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Back to Basics: A Look at Charitable Organizations

"This is a football."

Imagine a professional coach telling his team—a team that almost won it all the year before—about the ball that was at the center of their professional lives. Crazy! Yet, this is exactly what the legendary Vince Lombardi did in his early years with the Green Bay Packers. Lombardi believed that to achieve success, his players needed to revisit the basics that made them professional players in the first place.

Lombardi was exactly right. Following his strict emphasis on fundamentals and execution of the basics, the Packers went on to win five NFL championships, including the first two Super Bowls. The legend of Lombardi's leadership lives on today, and his influence was so predominant that the National Football League named the Super Bowl trophy after him.

Revisiting and mastering the basics may feel like a step backward. However, whether the task is making a tackle or providing transactional advice to a client who wants to make a gift, it is essential that we remember the basics, take the proper approach, and follow through to an effective conclusion.

In this issue of *The Good Advisor*, we will look at the differences between charitable organizations, because differentiating between the various types of charities can impact the advisability and deductibility of gifts.

Distinguishing Nonprofits, Tax-Exempt Organizations, and Qualified Charities

Nonprofits, tax-exempt organizations, and qualified charities are all entities created to achieve social good. It is possible that an entity could be all three at once, but for the purposes of the Internal Revenue Code (IRC), these are distinct types of organizations.

Nonprofits

As the name indicates, a nonprofit is created for purposes other than generating profit, so no part of the organization's income can be distributed to its members, directors, or officers. Nonprofit status is conferred under state statute rather than federal law, so the requirements of and benefits to these organizations vary from state to state.[1] As an entity formed under state statute, a nonprofit must follow all state requirements and entity organizational filing requirements.

Tax-exempt organizations

A tax-exempt organization is a nonprofit that is exempt from federal income taxation—a clear advantage indeed.[2] To qualify for tax-exempt status, a nonprofit must be organized and operated exclusively for one or more exempt purposes as identified in the Internal Revenue Code. The types of organizations that can claim tax-exempt status are listed in IRC Sec. 501(c).

Qualified charitable organizations

For a donor to receive a charitable tax deduction for a contribution, the charity must not only be tax-exempt, it must be "qualified." A charity may be qualified for income tax purposes, but not necessarily qualified for gift and/or estate tax purposes—IRC Secs. 170(c), 2522, and 2055(a) individually list the categories of qualified charities that allow a donor to deduct contributions for income, gift, and estate tax (respectively).

501(c)(3) organizations

There are 29 categories of tax-exempt organizations under IRC Sec. 501(c). A 501(c)(3) organization includes any corporation, community chest, fund, or foundation organized and operated for one of these purposes:

- Religious
- Charitable

- Scientific
- Testing for public safety
- Literary
- Educational
- Fostering athletic competition at the national or international level (if no funds go towards the facilities or equipment)
- Preventing cruelty to children or animals[3]

No net earnings generated by a 501(c)(3) organization, in whole or in part, may benefit private shareholders or individuals. Furthermore, the organization is prohibited from participating in political elections or devoting a substantial part of its activities to influencing legislation (by propaganda or otherwise).

To become a 501(c)(3) organization, the charity must meet these IRC requirements and file IRS Form 1023. If the organization files Form 1023 within 27 months after the end of the month of legal formation and the IRS approves the filing, the organization's tax-exempt status will be retroactively recognized to the date of formation.[4] If the organization files Form 1023 after 27 months, the tax-exempt status will only be recognized starting at the date of IRS approval.

Income Tax Deductions for Gifts to Qualified Charities

Donors make charitable donations for any number of reasons—a personal connection to the charity, a desire to help a specific cause, a family tradition of support or a tradition of charitable giving in general. Though it may not be the primary reason donors give, the income tax charitable deduction plays a role in philanthropic decisions and is the nexus between philanthropic intentions and tax planning.

Under IRC Sec. 170(c), a contribution or gift must be to or for the use of:

- The United States, a State, a possession of the United States, or any political subdivision, or the District of Columbia, but only if made for public purposes
- A corporation, trust, or community chest, fund, or foundation organized for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports, or for the prevention of cruelty to children or animals
- A post or organization of war veterans
- A domestic fraternal society, order, or association, operating under the lodge system, but only if contributions are used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals
- A cemetery company owned and operated exclusively for members, and not for profit with no part of the earnings benefitting any private shareholder or individual

50% or 30%? That Is the Deductibility Question

Not every charitable contribution will be deductible in the same way for income tax purposes. There are distinctions to draw between the deductibility of contributions made to a 50% organization as opposed to a 30% organization.

50% organizations are the qualified charities expressly described under IRC Sec. 170(b)(1)(A):

- Churches
- Hospitals and medical research organizations
- Educational organizations
- Governmental units
- Publicly supported charities
- Certain private foundations
- Supporting organizations

CONCERNING PUBLICLY SUPPORTED CHARITIES

There are two ways that an entity may be considered a publicly supported charity for purposes of IRC Sec. 170(b)(1)(A):

1. A charity that normally receives a substantial part of its support from governmental units and/or direct or indirect contributions from the general public. This support does not include income received in the exercise or performance of its tax-exempt purpose.[5]
2. A charity that normally receives more than one-third of its support annually from any combination of gifts, grants, contributions, or membership fees and gross receipts from admissions, sales of merchandise, performance of services, or the furnishing of facilities in an activity which is not an unrelated trade or business, and normally receives not more than one-third of its support from gross investment income and net unrelated business taxable income.[6]

30% organizations are all the qualified charities not described under IRC Sec. 170(b)(1)(A). Generally speaking, this refers to private foundations as defined under IRC Sec. 509(a).

