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Gifts, Money and Taxes 101
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Fundraisers need to understand basic tax laws and related rules that inform donors' decisions about charitable giving. Development officers who are aware of the tax motivations and laws that donors consider, or that donors should know more about, can better help guide conversations about major and planned gifts.

The "quiz" below is a bit of a self test. If you are unsure of the answers to the following questions, join us for this fun and fast-paced "game show." You may be the next contestant on Gifts, Money and Taxes 101! If you already participated in this conference session – or chose not to – the rest of this paper may serve as a useful resource.

Answers to these questions are according to tax laws and regulations in effect as of August 31, 2009.

1. If you were to die this year, how much could you pass to heirs free of estate tax? $_________________

2. If you were to die in 2010, how much could you pass to heirs free of estate tax? $___________________

3. If you were to die in 2011, how much could you pass to heirs free of estate tax? $_____________________

4. What is the limitation on charitable income tax deductions for gifts of cash in any one year? ____

5. What is the limitation on charitable income tax deductions for gifts of appreciated property in any one year? ______________________________

6. If an individual exceeds her limit on charitable income tax deductions in one year, what is the maximum number of years in which she can carry forward any unused (or excess) deductions?

   a. 1 year   b. 3 years   c. 5 years   d. 7 years   e. none

7. Dan Dollard contributes appreciated stock worth $100,000 to your charity on August 31, 2009. He bought the stock in 1995 for $25,000. What is the amount of his charitable income tax deduction? $__________

8. In the example above, what tax benefit does Dan realize in addition to his charitable deduction? ____

9. Assume that Dan Dollard makes the same gift as in #7 above, but he bought the stock in December 2008. What is the amount of his charitable income tax deduction? ____________________________

10. In this example with the revision in #9, what tax benefit does Dan realize in addition to his charitable deduction? ____

11. How much can an individual give to another individual (non-spouse) this year free of gift tax?

    a. $5,000   b. $10,000   c. $13,000   d. $20,000   e. $50,000

12. What is the amount of each person's lifetime gift tax exclusion?

    a. $15,000   b. $100,000   c. $500,000   d. $1,000,000   e. $5,000,000

13. A person can only name a charity as a beneficiary of his IRA if he is 70 ½ or older. True/False

14. The maximum amount a person can leave to charity from her IRA is $100,000. True/False

15. Under the Emergency Economic Stabilization Act of 2008, an individual age 70 ½ or older can make a gift from his IRA to charity and get an income tax deduction.   True/False

16. Why does it make sense for charitably inclined individuals to name charities as beneficiaries of their qualified retirement plan accounts? ____

17. Mary Material wishes to donate her condo in Naples, FL to a charitable remainder trust to benefit her college. She estimates the market value at $800,000. Which of the following are benefits to Mary of such a gift? (Choose all that apply.)

    a. income stream   b. income tax deduction   c. right to live in the condo for life
    d. removes condo from her estate   e. all of the above

18. What is the maximum long-term capital gains tax rate on the sale of appreciated securities?

    a. 15%   b. 20%   c. 25%   d. 28%   e. 30%

19. What is the maximum long-term capital gains tax rate on the sale of appreciated collectibles (art, jewelry, sports memorabilia, antique cars, etc.)?

    a. 15%   b. 20%   c. 25%   d. 28%   e. 30%

INCOME TAX

Most Americans must pay income tax to the federal government. The amount of income one receives, both earned income and unearned income generated by assets, determines how much tax he or she must pay.

Gifts of both income and assets to public charities generally entitle a donor to a federal income tax deduction in the year in which the gift is made (for itemizers). Income tax deductions reduce the amount of tax one must pay to the federal government by reducing taxable income. The type of income that an asset generates, and therefore the type of deduction it will produce, may help a donor decide what type of asset, or how much, to give.

Federal income tax brackets for 2009 are as follows:

Tax Rate %	*Married couples filing jointly*	*Most single filers*
10	not over $16,700	not over $8,350
15	16,700-67,900	8,350-33,950
25	67,900-137,050	33,950-82,250
28	137,050-208,850	82,250-171,550
33	208,850-372,950	171,550-372,950
35	over 372,950	over 372,950

Capital Gains Tax

Many things an individual owns and uses for personal purposes, pleasure or investment is a capital asset. When a capital asset is sold, the difference between the amount it sells for and the cost basis, which is usually what one paid for it, is a *capital gain* or a *capital loss*. All capital gains must be reported for income tax purposes. Capital losses on investment property, not on property held for personal use, may be deducted.

