



# Gift Planning Now

A Newsletter for Berkeley's Donor Advisors

Summer 2019

## Charitable Deductions and Tax-Free Income

Even with lower federal income tax rates and the maximum tax rate on long-term capital gains and dividends at 20 percent (15 percent for most taxpayers), some clients are looking for ways to reduce their tax burden even further. There are several options that generate an income tax charitable deduction while also allowing clients to receive tax-free income and satisfy philanthropic goals.

*Charitable gift annuity*—Tax-free return of a client's own principal offers a path to tax-exempt income. Donors are entitled to charitable deductions for the difference between the amount transferred to charity and the present value of the annuity retained by the donor.

Tax-free income is highest for gift annuities funded with cash. For example, a 70-year-old donor who transfers \$50,000 in cash for a one-life gift annuity would be entitled to a deduction of \$18,636 (assuming quarterly payments and a 2.8 percent \$7520 rate). Of the \$2,800 (5.6 percent) that the donor receives annually, \$1,971 would be tax free for the donor's 16-year life expectancy.

*Charitable remainder unitrust*—A standard payout charitable remainder trust can be invested to produce partly tax-free return of principal and favorably taxed long-term capital gains and dividends. While the income is not wholly tax exempt, such a plan can be extremely



tax efficient for the donor/beneficiary who is in a 35 percent or 37 percent federal tax bracket.

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## Working Towards Eliminating Student Hunger

A study conducted across the UC system shows that 44 percent of undergrads and 26 percent of grad students in UC schools experience food insecurity, according to a report from the UC Global Food Initiative. In 2014, the first year UC Berkeley's Food Pantry opened, 500 students came in to use it. Now, nearly 7,000 students use the UC Berkeley Food Pantry each year, out of 42,000 students on campus. Students who need food are allowed to take what they need in terms of produce and bread, but for shelf-stable foods such as pasta and canned beans, they are allotted about five per visit, with a cap at two visits per month. In addition to the food pantry, Berkeley is building a space next door for basic needs. It will offer workshops, help more students sign up for CalFresh or UC Berkeley's Food Assistance Program, work with homeless students, and more. If you have a client who would be interested in providing support for hungry students, please contact our office at 800.200.0575.

## Charitable Deductions . . . (continued from Page 1)

*Charitable remainder annuity trust*—A client who plans to leave a significant charitable bequest could advance the gift to charity

by funding an inter vivos charitable remainder trust with cash or tax-exempt bonds. The trustee cannot be required to hold or purchase tax-

exempt investments, and investing 100 percent in tax-free bonds may run afoul of prudent investor rules.

## A Time for Everything

Deadlines and expiration dates are a fact of life, and this is especially true with the tax code. Consider a few of the deadlines that apply to charitable gifts:

*Qualified appraisal*—Donors who make non-cash gifts in excess of \$5,000 must have a qualified appraisal to claim a charitable deduction [Code §170(f)(11)]. The appraisal must be obtained

no earlier than 60 days prior to the date of the gift and no later than the due date of the return on which the deduction is claimed (including extensions) [Reg. §1.170A-13(c)(3)(i)(A)].

*Contemporaneous written acknowledgment*—For cash gifts in excess of \$250, donors must obtain written substantiation from the charity prior to the filing of the

income tax return [Code §170(f)(8)]. The acknowledgment must include the amount of cash given and a description of any property other than cash contributed to the organization, along with a statement that no goods or services were provided in return for the gift or a good faith estimate of the value of any such quid pro quo items [Code §170(f)(8)(B)].

UC Berkeley Planning Pointer:

## Charitable Gifts of Real Estate—Do Your Clients Have to Give 100 Percent?

It is well known that charitable gifts of real estate have the potential to benefit both your clients and their favorite charities. For example, your clients can claim an immediate income tax charitable deduction, pay no capital gains tax, diversify their assets, relieve themselves of the burdens of real estate ownership, perhaps receive income for life, and make a significant charitable gift during their lifetimes. With the sky-high prices of Bay Area real estate—

the median price of a single family home is \$830,000—your clients may hesitate to make a charitable gift of their entire interest in their real estate. But do your clients have to commit to giving 100% of their ownership interest when it comes to charitable gifts of real estate? Actually, no: partial undivided interests in real estate make great charitable gifts! For example, your married clients with highly appreciated real estate who are planning to downsize can make a gift of a 51 percent undivided interest

of their personal residence to Cal, retaining their 49 percent. When the real estate is sold, your clients can drastically reduce or altogether avoid paying capital gains taxes by utilizing both the charitable deduction as well as the \$500,000 home sale exclusion for married couples. Your clients can also consider funding a charitable remainder trust with that 51 percent undivided interest to create an additional income stream during their retirement years.