Deductibility Distinctions

A fundamental understanding of the differences between a 50% organization and a 30% organization provides the basis for looking at how donors may deduct charitable contributions. For the sake of clarity, 50% organizations and 30% organizations will be referred to as public charities and private foundations, respectively.

The contribution base is the donor's adjusted gross income without regard to any net operating loss carryback to the taxable year.[7]

Cash Gifts

- A cash contribution to a public charity is deductible up to 60% of the donor's tax contribution base. The Tax Cuts and Jobs Act of 2017 increased this from the original 50% for any taxable year beginning after December 31, 2017, and before January 1, 2026.[8] Starting January 1, 2026, a cash contribution to a public charity is scheduled to revert to being deductible up to 50% of the donor's tax contribution base.[9] The Coronavirus Aid, Relief, and Economic Security (CARES) Act allowed individuals to deduct cash gifts to public charities up to 100% of their adjusted gross income in 2020, and the recently passed stimulus package has extended that for 2021.
- A cash contribution to a private foundation is deductible up to 30% of the donor's contribution base.[10]

Property Gifts

- A contribution of property to a public charity is deductible up to 30% of the donor's tax contribution base.[11] Appreciated property is deductible at its full fair market value if the sale of the property would have resulted in long-term capital gain.[12]
- A contribution of property to a private foundation is deductible up to 20% of the donor's contribution base.[13] It is deductible only at its tax basis as ordinary income property,[14] with one significant exception—a gift of qualified appreciated stock (defined as publicly traded stock that would produce long-term capital gain if sold) can be deducted at its fair market value.[15]

An Option When Giving to a Public Charity

A donor who gives appreciated property to a public charity may choose to value the property at its income tax basis rather than its fair market value, as if the donor were giving the property to a private foundation rather than a public charity. In doing so, the donor gains the advantage of deducting the contribution at 50% of his or her tax contribution base as if it were a gift of cash.[16] This would be a sensible choice if the property had little appreciation and/or the donor wanted to deduct a greater percentage of the contribution base in that particular tax year.

Gifts "for the use of" a Charity

In most instances, a donor makes a gift directly to a charity. However, occasionally a donor may make a gift "for the use of" the charity instead. A gift made for the use of a charity has the same applicable percentage limitations as those for 30% organizations.[17]

For example, Alicia owns a life insurance policy, which she gives to her favorite charity. Alicia still owes a few additional premium payments on the policy, but she is concerned about making a gift that will require the charity to make a payment. To further benefit the charity, Alicia decides to make the necessary premium payments herself.

- If Alicia sends a check in the amount of the premium to the charity, that is a gift to the charity, subject to the 60% limit (as previously noted).
- If Alicia sends a check for the premium directly to the insurance company, that is a gift for the use of the charity, and therefore subject to the lower 30% limit.

Back to the Basics

Because of COVID-19, many of us have spent more time at home than ever before. More people are spending time cooking and baking from scratch, creating their own at-home fitness routines, even tackling home improvement projects. In many areas of life, we are rediscovering the fundamentals of doing things on our own.

In the spirit of returning to basics, advisors can also take their professional lives "back to the basics" by revisiting the fundamental concepts of charitable organizations. After all, this foundational knowledge holds the key to using techniques and planning tools that will best benefit charitably inclined clients.

ENDNOTES

1 The first resource for researching nonprofit law will be the state statues of the state in which the entity is organized. Another resource may be the Revised Uniform Unincorporated Nonprofit Association Act—a law promulgated by the National Conference of Commissioners on Uniform State Laws—which governs all unincorporated nonprofit associations that are formed or operate in a state that adopts the Act.

2 IRC Sec. 501(a).

3 Reg. Sec. 1.501(c)(3)-1.

4 IRC Sec. 508.

5 IRC Sec. 170(b)(1)(A)(vi). There are two tests to determine if a charity normally receives a substantial part of its support from governmental units and/or contributions from the general public. Meeting either test qualifies the charity. One, the charity normally receives at least one-third of its total support from governmental units and/or the general public. And two, the support from governmental units and the general public is at least 10% of the organization's total support, and the charity is organized and operated so as to attract new and additional support from the government and the general public, and the charity can show a substantial degree of public support by various sources of support, the breadth of interests represented by the governing body, and the availability of public facilities and services.

6 IRC Sec. 170(b)(1)(A)(viii). See also IRC Secs. 509(a)(2) and (3).

7 IRC Sec. 170(b)(1)(G).

8 IRC Sec. 170(b)(1)(G).

9 IRC Sec. 170(b)(1)(A).

10 IRC Sec. 170(b)(1)(B).

11 IRC Sec. 170(b)(1)(C)(i).

12 IRC Sec. 170(b)(1)(C)(iv).

13 IRC Sec. 170(b)(1)(D)(i).

14 IRC Sec. 170(e)(1)(B)(ii).

15 IRC Sec. 170(e)(5).

16 IRC Sec. 170(b)(1)(C)(iii).

17 Reg. Sec. 1.170A-8(a)(2).

Access more information now!

An electronic copy of our companion booklet with more information about charitable organizations, including a discussion of supporting organizations, donor-advised funds, community foundations and private foundations is available in the Professional Advisor section of our webite at **www.catholicfoundation.com**.

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