40 percent or less of the amount determined to be the correct value. IRC Sections 170(f)(11)(E), 6662, 6664 and 6695A.

GIFT TAX REPORTING BY DONORS

OUTRIGHT GIFTS

Gifts that qualify for the \$13,000 annual-per-donee exclusion aren’t reportable whether made to an individual or a charity.

Outright charitable gifts of cash (including IRA rollovers) regardless of the amount and property gifts (regardless of the value) qualify for the unlimited gift tax charitable deduction and generally aren't reportable.

An outright charitable gift of a partial interest (e.g., an undivided one-fifth interest in Greenacre) is reportable. But no gift tax is payable because it qualifies for the unlimited gift tax charitable deduction.

If a gift tax return is required to report noncharitable gifts and there were also gifts to charities, these gifts to charity must also be included on the return.

SPLIT INTEREST GIFTS

Gift tax reporting is required for gifts to charities of remainder and lead interests. Offsetting gift tax charitable deductions are available for those gifts resulting in a wash. Taxes may, however, be incurred on a noncharity's interest in those arrangements if the gift is not offset by the \$13,000 annual exclusion and the lifetime \$1 million gift tax exemption. The rules differ—depending upon whether the gift is a unitrust, annuity trust, pooled income fund, gift annuity, deferred payment gift annuity, remainder interest in a personal residence or farm or charitable lead trust. And different rules often apply when the beneficiaries are spouses. There are different rules for citizen and non-citizen spouses. And to make things even more complicated, how the property is owned (separate property, joint ownership, tenancy in common, community property) and whether an income beneficiary is the first, joint or successor beneficiary must be taken into account. Also, the type of life-income plan must be considered.

REPORTING BY DONEES

The donee of any "charitable deduction property" that sells, exchanges, consumes or otherwise disposes of the property within three years after the gift must file an information return (Form 8282). IRC Section 6050L(a). "Charitable deduction property" is any property (other than money or publicly traded securities) valued at more than \$5,000 for which a donee-charity signs an appraisal summary (Section B of Form 8283). IRC Section 6050L(b); Treas. Regs. Sections 1.6050L-1(e), 1.170A-13(c)(4)(ii).

Form 8282 need not be filed by a charity if, at the time of the charity's signature, the appraisal summary it signed for the item contained the donor's signed statement that the appraised value of the item does not exceed \$500 (Treas. Regs. Section 1.6050L-1(a)(2)(i)); or when the charity's consumption or distribution of the charitable deduction property is in furtherance of its exempt purpose and without consideration (related use) (Treas. Regs. Section 1.6050L-1(a)(3)). The donee must file the information return within 125 days of disposing of the property. Treas. Regs. Section 1.6050L-1(f)(2)(i). But if, on the date it received the property, the donee had no reason to know that it would have to report its disposition, the due date for reporting is extended to 60 days after it learned that reporting was necessary. Treas. Regs. Section 1.6050L-1(f)(2)(ii). A copy of the donee information return must be provided to the donor, IRC Section 6050L(c); the charity must keep a copy as well. Each failure to file can subject the charity to penalties.

“Successor donees” must also report. A successor donee is one who receives property from an “original donee” (or another successor donee) for less than FMV. Treas. Regs. Section 1.170A-13(c)(7)(vii). A successor donee that receives charitable deduction property from a preceding donee must report its disposition of property transferred by the original donee. Treas. Regs. Section 1.6050L-1(c)(1).

PENALTIES—Penalties are imposed for failure to comply. IRC Sections 6721, 6722 and 6724. Civil and criminal penalties are imposed for negligence, fraud and valuation overstatements. IRC Sections 6662, 6663, 7206 and 7207. The ultimate penalty is called “Leavenworth.”

PERSONAL SERVICES

No charitable deduction for value of personal services rendered free for charity. *Grant v. Comm’r*, 84 T.C. 809 (1985), *aff’d*, (4th Cir. 1986) (unpublished opinion). Treas. Regs. Section 1.170A-1(g), Rev. Rul. 57-462, 1957-2 C.B.C.B. 157 and Rev. Rul. 1967-2 C.B.C.B. 103.

VOLUNTEER EXPENSES

Deductible when unreimbursed and incurred in rendering services for charity. Rev. Rul. 55-4, 1955-1 C.B.C.B. 291. The optional standard mileage rate is 14¢ per mile for unreimbursed automobile expenses. IRC Section 170(i). Unreimbursed parking and toll costs are also deductible.

