An Overview of Charitable Tax Deductions

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A key to charitable gift planning is assuring that the gift obtains a charitable deduction against the appropriate tax, the income, estate, or gift tax (or results in income exclusion). We will deal with all three taxes in this outline, but as will become clear, the income tax rules are the most detailed and technical. The deduction sections are IRC §§ 170 (income tax), 545(b)(2) (income tax deduction for personal holding company; varies some provisions of IRC § 170), 642(c) (estate or trust’s deduction for amounts paid or permanently set aside for certain charitable use), 2055 (estate tax), 2106(a)(2) (estate tax on nonresidents), and 2522 (gift tax).

The benefits of a charitable deduction can be quite valuable. Tax benefits from a charitable income tax deduction are larger where the state and federal tax blended rate is larger. A deduction of $20,000 for married Utah taxpayers filing jointly, in the 35% federal income tax marginal bracket (for 2013, over $388,350) and the state 5% bracket (starting in 2008), would be worth (ignoring "take-backs" such as personal exemption phase outs, limitations on itemized deductions, etc.) in the neighborhood of 38% (which is .35 + [(1-.35) x .05] of the $20,000, or $7,600. The estate and gift taxes hit high rates quickly, and the top rate (2013) is 40%; some amounts may be covered by the unified credit (the “applicable amount” of transfer without tax in 2013 is $5.25 Million, for estate and gift tax).

1. **The Charity.** The first matter of concern is whether the organization to which the gift is to be made qualifies for the receipt of deductible gifts. Not all nonprofit organizations are tax exempt, and not all tax-exempt organizations qualify for tax deductible contributions, and of those that do qualify, different deduction limits may apply for income tax purposes, depending on the classification of the charity (which are discussed below at sections 4 and 5).

   a. **Typical Qualifying Organizations.** Deductible contributions may be made to U. S. nonprofit literary, religious, charitable, education, health care, or scientific organizations or those for the prevention of cruelty to children or animals, or for fostering national or international amateur sports competition (where no part involves providing facilities or equipment, other than under IRC § 501(j) for certain qualified amateur sports organizations) (IRC §§ 501(c)(3); 170(c)), or to federal, state, or local governments or public park or recreation facilities, war veterans organizations, certain restricted gifts for charitable use to fraternal societies, or (for income tax) certain cemetery organizations for members. The local Girl Scouts council is a classic organization to which deductible contributions can be made.

   i. **Organizations Not Individuals.** Only gifts to organizations can qualify; no gifts to individuals are deductible, regardless of the charitable intent behind the gift. Thus, gifts to cover personal expenses of missionaries, clergy, and the like do not qualify (Rev.
Rul. 79-81, 1979-1 C.B. 107). However, where the charity controls the use, the deduction will generally be available despite the donor's hope a particular missionary benefits. See Rev. Rul. 56-304, 1956-2 C.B. 306 (criteria for selecting individuals to benefit); Peace v. Com'r, 43 T.C. 1 (1964). The organization may be a corporation, trust, community trust, fund, or foundation. It may not be a partnership. Donations to a disregarded single member limited liability company owned by a charity are treated as donations to the charity if the other requirements under IRC § 170 are met. Notice 2012-52, 2012-35 IRB.

ii. Types of Organization for Types of Taxes. The descriptions of organizations are very similar under IRC § 170(c) (income tax), 2055(a) (estate tax), and 2522 (gift tax). There are a few differences, however; for example, certain cemetery organizations are mentioned for income tax purposes only, certain employee stock plans (under IRC § 664) are mentioned for estate tax purposes only, and the description is slightly different for U. S. residents and nonresidents for gift tax purposes.

b. Typical Nonqualifying Organizations. No charitable deduction is allowed for contributions to civic leagues, social or sports clubs, labor unions, chambers of commerce or business leagues, foreign organizations or conduits to organizations in foreign countries (some exceptions exist for Canadian, Mexican, or Israeli charities (under income tax treaties), for U. S.-based charities with foreign operations (Rev. Rul. 80-286, 1980-2 C.B. 179, Rev. Rul. 71-460-1971-2 C.B. 231, Rev. Rul. 68-165, 1968-1 C.B. 253, and Rev. Rul. 68-117, 1968-1 C.B. 251), or for U. S.-based "friends of" charities for other foreign countries, which are more than conduits (Rev. Rul. 75-65, 1975-1 C.B. 101, Rev. Rul. 63-252, 1963-2 C.B. 101, and Rev. Rul. 66-79, 1966-1 C.B. 48)), foreign organizations engaged in prohibited transactions (IRC § 4948(c)(4)), political or lobbying groups, homeowners associations, fraternal lodges (except for some gifts by individuals to a fraternal society or lodge where it is to be exclusively used for religious, charitable, scientific, literary, or educational purposes, or the prevention of cruelty to children or animals), organizations testing for public safety, and so on. Certain exempt organizations which are not qualified to receive tax deductible contributions must conspicuously state this in every fund raising solicitation. IRC §§ 6113 (requirement) and 6710 (penalty).

i. Other Possible Deductions. Perhaps some dues, fees, contributions, etc., to such groups may qualify for a business expense (see IRC § 162) or other deduction, but they do not qualify for charitable deductions. Some such nonqualifying organizations may sponsor separate charities which do qualify, however.

ii. Donor-advised Fund. There are special restrictions (discussed further below) denying deductions for contributions to certain donor-advised funds (see IRC § 4966(d)(2)), including, in particular, Type III supporting organizations not functionally integrated (see IRC § 4943(f)(5)(A)). See IRC § 4966(d)(2) (defining donor-advised fund); IRC §170(f)(18)(A) (income tax), 2055(e)(5)(A) (estate tax), 2522(c)(5)(A) (gift tax) (denying deduction except if conditions are met, including also denying a deduction for contributions to a donor advised fund of a veterans organization, fraternal lodge, or cemetery company). Also, a contribution to a donor-advised fund not otherwise denied the deduction requires a special
acknowledgment from the sponsoring organization that such sponsor has exclusive legal control
over the assets contributed. IRC §§ 170(f)(18)(B), 2055(e)(5)(B), 2522(c)(5)(B).

c. **Disqualifying An Organization.** If an organization otherwise organized
for an appropriate qualifying purpose engages in certain conduct, it may lose its tax exemption
and ability to receive tax deductible contributions. For example, inurement to private benefit,
nonpublic benefits, political campaign or lobbying activity (beyond an allowed type or
insubstantial amount of legislative influence) racially discriminatory policies (Rev. Rule. 71-447,
1971-2 C.B. 230), Communist control (IRC § 170(k)), and private foundations engaging in
prohibited transactions or subject to a foundation termination tax (IRC §§ 508(d) and 507(c)),
will all potentially destroy the deduction to an organization. However, a contribution made
before the loss of qualification is published as a revocation of a determination letter in the
Internal Revenue Bulletin (see Pub. 78 of the Service, only available online, for a list of current
organizations with determination letters; it is not all inclusive, however) or before the donor is
aware that a determination letter issued by the Service was revoked or its revocation was
imminent but where the donor was not in part responsible for the conduct causing the revocation,
will still be deductible by a donor relying on a Service-issued determination letter. Rev. Proc.
2011-33, 2011-25 IRB 887. Without a determination letter (churches, for example, are not
required to obtain one), such special protection of the deduction does not exist, but the donor

d. **Social Welfare Gift Tax Effects.** For gift tax purposes, charitable gifts are
deducted in determining taxable gifts. IRC § 2522; see 8.b. below. Also, there is no gift tax on a
transfer to a political organization described under IRC § 527(e)(1). IRC § 2501(a)(4). Gifts to
social welfare organizations described in IRC § 501(c)(4), on the other hand, do not qualify for
this political exclusion or for the deduction for charitable gifts under Code Sec. 2522, and thus
appear taxable as gifts to the extent the annual exclusion ($13,000 per donee of present interest
gifts under IRC § 2503(b)) does not apply and the unified credit does not cover the tax. Note
that donors to political organizations need to be disclosed, but not so with social welfare
organizations and that (among other differences) the stronger political restrictions on charities
do not apply to IRC § 501(c)(4) social welfare organizations. Some incidental political
campaigning is permissible under IRC § 501(c)(4), but is subject to a tax under IRC § 527(f) on
political organization taxable income, and any dues for lobbying would not be deductible (e.g.,
as a business expense).

2. **Cash or Property Given.** A deduction is only allowable for cash or property
contributed to or for the use of a qualified charity. A contribution “for the use of” a charity must
Certain types of property or rights create special issues, including:

a. **Services.** Services are not deductible, nor is time lost from work (there is
no income from the service, however). Reg. § 1.170A-1(g). See also, *Levine v. Com'r*, 54 TCM
1986) (denying deduction for legal services to charities); Rev. Rul. 57-462, 1957-2 C.B. 157
(free advertising is a service and nondeductible).
However, out-of-pocket expenses in providing services, including normal volunteer service not of a type for which compensation is usually paid, are deductible for income tax purposes. This can include travel expense, where there is no significant element of vacation or recreation. IRC § 170(j). Actual auto expense may be used, or a statutory (not indexed) 14¢ per mile can be used. IRC § 170(i).

b. **Blood and Organs.** Blood and organ donations are not deductible. See Rev. Rul. 53-162, 1953-2 C.B. 127; Lary v. U.S., 787 F.2d 1538 (11th Cir. 1986) (blood not deductible whether deemed property or service; lacks proven basis or holding period; sale of blood would be taxable income under IRC § 61).

c. **Appraisal Fees.** The determination of the value of donated property is not charitable. It might, however, qualify as a deduction for tax determination under IRC § 212 (subject to the 2% of adjusted gross income miscellaneous itemized deduction floor before which the deduction is not allowed).

d. **Pledges and Notes.** Until paid, pledges and promissory notes to charity are not deductible. Regs. § 1.170A-1(a). They generally lack consideration and are unenforceable. See Rev. Rul. 68-174, 1968-1 C.B. 81; compare to Mackay v. U.S., 503 F.2d 591 (10th Cir. 1974) (promissory note on a debt payable by a corporation to an individual was assigned by the individual to charity and the deduction was allowed). Even an accrual basis taxpayer gets no income tax deduction. However, an enforceable pledge might allow a gift tax deduction for an individual. See Rev. Rul. 81-110, 1981-1 C.B. 479.

