

# 2018 Charitable Planning Review

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# CHARITABLE CONTRIBUTIONS

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## **IRC §170(c), a contribution or gift to or for the use of:**

1. A state, possession of the U.S. or any political subdivision, U.S. or District of Columbia, if used for a public purpose
2. Corporation, trust or foundation organized in the U.S. and operated exclusively for (i) religious, charitable, scientific, literary or education purposes; (ii) fostering national or international amateur sports competitions; or (iii) for the prevention of cruelty to children or animals.
3. A post or organization of war veterans organized in the U.S. (e.g. American Legion groups).
4. A domestic fraternal society or association (e.g. Elks Lodge, Knights of Columbus – however, gift must be used for exclusively for religious, charitable, scientific, literary or educational purposes, or for the prevention of cruelty to children or animals).
5. A cemetery company (only if gift is to be used to care for the cemetery as a whole, and not for individual plots).

**Contributions to any of the above are deductible for income tax purposes, provided they are U.S.-based organizations.**

**Exceptions** – certain charities in Canada, Mexico and Israel, if there is source-income in those countries.

# CHARITABLE CONTRIBUTIONS

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IRC §170(a)(1) allows an income tax deduction for charitable contributions made to qualified recipients within the donor's taxable year.

What are "charitable contributions?"

1. Cash – cash contribution reduced by tangible benefit received by donor from donation.
2. Services – only unreimbursed out of pocket expenses directly connected with services (value of service itself not deductible).
3. Property – (ordinary income property, short term capital gain property, long-term capital gain property).

# CHARITABLE CONTRIBUTIONS

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**Question:** On what value is the charitable deduction determined?

**Answer:** It depends on the type of entity receiving the contribution and the type of property contributed.

# CHARITABLE CONTRIBUTIONS

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## Public Charities vs. Private Foundations

### Public Charity

1. Cash
2. Ordinary Income Property (e.g. inventory, patents, copyrights) – Lesser of Adjusted Basis and FMV.
3. Short-Term Capital Gain Property – Lesser of Adjusted Basis and FMV.
4. Long-Term Capital Gain Property.
  - a. Intangible – FMV.
  - b. Tangible – FMV for "related use" (i.e. to carry out the organization's exempt purpose); Adjusted Basis for unrelated use.
  - c. Real Property – FMV.

# CHARITABLE CONTRIBUTIONS

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## Public Charities vs. Private Foundations

### Private Foundation

1. Cash
2. Ordinary Income Property – Lesser of Adjusted Basis and FMV.
3. Short-Term Capital Gain Property – Adjusted Basis.
4. Long-Term Capital Gain Property.
  - a. Intangible – FMV for "qualified appreciated stock" (IRC Section 170(e)(5)); Adjusted Basis for all others.
  - b. Tangible – FMV for "related use" (i.e. to carry out the organization's exempt purpose); Adjusted Basis for unrelated use.
  - c. Real Property – Adjusted Basis.

# CHARITABLE DEDUCTIONS

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**Question:** How much can be deducted?

**Answer:** It depends on the type of entity receiving the contribution and the type of property contributed.

**Deductions are limited to 60%, 50%, 30% or 20% of the donor's "contribution base" for the tax year.**

**"Contribution base" = adjusted gross income without regarding to any net operating loss carryback**

# CHARITABLE CONTRIBUTIONS TO “50% ORGANIZATIONS”

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## "50% Organizations"

1. Public charities
2. Private operating foundations

## Types of Property Contributed

1. Cash – 60% (until 12/31/25) or 50% of contribution base
2. Ordinary Income Property – 50% of contribution base
3. Long-Term Capital Gain Property if deduction based on FMV – 30% of contribution base
4. Long-Term Capital Gain Property if deduction based on Adjusted Basis – 50% of contribution base



# CHARITABLE CONTRIBUTIONS TO “30% ORGANIZATIONS”

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## **“30% Organizations”**

1. Private nonoperating (i.e. "grantmaking") foundations
2. Post or organization of war veterans organized in the USA
3. Domestic fraternal society or association
4. Cemetery company

## **Types of Property Contributed**

1. Cash – 30% of contribution base
2. Ordinary Income Property – 30% of contribution base
3. Long-Term Capital Gain Property if deduction based on FMV – 20% of contribution base
4. Long-Term Capital Gain Property if deduction based on Adjusted Basis – 20% of contribution base

# CARRYFORWARD FOR DISALLOWED GIFTS

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Any charitable deductions disallowed because of AGI limitations may be carried over for 5 years and are used in a first-in-first-out order.

