



# Gift Planning Now

A Newsletter for Berkeley's Donor Advisors

Fall 2013

## Gifts of Securities: A Review of the Rules

Year's end is a time when many clients choose to make charitable gifts, in order to qualify for a deduction on the current year's tax return. Many financial advisors recommend that donors make their charitable gifts with long-term capital gain property, rather than cash. That advice could be especially wise this year as many clients could be subject to the higher income and capital gains tax rates, the new 3.8% net investment income tax on the sale of securities, and the higher California tax rates. The donor is entitled to a charitable deduction for the full fair market value of the donated shares held more than one year, and no capital gains tax is owed at the time of transfer.

A review of the rules governing gifts of securities may be in order for donors:

- Clients should not contribute depreciated stock. The charitable

deduction is limited to the fair market value. Instead, donors should sell the shares, thereby securing a capital loss deduction. They then can contribute the proceeds to charity, entitling them to a second tax deduction for the cash gift to charity.

- The deduction for a gift of stock held one year or less is the lesser of the donor's basis or the fair market value [Code §170(e)(1)].

- The value of a gift of publicly traded stock is the mean (average) between the high and low selling price on the date the charity receives the gift [Reg. §25.2512(a)]. If there are no trades on the date of the gift, the regulations provide for a weighted average to be used [Reg. §25.2512-2(b)(1)]. The average is weighted inversely by



the respective number of trading days between the last sale occurring before the gift, the date of the gift, and the date of the first recorded sale date after the gift. Because Saturdays and Sundays are not trading days, gifts made on a weekend are averaged

*(continued on page 2)*

### Our 2013 Incoming Graduate Class

Among the 36,000 students at Berkeley, nearly 30% are pursuing doctoral and master's degrees in more than 100 disciplines. Out of 37,956 graduate applicants for the 2013 school year:

- 12% of doctoral applicants (950) and 21% of master's applicants (2,100) received offers of admission.
- 31% come from California, 42% come from other states, and 27% are international students.
- The average application age is 28 with the youngest applicant being 19 and the oldest being 72.

## Gifts of Securities . . . (continued from page 1)

between the mean sale prices on Monday and Friday.

- The value of mutual fund shares is the net asset value in effect at the time of the gift [Reg. §25.2512-6(b)]. The gift is considered complete when the shares are received in the charitable donee's fund account. Check with the Office of Gift Planning regarding transfer instructions.
- A donor who claims an income tax charitable deduction for a non-cash gift of \$5,000 or more must obtain a qualified appraisal and file IRS Form 8283. This requirement does

not apply to gifts of publicly traded securities. If the gift involves closely held stock, an appraisal is required if the deduction is \$10,000 or more.

- A gift of appreciated securities to a public charity is deductible up to 30% of the donor's adjusted gross income [Code §170(b)(1)(B)]. Excess deductions may be carried over for up to five additional years. The donor may make an election under Code §170(b)(1)(C)(iii) to deduct only up to the stock's basis and be eligible for a 50%-of-AGI limitation.
- Most clients who own shares

will have the stock in a brokerage account. Gifts can be made by a direct transfer and will be complete when the shares arrive in the charity's account. Clients should notify our office when a gift is being made, both to get transfer instructions and to assure that proper substantiation is given.

Because the transfer process can be subject to delays, clients should allow ample time for gifts to be completed before year's end. This is especially true for transfers of mutual fund shares, which can take longer than transfers of stock from a brokerage account.

### UC Berkeley Planning Pointer:

## IRA Charitable Rollover Distribution Can Be Ideal Year-End Gift to Cal

The American Taxpayer Relief Act extended the IRA charitable rollover distribution through December 31, 2013. While Congress has extended this provision of the Internal Revenue Code several times since 2006, the legislative climate in Washington appears more challenging than ever. Thus, it is not at all clear that Congress will again extend this taxpayer friendly provision for 2014.

