

The American Jobs Creation Act of 2004 will change the rules on car donations starting on January 1, 2005.

Crescendo eNotes - October 11, 2004

President Signs Tax Cut

On October 4, 2004, President Bush signed the Working Families Tax Relief Act of 2004 (H.R. 1308). At the signing in Des Moines, Iowa, President Bush stated, "The law I signed this morning comes at just the right time for America."

President Bush also thanked Senate Finance Committee Chair Charles Grassley (R-IA) and House Ways and Means Chair Bill Thomas (R-CA) for their efforts to pass the bipartisan bill.

The bill extends three tax benefits. The 10% income tax bracket, the \$1,000 per child tax credit and the doubling of the married couple tax brackets are extended until 2010. It also extends the current alternative minimum tax exemptions for married couples and single persons.

Chairman Grassley stated, "President Bush's tax bills reduce taxes for married couples, for parents, for those saving for college, and for workers saving for retirement. Today's tax bill marks the fourth time we've worked together to put more money in the paychecks of working families. It won't be the last."

In a release from Senator Grassley's office, the typical married couple with two children and \$50,000 in income would save \$925 per year with the Working Families Tax Relief Act.

Senator Max Baucus (D-MT) also praised the act. He noted, "For middle-income families, I was pleased that by working with my colleagues we were able to provide significant tax relief by extending marriage penalty relief, the 10% rate bracket, and the \$1,000 child tax credit."

American Jobs Creation Act of 2004 Passes House

By a vote of 280-141, the House approved the Conference Report of the American Jobs Creation Act of 2004 (H.R. 4520). The bill was sent to the Senate and a vote is anticipated very soon.

The bill was made necessary by a determination by the World Trade Organization (WTO) that current laws affecting American multi-national corporations included illegal subsidies. The Jobs Act repeals the illegal subsidy and reduces the corporate tax on manufacturing from 35% to 32%. It is expected that the Senate will pass the bill and that President Bush will sign the bill within a week or 10 days.

Charitable Gifts of Patents and Vehicles

While the final vote by the Senate and signature by the President may take several days, the language of the American Jobs Creation Act of 2004 is now final. Sections 882, 883 and 884 of H.R. 4250 will have major impact on charitable gifts of patents and vehicles.

Sec. 882 -- Crackdown on Patent Gifts

Under current law, gifts of patents are generally determined to be gifts of appreciated capital assets and deductible at fair market value. But patent gift appraised values have in some circumstances far exceeded the actual benefit to the charity. Therefore, Sec. 882 modifies the rules on gifts of patents after June 3, 2004.

Under the new rules, the initial charitable deduction will be the lesser of the taxpayer's basis or the fair market value of the property. Since many patents have a fairly modest basis for the creator, the deduction may be fairly limited.

After the charitable donee receives the patent, it then may license the patent and produce "Qualified Donee Income (QDI)." The donor may then receive additional qualified charitable deductions for QDI in excess of basis produced for 10 years after the gift. The deduction starts at 100% of the QDI received each year and declines over the period to 10% of the QDI in tax year 11. The charitable donee will be required to track the QDI attributable to the gift of the patent and report that amount to the donor and the IRS to substantiate the deduction.

The deduction is limited to the life of the intellectual property. There are also various anti-abuse rules to discourage "bundling" or creation of other entities to circumvent these rules.

Sec. 883 -- Non Cash Gifts Over \$500,000

Under current law, if an individual makes a noncash gift of greater than \$500, IRS Form 8283 must be filed. If the gift is more than \$5,000 (or \$10,000 for closely held stock), then a qualified appraisal must be obtained. For gifts of art over \$20,000 in value, the qualified appraisal must be attached to the return.

The new law makes two major changes. The qualified appraisal rule for noncash gifts over \$5,000 now applies to corporations. In addition, if the deduction value exceeds \$500,000, then the appraisal must be appended to the return.

Sec. 884 -- Abusive Vehicle Gift Deductions Curtailed

Under current law, taxpayers with cars, boats, RVs and aircraft usually have a fair market value that is less than their cost basis, since the property has depreciated. When they give an asset to charity, the deduction is the fair market value of that vehicle. However, research by the IRS has shown that many taxpayers are deducting Blue Book value for vehicles that are not in good condition. In one case, a donor gave a compact car with 194,000 miles to charity and claimed a deduction of \$1,500. The charity sold the car at auction for \$350.

With direct intervention by Senator Grassley (R-IA), the rules on vehicle donations will change radically. After December 31, 2004, the deduction for vehicle gifts will be substantially limited.