e. **Checks, Credit Cards, Letters of Credit.** Checks paid in the normal course are treated as cash paid in the year the check is deposited by the donee or the donor gives up dominion and control (for example, by mailing it to the charity). See Metzger Est. v. Com'r, 38 F.3d 118 (4th Cir. 1994) and Dillingham Est. v. Com'r, 88 T.C. 1569 (1987) aff'd, 903 F.2d 760 (10th Cir. 1990). Credit card charges are treated as immediate donations with borrowed funds. Rev. Rul. 78-38, 1978-1 C.B. 67. Irrevocable letters of credit drawable immediately are treated similarly. PLR 8420002.

f. **Credit Card Rebates.** A cash rebate received from the party to whom the buyer directly or indirectly paid the purchase price for an item is an adjustment to the purchase price rather than an accession to wealth, and is not includible in the buyer's gross income. Rev. Rul. 76-96, 1976-1 CB 23, as modified by Rev. Rul. 2005-28, 2005-1 CB 997. The Service has privately ruled in PLR 201027015 that where credit card cash rebates may be paid to a charity or received in cash as instructed by the taxpayer, the payments of the rebates to charity are a voluntary charitable contribution which can be deductible if the other requirements for deduction are met. One such requirement is that where such contribution is of $250 or more the taxpayer needs to substantiate the contribution by a contemporaneous written acknowledgment of the contribution by the donee organization meeting all requirements for the substantiation. Code Sec. 170(f)(8)(A). Query: If some of the credit card purchases giving rise to the rebate were earlier deducted, how should the rebate be allocated to avoid a double deduction?
g. **Options.** For gift tax purposes, an enforceable option generates a deduction on transfer (Rev. Rul. 80-186, 1980-2 C.B. 280); but for income tax purposes, only when the option is exercised with a difference between fair market value and the exercise price is the gift deductible (Rev. Rul. 82-197, 1982-2 C.B. 72).

h. **Clothes and Household Items.** Clothes and household items must be in good, used condition or better, or (regardless of condition) must have a qualified appraisal where valued over $500, for income tax purposes. IRC § 170(f)(16).

i. **Vehicles.** Cars, boats, and planes over $500 must have qualified appraisals for income tax deductibility, and no more than the lesser of the fair market value (limited to cost or other basis, if the vehicle is not useable by the charity in its exempt function) or the proceeds obtained by the charity (unless the charity materially improves the vehicle or the vehicle is sold below value to a needy individual by the charity) is deductible. IRC § 170(f)(12). Special acknowledgment rules apply. Notice 2005-44, 2005-25 IRB 1287 and Notice 2006-1, 2006-4 IRB 347.

j. **Taxidermy.** The income tax deduction is the smaller of fair market value or cost or other basis. IRC §§ 170(e)(1)(B)(iv) and 170(f)(15).

k. **Partial Interests.** Contributions of rights to use property, which rights are less than the donor's entire interest in the property (or loans of cash) do not generate deductions for income, gift, or estate tax purposes. IRC §§ 170(f)(3), 2522(c)(2), 2055(e)(2). However, remainder interests in homes or farms, or an undivided, fractional interest in every part of the donor's interest, or a conservation grant in real property (see l. below), may qualify for a deduction. Also, special technical rules apply to charitable lead or charitable remainder (split interest) trusts; they must be a special type of annuity trust, unitrust, or pooled income fund. IRC § 664 governs charitable remainder trusts; charitable lead trusts are governed by a number of IRC provisions. The interests are valued actuarially. See IRC § 7520.

i. **Tangibles.** With respect to tangible personal property (e.g., a painting) the entire interest (including the copyright if the donor of the art holds the copyright) must be held by the donor or by the donor and the charity. IRC § 170(o)(1)(A). For a painting, a 25% fractional interest entitling the charity to actual possession for three months each year may qualify. The deduction is recaptured, along with interest and a 10% penalty tax, if the rest of the interest is not contributed to the charity in 10 years or on death, whichever is sooner, or if in that time the charity has not taken substantial physical possession for its related purposes. IRC § 170(o)(3)(A). IRC § 170(o) is only an income tax rule; it does not apply to estate or gift taxes.

ii. **Undivided Interest.** An undivided interest is usually of a percentage of the entire asset but may be a percentage of each year. PLR 9303007.

iii. **Estate Tax Effect Concerning Tangibles.** With respect to gifts and bequests after August 17, 2006, for estate tax purposes, there is no longer a problem relating to the requirement that additional interests in tangible personal property passing to charity on the
donor’s death were valued at the lesser of the original gift value or estate tax value. This caused the appreciation in the donor’s retained fractional interest after the making of the initial gift to be subject to the estate tax without an offsetting charitable deduction. IRC § 2055(g)(1). It was retroactively repealed under the Technical Corrections Act of 2007 § 3(d), IRC §§ 2522(e)(2) and 2055(g) after repeal.

iv. **Remainers in Homes or Farms.** Although a partial interest, a remainder in a home or farm may be deductible. IRC § 170(f)(3)(B)(i); Reg. §§ 1.170A-7(b)(3) and (4); 20.2055-2055-2(e)(2), 25.2522(c)-3(2)(ii). Under these regulations, a residence includes a second vacation home. Also, a houseboat, trailer, or other dwelling may qualify. See analogous rules under IRC §§ 1034 and 216 concerning “personal residence.” For example, leaving a life estate in a residence or farm to the surviving spouse, remainder to charity, would qualify for a charitable deduction for the value of the remainder interest.

1. **Conservation Easements.** Easements in property are partial interests which absent an exception could not be deductible. Qualified conservation easements, however, can generate charitable tax deductions but have special rules to meet. IRC § 170(f)(3)(B)(iii). The donation must be to a governmental unit or publicly-supported charity (or an organization controlled by the government or charity for the exclusive benefit of the government or the charity), and must be of the donor’s entire interest in surface rights (not mineral rights), a remainder interest, or a perpetual restriction, and must be for special outdoor or historic conservation purposes. IRC § 170(h). See Herman v. Com’r, T.C.M. 2009-205, (2009) (partial air space development rights on a historic preservation property where underlying land could not be unilaterally restricted, found insufficient for deduction). The easement needs to be protected in perpetuity (IRC § 170(h), Reg. § 1.170A-14(b)(2)), but with historic facades, a mortgage on the property often means that the lender will have priority to insurance proceeds in the case of a casualty to the building, thus leaving the easement without value in such a case; this can destroy the deduction. See 1982 East, LLC v. Com’r, TC Memo 2011-84. The lender must subordinate to the easement (see Reg. § 1.170A-14(g)(2)) (general subordination requirement), but if the insurance proceeds go to the lender, the easement deduction may fail unless the proportionate value of the easement is payable to the conservation group holding the easement. But see Kaufman v. Shulman, 687 F.3d 21 (1st Cir. 2012) (reversing Tax Court restrictive reading of regulations as “surely contrary to the purpose of Congress”). Although some courts have been more forgiving (see Scheidelman v. Com’r, 682 F.3d 189 (2d Cir. 2012)), the Tax Court has been very picky about the sort of appraisal which will be deemed sufficient as a qualified appraisal (Reg. § 1.170A-13(c)(3) to support a conservation easement deduction. Rothman v. Com’r, TC Memo 2012-218 (virtually identical appraisal method as in Scheidelman found insufficient after reconsideration in light of Scheidelman). Conservation easements raise interesting and difficult valuation issues in any event. See Trout Ranch, LLC v. Com’r, 110 AFTR 2d ¶ 2012-5208, 2012 WL 3518564, not published (10th Cir. 2012) aff’g T.C. Memo. 2010-283.

The deduction is enhanced through 2013 (IRC § 170(b)(1)(E)(vi); for corporate farms see IRC § 170(b)(2)(B)(iii)) by being subject to the 50% of contribution base rule (rather than the usual 30% for capital gain assets) (IRC § 170(b)(1)(E)(i)), and for qualified farmers and ranchers (with over half of their income from such trade or business), the deduction can be up to 100% of
the contribution base (IRC § 170(b)(1)(E)(iv)(I)), in either event (50% or 100% of contribution base) with a 15-year special carryover where the conservation contribution exceeds 50% of the contribution.

m. Nonfood inventory. Income tax charitable deductions for nonfood inventory of a business are generally limited to the lower of market value or basis, with rules for the proper determination of inventory costs in a prior year; if the goods are not in the year’s beginning inventory, no deduction is allowed, but the price of goods bought and donated in the same year is treated as included in costs of goods sold (thus, potentially reducing income). See Regs. § 1.170A-4(b)(1). See Regs. § 1.170A-4(b)(1).

i. Corporate Donations. C-corporations may benefit from enhanced deduction rules for qualified inventory donations where inventory is donated to a public charity or operating foundation for use (without a transfer for any consideration) related to the recipient’s tax-exempt function to benefit ill, needy, or infant persons. The contribution deduction reduction for such a donation is less than usual; the deduction limit is the lesser of donor's basis plus half the unrealized appreciation or else twice the donor's basis in the property. A special written acknowledgment from the donee about the use and disposition of the property is required. IRC § 170(e)(3)(A) and (B).

ii. Book Inventory. Donors which are C-corporations benefited through 2011 from a similar enhanced deduction limitation for book inventory donations to public schools. A special certification by the recipient is required. The donee need not be limited to public charities or operating foundations. IRC § 170(e)(3)(D).

n. Food Inventory. Food inventory donated may be deducted for income tax purposes if it is apparently wholesome and in regulatory compliance, and is used (without a transfer for consideration) for ill, needy, or infant persons, by a public charity (not a private operating foundation) where such use is related to its exempt purpose, and the special donee acknowledgment procedures are met. General inventory rules also apply. The deduction is enhanced through 2013 because it is limited to the lower of the donor's basis plus half its unrealized appreciation, or twice the property's basis; but the total deduction for a non-C-corporation donor may not exceed 10% of the donor’s net income (without regard for the food inventory deduction). IRC § 170(e)(3)(B) and (C). The donation may be by any donor, not just by a C-corporation. A special enhancement for certain farmers and ranchers applied for food donations during the short period October 3, 2008 through December 31, 2008; the percentage limitations do not apply (similar to conservation easements described at k. above). IRC § 170(b)(3).

o. Scientific Research Property or Computers. Donations of new (first use by the donee) scientific research tangible personal property constructed or assembled no more than two years before the donation receives the same enhanced limit on deductibility as applies to qualified inventory donations. The donor must be a C-corporation, which is not a personal holding company or service organization, and the donee must be described in IRC § 41(e)(6)(A)
or (B) (institutions of higher education or certain scientific research organizations), and a special written acknowledgment is needed. IRC § 170(e)(4).