Ceiling is 50 percent of AGI, with a five-year carryover. *Rockefeller v. Comm’r*, 76 T.C. 178, *aff’d*, 676 F.2d 35 (2d Cir. 1982) and Rev. Rul. 84-61, 1984-1 C.B. 39. No deduction is allowed for charitable travel expenses if “there is a significant element of personal pleasure, recreation or vacation” in the travel. IRC Section 170(j).

Unreimbursed babysitting expenses incurred to render volunteer services are not deductible. *See* Rev. Rul. 73-597, 1973-2 C.B. 69.

PATRON’S GIFTS

Contribution is amount transferred by donor minus value of theater ticket, meal or other privilege donor is entitled to receive. Rev. Rul. 67-246, 1967-2 C.B. 104; Rev. Rul. 86-63, 1986-1 C.B. 88; Rev. Proc. 90-12, 1990-1 C.B. 471; Rev. Proc. 92-49, 1992-1 C.B. 987 and Rev. Proc. 2008-66, 2008-45 IRB 1107, for special de minimis rule.

PAYMENTS FOR RIGHT TO PURCHASE ATHLETIC TICKETS—A special rule applies when a donor makes a charitable contribution to or for a college or university and is thereby entitled to purchase tickets to athletic events. A deduction is allowable for 80 percent of the amount paid to a tax-exempt institution of higher education for seating options—the right to buy tickets—at the institution’s stadium (but not for the price of the tickets themselves.) Twenty percent of the amount paid for the right to buy tickets for seating at college or university athletic events is treated as the right’s FMV. IRC Section 170(l), Treas. Regs. Sections 1.170A-13(f)(14) and 1.6115-1(c).

DEBTS AND LOANS

INSTALLMENT OBLIGATIONS—Gift of installment obligations (gain reported under IRC Section 453) accelerates remaining deferred gain in year of gift. Rev. Rul. 55-157, 1955-1 C.B. 293.

CHARITABLE LOANS—No income, gift or estate tax deductions for interest-free loan or rent-free use of property. IRC Section 170(f)(3)(A), Treas. Regs. Section 1.170A-7(a), IRC Sections 2522(c)(2) and 2055(e)(2).

Exceptions: Although uncharged interest is generally imputed to lender of interest-free loan, regulations exempt charitable loans up to \$250,000 per charity. Temp. Regs. Section 1.7872-5T(b)(9). Rent-free loan of artwork to public charity for a related use is exempt from gift tax. IRC Section 2503(g).

LIFE INSURANCE GIFTS

Donor names charity beneficiary of his insurance policy and irrevocably assigns incidents of ownership to it.

Caution: State law must permit a charity to have insurable interest in donor's life. PLR 9110016.

GIFT OF POLICY ON WHICH PREMIUMS REMAIN TO BE PAID—Income tax deduction is slightly above cash surrender value. Treas. Regs. Section 25.2512-6(a). However, if that amount exceeds policy's cost basis, deduction is for cost basis. IRC Section 170(e)(1)(A). Continued payment of premiums gives donor deduction for annual premiums. *Awrey v. Comm'r*, 25 T.C. 643 (1955).

GIFT OF FULLY PAID POLICY—Income tax deduction is generally replacement cost. Treas. Regs. Section 25.2512-6(a). But if that amount exceeds policy's cost basis, deduction is for cost basis. IRC Section 170(e)(1)(A).

ENDOWMENT POLICY—Charitable deduction for value minus amount that would be taxed as ordinary income on a sale. IRC Section 170(e)(1)(A). *But see* Treas. Regs. 1.170A-4(a).

Caveat: Donor has ordinary income of difference between cost and maturity value in year charity receives proceeds. Rev. Rul. 69-102, 1969-1 C.B. 32 and *Friedman v. Comm'r*, 41 T.C. 428, *aff'd*, 346 F.2d 506 (6th Cir. 1965).

Caution: Congress and IRS have clamped down on "charitable" insurance schemes. The strategy enables private investors to buy life insurance on other individuals' lives by making a charity a minor partner in the venture.

A temporary reporting requirement is imposed on the acquisition of interests in such life insurance policies. The penalty for failure to file the return is 10 percent of the value of the benefit of any contract with respect to which information is required to be included on the return. The law is applicable to transactions occurring after Aug. 17, 2006 and before Aug. 18, 2008.

