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Giving in an Uncertain Economy: The Strategic Tax Benefits of Charitable Giving

Antarctica is one of the most inhospitable places on Earth. It is covered by a sheet of ice and has recorded the world's lowest temperature at -128.6 degrees Fahrenheit.[1] Yet its scientific importance is so great that in 1955, the U.S. Navy sent a group of Seabees (the Construction Battalion) to establish a naval station. Unsurprisingly, the men were soon cold and homesick.

In New Jersey, teenage brothers Jules and John Madey connected with the group on their ham radio,[2] and soon realized their radio provided the best connection between the men and their family and friends at home. Jules in particular worked tirelessly to relay calls, deliver messages, and share news, and this great gift of time and effort contributed to the ultimate success of the mission despite the harshest circumstances. A naval radio operator said:

> The men would come into the ham shack … and I'd put them through to Jules. I'd watch the person change from morose to his morale going way up as soon as he heard Jules' voice, putting through the phone patch. I do not think Jules could possibly understand at his young age how important he was to us.[3]

In uncertain economic times, donors may hesitate to give. Sometimes, it is only with professional guidance that a potential donor makes the connection—it is possible to remain comfortable financially while contributing to the success of an important charitable mission. In this quarter's newsletter, we look at tax-wise giving—in particular, the charitable income tax deduction and the charitable gift annuity.

Tax-Wise Giving

When the economic forecast looks uncertain, donors tend to focus on protecting their family's financial health, becoming more reluctant to make substantial charitable gifts. The truth, of course, is that donors who continue to give will positively impact the vital work of the charitable recipients—but they will also reap personal benefits, most often in the form of tax advantages.

The Charitable Income Tax Deduction

Understanding the tax benefits of charitable giving begins with a look at the basics of the charitable income tax deduction. The general rule, as stated in §170 of the Internal Revenue Code (IRC), states that "there shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year."[4]

The law sets out the clear framework for obtaining a charitable deduction—any taxpayer who itemizes deductions may deduct a contribution to a qualified charity in the year in which the contribution is made. To do this, the donor must meet the two basic requirements for claiming a charitable deduction:

1. Determine the fair market value of the property donated to the charity, and
2. Retain documentation to substantiate the donation (described in the Treasury regulations as maintaining adequate records to substantiate the gift).[5]

The donor can satisfy the substantiation requirement with a cancelled check, a receipt from an online contribution or electronic fund transfer, a bank record, or a letter or other written communication from the charitable recipient. A written communication from the charity should list the name of the charity plus the date and amount of the contribution.[6] If the donation is made in a circumstance where a receipt from the charity is impractical (such as a donation made at a charity drop-box), the taxpayer must keep a reliable written record of each item donated.[7] Of course, the taxpayer's reliable record must include all of the information required in the regulations.[8]

The IRC lists additional substantiation requirements as the amount of the gift increases:

- **Cash donation of $250 or more.** The Code requires the donor to obtain a "contemporaneous written acknowledgment" for the donation.[9]
- **Gifts of property over $500 but not more than $5,000.** The donor must include a description of the donated property with their federal income tax return on IRS Form 8283.[10]
- **Gifts of property worth $5,000 or more.** The donor must obtain a qualified appraisal of the donated property and include an appraisal summary with the tax return.[11] If the donation is non-publicly traded stock, certain publicly traded securities, or a contribution by a C corporation, the donor must maintain additional records.[12] However, publicly traded stock that exceeds $5,000 but is less than $10,000 and non-publicly traded stock with a value less than $10,000 do not need a qualified appraisal.[13] Obviously, the appraisal of stock can be difficult depending on the availability of market quotations.

Donors must use caution, as certain gifts are not usually deductible, including:

- Volunteer time (work not done as a professional service)
- Donations to foreign charitable organizations
- Donations made to specifically benefit an individual or small group of individuals
- Donations made in a quid pro quo manner where the donor receives something of value back from the charity

While an income tax deduction is an important benefit for donors, it does not eliminate the cost of making the gift and is not typically the primary reason donors give. After all, altruism creates dopamine—the "happiness chemical"—which helps account for American giving during the pandemic. In that most uncertain of times, 2020 and 2021, donors gave $471[14] and $485 billion, respectively.[15]

The Charitable Gift Annuity

Those who want to make a charitable gift but are concerned about future income have a tax-advantaged way to meet their goals—the charitable gift annuity (CGA). The CGA is a contractual agreement between the donor and the charity in which the donor makes a gift to the charity and the charity, in return, provides a lifetime income stream to one or two annuitants selected by the donor. An annuitant must be a living person (not a trust, corporation, LLC, or charity), and the payments must be made for life, not a term of years or a specified number of payments. (A charitable remainder trust, on the other hand, can offer payments for a term of up to 20 years OR for the life or lives of the income beneficiaries.)

The gift annuity transaction is not a straight quid pro quo, though. The IRS views a charitable gift annuity as part gift and part annuity, meaning the present value of the donor's annuity is less than the value of the property transferred. The donor receives an income tax charitable deduction in the year of the gift, but only for the gift portion of the transfer, calculated as the value of the contributed cash or property less the present value of the annuity payments.