Similarly, through 2011, such donors could have received this same enhanced deduction for software, computers, peripheral equipment, and fiber optic computer cables donated within three years of being acquired, constructed, or assembled, to schools, exempt organizations supporting primary or secondary education, or public libraries. The rules were: the donee can only pay shipping costs and the property must be used by the donee in its exempt function, fit its education plan, and meet some technical specifications. It must be put to its first use by the donor or the donee. IRC § 170(e)(6). Donations of tangible personal property worth over $5,000 may be subject to recapture where the deduction is not limited to basis and the property is disposed of by the charity which was to use it in its exempt purpose.

p. **Intellectual Property.** Patents, copyrights (mostly; see IRC § 1221(a)(3) (self-created copyright, composition, letter, memo, etc., or letter, memo, etc., prepared for taxpayer, are not capital assets) or 1231(b)(1)(C) (such items not treated as used in trade or business)), trademarks or trade names, trade secrets or know-how, software (mostly; see IRC § 197(e)(3)(A)(i)), are generally capital assets deductible for income tax purposes only to the lesser of fair market value or basis (IRC § 170(e)(1)(B)(iii) (reduction for long-term capital gain)). Some self-created items or letters, memos, etc., created for the taxpayer are ordinary income assets (IRC §§ 1221(a)(3) or 1231(b)(1)(c)) and the deduction is also limited to the lesser of value or basis (IRC § 170(e)(1)(A) (reduction by gain which would not have been long-term capital gain)). However, a declining level of deduction for income from the property over up to 10 years of the anniversary of the donation or the life of the property, may be taken under special rules (but not for donations to certain private foundations). IRC § 170(m)(1). Copyrights are separate from the art to which they apply for gift and estate tax purposes, but generally not for income tax purposes. If a charitable organization, other than a private foundation that doesn't qualify as a 50% charity, receives or accrues net income during a tax year from a qualified intellectual property contribution, it must make an annual information return (Reg. § 1.6050L-2(a)). The donee generally must file the information return (with a copy furnished to the donor) on or before the last day of the first full month following the close of the donee's tax year to which net income from the qualified intellectual property is properly allocable (Reg. § 1.6050L-2(c), Reg. § 1.6050L-2(d)(2)).

q. **Life Insurance.** A policy purchased to be given to a charity may need to qualify under state law insurable interest rules. See PLR 9110016 (revoked by PLR 9147040, but only due to a change in state law). In Utah, there is a special provision in the Insurance Code authorizing charities to obtain life insurance, notwithstanding the general rules on insurable interests. See UCA §§ 31A-21-104(2) (insurable interest) and 104(6) (special rule for charities and certain other tax-exempt organizations). Also, the deduction for income tax purposes is effectively limited to cost basis under IRC § 170(e)(1)(A). (Note: giving the policy itself is not the same as naming the charity as the beneficiary of the policy). The gift of a policy is effective only after any 30-day or similar right of the donor to cancel the policy has expired. PLR 200209020.
There are special restrictions for charitable split-dollar life insurance programs, essentially prohibiting them as personal benefit contracts where a donor or family member benefits from any premium paid by the organization. See IRC § 170(f)(10). There are exceptions for gift annuities purchased by the charity to meet its obligations to pay a lower annuity to a donor (IRC § 170(f)(10)(D)), or where a charitable remainder trust holds all incidents of ownership and is entitled to all benefits. IRC § 170(f)(10)(E). There is an excise tax on the charity of 100% of any premiums paid for any personal benefit contract. IRC § 170(f)(10)(F). Also, IRC § 6050V creates special reporting requirements by the charity.

r. IRAs. For 2006 through 2013, a charitable IRA direct rollover distribution (from a traditional or Roth IRA) may be used to make a charitable contribution without incurring tax by the donor on the income inherent in the IRA, but only if the donor is aged 70 1/2, and only to the extent the excluded amount, in the aggregate for all IRAs of the donor, does not exceed $100,000 for the year. IRC § 408(d)(8). This is an exclusion from income, not a deduction and is not taken into account in determining the deduction under IRC § 170. IRC § 408(d)(8)(E). However, the contribution from the IRA must otherwise (i.e., absent the exclusion) be deductible under IRC § 170 for the exclusion to apply. IRC § 408(d)(8)(C). The exclusion does not apply to distributions to supporting organizations (IRC § 509(a)(3)) or to donor advised funds (IRC § 4966(d)(2)). IRC § 408(d)(8)(B)(i). (Since this provision was extended in late 2012, there is an election to treat distributions made in January 2013 as if made in 2012.)

3. **Charitable Intent and Retained or Received Benefit.** There must be charitable intention. For example, dedication of a street by a real estate developer will not qualify as a charitable donation. McConnell v. Com'r, T.C.M. 1988-307; see also Rev. Rul. 76-257, 1976-2 C.B. 52. See further PLR 201222004 (conservation easement for transferable ecological mitigation credits is a sale or exchange). The charitable motive need not be the only motive (see Waller v. Com'r, 39 T.C. 665 (1963) acq., 1963-2 C.B. 5 (desire to save taxes does not negate charitable intent)), so long as nothing of substance is received in return. Tuition for a religious education is not a charitable donation. Graves v. Com'r, 68 T.C.M. 1445 (1994); Sklar v. Com'r, 282 F.3d 610 (9th Cir. 2002). Also, any retained benefit or benefit received in return will reduce or eliminate (e.g., under the partial interest rules or quid pro quo rules) the deduction.

Incidental benefits do not arise to the dignity of a quid pro quo. See Rev. Rul. 80-77, 1980-1 C.B. 56 (deductible contribution to Girl Scouts of America where daughter was in a local Girl Scout troop). However, the purchase of Girl Scout cookies is not deductible because the value received is equivalent. Werbiansky v. Com'r, 34 T.C.M. 467 (1975). State tax benefits are generally incidental and will not destroy the deduction. In a situation that pushes the extremes of this doctrine, the receipt by the taxpayer of a transferable state tax credit that can be carried forward into a later year under a state credit incentive program for donations to charity or to the state was stated by the Service’s Chief Counsel not to destroy the federal deduction in the year the credit was received because state deductions or credits do not negate charitable intent and are not treated as a quid pro quo, but on the sale of the credit, the proceeds would be included in income. CCA 201105010.
Retaining control of donated funds or property can destroy the deduction. *Gundanna and Viralam v. Com’r*, 136 TC No. 8 (2011) (purported contribution to donor advised fund usable at will by donor for student loans to donor’s child and compensation for family members for good works, was denied the deduction and an accuracy related penalty was imposed; beneficial ownership was not transferred and the quid pro quo of goods or services received in consideration, in whole or part, for the donation, such as the future student loans etc., was not reported by donee organization).

a. **Fund-raising Activities.** The donor needs to prove what part of a gift is truly for charity and does not reflect some return benefit. Rev. Rul. 67-246, 1967-2 C.B. 104. Tickets to fund-raising events, preferential rights to attend cultural or athletic events (see IRC § 170(1) on special rules for colleges allowing 80% as a charitable contribution), and token thank-you gifts are typical return benefits. The test for whether any deduction is allowed where there is a return benefit, is derived from *U.S. v. American Bar Endowment*, 477 U.S. 105 (1986) and is in Reg. § 1.170A-1(h), which requires that the donor intends to, and actually does, make a payment in excess of the value of the goods or services received in return. If the test is met, only the excess over the value received in return is deductible. There are exceptions, so that some return value is ignored where the cost to the charity does not exceed the low-cost item limit for unrelated business (IRC § 513(h)(2); $9.90 in 2012) or either:

i. **Insubstantial Value.** The goods or services have only insubstantial value to the donor (see Rev. Proc. 90-12, 1990-1 C.B. 471, and Rev. Proc. 92-49, 1992-1 C.B. 987 as supplemented, which provide guidelines); the safe harbor for 2012 is either token items (logo cups, T-shirts, etc.) of $9.90 or less for a contribution of $49.50 or more, or benefits no more than 2% of the contribution, with the benefit capped at $99; or

ii. **Events.** Annual membership benefits are offered for $75 or less per year consisting of rights to purchase event tickets from colleges (see IRC § 170(1); the price of the tickets themselves will not be deductible, however) exercisable frequently, or rights to attend member-only events, where the cost per person (excluding overhead) is reasonably projected to be within IRC § 513(h)(2) “low-cost article” limits ($9.90 in 2012).

b. **Bargain Sales.** A sale to charity for less than full value may be a partial charitable contribution and a partial sale or exchange. The gift portion is deductible within IRC § 170 limits; the sale or exchange portion generates taxable gain or loss, with basis allocated proportionately pursuant to IRC § 1011(b).

i. **Reduction Rules Effect.** If the bargain sale is of the sorts of property for which IRC § 170(e) reduces the deduction to basis (by reduction to eliminate the gain portion of the value), such as ordinary income property (such as inventory), tangible personal property capital gain property not related to the charity’s exempt purpose, or capital gain property given to a nonoperating private foundation, the bargain sale rules are not used, but the reduction rule is used instead. Reg. § 1.1011-2(a)(1). The reduction rules are discussed in section 5 below.
ii. **Gain.** The gain on sale is determined by allocating basis proportionately to full market values of the contributed and sold portions. Reg. § 1.170A-4(c)(2)(i). The basis of the sold portion offsets the price (amount realized) for determining gain. The potential gain on the donated portion is similarly determined and reduces the deduction, essentially to the basis allocated to the donated portion, where a reduction rule applies.

c. **Encumbered Assets.** The debt to which property is subject is an amount realized on its sale. *Crane v. Com'r*, 331 U.S. 1 at 12-14 (1947); *Com'r v. Tufts*, 461 U.S. 300 at 310 (1983). The transfer of encumbered property to charity is treated as a sale of the property. Reg. § 1.1011-2(a)(3); *Ebben v. Com'r*, 783 F.2d 906 (9th Cir. 1986). This is true, even where the debt is nonrecourse or is not assumed. *Guest v. Com'r*, 77 T.C. 9 (1981). The bargain sale rules for a part sale, part contribution, would apply. Also, the deduction reduction rules of IRC § 170(f)(5) apply to any interest prepaid by the donor, so that there will be no double deduction. The reduction is not necessary if the interest expense is not deducted.

d. **Charity Raffle Concerns.** Before reaching the deductibility of amounts donated for a charity raffle, the very legality of holding the raffle must be considered. The Utah Constitution, Article VI, Section 27, prohibits the legislature from authorizing ‘any game of chance, lottery or gift enterprise under any pretense or for any purpose.’ Pursuant to this constitutional mandate, the legislature has prohibited certain gambling activities as criminal offenses. Utah Code Ann. §§ 76-10-1101(1), (2), 76-10-1102(1), 76-10-1104(1). Real raffles are treated as unlawful gambling. However, an opportunity drawing where there is only a suggested donation should not be so treated. If someone wants a ticket and is unwilling to make any or all of the suggested donation, the ticket must nevertheless be provided. This way there is not an amount wagered or paid for the ticket. Naturally it must be clear that the donation is voluntary. Normally people attend events to support the charity and will make the donation because it will help the charity. Where the donation is voluntary, the “raffle” does not require any amount of contribution at all, so there appears to be no wager or other payment for state law purposes (*Albertson's, Inc. v. Hansen*, 600 P.2d 982 (Utah 1979) (payment required; merely showing up, etc., is not sufficient consideration to make it a prohibited wager), and the drawing becomes more like a simple door prize.

