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The Nuts and Bolts of Planning a Charitable Gift

The Super Bowl is the championship game of the NFL, but over the years, it has also become a cultural event approaching national holiday status. Companies paid attention as the number of sports fans viewing the game on television increased and those fans started inviting family and friends to watch with them. Suddenly, there was an event most of the country watched, and the result was some of the most creative and memorable advertising in history:

- Mean Joe Greene and the kid with the Coke
- Apple's mesmerizing *1984*-style ad introducing the Mac
- Wendy's "Where's the beef?" dig at competitors
- The Budweiser Clydesdales and the Budweiser frogs

Thanks to the guidance of experienced advertising agencies, each campaign was well conceived and targeted to the specific audience watching the game.

When a donor starts thinking about making a sizeable charitable gift, it may feel daunting—especially if it's their first larger gift. Luckily, they can turn to a professional to help them consider the impact and target the right asset for donation. Whether the gift ends up being straightforward or creative, with the right professional guidance, donors can approach the charitable giving process with the confidence of a championship player.

In this issue of *The Good Advisor* we provide a basic framework for helping clients who are contemplating making a sizeable donation, including assessing the impact and choosing the best asset to give.

Assessing the Family Impact

A donor who is excited to further the work of a meaningful charity can easily overlook the impact such a gift can have on the mindset and stability of the family going forward.

Building a legacy. A sizeable gift can begin a family legacy of charitable giving, establishing philanthropy as a family value to be shared and passed on to future generations. Creating such a mindset can result in a compounding of gifts over time and across generations.

Maintaining harmony. Family members who support a gift in theory may not support the specifics. This is common with gifts of tangible assets (a painting, for example) or property (say, a vacation home). If family members have concerns, there are many alternative assets to be explored.

Protecting the future. A donor must also carefully consider the impact of the gift on the family finances. If there is concern that the donated assets could be needed in the future, there are many charitable giving options and solutions to consider, including testamentary gifts, life income gifts, or blended gifts that combine a smaller immediate gift with a larger gift in a will or trust.

Selecting the Best Asset to Give

When clients think about making a gift, they may first think of cash. However, there are many types of assets, and the best one to give will vary depending on the donor and the situation. You can help clients analyze how the gift fits within their financial and estate plans, consider the tax impact, and present informed options for consideration.

While the best asset for a particular gift depends on the donor's specific situation, the following information about broad categories of assets is a good starting point for the review process.

Cash

Cash is the most common asset for charitable gifts.

Pros and Cons. A cash gift is simple and easy. However, many of your clients own other assets that could offer more tax advantages.

Best Uses. Cash works well for smaller annual contributions, or for more substantial gifts when an individual has received a large performance bonus, inheritance, or other cash infusion. At these times, the donor may benefit from an income tax charitable deduction to offset the relatively outsized tax liability.

Deduction Limitation. 60% of AGI.[1]

Securities

A gift of securities is the most common non-cash gift. Donors typically give publicly traded stocks, but may also give bonds, mutual fund shares, or closely held stock.

Pros and Cons. This is a fairly easy gift to make, particularly if the stock is listed on one of the major exchanges or actively traded over the counter. However, some securities (such as closely held stock) require more attention to properly value the gift.

Best Uses. A donation of securities can help rebalance a portfolio due to changes in the market or in the donor's risk tolerance. In addition, highly appreciated stock held long term avoids capital gains tax when donated to charity—a potentially huge advantage. (On the other hand, depreciated securities do not make good gift assets. The donor should instead sell these assets, deduct the loss, then use the sale proceeds to make a cash donation.)

Deduction Limitations. The charitable deduction for a gift of securities to a public charity depends on the length of time the donor owned the securities.[2]

- Short-term securities (held for one year or less)—50% of AGI[3]
- Long-term securities (held for more than one year)—30% of AGI[4]

In either case, the donor can deduct the excess amount in subsequent years (up to five years).

Reduction Rules. 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 securities had been sold.[5] A similar gift of long-term securities can be deducted for the full fair market value (FMV) on the date of the gift.[6]

Appraisal Requirements. Gifts of closely held stock require an appraisal that accounts for certain factors, including market price, book value, financial condition, earnings and dividend-paying capacity, previous sales of stock, the size of the block of securities to be valued, and the economic outlook.[7]

Retirement Accounts

Most people have a retirement plan account, such as a 401(k) or an individual retirement account (IRA), but people don't always think of using these assets to make a charitable gift.

Pros and Cons. Clients rely on these assets to provide income in retirement and often expect to pass anything remaining at death on to loved ones. However, retirement assets can be taxed twice—once in the estate and once to the recipient—making them a good candidate for a charitable gift. In addition, gifting retirement assets can avoid the complex rules that govern distributions or transfers of the assets after the account owner's death.

Best Uses. There are two ways to make gifts of retirement assets, each with distinct benefits.

