

# THE Good Advisor

## Beyond Vanilla: Choosing the Right Asset to Give

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Likewise, when our clients think about making gifts, their first thought is often vanilla—a generous gift of cash. But clients who own a variety of assets have a number of gift possibilities. Financial professionals advising clients on gift planning need to understand the implications of how each asset class is treated in a charitable giving context. To help you assist your clients in choosing their “personal best” gift assets, this issue of *Good Advisor* is devoted to some of the most attractive giving options:

- **Cash: Still Favored After All These Years**
- **Securities: An Alternative with Benefits**
- **Retirement Assets: Advanced Giving at an Advancing Age**

### **CASH: Still Favored After All These Years**

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gifts of cash are the simplest to execute and also the most common. As a consequence, most people have a basic understanding of how the federal income tax will impact gifts of cash. Still, you may have to review additional considerations.

#### **Documentation Requirements**

For a donor to receive an income tax charitable deduction for a cash gift, the Internal Revenue Code (IRC) requires contemporaneous written acknowledgement from the charity of any gift of \$250 or more.<sup>1</sup> This acknowledgement must show the name of the organization plus the date and amount of the contribution.<sup>2</sup> For smaller gifts, a bank record is sufficient. Either way, it is up to the individual to maintain appropriate records of any cash gifts in order to secure the deduction.

#### **Adjusted Gross Income Limitation**

As with all charitable gifts, any income tax deduction is limited to a percentage of the donor’s adjusted gross income (AGI) for that tax year.<sup>3</sup> It is important to remember that this is for income tax purposes only and does not apply to the gift or estate tax charitable deduction. The IRC provides that the aggregate income tax charitable deduction cannot exceed 50% of the taxpayer’s contribution base for the year that gifts are made to a public charity, government or operating private foundation.<sup>4</sup>

If a donor has substantial assets but little income (perhaps an individual who retired after an exceedingly successful career), a large charitable gift of cash is more likely to result in the individual being affected by the 50%-of-AGI limitation. If the donor cannot deduct the full amount of a charitable contribution in the initial tax year, any excess can be carried over and

used for up to five subsequent years.<sup>5</sup>

### Why Give Cash?

Cash is the easiest gift for donors and charities; it is typically the most accessible asset for donors and is immediately beneficial to the charitable organization that receives it. Also, a cash gift may be particularly well suited for an individual who has received an unusually large cash influx during the year (such as the sale of a business, an inheritance, or a performance bonus).

## SECURITIES: An Alternative with Benefits

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Securities are a good gift option when a client is reallocating assets within a portfolio of investments, or when the donor wants to make use of a capital gain from a highly appreciated stock without paying the capital gains tax on the appreciation.

### Limits on Charitable Deductions

The charitable deduction for a gift of securities depends on the length of time the donor owned the securities:<sup>6</sup>

- A gift of short-term securities (held for one year or less) to a public charity cannot exceed 50% of the donor's AGI in the year the gift is made.<sup>7</sup>
- A gift of long-term securities (held for more than one year) made to a public charity cannot exceed 30% of the donor's AGI in the year the gift is made.<sup>8</sup>

As with cash gifts, any excess charitable contribution that cannot be deducted due to AGI limitations can be deducted in up to five subsequent years.

A gift of short-term securities made to a public charity must be reduced by the amount of ordinary income that would have been realized if the owner had sold the securities rather than donating them.<sup>9</sup> A gift of long-term securities made to a public charity, however, can be deducted for the full fair market

value of the securities on the date of the gift.<sup>10</sup> If the security is listed on a market exchange (e.g., on the NASDAQ®), the gifted security requires no qualified appraisal. The mean price on the date of the gift is the value of the gifted security.<sup>11</sup>

### Why Give Appreciated Stock?

A gift of appreciated stock allows the donor to make a valuable charitable gift while avoiding the capital gains tax that would have been imposed if the appreciated stock had been sold and the cash proceeds donated—a “win-win” situation for the charity and the individual.

## The Benefits of Giving Appreciated Stock: An Example

Cherie is a successful business owner who wants to make a charitable donation of \$50,000. She has significant assets and plans to write a check for the donation. In reviewing her portfolio, Cherie determines that she has appreciated stock in the same amount. She could write a check for \$50,000 or sell the stock and give the charity the \$50,000 value of the appreciated stock. With either gift, Cherie would be allowed to claim the \$50,000 as a charitable contribution if she itemizes deductions on her federal income tax return.

The advantage of giving securities rather than cash is the avoidance of the imposition of capital gains tax. Ten years ago, Cherie purchased the stock for \$10,000. If she sells the stock, she will have to pay a capital gains tax of approximately \$8,000 (a gain of \$40,000 taxed at the 2017 capital gains tax rate of 20%). Cherie is a single filer and has a modified adjusted gross income above \$200,000, so she has to include the net investment income tax of 3.8% that is due on capital gains for taxpayers in her bracket. That would be an additional \$1,520 in tax due on the sale of the securities. Thus, the real after-tax value if Cherie sells the stock to make the donation is only \$40,480.

