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Outright Gift to Charity

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Outright Gift to Charity

What is it?

An outright gift to charity is simply a voluntary transfer of property to a charitable organization. You can donate any type of property, assuming the charity will accept it, at any time and in any manner you wish. An outright gift to charity is also called a charitable contribution. There are three basic requirements for your gift to charity to be deductible for income, gift, and estate tax purposes:

- The organization to which you donate must be a qualified charity as defined by the tax code. There are eight categories of activity that make an entity eligible to receive charitable donations: charitable, educational, religious, scientific, literary, testing for public safety, fostering national or international amateur sports programs, and preventing cruelty to children or animals. Government units and certain types of private foundations also qualify.

- Your gift must be some kind of property--the value of your time or personal services donated to a charity is not tax deductible. For example, if a carpenter spends 10 hours building pews for his church, the IRS will not allow him to deduct his normal hourly wage as a charitable contribution. However, the IRS will allow him to deduct the cost of any building materials he purchased to construct the pews.

- The property must be given to charity before the end of the tax year for you to take the deduction.

You can make a gift to charity either during your lifetime or at your death. During your lifetime, a gift to charity can be made by writing a check, assigning stock, transferring a life insurance policy, signing a deed to real estate, or conveying property to charity in any other outright manner. At your death, gifts to charity can be made by will, life insurance contract, or trust. A charity receives benefits from your gift as well. A charity pays no tax on the receipt of property and, in most cases, pays no tax on any income earned by the donated property.

When can it be used?

You want to make a gift to charity

An outright gift to charity can be used when you want to benefit a charity for non-tax reasons or when you want to reduce your income or estate taxes by taking advantage of the deductions the tax code allows for such gifts.

Strengths

Provides income tax deduction

When you make a gift to charity, you are entitled to an immediate income tax deduction for the fair market value of the gift, assuming you itemize deductions. However, your allowable deduction is limited to either 30 percent or 50 percent of your adjusted gross income (AGI), depending on the type of charity and the type of property donated to charity. Any amount that cannot be deducted in one year can be carried over and deducted in the following year, for up to five succeeding years.

> **Example(s):** Sam donates $20,000 cash to his favorite public charity and is thus permitted a deduction of up to 50 percent of his AGI. Assume Sam itemizes deductions and his adjusted gross income is $36,000 for the year the charitable gift is made. The result is that Sam is entitled to deduct $18,000 in the year the gift is made (50 percent of $36,000). He can then carry over and deduct the remaining $2,000 ($20,000 - $18,000) the following year.

Does not produce taxable gain when appreciated property is donated

It is a well-established rule of charitable giving that when you contribute appreciated property (property that has gone up in value) to charity, you do not incur taxes on the gain.

Caution: Just as gain is not recognized, neither is loss. So, if you have an asset that has depreciated in value from the time you bought it, you may want to first sell the property and then contribute the proceeds to charity so that you can claim the loss on your income tax return. Otherwise, if you donate the asset directly to charity, you cannot take any deduction for the loss.

Provides you with positive social, religious, and psychological benefits for donating to your favorite charity

Yes, the tax benefits can be great. In addition, donating to charity can be a real morale booster.

Reduces potential federal estate tax liability

When you make a gift to charity at death (e.g., by will, life insurance policy, or other means), the IRS allows the personal representative of your estate to deduct the fair market value of the gift from your gross estate. Thus, the smaller your gross estate, the less chance you have of owing estate taxes if you make testamentary charitable gifts.

Example(s): In his will, Chet donates stock worth $75,000 to his favorite charity. He purchased the stock 10 years ago for $10,000. The result is that Chet's executor can deduct $75,000 from Chet's gross estate.

To be tax deductible, the gift must be made by you, not by your estate or your beneficiaries. Thus, a deduction would not be allowed if the gift to charity required the approval of a third party.

Tradeoffs

Requires an irrevocable commitment

You think you want to leave your autographed vintage rock album to the Rock Museum, but you promised it to your cousin, Henry, last Thanksgiving. If you have any doubts about donating to charity, it's a good idea to wait until the fog clears. If you donate your album to charity, it's gone.

Assets donated to charity are assets lost to your family

After you donate a portion of your estate to charity, these assets are forever removed from your inheritable estate.

Requires particular records for contributions

When you donate money to charity, regardless of the amount, you must maintain either a bank record (e.g., cancelled check, credit card statement) or a written communication (a receipt or letter) from the charity that shows (1) the name of the charity, (2) the date of the donation, and (3) the amount of the donation. For donations made in taxable years beginning after August 18, 2006, no other type of recordkeeping will satisfy the IRS substantiation requirements. For donations made in taxable years beginning prior to August 18, 2006, in the absence of a bank record or receipt, the IRS accepts other reliable written records that shows (1) the name of the charity, (2) the date of the donation, and (3) the amount of the donation.

For a donation other than money that is valued at less than $250, you must maintain a receipt from the charity that shows (1) the name of the charity, (2) the date and the location of the donation, and (3) a detailed description of the property. For donations of property of $250 or more, however, you must maintain a contemporaneous written acknowledgement from the charity that includes (1) a description of the property, (2) whether the charity provided any goods or services in consideration for the donation, (3) a good faith estimate of the value of such goods or services. If the amount claimed for a noncash donation is more than $500, you must also complete Form 8283, Noncash Charitable Contributions, and attach it to your return.

Requires a qualified appraisal of donated property in some circumstances

When you make a gift to charity and the amount claimed as a charitable deduction for the property exceeds $5,000, the IRS requires you to obtain an appraisal of the property from a qualified appraiser, and attach the appraisal summary to your income tax return. Generally, a separate appraisal must be made of each item of property donated unless similar items are donated in the same year. This rule does not apply to gifts of publicly traded securities.