*Date of gift*—The mailbox rule generally applies to gifts by check, allowing the donor to mail a check as late as December 31 and take a deduction in that tax year if the check is received and cashed in the normal course of business [Reg. §1.170A-1(b)]. The same is true of gifts by credit cards, even though the amount will not appear on the donor's bill until the following year [Rev. Rul. 78-38]. Gifts of stock and mutual fund shares are generally complete when the shares reach the charity's account, not when the donor gives instructions to his or her broker to make the transfer [Reg. §1.170A-1(b)].

*Reformation of charitable remainder trusts*—The realization that a charitable remainder trust needs to be reformed often does not occur until a donor dies and the defect is discovered. Reformation rules are set out in the income tax [Code §170(f)(7)], estate tax [Code



§2522(c)] and gift tax [Code §2055(e)(3)] codes. In the case of testamentary trusts, reformation generally must occur within 90 days of the due date of the return (with extension), but Code §2055(e)(3)(C) provides that to be reformable, all payments to noncharitable

beneficiaries must be stated in specified dollar amounts or as a fixed percentage of the value of the property. An exception allows reformation if payments are begun within 90 days of the due date of the return as either a specified dollar amount or a fixed percentage.

## Appraisals: A Vital Part of Substantiating Noncash Gifts

Obtaining an appraisal for a gift to charity might seem like a nuisance, but clients who fail to follow the requirements could find their deductions denied or severely reduced. In general, an independent appraisal is needed for any noncash gift in excess of \$5,000 (\$10,000 in the case of closely held stock) [Code §170(f)(11)(C)]. No appraisal is needed for gifts of publicly traded securities, defined as securities for which market quotations are readily available on an established securities market [Code §6050L(a)(2)(B)], or for most vehicle donations, which

are subject to separate rules [Code §170(f)(12)(A)(i)].

What is required for a qualified appraisal? The appraisal must give a description of the property, the date or expected date of the contribution, the donor's name and address, the method used to determine the value (e.g., market-data, replacement-cost-less depreciation, income approach) and the qualifications of the appraiser. Donors may obtain more than one appraisal, but the appraiser cannot be the donor, a party to the transaction, the charity or anyone related or employed by the donor or

charity [Reg. §1.170A-(13)(c)(5)(iv)]. The appraiser's fee cannot be based on a percentage of the appraised value [Reg. §1.170A-13(c)(6)].

Appraisers must have (a) successfully completed college or professional-level coursework relevant to the property being valued, (b) have at least two years of experience in the trade or business of buying, selling or valuing the type of property being valued and (c) fully describe in the appraisal the education and experience that qualifies him or her to value the type of property [Reg. §1.170A-13(C)(5)].

# A Charitable Solution to Lost Alimony Deduction?

A charitable remainder trust that is used to satisfy a donor's legal obligations runs afoul of the self-dealing rules [Reg. §53.4941(d)-2(f)(1)]. For that reason, a remainder trust could not be established to make alimony payments under an existing divorce or settlement agreement. But could a charitable remainder trust be part of the negotiations prior to the entry of a court order? This question takes on added importance now that alimony paid pursuant to divorce or separation agreements executed after 2018 is no longer deductible by the paying spouse or included in the income of the receiving spouse. This change was part of the *Tax Cuts and Jobs Act of 2017*.

Why might the parties want to use a charitable remainder trust as part of or in place of alimony in the separation or divorce agreement? There would be several advantages:

- The paying spouse would be entitled to a charitable deduction in the year the trust is funded. If appreciated securities are used, capital gains taxes could be avoided. The receiving spouse would be subject to income tax on the payments received, under the

four-tier system [Reg. §1.66401(d)(1)].

- Allowing the receiving spouse to name the charitable remainderman could be an incentive to enter into an agreement.
- An independent trustee (bank, trust company or charity) would ensure that payments were made on a regular basis, thereby eliminating one area of contention in alimony payments.
- The trust could be established for a term of years (up to 20) or for the life of the income beneficiary/spouse.
- The trust might offer greater assurance to the receiving spouse that payments will be made, even in the event of a financial setback for the paying spouse.
- Where the divorce is acrimonious, the parties need have no further contact once the remainder trust is established.
- The trust could include qualified contingency language [Reg. §§1.664-2(a)(5)(i), 1.664-3(a)(5)(i)] that would cause income payments to cease and trust assets to be distributed immediately to the charity in the event of the recipient's remarriage.

Charitable gift annuities are not subject to the private foundation rules, so a gift annuity used to satisfy alimony obligations might also be an option. With a gift annuity, payments would have to continue for the life of the receiving spouse, rather than for a term of years. In addition, when a gift annuity is funded using appreciated securities for someone other than the donor—even for a spouse—capital gains tax on the annuity portion is not avoided. The spouse establishing the gift annuity would be entitled to a charitable deduction.

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