Carry over amounts retain their classification as 20%, 30% or 50% donations.

# CHARITABLE ESTATE TAX DEDUCTION

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Under IRC §2055, a testamentary contribution or gift to or for the use of:

1. A state, or any political subdivision, U.S. or District of Columbia, if used for a public purpose.
2. Corporation, trust or foundation organized and operated exclusively for religious, charitable, scientific, literary or education purposes.
3. A post or organization of war veterans organized in the U.S. (e.g. American Legion groups).
4. A domestic fraternal society or association (e.g. Elks Lodge, Knights of Columbus – however, gift must be used for exclusively for religious, charitable, scientific, literary or educational purposes, or for the prevention of cruelty to children or animals).
5. An employee stock ownership plan.

# CHARITABLE ESTATE TAX DEDUCTION

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**Question:** On what value is the charitable deduction determined?

**Answer:** Date-of death value (or value on alternate valuation date) for amount passing to charity at death.

**Question:** How much can be deducted?

**Answer:** Dollar-for-dollar deduction for amount passing to charity.

# OTHER ESTATE TAX RULES

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1. Donee need not be a 501(c)(3) organization
2. Donee need not be a domestic organization
3. No distinction between public charity and private foundation donees
4. Amount needs to be ascertainable at death
  - YES – Trustee shall distribute 50% of the residue to UCLA
  - NO – Trustee shall distribute up to 50% of the residue to UCLA, in the Trustee's sole discretion
5. Non-resident aliens generally must transfer property to U.S. charitable organizations to obtain deduction, and property must be included in gross estate (i.e. U.S. situs)

# CHARITABLE GIFT TAX DEDUCTION

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Under IRC Section 2522, a lifetime contribution or gift to or for the use of:

1. A state, or any political subdivision, U.S. or District of Columbia, if used for a public purpose
2. Corporation, trust or foundation organized and operated exclusively for religious, charitable, scientific, literary or education purposes
3. A post or organization of war veterans organized in the U.S. (e.g. American Legion groups).
4. A domestic fraternal society or association (e.g. Elks Lodge, Knights of Columbus – however, gift must be used for exclusively for religious, charitable, scientific, literary or educational purposes, or for the prevention of cruelty to children or animals).

# CHARITABLE GIFT TAX DEDUCTION

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**Question:** On what value is the charitable deduction determined?

**Answer:** Date of gift FMV (reduced by consideration received)

**Question:** How much can be deducted?

**Answer:** Dollar-for-dollar deduction for amount passing to charity.

# OTHER GIFT TAX RULES

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1. Donee need not be a 501(c)(3) organization
2. Donee need not be a domestic organization
3. No requirement to file gift tax return if donor's entire interest in property is transferred
4. Non-resident aliens generally must transfer property to U.S. charitable organizations to obtain deduction, and property must be tangible U.S. situs property



# PLANNING OPPORTUNITY

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## Gift of Partial Interest in Residence

### Facts:

- \$6 million FMV
- \$2 million cost basis

### Option 1 – No Planning:

- \$3,500,000 net gain (after IRC Section 121 exclusion)
- \$1,295,000 tax (combined 37% federal and California tax rate)
- \$4,705,000 net proceeds

# PLANNING OPPORTUNITY

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## Gift of Partial Interest in Residence

### **Facts:**

- \$6 million FMV
- \$2 million cost basis

### **Option 2 – Gift of 25% Interest to Donor-Advised Fund Pre-Sale:**

- \$1,275,000 charitable gift (15% discount for partial interest)
- \$3,000,000 net gain (after IRC Section 121 exclusion)
- \$1,275,000 charitable deduction (up to 30% of contribution base with 5 year carry forward)
- \$1,500,000 in DAF

