10 IRS Rules You Need to Know to Help Your Donors Make Great Gifts

PG Calc Featured Article, August 2020 eRate

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Life is full of rules, and planned giving is certainly no exception. When we talk about IRS rules and planned giving, we mean not only specific sections of the federal tax code, but also IRS rulings, conditions, limitations, and the like. In putting together our webinar for August 27, which will highlight 10 rules that gift planners should know, we thought it might be helpful to provide a brief preview in this format.

1. **Transfer appreciated assets between spouses prior to creating a Charitable Gift Annuity:** Federal tax laws allow assets to be transferred between spouses without triggering capital gain or transfer taxes. In some cases, it may be beneficial for assets to be transferred between spouses prior to establishing a split interest gift arrangement. For example, the capital gain due on a gift annuity is spread over the life expectancy of the donor. If one spouse in a married couple uses his separate appreciated assets to establish a 2-life gift annuity for both of them, his reportable capital gain will be spread ratably over his life expectancy. If both spouses jointly own the appreciated property, however, the reportable capital gains will be spread ratably over both lives. The result is that capital gain is spread out over more years.

2. **Related use rule for gifts of tangible property:** In addition to cash, securities, and real estate, some individuals prefer to make charitable gifts of tangible personal property. Such property consists of physical items such as jewelry, artwork, collections, and antiques. The income tax charitable deduction for a gift of tangible personal property is typically limited to the cost basis, the amount the donor paid for the property. But if the charity puts the property to a use that is related to the organization's charitable purposes, the deduction may be for the full fair market value generally documented in a qualified independent appraisal.

3. **Tax-free portion of gift annuity payments with low IRS discount rates:** In the current atmosphere of historically low IRS discount rates, we hear a lot about the negative effect on the charitable deductions for gift annuities. While this is true and not likely to change in the near future, there is a flip side to the bad news; the tax-free portions of gift annuity payments are higher when the discount rate is low. This can be especially attractive to non-itemizers and donors with low AGI who have more deductions than they can use.

4. **Additions may be made to Charitable Remainder Unitrusts:** In contrast to charitable gift annuities and charitable remainder annuity trusts, it is possible for donors to make additional contributions to charitable remainder unitrusts. This might be especially helpful to donors who wish to build up significant values in their trusts incrementally over the long run. Donors with a low AGI may want to space out their gifts so they can take the full income tax charitable deduction in the year of the gift.

5. **Bargain sales and capital gains:** One of the appealing aspects of bargain sale arrangements is that donors can escape the consequences of a portion of the long-term capital gains in addition to receiving a charitable income tax deduction. A bargain sale is the sale of property to the charity for less than fair market value. The net effect is that the bargain sale includes the gift of a portion of the property. Bargain sale properties typically have significant long-term appreciation; the proportion of the capital gains attributed to the charitable gift portion of the property is permanently forgiven, and the donor pays taxes only on the portion of the property that is sold. The charitable income tax deduction for the gift portion of the bargain sale offsets (at least partially) the tax on the reportable capital gains.

6. **Retained Life Estates with low IRS discount rates:** The retained life estate is a split interest gift of the donor’s home or farm, and as such, there is a charitable portion and a non-charitable portion. The value of the charity’s eventual right to sell or use the property is the charitable portion, while the value of the donor’s life tenancy is the non-charitable portion. When one goes up, the other goes down. The value of each year’s life tenancy is computed in part by using the IRS discount rate. If the discount rate is low, the value of the life tenancy is low, therefore, the value of the charitable portion is high.

7. **CRAT special rule from 2016:** Charitable remainder annuity trusts must pass a minimum 10% charitable interest test, like charitable gift annuities, pooled income funds, and charitable remainder unitrusts. But the CRAT must pass an additional probability of exhaustion test (probability of corpus exhaustion may not be greater than 5.0%). Depending on the ages of the beneficiaries, it can be difficult for CRATs to pass the probability of exhaustion test when the IRS discount rate is relatively low. A ruling was issued in 2016 allowing the insertion of a special clause in the governing documents of new CRATs; the provision calls for the trust to terminate in favor of the charity if the trust corpus falls below 10% of its initial value plus 0.8% interest.

8. **Deductions are high for PIF contributions right now:** The charitable income tax deduction for a contribution to a pooled income fund is based partly on the highest "PIF Rate of Return" of the past 3 calendar year (the so-called PIF Rate of Return is really just a slightly-adjusted measure of income yield). When the "PIF rates of return" are relatively low, that means the calculation assumes very little income will go to the income beneficiaries, suggesting that relatively more will be left for the remainder charities in the end. While the deductions for PIF contributions are not tied directly to the IRS discount rate, the "PIF Rate of Return" tends to move in parallel with the prevailing IRS discount rates.

9. **Relinquishing split interest gifts:** Life income gift arrangements (CGAs, CRTs, and PIFs) are mostly written for the remaining lives of named beneficiaries. If a beneficiary of one of these gift vehicles no longer needs or wants the income, he or she may permanently relinquish the life income benefit in favor of the charitable remainder organization. The same action may be taken with a retained life estate. This essentially accelerates the remainder gifts to charities, but the beneficiary or life tenant is giving up something of value; he or she may be entitled to an additional income tax charitable deduction for the additional gift to charity. Qualified appraisals are required if the value of the interest being relinquished is more than $5,000.

10. **QCDs also still attractive:** No current discussion of planned gifts would be complete without mentioning the ubiquitous Qualified Charitable Distributions (QCDs) from traditional IRAs. The so-called "IRA Rollover" allows persons who are 70 ½ years or older to transfer up to $100,000 each calendar year directly from traditional IRAs to qualified charitable organizations. There are no charitable income tax deductions for these gifts. Nonetheless a donor may choose to make a QCD because they will escape taxation that would otherwise be due on distributions of qualified retirement funds. This is especially attractive for non-itemizers and others who cannot derive any benefit from additional income tax charitable tax deductions.

We hope you have enjoyed our brief walk-through of these 10 IRS Rules. Please join us on Thursday, August 27, at 1 PM ET when we take a closer look at each of these topics. You may register for the webinar here.

In the meantime, please feel free to contact us if you have any questions. We love to hear from you!