



the importance of the "extenders" legislation to charitable gift planning

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A number of important tax provisions expired at the end of 2009. Many of these provisions are routinely extended by Congress, so that they essentially continue uninterrupted. However, advisors have been (im)patiently waiting all year for Congress to pass an "extenders bill" that would extend these provisions through 2010, and hopefully 2011. Unfortunately, as we head into the fourth quarter of 2010, that hasn't happened yet. But hope springs eternal - and here is why it is important to charitable giving that this legislation is enacted by the end of this year. Summarized below are tax provisions that are important to charitable gift planning and that would be covered by the hoped-for legislation.

1. Contributions for Conservation Purposes

Background: A qualified conservation contribution (QCC) is a contribution of a qualified real property interest to a qualified organization, exclusively for conservation purposes that are protected in perpetuity. A qualified real property interest includes a donor's entire interest in real property (other than subsurface oil, gas, and minerals), a remainder interest, and a restriction granted in perpetuity (i.e., an easement). For a contribution of a conservation easement to a public charity, the donor may claim a deduction for the value of the easement, generally the difference between the value of the property without the easement, less the value of the property with the easement. As with other gifts of appreciated capital assets, the amount of the deduction that the donor may use is limited to 30% of AGI, with the excess carried forward for up to 5 additional years, subject to the same limitation every year. The special rule, in effect 2006 - 2009, increased the limitation to 50% and the carry-forward period to 15 years.

Example: Bob has AGI of \$200,000 in the year in which he contributes a conservation easement restricting the use of his ranch to the regional land trust. The easement is valued at \$1,000,000.

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Result without extenders: Bob may claim a deduction of \$60,000 in the year of the gift. Assuming his AGI remains the same over the next 5 years, he can deduct \$60,000 each year, for a total of \$360,000, and he will derive no tax benefit from the remaining \$640,000 value of the contribution.

Result with extenders: With the 50% AGI limitation, Bob uses \$100,000 of the deduction in the year of the gift, and, assuming his AGI remains the same over the next 9 years, he can use the remainder of the deduction - \$100,000 per year - over that period. He has a 67% higher usable tax deduction in the year of the gift, and no portion of his deduction is wasted.

2. S Corporation Charitable Contribution Basis Adjustment

Background: The amount of losses and deductions that a shareholder of an S corporation may claim is generally limited to her adjusted basis in her stock and indebtedness of the corporation. When an S corporation makes a charitable gift of appreciated property, its deduction, passed through pro rata to its shareholders, is the full market value of the property. Under the general rule, the shareholder's basis in her shares is reduced by the full amount of the deduction. Under the special rule, in effect 2006 - 2009, the shareholder's stock basis is only reduced by her share of the S corporation's basis in the contributed property.

Example: Cindy has an adjusted basis of 100 in her shares of her wholly owned S corporation in the year it makes a charitable contribution of appreciated real estate valued at 100, with an adjusted basis of 10. The next year the corporation operates at a taxable loss of 50.

Result without extenders: In the year of the gift, Cindy is able to claim the entire deduction of 100, which reduces her stock basis to zero. In the following year, she is unable to claim any portion of the corporation's operating loss, since she lacks basis in her stock.

Result with extenders: Under the special rule, Cindy would still be able to claim the entire deduction of 100 in the year of the gift, but her stock basis would only be reduced by 10, the S corporation's basis in the appreciated property it contributed. Her stock basis at the end of the year would be 90. In the following year she would be able to deduct the entire operating loss passing through from the S corporation, since she has retained adequate stock basis to do so.

3. Charitable IRA Rollover

Background: In years 2006 - 2009, individuals age 70-1/2 or older could distribute up to \$100,000 tax-free annually from their IRA to charity, without taking a charitable deduction or including the distribution in gross income. To qualify, the distribution must be made directly by the IRA trustee to a public charity (not a supporting organization or donor-advised fund), and the entire distribution must be deductible under the normal rules (i.e., no quid pro quo that is more than de minimus)

Example: John has AGI from other sources of \$50,000 in the year in which he instructs his IRA trustee to distribute \$100,000 directly to the university.



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Result without extenders: The transfer from the IRA to charity would be treated as a distribution to John, followed by his contribution to the university. The deemed distribution would increase his AGI from \$50,000 to \$150,000. The contribution would be allowed as a deduction up to 50% of AGI, or \$75,000, leaving him with additional AGI subject to tax resulting from the IRA distribution to the university of \$25,000, even though the entire distribution went to charity.