Capital gains and losses are classified as *long-term* or *short-term*, depending on how long the property is held before it is sold. If it is held for more than one year, the capital gain or loss is long-term. If it is held for one year or less, the capital gain or loss is short-term. The tax rates that apply to capital gain from property held long-term are generally lower than the tax rates that apply to other income and are called the maximum capital gains rates. For 2009, the maximum capital gains rates are 0%, 15%, 25% or 28%.

Type of Capital Asset	*Holding Period*	*Tax Rate*
Short-term capital gains (STCG)	one year or less	ordinary income tax rates up to 35%
Long-term capital gains (LTCG)	more than one year	0% for taxpayers in the 10% and 15% tax brackets; 15% for tax payers in the 25%, 28%, 33% and 35% tax brackets
Collectibles	one year or less	STCG tax rates up to 35%
Collectibles	more than one year	28%
Small business stock gains (Section 1202)	more than five years	STCG
Real estate main home	one year or less	STCG
Real estate main home	more than one year	LTCG taxed at 0% or 15% after Any exclusion amount

Tangible Personal Property

Tangible personal property is non-monetary physical assets, such as furniture, cars, jewelry, artwork and coins. A donor may consider any of these for a gift to his or her favorite charitable cause.

A key issue a donor must consider before making a gift of tangible personal property is whether or not the charity is able to put the property to a “related use” - - this determines the tax consequence to the donor.

For an outright gift of tangible personal property, the charitable income tax deduction the donor receives will depend on what the charity does with the property. If the donor is to be eligible for a charitable income tax deduction equal to the full-appraised value of the item, the charity must be able to use the item to further its charitable goals. For example, an individual who donates books to a library would be eligible for a charitable deduction equal to the appraised value of the contributed books.

If the donated property is unrelated to the charity’s tax-exempt purpose, however, the donor is not allowed a full-value income tax deduction. The charity can accept the gift and will likely sell the property. The donor’s charitable income tax deduction would be equal to the cost basis of the property. For example, an individual who donates antique coins to a hospital would be eligible for a deduction equal to the cost basis of the coins.[1]

For gifts valued in excess of $5,000, the donor must prove this value through a "qualified independent appraisal." The IRS has strict guidelines for this proof, including that the appraisal must be made, signed and dated by a qualified appraiser and must not be made earlier than 60 days before the date of the gift. [2]

A donor who claims an income tax deduction for charitable contributions of non-cash property must file IRS Form 8283 with his or her tax return. If the donated property is other than readily marketable securities and the recipient charity sells it within three years of donation, the charity must file IRS Form 8282, which reports the proceeds of the sale. [3] Form 8282 is sometimes referred to as the "tattletale form."

The Pension Protection Act of 2006 created a presumption, subject to an exception noted below, that property sold by the recipient charity within three years of the contribution does not meet the related-use test necessary to deduct the fair market value at the time of donation. If the disposition of the donated property occurs within the tax year of the gift, only the tax basis is deductible. If the disposition occurs in year 2 or 3 after the donation, the donor must include as ordinary income for the year of disposition the excess of the claimed deduction over his or her tax basis. The exception comes into play if the donor certifies under penalty of perjury that either the use was related at the time of donation or the intended use became impossible or infeasible to implement. In that case, the recapture of income does not apply.[4]

Alternative Minimum Tax (AMT)

The AMT is an attempt to ensure that individuals who are allowed special deductions and credits for certain expenses still pay income tax. The AMT is a separately figured tax that eliminates many deductions and credits, thus increasing tax liability for an individual who would otherwise pay less tax. It is designed to ensure that individuals with large deductions pay a minimum amount of tax. Charitable deductions are allowed in calculations for both regular tax and the AMT.

Qualified Dividends

Dividends are a share of a company's profits that is distributed among shareholders. The Jobs and Growth Tax Relief and Reconciliation Act of 2003 specified that dividends will be taxed as either *ordinary income* or *qualified dividends*. Qualified dividends are taxed at the same rates as capital gains (see Capital Gains Tax above). To qualify for the 0% or 15% maximum tax rate, according to www.irs.gov, the following requirements must be met:

- The dividends must have been paid by a U.S. corporation or qualified foreign corporation
- The dividends are not of the type listed under "dividends that are not qualified dividends"
- The investor must have held the stock for more than 60 days during the 121-day period that begins 60 days before the ex-dividend date. The ex-dividend date is the first date following the declaration of a dividend on which the buyer of a stock will not receive the next dividend payment. When counting the number of days an investor has held the stock, include the day the stock was disposed of, but not the date it was acquired.