The Service denies any tax deduction for any amounts paid for a raffle, but where there is no real gamble at all, the rule should be different. See PLR 200012061. Also, if the amount paid for the raffle (assuming a real raffle) can be broken out, there is at least some chance that the rest of the donation may be deductible. See *Goldman v. Com'r*, 388 F.2d 476 (6th Cir. 1967), aff'd 46 TC 136 (1966). For the true raffle part, the best possibility for a deduction would be as a gambling loss if the requirements for that deduction are met. See IRC § 165(d).

Certain other tax rules need to be considered as well, and the issue will be whether there are exemptions or exceptions applicable to this nonraffle fund-raising method. Let’s assume as an example that a tax exempt public charity under IRC § 501(c)(3) holds a prize drawing from 250 tickets with a suggested donation of $100 each, with the prize being 40% of any donations received for the tickets, which tickets will be given away to anyone at the event who requests one.
Although the winner may receive over $600, the maximum winnings, $10,000, would not be more than 300 times any wager unless the wager was less than $33.33 (a different wager amount would of course apply if a lesser payoff occurred; also, without any wager at all, as appears to be the case here, the windfall would be infinite, but there is authority that it is just not the sort of thing that is treated as a gambling win; see Tax News 1977-6, 3/4/77); thus reporting of the winning to the Service on form W-2G (IRC § 6041 and related rules) appears not to be required. Treas. Regs. § 31.3402(q)-1(d), Ex. 10.

Also, although the winnings could exceed $5,000, where the winner paid nothing and was not required to purchase anything for the opportunity, the withholding of tax (IRC § 3402(q) and related rules) appears not to be required. Tax exempt charities have no general exemption from the withholding rule, however. Rev. Rul. 85-46, 1985-1 CB 334.

Although a charity is not generally exempt from the wagering excise tax (IRC § 4401 et seq.), which applies to lotteries (IRC § 4421), there is nevertheless an exception for a drawing where no part of the net proceeds received by the charity inures in any way to private benefit (IRC § 4421(2)(B)). This exception would not apply if, for example, the tax exemption was for a club, lodge, or similar organization, and outsiders donated for the tickets because the nonmembers are then contributing toward expenses and costs which would otherwise be the responsibility of the members, and thus there is a benefit to such members.

Although nothing is paid for the opportunity, it is nevertheless something that a donor receives (even if a non-donor also receives the same opportunity) and thus, as a matter of caution, it probably should be taken into account in the charitable disclosure of quid pro quo benefits affecting the amount of any charitable deduction; such a disclosure of the good faith estimate of value of goods or services received by a donor is required with respect to any donation of $75 or more. IRC § 6115.

If done regularly, the raffle could constitute an unrelated trade or business under IRC § 513 subject to unrelated business income tax under IRC § 512. See TAM 8023002 (weekly lottery). However, the exception under IRC § 513(a)(1), where substantially all the work is performed without compensation, could apply. PLR 8013050.

4. Classification of Charities. Tax exemption is often based on Code § 501(c)(3) which applies to organizations organized and operated exclusively for one or more of these purposes: charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition (not involving providing facilities or equipment), or the prevention of cruelty to animals. An organization must be careful to actually operate for its exempt purpose and to benefit the community. There can be no inurement to private benefit for insiders or impermissible private benefits for others. No substantial lobbying or political activity is allowed. No commercial insurance business may be conducted. IRC § 501(m). A private organization must be a corporation, trust fund or foundation, or a community chest, and may not be a partnership or individual. If the technical organizational and operational standards are met, the organization will be tax exempt and able to accept tax-deductible charitable donations. The benefits and burdens of such an organization, and the limits on income
tax deductions for contributions to them, however, vary by the type of IRC § 501(c)(3) organization, classified basically by source of support.

a. **Private Foundations.** This is the "default" classification for a § 501(c)(3) organization; an organization will be a private foundation unless it qualifies as some other type. IRC § 508(b). A typical private foundation would be a nonprofit charitable foundation (usually a corporation or trust) established by a charitably inclined family or business to help administer its tax deductible charitable giving.

   i. **Disadvantages.** Most organizations would like to avoid being a private foundation because they are subject to even more stringent operational restrictions designed to prevent abuses, with rather onerous punitive excise taxes to put teeth into the rules. IRC §§ 4941 to 4948.

   ii. **Split-interest Trusts.** Charitable split-interest trusts, such as charitable lead or remainder annuity trusts, unitrusts, or pooled income funds (see e.g., IRC § 664), would not be private foundations, but are governed by special rules of their own. However, certain foundation excise taxes will apply to such split-interest trusts. IRC § 4947(a)(2).

   iii. **Supporting Organization Problems.** A charity which is not otherwise a private foundation can become one if it is a supporting organization (Type I or III (as described in d.iii. below)), which accepts a donation from a person who directly or indirectly, together or with related persons, controls the supported organization. IRC § 4958(c)(2) and (c)(3)(C)(ii). This would cause all the foundation excise taxes to apply. Also, the excess business holdings excise tax will apply to Type II or Type III not functionally integrated supporting organizations on contributions from such a control person, and will apply to a public charity's donor-advised funds.

b. **Private Operating Foundations.** This is a private foundation that does something more than give away money through grants to other charitable organizations; it actually conducts charitable operations.

   i. **Hybrid Treatment.** It is treated like a public charity for some purposes, but not for most others, and is subject to the major restrictions on private foundations. It is treated like a public charity for charitable donation deduction purposes generally allowing donors a larger deduction, and is not subject to the excise tax on the undistributed income of private foundations.

   ii. **Income Tests.** It must meet the income test, which requires it to distribute for the active conduct of its exempt activities substantially all of its income or its minimum investment return. It must also meet one of three alternative tests:

      (1) the asset test which requires substantially more than half of its assets be held for use in its exempt function;
(2) the endowment test which requires direct distribution of at least two thirds of its minimum investment return (2/3 of 5% of the value of its assets not used directly in its exempt function = 3 ⅓% of its endowment); or

(3) the support test which requires that at least 85% of its support (other than investment income) be from a combination of general public donations and 5 or more exempt organizations, that not more than 25% of support be from any one exempt organization, and that not more than 50% be from gross investment income.

c. Public Charities. Public charities are generally (see, however, a.iii. above) not subject to the private foundation excise taxes and have a great deal more flexibility than private foundations. They are, however, subject to excise taxes related to excess benefits for insiders and related persons or organizations. IRC § 4958.

i. Statutory Types Based on Activities. Some organizations qualify under the Internal Revenue Code as public charities (which are not private foundations) by reason of the nature of their activities.

(1) Churches and conventions or association of churches.

(2) Certain educational organizations with regular faculty, curriculum, and student body which may be at any educational level.

(3) Certain hospital and medical research organizations.

(4) University endowment foundations.

(5) Governmental units.

ii. Publicly-supported Groups. For most purposes this is the most important classification for avoiding private foundation status. It comes in two flavors: §170(b)(1)(A)(vi)/509(a)(1) which is aimed at organizations primarily supported by gifts, grants, and contributions (although sometimes referred to as a Type I organization, let's call this a gift supported organization or GSO), and §509(a)(2) which is aimed at organizations primarily supported by revenues from its exempt function (although sometimes referred to as Type II, let's call this a function supported organization or FSO).

(1) It is not unusual to qualify as both a GSO and an FSO, but it is better to be a GSO than an FSO only, if possible.

(a) GSOs can be beneficiaries of pooled income funds, can qualify as distributees on a tax-free termination of a private foundation, can make grants to an FSO qualified under the FSO support tests without the limitation on the amount of support from any one organization.
(b) GSOs also have technical advantages in qualifying for the various tests imposed by the Code.

(2) Some FSOs, which Congress thought would be typical of the organizations qualifying under the FSO provisions, include symphony societies, garden clubs, alumni associations, scout groups, such as Girl Scouts of Utah, PTA’s, and other membership organizations. An FSO must meet two tests:

(a) It must normally receive more than 1/3 of its support in each year from a combination of (y) gifts, grants, contributions, and membership fees, and (z) gross receipts from admission fees, sales, services, furnishing facilities, to the extent these activities are not an unrelated trade or business; and

(b) It must normally receive not more than 1/3 of its support from gross investment income and the net amounts, after tax of unrelated business taxable income.

(3) GSOs receive support from governmental units or the general public; examples are publicly or governmentally supported museums, libraries, community centers to promote the arts, organizations providing facilities for opera, drama, symphony, or ballet or other services to the public such as the American Red Cross. GSOs must meet one of two alternative tests of public support:

(a) It normally receives at least 1/3 of its total support from governmental units, direct or indirect contributions from the general public, or a combination of these; or

(b) It normally receives a substantial part (10% or more) of its support from government or the general public or a combination of them, and it meets a facts and circumstances test by showing factors which indicate that it is organized and operated to attract public and governmental support on a continuing basis, including maintaining a continuous bona fide program for soliciting funds or conducting activities to attract support from governmental units or other publicly oriented organizations.

d. Other Classifications. There are other classifications of organizations that are not private foundations which can be significant.

i. Community Trusts. This is a particular type of publicly supported organization designed to be created by a few large donors to attract other contributions for the benefit of a particular community or area with a governing body consisting of representatives from that community or area. Some special rules apply to these.

ii. Organizations Testing for Public Safety. Although contributions to these are not deductible, the organization is tax exempt. Because Congress found them not to be subject to abuse, it allowed them nonprivate foundation status.
iii. **Supporting Organizations.** These are organized and operated exclusively for the benefit of or to perform the functions of public charities (including government). IRC § 509(a)(3). They also must be operated, supervised, or controlled by, or in connection with, a public charity and must not be controlled directly or indirectly by disqualified persons other than foundation managers and other than one or more public charities. Although generally treated like public charities, in some circumstances, some or all foundation excise taxes may apply (see a.iii. above and d.iv. below).

