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# FINANCIAL STRATEGIES

For estate planning and planned giving.

- Legislation
- Court decisions
- IRS developments

UNIVERSITY OF  
**ROCHESTER**

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Winter 2006

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## PRESIDENT'S ADVISORY PANEL MAKES RECOMMENDATIONS ON CHARITABLE GIVING

The President's Advisory Panel on Federal Tax Reform recently presented its final report with recommendations for overhauling the federal income-tax system. Included in the 307-page report were recommendations for "Improving Tax Benefits for Charitable Giving."

The Panel made several recommendations "[to] strengthen incentives for charitable giving and to improve tax administration...." According to the Panel, these recommended changes would simplify the deduction for charitable contributions and make charitable incentives available to more taxpayers while reducing opportunities for abuse of deductions.

The Panel offered one or more recommendations under four general categories:

**I. Providing Better Incentives to Give to Charity.** Under current law, only taxpayers who itemize deductions realize a direct tax benefit from their charitable contributions. According to the Joint Committee on Taxation, the report noted, "more than three-fourths of the estimated tax expenditure for the charitable

contribution deduction went to the 12% of taxpayers who had cash income of \$100,000 or more in 2004."

Expressing the opinion that a tax benefit for charitable contributions should be available to all taxpayers who give to charity, the Panel made two recommendations to create incentives to give to charity:

**RECOMMENDATION—*Create a deduction for charitable contributions that exceed 1% of income. The deduction would be available to all taxpayers.***

The report indicates that the 1% threshold is based on the observation that most taxpayers already contribute more than 1% of income to charity. In 2003 approximately 74% of taxpayers who claimed a deduction for charitable giving contributed more than 1% of adjusted gross income (AGI). The Panel also felt that the 1% threshold would reduce the recordkeeping burden and potential for cheating on small deductions.

COMMENT—Many in the charitable community have long been advocates of a non-itemizer charitable deduction, believing it would create additional incentives for support of charitable organizations. The idea of a threshold below which contributions by non-itemizers would not be deductible has been explored in the past

as well. It seems reasonable to conclude that the assumptions underlying the standard deduction assume some level of charitable giving as a component of the standard deduction.

As such, establishing a threshold relatively equal to the assumed charitable-contribution component of the standard deduction seems reasonable. However, there is little reason to subject the deductions of itemizers to that same threshold. Persons who itemize have, by definition, amassed itemized deductions exceeding those assumed by the standard deduction. Itemized deductions are, in reality, only beneficial to the extent those deductions exceed the standard deduction. Requiring the charitable contributions of those who itemize to exceed a threshold before being deductible would, in effect, be requiring them to exceed two thresholds: one for the charitable-giving component built into the standard deduction as well as any newly enacted percentage of AGI threshold.

**RECOMMENDATION—*Allow tax-free distributions from IRAs to be made directly to qualified charitable organizations.***

This recommendation applies to taxpayers over the age of 65, according to the report. Currently, a taxpayer who donates IRA assets

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to charity is treated as having received a taxable distribution from the **IRA** and must claim a deduction for the gift to charity. Depending on the taxpayer's circumstances, he or she may not be able to deduct some or all of the amount in the year of the gift, if ever; may incur reduction of other itemized deductions and personal exemptions; and may be subject to state income tax on some or all of the distribution.

Under this recommendation the contribution would pass directly from the **IRA** to the charity without being included in the taxpayer's income and would not give rise to any charitable deduction. This would ensure that the taxpayer would not suffer any of the potentially negative consequences that are possible under current law.

**II. Improving Recordkeeping for Charitable Gifts.** The Panel made one recommendation for new rules related to "large" gifts:

**RECOMMENDATION—Require information reporting for large charitable contributions.**

According to the report, the **IRS** currently has no way to verify a claimed charitable deduction, short of performing an audit. As such, the Panel recommends that charities be required to report gifts of \$600 or more directly to the **IRS** and to the taxpayer, and says that this will assist taxpayers in claiming correct amounts and allow the **IRS** to verify deductions.