Since it first became law, UC Berkeley has received more than \$12,765,000 in IRA rollover gifts, primarily providing support for undergraduate scholarships, graduate fellowships, and faculty research. This can be an ideal way to make a charitable gift to Cal because, unlike a typical distribu-

tion from a retirement account, an IRA charitable rollover distribution is not includable in the taxpayer's gross income. Thus, it makes an excellent gift option for many donors, including donors who have already reached the ceiling on their income tax charitable deductions for 2013. When counseling clients about a possible IRA charitable rollover distribution, keep in mind the following requirements:

- The donor must be age 70½ or over.
- Total combined IRA charitable rollover distributions cannot exceed \$100,000 in any one year.
- Charitable distributions from an IRA must go to a public charity. Distributions to donor-advised funds and private foundations do not

qualify as tax-free IRA charitable rollover distributions.

- Distributions must be made from traditional individual retirement accounts or Roth IRAs.
- Distributions must be payable directly from the IRA custodian to the public charity.
- Donors cannot receive goods or services in return for the contributions.
- Pledges can be paid off with a rollover.

The \$3B *Campaign for Berkeley* ends December 31, 2013. With an IRA charitable rollover distribution, your client can help Cal reach its goal.

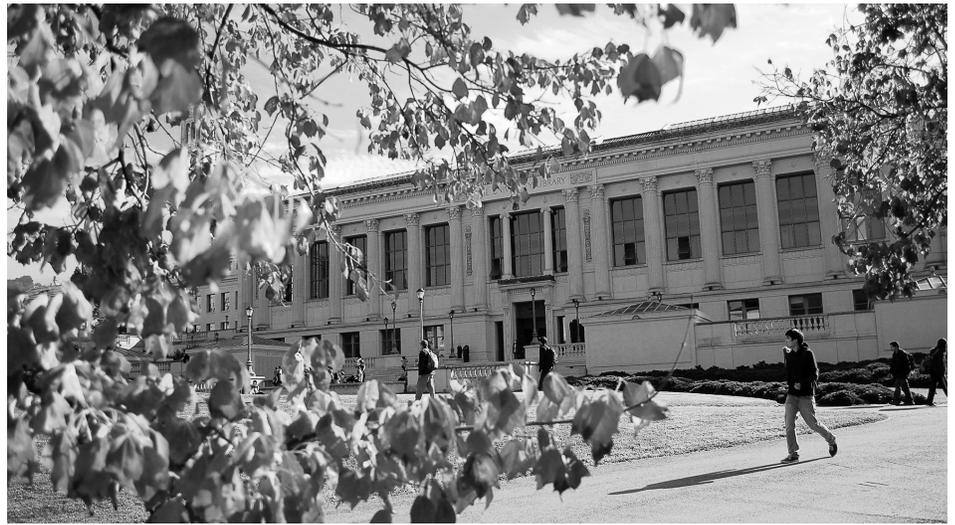
## The Incredible Shrinking Income Interest

Hector and Betty created a net-income with make up charitable remainder unitrust sometime prior to 2008. They have become disappointed with the returns and would like, with the agreement of the charitable remainderman, to terminate the trust. Hector and Betty would receive the actuarial value of their income interest and charity will receive the balance.

The IRS was asked to rule on the consequences of the trust's termination. Both Hector and Betty have been examined by their doctors, who submitted statements that the couple have no medical conditions that are likely to result in shorter life expectancies than expected for persons of their ages.

Hector and Betty are disqualified persons in relation to the trust [Code §4946(a)(1)(A)], but under Code §4947(a)(2)(A), amounts payable under the terms of the trust are not self-dealing. Payments received on the termination of the trust would not be considered self-dealing, provided the allocation method is reasonable and does not result in a greater allocation of trust assets to the couple than appropriate, said the IRS.

Net-income with make up unitrusts do not necessarily pay a stated percentage of the trust value each year, the IRS noted. It's possible, therefore, that the income beneficiaries could receive an amount in excess of the



rates specified in Code §7520. Therefore, the allocation must be adjusted to reflect amounts that "reasonably may be paid to the beneficiaries." The IRS set forth what it called a "reasonable method" to prevent a greater allocation of assets to Hector and Betty than is appropriate, involving the use of a special §7520 factor.

The IRS assumed that the termination would occur in March or April 2013, when the §7520 rate was 1.4%. Hector and Betty were ages 72 and 70. Therefore, the unadjusted payout rate of 1.4% and annual payments made at the beginning of each year yield a remainder interest of .77971. The present value of the income interest is \$1 minus \$.77971, or \$.22029 for each dollar of trust value. The amount received by Hector and Betty will be treated as an amount realized from the sale or exchange of a capital asset under Code §1222, taxed as long-term capital gain (Ltr. Rul. 201325018).