[1] IRC § 170(e)(1)(B)(i) There is an exception to the related use rule for contributions of tangible personal property to a museum if the property is of the type normally retained by museums for museum purposes. [IRS Reg. § 1.170A-4(b)(3)(ii)(b)]
[2] IRC § 170(f)(11)(E)(ii), as added by the Pension Protection Act of 2006
[3] IRC § 6050L(a), as amended by the Pension Protection Act of 2006.
[4] IRC § 170(e)(7), as added by the Pension Protection Act of 2006

Limitations on Deductions

Charitable contribution tax deductions do have limits - - there are limits specific to the contribution and there are general limits on itemized deductions.

Charitable gifts of *cash* are deductible up to *50% of the donor's adjusted gross income (AGI)*. AGI is calculated by taking one's gross income and subtracting allowable exemptions and adjustments (such as deductions for payments to IRAs and self-employed health insurance). For example, a donor whose AGI is $100,000 may deduct $50,000 worth of cash gifts.

Long-term capital gain property, such as gifts of stocks, bonds, works of art, or other assets, are limited to *30% of the donor's AGI.*

Donors making gifts of *tangible personal property*, as discussed above, to be used for a charity's *related purpose,* are able to deduct the full fair market value of the item, up to *30% of their AGI*.

Donors making gifts of tangible personal property for *use unrelated to a charity's purpose*, may only deduct *their cost basis of the item, up to 50% of their AGI*.

Any excess charitable deductions may be carried over to subsequent years' tax returns for a maximum of five additional years.

Determination of Value of Charitable Deduction

Different types of gifts are deductible at different rates. Gifts of cash are 100% deductible (up to 50% of one's adjusted gross income). The value of the deduction for marketable securities is calculated using the mean share price on the date the charity takes possession of the securities. The value of the deduction for other property, such as real estate or works of art, is equal to its appraised value. Deductions greater than $5,000 claimed for contributions of non-cash property other than marketable securities require a "qualified" appraisal (see section on Tangible Personal Property above).

The "value" of volunteer time to a charity is not deductible, although expenses related to the voluntary work generally are.

Direct contributions to individuals are not deductible. For example, gifts given directly to a needy family are not deductible; gifts to one's local food bank, assuming it is a qualified public charity, are deductible.

TRANSFER TAX

Estate Tax

The estate tax is a tax on the transfer of assets at an individual's death. Calculating the estate tax requires an accounting of everything an individual owns or has certain interests in at the date of death to determine the value of the "gross estate." The property is reported at its fair market value, generally determined as of the date of death. The includible property may consist of cash and securities, real estate, insurance, trusts, annuities, business interests and other assets.

Once the gross estate has been accounted for, certain deductions (and in special circumstances, reductions to value) are allowed in arriving at the "taxable estate." These deductions may include mortgages and other debts, estate administration expenses, property that passes to surviving spouses and property passing to qualified charities. The value of some operating business interests or farms may be reduced for estates that qualify.

After the net amount is computed, the value of lifetime taxable gifts (beginning with gifts made in 1977) is added to this number. If the value of those gifts does not exceed $1,000,000, no gift tax is due. At the donor's death, if the cumulative lifetime and death transfers exceed that year's estate tax exemption (explained below), estate tax will be due on the excess.[5]

Exemption

The estate tax exemption is the amount one's estate may transfer free of tax. Under the Economic Growth and Tax Relief Reconciliation Act of 2001, the following chart outlines the amount exempted under this law:

Year of Death	*Amount Exempted*
2001	$675,000
2002	$1,000,000
2003	$1,000,000
2004	$1,500,000
2005	$1,500,000
2006	$2,000,000
2007	$2,000,000
2008	$2,000,000
2009	$3,500,000
2010	estate tax repealed
2011	$1,000,000

Unlimited Marital Deduction

Federal estate tax law provides an unlimited marital deduction for U.S. citizens. Assets distributed to a surviving spouse are passed free of estate tax.

If property passes outright to a spouse through a will or trust, it should qualify for the unlimited marital deduction. However, it will be included in the taxable estate of the spouse unless it is spent or gifted during the survivor's lifetime, or unless the surviving spouse remarries and the unlimited marital deduction allows the estate to pass to his or her surviving spouse.

Gift Tax

Gift tax is a tax on the transfer of property by one living individual to another while receiving nothing, or less than full value, in return. The tax applies whether the donor intends the transfer to be a gift or not.

Annual Exclusion

In 2009, an individual may make gifts of up to $13,000 to an unlimited number of people without incurring gift tax.

[5] Adapted from www.irs.gov

Lifetime Exemption

In addition to the annual exclusion, individuals also have a lifetime exemption. The lifetime exemption is $1,000,000. This exemption shelters gifts that exceed the annual exclusion.

Unlimited Marital Deduction

The same unlimited marital deduction against estate tax for U.S. citizens applies to gift tax.

