

Fall 2005

IRS CLARIFIES NEW RULES FOR DONATIONS OF VEHICLES

Amid growing concerns over inflated valuations, charitable contributions of used vehicles ran into a road block at the start of 2005. Beginning this year, provisions in the American Jobs Creation Act of 2004 (AJCA) established a whole new set of ground rules for determining the amount of deduction available for such gifts.

The AJCA added two new sections to the Internal Revenue Code: 170(f)(12) and 6720. Essentially, these new provisions limited the deduction to the gross proceeds realized upon sale of a vehicle by the charity unless the charity used the vehicle for its exempt purposes or made substantial improvements to it. In such cases, a donor can still take a deduction for the fair-market value of the vehicle in most cases.

The new provisions also created an affirmative duty on the part of the charity to provide appropriate acknowledgment to the donor of the sales proceeds or the retention of the vehicle by the charity for a qualified use. However, the legislation left several substantive and procedural questions unanswered. Recently the IRS issued Notice 2005-44; 2005-25 IRBI to provide

further guidance on how the new rules should be carried out.

Background. IRC §170(f)(12) contains rules for determining the amount that a donor may deduct for a charitable contribution of a qualified vehicle, whose claimed value is more than \$500. It also sets out substantiation and information-reporting requirements.

IRC §6720 imposes penalties on a donee organization that receives a contribution of a qualified vehicle subject to IRC §170(f)(12) and knowingly furnishes a false or fraudulent acknowledgment of the contribution to the donor, or knowingly fails to furnish the acknowledgment. These sections apply to contributions made after December 31, 2004. No deduction is allowed where the claimed value is more than \$500 unless the donor substantiates the contribution by a contemporaneous written acknowledgment that meets the requirements of IRC §170(f)(12)(B), including:

- The name and tax identification number of the donor
- The vehicle identification number
- The date of the contribution

Certain other certifications are required, depending on the use or disposition of the vehicle by the charity. To be considered

contemporaneous, the acknowledgment must be obtained within 30 days of the contribution or disposition of the vehicle by the donee organization, as applicable. A copy of the acknowledgment must be included with the donor's tax return on which the deduction is claimed.

Deductions in Excess of \$500.

If the charity sells the vehicle without any intervening use or material improvement, the deduction allowed may not exceed the gross proceeds of the sale, which must be reported on the acknowledgment. In no event may the deduction exceed fair-market value.

The donor may take a deduction for the fair-market value of the vehicle if the charity makes a significant intervening use or material improvement. According to §7.01(1) of the notice, a charity must actually use the vehicle to substantially further the organization's regularly conducted activities to constitute a "significant intervening use."

Similarly, a "material improvement" includes such things as a major repair that significantly increases the value, according to §7.01(2) of the notice. Interestingly, the notice expressly

excludes painting or repair of dents from this definition.

A fair-market value deduction may also be available if the charity gives or sells the vehicle at a significantly reduced price to a needy individual, according to §3.02(3). This applies, however, only if such a transaction is in “direct furtherance of a charitable purpose of the donee organization of relieving the poor and distressed or the underprivileged who are in need of a means of transportation.”

Acknowledgment

Requirements. Notice 2005-44 provides guidance on additional requirements for acknowledgments. If the vehicle is sold, the acknowledgment must contain the date of the sale, the amount of the gross proceeds, and a certification that the vehicle was sold in an arm’s length transaction between unrelated parties. An acknowledgment will be “contemporaneous” if the donee furnishes it to the donor no later than 30 days after the date of the sale (§3.03[2]).

If the charity plans to use or materially improve the vehicle, the acknowledgment must contain a certification and detailed description of the intended use and the intended duration of that use and certification that the vehicle will not be sold prior to completion of that use or improvement. It must be provided to the donor within 30 days of the

contribution to be considered contemporaneous (§3.03[3]).

Similarly, if the vehicle will be given or sold at a bargain price to a needy individual, the charity must certify that the transaction will be in direct furtherance of the charity’s charitable purpose of relieving the poor and distressed or underprivileged who are in need of transportation. Again, the acknowledgment must be furnished within 30 days of the date of the contribution (§3.03[4]).

A contemporaneous written acknowledgment is required under IRC §170(f)(8) if the claimed value of a donated vehicle is at least \$250 but not more than \$500. Such an acknowledgment should include a description of the vehicle (but not the value) and state the value of any goods or services the donor received in exchange for the contribution, if any. If a donated vehicle is sold (other than to a needy individual at a discount or as a gift) and the sale generates gross proceeds of \$500 or less, the donor may deduct the lesser of fair-market value or \$500 (§4.02).