# SPLIT INTEREST CHARITABLE TRUSTS

## CRUTs and CRATs

1. Irrevocable trust whereby the donor retains income for an initial term and thereafter benefiting one or more charities.
2. Income retained may be paid out as (i) an annuity (a CRAT), and must be at least 5% and no more than 50% of initial FMV of assets or (ii) a unitrust amount (a CRUT), and must be at least 5% and no more than 50% of current FMV of assets.
3. Income Tax: CRTs are exempt from income tax, but subject to a 100% excise tax on unrelated business taxable income.
4. Income Tax Deduction: total value of property less present value of retained annuity or unitrust payments (i.e., a charitable contribution deduction for the calculated present value of the remainder interest passing to charity at the end of the initial term).
5. The calculated present value of the remainder interest is also deductible for estate and gift tax purposes.

# SPLIT INTEREST CHARITABLE TRUSTS

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## CRAT vs. CRUT

### Advantages

- a) CRAT: protects against declining balances; provides certain and fixed income stream.
- b) CRUT: inflation protection; can make subsequent contributions.

### Disadvantages

- a) CRAT: no inflation protection; income stream percentage may be limited by 5% test.
- b) CRUT: requires annual reevaluation; principal erosion risk.

# SPLIT INTEREST CHARITABLE TRUSTS

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- **CRUT Variations**: NIMCRUT, NICRUT, Flip-CRUT
- 2005 Rev. Proc. Forms for CRATs and CRUTs
- Charitable Deduction Rules – who is the potential remainderman?
- CRTs subject to certain private foundation excise taxes (IRC Sections 4941, 4943, 4944 and 4945)

# CHARITABLE REMAINDER TRUST

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## Funding Issues

1. Tangible personal property
2. Closely-held stock
3. Encumbered property
4. Partnership/LLC interests

# CHARITABLE REMAINDER TRUST

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## Case Study – Proposed Gift of Apartment Building with Debt

1. Client goals – income stream or tax deferral
2. Dealing with loan – is payoff possible?
3. Tax problems with transferring property subject to loan:
  - a. Possible grantor trust
  - b. Bargain sale
  - c. Self-dealing
  - d. UBTI

# SPLIT INTEREST CHARITABLE TRUSTS

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## CLUTs and CLATs

1. An irrevocable trust whereby the charitable organization receives income interest during term of trust and a non-charitable beneficiary receives the remainder interest.
2. Taxable as complex trusts, unless the trust is structured as a defective grantor trust.
3. No income tax deduction is allowed for a contribution to a CLT, unless the CLT is structured as a defective grantor trust. In that case, an income tax deduction is allowed for the calculated present value of the charitable lead interest.
4. The calculated present value of the charitable lead interest is also deductible for estate and gift tax purposes.
5. Best Candidates: donor holds assets likely to appreciate over time; donor has no cash flow concerns; donor has large estate tax exposure; transaction occurs in a low interest rate environment.



# SPLIT INTEREST CHARITABLE TRUSTS

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## CLT Forms

### Charitable Lead Trust Forms:

1. Rev. Proc. 2007-45 and 2007-46 (CLATs) (increasing annuity payments OK)
  2. Rev. Proc. 2008-45 and 2008-46 (CLUTs)
- Charitable deduction for gifts to grantor CLTs – 30% of contribution base (or 20% if appreciated capital gain property).

# SPLIT INTEREST CHARITABLE TRUSTS

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## Testamentary Charitable Lead Annuity Trust (T-CLAT)

**When to Consider:** If donor has already provided for children/grandchild through lifetime transfers of other assets, because assets transferred to T-CLAT will not be available until the expiration of the term of the CLAT.

**Structure:**

1. Portion of living trust subject to estate tax transferred to a T-CLAT upon death of Trustor (or surviving spouse).
2. Must make annual annuity payments to Private Foundation or DAF.
3. Term of T-CLAT based on formula designated to generate deduction that would reduce value of taxable estate to zero.
4. Upon expiration, all assets pass to designated beneficiaries.

