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Basic Estate Planning Fact Sheet Series

Giving

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Many institutions have excellent materials concerning charitable giving at no cost. One is the “Guide to Giving,” supplied by the Office of Planned Giving, The Ohio State University. To receive your copy call 1-800-327-7907. Other colleges and institutions also have excellent materials.

Charitable Contributions

Monetary benefits from charitable contributions can include income tax deductions, avoidance of capital gain tax, reduction or elimination of estate tax otherwise payable, and may even allow more assets to be passed to heirs than otherwise would have been possible.

Non-monetary benefits are also important benefits of giving. Most of us make charitable contributions during our lives and would like to give more. Many wills include bequests to charities. Maybe the money in the will was

reserved for the rainy day that never came. Maybe the heirs don't really need all the assets. Maybe there is no one with which you wish to leave your assets. Maybe you have always wanted to give more to charities, but never got it done. At any rate, charitable giving has monetary as well as psychological rewards.

Giving

Giving is a very important tool in estate planning. Giving strategies may be very simple or very complex. Strategies may involve giving during one's lifetime, by bequest, or both. Strategies may involve giving cash or property outright and in total, or may give only certain rights of property, such as only remainder rights, only current income rights, only future income rights, etc. Gifts may be made to family members, other heirs, or to charities. All of these gifts have their place and are important tools in estate planning.

This fact sheet is only an introduction to giving and its place in estate planning. If you are seriously considering charitable giving, start at the development office of the charitable organization(s) of your choice. A team of professionals should assist you in developing the plan for a sizable gift, including at least an attorney, an accountant, and a development officer.

Giving under \$13,000

By far the most used giving tool is that of giving \$13,000 or less per person per year (\$12,000 in 2008). Even if not given to a charitable organization this gift can be made to as many different people as the person can afford and has money and people to which they desire to give, without federal or state estate tax or federal gift tax implications and no additional tax forms. Also, a husband and wife can each give up to \$13,000 to one person in one year, with that person receiving a total of \$26,000 from the couple, even if the gift given was owned by only one of them. This strategy is simple, transfers funds and assets tax free, and requires no tax forms to be filed; however, if the \$26,000 gift is from only one spouse, a gift tax return is required to elect to have the gift split between the spouses. If this is done over a number of years, estates can be significantly reduced, thus eliminating transfer costs for those assets.

Also, the \$13,000 is now increased at the rate of inflation, but rounded down to the nearest \$1,000 increment. At the present rate of inflation it may be a couple years before the amount increases to \$14,000.

Gifts and Gift/Estate Taxes

Gifts up to \$13,000 per person per year are transferred tax free and do not use up unified credit, but gifts over that amount are often appropriate.

If assets (real estate, stocks, or personal property) are expected to appreciate, it may be appropriate to give more than \$13,000 per year per person per donee. Giving more than the \$13,000 limit uses up dollar for dollar the federal estate tax exclusion, up to a limit of \$1 million, unless the gift is from one spouse to the other in which case there is an unlimited exclusion and gift allowance if the recipient is a U.S. citizen. So, up to \$1 million can be given over a lifetime (over the \$13,000 per person per year) with no gift tax but the federal estate tax exclusion will be reduced dollar for dollar. However, if assets are expected to appreciate, less federal estate tax exclusion will be needed to negate tax on a gift made before appreciation than after the assets have appreciated. Put another way, a set amount of unified credit will allow more assets to transfer federal tax free (gift and/or estate taxes) before the assets appreciate.

For example, Mom, (a widow) wishes to transfer the farm to son. The farm is worth \$1,000,000 now, but is projected to be worth \$4.5 million at Mom's death, because a four lane highway interchange will be constructed near the farm. Mom has \$100,000 in assets other than the farm, which she plans to spend or keep, but that are not expected to appreciate. Mom can give the farm to son, and use up the gift tax applicable exclusion amount. She will not have to pay federal gift tax because the exclusion amount will offset the gift tax. However, if Mom wills the farm to Son and the farm is worth \$4.5 million when Mom's estate is settled in 2009, estate taxes of about one-half million dollars may be assessed because there is only a \$3.5 million federal estate tax exclusion. By giving the property before appreciation, a half million or more may be saved.

