23. VALUATION AND SUBSTANTIATION OF GIFTS

Importance of Valuing Assets

One of the most complex and uncertain aspects of the gift planning and the estate planning process is the valuation of property for income, gift and estate tax purposes. The taxpayer's representative may value property at one amount, the IRS may attempt a second figure and if the issue cannot be settled between the taxpayer and the IRS, the tax court may settle at another amount.

Values are important for a variety of purposes; establishing property tax assessments, purchase or sales price, computing gain or loss on sale, tax deduction, trust accounting and financial accounting purposes. The purpose or use of a value will determine the method by which it is obtained and the qualification of the person making the valuation. While a Realtor's market analysis value of a particular parcel might be sufficient for establishing a listing price, it is insufficient for trust accounting purposes or for tax purposes. Further, when the property sells the sale price will have been the result of negotiation between buyer and seller and maydiffer widely from the Realtor's market analysis value. A county tax assessor will use specific methods and assumptions in establishing a value for property taxation purposes which may or may not relate to market value.

For estate planning purposes, the estate owner needs to have a reasonable understanding of the estate value to determine the estate's liquidity needs. In order to avoid the need for a "fire sale" liquidation of estate assets to generate cash to pay estate taxes or fund buy-sell agreements sufficient liquidity needs to be built into the estate plan. Liquidity can be obtained through life insurance, cash or cash equivalents, or specialized stock redemption plans and installment payment of taxes related to business interests.

Some individuals will consider lifetime gifts as a way of transferring assets at the most reasonable transfer cost. Charitable gifts can yield benefits to the estate holder. Before a person can estimate how beneficial a lifetime gifting program might be the estate's value must be known.

Valuation Date for Gift and Estate Tax Purposes

Generally, the value of an asset for determining the transfer tax cost is its fair market value as of the date of transfer (gift tax purposes) or the date of death (estate tax purposes). A date six months after the date of death (the alternate valuation date) for estate tax purposes may be used if elected by the personal representative and only if the election will decrease the value of the gross estate and decrease the sum of estate and generation skipping tax imposed. Once the date-of-death valuation or the alternate valuation date is selected, that valuation date applies to all assets in the estate

Certain exceptions apply to this general rule. If the alternate valuation date is selected and property is distributed, sold, exchanged, or otherwise disposed of within the six month period after the decedent's death, that property is valued as of the date of distribution, sale, exchange, or

other disposition, not as of the alternate valuation date. Certain types of property diminish in value as time goes on. Any property interest or estate whose value is affected by the mere passing of time, such as an annuity, is valued as of the date the decedent died, even if the alternate valuation date applies to other estate assets.

Fair Market Value

For tax purposes, the "willing buyer-willing seller rule" guides the determination of value. A property's fair market value (synonymous with fair value or market value) is "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." It is an opinion of value that is not always easily determined. Its accuracy is based on the qualifications and methodology of the one doing the valuation as well as other variables.

Some property types present minimal valuation problems. The fair market value of money is its face value unless it is in the form of a collectible. Publicly traded securities are readily valued per the applicable market exchange.

Valuation of other property types may be complex. Publicly traded securities for which there were no sales on the transfer date require a weighted average of sales prices on the sale date immediately before and after the valuation date. If a block of stock is large enough to depress the market value if sold within a short period thus making it difficult to sell, its value may be subject to a "blockage discount." Large holdings representing a controlling interest may experience a "majority premium" which adds value to the asset. Conversely, if the size of the interest valued does not provide control a "minority discount" would reduce the value reflecting the lack of control. Valuation of closely held stock (as in a family owned business), since it is seldom traded, is typically difficult to value. The absence of marketability reduces asset value due to a "marketability discount." Many factors affect real estate values including size, shape, location, environmental issues, actual or intended use, and market value of similar properties in the area. Other property types such as partnership interests, collectibles, art work, and copyrights can be very complex to value. The services of professional appraisers are often required to document and render an opinion of value.

Valuation for Income Tax Charitable Deduction

Generally, the value for income tax charitable deduction purposes is the fair market value of the donated property on the date of transfer to the charity. Fair Market Value (FMV) for the purpose of determining income, gift and estate tax charitable deductions may be affected by various factors such as restrictions placed on donee's use of the asset, difficulties in use of the asset by donee, or other circumstances of the transaction. These factors must be reflected in the value of the property for charitable deduction purposes.

In certain situations a charitable deduction may be limited to the donor's basis irrespective of the fair market value. Property that if sold by the donor would produce ordinary income or short term capital gain is limited for income tax charitable deduction purposes to the donor's adjusted basis. Included in this category of donated property are items such as business inventory, real

property held short term, crops, and items created by the donor such as paintings or sculpture. If the fair market value is less than the basis then the lower value is used as the deductible amount.

Gifts of Remainder Interest

Gifts in trust of a charitable remainder are deductible for income, gift and estate tax purposes only if they are made through a qualified charitable remainder unitrust, charitable remainder annuity trust or pooled income fund. The deductible amount is limited to the present value of the charitable remainder which is the remainder after subtracting the present value of lifetime payments from the fair market value of property transferred to the trust. A qualified appraisal is required to establish the fair market value of donated property upon which the present value calculations are based.