Instead of selling the stock, Cherie can give the long-term appreciated stock to the qualified charity, incurring no capital gains tax. This would result in a capital gains tax savings of \$9,520 for Cherie.

## RETIREMENT ASSETS: Advanced Giving at an Advancing Age

Gelato comes in traditional flavors (*bacio*, *mandorla*, *zabaione*, or *fico*) as well as more modern creations (pear ginger, for example). In spite of the variety available, children still tend to prefer ice cream, as gelato's denser consistency and more complex flavors appeal more to adults.

In much the same fashion, gifts of retirement assets appeal more to those who are older—particularly those who are already subject to required minimum distribution requirements. For these donors, a charitable gift of retirement assets might be the best option. After all, when an individual retires, income from wages drops, but income from retirement assets (pensions, investment accounts, or retirement accounts) may be significant.

### Qualified Charitable Distributions

The primary benefit of IRAs and qualified retirement plans is the tax deferral available on contributions and earnings inside the account.<sup>12</sup> However, while this is a clear benefit during the accumulation years, it may create an income tax problem once the owner needs to take distributions. Owners typically rely on the accounts to provide retirement income and expect to pass on what they don't use to loved ones. However, for many donors, drawing on these assets for charitable gifts may be a tax-efficient option.

A qualified charitable distribution (QCD) allows an IRA owner to make a distribution of up to \$100,000 directly from the IRA to a qualified charity. This distribution is not considered income to the donor, but does count toward the donor's required minimum distribution (RMD).<sup>13</sup> This lets high-income individuals take an annual RMD and use it to make a charitable contribution without subjecting the distribution to the individual's higher tax rate.

### Why Give IRA Distributions?

Let's look at the benefits of this gift through an example. John and Maureen, both 72, were successful medical technology entrepreneurs who sold their business five years ago. Both still work as highly paid consultants. Their success allowed them to accumulate significant assets while also building solid retirement accounts, and their current employment provides a continuing source of high income. Since John and Maureen are over 70½, they are each

required to take minimum distributions from their retirement accounts. However, they do not need the distributions, nor do they want to pay income tax at their current rate on the distributions.

John and Maureen are excellent candidates to use a QCD (otherwise known as an IRA charitable rollover) allowed under the Internal Revenue Code. The qualified charitable distribution would allow John and Maureen to direct the amount of their RMD from each of their accounts straight to a qualified charity. Since neither distribution would be considered as income, no tax would be due on the RMDs.

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## ENDNOTES

- 1 IRC 170(f)(8)(A).
- 2 IRC 170(f)(17).
- 3 IRC Sec. 170(b)(1)(B).
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- 5 IRC Sec. 170(d)(1); Reg. Secs. 1.170A-8, 1.170A-10.
- 6 IRC Sec. 1222.
- 7 IRC Sec. 170(b)(1)(A).
- 8 IRC Sec. 170(b)(1)(C)(i).
- 9 IRC Sec. 170(e)(1)(A).
- 10 Ibid.
- 11 Reg. Secs. 25.2512(b)(1), 20.2031-2(b)(1).
- 12 <https://www.irs.gov/retirement-plans/plan-sponsor/types-of-retirement-plans-1>
- 13 IRC 408.

### **Access more information now!**

An electronic copy of our companion booklet with a more in-depth treatment of basic estate planning documents and charitable giving hazards as well as an additional discussion on gifts of real estate, including deductions, conservation easements, and charitable remainder interests may be accessed in the Professional Advisor section of our website at [www.catholicfoundation.com](http://www.catholicfoundation.com).

You can download this PDF and store it on your PC or tablet for easy access.

This newsletter is only for professional advisors and only for their information and discussion. It is intended only to provide general information about charitable gifts and charitable-gift planning. This newsletter is not (1) legal, tax, accounting, or financial advice, (2) any solicitation of legal, tax, accounting, or financial services, (3) any securities or investment advice, or (4) any solicitation of securities or investment advisory services. Each professional must evaluate the tax and financial consequences of each individual situation.

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The term “retirement account” generally refers to an account such as a 401(k) or an individual retirement account (IRA).<sup>12</sup> The rules regarding these tax-deferred retirement accounts can be complex in terms of participant qualification, contribution limits, penalties for early distribution, required minimum distributions, and the after-death distribution or transfer of the account.

### Charitable Beneficiaries

One way to provide a testamentary charitable gift of retirement assets is by naming a charity the beneficiary of an IRA or qualified retirement plan account. By making this designation, the charity will receive the remaining funds in the account at the owner’s death. Leaving retirement assets to heirs can be complicated because of the tax consequences, whereas making a charity the beneficiary of the IRA or retirement plan can be a more straightforward solution for charitably minded individuals.

