

# Trusts & Estates.

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

UPDATED  
MAY 2008

*The federal government helps your 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. To assure clients' tax benefits, advisors need to know every jot and tittle. 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 or library.) 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).

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 the 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 less. 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.

**Caveat:** 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. Reg. 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 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). However, 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. An exception to this rule is that 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*, 68-1 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 2007. [As of May 15, 2008, this provision has not yet been extended. It is believed that if the provision is extended, it will be retroactive to Jan. 1, 2008.]

**FOOD INVENTORY GIFTS**—For 2007, 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). [As of May 15, 2008, this provision has not yet been extended. It is believed that if the provision is extended, it will be retroactive to Jan. 1, 2008.]

**BOOK INVENTORY GIFTS**—For 2007, 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 nonoperating 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 2007, the usual 30 percent AGI ceiling on deductibility for individuals doesn't apply to qualified conservation contributions. Instead, individuals may deduct the fair market value (FMV) of any qualified conserva-

tion 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).

[As of May 15, 2008, this provision has not yet been extended. It is believed that if the provision is extended, it will be retroactive to Jan. 1, 2008.]

## IRA ROLLOVERS

For 2007, an individual age 70 1/2 or older can make direct charitable gifts from a traditional or Roth individual retirement account (IRA)—including required minimum distributions—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).

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!"

[As of May 15, 2008, this provision has not yet been extended. It is believed that if the provision is extended, it will be retroactive to Jan. 1, 2008.]

## 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 \$159,950 (over \$79,975 if married, filing separately) in 2008. 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, date of mailing is the delivery date; if delivered by other means 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.

**CHECK**—If mailed, date of mailing is delivery date; if delivered by other means, date received by charity is delivery date.

**ARTWORK AND OTHER TANGIBLE PERSONAL PROPERTY**—Date charity receives the property is the delivery date.

**REAL ESTATE**—Date charity receives the properly exe-

cuted 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 CB 297.

## FAIR MARKET VALUE (FMV)

**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, in this guide.) 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 CB 125. For guidelines on appraisals, see Rev. Proc. 66-49, 1966-2 CB 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

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.)

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.

To deduct any gift of \$250 or more, a donor must have 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).

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**—The appraiser is an individual who has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements to be determined by the IRS in regulations; regularly performs appraisals for which he or she receives compensation; can demonstrate verifiable education and experience in valuing the type of property for which the appraisal is being performed; has not been prohibited from practicing before the IRS by the Treasury at any time during the three years preceding the conduct of the appraisal; and is not excluded from being a qualified appraiser under applicable Treasury regulations.

**QUALIFIED APPRAISAL**—An appraisal is qualified if it is prepared by a qualified appraiser (as defined above) following generally accepted appraisal standards and any Treasury regulations or other guidance. 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; includes a description of the property appraised, the FMV of the property on the contribution date and the specific basis for the valuation, a statement that the appraisal was prepared for income tax purposes, the qualifications of the qualified appraiser, and the signature and taxpayer identification number of the appraiser; and doesn't involve an appraisal fee that is based on a percentage of the appraised value unless paid to a tax-exempt association of appraisers.

**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.

**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.

**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.

## REPORTING BY DONEES

Charities, charitable remainder trusts and charitable lead trusts disposing of donated property (subject to the appraisal requirements) within three years of receiving the gift must report its disposition to the IRS and the donor. IRC Section 6050L, Treas. Regs. Section 1.6050L-1 and Form 8282.

**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 CB 157 and Rev. Rul. 1967-2 CB 103.

## VOLUNTEER EXPENSES

Deductible when unreimbursed and incurred in rendering services for charity. Rev. Rul. 55-4, 1955-1 CB 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 carry-over. *Rockefeller v. Comm’r*, 76 T.C. 178, aff’d, 676 F.2d 35 (2d Cir. 1982) and Rev. Rul. 84-61, 1984-1 CB 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 CB 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 CB 104; Rev. Rul. 86-63, 1986-1 CB 88; Rev. Proc. 92-49, 1992-1 CB 987 and Rev. Proc. 98-61, 1998-2 CB 811 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 CB 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 CB 32 and *Friedman v. Comm'r*, 41 T.C. 428, aff'd, 346 F.2d 506 (6th Cir. 1965).

**Caution:** Congress is clamping 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 on an allowable triggering event (for example, sale of closely held stock) specified in the trust agreement.

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.

**CRAT**—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).

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); Rev. Rul. 72-395, 1972-2 CB 340; Rev. Rul. 82-128, 1982-2 CB 71; Rev. Rul. 82-165, 1982-2 CB 117; Rev. Rul. 88-81, 1988-2 CB 127; Rev. Rul. 92-57, 1992-2 CB 123; Rev. Proc. 89-20, 1989-1 CB 841; Rev. Proc. 89-21, 1989-1 CB 842; Rev. Proc. 90-30, 1990-1 CB 534; Rev. Proc. 90-31, 1990-1 CB 539; Rev. Proc. 90-32, 1990-1 CB 546; and Rev. Proc. 98-56, 1998-2 CB 667.

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 Seventh Circuit Court of Appeals 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*, 274 A.D.2d 87, 712 N.Y.S.2d 662 (N.Y. App. Div., 3d Dept. 2000), motion for leave to appeal denied, 96 N.Y.2d 707, 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 Regs. Treas. 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 trust 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.

**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.

**NIM-CRUT TERMINATED; VALUING THE INTERESTS**—The donor created a 10 percent net income with makeup charitable remainder unitrust (NIM-CRUT). 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 NIM-CRUT 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, 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, 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 minus \$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.

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

**UNITRUSTS**—Treas. Regs. Sections 1.664-3(d) and -4; IRS Pub. 1458.

**ANNUITY TRUSTS**—Treas. Regs. Sections 1.664-2(c) and 20.2031-7; IRS Pub. 1457.

**Caveat:** Annuity trusts must meet "5 percent probability test" of Rev. Rul. 77-374, 1977-2 CB 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.

**CAPITAL GAIN**—No capital gain incurred on transfer of unmortgaged appreciated assets to trust. Rev. Rul. 55-275, 1955-1 CB 295 and Rev. Rul. 60-370, 1960-2 CB 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 CB 203.

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

**ESTATE TAX—NEW:** Proposed Regulations:

The IRS has issued Proposed 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 Proposed Regulations confirm and amplify revenue rulings issued in 1976 and 1982 (see Rev. Ruls. 76-273 and 82-105). The Proposed Regulations don'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 Proposed 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 REG-119097-05, 2007-28 I.R.B. 74 (July 9, 2007).

**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 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 CB 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 2008 gifts to alien spouses, an annual exclusion of \$128,000 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 20.2056A-2(b).

**CHARITABLE LEAD ANNUITY TRUSTS (CLAT)—**

IRS issues safe-harbor sample trusts. The IRS has issued sample inter vivos CLATs (nongrantor and grantor) and a testamentary CLAT. There are numerous alternate provisions and instructive annotations. The IRS guarantees that CLATs 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 nongrantor and grantor CLATs) and Rev. Proc. 2007-46 (testamentary CLAT). The Service is still working on specimen charitable lead unitrusts.

**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.

**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.

**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. **TE**