There are two categories for the new rules. If the charity sells within 30 days, the "sale" category rules apply. The receipt to the donor must list the name and Social Security number of the donor, the vehicle identification number and must also state that the vehicle was sold "in an arms length transaction between unrelated parties." It must also show the gross proceeds of the sale plus state that the deduction may not exceed the gross proceeds.

In effect, all gifts of vehicles that are sold will now have a charitable deduction limited to the proceeds received by the charity. Since many charities sell vehicles at auctions where the prices are usually below Blue Book, the deduction for gifts of vehicles will be greatly reduced.

The second option is the "hold" category. If a charity plans to hold the vehicle, then within 30 days it must certify the intended use and the duration of that use. The charity must also promise that the vehicle will not be sold prior to the anticipated "completion of such use."

Penalty Taxes - If a charity issues a "fraudulent acknowledgement" for either a "sale" or "hold" vehicle, there may be stringent penalties. For a "sale" case, the penalty is the greater of the gross proceeds or the claimed sales price times the maximum income tax rate. For a "hold" case, the penalty is a minimum of \$5,000, but may be greater if the claimed value times the highest income tax rate is a larger amount.

Editor's Note:

Many charities lobbied for less stringent rules on vehicle donations. The lobbying effort appears to have been unsuccessful. Requiring charities to sell within 30 days and permitting only the amounts received, as charitable deductions will dramatically reduce the number of vehicles given to charity. It seems quite probable that some charities may terminate their vehicle donation programs.

In his efforts to "clean-up" the field of philanthropy, Sheriff Grassley has just fired a shot over the bow. All charities and advisors to donors are on notice that he will address any abuses within the charitable sector. It now is clear that the cure for any problem may include serious adverse side effects for some charities.

Crescendo eNotes - October 18, 2004

• WASHINGTON UPDATE

Sen. Grassley says, "We are coming after you."

Sen. Charles Grassley (R-IA), Chair of Senate Finance, spoke on the Senate floor in support of the American Jobs Creation Act of 2004 (H.R. 4520). He highlighted the "loophole closers" in the Jobs Act and also suggested areas for further future changes. The President will sign the Jobs Act this week.

There are six "loopholes" that are closed in this bill. They are:

1. Fuel tax evasion. A suspected terrorist was caught "skimming off fuel and selling it using the money for God only knows." In another incident, workers in Miami classified fuel as contaminated and then sold 2.7 million gallons.
2. SILO - Sales In and Lease Out. City improvements such as subways and sewers were being bought by investors and leased back to the same cities. The depreciation deductions were billions of dollars.
3. Intellectual Property Gifts. Corporations were giving patents to universities and taking millions of dollars in deductions, even if the university received little or no benefit. The new rules will limit deductions to benefits received by the charity.
4. Car Donations. Donors were giving "some junker" to charity and claiming a "Blue Book" full deduction. Gifts in 2005 of vehicles will generally produce a deduction for the value received upon sale by the charity.
5. Corporate Travel Limits. Corporate executives sometimes use their company jets for personal trips. New rules limit the ability of companies to deduct the cost of these trips. Sen. Grassley closed the door on "many people going down to the Virgin Islands to not only get a tan but also to avoid the tax man."
6. SUV extra depreciation. Up to \$100,000 (plus indexed increases) in extra depreciation may be taken as an expense for new machinery purchases by a business. The extra deduction for an SUV is reduced from up to \$102,000 in 2004 to \$25,000 the first year. Sen. Grassley noted "it would be an embarrassment if we couldn't deal with this abuse."

Sen. Grassley also predicted future action to change rules for other gifts to charity. There is still "an ongoing bipartisan Senate Finance Committee review of nonprofits." There will be future changes in areas "such as land donation and façade donations." But he is not yet finished. For those taxpayers who still are taking unfair or improper advantage of tax loopholes, he replies that, "He is coming after you."

Editor's Note: Sen. Grassley and Sen. Baucus have been long-time supporters of charity and generally approve of gifts of land. They believe that addressing the areas of abuse in charitable deductions will be helpful in preserving full benefits for the vast majority of donors who desire to help charity and value property gift deductions fairly.

Independent Sector Appoints a Blue Ribbon Panel To Suggest Changes

As part of their efforts to improve charitable giving, Sen. Grassley and Sen. Baucus (D-MT) sent a letter to Diana Aviv, President of Independent Sector. The Senators said they were "considering a number of comprehensive reforms to protect charities from bad actors and strengthen their accountability to donors."

While their efforts are designed to encourage "responsible work that leads to the improvement of the common good," they are also aware of the need for "good governance, ethical conduct and effective practice of public charities." To assist in that effort, they asked Diane Aviv to select a Blue Ribbon Panel. The panel recommendations will be due in February of 2005.