Only qualified charitable organizations may issue gift annuities and they are often subject to state regulations. In some cases, state laws require issuing charities to maintain segregated reserves to cover their potential obligations to annuitants under gift annuity agreements.

Determining the Payout

The charity sets the payout rates for the CGA based on the annuitant's age—generally, the older the annuitant, the higher the payout rate. However, the offered payout rate must also pass the 10%-residuum-to-charity rule set forth in the Internal Revenue Code.[16] The American Council on Gift Annuities (ACGA), a nonprofit with a volunteer board made up of active planned giving professionals, conducts research and publishes suggested CGA payout rates.[17] At its Board of Directors meetings, the ACGA reviews the assumptions that go into the suggested CGA rates and adjusts the rates if necessary. The ACGA suggested rates are "generally … designed to produce a target gift for charity at the conclusion of the contract equal to 50% of the funds contributed for the annuity."[18] While the charity may set its own rates, many charities follow the rates suggested by the ACGA.

The ACGA raised CGA rates starting July 1, 2022.[19] Rates for a single life annuity are:

Age	70	75	80	85	90
Payment rate	5.3%	6.0%	7.0%	8.1%	9.1%

Taxation of the Payout

At the outset, a CGA payout can be taxed as income in three ways:

- **Tax-free return of principal.** Part of the annuity payment is considered a tax-free return of principal until the assumed cost of the annuity (as determined by IRS tables) has been recovered.
- **Long-term capital gain.** If the donor is the annuitant and funds the CGA with long-term capital gain property, part of each payment will be taxed as long-term capital gain.
- **Ordinary income.** After the tax-free and capital gain portions of an annuity payment have been determined, the balance of the payment represents ordinary income.

Once the annuitant attains life expectancy, all principal attributable to the sale portion will have been recovered free of income tax and all capital gain attributable to the sale portion will have been recognized. Thereafter, the entire annuity payment will be taxable as ordinary income.

CGA Benefits

The CGA provides a dual benefit—a gift for the charity and an income stream for the annuitant. This combination alone makes the CGA a unique and attractive giving option, especially during uncertain economic times. Many donors appreciate the additional benefits of the CGA as well:

- Newly increased gift annuity rates lock in a higher fixed payment for life.
- Payment amounts generally increase for older donors and for donors who choose to defer the start of payments.
- The present value of the charity's interest in the gift annuity qualifies for a charitable tax deduction.
- Part of each annuity payment is considered tax-free return of principal.
- When the donor transfers appreciated property in exchange for the CGA, the resulting capital gains tax on the non-gift portion of the transaction can be spread out over the donor's life expectancy (if the donor is the annuitant).

Creating a Pattern of Success

The ham radio communications efforts by Jules and John Madey were key to keeping up the morale of the men who found themselves in Antarctica's harsh environment. Their selfless sacrifice of time (and sleep!) also helped create a pattern of success and giving back that followed Jules and John for the remainder of their lives. John went on to invent the free-electron laser while working at Stanford University. Jules invented the EZ-pass for the toll road system used by New York and New Jersey.

During uncertain times, donors can find effective ways to continue giving to meaningful organizations. These gifts not only provide financial support, but also raise morale for both the charity and those the charity serves. In this way, donors can also create a pattern of success and giving back, reaping the benefits of important tax savings while helping others.

ENDNOTES

1 Lize-Marie van der Watt, "Antarctica," *Britannica*, August 19, 2022.

2 Roman Chiarello, "Two Kids, a Ham Radio, and the World at Their Fingertips: How the Madey Brothers Made History in Clark," *TAPinto Clark*, December 17, 2020.

3 Elaine Hood, "Young ham radio operators kept IGY crew in touch with friends, family," *The Antarctic Sun*, January 30, 2009.

4 IRC §170(a)(1).

5 Treas. Reg. §1.170A-13(a)(1).

6 *Id*.

7 Treas. Reg. §1.170A-13(b)(1)(iii).

8 *Id*. See also Treas. Reg. 1.170A-13(b)(2)(ii).

9 IRC §170(f)(8)(A).

10 IRC §170(f)(11)(B).

11 Treas. Reg. §1.170A-13(c)(2)(i)(B).

12 Treas. Reg. §1.170A-13(c)(2)(ii).

13 Treas. Reg. §1.170A-13(c)(2)(ii)(A).

14 Haleluya Hadero and The Associated Press, "Americans gave a record $471 billion to charity in 2020," *Fortune*, June 15, 2021.

15 Anna Pruitt and Jon Bergdoll, "Americans gave a near-record $485 billion to charity in 2021, despite surging inflation rates," *The Conversation*, June 21, 2022.

16 IRC §514(c)(5).

17 "Who We Are," American Council on Gift Annuities.

18 "Current Gift Annuity Rates," American Council on Gift Annuities.

19 *Id*.

Access more information now!

An electronic copy of our companion booklet with a discussion of the tax benefits of various gifts is available in the *Professional Advisor* section of our website at **www.catholicfoundation.com**.

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