Payments Directly to Institution

Payments made *directly* to hospitals, universities, or colleges are not considered to be taxable gifts even though they may exceed \$13,000 per person per year and may be for services that directly or indirectly benefit the giver or their family. Even though they do not qualify for a charitable deduction for income tax purposes, such payments will not impact gifts of \$13,000 per year per person nor will they reduce the unified credit or have gift tax implications. Thus, grandparents who wish to provide for grandchildren's tuition expenses or who wish to assist with grandchildren's medical expenses may wish to pay the institution directly. These payments do not reduce the \$13,000 per year gift that the grandparent can give to that grandchild, nor do they add to the tally of gifts that use up unified credit.

This strategy could significantly reduce the size of an estate, along with accompanying transfer costs, especially if the grandparent has numerous grandchildren that attend college.

Charitable Contributions and Taxes

A charitable deduction may be applied to three different types of taxes: 1) income tax (including income tax on gain); 2) gift taxes; 3) estate taxes. When making sizable gifts, most people make them in a manner so that they qualify for several tax deductions. If a gift is made over a period of time, during one's lifetime, attention needs to be given by professionals to income and gift tax considerations, as well as estate tax ramifications. Likewise, when a charitable gift is made by means of an irrevocable trust, it is important that it qualifies for the charitable deductions. If the gift is made outright during one's lifetime, qualification for both income tax and gift deductions are more straight forward, given the institution qualifies as a charitable

organization. However, it is still important to involve a team of professionals to make sure everything is in order.

Charitable Organizations

All organizations are not considered equal for tax purposes. Furthermore, exempt organizations are not necessarily charitable organizations. Exempt organizations are exempt from paying income tax—e.g., business leagues, fraternal societies, condominium associations, and Blue Cross. A charitable contribution deduction to them may not qualify you for a charitable contribution deduction from your taxes.

However, contributions to charitable organizations do qualify for deductions from income, gift and/or estate taxes. In general, contributions to charitable organizations reduce the taxable amount on which federal estate taxes and/or federal gift taxes are figured, dollar for dollar. However, contributions do not necessarily reduce one's taxable income for income tax calculation dollar for dollar, at least not in the year of contribution.

Income Tax Charitable Deduction

On your income tax forms, Schedule A is filled out if you itemize your deductions. For schedule A to be to your advantage, the total of itemized deductions must be more than the standard deduction. Charitable deductions allow a person to reduce their income tax by only a portion of the contribution in the year the donation is made. In many situations the unused portion of the allowed deduction may be carried forward as much as five years, if the donor doesn't have enough income to use it up in the year of the gift.

To maximize tax benefits, most need to make sure they donate to a charitable organization,

not an exempt organization. There are 50% and 30% charitable organizations, and private foundations. The type of organization may influence the percentage of the donation that can be used to reduce adjusted gross income (AGI) for income tax calculation the year of donation.

A donor is allowed to deduct the year of a cash donation, only 50% (30% for 30% charitable organizations) of their adjusted gross income (AGI), assuming there is no net operating loss carryback to the year. However, deductions unused can be carried forward as many as five years.

The most common examples of charitable organizations that qualify for the maximum 50% of adjusted gross income for cash contributions the year of the donation are churches; educational organizations, and organizations for the benefit of certain state and municipal colleges and universities; hospitals and medical research/educational organizations; governmental units; and certain community foundations as designated by the Internal Revenue Code.

Private foundations (30% charitable organizations) are all those charitable organizations not named in the Internal Revenue Code as 50% organizations. It appears the major difference between 50 and 30% organizations is that the 30% organizations lack a broad base of public support.

The gift and/or estate tax deduction for charitable contributions will likely be the same whether you donate to a 30%, 50% charitable organization or private foundation. So, the 30% or 50% refers to the percentage allowed for the income tax deduction on Schedule A.

The deduction amount the year of contribution is further limited for long term capital gain property (real estate, stocks, etc.). Income tax deduction in one year for gifts of such property is limited to 30% of AGI for 50% organizations, and 20% of AGI for 30% organizations, with the same five year carry forward. A donor can elect to take the full 50% or 30% deduction for long term capital gain property in a given year, but the deduction is limited to the donor's cost basis of the property, and no carry forward is allowed. Needless to say, if one is to make a sizable gift (one more than 20 to 30% of yearly income for appreciated property), it is necessary to work with an accountant and other professionals to fully utilize gift-estate-income tax deductions. If planning to make a sizable gift to other than a 50% charitable organization, check with your accountant to see how much tax advantage there would be to give instead to a 50% charity.