Result with extenders: Under the special charitable IRA rollover provision, the distribution from the IRA trustee to the university would not increase John's AGI (nor would it entitle him to a charitable contribution deduction), with the result that he makes a gift in the same amount, but ends the year with AGI of \$50,000.

4. Contributions of Food Inventory

Background: From 2005 to 2009, corporations and all other taxpayers (e.g., S corporations, sole proprietors, etc.) were allowed to make a donation of food inventory that qualified for preferred treatment. The deduction only applies for food that qualifies as "apparently wholesome," defined elsewhere in Federal statutes as food that meets government labeling standards "even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions." Under the expired provision, a donor making a donation of apparently wholesome food could receive a deduction equal to the donor's basis in the food, plus one-half of the ordinary income that would have been realized if the food had been sold at its fair market value at the time of donation, not to exceed twice the donor's basis in the donated food. Even if the donor is not a C corporation, the deduction for the food inventory is limited to 10% of the donor's taxable income for the year with a carryover of 5 years.

Example: Delicious Pastries, Inc., wishes to donate a substantial amount of excess food inventory to a local charity. Delicious Pastries has a basis of \$50,000 in the food to be donated and the food has a fair market value of \$80,000.

Result without extenders: Delicious Pastries, Inc., may claim a deduction of \$50,000, since its deduction for inventory is limited to basis under the general rules.

Result with extenders: Delicious Pastries, Inc., may claim a deduction of \$65,000 (\$50,000 of basis plus 1/2 of the \$30,000 of ordinary income that would have been realized if the food had been sold at its fair market value at the time of donation).

5. Contributions of Book Inventory

Background: For contributions of property, a corporation's charitable deduction is generally limited to the corporation's basis in the property. However, "qualified book contributions" of book inventory to public schools for educational purposes qualify for preferred treatment. As defined by IRC § 170(e)(3)(D), a qualified book contribution means a charitable contribution of books to a public school that is an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on and that provides elementary education or secondary education (kindergarten through grade 12). In addition, the donee must



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certify in writing that the books are suitable, in terms of currency, content, and quantity, for use in its educational programs and that the donee will use the donated books in those programs. Under this expired provision, a corporate donor making a qualified book contribution could receive a deduction equal to the basis in the donated books plus one-half of the ordinary income that would have been realized if the books had been sold for their fair market value at the time of donation, not to exceed twice the donor's basis in the donated books.

Example: Schooltastic Text Books, Inc., wishes to donate a number of textbooks to a local elementary school. Schooltastic Text Books, Inc.'s basis in the books to be donated is \$30,000 and the fair market value of the books is \$50,000.

Result without extenders: Schooltastic Text Books, Inc., may claim a deduction of \$30,000.

Result with extenders: Schooltastic Text Books, Inc., may claim a deduction of \$40,000 (\$30,000 of basis plus 1/2 of the \$20,000 of ordinary income it would have received if the donated books had been sold at the time of donation).

6. Contributions of Computer Equipment

Background: "Qualified computer contributions" of computer technology and equipment for certain educational purposes also qualified for enhanced deductibility under the expired rules. As defined by IRC § 170(e)(6)(B), a qualified computer contribution means a charitable contribution by a corporation of any computer technology or equipment to: a) an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance, at the place where its educational activities are regularly carried on; b) a 501(c)(3) entity organized primarily for purposes of supporting elementary and secondary education; or c) a public library. The contribution of computer equipment must occur within 3 years of acquiring or constructing the equipment, and the original use of the equipment must be by the donor or donee. Substantially all of the use of the property by the donee must be within the United States for educational purposes that are related to the purpose or function of the donee. In addition, the property must fit productively into the donee's educational plan. Further, the property must be functional and suitable for educational purposes. The donor cannot receive money, property, or services in exchange for the donation, except for shipping, installation, and transfer costs. Under this provision, a corporate donor making a qualified computer contribution could receive a deduction equal to the corporate donor's basis in the donated property, plus one-half of the ordinary income that would have been realized if the computer equipment had been sold for its fair market value at the time of the donation, not to exceed twice the donor's basis in the donated computer property.

Example: Computer Tech, Inc., wishes to donate computer equipment it manufactures to local schools and libraries. Computer Tech, Inc.'s basis in the computer equipment to be donated is \$150,000 and the fair market value is \$300,000.

Result without extenders: Computer Tech, Inc., may claim a deduction of \$150,000.

Result with extenders: Computer Tech, Inc., may claim \$225,000 (\$150,000 of basis plus 1/2 of \$150,000 of ordinary income it would have received if the donated computer equipment had been sold at the time of



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donation).