CHARITABLE REMAINDER TRUSTS

In Rev. Proc. 2005-24, 2005-16 IRB 909, the IRS ruled that inter vivos CRUTs and CRATs were disqualified if a spousal right of election existed under state law. The IRS provided safe harbor procedures for avoiding disqualification by obtaining a waiver of the right of election. For trusts created before June 28, 2005, the Service ruled it would disregard the right of election, even without a waiver, but only if the spouse did not exercise the right of election. Rev. Proc. 2005-24, 2005-16 IRB 909. However, Rev. Proc. 2005-24 created many practical problems for donors, trustees, advisors and charities. In IRS Notice 2006-15, 2006-8 IRB 501, the Service stated that, until further notice, a spousal waiver of a right of election is no longer needed for CRUT and CRAT qualification. The Service extended the June 28, 2005 grandfather date indefinitely. Therefore, a spouse's right of election, even without a waiver, will be disregarded, but only if the surviving spouse doesn't exercise that right.

CRUTS—Specifies that the income beneficiary will receive annual payments determined by multiplying a fixed percentage (at least 5 percent but not more than 50 percent) by the net FMV of the trust assets determined each year. For each contribution to the trust, the value (determined under IRC Section 7520) of the remainder interest must be at least 10 percent of the net FMV of the property as of the date the property is contributed. IRC Section 664(d)(2)(D). On the death of the beneficiary (or survivor beneficiary, if there is more than one), the charity gets the remainder. IRC Section 664(d)(2).

A variation, net income with makeup charitable remainder unitrust (NIMCRUT), calls for the trustee to pay only trust income if actual income is less than the stated percentage. Deficiencies in distributions (when trust income is less than the stated percentage) are made up in later years if trust income exceeds the stated percentage. Under another variation, net income charitable remainder unitrust (NICRUT), deficiencies are not made up. IRC Section 664(d)(3) and Treas. Regs. Section 1.664-3(a)(1)(i)(b). The regulations prohibit pre-contribution capital gain as NIMCRUT and NICRUT income. TD 8791.

Regulations authorize “flip” unitrusts (FLIPCRUT), a NIMCRUT or NICRUT that switches to a standard (fixed percentage) CRUT (STANCRUT) on an allowable triggering event specified in the trust agreement. An allowable triggering event may be: (a) the sale of unmarketable assets, such as, real property, closely held stock or unregistered securities, held by the trust; (b) a specific date; or (c) a single event whose occurrence is not discretionary with, or within the control of, the trustee or any other persons. For maximum flexibility, use a FLEXCRUT, which is a FLIPCRUT drafted to give great flexibility in determining when, if ever, a NIMCRUT will flip to a STANCRUT. If the CRT is to flip on the sale of a parcel of real estate, on a specified date or event, that should be specified. However, for maximum flexibility, specify that the trust is to flip on the sale of an unimportant unmarketable asset that is one of the assets used to fund the trust.

Appraisal requirements on CRUTs funded with “unmarketable assets” are imposed for determining the trust's annual payment when the donor, the donor's spouse, a beneficiary or a related or subordinate party is the trustee.

CRATS—Specifies a fixed dollar amount (at least 5 percent but not more than 50 percent of the initial net FMV of transferred property) paid annually to the income beneficiary for life. The value of the charitable remainder interest, determined under IRC Section 7520, must be at least 10 percent of the initial net FMV of all property placed in the trust. IRC Section 664(d)(1)(D). On the death of the beneficiary (or survivor beneficiary, if there is more than one), the charity gets the remainder. IRC Section 664(d)(1). It is also essential that a CRAT pass the 5 percent probability test of Rev. Rul. 77-374.

For charitable remainder trusts (CRTs), the 50 percent maximum annual payout requirement applies to transfers to trusts after June 18, 1997. The 10 percent minimum remainder interest requirement is effective for transfers to trusts after July 28, 1997. The 10 percent requirement doesn't apply to transfers in trust under a will executed before July 29, 1997 if the decedent died before 1999 without having republished the will or, on July 28, 1997, was under a mental disability preventing him from changing the disposition of his property and didn't regain competence to dispose of the property before he died.

Regulations give a host of rules for CRUT and CRAT payments after year-end (by April 15) to satisfy the prior year's required payout. *See* TD 8791 and TD 8926.

GOVERNING INSTRUMENT REQUIREMENTS—To assure charitable deductions and avoid adverse tax consequences, a governing instrument must contain specific provisions. Treas. Regs. Sections 1.664-1 through 1.664-3; IRC Sections 508(e) and 4947(a)(2).