(1) **Qualified Charitable Distributions (QCDs).** A QCD is a direct transfer by someone over age 70½ from an IRA to a qualified charity (not a Donor Advised Fund or a §509(a) Supporting Organization).[8] The QCD must be a gift that would otherwise have qualified for a charitable income tax deduction.[9] A person can direct up to $100,000 per year in this manner (annual aggregate amount), but contributions made after age 70½ count against QCD amounts. The distributed amount does not qualify for a charitable deduction, but it is excluded from income for federal tax purposes. Furthermore, the distribution counts toward the taxpayer's annual RMD if one is due.

(2) **Beneficiary Designations.** Using a beneficiary designation form to name the charity as a sole, partial, or contingent beneficiary of an IRA or qualified retirement plan account is an attractive and straightforward way to make a testamentary charitable gift. This designation controls the distribution of the account at death (instructions left in a will or trust have no effect unless the assets are left to the estate or the trust).

Real Estate

Residential or commercial real estate held long term is an asset with great potential for charitable giving.

Best Uses. Clients who own property they no longer want or need may find it beneficial to donate, particularly if the property is highly appreciated in value. It is also possible to make a gift of a remainder interest in a personal residence or farm, which provides a current income tax deduction for the charity's future interest with no current change in lifestyle.[10]

Deduction Limitations. Long-term property is deductible up to 30% of AGI. Short-term property is deductible up to 50% of AGI.

Reduction Rules. The donor can deduct a contribution of real estate for FMV if held for the long term and avoid capital gains tax on the appreciated value. Otherwise, a gift will be valued at FMV 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.[11] Also, if the owner regularly purchases and sells real estate for profit, the properties might be viewed as inventory, which is considered ordinary income property.[12]

Appraisal Requirements. An appraisal is necessary to properly value the real estate. The value is based on its "highest and best use," which may be different than the donor's use or the how the charity would actually use it.[13]

In addition, the charity itself will likely require documentation before accepting a gift of real estate (e.g., an environmental review, a clear title search). The donor will need to consult with the charity's development office.

Tangible Personal Property

Tangible personal property includes items such as antiques, artwork, precious gems, coin collections, and motor vehicles. It does not include land and improvements (buildings and permanent structures).[14]

Best Uses. These are typically items (or collections of items) expected to increase in value. However, there may come a time when the holder no longer wishes to manage their collection or wishes to give a specific item to a certain charity.

Deduction Limitations. Like other assets, long-term property can be deducted up to 30% of AGI and short-term property can be deducted up to 50%.

Reduction Rules. The donor can deduct a contribution of long-term property for the fair market value. Otherwise, the gift will be valued at FMV minus any amount that would be considered ordinary income to the donor if the property were sold.

A donor must also consider the related-use rule: If the gift of tangible personal property is unrelated to the charity's exempt purpose, the deduction must be reduced by the amount of gain that would have been realized had the property been sold at its FMV.[15]

Furthermore, if the charity disposes of the item within three years, the donor is subject to an adjustment of the tax benefit.[16] An exception is made if the charity certifies that the property had a related-use function and was actually used in that capacity before its sale, or that the intended use of the property at the time of contribution became impossible or infeasible after the gift.[17]

Appraisal Requirements. In addition to the general requirement that all property valued at more than $5,000 have a qualified appraisal, certain types of property require additional or specific documentation. For instance, gifts of artwork require photographs and attachment of the appraisal itself. Further, due to abuse in claiming deductions, gifts of motor vehicles can be limited to the price the charity receives at a subsequent sale.[18]

Basketball at the Super Bowl

In 1993, Michael Jordan and Larry Bird—two of the world's most popular, skilled, and competitive basketball players—were featured in a Super Bowl commercial for McDonald's. The premise was an outrageous game of HORSE in which the winner received a Big Mac. While it may not have been intuitive to suggest that basketball players would be a great fit for a championship football game, McDonald's understood that the players' star power and charisma, combined with the clever premise, would result in a win.

A donor planning a large charitable donation may also have uncommon ideas. With your knowledge and guidance concerning rules and options, those creative gift ideas may just result in a win-win for the donor and the charity.

ENDNOTES

1 IRC §170(b)(1)(A); Reg. Sec. 1.170A-8(b).
2 IRC §1222.
3 IRC §170(b)(1)(A).
4 IRC §170(b)(1)(C)(i).
5 IRC §170(e)(1)(A).
6 Ibid.
7 Reg. Secs. 25.2512-3(a), 20.2031-3.
8 IRC §408(d)(8).
9 IRC §408(d)(8)(B)(i).
10 IRC §170(f)(3)(B)(i).
11 IRC §170(e)(1)(A).
12 Ibid.
13 *McGuire v. Comm'r*, 44 TC 801 (1965).
14 Reg. Sec. 1.48-1(c).
15 IRC §170(e)(1(B)(i).
16 IRC §170(e)(7).
17 IRC §170(e)(7)(D).
18 IRC §170(f)(12).

Access more information now!

An electronic copy of our companion booklet with further discussion on helping donors plan a gift—types of charities, charitable income tax deductions, and mitigating the impact on a donor's future income needs—is available in the *Professional Advisor* section of our website at **www.catholicfoundation.com**.

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