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THE GIVING OF CHARITABLE GIFTS

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Foreword

Persons interested in making gifts to a charitable organization should contact them for more information. They also should consult their legal, tax, or estate planning advisers to determine the effects of any gifts upon their own estates and taxes.

Acknowledgements

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THE GIVING OF CHARITABLE GIFTS

by

Jerel Schimmelpfennig, Jerome E. Johnson, and Owen Anderson*

Giving gifts of personal and real property to charitable organizations is a part of the American way of helping support certain societal goals. The giver derives both personal satisfaction in helping advance her/his selected organization and obtains some tax benefits. The taxpayer can reduce both her/his current taxable income and the future tax liability of her/his estate by timely use of gifts.

The gifting taxpayer should check the charitable status of the organization. Only certain kinds are charitable. Most educational institutions (colleges or universities and their development foundations) are charitable. Charitable organizations will gladly indicate their charitable gift tax status upon request, so the donor can be assured that the gift will be a legal tax deduction.

A gift is any transfer of money or property for less than full and adequate payment. A federal gift tax is usually applied when a donor exercises her/his right to transfer property as a gift. Each person can give up to $10,000 in gifts each year to each donee and to any number of people tax free. Any amount over $10,000 given to any one person in one year is subject to the gift tax. The gift tax is normally imposed on the person giving the gift, but a gift may be given subject to the recipient paying the tax. Also, gifts to charitable organizations are not gift taxed. Gifts can reduce the value and therefore the tax liability of the donor's estate because these property will be owned by someone else when the donor dies.

This pamphlet looks at how gifts can be used to reduce income and estate taxes. Real property which has greatly appreciated in value may be a good item to gift away. There is much flexibility in gifting, where you can give a future interest in some property while retaining current use of it. Mineral interests are another type of property often given as gifts and are explored in this report.

How Gifts Reduce Taxable Income

Gifts to charitable organizations are deductible from adjusted gross income. The value of each gift reduces taxable income, dollar for dollar. A dollar given to a charitable organization results in that dollar not being taxed. The cost of a gift to the taxpayer is the value of the gift minus taxes saved. A taxpayer who is in the tax bracket where 50 percent of his added income is taken in taxes can shift that amount from the government to a charitable organization. For example, if he earns an additional $1,000 at the 50 percent tax bracket, $500 is his and $500 goes to the federal government. Suppose he were to give that $1000

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to a charitable organization. Since the $1000 is not taxable, the $500 that would have gone to the federal government goes to the charitable organization along with the $500 from his pocket. The real cost to the taxpayer of a $1000 gift is $500 because in effect the federal government "contributes" what it would have received in taxes.

Some general rules apply to all forms of charitable gifts. The organization receiving the gift must qualify as a charitable organization. The maximum deduction for charitable contributions in a tax year is 50 percent of a donor's adjusted gross income or 30 percent of adjusted gross income for gifts of appreciated capital gain property. Contributions which exceed the limitations may be carried forward for five years.

To compute the amount of the charitable deduction, the gift to each charitable organization receiving a gift must be reduced by the $10,000 annual exclusion. Gifts to charitable organizations reduce adjusted gross income only to the extent that they exceed the annual exclusion. The value of a gift is generally its market value at the time given. However, the deductible amount may be less than the value if the gift involves appreciated property, deductible interest, or a gift of a partial interest.

Added Benefits of Contributing Appreciated Property

Property which has a greater value at present than when bought is generally deductible at its full market value. When a taxpayer gives appreciated property he receives tax benefits not available to cash contributors: the appreciation in value is not taxed although the taxpayer is able to deduct it as a charitable contribution, so a taxpayer is able to purchase property, derive its ownership benefits, and then give it to a charitable organization. If he were to sell it at this point he would be subject to capital gains taxes on the appreciated value. Giving it to a charitable organization lets him avoid the tax on the capital gain, yet he can figure that gain as part of his gift.

The taxpayer has a choice when giving appreciated capital gain property. He can either (1) deduct up to 30 percent of his adjusted gross income, or (2) he can reduce the deductible amount by 40 percent of the property's appreciation in value and deduct up to 50 percent of his adjusted gross income. The taxpayer is electing to exchange a reduced deduction for each separate contribution of appreciated capital gain property for the more liberal 50 percent limitation. A taxpayer giving highly appreciated long-term capital gain property to a public charity can deduct the full value up to 30 percent of his contribution base and also give cash gifts for another 20 percent and thereby enjoy the full 50 percent limit by a combination of property and cash gifts.