Gifts of remainder interest in a personal residence or farm are also deductible at the present value of the remainder interest. Gifts of a charitable remainder through a charitable gift annuity contract are also valued at the present value of the charitable remainder. As in the charitable remainder trust and pooled income fund, the fair market value of donated property is the starting point for computing the present value of the charitable remainder and establishing the deductible amount.

The fair value of non-cash property is determined by a qualified appraisal. If publicly traded securities are donated to these split interest gift plans market value is the mean between the high and low sale price on the day of transfer.

Appraisals

A “qualified appraiser” is someone who (a) holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis and is paid for appraisals, (b) has earned an appraisal designation from a recognized professional appraiser organization and demonstrates verifiable education and experience in valuing the type of property subject to the appraisal, (c) has not been prohibited from practicing before the Internal Revenue Service, (d) does not establish the appraisal fee as a percentage of the appraised value, (e) knows that making an intentionally false or fraudulent overstatement will subject him/her to a penalty, and (f) has not been excluded by Treasury regulations from serving as an appraiser. The appraiser cannot be the donor or donee or a party to the transaction by which the donor obtained the property. The appraiser cannot be an employee of, or married to, any person who is related to the foregoing persons. The appraiser can be used by the donor or donee to perform other appraisals, but must perform the majority of his/her appraisals for other persons.

For real property gifts on returns filed after October 19, 2006, the appraiser meets the required standards if he or she is licensed or certified for the type of real property by the appropriate state agency. Some state agencies have a separate certification for residential real estate and other types of real estate such as commercial real estate. In these states the appraiser must have the appropriate designation for the type of real estate gifted to charity.

For gifts that are not real property, on returns filed after February 16, 2007, the appraiser must fulfill three requirements. He or she must have completed "college or professional-level coursework," must have two years of experience in buying, selling or valuing the type of gifted property, and must thoroughly describe in the appraisal his or her education and qualifying experience. (Crescendo Pro Gift Law 1.5.2 referencing IRS Notice 2006-96; 2006-46 IRB 1 (19 Oct 2006).

Qualified Appraisal

The qualified appraisal rules apply to gifts of property (with some exceptions) where the income tax charitable deduction claimed exceeds $5,000 or where the deduction claimed for closely held stock exceeds $10,000. Qualified appraisal exceptions include stock traded on a public exchange, inventory and vehicles sold by the donee without significant intervening use or material improvement. The donor must: 1) obtain a qualified appraisal; 2) attach a properly completed appraisal summary (Form 8283, Section B) to the tax return on which the deduction is first claimed; and 3) maintain appropriate records for gifts of property. The appraisal must be prepared not earlier than 60 days before the date of transfer of the property to the charity and must be received by the donor no later than the due date (plus extensions) of the return on which the deduction is first claimed. For a deduction first claimed on an amended return, the appraisal must be received before the date the amended return was filed.

A separate qualified appraisal and a separate Form 8283 (to be discussed below) are required for each item of property except for an item that is part of a group of similar items. Only one appraisal is required for a group of similar items contributed in the same tax year, if it includes all the required information for each item. If similar items are donated to more than one donee for which a total deduction of more than $5,000 is claimed a separate Form 8283 for each donee must be attached to the return in which the deduction is claimed.

Generally, appraisals will qualify if consistent with the Uniform Standards of Professional Appraisal Practice set forth by the Appraisal Standards Board of the Appraisal Foundation. There are several statements that <u>must be included</u> in a qualified appraisal:

1. A description of the donated item (including a description of the physical condition in the case of tangible personal property).
2. The date of the appraisal.
3. The date or expected date of gift.
4. The fair market value of the donated item on the date or expected date of the gift.
5. The basis for the determination of fair market value.
6. A description of any agreement or understanding affecting the use of the donated item by the donee organization.
7. A statement that the appraisal was prepared for federal income tax purposes.
8. A description of the fee arrangement between the donor and the appraiser (can't be a percentage of the appraised value).
9. The appraiser's name, address, and tax ID number.
10. A listing of the appraiser's education, background, training, and experience, including membership (if any) in professional appraisal associations.

Form 8283 (see IRS Form 8283 for complete filing instructions)

Internal Revenue Service Form 8283 is required to report information about non cash charitable contributions when the total deduction claimed is greater than $500 for all contributed property. Form 8283 is filed with the donor's tax return for the year in which the donor contributed the property and first claimed a charitable deduction.

Charitable non cash gifts of more than $500 but $5,000 or less are reported in Section A of Form 8283 without the need for an appraisal. Gifts of publicly traded securities are also reported in Section A even if their value is greater than $5,000.

All non cash gifts (with certain exceptions as noted above) where the deductible amount is more than $5,000 per item or group (or $10,000 for non-publicly traded stock) require a qualified appraisal by a qualified appraiser if the donor intends to claim a federal income tax charitable deduction. These items are listed in the Appraisal Summary; Section B of Form 8283.