*Note:* The calculation proposed by the IRS results in the income beneficiaries potentially receiving significantly less than they might otherwise be

entitled to if the actuarial interests were valued using the stated payout percentage (minimum 5%).

### Tax Planning Pointer

When reviewing or establishing a client's estate plan, consider not only the inclusion of a bequest to favorite charities, but also the best assets to fund the bequest. Appreciated securities and other capital assets are best left to family members due to the step-up in basis. Tangible personal property may be an option for charitable bequests if family members are not interested in the items and the charity can use or easily liquidate them. The unrelated use rule [Code §170(e)(1)(B)(i)], which limits the donor's income tax deduction to basis during lifetime, does not apply to bequests. But by far the best assets to leave to charity are those that would generate income in respect of a decedent [Code §691(a)], such as qualified retirement plan assets – IRAs, 401(k)s, 403(b)s – or US savings bonds. Unlike a charity, family members receiving these assets pay income tax, reducing their value.

## Gifts by Agent Reimbursed, Deductible

Larry Zavadil sold his shares in American Solutions for Business (ASB) to an employee stock ownership plan in 2000, but remained as an unpaid member of the company's board and its CEO. The company maintained a ledger account for Zavadil for non-ASB expenditures, from which he made numerous charitable gifts. Zavadil reimbursed ASB by the end of each month.

Zavadil claimed charitable deductions of \$576,827 and \$535,731, respectively, in 2004 and 2005. The IRS disallowed a significant portion of each year's deductions.

Zavadil initially conceded he was not entitled to some of the disallowed deductions, but before the Tax Court, he said that the IRS would not be prejudiced if the court disregarded the concessions because the dispute centered on whether the deductions were Zavadil's or properly belonged to ASB. The court agreed.

The IRS claimed that ASB, not Zavadil, "bore the economic burden" of the charitable contributions that were charged to his ledger account.

The court said the IRS's argument failed to recognize that during the years Zavadil repaid the ledger bal-

ances with his own funds. Because the balances were paid off by the end of 2004 and June 2005, Zavadil, not ASB, bore the economic burden of the gifts and was entitled to the deductions. The court found ASB was acting as Zavadil's agent in making the gifts. However, Zavadil was unable to show which, if any, of the gifts made after June 2005 were paid with his own funds. Therefore, he was not entitled to the charitable deductions for gifts made after June 2005, the court ruled (*Zavadil v. Comm'r.*, T.C. Memo. 2013-222).

## Lack of Appraisal Reduces Deduction

Jay and Cynthia Haskett made separate cash gifts of \$1,000 and \$250 in 2008 to their local humane society in connection with a charity preview and auction. They received a receipt indicating donations were deductible to the extent that they exceeded \$50 per person for the value of refreshments.

The same year, Cynthia made several donations of clothing and household items to the humane society's thrift shop. The receipts she received estimated the value of the goods. The couple claimed \$1,250 in cash contributions and \$10,000 in contributions of clothing and housewares to the thrift shop. The IRS disallowed all but \$1,050 of cash contributions and \$3,600 thrift shop contributions.

The Tax Court said the \$50 per person value placed on the refreshments covered both the preview party and the auction and that the Hasketts had adequately substanti-

ated cash gifts of \$1,150. However, for the noncash gifts in excess of \$500, Reg. §1.170A-13(b)(3) requires that they maintain records showing how the donated items were acquired, the approximate date of acquisition and the cost or adjusted basis of the property. The court said they lacked these records and failed to show reasonable cause for not providing the information. In addition, Reg. §1.170A-13(b)(2)(ii)(c)(2) requires a qualified appraisal for noncash gifts in excess of \$5,000. The Hasketts did not have a qualified appraisal for the clothing or household items, the court said. The court noted that pursuant to Code §170 (f)(11)(F) and Reg. §1.170A-13(c)(1)(i), (7)(iii), the values of all similar items of property contributed to one or more donees are considered in the aggregate. Their deduction for the noncash gifts was limited to the amount allowed by the IRS (*Haskett v. Commissioner*, T.C. Summary Opinion 2013-76).

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