

## Deduction Rules For Charitable Giving

For many individuals, charitable donations are an important means of accomplishing both philanthropic and tax planning goals. Individuals who wish to make tax-deductible charitable donations should be sure that the receiving charity is a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code, and they should be aware of the rules governing the deductibility of such donations.

### Gifts to Public Charities

*Cash.* Gifts of money to a public charity are deductible up to 50 percent of a donor's adjusted gross income ("AGI"). A five-year carry forward is allowed for any available deductions in excess of the 50 percent of AGI level. Donors must retain a record of gifts by credit card or check although any gift in excess of \$250 requires substantiation from the donee-charity. Gifts of cash (in any amount) require a receipt from the charity to be deductible.

*Capital-Gain Property.* Gifts of securities, business interests, and real estate held longer than one year are deductible at the full present fair market value, with no tax on the appreciation. Donations of long-term appreciated property are deductible up to 30 percent of AGI, with a five-year carry forward. Before making a charitable donation of a business interest or real property, donors should consider the following:

- **Business Interest Valuation Issues.** Many factors will affect the fair market value of a business interest to be donated to charity, including: the nature and history of the business, the economic outlook of the particular industry, the book value of the stock and condition of the business, the earning capacity of the business, goodwill or other intangible value of the business, and the dividend-paying capacity of the business. Discounts for a minority interest and lack of marketability may also apply.
- **Real Property Considerations.** Before donating real property to charity, a donor should be aware of the following considerations:
  - **Appraisal.** If the deduction will exceed \$5,000, the donor must obtain a qualified appraisal of the property before the income tax return is filed.
  - **Mortgage.** Gifts of mortgaged property are taxed as a bargain sale, and the donor will realize some income if property is contributed to a charity subject to the mortgage. In some cases, the charity's assumption of the donor's debt on the property may be treated as acquisition indebtedness so that a sale by the charity will generate a gain that is taxable to the charity as unrelated business taxable income.
  - **Liabilities.** A charity's receipt of real property will subject it to all the liabilities of an owner. These may include liabilities arising from conditions on the property or the

liability of environmental hazards. A charity may want to protect itself against such liabilities through adequate insurance and a thorough environmental inspection.

- A charity may be reluctant to accept real estate because of carrying costs, management of the real property, and uncertainties about the subsequent sale of the property.

*Ordinary Income Property.* "Ordinary income" property is an asset that generates ordinary income when sold (e.g., gifts of inventory, certain stock, or crops). A deduction is allowed for the property's cost basis or its fair market value, whichever is lower. The deduction ceiling is 50 percent of AGI, with a five-year carry forward.

*Tangible Personal Property.* The rules for gifts of artworks, antiques, books, and other collectibles held long term depend on how the charity will use the gifts. When the charity's use of the property is related to its exempt function (e.g., a painting given to an art museum), the donor can deduct the full present fair market value of the property. These gifts are deductible up to 30 percent of AGI, with a five-year carry forward. If the gift is unrelated to the donee's exempt function, the deduction is for cost basis or fair market value, whichever is lower. These gifts are deductible up to 50 percent of AGI, with a five-year carry forward. A gift in excess of \$250 requires substantiation from the donee-charity. A gift in excess of \$5,000 requires a qualified appraisal to be deductible.

### **Gifts to Private Foundations**

*Cash.* A gift of cash to a private foundation is deductible up to 30 percent of the donor's AGI, with a five-year carry forward.

*Capital-Gain Property.* Long-term appreciated securities, real estate, and tangible personal property are deductible at cost basis only and are deductible up to 20 percent of a donor's AGI with a five-year carry forward.

*Qualified Appreciated Stock Exception.* Individuals donating qualified appreciated stock to a private foundation may deduct the full fair market value of the stock. "Qualified appreciated stock" is defined as stock of a corporation for which market quotations are readily available on an established securities market, but probably does not include stock with restrictions on sales or exchanges to third parties. The exception applies only to the extent that the amount of the stock contributed by the donor and the donor's family, in combination with the stock already held by the foundation, does not exceed more than 10 percent of the value of all of the outstanding stock in the corporation.

*Excise Tax Rules.* Severe penalties apply against private foundations under the following circumstances: (a) The foundation or the donor engage in certain prohibited acts of self-dealing; (b) the foundation fails to distribute at least 5 percent of its assets each year to qualified public charities; (c) the foundation has excess business holdings; (d) the foundation invests in such a way as to jeopardize its

charitable purpose (e.g., through risky investments); or (e) the foundation violates the limitation on spending to influence legislation or makes grants to individuals and foreign charities.

*This material is intended for general informational purposes only and should not be construed as legal advice or a legal opinion on specific facts or circumstances. You are urged to consult an experienced lawyer concerning your particular factual situation and any specific legal questions you may have.*