1. The required relationship to the supported organization must insure that the supporting organization will be responsive to the needs of the supported organization and either be an integral part of, or else maintain a significant involvement in, the operations of one or more public charity supported organizations. The required relationship must be one of these three:

   - operated, supervised, or controlled by (Type I)
   - supervised or controlled in connection with (Type II)
   - operated in connection with (Type III).

2. The integral part test requires either the function be one that, but for the supporting organization, would be done directly by the supported one, or else substantially all the income of the supporting organization is paid to the supported organization(s) and this is a large enough part of the support for the supported organization(s) to ensure their attention. Temporary Regulations require that a non-functionally integrated supporting organization annually distribute a “distributable amount” equal to the greater of 85% of adjusted net income or 3.5% of the fair market value of the supporting organization’s non-exempt-use assets. Reg. § 1.509(a)-4T(i)(5)(ii)(B).

3. The first two types of relationship require that a majority on the board of the supporting organization be controlled by the supported organizations.

4. The third type of relationship does not have this board majority requirement but must either name the supported organization or organizations in the supporting organization’s articles (although another may be substituted later from a like class, and the level of support may vary) or else have a historic and continuing relationship with the public charity supported with a substantial identity of interests. In either event, it must work closely with the supported organization in a way to be responsive to its needs, and must do so by meeting a significant voice test under Reg. § 1.509(a)-4.

   a. The relatively loose standard for this third, or Type III, supporting organization of “operated in connection with” coupled with the relatively loose standard of “maintaining a significant involvement in” (rather than being an integral part of) the supported organization, has led to some abuses.
(b) This third type of supporting organization can be subject to special excess benefit excise tax rules designed to avoid some abuses by making certain transactions automatically excess benefit transactions, and to the full amount involved (not just the “excess” amount).

(c) Also, if it is a donor-advised fund (see IRC § 4966(d)) and not functionally integrated, donations to it are denied any tax deduction, but even if not denied outright, a deduction for a contribution to a donor-advised fund requires a special acknowledgment of exclusive control of the assets by the sponsoring organization.

(5) Supporting organizations must report all supported organizations, including their type, and must certify that the supported organization is not controlled by any disqualified person. IRC § 6033(l).

iv. Donor-advised Funds. Donor-advised funds (defined in IRC § 4966(d)(2)(A)) are subject to a number of additional excise taxes: on excess business holdings (IRC § 4943), taxable distributions (IRC § 4966(a); and see IRC § 4945(h) on expenditure responsibility), prohibited benefits (IRC § 4967), and certain excess benefit payments (grant, loan, compensation, etc., are treated automatically as taxable to full amount involved under IRC § 4958).

(1) A donor-advised fund is a fund or account separately identified by reference to contributions from a single donor or group of donors, which is owned or controlled by a sponsoring organization, and with respect to which a donor (or designee) has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in the fund or account by reason of the donor’s status as a donor.

(2) However, a fund or account is not treated as a donor-advised fund under two exceptions:

(a) If it makes distributions only to a single, identified organization or governmental unit, even if named for the donor and the donor has advisory privileges with respect to distributions; or

(b) If it makes grants to individuals for travel, study, or similar purposes on the advice of the donor, but the donor’s advisory privileges are performed exclusively by the donor, or donor's advisor, as a member of a committee, all members of which are appointed by the sponsoring organization, where no combination of the donor or the donor’s advisor controls the committee directly or indirectly, and the sponsoring organization awards all grants on an objective, nondiscriminatory basis pursuant to a procedure approved in advance by its governing board, and these procedures comply with IRC § 4945(g)(1)(2), and (3) (relating to similar grants by private foundations).

The procedure under IRC § 4945(g) needs to be approved by the Secretary, and the grant must be either a scholarship or fellowship for study at an educational organization (under IRC § 170(b)(1)(A)(ii): regular faculty, curriculum, and enrolled student body at a location) or a prize
or award to an individual selected from the general public and subject to IRC § 74(b) tax exclusion (i.e., primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement, where the individual recipient is selected without any action on the recipient's part, without any required future service, and the award is transferred to a certain type of governmental unit), or to achieve a specific objective, produce a report or similar product, or improve or enhance a literary, artistic, musical, scientific, teaching, or similar capacity, skill, or talent of the grantee.

(3) Without incurring an excise tax on taxable distributions under IRC § 4966(a), a donor-advised fund can make distributions only to:

(a) a public charity which is not a supporting organization (of any type) controlled (directly or indirectly) by the donor or donor advisor, and which is not a Type III nonfunctionally integrated supporting organization (thus, distributions to a noncontrolled Type I, II, or functionally-integrated Type III organization would be allowed);

(b) the sponsoring organization;

(c) some other donor-advised fund (whether or not sponsored by the same organization); or

(d) any person for a charitable purpose (under IRC § 170(c)(2)(B), i.e., religious, charitable, scientific, literary, educational, etc.), but only if the sponsor exercises expenditure responsibility (IRC § 4945(h)).

(4) Also, sponsoring organizations must report on donor advised funds held by them at the end of a tax year. IRC § 6033(k).

5. **Charitable Income Tax Deduction Limitations.** Income tax charitable deductions are subject to limits not applicable for gift tax or estate tax purposes.

a. **Property Type Limitations.** Although normally the deduction for contributed property is of fair market value, including appreciation in value after acquisition of the property, there are exceptions.

i. **Sales.** Bargain sales have been discussed above at 3.b. Also, prearranged sales, where the charity does not have the ability to choose to retain or sell the property, will cause the donor to be treated as first having sold the property. Rev. Rul. 78-197, 1978-1 C.B. 83; Ravenlast v. Com'r, 119 T.C. 157 (2002).

ii. **Ordinary Income and Short-term Gain Property.** Under IRC § 170(e), the built-in gain or value over basis of ordinary income and short-term gain property is removed from market value in determining the deduction for income tax purposes, essentially reducing the deduction to the donor's basis. This rule applies, among other things, to inventory, donor-created art or manuscripts or those produced for the donor (see Jones v. Com'r, 129 T.C. 146 (2007), aff'd on other grounds 560 F.3d 1196 (10th Cir. 2009), cert denied (2009) (the Tax
Court held that even if an attorney owned the client files, donation would not be deductible beyond any basis (and here there was none) under IRC §§ 170(e)(1)(A) and 1221(a)(3)(A); the Tenth Circuit affirmed under IRC § 1221(a)(3)(B) instead of § 1221(a)(3)(A); this case relates to the court and related papers in the custody of the lawyer for the notorious Oklahoma City bomber), capital assets held for less than one year, and stock under IRC § 306, which does not receive long-term gain treatment. See IRC § 170(e)(1)(A), Reg. § 1.170A-4(b)(1), IRC § 1221(a)(3). It also applies to collapsible corporation (IRC § 341) or foreign stock (IRC § 1248(a), assets subject to recapture of depreciation-type deductions (IRC §§ 1231, 617(d)(1), 1245(a), 1250(a), 1252(a), 1254(a)), partnership interests or S-corporation stock with "unrealized receivables" or appreciated inventory (IRC § 751(a); IRC § 170(e)(1)), unpurchased government publications (IRC § 1221(a)(5)), and original issue discount or market discount bonds (IRC §§ 1271 and 1276). However, as noted above at 2.l., m., and n., food inventory and some other items are subject to a different, more favorable, reduction rule during the time periods in which the special rules apply. As is generally the case, the taxpayer has the burden to establish basis.

iii. Long-term Gain Property. Long-term gain property consists of business use, investment, and personal use (e.g., home) property held over a year. In a few special cases, the deduction for contributions of such property will not be its full market value.

(1) Foundations. A donation to a nonoperating foundation reduces the deduction, essentially to the donor’s basis (IRC § 170(e)(1)(B)), unless the donation is of “qualified appreciated stock,” i.e., marketable securities with readily-available market quotations where the donor and the donor’s family have contributed no more than 10% in value of the stock (including prior donated shares). IRC § 170(e)(5). Stock subject to distribution restrictions under SEC Rule 144 can qualify. PLR 9746050.

(2) Tangibles Related Use. Also, a donation of long-term tangible personal property which is not used by the charity in a use related to its exempt purpose will cause a reduction in the deduction. Further, even if used in a related use, if the charity disposes of it in three years, the deduction is reduced or recaptured. IRC §§ 170(e)(1) and 170(e)(7). This is avoided if the charity certifies in writing under penalty of perjury that the property was used in a related function and that use was substantial, or that it was intended to be so used, but the use became impossible or imprudent to implement. IRC § 170(e)(7)(D).

(3) Intellectual Property. Also, as noted above at 2.o., the deduction for intellectual property is reduced to basis or value (whichever is less), but there is a declining schedule for further deduction of income derived from it by the charity which may apply. IRC § 170(m)(1).

(4) Other. Restrictions on deductions for used clothes and taxidermy have been described in 2.g. and i. above.

b. Charity Type Limitations. As described in section 4 of this outline, charities are classified under the Code. These classifications can affect the charitable deduction for contributions made to them. The maximum charitable income tax deduction is measured by a...
contribution base which varies by class of charity. The contribution base is a percentage of the donor's adjusted gross income (aggregated for joint returns) without taking into account any net operating loss carryback. IRC § 170(b)(1)(F). Amounts which cannot be used in one year, can be carried forward to be used in future years, normally the next five years, subject to the same contribution base limitation. To the extent not used in the carryover period, the deduction is lost.

i. **50% Organizations.** Public charities are called 50% charities because generally donations to them may be used up to 50% of the contribution base. IRC § 170(b)(1)(A). Private operating foundations are also included. Nonoperating private foundations are generally not included; however, one may be included if it is a pass-through for 100% of the contribution within three months and 15 days or if it is a pooled fund passing through its income within three months and 15 days after its tax year and distributing corpus to charity within a year of the death of the donor (or surviving spouse if the spouse has a right to designate the charity to receive it). IRC §§ 170(b)(1)(A)(vii) and 170(b)(1)(F). However, long-term capital gain property does not get the benefit of the 50% contribution base; rather, unless the donor elects to value the donation at basis (and thus get 50% treatment), such donations are subject to only a 30% contribution base cap. IRC § 170(b)(1)(C)(i) and (iii).