The IRS has issued specimen charitable remainder annuity trust agreements, Rev. Proc. 2003-53 through Rev. Proc. 2003-60, and specimen charitable remainder unitrust agreements, Rev. Proc. 2005-52 through Rev. Proc. 2005-59.

DEFECTIVE CRUT—substantial compliance doctrine inapplicable. The Court of Appeals for the Seventh Circuit ruled that a defective charitable remainder unitrust couldn't qualify based on the substantial compliance doctrine. Although the defective CRUT could have been patched up by a timely brought judicial proceeding, no proceeding was brought and the trust was never reformed, with or without a judicial proceeding. The IRS denied the charitable deduction on the ground that the charitable remainder, as defined in the trust, was not in a qualified charitable remainder trust because the trust didn't specify either a fixed dollar amount or a percentage of the trust's fair market value. The trust, as drafted, was clearly and fundamentally defective. However, the trust was administered by following the Code's CRUT requirements and this was stated on the estate tax return. The trustee argued that the statement on the estate tax return, coupled with the trustee's continued administration of the trust as if it were a qualified unitrust, should be deemed substantial compliance. The appellate court rejected this argument, ruling that the substantial compliance doctrine should not extend beyond cases in which the taxpayer had a good excuse for failing to comply with either an unimportant requirement or one "unclearly or confusingly" stated in the regulations or statute. The court ruled that the failure to bring the required judicial proceeding to reform the trust was neither an unimportant requirement nor was it stated unclearly or confusingly in the Code. The substantial compliance doctrine was, therefore, inapplicable. *See Estate of Tamulis*, 509 F.3d 343 (7th Cir. 2007).

Substantial compliance with the appraisal requirements. See e.g., *Bond*, 100 T.C. 32 (1993); *Fair*, T.C. Memo 1993-377; *D’Arcangelo*, T.C. Memo 1994-572; *Hewitt*, 109 T.C. 258 (1997).

Caveat: CRUTs and CRATs must be operated according to their explicit terms. In *Atkinson v. Comm’r*, 309 F.3d 1290 (11th Cir. 2002), *cert. denied*, 540 U.S. 946 (2003), a CRAT’s failure to comply with the required annual payment regulations resulted in complete loss of the estate tax charitable deduction where seven quarterly payments weren’t made. An additional estate tax of \$2,654,976 was incurred. That certainly got everyone’s attention. And in Technical Advice Memorandum 2006280268, a CRUT that wasn’t operated according to its terms was not qualified and was disregarded, even though the trust document met all the requirements of a CRUT. The trust should also meet state law investment requirements, such as prudent investor rules. See *Estate of Rowe*, 712 N.Y.S.2d 662 (N.Y. App. Div. 3d Dept. 2000), *motion for leave to appeal denied*, 725 N.Y.S.2d 637 (2001).

HOW PAYMENTS ARE TAXED TO RECIPIENT—For CRUTs and CRATs, amounts paid to the recipient retain the character they had in trust. Each payment is treated as:

- first, ordinary income to the extent of the trust’s ordinary income for the year and undistributed ordinary income for prior years;
- second, capital gain to the extent of the trust’s capital gain for the year and undistributed capital gain for prior years (which can be offset by any capital losses the beneficiary may have from other investments);
- third, tax-exempt income to the extent of the trust’s exempt income for the year and undistributed exempt income for prior years; and
- fourth, a tax-free distribution of principal.

Ordering rules also apply for classes of income within first and second categories. IRC Section 664(b) and Treas. Regs. Section 1.664-1(d).

Regulations, which apply retroactively, revise IRC Section 643(b)’s definition of income for NIMCRUTs, NICRUTs and FLIPCRUTs (before they flip) to take into account changes in how a state’s laws define trust accounting income. Treas. Regs. Section 1.643(b)-1.