Property having a value greater than that which the owner wishes to give can yield the same advantage as a gift of appreciated property. The owner sells the property at a reduced price to the charitable organization. A part of this transaction is a sale and a part is a charitable contribution. The difference between its fair market value and its sale price is considered a tax deductible gift. The seller is taxed on a part of the

the appreciation over cost, and only that share of the total gain which is allocated to the sale part of the transaction is subject to the capital gains tax.

Partial Interests: Giving a Future Interest and Retaining a Present Interest

A donor can give property by separating ownership into a present and a future interest. There are many ways to do this with the added advantage that the donor may allow the charitable organization to manage and invest the property. If the donor has retained ownership of the present interest, he is paid an annual sum taken from the property itself or its earnings. The death of the donor, or the person he/she designates to receive the annual payments, results in the charitable organization becoming the sole owner because it is the future interest holder.

For example, a person could give land, such as a farm, to a university and retain a life estate for himself and his wife so the givers can use it during their lives. Only after both have died would the university become sole owner of the farm. This type of gift is limited to certain specific methods. A gift to a charitable organization of a future interest in property yields tax treatment favorable to the taxpayer if one of the following is met:

1. The transferred property was either a personal residence; or
2. The transfer is to:
   a. A charitable remainder annuity trust; or
   b. A charitable remainder unitrust; or
   c. A pooled income fund.

The first situation allows a gift of a personal residence or a farm. A taxpayer can give future title to his personal residence or farm and still retain full use and responsibility for the property during his lifetime or during the lives of himself and/or a surviving spouse or beneficiary. Here the taxpayer has given the future interest in the property and retained a present interest. This gift can be given either while the taxpayer is alive through a life estate contract or through his will, reserving the present interest for a surviving spouse or other beneficiary. The amount that the taxpayer is allowed to deduct is the present value of the future interest. The charitable organization will not receive actual ownership and use of the property until some future time, so the deduction allowed is an estimate of the present value of that future interest.

The other three conditions use a trust in gifting a future interest. A trust allows the taxpayer to transfer property to a trustee who owns and manages it. The trustee pays current income to the taxpayer for a specified period of time after which the trustee transfers the assets to the designated charitable organization.

The annuity trust requires that a specific sum be paid at least annually to the donor or designated beneficiary. The amount paid must be not less than 5 percent of the initial fair market value of all property transferred to the trust. The period of payments must be either a term of years (not to exceed 20 years) or for the life or lives of the person(s) to receive the annuity. The trust assets must be transferred to a qualified charitable organization when the payments terminate.

The unitrust is similar to the annuity trust, but the amount paid annually to the trust beneficiaries must not be less than 5 percent of the net fair market value of the trust's assets which are valued annually. The pooled income fund is a trust into which a number of donors have transferred property. The trust income is paid to the donors and the principal is paid to qualified charities. All three trusts allow the donor an immediate deduction from adjusted gross income for the remainder that will be transferred to a charitable organization.

Gifts of Mineral Interests

Gifts of mineral interests to charitable organizations are generally treated the same as gifts of other property. The donor is generally able to treat the value of the gift as a charitable deduction. The value of the gift is the fair market value at the time of contribution. The amount of the charitable deduction is not required to be reduced by any intangible drilling and development costs previously deducted by the donor. Income from the property is excluded from the donor's income after the transfer of the gift.

The type of gift given affects the donor's ability to deduct the gift as a charitable deduction. For example, a gift of a production payment is treated as if it were a gift of a mortgage loan on the property, and its value would be taxed as of the date of the gift. As oil sales were applied on the oil payment they would be included in the donor's income and not in that of the charitable organization.

A mineral interest could generally be given through a trust. Use of an annuity trust, a unitrust, or a pooled income fund would allow the charitable organization to receive the benefits of the gift after the donor has died or after a period of years. Another approach is for the donor to give the current income interest for a period of years and to retain the remainder interest for himself. This approach is the reverse of the life estate described above.

However, specific rules apply when a person wishes to give part of his interest in property and not use a trust and still retain either present or future interest. For example, a charitable deduction was not allowed when land was given to a charitable organization because the donor retained all mineral rights and the sole right to exploit and sell the minerals.

Establishing the value of mineral interests given to a charitable organization can be difficult due to the speculative nature of such interests. In theory, fair market value is the amount that would induce a willing seller to sell and a willing buyer to buy. Evidence of fair market value includes bona fide offers to sell or purchase, sales of similar properties in the same general area, opinions of oil and gas or mineral developers, and appraisals by geologists or petroleum or mining engineers.