1. The 50% election is irrevocable and is all or none for all long-term capital gain property donated in the year and also for any 30% carryover from prior years. Reg. § 1.170A-8(d)(2)(i) and (ii); Woodbury v. Com'r, 900 F.2d 1457 (10th Cir. 1990).

2. As described above (at 2.k.), contributions of conservation easements by farmers and ranchers enjoy special treatment. They may be subject to a 100% of contribution base limit and carried forward for up to 15 years. IRC § 170(b)(1)(E)(iv).

3. The 50% of contribution base election for a donation reduced by its gain (i.e., reduced to its basis) may be worth considering where a large donation deduction can't be fully used over 5 years of carryover at the 30% level, the long-term gain is small, future years will be in lower tax brackets (e.g., this may occur on retirement), or the taxpayer has died (there will be no carryover after the final return).

ii. **30% Organizations.** Private, nonoperating foundations, veterans groups, fraternal societies, and cemetery associations are called 30% organizations, because donations to them are generally limited to 30% of the contribution base, subject, however, to ordering rules which take into account 50% contribution base donations for that year. However, long-term gain property donated to a 30% organization is subject to a 20% contribution base limit, again subject to the ordering rules.

iii. **Ordering Rules.** The ordering rules are in Reg. § 1.170A-10. They are complex and favor 50% limitation contributions over 30% or lower limitation contributions. For example, the 30% contributions are deductible up to the lesser of (i) 30% of the contribution base, or (ii) 50% of the contribution base, less the 50% contributions to organizations, including capital gain property subject to a 30% limitation. Similarly, 30% limitation contributions have priority over 20% limitation contributions. Thus, in some cases, it may be a good idea to
consider taking the basis deduction election on capital gain property given to a 50% organization in order to increase the overall deduction in earlier years, where there are also contributions to 30% organizations. For example, assuming a $50,000 total contribution base:

<table>
<thead>
<tr>
<th>Donation</th>
<th>w/o election</th>
<th>w/election</th>
</tr>
</thead>
<tbody>
<tr>
<td>$2,000 cash to public charity 50% Org.</td>
<td>$2,000</td>
<td>$2,000</td>
</tr>
<tr>
<td>long-term gain land $28,000 value, $22,000 basis, to 50% Org.</td>
<td>$15,000 limit (30% of $50,000)</td>
<td>$22,000 (basis)</td>
</tr>
<tr>
<td>$5,000 cash to private foundation 30% Org.</td>
<td>no limit left ($28,000 + $2,000 exceeds $25,000)</td>
<td>$1,000 (up to the 50% of $50,000 = $25,000 limit)</td>
</tr>
</tbody>
</table>

Total Usable Now | $17,000 | $25,000 |

Carry Forwards | $13,000 | no cap gain $

Potentially Usable | $35,000 | $29,000 |

iv. **Donor-advised Fund.** A contribution to a functionally-nonintegrated, Type III supporting organization, which is a donor-advised Fund (IRC § 4966(d)(2)(A)), will be denied any income, estate, or gift tax deduction at all. IRC §§ 170(f)(18)(A), 2055(e)(5)(A), 2522(c)(5)(A). See discussion at section 4.d.iv. above of what is a donor advised fund. Where the Type III supporting organization is functionally integrated, contributions to it may be deductible, even where it is a donor-advised fund, but only if the charity provides a written acknowledgment to the donor specifying that the organization has exclusive control of the assets. IRC §§ 170(f)(18)(B) (income), 2055(e)(5)(B) (estate), 2522(c)(5)(B) (gift).

c. **For-use-of Limitations.** Property donated “for the use of” a 50% organization becomes subject to a 30% limitation. This occurs with charitable lead trusts or similar trusts providing an income interest for the charity or with a charitable remainder trust which continues to hold the remainder for the charity after the term interest ends. Reg. § 1.170A-8(a)(2). See *Davis v. U.S.*, 495 U.S. 472 (1990) (enforceable trust requirement).

d. **Other Limits.** Nonmedical, itemized deductions are cut back where the donor’s “applicable amount” exceeds a certain level (for 2009 it is $166,800 joint, $83,400 married filing separately). The reduction is scheduled for phase out through 2009 (the deduction
reduction has two-thirds effectiveness in 2007, one-third for 2008 and 2009); no reduction applies in 2010. IRC § 68(f) and (g). The reduction in total itemized deductions is in the lesser of 3% of adjusted gross income over the “applicable amount” or 80% of otherwise-allowable, itemized deductions.

Also, the alternative minimum tax, where it applies, may indirectly reduce the benefit of the donor of the charitable deduction. See IRC §§ 55-59.

e. **Corporations.** Under IRC § 170(b)(2)(A), the deduction for charitable contributions in a tax year by a corporation (a C-corporation, i.e., without the S-election) can’t exceed 10% of its taxable income for that year. Taxable income for purpose of this limit is computed taking into account most of the usual items including the dividends paid deduction (IRC § 561), but without regard to certain items (IRC § 170(b)(2)(C)):

1. charitable contributions (IRC §170);
2. dividends-received deductions (IRC §§ 241, 243 through 247);
3. deductions of premium on repurchase of convertible debts (IRC § 249);
4. net operating loss (NOL) carryback to the tax year (IRC § 172);
5. domestic production activities deduction (IRC § 199); and
6. capital loss carryback to the tax year (IRC § 1212(a)(1)).

Some further adjustment is necessary for a regulated investment company. For it, taxable income is generally its taxable income, adjusted for the dividends paid deduction, but computed without regard to capital gain dividends and exempt-interest dividends. IRC § 852(b)(2); PLR 200845007.

f. **Flow-through Taxpayers.** S-corporations (see IRC §§ 1371-1375) and partnership-taxed organizations (general and limited partnerships and most limited liability companies) have pass-through tax treatment and generally are not themselves taxpayers. The charitable deduction for donations made by these organizations passes through to their shareholders, partners, or members.

i. **Basis Adjustment.** The deduction may be based on the market value of the property donated (where otherwise applicable), and the shareholder, partner, or member reduces his or her basis in the stock, partnership interest, or company interest by his or her pro rata share of the corporation’s, partnership’s, or company’s basis in the property donated. Rev. Rul. 96-11, 1996-1 C.B. 140 (partnership-taxed organizations) IRC § 1367(a)(2) (S-corporations). For S-corporations, after 2013, the rule reverts to its prior requirement that the basis of stock be reduced by the full fair market value of the donated property. IRC § 1367(a)(2). This could put the shareholders of S-corporations at a disadvantage due to the quicker basis reduction, even if under the basis limit rules (described below) the deduction for the contribution can be used by the shareholders.

ii. **Basis Limit.** Losses and deductions for S-corporation shareholders are limited to their basis in their stock. IRC § 1366(d)(1). No such limitation applies for
partnership-taxed organizations. See IRC §§ 705(a) (basis determination), 703 (partnership computations), 704(a) and (d) (allocations by partnership agreement; limitation on losses); McKee, Nelson, & Whitmire, 1 Federal Taxation of Partnerships and Partners ¶ 10.05 [1][b] (3d ed. 2004); PLR 8405084; Reg. § 1.704-1(d)(2) (list of losses under IRC § 704(d) does not include charitable deductions). A zero basis taxpayer may still obtain a charitable deduction without basis reduction, but partners with a positive basis would reduce basis.

S-corporation shareholders would be at a disadvantage if the reduced basis described above limited their deductions and losses. However, under revised IRC § 1366(d)(4) (effective for contributions made in 2006 or later) the basis limit won't apply to the extent of the excess, if any, of the shareholder's share of the charitable contribution over the shareholder's share of the basis of the contributed property.

g. Trusts and Estates. An income tax charitable deduction is allowed to a trust only for contributions made out of gross income. IRC § 642(c)(1). Even if the property was purchased out of prior year's gross income by the trust, the charitable deduction is allowed only for the adjusted basis of the donated property, and not for the higher fair market value of the property without a realization event. CCA 201042023 (admitting, however, that no known prior authorities had so limited such a deduction). The deduction under IRC § 642(c)(1) is in lieu of the deduction under IRC § 170(a) but applies to amounts paid for a purpose described in IRC § 170(c), i.e., typical charitable purposes, but without regard to the IRC § 170(c)(2)(A) limit to U.S. organized organizations. Such amounts paid from gross income are, under IRC § 642(c)(1), “without limitation” so the usual percentage limitations applicable to individuals do not apply. (Nonexempt charitable and split interest trusts, on the other hand, are treated as taxable private foundations and their charitable deductions are under the regular income tax charitable deduction rules and thus are subject to the percentage and other limitations of those rules.)

Also, trusts may deduct contributions paid in one year from the immediately preceding year's income; the deduction would be for the preceding year even though paid in the later year. IRC § 642(c)(1). The election must be made not later than the due date, with extensions, of the trust's return for the succeeding year and is made by filing a statement with that year's return. The election may be revoked only with IRS consent. Reg. § 1.642(c)-1(b).

A trust may claim a charitable deduction for its distributive share of a charitable contribution made by a partnership taxed organization in which the trust is a partner or member, even though the trust's governing instrument doesn't authorize the trustee to make charitable contributions. Such an authorization (which need not be mandatory) is generally needed for a trust to receive a charitable deduction for its own paid contributions (Old Colony Trust Co. v. US, 301 US 379 (1937); however, set aside amounts must be required by the trust document); but since the partnerships contributions are not those of the trust itself, this general rule would not apply. Rev. Rul. 2004-5, 2004-3 IRB 295; Field Service Advice 200140080. A donation is not deductible however if it is “allocable” to income that would, if the trust were a tax-exempt organization described in IRC § 501(c)(3), be unrelated business taxable income. IRC § 681(a).