In response to this request, Independent Sector formed the "'Panel on the Nonprofit Sector." Leaders of the panel will be Hewlett Foundation President Paul Brest and American Heart Association CEO Cass Wheeler.

The panel will review rules on the duties of directors, excessive compensation of officers, travel expenditures and tax filing and disclosure requirements.

Hewlett Foundation President Paul Brest stated, "This is an important opportunity for our sector to take up the challenge of looking at how we conduct our business. We hope that the broad experience and expertise of this diverse panel can be of real assistance to the Senate Committee."

Crescendo eNotes - November 29, 2004

- **WASHINGTON UPDATE**

Charities Seek 2005 Car Donation Exemption

Under the American Jobs Creation Act of 2004, Section 884 changes the rules on gifts of automobiles to charities. Starting in 2005, charities that receive automobiles and then sell them will need to disclose the sale price to donors. The actual gross sale proceeds will be the deduction amount claimed by the donor on his or her income tax return.

Two charities have sent letters to the Treasury Dept. requesting regulations that exempt them from this rule. The Volunteers of America and Vehicles for Change have programs in which they receive automobiles as gifts and then sell them to people in need.

For example, Vehicles for Change notes that they charge \$825 for a typical car, even though the typical fair market value could be \$3,700. The recipients are usually single mothers with children who need the vehicle in order to obtain employment. Similarly, the Volunteers of America offer their vehicles to low-income persons at affordable prices.

The Treasury has authority to issue exemptions for charities that operate vehicle programs in "direct furtherance" of their exempt missions. Both organizations are requesting this exemption.

IRS Claims False Fronts on Facade Donations

At a meeting in Washington on November 24, 2004, IRS representative Karen Gross indicated that there is continuing concern about excessive deduction on conservation easements.

One type of charitable deduction is a gift of the facade of a historic home. Many donors

and their advisors have made these gifts and taken deductions of 10-15% of the value of the home.

However, Ms. Gross notes "that is an area where there is some abuse." In many historic districts, the donor is not permitted to change the facade because of the historic nature of the home and rules of the district. Therefore, the gift of a conservation easement of the facade may have no direct value.

Another area of concern is sales to charities of property with conservation potential. The charity then may resell the property at a lower price to another party who also then makes a "gift" to the charity. The transaction could result in an audit and the IRS would claim that the entire purchase price plus gift amount was in essence the purchase cost.

Congress Acts to Protect IRS Taxpayer Records

The House and Senate are still working to pass the final version of the combined spending appropriations bill for the fiscal year 2005. However, a major flap developed when a Senate staffer discovered in the fine print of the bills, that the House and Senate chairs of the Appropriations Committee would have complete access to tax returns of any American citizen.

When the offending clause was discovered, members of the House and Senate rushed to claim that they had no part in the writing of that provision in the bill. In addition, Senator Kent Conrad (D-ND) wrote a letter to IRS Commissioner Mark Everson and stated that he was "extremely concerned about the genesis" of the tax provision opening IRS records to House and Senate appropriation chairs. Senator Conrad asked for information to explain who drafted the provision and included it in the bill.

House and Senate negotiators are currently discussing ways to delete this offensive provision and still pass the balance of the Appropriations bill prior to the end of the year. Senate Finance Chair Charles Grassley (R-IA) scolded his Congressional counterparts. He indicated that all tax legislation needed to originate in the Senate Finance Committee or the House Ways and Means Committee. When other committees start writing tax legislation, those additions tend to be "poorly conceived and poorly drafted tax provisions that try to sneak in at the dark of night." Senator Grassley continued, "Members and staff should remember today's events the next time they are approached to insert a "harmless" tax measure into an unrelated bill."

Crescendo eNotes - December 6, 2004

WASHINGTON UPDATE

Possible 2004 Car Donations Surge

The American Jobs Creation Act of 2004 will change the rules on car donations starting on January 1, 2005. At that time, gifts of vehicles valued at over \$500 will be deductible in most cases at the amount of the gross sales proceeds when the charity sells the vehicle.

In discussing the change for 2005, Sen. Chuck Grassley has stated, "The new rules on car donations will make it easier for taxpayers to determine the value of their donation for tax

deductions. No one will have to risk getting in trouble with the IRS over a bad guess."

Many charitable organizations believe that deductions at the charity's selling price will have a "chilling effect" on the gift of cars in 2005. Some organizations have been urging their donors to complete gifts of cars, trucks, RV's and other vehicles during 2004.