INCOME IN RESPECT OF A DECEDENT (IRD)

IRD is income to which a decedent was entitled but that was not included in the decedent's gross income in the year of death. The fair market value of income in respect of a decedent must be included in the tax return of the beneficiary of those assets. The most common IRD assets are retirement plan accounts, such as IRAs, 401(k)s and 403(b)s.

Retirement Plans and Lifetime Gifts

Retirement funds left to family or other heirs are immediately taxable as ordinary income in the hands of the recipient (except for a spouse). If the account owner assigns retirement fund assets to charity, these dollars avoid estate *and* income taxes. If those funds are left to other individuals, as much as 65% of their value could be eroded by taxes. For this reason, these funds make very good charitable gifts at death.

Lifetime withdrawals from retirement accounts (except Roth IRAs) are taxable as ordinary income. A donor may wish to withdraw funds from an IRA in order to make a gift to charity. Such a gift would receive an off-setting deduction which would typically render the gift tax neutral. The 50% of AGI limitation on charitable deductions, however, may prevent donors from being able to deduct the full value in the year of the IRA withdrawal, which would then cause the donor to pay a greater amount in tax than he otherwise would have. (See Limitations on Deductions, above.)

Under the Pension Protection Act of 2006 (PPA) and extended by the Emergency Economic Stabilization Act of 2008 (EESA), individuals aged 70 ½ or older are able to make charitable gifts from IRAs that are excluded from their taxable income. These donors do not, however, receive a charitable deduction for the gift. The restrictions on charitable IRA distributions under this legislation are:

- Donors aged 70 ½ or older at the time of the distribution;
- The maximum charitable distribution per year is $100,000;
- Distributions must be made from the IRA directly to charity;
- Distributions must be made before December 31, 2009;
- Distributions are for outright gifts only, not to fund charitable gift annuities, charitable remainder trusts or pooled income funds.

IRD and these provisions of PPA and EESA are separate but related issues. With or without “charitable IRA rollover” legislation, naming charitable beneficiaries of retirement plan accounts is a very good option. Individuals at any age may make such a designation, and doing so is simple - - the donor merely needs to complete a beneficiary designation form often found on their plan administrator’s web site.

Retirement plan designations are a great option for employees of charities - - faculty and staff at colleges and universities; staff and doctors at animal shelters; and musicians in symphony orchestras, for example.

CONCLUSION

This paper is not intended to be a comprehensive review of tax law and regulations, but rather a "primer" on basic tax rules that impact charitable decisions. We believe that it is important for development professionals to have a solid foundation in these principles so they can credibly represent their institutions and help donors make gift planning decisions that both beneficial to charity and cost-effective to the donor. An understanding of relevant tax law also helps fund raisers appreciate and address roadblocks to closing some gifts. We encourage the reader to consult qualified experts and available resources, some listed at the end of this paper, when assisting clients or donors with their philanthropic plans.

Quiz Answers:

1. $3,500,000
2. An unlimited amount
3. $1,000,000
4. 50% of one's adjusted gross income
5. 30% of one's adjusted gross income
6. 5 years
7. $100,000
8. He avoids the capital gains taxes he would have paid if he had sold the stock for himself.
9. $25,000
10. He avoids the capital gains taxes he would have paid if he had sold the stock for himself.
11. $13,000
12. $1,000,000
13. False
14. False
15. False
16. Those assets will pass fully to the charity, which will not have to pay income tax on them. If left to heirs, they will have to pay the income (and possibly estate) taxes, due to "Income in Respect of a Decedent" rule.
17. a. income stream; b. income tax deduction; d. removes the home from her estate
18. 15%
19. 28%

SELECT WEB RESOURCES

Internal Revenue Service: Tax-related news, publications, FAQs, etc.:
www.irs.gov

Forms and publications:
http://www.irs.gov/formspubs/index.html?portlet=3

Estate and Gift Tax:
http://www.irs.gov/businesses/small/article/0,,id=98968,00.html

Partnership for Philanthropic Planning: Legislative information related to charitable giving and gift planning resources:
www.pppnet.org

Planned Giving Design Center: Articles and news on tax charitable planning topics:
www.pgdc.com

Bloomberg: Stock quotes and information:
http://bloomberg.com

Yahoo Finance: Business news
http://finance.yahoo.com/

Google Finance: Business news
http://www.google.com/finance

PRINT RESOURCE

Tax Economics of Charitable Giving, by Joseph P. Toce, Byrle M. Abbin, William M. Pace, Mark L. Vorsatz, WG&L (Available at a discount to members of the Partnership for Philanthropic Planning; see information in the members' section at www.pppnet.org.)

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