The rules applicable to trusts also generally apply to estates as well. IRC § 642.
6. **Dealing with Donors by Charity.** There are a number of rules relating to the requirements for a charity in dealing with and informing its donors about matters relating to deductible donations. IRS Publication 1771, “Charitable Contributions - Substantiation and Disclosure Requirements” is helpful.

a. **Sale Reports.** If the charity receives charitable deduction property, other than marketable securities and cash, valued at more than $500 and within three years sells, exchanges, or disposes of that property (other than as a distribution for charitable purposes), then the charity must file a Form 8282 “Donee Information Return” within 125 days of the disposition and give a copy to the person who donated the property to the charity. It must state how the donated property was used prior to disposition and whether the use was related to the charity's tax-exempt function. IRC § 6050L. The statement must also state that such use was substantial (for contributions after September 1, 2006). IRC § 170(c)(7)(D)(I).

b. **Appraisal.** If the value of donated property, other than cash or marketable securities, exceeds $5,000, the donor must obtain an independent qualified appraisal for it; such appraisal must be made no more than 60 days before the gift and no later than the due date of the return. Treas. Reg. § 1.170A-13(c). The charity is not such a qualified appraiser. This qualified appraisal rule is strictly enforced, as are the other substantiation rules, and can produce harsh results. *Mohamed v. Com’r*, TC Memo 2012-152 (flat denial of $18.5 Million deduction for real estate without any issue of over valuation; relief under Reg. § 1.170A-13(c)(4)(iv)(H) (which allows a donor to provide a forgotten appraisal summary within 90 days of IRS's request without penalty) could not help where the original appraisal was not a qualified appraisal completed before the due date of the return and later appraisals were untimely).

c. **Acknowledgments.** Special acknowledgments from the charity are required in a number of cases.

i. **Over $5,000 and Illiquid.** For any noncash, nonmarketable securities, donations over $5,000 (appraisals are required for these), the charity would need to have an authorized person sign Form 8283. The donor needs the form to get a deduction for securities, too, but the charity does not need to sign it. The charity's signature on Form 8283 only means it has received the property and knows of the information reporting requirements on dispositions which were described above. The signature does not indicate any opinion on, or concurrence in, the value of the property.

ii. **$250 or More.** Donors need a written acknowledgment from the charity to deduct any contribution of $250 or more. IRC § 170(f)(8)(B)(i). The acknowledgment will be needed by the earlier of the date the donor files the income tax return for the year of the gift, or the due date, including extensions, for such return filing. IRC § 170(f)(8)(C). It must contain a statement whether the donee organization provided any goods or services in consideration, in whole or part, for the donation and if so an estimate of the value. Failure of the timing and content of the acknowledgement is fatal to the deduction for the contribution. *Durden v. Com’r*, TC Memo 2012-140.
iii. **Over $75 Quid Pro Quo.** The charity must provide a donor a disclosure statement for what is known as a “quid pro quo” contribution over $75. IRC § 6115. A quid pro quo donation is one where the donor receives something of value in return, so the payment is in part a contribution and in part for goods or services. The written disclosure would need to inform the donor of the amount that is deductible and a good-faith estimate of the value of goods or services received by the donor. There are some exceptions, such as goods or services of insubstantial value (for 2012 the safe harbor is for token items (logo cups, T-shirts, etc.) costing the charity $9.90 or less for a contribution of $49.50 or more, or benefits no more than 2% of the contribution, with the benefit capped at $99), or pure sales without a donative element (e.g., museum gift shop sales).

iv. **Donor Advised Funds.** Contributions to donor-advised funds of a Type III supporting organization which is not functionally integrated will not be deductible at all, as discussed above. Even deductible contributions to a donor-advised fund will require a special acknowledgment from the sponsoring organization of the fund asserting exclusive legal control over the fund. IRC §§ 170(f)(18) (income), 2055(e)(5) (estate), 2522(c)(5) (gift).

v. **Intellectual Property.** Where a public charity receives or accrues net income during a tax year from a qualified intellectual property contribution, it must make an annual information return and provide a copy furnished to the donor. Reg. § 1.6050L-2(c), Reg. § 1.6050L-2(d)(2). The return needs to show, among other things, the amount of the donee’s net income for the tax year that is properly allocable to the qualified intellectual property (determined without the IRC § 170(m) limitations that would exclude income not reported to the donee, income received ten years after the initial contribution, and income beyond the legal life of the qualified intellectual property). Reg. § 1.6050L-2(b).

d. **Conservation Easement State Rule.** If a conservation easement is to be received, the charity needs to provide the donor a three-day notice of the sorts of easements available and of the desirability of obtaining tax advice. See UCA § 57-18-3 et seq.

7. **Valuation and Related Issues.** Other than cash, donated property needs to be valued in order to determine the deduction.

a. **General Rules.** Valuation starts at fair market value as of the date of transfer, although as we have seen, certain types of donations may be subject to reductions, for example, to eliminate appreciation (e.g., IRC § 170(e)). The normal definition of fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. Reg. § 1.170A-1(c)(2). See also discussion at sections 7.b.ii. and 7.c.iii. below.

i. **Appraisal.** Special appraisal and substantiation rules apply to certain types of property donations. Internal Revenue Service Publication 561 “Determining the Value of Donated Property” provides helpful guidance. See also Publication 526 “Charitable Contributions” and instructions to Form 8283. A qualified appraisal by an independent qualified

ii. **Accession to Wealth.** If property is actually an accession to wealth when acquired, income may be increased to offset the effect of the charitable contribution deduction. *Holcombe v. Com'r*, 73 T.C. 104 (1979) (optometrist who obtained glasses, frames, etc., from friends, patients, and others in connection with business, had income increased by their value when they were donated to charity; they were not gifts but “accessions to wealth”); *Haverly v. U.S.*, 513 F.2d 224 (7th Cir. 1975) (school principal who received unsolicited text books and donated them to the school library had taxable income in year of donation); Rev. Rul. 70-498, 1970-2 C.B. 6 (books received by a newspaper book reviewer treated similarly). Gross income includes “income from whatever source derived.” Internal Revenue Code (“IRC”) § 61. This includes “accessions to wealth.” *Com'r v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955).

iii. **Estate Tax.** The value for estate tax purposes is determined at date of death or at the alternate valuation date of six months after date of death where an all or none election is made. IRC §§ 2031(a) and 2032. Certain types of real property used in a trade or business may have special valuation rules apply to them, such as family farm and ranch use property valued at such use rather than at highest and best use. See IRC §§ 2032A.

b. **Valuation and Related Penalties.** Penalties related to erroneous valuations have long been a staple of tax law, often with respect to charitable donations, sometimes in connection with organized scams, but more often in connection with taxpayers overzealous in obtaining increased tax deductions. Although a showing of “reasonable cause” may eliminate some penalties, it is not available as a defense against some key penalties.

i. **Substantial Valuation Misstatement.** If the value (or basis of property asserted by the taxpayer is 150% or more of actual value, an) underpayment of tax of $5,000 ($10,000 for a corporation other than a personal holding company or S-corporation) or more is subject to a 20% penalty. IRC §§ 6662(a), 6662(b)(3), and 6662(c)(1)(A). No reasonable cause exception applies; however, erroneous marketable security quotes do not generate a penalty. IRC § 6664(c)(2) and (3)(A).

ii. **Gross Valuation Misstatement.** If the value asserted (or basis) of property is 200% or more of the actual value, a 40% penalty on any underpaid tax is imposed. IRC § 6662(h)(1) and (2)(A). Again, there is no reasonable cause defense. IRC § 6664(c)(2) and (3)(A). There is no $5,000 of tax floor.

iii. **Negligence.** A negligence or disregard of rules penalty might be asserted under IRC § 6662(b)(1). The penalty is 20% of the tax understatement.
iv. **Understatement of Income Tax.** If the tax discrepancy is over 10% of the actual tax or $5,000 (whichever is greater), a penalty for substantial underpayment of income tax may apply. It is 10% of the tax over $5,000. For corporations (other than S-corporations or personal holding companies) the trigger point is the lesser of (i) the greater of 10% of tax or $10,000, or (ii) $10 Million. Proper disclosure on a return can reduce this penalty, except for tax shelters. IRC § 6662(d).

v. **Fraud.** In aggravated situations, the fraud penalty of 75% of the underpaid tax may apply. IRC § 6663(a). A reasonable cause defense may apply. IRC § 6664(c)(1).

vi. **Interest.** Interest runs on the donor's underpaid tax, on the negligence and valuation penalties, and on the fraud penalty from the date the return was required to be filed (including extensions). IRC § 6601.

vii. **Appraisal Penalty.** Any person responsible as an appraiser who knows, or reasonably should have known, that the use of the appraisal for a deduction in a return or refund claim would result in a substantial or gross valuation misstatement (for income tax or estate or gift tax purposes) is subject to a penalty equal to the greater of 10% of the amount of tax underpayment attributable to the misstatement, or $1,000, or 125% of the gross income of the appraiser for the appraisal. The defense that the appraisal value was more likely than not the actual value is available. IRC § 6695A(b) and (c).

1) This appraiser penalty is new (2006) and its scope is unclear. It applies to "any person." This appears to go beyond those doing "qualified appraisals" but would apply to any appraisal. Does it apply to government appraisers, too? What is an appraisal, anyway? Does the personal representative become subject to this penalty in reporting a value on an estate tax return? Does the lawyer or CPA? What if a business appraiser relies on the value of real estate established by a real estate appraiser or relies on an attorney's opinion as to the nature of the rights in the company being valued?

2) Can an “appraiser," whoever that is, be blacklisted under Circular 230, which refers to IRC § 6701(a) (aiding and abetting understatement of tax liability)? The answer appears to be yes. This may be far worse than the monetary penalty itself.

viii. **Aiding and Abetting.** The penalty for aiding and abetting applies to any person who aids or assists in, procures, or advises with respect to, the preparation or presentation of any portion of a return, affidavit, claim, or document, who knows or has reason to know that portion will be used in connection with any material tax matter and who knows that if so used, it would result in an understatement of the tax of another person. The penalty is generally $1,000 ($10,000 for the tax of a corporation). It applies to acts of subordinates and is in addition to any other penalty, except that, where it is assessed, it supersedes return-preparer penalties under IRC § 6694(a) or (b) or under IRC § 6700 (promoting abusive tax shelter).
ix. **Other Sanctions.** Tax advisors and return preparers may in some circumstances be subject to penalties, debarment, or other sanctions for wrongful conduct relating to charitable deductions. See, e.g., Circular 230, IRC § 6694, and professional rules of ethics.

x. **Charity Penalties.** The charitable recipient has some disclosure and reporting duties, and the failure to meet them can give rise to penalties. See, e.g., IRC § 6714 (penalty for failure to make required disclosure regarding quid pro quo contributions; $10 per contribution up to $5,000 per event or mailing), IRC § 6721 (penalty for not filing information return on failure to report disposition of donated related use property under IRC § 6050L(a) or failure to report personal benefit contracts under IRC § 6050V; generally $50 per return up to $250,000 per year, but the penalty may be lower if failure is timely corrected or if gross receipts are less than $5 Million, or the penalty may be higher if the failure is due to intentional disregard). See Internal Revenue Service Publication 1771 “Charitable Contributions - Substantiation and Disclosure Requirements.”