**COMMENT—**The law already requires that taxpayers must receive receipts for any gift of \$250 or more prior to claiming a deduction for such gifts. Requiring charities to issue another set of receipts to the **IRS** starting at a different threshold would put a significant financial and administrative burden on charities, particularly larger charities that process thousands of such gifts each year. If verification is an issue, could that not be accomplished merely by having copies of receipts attached to taxpayers' returns?

The appendix to the report seems to suggest that the \$600 threshold would be a cumulative threshold for all gifts given by a donor in a year. If it is cumulative, what about entities that are on a fiscal year other than the calendar year? Would charities be required to inquire as to the fiscal year of all entities that are donors?

One of the stated objectives of the recommendation is to assist taxpayers in knowing the correct amount to claim as a deduction. That would seem to be obvious in the case of cash gifts. And what about noncash gifts? The **IRS** has always cautioned charities against valuing noncash gifts, but a reporting requirement such as this may mean they would have to become involved in the valuation process.

**III. Reducing Controversy and Uncertainty in Valuing Gifts of Property.** Under current law,

taxpayers are entitled to deduct the full fair-market value of gifts of some types of property. But, the report says, the **IRS** does not have a cost-effective way to verify the value of donated property. While recommending that the current rules allowing such deductions be retained, the Panel offers two recommendations to tighten the rules and make them more explicit to prevent abuses:

**RECOMMENDATION—Allow taxpayers to sell property and donate the proceeds to charity.**

The Panel recommends that taxpayers be allowed to sell property without recognizing gain and receive a full charitable deduction if the entire sales proceeds are donated to a charity within 60 days of the sale. This rule would apply to the same extent that property would be eligible for a charitable-contribution deduction equal to fair-market value under current law (other than items of personal property that are eligible because they are related to the charity's purpose or function). Any sale would need to be at arm's length to an unrelated party, and the deduction would be subject to the 1%-of-income threshold.

**COMMENT—**This proposed change would seem to bring a higher degree of certainty to the value of some types of noncash-property gifts that are used to fund charitable gifts. It would be the most useful when a buyer for the property has already been

## 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 million exemption.

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

identified. If there is no ready buyer, a donor may find it more advantageous to go ahead and make the gift at a time that best fits his or her objectives and timetable. If so, presumably the donor would still need to comply with existing rules for substantiating the value of noncash gifts.

This proposed process may also not be appropriate when a donor wants to make a bargain sale to a charity. For example, a donor can sell stock worth \$10,000 to a charity for \$5,000, take a deduction for \$5,000, and avoid having to recognize half of the gain he or she would have recognized at a sale for full fair-market value. Under the proposed rule, it seems that if the taxpayer sold the stock for \$10,000 and made a gift of just \$5,000, he or she may have to recognize all of the gain since there was not a gift of the *entire* proceeds of the sale. If that is not the intent of the recommendation, that issue could easily be addressed in the implementation process of any changes in the rules.

**RECOMMENDATION—  
Improve rules for valuing gifts  
of property to charities.**

The Panel believes that it is necessary to implement better standards for appraisals. Accordingly, it recommends (1) new rules requiring clearer standards for appraisals; (2) information reporting by appraisers to the IRS, the donor, and the charity of the appraised

value of the property; and (3) new penalties for appraisers who misstate the value of property.

The Panel also expressed a concern about potential for overvaluation of contributions of used clothing and household items under current rules. The report suggests allowing deductions only when the taxpayer receives a price list and an itemized receipt from the charity.

COMMENT—The law currently requires the filing of IRS Form 8283 when a donor claims noncash contributions in excess of \$500. Except for gifts of publicly traded securities, if the claimed deduction exceeds \$5,000, (\$10,000 in the case of closely-held stock) the donor must obtain an appraisal and the appraiser must sign Form 8283. By signing the appraisal summary, the appraiser already accepts substantial responsibility and subjects himself or herself to significant penalties for overstating the value of property. The appendix indicates, without elaboration, that the Panel finds the current penalties to be insufficient to stop overvaluation by appraisers.

In regard to donations of used clothing and household items, the law already requires a donor to have a receipt that describes the donated property if the value of the claimed deduction is \$250 or more. Requiring donee charities to verify the price of such items seems to be a significant departure from the policy of discouraging

charities from valuing noncash gifts. It also seems particularly onerous for many types of charities that receive such gifts to provide a price list when they may not be in any better position to value the property than the donor.