In response to the rule change, on November 30, 2004 the IRS published IR-2004-142, a news release that discussed gifts of automobiles. IRS Commissioner Mark W. Everson suggested that the gifts of cars in 2004 should still carefully follow the rules. He noted, "Just because the rules will be tightened for vehicles donated next year doesn't mean anyone should give a car to charity and claim an inflated value this year."

The IRS news release suggests several steps by taxpayers. Donors should make sure that the charity is qualified to offer charitable deductions for gifts. The donor will need to itemize to benefit from the charitable deduction.

Deductions must be at fair market value. This value must reflect not just the "Blue Book" number, but should also consider the mileage, condition and other factors that relate to the value of the vehicle.

Crescendo eNotes - October 25, 2004

- **WASHINGTON UPDATE**

Cafferata Suggests IRA Gift Methods Without CARE Rollover Bill

Many donors and their professional advisors have been waiting for final passage of the CARE Act with its provisions that permit direct and deferred gifts from IRAs. The CARE Act and similar Charitable Giving Act passed both the House and Senate last year but have not yet been sent to a House-Senate Conference Committee.

Attorney Reynolds Cafferata, partner with Bingham McCutcheon LLP, suggests that charitably-minded donors may nearly duplicate the results of the CARE Act by acting today and using the proper withdrawal methods. His suggestions cover both direct and deferred gifts from IRA accounts.

Direct IRA Gifts

The CARE Act would permit gifts directly from IRAs to charity. A similar result may occur with a combination of withdrawals from the IRA and then gifts to charity. First, donors over age 70 may take the minimum withdrawal and then give that amount to charity. There will be an increase in adjusted gross income (AGI) due to the withdrawal, with an offsetting charitable deduction. For many donors, Cafferata estimates that the increase in AGI will have a minor effect on itemized deductions, and the net cost compared with the CARE Act rollover would be about 1% of the total gift.

Second, a very charitable donor could take a larger IRA distribution. Since a donor may give and deduct an amount up to 50% of adjusted gross income, this larger IRA

withdrawal could enable gifts up to that maximum 50% of AGI level. This amount will increase AGI even more than the minimum IRA withdrawal, but the total cost for the gift may be about 1.3% to 1.7% of the value of the gift from the IRA. For example, if Miss Donor has other income of \$40,000 and a large IRA, she could take a withdrawal of \$40,000 this year and give it to charity. Her total income would be \$80,000, and the permitted deduction would be \$40,000.

Deferred IRA Gifts

The CARE Act proposes to permit gifts from IRAs to charitable gift annuities and charitable remainder trusts. Cafferata suggests that a withdrawal plan plus selection of the charity as the designated beneficiary may be quite effective. That is, the net charitable gift could be nearly the same as the result with the CARE Act rollover.

Consider the effect of an IRA owner age 71 taking a CARE Act gift annuity or a similar IRA withdrawal plan. If the CARE Act gift annuity rollover were permitted with \$100,000, then an annuity of 6.6% would be paid for life. With the CARE Act rollover to a gift annuity, all payouts would be ordinary income. A similar plan would be to take 6.6% payouts from the IRA for life. Cafferata notes that there are "certain advantages for both the donor and the charity" with this plan. The donor has "the flexibility to decrease or increase the IRA payments if his or her financial circumstances change." The donor takes a 6.6% withdrawal until age 85, when the minimum required IRA distribution amount increases to about 6.8%. After age 85, the IRA owner gives the extra withdrawal amounts over 6.6% to charity. His or her taxable income is, thus, the same under both options.

If the donor lives to age 93 and selects the charity as designated beneficiary of the IRA, the net cost of the plan is estimated at about 2% of the total gift. The donor-IRA-annuity will closely equal the proposed CARE Act IRA-to-gift-annuity rollover.

With the CARE Act, there also would be an opportunity to roll over an IRA into a charitable remainder unitrust. For example, a 6% unitrust could be selected and payouts would be ordinary income. However, under current law an IRA owner age 71 could decide to take 6.5% payouts from the IRA and select the charity as the designated beneficiary. After age 84, the IRA required distribution would exceed the 6.5%, and the extra amount could be given to charity. With both the CARE Act unitrust and the IRA plan, growth will still be tax free, but payouts will be ordinary income.

Again, if the IRA owner lives to age 93 and has selected the charity as IRA designated beneficiary, when he or she passes away the remaining value will be given to charity. Cafferata estimates that the cost of this plan to the IRA owner when compared to the CARE Act unitrust will be less than 1%. Therefore, charitably minded IRA owners might not wait for the CARE Act, but could begin to use a similar plan today.

Editor's Note: Respected attorney Reynolds Cafferata provides a great service to donors and their tax advisors. His "withdrawal plus gifts" methods are both creative and practical today.