TAX EXEMPTION; UNRELATED BUSINESS TAXABLE INCOME—For taxable years beginning before Jan. 1, 2007, IRC Section 664(c) provided that a charitable remainder unitrust or annuity trust would not be exempt from income tax for any year in which the trust had any unrelated business taxable income (UBTI) (within the meaning of IRC Section 512). Instead, the trust was taxed for each such year under subchapter J as though it were a nonexempt, complex trust. For taxable years beginning after Dec. 31, 2006, charitable remainder trusts that have UBTI remain exempt from federal income tax, but pay a 100-percent excise tax on their UBTI. IRC Section 664(c)(2)(A) provides that the amount of UBTI is determined under IRC Section 512. Under that section, UBTI is computed with the modifications in IRC Section 512(b) including the \$1,000 deduction in IRC Section 512(b)(12). The excise tax imposed under IRC Section

664(c)(2)(A) is treated as imposed under the excise tax rules that apply to private foundations and other tax-exempt organizations other than the rules for abatement of first and second-tier taxes (chapter 42, other than subchapter E of chapter 42). The IRS has issued proposed regulations that provide guidance under IRC Section 664 on the tax effect of UBTI on charitable remainder unitrusts and annuity trusts. These proposed regulations reflect the changes made to IRC Section 664(c) by Sections 424(a) and (b) of the Tax Relief and Health Care Act of 2006.

Four-Tier Taxation of CRT Beneficiaries. IRC Section 664(b) provides that distributions from a charitable remainder trust for the year that the annuity or unitrust amount is required to be distributed are treated in this order: (1) as ordinary income to the extent of the trust's ordinary income for that year and undistributed ordinary income for all prior years; (2) as capital gains to the extent of the trust's capital gain for that year and undistributed capital gain for all prior years; (3) as other income (for example, tax-exempt income) to the extent of the trust's other income for that year and undistributed other income for all prior years; and (4) as corpus. Income of the charitable remainder trust is allocated among the trust income categories without regard to whether any part of that income constitutes UBTI under IRC Section 512. The proposed regulations provide that the excise tax is reported and payable "in accordance with the appropriate forms and instructions." The appropriate form to report and pay the excise tax on charitable remainder trusts with UBTI is Form 4720, "Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code." The proposed regulations clarify that, consistent with Treas. Regs. Section 1.664-1(d)(2), the excise tax imposed upon a charitable remainder trust with UBTI is treated as paid from corpus and the trust income that is UBTI is income of the trust for purposes of determining the character of the distribution made to the beneficiary. *See* REG-127391-07, 73 Fed. Reg. 12,313.

INCOME TAX CHARITABLE DEDUCTION—Allowed for value of remainder interest; computed using Treasury tables. IRC Section 170(f)(2)(A).

VALUING PLANNED GIFTS—LONGER LIFE-EXPECTANCY TABLES—In valuing charitable life-income and charitable lead gifts measured by one or more lives, the IRS's tables take into account life expectancies *and* a prescribed interest rate for the month of the gift or either of the two prior months, at the taxpayer's election. Although the prescribed interest rates change monthly, the life expectancy component of the IRS's tables change once every 10 years. The Treasury has issued tables reflecting longer life expectancies. The new tables apply to transfers starting May 1, 2009, but see below for transitional rules.

Temporary regulations, which also serve as the proposed regulations, incorporate revised Table S (Single Life Remainder Factors) and Table U(1) (Unitrust Single Life Remainder Factors), effective for transfers for which the valuation date is on or after May 1, 2009 based on data compiled from the 2000 census as set forth in the recently issued Life Table 2000CM. The old tables, effective for transfers for which the valuation date was after April 30, 1999, and before May 1, 2009, are moved to sections containing actuarial material for historical reference. Table B, Table D, Tables F(4.2) through F(14.0), Table J, and Table K, which are not based on mortality experience, are not changed. With slightly longer life expectancies, the value of charitable remainders will be slightly lower and the value of lead trust remainders to family members will also be slightly lower.

Transitional rules:

- For *gift tax purposes*, if the date of a transfer is on or after May 1, 2009, but before July 1, 2009, the donor or donor's executor may choose to determine the value of the gift and/or any applicable charitable deduction under tables based on either Life Table 90CM (old tables) or Table 2000CM (new tables). However, the IRC Section 7520 interest rate to be utilized is the appropriate rate for the month in which the valuation date occurs, subject to these special rules for some charitable transfers.
- When a *charitable deduction* is involved (in accordance with this transitional rule and the rules contained in Treas. Regs. Sections 1.7520-2(a)(2), 20.7520-2(a)(2) and 25.7520-2(a)(2)), if the valuation date occurs on or after May 1, 2009, and before July 1, 2009, and the executor or donor elects under IRC Section 7520(a) to use the IRC Section 7520 interest rate for March 2009 or April 2009, the mortality experience contained in Table 90CM (old tables) must be used. If the executor or donor uses the IRC Section 7520 interest rate for May 2009 or June 2009, the tables based on either Table 90CM (old tables) or Table 2000CM (new tables) may be used. However, if the valuation date occurs after June 30, 2009, the executor or donor must use the new mortality experience contained in Table 2000CM even if the use of a prior month's interest rate is elected under IRC Section 7520(a).
- For *estate tax purposes*, the estate of a mentally incompetent decedent may elect to value the property interest included in the gross estate either under the mortality table and interest rate in effect at the time the decedent became mentally incompetent or under the mortality table and interest rate in effect on the decedent's date of death if the decedent was under a mental incapacity that existed on May 1, 2009, and continued uninterrupted until the decedent's death, or the decedent died within 90 days after regaining competency on or after May 1, 2009.