Technical Note: The IRS defines a qualified appraiser as an individual who (1) has earned an appraisal designation from a recognized professional appraisal organization or has otherwise met minimum education and experience requirements, (2) regularly performs appraisals for which he or she receives compensation, (3) can demonstrate verifiable education and experience in valuing the type of property for which the appraisal is being made, (4) has not been prohibited from practicing before the IRS at any time during the three years preceding the appraisal, and (5) is not excluded from being a qualified appraiser under Treasury regulations.

Caution: The tax code imposes penalties on taxpayers who overvalue charitable gifts.

How to do it

Pick a charity you wish to donate to and verify that it is a qualified charity

Just because you like the local church choir doesn't mean the IRS will. The IRS allows you to deduct contributions made to qualified charities. Generally, qualified charities are those operated exclusively for religious or educational purposes, medical or hospital care, government units, and certain types of private foundations. Every year the IRS publishes a list of all qualified charities in IRS Publication 78, commonly known as the Blue Book. Check to make sure your charity is listed in this publication if you are concerned about the deductibility of your contribution.

Tip: After you pick a charity, it is a good idea to contact the charity to make sure it is willing to accept your gift. Just because you treasure your miniature rabbit figurines collection doesn't mean the charity will.

Identify the asset(s) you want to donate to charity

You can donate any type of property to charity (assuming the charity will accept it), such as cash, securities, real property, life insurance, or a rare collectible item.

Tip: You enjoy a double advantage when you donate appreciated long-term capital gain property (property held more than one year), like stock or real property. You avoid capital gains taxes that otherwise would have been incurred on the potential profit upon disposition of the property, and you also receive a deduction for the full fair market value of the gift.

Example(s): Suppose you donate stock worth $25,000 to the United Way. The stock cost you $12,000 when you purchased it four years ago. By donating the stock to charity, you avoid the tax on the $13,000 capital gain and receive a potential income tax deduction (depending on your adjusted gross income) of $25,000, the full market value of the gift.

Tax considerations

Income Tax

Provides for income tax deduction

When you make a gift to charity, you are entitled to deduct the contribution on your income tax return, assuming you itemize deductions. However, your deduction is limited to 20 percent, 30 percent or 50 percent of your contribution base, depending on the type of property donated to charity and the classification of the charity as either a public charity or private foundation. Any amount that cannot be deducted can be carried over and deducted in the following year, for up to five succeeding years.

Tip: Generally, a public charity is a publicly supported domestic organization; a private foundation does not have the same base of broad public support. IRS Publication 78 notes whether a charity is public or private.

Gift Tax

No gift tax on charitable gifts

When you make a gift to a qualified charity, you owe no federal gift tax on the transaction, regardless of the size of your gift.

Estate Tax

Reduces size of gross estate

When you make a gift to charity at death through your will, for example, the IRS allows the personal representative of your estate to deduct the fair market value of the gift from your gross estate. The smaller your gross estate, the less likely your estate will owe estate taxes if you make substantial testamentary charitable gifts.

> **Example(s):** In your will, you leave an original painting, worth $1 million, to the Girl Scouts. As a result, your executor can deduct $1 million from your gross estate.

Questions & Answers

Do you get a charitable deduction for donating the use of your property to charity?

No, the IRS does not allow you to take a charitable deduction when you donate the use of your property to charity. So, if you graciously allow the local American Red Cross chapter to use your spacious office rent-free, you do not get a charitable deduction.

What happens if you receive a benefit from the charity in connection with your charitable gift?

If you receive a benefit from the charity as a result of your charitable gift, your gift to charity is deductible only to the extent that the value of your gift exceeds the value of any benefits you receive from the charity.

> **Example(s):** Suppose you donate $10,000 to the Art Museum. In return, the museum gives you a free membership for one year, a benefit worth $1,000. The result is that the IRS considers your gift to the museum to be $9,000.

What is a gift of a partial interest?

A partial interest is a gift that is split between charitable and non-charitable beneficiaries. There are four types of partial interest gifts: (1) a gift of an undivided portion of your entire interest in a piece of property, (2) a gift of a remainder interest in a personal residence or farm, (3) a gift of a remainder interest in real property granted only for conservation purposes, and (4) a gift transferred in trust. In the last situation, the IRS has established strict rules that must be followed in order for favorable tax benefits to apply. Such trusts are either charitable remainder annuity trusts (CRATs), charitable remainder unitrusts (CRUTs), pooled income funds, or charitable lead trusts. In any event, the gift of a partial property interest is not considered an outright gift to charity.

How do you calculate the after-tax savings and out-of-pocket cost of a charitable contribution?

To calculate the income tax savings of a charitable gift, multiply the amount of the gift by your marginal tax bracket.

> **Example(s):** A $2,000 gift by a taxpayer in the highest tax bracket (39.6 percent) would result in tax savings of $792 ($2,000 x 0.396). Then, to calculate your out-of-pocket cost of the gift, subtract the tax savings from the amount of your gift.

> **Example(s):** The out-of-pocket cost for the $2,000 gift above would be $1,208 ($2,000 - $792).

What happens if you are allowed to purchase tickets to collegiate athletic events as a result of your donation to the college?

The IRS has specifically singled out the receipt of tickets to athletic events. The rule is that if you donate to a college or university and as a result are able to purchase tickets for athletic events, then only 80 percent of your gift is deductible. Your deduction is then further limited to either 30 percent or 50 percent of your adjusted gross income.

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