The above is only a summary. Some charitable organizations will qualify for one federal tax deduction and not for the other. Work with a professional to make sure your charity qualifies for the deductions you need.

Caution: The above paragraphs are not a complete description of tax treatment of charitable deductions for income tax purposes. Instead, the intent is to give you a concept of the tax treatment of charitable deductions for income tax purposes. An accountant should be included on your team of professionals to make sure you have maximized your income tax benefits with any sizable charitable gift.

Capital Gains

If a donor has appreciated assets, it is generally advisable to contribute the asset directly to a charitable organization instead of selling

the asset and contributing the cash from the sale. The reason for this is that the donor does not realize any income tax liability on the gain when the appreciated asset is donated, but would if sold. The donor could, as a result, make a larger gift because they don't have to spend a portion of the proceeds to pay more income tax, due because of capital gain of that asset.

For example, a donor is considering donating \$50,000 to a charitable organization. The donor has owned a farm field for some time, now valued at \$50,000, but purchased at a cost of \$10,000. The donor is considering selling the field then donating the money or directly donating the field to the charity. The purchase price of \$10,000 is referred to as cost basis, so the gain on the farm field, if sold would be \$40,000 (\$50,000 – \$10,000). If the field is donated directly as opposed to the property sold first and then proceeds donated, the donor will save \$6,000 in federal income tax (assuming a 15% federal income tax on gains, $\$40,000 \times 15\% = \$6,000$), not to mention savings also in Ohio income tax. With direct donation of appreciated property, capital gain tax liability is averted.

Either giving method will reduce the income tax bill of the donor because of the income tax charitable deduction, but the direct gift to a charitable organization of appreciated assets (assuming those assets were held for more than one year) has the additional benefit of averting the capital gains portion of income tax liability.

An additional benefit of donating appreciated property is that the donor can get credit for tax purposes for an amount larger than the initial cash outlay of the donor, without paying tax on the gain. In the previous example,

the donor paid \$10,000 for the farm field, but will be entitled to an income tax deduction in the amount of \$50,000, with no income tax on the gain. A logical strategy for donors who plan to donate to a charitable organization in the future may be to buy assets that will appreciate and plan to donate those appreciated assets directly to a charitable organization in the future.

What Property Should Be Donated To Charity

Appreciated property that has been held for at least one year is best suited to favorable income tax treatment when donated directly to a charitable organization. It is best that this property be easily valued, i.e., land, real estate, farms, stocks, etc. Hard to value assets, i.e., art work, jewelry, books, closely held stock, etc., are often audit targets. However, hard to value assets should not be excluded as a prospect for charitable giving, provided sufficient care is given in obtaining a professional appraisal.

Problem Property

Some property even though it has appreciated, is not a good candidate for giving to a charity, as the income tax deduction is limited to the cost basis of the property. This includes property taxed as income (not as capital gain), short-term capital gain property, inventory, and art work or computer programs donated by the creator. If raised livestock that cannot be directly and immediately used by the charitable organization is donated to a charity, income from the sale of the livestock would be taxed as all income, thus there would be no deduction allowed. However, if personal property is directly and immediately used by the charitable organization in fulfilling its mission, the donor may be able to apply the full market value of the property as an income tax deduction.

There is a limited exception in 2008 and 2009 for Individual Retirement Account funds in an amount up to \$100,000 for an individual who is over 70 years of age to allow the full value to go to charity.

Also, for gifts to charity balls/banquets, charity raffles/auctions, or for any gifts where you are given goods or services in return, the charitable deduction must be reduced by the value of the goods or services received. Precise documentation should be provided by the charity. If it is not, request it. If it is still not provided and credit for the gift for tax purposes is important to you, consider a different charity.

Other cautions on giving: For gifts of \$200 or more a receipt from the charity is required (a canceled check is no longer enough). For gifts of property exceeding \$500, Form 8283 must be filed with the 1040, and for gifts of property exceeding \$5,000 (other than publicly traded securities) a qualified appraisal is required as a part of Form 8283.

Giving Mechanisms

Different gift mechanisms may be used to give to charitable organizations. If your estate is quite large and has highly appreciated property, you may even be able to gift to charity while passing more to your heirs than otherwise would be possible without the charitable

gift. Talk to the Development Office(s) of the charity(ies) of your choice, or to other members of your estate planning team.