UNITRUSTS—Treas. Regs. Sections 1.664-3(d) and -4; IRS Pub. 1458 (Actuarial Values—Book Beth, Version 3B, Revised May 2009).

ANNUITY TRUSTS—Treas. Regs. Sections 1.664-2(c) and 20.2031-7; IRS Pub. 1457 (Actuarial Values—Book Aleph, Version 3A, Revised May 2009).

Caveat: Annuity trusts must meet “5 percent probability test” of Rev. Rul. 77-374, 1977-2 C.B. 329. *But see Moor*, 43 TCM 1530 (1982). A 1978 General Counsel's Memorandum (GCM 37770) proposed a ruling to the IRS (but was not issued by IRS) that would in limited circumstances, depending on the facts of each case, apply Rev. Rul. 77-374 to CRUTs.

Caution: Low charitable mid-term federal (CMFR) rates may result in not meeting the 10 percent minimum remainder interest requirement for charitable remainder trusts, the more-than-10 percent-gift portion for charitable gift annuities, and flunking the 5 percent probability test of Rev. Rul. 77-374 for charitable remainder annuity trusts.

CAPITAL GAIN—No capital gain incurred on transfer of unmortgaged appreciated assets to trust. Rev. Rul. 55-275, 1955-1 C.B. 295 and Rev. Rul. 60-370, 1960-2 C.B. 203. Similarly, there's no capital gain to donor on a sale by trust, except as taxable under four-tier system.

Exception: Gain taxable to donor if trust assets sold and invested in tax-exempt securities pursuant to agreement between donor and trustee. *See* Rev. Rul. 60-370, 1960-2 C.B. 203.

Caution: Don't fund unitrusts or annuity trusts with mortgaged property or donor-created undivided interests. PLRs 9015049 and 9114025.

SPECIALIZED SMALL BUSINESS INVESTMENT COMPANY—A small business investment company (SSBIC) is one way to avoid capital gain on an earlier sale. An SSBIC is a corporation or partnership licensed by the Small Business Administration, which finances small businesses owned by the disadvantaged. You can rollover tax-free up to \$50,000 of gain on publicly traded securities in any year (with a \$500,000 lifetime cap.) IRC Section 1044 and Small Business Investment Act of 1958 as amended, P.L. 85-699, 15 U.S.C. 681 et seq. The basis in the SSBIC is reduced by the amount of any gain not recognized on the sale of the publicly traded securities. Thus, any gain protected from tax on the rollover will be taxed on a later sale of the SSBIC stock. The SSBIC rollover can serve as a capital gains escape hatch for an individual who sold long-term appreciated publicly traded securities and then learns that he could have made an outright charitable gift of the securities—or transferred them to a charitable remainder trust for sale and reinvestment—without having to pay capital gains tax. The donor within 60 days of the sale of his publicly traded stock can use the sales proceeds (within the \$50,000 annual limit on gain) to buy stock in an SSBIC. Then, the donor either makes an outright gift of the SSBIC stock to charity or contributes the SSBIC stock to a charitable remainder trust. The charity can keep the SSBIC stock or sell it—without capital gains to the charity or the donor. And a charitable remainder trust can keep the SSBIC stock as an investment or can sell the SSBIC stock and reinvest the sales proceeds without capital gains to the donor or the trust.