### Qualified Charitable Distributions

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## REAL ESTATE: The Kitchen Sink Sundae

In many ice cream parlors (if that term even exists in this modern age of “fro-yo”), the owners advertise a dessert of outlandish proportions suitable for a hungry high school sports team—an unbelievable number of scoops of ice cream topped with layers of whipped cream, syrup, nuts, sprinkles, marshmallows, and pieces of candy or cookie.



In some ways, charitable gifts of real estate have the same allure. Real estate is the asset most often held as a long-term investment and, as a result, is an excellent gift to donate to a charity. For some investors, real estate is both the most important and most valuable part of their investment portfolio. Whether an individual owns a number of single-family rental houses, a farm with significant acreage, a commercial building, or an undeveloped tract of land, gifts of real estate can hold an untold number of variables.

However, like the sundae, a gift of real estate is also complex, which can give both the prospective donor and the charity cause for greater caution. A charitable transfer of real estate must meet all the real estate requirements (clean title, clean environmental review, etc.) as well as all the tax requirements for charitable giving.

### Taking a Deduction

Generally, the individual donating the property may take a charitable income tax deduction equal to the full value of the real property minus any encumbrances.<sup>15</sup> The donor can deduct a contribution of real estate for the fair market value if held for the long term.<sup>16</sup> Otherwise, a gift will be valued at fair market value minus any amount that would be considered ordinary income to the donor if the property were sold. The recapture of the depreciation deduction previously taken by the owner is considered ordinary income property.<sup>17</sup> Also, if the owner regularly purchases and sells real estate for profit, the property might be considered inventory, which is ordinary income property.<sup>18</sup>

A real estate appraisal will undoubtedly be necessary to determine the value of the real estate. In addition to the appraisal, the charity itself will likely require documentation before accepting a gift of real estate (e.g., an environmental review, a clear title search). Charities have gift acceptance policies that outline specific conditions for accepting a gift of real estate. Consultation with an anticipated development office is necessary to initiate such a gift.

### Real Estate Giving to Conserve: The Conservation Easement

A conservation easement is a restriction on the property that will keep the property in a certain state to be enforced by the charity holding the easement. A donor may take a charitable deduction for contributing a perpetual restriction on real property, such as an easement or a restrictive covenant.<sup>19</sup>

A qualified real property interest consists of one of three interests:

- an entire interest in real property (even if the donor retains a qualified mineral interest),
- a remainder interest in real property, or
- a perpetual conservation restriction (including an easement, conservation restriction, restrictive covenant or other similar state law provision).

A conservation easement can only be granted to governments and publicly supported charitable organizations.<sup>20</sup> Conservation purposes include public recreation or education, protection of environmental systems, and/or preservation of open space.<sup>21</sup>

### Giving a Charitable Remainder Interest

Another giving option is the donation of a charitable remainder interest in a personal residence or farm. Personal residence includes the principal residence, a vacation home or condominium.<sup>22</sup> A farm consists of land used to produce crops, agricultural products or livestock sustenance.<sup>23</sup> It includes barns, farmhouses and improvements.<sup>24</sup>

With this gift, the donor retains a life estate, with the property irrevocably transferred to the charity at the donor's death. The donor receives an income tax charitable deduction for the discounted present value of the charity's future interest.<sup>25</sup> This remainder value is determined using the value of the land and improvements, but must be reduced by the value of the donor's lifetime use of the property.<sup>26</sup>

This gift is useful for a donor who wants to make a significant contribution without a change in personal lifestyle.<sup>27</sup>

## Why Real Estate?

A gift of appreciated real estate provides the opportunity for the donor to make a gift while avoiding the recognition of capital gains tax. Much like a gift of appreciated stock, a gift of appreciated real estate (rather than a gift of cash from the proceeds of the sale of the real estate) will give the charity the full value of the donation while the donor avoids paying capital gains tax.

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- 12 <https://www.irs.gov/retirement-plans/plan-sponsor/types-of-retirement-plans-1>
- 13 IRC Sec. 408.
- 14 IRC Sec. 408(d)(8).
- 15 Reg. Sec. 1.170A-1(c)(1).
- 16 IRC Sec. 170(e)(1)(A).
- 17 Id.
- 18 Reg. Sec. 1.170A-1(c)(3).
- 19 IRC Sec. 170(f)(3)(B)(iii).
- 20 IRC Sec. 170(h)(3).
- 21 Reg. Sec. 1.170A-14(c)(1).
- 22 Reg. Sec. 1.170A-7(b)(3).
- 23 Reg. Sec. 1.170A-7(b)(4).
- 24 Ibid.
- 25 IRC Sec. 170(f)(4); Reg. Sec. 1.170A-12(b)(2).
- 26 Reg. Sec. 1.170A-7(c).
- 27 IRC Sec. 170(f)(3)(B)(i).

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