Conservation Easements

As the farmland and open space preservation/retention movements gain momentum, there continue to become more land trusts available to accept gifts of “conservation or agricultural easements” in which case the right to develop land has been given to the land trust. Also, government entities can now purchase development rights. Keep in mind for income tax purposes, land or a portion of land value (value of easement) that is sold is subject to capital gain tax liability. Likewise, land or a portion thereof donated can result in a charitable donation deduction. Land where the conservation easement has been given away or sold will be valued at a farmland or open space value, in most cases significantly less than the development or fair market value.

Currently available from the federal government are permanent easement payments in exchange for a conservation easement for environmentally sensitive land such as wetlands or border strips along streams and rivers. Landowners that gift easements may be eligible to exclude 40% of the value of such land from estate tax calculations in an amount up to \$500,000.

These fact sheets should in no manner be considered as a replacement for consulting with estate planning professionals, nor should the general principles in these fact sheets be applied to specific situations without consulting with an attorney.

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Your Response

Fact Sheet 8

1. Assume Bob and Ellen are married and have three children, each married, with a total of five grandchildren. Assume also that this Christmas they are feeling especially generous and that they have not yet gifted anything thus far this year to any of the above family members. Also assume that they are really rich and have enough assets to gift as much as they wish. How much can they as a couple give in 2009 to the above family members without reducing the federal estate tax exclusion amount remaining to be used when their estates are settled?

\$ _____

2. Contributions to charitable organizations qualify the donor for deductions from what possible three types of federal taxes?

_____ taxes _____ taxes _____ taxes

3. For what two taxes will a dollar of donation likely reduce the federal tax a dollar, regardless of if the charitable organization is a 50% or 30% organization?

_____ taxes _____ taxes

4. For which of the above taxes will it likely make a difference if money is donated to a 50% or 30% organization in how much tax deduction is allowed the year of donation?

_____ taxes

5. The tax liability that occurs upon the sale of appreciated property (capital gain liability) is generally averted when such property is donated to a charity, even if the charity subsequently sells the property. Capital gain liability increases which type of tax, provided the owner sells the property first, then donates the proceeds?

_____ tax

Answers

Fact Sheet 8

1. Assume Bob and Ellen are married and have three children, each married, with a total of five grandchildren. Assume also that this Christmas they are feeling especially generous and that they have not yet gifted anything thus far this year to any of the above family members. Also assume that they are really rich and have enough assets to gift as much as they wish. How much can they as a couple give in 2009 to the above family members without reducing the federal estate tax exclusion amount remaining to be used when their estates are settled?

\$ 286,000

Both Bob and Ellen can donate \$13,000 per year and each can donate to each and every one of their children, children's spouses, and grandchildren, so

3 children + 3 spouses of children + 5 grandchildren = 11 recipients X 2 spouses donating = 22 gifts

22 gifts @ \$13,000 per gift = \$286,000.

2. Contributions to charitable organizations qualify the donor for deductions from what possible three types of federal taxes?

income taxes gift taxes estate taxes

A portion of the federal gift and estate taxes are offset dollar for dollar by charitable contributions. Taxes can be reduced by either a gift during one's lifetime or a charitable donation made through the will. However, income taxes may be reduced by a deduction on Schedule A of a charitable contribution, thus are available only if done during one's lifetime.

3. For what two taxes will a dollar of donation likely reduce the federal tax a dollar, regardless of if the charitable organization is a 50% or 30% organization?

gift taxes estate taxes

In general, every dollar given to a charitable organization is subtracted from the total value of the estate or from the total value of the gift, so there is a dollar per dollar reduction in the amount upon which tax is figured.

4. For which of the above taxes will it likely make a difference if money is donated to a 50% or 30% organization in how much tax deduction is allowed the year of donation?

income taxes

With income taxes, only a portion of the amount of the gift is allowed to be deducted on Schedule A and that amount will likely differ for 50% and 30% organizations.

5. The tax liability that occurs upon the sale of appreciated property (capital gain liability) is generally averted when such property is donated to a charity, even if the charity subsequently sells the property. Capital gain liability increases which type of tax, provided the owner sells the property first, then donates the proceeds?

income tax

The dollar amount that property appreciates is taxable income and is included as capital gain in the year in which it is sold on one's income tax. The percent of federal tax charged for such gain has been reduced, but can still easily be 15% unless you are in the lower tax bracket. However, if a charity sells the property it is not assessed that tax.