ESTATE TAX—REGULATIONS:

The IRS has issued regulations that detail the estate tax consequences for charitable remainder annuity trusts and unitrusts created during a donor's life for the period of his or her life. The regulations confirm and amplify revenue rulings issued in 1976 and 1982 (*see* Rev. Ruls. 76-273 and 82-105). The proposed regulations didn't deal with the estate tax implications of inter vivos pooled income fund gifts or inter vivos gifts of remainders in personal residences and farms. The final regulations were amplified to cover these additional topics and provide additional relevant examples. The regulations provide that if a decedent transfers property during life to a trust and retains the right to an annuity, unitrust, or other income payment from the trust for his life or for a period that doesn't in fact end before his death, or for a period not ascertainable without reference to his death, he has retained a right to income described in IRC Section 2036. The portion of the trust corpus includible in the decedent's gross estate is that portion of the trust corpus, valued as of the date of his death (or the alternate valuation date, if applicable) necessary to yield that annual payment using the appropriate IRC Section 7520 interest rate. Because the specific portion of corpus includible in the gross estate is properly determined as of the decedent's death, the appropriate IRC Section 7520 rate is the rate in effect on the decedent's date of death (or on the alternate valuation date, if applicable).

The IRS and Treasury noted that in many cases both IRC Sections 2036 and 2039 may be applicable to annuity and unitrust interests and to other payments retained by a grantor. However, IRS and Treasury believe that in the interest of ensuring similar tax treatment for similarly situated taxpayers, the applicable provision is IRC Section 2036 and IRC Section 2039 shall not be applicable. *See* TD 9414, 73 Fed. Reg. 40173 (July 14, 2008).

GIFT TAX—IRC Section 2522(c)(2)(A). Value of the charitable remainder is fully deductible, so charitable gift is immune from gift tax. When there is a life interest other than donor's, there is a gift by donor to non-charity beneficiary of value of beneficiary's life interest. Value of that gift depends on type of property ownership and when other beneficiary's payments are to begin. It's often possible for donor to avoid gift tax (when donor is one of the beneficiaries) by reserving the right to revoke life beneficiary's interest by will only. Treas. Regs. Section 1.664-3(a)(4) and Rev. Rul. 74-149, 1974-1 C.B. 157.

GIFT AND ESTATE TAX MARITAL DEDUCTIONS—When donor's U.S. citizen spouse is the only other beneficiary, a marital deduction is allowed for the spouse's life interest. IRC Sections 2056(b)(8) and 2523(g). And a charitable deduction is allowed for the remainder interest. IRC Sections 2055(e)(2) and 2522(c)(2). Thus, there is no transfer tax. For 2009 gifts to alien spouses, an annual exclusion of \$133,000 in gift tax (adjusted annually for inflation) may be available and estate tax marital deduction may be available if qualified domestic trust (QDOT) rules are met. Treas. Regs. Section 20.2056A2(b).

EARLY TERMINATION OF CRT—The IRS approved the early termination of a CRT and division of the assets between the life tenant and the charitable remainder organizations (based on the value of their respective interests) where all the remainder organizations were public charities. Such termination would not be self-dealing by the donor or trustee under IRC Section 4941(a)(1). *See* PLR 200616035. *See also* PLRs 200252092, 200408031.

CRT CAPITAL GAIN AVOIDANCE PLAN ON IRS RADAR—Notice 2008-99 deals with the Treasury and IRS's concerns about early terminations of charitable remainder trusts by some donors who attempt to get back most of the assets of their charitable remainder trusts and avoid capital gains taxes by using the CRT to step-up the basis of the returned assets. Both the IRS and Treasury believe that this transaction has the potential for tax avoidance or evasion and are seeking information to determine whether the transactions should be identified as a tax avoidance transaction. The IRS identifies this transaction and substantially similar transactions as transactions of interest for purposes of Treas. Regs. Section 1.6011-4(b)(6) and IRC Sections 6111 and 6112. The IRS also alerts persons involved in these transactions to certain responsibilities that may arise from their involvement. The IRS and the Treasury are concerned about the manipulation of the uniform basis rules to avoid tax on gain from the sale or other disposition of appreciated assets. Transactions that are the same as, or substantially similar to, those described in Notice 2008-99 are identified as transactions of interest effective Oct. 31, 2008, the date Notice 2008-99 was released to the public. Persons entering into these transactions on or after Nov. 2, 2006, must disclose the transaction. Material advisors who make a tax statement on or after Nov. 2, 2006, with respect to transactions entered into on or after Nov. 2, 2006, also have disclosure and list maintenance obligations.