There are numerous car valuation services available, both on-line or otherwise, and these services often provide multiple values for vehicles, such as trade-in, retail, and private-party value. The notice indicates that the IRS and the Treasury Department intend to issue regulations setting the private-party value as the maximum acceptable value for

deduction purposes. This will apply to all contributions after June 3, 2005.

Penalties. Charities that issue false or fraudulent acknowledgments or knowingly fail to furnish acknowledgments can face penalties under IRC §6720. Notice 2005-44 amplifies the application of those penalties.

An acknowledgment containing a certification that the vehicle will be retained for use, improved, or transferred to the needy under §3.03(3) or (4) will be presumed to be false or fraudulent if the vehicle is sold to a buyer other than a needy individual without a significant intervening use or material improvement within six months of the date of the contribution.

If the acknowledgment indicates a gross selling price higher than the actual gross selling price, the penalty will be the greater of either (1) the product of the highest marginal income-tax rate (currently 35%) and the selling price stated on the acknowledgment or (2) the gross proceeds from the sale of the vehicle. If the acknowledgment incorrectly indicates the vehicle will be used, improved, or transferred to a needy individual and the claimed value is more than \$500, the penalty is the greater of either (1) the product of the highest marginal income-tax rate and the claimed value of the vehicle or (2) \$500.

The Tax Relief Act of 2001

Impact on Estate and Gift Planning

Fewer and fewer estates will be affected by the federal estate tax for the rest of this decade as the exemption-equivalent amount climbs to \$3.5 million in 2009 (see chart at right). The tax is repealed for the year 2010. But unless repeal or higher exemption amounts are **reenacted** into law at that time, the estate tax of 2001 will be back in full force in 2011 with a \$1,000,000 exemption.

Rate and Exemption Schedule

Calendar Year	Exemption	Highest Tax Rate
2005	\$1.5 Million	47%
2006	\$2 Million	46%
2007	\$2 Million	45%
2008	\$2 Million	45%
2009	\$3.5 Million	45%
2010	Estate Tax Repealed	

Tax Preparer Unprepared to Substantiate Deductions

A taxpayer who made his living as an income-tax preparer was found to have woefully inadequate records to substantiate his and his wife's own claimed deductions in a recent decision by the Tax Court (*Marcus V. Booker et ux v. Commissioner*; TC Summ. Op. 2005-90, No. 14036-03S).

Upon review of the taxpayers' return for 1999 and 2000, the IRS had denied their claim of a dependency exemption for a parent, business deductions, and charitable-contribution deductions due to lack of documentation to substantiate their claims. In addition, the Bookers were assessed additional tax for failure to timely file and were also assessed negligence-related penalties.

The 1999 return contained claims for \$2,400 of charitable contributions of cash and \$9,250 of noncash contributions. In 2000, the Bookers again claimed \$2,400 of cash contributions and \$11,005 of noncash contributions.

IRC §170(f)(8)(A) provides that no deduction is allowed for any contributions of \$250 or more unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgment of the contribution by the donee charity. A taxpayer is required to include in the records a "good faith estimate" as to the value of noncash property contributed in kind (IRC §170(f)(8)(B)(iii)).

At trial, the Bookers did present receipts as evidence to support their deductions but admitted that they were issued in blank by the charities and filled in by the taxpayers. The receipts purported to establish that the taxpayers made significant in-kind contributions during 1999, including at least 71 bags of clothing, 4 humidifiers, 4 dehumidifiers, 4 vacuum cleaners, 6 chairs, and 25 wall fixtures. In addition to the problems with the receipts, the Court found the taxpayers' estimate of \$9,250 to be inflated and not in good faith and denied the entire amount.

In regard to the cash contributions, Mr. Booker told the Court, "I just made a rough estimate." The taxpayers testified that the amount included cash donations to several churches, Mrs. Booker's mother, and several street beggars. The Court pointed out that any amounts given to relatives or to street beggars would not have been qualified deductible contributions under IRC §170(c) in any event and disallowed the entire \$2,400. All of the charitable deductions claimed for 2000 were also denied on the same grounds.

The Tax Court also upheld a penalty finding that the taxpayers were negligent or disregarded rules or regulations in filing their returns. Finally, the Court agreed with the IRS's assessment of additional tax under IRC §6651(a)(1) for failure to file a timely return.

Breaking Up Not So Hard to Do

A married couple created a charitable remainder unitrust (CRUT) under IRC §664. The trust was a standard CRUT, which distributed 10% of its annual value to the couple out of income and, to the extent income was not sufficient, out of principal. Upon the death of either spouse, the surviving spouse would continue to receive the entire 10% distribution.