# SPLIT INTEREST CHARITABLE TRUSTS

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## Charitable Lead Trust Funding Issues

1. Possible estate tax inclusion under IRC Sections 2036/2038 if charitable beneficiary is donor's private foundation.
2. CLTs subject to certain private foundation excise taxes (IRC Sections 4941, 4943, 4944 and 4945).
3. Recapture rule for grantor CLTs.
4. GST Tax and inclusion ratio of CLT.

# ASSIGNMENT OF INCOME DOCTRINE

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Under the anticipatory assignment of income doctrine, a taxpayer who earns or otherwise creates a right to receive income will be taxed on any gain realized from it if the taxpayer has the right to receive the income or if, based on the realities and substance of events, the receipt of income is practically certain to occur, even if the taxpayer transfers the right before receiving the income.

**Example:** Taxpayer donates stock to a charity that is about to be acquired by the issuing corporation via a redemption, or by another corporation in a merger or acquisition.

# PRIVATE FOUNDATIONS & DONOR ADVISED FUNDS

## Private Foundations

1. **Organization**: A private foundation could be established as either a non-profit corporation or an irrevocable charitable trust. With either form of entity, it is possible for legal control of the private foundation and its assets to remain with the founder's family for multiple generations.
2. **Grant Making**: Grantmaking decisions are under the complete control of the private foundation's board or trustees. A private foundation is required to distribute at least 5% of its assets each year for charitable purposes. Grants to organizations other than U.S. public charities require foundation to exercise “expenditure responsibility.”
3. **Investments**: A private foundation retains complete control over its investments, investment strategy and investment advisors.

# PRIVATE FOUNDATIONS & DONOR ADVISED FUNDS

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## Private Foundations Cont.

#### 4. Income Tax Deductions:

- a) A donor to a private foundation may deduct the amount of cash donated to the private foundation up to 30% of the donor's contribution base in the year of donation.
- b) A donor to a private foundation may deduct the value of qualified appreciated stock donated to the private foundation up to 20% of the donor's contribution base in the year of donation, based on the fair market value of the stock.
- c) A donor to a private foundation may deduct the amount of long-term capital gain property other than publicly-traded securities (e.g. real property, closely-held business interests) donated to the private foundation up to 20% of the donor's contribution base in the year of donation, based on the income tax basis of the donated property.
- d) Any portion of the charitable gift to the private foundation which cannot be deducted in the year of the gift, due to percentage limitations described above, can be carried forward and deducted in future tax years (up to five years).

# PRIVATE FOUNDATIONS & DONOR ADVISED FUNDS

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## Private Foundations Cont.

### 5. Other Rules

- a) Assets in a private foundation may be distributed to a DAF.
- b) Beware of private foundation excise taxes.

# PRIVATE FOUNDATIONS & DONOR ADVISED FUNDS

## Donor-Advised Fund

1. **Organization**: The founder of a DAF never has legal control of the fund, instead the fund's sponsor organization maintains legal control of the fund.
2. **Grant Making**: The founder of a DAF technically does not control the DAF's grantmaking decisions. The founder (or the founder's family members) makes recommendations to the DAF sponsor organization as to the distributions to be made from the DAF for charitable purposes. In most cases, the sponsor complies with the recommendations, but it is not legally obligated to follow the direction of the founder. There is no minimum annual distribution requirement for a DAF. Grants made from a DAF are not required to be reported to the IRS and are not public record.
3. **Investments**: The founder of a DAF does not have legal control over its investments. Some sponsors allow the DAF's funds to be managed by the same advisor used by the founder for the founder's personal investments; however, the founder cannot control investment decisions.



# PRIVATE FOUNDATIONS & DONOR ADVISED FUNDS

## Donor-Advised Fund

### 4. Income Tax Deductions:

- a. A donor to a DAF may deduct the amount of cash donated to the DAF up to 60/50% of the donor's AGI in the year of donation.
- b. A donor to a DAF may deduct the amount of publicly-traded securities donated to the DAF up to 30% of the donor's AGI in the year of donation, based on the fair market value of the securities.
- c. A donor to a DAF may deduct the amount of long-term capital gain property other than publicly-traded securities (e.g. real property, closely-held business interests) donated to the DAF up to 30% of the donor's AGI in the year of donation, based on the fair market value of the donated property.
- d. Similar to a private foundation, any portion of the charitable gift to the DAF which cannot be deducted in the year of the gift, due to percentage limitations described above, can be carried forward and deducted in future tax years (up to five years).
- e. A DAF generally cannot make grants to a private foundation or later convert to a private foundation.