8. **Gift, Estate, and Generation-skipping Taxes.** The discussion above has related not only to income tax but also to estate and gift tax. However, some matters related to gift and estate tax are worth reiterating or raising to the extent not earlier discussed. Also, some points should be highlighted concerning the generation-skipping tax.

a. **Generation-skipping Tax.** For generation-skipping tax purposes, a charity is deemed to be in the donor's generation. IRC § 2651(e)(3). However, there is still some benefit, because in determining the inclusion ratio the fractional denominator is reduced by estate or gift tax charitable deductions under IRC §§ 2055 or 2522. IRC § 2652(a)(2). Reg. §§ 26.2642-1(c) and 26.2642-3. This can affect a charitable remainder trust where the lifetime benefit is for grandchildren or more remote descendants, or a charitable lead trust where the remainder passes a grandchild or more remote descendant. For example, if a charitable remainder trust for a specific charity designated at the creation of the trust is funded with $1 Million, the lifetime interest is valued at $700,000, and the charitable remainder is valued at $300,000, the GST exclusion necessary to eliminate GST (reducing the inclusion ratio to zero) is $700,000 (not $1 Million). (Without a named designated charity, there is an issue concerning whether there is a direct skip or a later taxable termination taxable to the trust, rather than a taxable distribution taxable to the skip person.)

b. **Gift Tax.** Gift tax charitable deductions are not limited to annual exclusion amounts (currently $13,000 per year per donee) but are unlimited. However, the partial interest rules apply to limit certain types of charitable gifts. One of these partial interest rules applies a little differently for purposes of estate and gift taxes: works of art are items subject to copyright but are separate from the copyright. See IRC §§ 2055(e)(2) and (4)(b) (“work of art”) and Reg. § 20.2055-2(e)(1)(ii)(a). Thus, an unlimited deduction is available both for the work itself and for the copyright, which would not be the case for income tax purposes. However, the recipient must be “qualified organization,” meaning a public charity or private operating foundation (IRC § 2055(e)(4)(D)), which uses the property in a manner related to its
tax-exempt function. IRC § 2055(e)(4)(C). See also 1.d. above on taxable gifts to certain social welfare organizations.

i. **Return Requirements.** A gift tax return will often be necessary but is not required if the only gifts above the annual exclusion amounts are gifts to charity of the donor’s entire interest. IRC § 6019(a)(3). There is an exception for qualified conservation easements under IRC § 2522(d). Pursuant to IRC § 6019(a)(3)(B), these need not be reported on a gift tax return if there are no other reportable gifts.

ii. **Valuation Formulas.** In order to protect against the dangers of formula provisions or other pricing methods which may not equal fair market value, some agreements involving business interests have contained revaluation clauses designed to make the price come out the same as the tax value. These are controversial. They may possibly work where the clause simply requires additional payments. See *Estate of Dickenson, Jr. v. Com'r*, 63 T.C. 771 (1975); *King v. U.S.*, 545 F.2d 700 (10th Cir. 1976); *McCord v. Com'r*, 461 F.3d 614 (5th Cir. 2006) *rev'd and remanding* 120 T.C. 358 (2003) (involving a defined value clause where the transferor gets nothing back). But if the clause revokes or rescinds the transaction (for example, by reducing the size of the interest transferred to fit the price paid after the tax value is established), this will violate public policy and will not be effective to prevent taxation. *Com'r v. Proctor*, 142 F.2d 824 (1944); Rev. Rul. 86-41, 1986-1 C.B. 300; *Ward v. Com'r*, 87 T.C. 78 (1987); *Est. of McLendon v. Com'r*, TCM 1993-459 *rev'd on other grounds*, 77 F.3d 477 (5th Cir. 1995); PLR 9309001; Field Service Advice 200122011. An example of a possibly permissible formula provision would be: I give to child X a fractional portion of my company interest in A, LLC, the numerator of which is $1 Million and the denominator of which is the fair market value of my company interests in A, LLC, as finally determined for federal gift tax purposes, and I give the balance to Y charity. This same issue can arise with respect to estate tax, as well.

c. **Estate Tax.** As with the gift tax, the estate tax charitable deduction is not limited, but could, if maximized, eliminate all estate tax.

i. **Ascertainable Amount.** For an estate tax charitable deduction to apply, the amount to pass to charity must be ascertainable at the time of death. Merchants Bank of *Boston v. Com'r*, 320 U.S. 256 (1943). For example, if the personal representative can determine amounts to pass to others without an objective standard, the charitable portion may not be ascertainable. *Est. of Marine v. Com'r*, 97 T.C. 368 (1991) *aff'd* 990 F.2d 136 (4th Cir. 1993) (the personal representative could give up to 1% to each person who assisted decedent; because 100 gifts of 1% were possible, there was no deduction for the large amounts left to two universities).

ii. **Tax and Expense Apportionment.** Tax and expense apportionment is important to keep the charitable bequest, and consequently the charitable deduction, from being reduced. Under IRC § 2055(c), there is a circular calculation if any taxes are payable out of the charitable bequest. Also, it may be important, if substantial management other expenses are expected, to exonerate the charitable bequest at least from expenses not directly related to the

“Transmission expenses” must, however, be charged against the income generated by the charitable bequest, thus reducing the deduction. These “transmission expenses” do not include estate management, but do include expenses “that would not have been incurred but for the decedent’s death and consequent necessity of collecting the decedent’s assets, paying the decedent's debts and death taxes, and distributing decedent's property.” Reg. § 20.2055-3(b). These transmission expenses include personal representative's, appraisal, and attorney's fees, probate costs, and will contests and will construction dispute costs.

iii. Setting Business Value by Agreement. It is often important in planning a business buy-sell arrangement that the agreement fix the value of the stock or other business interest for tax purposes, but it is almost always critical that the agreement not fix a low price for state law purposes and yet leave it open to the Service to set a higher value for tax purposes. See True v. Comm’r, 390 F.3d 1210 (10th Cir. 2004) (large deficiency plus penalty for under statement of value). This has become a much less certain, and thus more risky, area. These agreed values can affect the estate tax charitable deduction, as well as taxable estate value.

(1) Value and Restrictions. The provisions of IRC § 2703 apply to agreements entered into or substantially modified after October 8, 1990. Under IRC § 2703(a), the value of stock for gift, estate, and generation-skipping tax purposes is not affected by an agreement to purchase for less than fair market value or by any restriction on the right to use or sell the property. The buy-sell price may, however, fix the value for tax purposes if under IRC § 2703(b) the agreement:

(a) is a bona fide business arrangement;

(b) it is not a device to transfer property to family for less than adequate consideration; and

(c) its terms are comparable to those entered into in arms length transactions.

(2) Comparability. This third requirement of comparability is new and creates a significant area of uncertainty. The regulations require a showing that the rights and restrictions of the agreement could have been obtained in a fair bargain between unrelated persons in the same type of business. A right or restriction is considered to be such a fair bargain if it conforms with the general practice of unrelated parties under negotiated agreements in the same business considering a number of factors. Isolated comparables are insufficient to show a general business practice. If more than one valuation method is commonly used, the test won't be failed by using one of the recognized methods. Regs. § 25.2703-1(b)(4)(i) and (ii).
(3) **Safe Harbor.** There is a regulatory safe harbor. Regs. § 25.2703-1(b)(3). A right or restriction will be considered to meet the three requirements if more than 50% by value of the property subject to the right or restriction is owned directly or indirectly (under Regs. § 25.2701-6) by individuals who are not members of the transferor’s family (under Regs. § 25.2701-2(b)(5) and any other individual natural object of the transferor’s bounty) and the property of the nonfamily members is subject to the right or restriction to the same extent as the transferor’s property.

(4) **Older Standards.** IRC § 2703 is layered on top of prior rules relating to when agreements may set the value of property for transfer tax purposes. See Regs. § 20.2031-2(h); Rev. Rul. 59-60, 1959-1 C.B. 237, Section 8 at 243. For estate tax purposes, the price setting agreement needs to be:

   (a) binding on the decedent during life, as well as at death (call options may work if supported by separate consideration to make enforceable; see *Armstrong Est. v. Com'r*, 146 F.2d 457 (7th Cir. 1944) and *Lamb v. Sagden*, 82 F.2d 166 (2d Cir. 1936); put options don’t work, and rights of first refusal don’t work),

   (b) a bona-fide business arrangement (ownership group or family control qualify; see *Bishoff v. Com'r*, 69 T.C. 32 (1977), and *N.L. Roth v. U.S.*, 511 F. Supp 653 (D. Mo. 1981) rev’d on other grounds *St. Louis Co. Bnk v. US*, 674 F. 2d 1207(8th Cir. 1982); *Hall Est. v. Com'r*, 92 T.C. 312 (1989)), and

   (c) must not be a device to pass the interest to the natural objects of the decedent’s bounty for less than an adequate and full consideration in money or money’s worth. See *True v. Com'r*, 390 F.3d 11210 (10th Cir. 2004).

Even if not sufficient to establish value, contractual rights may have affected value under the old rules, but under IRC § 2703 such rights must meet the new tests to be considered at all.

iv. **Income in Respect of a Decedent.** Specific bequests or residuary bequests of items which carry with them income in respect of a decedent (IRD) under IRC § 691 can create both estate tax and income tax deductions. See IRC §§ 642(c)(1) and 2055. Income in respect of a decedent is untaxed income which will otherwise be taxed after the decedent’s death and includes such things as retirement plans, IRAs, shares of partnership income on date of death, last salary check, stock bonuses and options, savings bond interest, installment payments payable to decedent, accrued royalties, etc. Such specific or residuary bequests are better than satisfying a pecuniary devise to charity with IRD, because although such satisfaction would cause the income to be included in the estate’s income. Charities receiving IRD do not need to pay tax on it because they are tax exempt.
An Overview of Charitable Tax Deductions

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