**IV. Better Oversight of  
Exempt Organizations.**

The Panel issued one sweeping recommendation calling for enhanced oversight of charities:

**RECOMMENDATION—  
Effective action should be taken  
to ensure better oversight and  
governance of exempt  
organizations.**

Without making specific recommendations, the Panel urged action that would ensure that a tax exemption is “extended only to organizations that are truly serving the public interest.” It recommended that Congress review the standards for qualifying for and maintaining status as a charitable organization.

SUMMARY COMMENT—At this time the recommendations of the Panel simply represent its views on issues related to charitable organizations and the rules governing contributions to them. It is important for charitable organizations and those who support them to make their opinions known as future policy is formulated. **Note:** A full text of the report can be found at <http://www.taxreformpanel.gov/final-report/>.

### 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/linfo.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** National Committee on Planned Giving members-only discussion list for all issues and queries related to gift planning. [http://www.ncpg.org/members/gift\\_pl.asp?section=4](http://www.ncpg.org/members/gift_pl.asp?section=4)

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## BRIEFLY...

**Trust Reformed to Address Payment of Estate Tax.** Under the trust of a decedent, the residue is to be divided into a charitable share for the decedent's private foundation and a children's share for the decedent's two children. The children's share is further divided between two children. The entire share of one child is to be held as a charitable remainder unitrust (CRUT) while the share of the other child is to be divided between a noncharitable trust and a CRUT for the benefit of that child. The decedent's trust provided generally that all transfer taxes are to be paid out of the children's share.

Having not yet determined the decedent's transfer-tax liability, the trustee of the decedent's trust has not yet funded either CRUT. The trustee seeks permission to amend the decedent's trust to be sure the CRUTs do not run afoul of the requirements of IRC §664(d)(2)(B) prohibiting payments from a CRUT of any amount other than the unitrust amount to any person other than an organization described in IRC §170.

Specifically, the trustee wants to amend the trust to add language requiring the beneficiaries of the CRUTs individually to pay their CRUTs' proportional share of any

deficiencies should the trustee go ahead and fund the trusts and not retain sufficient funds to pay the taxes. The IRS approved the request and cleared the way for the trustee to fund the CRUTs during administration. (Ltr. Rul. 200539022)

**Foundation Payment to Board Member Who Is Judge Not Self-Dealing.** IRC §4941(a) imposes an excise tax on acts of self-dealing between a private foundation and a disqualified person, including certain government officials described in IRC §4946(c). A private foundation sought a private letter ruling to determine whether payments to a board member who serves as a district judge would be acts of self-dealing.

According to IRC §4946(c)(5) a disqualified government official is one who holds elective or appointive office and receives gross compensation of \$20,000 or more annually. Section 53.4946-1(g)(2)(i) of the Foundation and Similar Excise Tax Regulations distinguishes "public office" from mere public employment primarily on the question of whether the person is involved in the independent performance of policymaking activities. The IRS determined that the judge's duties were limited to applying existing state laws and therefore

did not constitute independent policymaking functions. (Ltr. Rul. 200542037)

**Taxpayer Fails to Establish Organization Functioned Exclusively as Charity, Loses Deductions.** A taxpayer claimed charitable-contribution deductions for amounts transferred to an organization he incorporated, contending that the organization operated as a church and that the funds were used for the publication and distribution of religious materials. Those deductions were denied by the IRS for lack of substantiation.

The Tax Court found that the taxpayer provided little evidence to establish that the organization was, in fact, a church. It further determined that, despite the taxpayer's claim that the materials were distributed at cost, in the absence of any financial statements it could not determine if the organization made a profit. As such, it determined "that the publishing and distribution of books by the [organization] was a substantial nonexempt activity." Since the organization did not function exclusively as a charity, the court upheld the IRS's denial of the deductions. (Gillis Triplett v. Commissioner; T.C. Summ. Op. 2005-148; No. 19733-03S)

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*Financial Strategies* is intended for 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.

UNIVERSITY OF  
**ROCHESTER**

590 Mt. Hope Avenue  
Rochester, New York 14620  
(585) 273-5930  
toll free (800) 635-4672