# RECENT DEVELOPMENTS

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## IRS Notice 2017-73 – Proposed Regulations for DAFs

1. **Quid Pro Quo Transactions**: proposing to issue regulations that would not allow the DAF to pay any portion of a quid pro quo transaction. Recommendations: DAF should structure events with various levels of giving – one quid pro quo and others that do not provide benefits regarding the donor's deduction.
2. **Satisfying a Pledge**: proposing to issue regulations that would allow the payment of an enforceable pledge from a DAF in certain circumstances. DAF can make a payment that is used to satisfy a pledge if the DAF sponsor makes no reference to the existence of a pledge when making the distribution from the DAF. The donor must not receive any other benefits in connection with the payment and the donor must not claim a deduction for the payment even if the charity erroneously sends the donor a receipt.

# RECENT DEVELOPMENTS

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## Tax Cuts and Jobs Act

1. Deduction up to 60% of contribution base for cash gifts to charity (provided it is your only gift).
2. No more 80% charitable deduction for gifts made in exchange for college athletic event seating rights.
3. "Newman's Own Exception" to Excess Business Holdings Rule.
4. Qualified charitable distributions from IRA remain.
5. Repeal of Pease limitation

# RECENT DEVELOPMENTS

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## 1. Rev. Proc. 2018-15 – New Exemption Applications for Corporate Restructuring

Effective for tax years beginning on or after January 1, 2018, the IRS has indicated that it will generally not require a new exemption application from a domestic IRC Section 501(c) organization that changes its form or place of organization (e.g. California public benefit corporation to a Delaware non-stock corporation).

## 2. Rev. Proc. 2018-32 - IRS List of Charitable Organizations

# RECENT DEVELOPMENTS

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## Rev. Proc. 2018-15 - New Exemption Applications for Corporate Restructuring

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# RECENT DEVELOPMENTS

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## *Belair Woods v. Comm'r* (TCM 2018-159).

**Facts:** Taxpayer entered into a deed of conservation easement and filed a tax return with an appraisal and Form 8283, but the form did not include the basis of the property donated. Taxpayer, with the advice of counsel, attached to the form an explanation that the basis information was not necessary. The IRS disallowed the entire deduction because the basis information was not provide and there was no explanation explaining that the Taxpayer was unable to provide the information.

**Holding:** The Court held that this action constituted a failure in compliance despite the taxpayer having received advice that providing basis in the case of a contribution was not truly required. However, the Court determined that even though the taxpayer's position was clearly wrong, there was still a possibility the taxpayer might be able to show it had "reasonable cause" for its failure that could preserve the deduction. However, whether it had such cause or not must be determined in a later proceeding, since several material facts remained to be shown by the taxpayer to justify its reliance on the information relayed from the attorney.

# RECENT DEVELOPMENTS

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## *Chrem v. Comm'r* (TCM 2018-164)

**Facts:** Taxpayers owned 100% of the stock of a foreign corporation. A related company proposed to purchase all of the Taxpayers' shares. After shareholders agreed to tender 87% of their shares, they donated the remaining shares to a public charity. Acquiring company then completed the acquisition of all of the shares.

**Holding:** The Tax Court denied summary judgment in a case in which the IRS argued that several taxpayers were liable for tax under the assignment-of-income doctrine on their transfers of stock to a charity for which they took charitable contribution deductions. The court also concluded that, because the record was silent concerning the advice (if any) that a CPA provided the taxpayers regarding certain substantiation and compliance issues relating to the donations and whether the taxpayers relied in good faith on whatever advice the CPA may have supplied, the taxpayers' ability to rely on the reasonable cause defense presented genuine disputes of material fact that were not susceptible to resolution by summary judgment.

# THOUGHTS OR QUESTIONS?

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