NIMCRUT TERMINATED; VALUING THE INTERESTS—The donor created a 10 percent NIMCRUT. Donor is the income beneficiary. Donor is trustee along with an independent special trustee. The remainder organizations are publicly supported charities. Donor wishes to terminate the NIMCRUT before the life beneficiary's death with the assets being divided between the income beneficiary and the charitable remainder organizations. The primary thrust of the ruling by the IRS is that the termination won't involve a prohibited act of self-dealing. However, the real significance of the ruling is how the IRS rules on the valuation of the income and remainder interests, which is not favorable to the donor/income beneficiary. Under an agreement with the taxpayer, the payout rate to be used in calculating the respective interests will be the lesser of the IRC Section 7520 rate in effect at the time of termination of the trust and the stated interest rate (unitrust amount) contained in the agreement.

Using the IRS methodology in this letter ruling, the donor's income interest is calculated as follows: The IRC Section 7520 rate for May 2006 is 5.8 percent. Assuming the termination occurred in May 2006, the lesser of this rate and the trust's stated payout percentage is 5.8 percent. The assumed taxpayer's age as of the nearest birthday is 75. Based on Table 90CM (see above for discussion of Table 2000CM), interest at 5.8 percent, and quarterly payments made at the end of each quarter, the present value of the remainder interest in a unitrust which falls in at the death of a person aged 75 is \$0.56904 for each \$1.00 of the trust estate. The present value of the payout interest in the same unitrust until such death is \$1.00, less \$0.56904, or \$0.43096 for each \$1.00 of the trust estate. The income recipient is not expected to receive more than he would during the full term of the trust under this methodology for valuing his interest in a charitable remainder trust with a net income make-up feature. *See* PLR 200725044.

CHARITABLE LEAD TRUSTS (CLATs and CLUTs)—A donor irrevocably transfers assets to a trustee who makes payments to a charity for a predetermined number of years (or for a term measured by one or more lives), with either a reversion to the grantor or a remainder to family members or other noncharitable remaindermen. The lead trust is the converse of the charitable remainder trust, in which the grantor, other noncharitable beneficiaries or both ("recipients") receive trust payments for life or a term of years (not to exceed 20 years), with a remainder interest to one or more charitable institutions.

IRS issues safe-harbor sample trusts. The IRS has issued sample inter vivos (non-grantor and grantor) and testamentary CLATs and CLUTs. There are numerous alternate provisions and instructive annotations. The IRS guarantees that CLATs and CLUTs that are "substantially similar" to the sample trusts or properly integrate one or more of the IRS's sample alternate provisions will be qualified trusts and the donor will receive the applicable charitable deductions. *See* Rev. Proc. 2007-45 (inter vivos non-grantor and grantor CLATs), Rev. Proc. 2007-46 (testamentary CLAT), Rev. Proc. 2008-45 (inter vivos non-grantor and grantor CLUTs) and Rev. Proc. 2008-46 (testamentary CLUT).

CHARITABLE GIFT ANNUITY—A donor irrevocably transfers money or property to a charity and receives a guaranteed income for life. The donor's income is a fixed percentage of the gift and remains constant for life. The transfer is part charitable gift and part purchase of an annuity.

Immediate payment charitable gift annuity: an annuity providing payments that begins within one year of the transfer.

Deferred payment charitable gift annuity: the annuity payments begin at a specified date more than one year after the transfer, usually starting at retirement.

Flexible starting date deferred charitable gift annuity: the donor's annuity agreement allows the donor, during a specified period in the future, to choose when the annuity payments are to begin. *See* PLR 200449033. *See also* PLR 9743054 and PLR 9017071 (two-life flexible payment gift annuity). The capital gains incurred when the gift annuity is funded with appreciated assets are not reportable until payments begin and would then be reported ratably over the life expectancy determined as of the starting anniversary date. *See* PLR 200742010.

Annuity payout rates: a charity decides the rates it will pay. The rate must meet state law requirements. Many charities use the rates recommended by the American Council on Gift Annuities. **Caution:** Low charitable mid-term federal (CMFR) rates may result in not meeting the more-than-10 percent-gift portion for charitable gift annuities.

Tax treatment of payments: a significant portion of each payment the annuitant receives is tax-free. Capital gain is incurred when a gift annuity is funded with appreciated property. However, the capital gain is not all reportable in the year of the transfer for the gift annuity. It is reported ratably over the annuitant's life expectancy when the annuity is nonassignable and donor is an annuitant.

CAVEAT ADVISOR. I hope that the above is helpful. But the law changes frequently. And although this Guide goes into considerable detail, this is just the tip of the IRSberg. So be careful out there.—Conrad Teitell