Now the couple is asking the IRS to approve the division of the CRUT into two separate trusts, with the trust's assets divided equally and on a pro rata basis between the two new trusts—all presumably pursuant to a divorce. Each spouse would be the current income beneficiary of one of the trusts. Each spouse would also continue to have a contingent survivorship interest in the trust currently benefiting the other spouse. In a recent private letter ruling, the IRS determined that such a division should be allowed and would not have any negative tax consequences (Ltr. Rul. 200524013).

The IRS determined that the original trust as currently constituted satisfies all requirements for a qualified CRUT under IRC §664. Since the trust will simply be divided equally into two separate trusts, nothing would prevent the new trusts from being qualified CRUTs.

E-mail Discussion Lists for Gift Planners

- **ABA-TAX** A tax-law Internet discussion group sponsored by the American Bar Association Tax Section. Participation is limited to practitioners, law professors, and law students. <http://www.abanet.org/tax/lsinfo.html>
- **ABA-PTL** Sponsored by the Probate Division of the Real Property, Probate & Trust Law Section of the American Bar Association, intended primarily for the use of Section members and related professionals so they can discuss estate-planning and administration issues by e-mail. <http://mail.abanet.org/scripts/wa.exe?SUBED1=aba-ptl&A=1>
- **FUNDVCS** Fund-raising services technical discussion list. <http://lists.duke.edu/archives/fundsvcs.html>
- **Yahoo PLANNED GIVING** An open list for discussion of gift-planning topics. <http://groups.yahoo.com/group/plannedgiving/>
- **GIFT-PL** NCPG members-only discussion list for all issues and queries related to gift planning. http://www.ncpg.org/members/gift_pl.asp?section=4

Reg. §1.1001-1(a) provides that, generally, gain or loss from an exchange of property for other property differing materially either in kind or extent is treated as income or as loss sustained. IRC §1041(a) further provides that no gain or loss will be recognized on a transfer of property from an individual to (or in trust for the benefit of) a spouse, or former spouse if the transfer is incident to divorce.

In this case, the IRS determined that the property interests acquired by each spouse in a division of the trust would be substantially similar to the interests each held before. Even if the interests were different, IRC §1041(a) would apply, according to the ruling, and there would be no gain or loss recognized by either spouse in any event.

Because, as a split-interest trust, the CRUT is treated as if it were a private foundation, the proposed division raises questions of whether it would constitute a termination of the private foundation status under IRC §507(a)(1). Since the proposed transfer will neither be for full and adequate consideration nor a distribution out of income, the transfers will be IRC §507(b)(2) transfers. Such transfers, according to the ruling, do not constitute a termination unless the trust gives voluntary notice of termination.

Likewise, since the two new trusts will be treated as if they were the original trust for purposes of IRC §4941, the division will not result in self-dealing. Moreover, it will not be a taxable expenditure under IRC §4945(d) since the transfer of assets will be to an organization described in IRC §4947.

Finally, the trust would incur expenses in effecting the division. As long as those expenses were reasonable, payment of the expenses would not constitute taxable expenditures. Because the trust had already obtained approval for the division from the appropriate state court contingent on IRS approval, the ruling cleared the way for the division to move ahead.

BRIEFLY...

Disclaimer Effective to Secure Deduction. A disclaimer of an interest under a will resulting in assets passing to charity has been deemed sufficient for the estate to be able to claim a charitable deduction (Ltr. Rul. 200519042).

A decedent's daughter disclaimed a portion of her interest under the decedent's will, causing assets to pass to a foundation of which she was president. The foundation had taken substantial steps to ensure both that the assets so passing

would go into a special fund over which the daughter had no control and that she would have no control of the membership of the committee administering that fund. As such, the IRS was satisfied that the daughter would have no prohibited ability to benefit from or control the benefit of the funds and approved a charitable deduction for the estate.

IRS Grants Additional Time to Dispose of Excess Business Holdings. A private foundation was given additional time to dispose of complex excess business holdings in a recent private letter ruling (Ltr. Rul. 200524030). Typically, when a foundation's holdings in certain business interests exceed threshold amounts, the excess holdings must be disposed of within five years.

In this case, the foundation received interests that were part of a group of complex and related businesses. Despite good faith efforts to dispose of the holdings at a reasonable price, the foundation was unable to do so within the first five years. The IRS was satisfied that the foundation had been diligent in its efforts and that it had presented a reasonable plan for disposal of the holdings in the future. Consequently, it granted the foundation an additional five years under IRC §4943(c)(7).

Financial Strategies is distributed to a select group of attorneys, accountants, trust officers, insurance advisors, investment counselors, and financial planners. It is designed to keep philanthropic planners up to date on developments in estate planning as they relate to testamentary and lifetime plans of support of qualified charities.

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