The taxpayer, and/or appraiser completes Part I of Section B. In certain instances a complete copy of the signed Appraisal must be attached. The donor completes the declaration in Section B Part II. The appraiser completes the Appraiser Declaration in Part III of Section B.

The charitable donee completes and signs the Donee Acknowledgement in Section IV. In doing so the charity acknowledges receipt of the listed property, affirms its status as a qualified charitable organization, and, in the case of tangible personal property, indicates whether the intended use of the property is related to its exempt purpose. In addition, the donee affirms that it will file Form 8282 in the event it disposes of the property described in Section B, Part I (or any portion thereof) within three years after the date of receipt of the property. It is not agreeing with the claimed fair market value. Treasury Regulations require the charitable donee to retain a copy of the donor's appraisal summary (8283) for so long as it may be relevant.

If there is more than one property gift, a separate Form 8283 is required for each gift, except where an item is part of a group of similar gifts. If similar gifts are given to more than one charity, the donor will need each charity to sign a separate Form 8283.

When a gift is received through a split interest gift such as, a charitable remainder trust, charitable gift annuity, bargain sale, life income fund agreement, or similar plan, only the portion claimed as a charitable gift is reported. For example, if the value of the property transferred is $7,500, but the gift portion is only $4,500, Form 8283 must be filed since the gift portion exceeds $500, but an appraisal is not necessary since the gift portion is under $5,000.

Form 8282 (see IRS Form 8282 for complete filing instructions)

Internal Revenue Service Form 8282 (also known as the "tattletale" form) is used by the original or successor donee organization to report information about dispositions of certain charitable deduction property. IRS instructions for Form 8282 define charitable deduction property as "Property (other than money or certain publicly traded securities) for which the original donee signed, or was presented with for signature, the Appraisal Summary (Form 8283, Section B)." If

a charity disposes of charitable deduction property, valued at more than $5,000, within three years of the date the original donee received it and; the property was not consumed or distributed for charitable purposes, the charity must file Form 8282 within 125 days after the date of disposition. The charity must give the original donor a copy of the Form 8282 filed with the IRS. A charity may be subject to a penalty under Code Section 6721 if it fails to file a complete and accurate Form 8282 in a timely manner.

Substantiation Rules for Charitable Contributions

Cash gifts of any amount are deductible only if supported by either a bank record or a receipt from the charity specifying the amount and date of the contribution. This new rule established by the Pension Protection Act of 2006 is effective for gifts made in calendar tax years 2007 and thereafter. This rule eliminates the prior-law ability to support such donations with “other reliable records” in the absence of a bank record or written donee receipt

For gifts of $250 or more the donor must obtain and maintain contemporaneous written substantiation typically in the form of a receipt or letter. Cancelled checks are not acceptable as substantiation of gifts of $250 or more. To be "contemporaneous" the written substantiation must generally be obtained by the donor no later than the date the donor actually files his/her return for the year the contribution is made.

A gift to a CRAT or a CRUT is deductible without a receipt from a charity. While the remainder interest must be irrevocably committed to a charitable entity, the donor is not required to vest any specific charity with the remainder at the time the gift is created. Therefore, no receipt is required. While no receipt is required for the charitable deduction, Form 8283 is required for donations ofproperty other than cash. If required, the Donee Acknowledgement section of Form 8283 would be signed by the trustee of the charitable remainder trust.

For charitable transfers to a pooled income fund or in exchange for a charitable gift annuity, the normal receipt requirements apply. Only the remainder interest in a pooled income fund or the gift interest in a gift annuity qualifies for a charitable deduction. The receipt or receipt letter should indicate the value transferred. Since an income interest is retained with a pooled income fund and an annuity interest is retained with a charitable gift annuity, the charity should show on the receipt the value of the charitable interest. A copy of the charitable contribution calculation form should be included with the receipt/substantiation letter sent to the donor.

The Donor Must Maintain Certain Records

The donor must keep records to prove the amount of the cash and non-cash contributions made during the year. The kind of records depends on whether the donated amount is less or greater than $250.00 and whether cash or non-cash property is contributed.

For a cash contribution of less than $250.00 a cancelled check or a readable account statement showing the check number, posting date, amount and to whom the check was payable is acceptable. If payment is made by electronic fund transfer a statement showing the amount paid, posting date and the donee name. If payment was charged to a credit card a credit card statement

showing amount, transaction date and donee organization name. A receipt from the charitable organization stating organization's name, amount, and contribution date is also an acceptable record. The burden of proof regarding the "reliability" of those records, i.e., whether the IRS will accept them, rests with the taxpayer.

For cash contributions of $250 or more, a deduction can be substantiated only by contemporaneous written acknowledgment from the charitable organization or certain payroll records if the gift is made via payroll deduction. In the case of a payroll deduction the donor must keep a pay stub, Form W-2, or other employer furnished document that proves the amount withheld and a pledge card or other document from the charity that states that no goods or services were provided in exchange for the donated amount.

For any non-cash contribution the donor must maintain a receipt from the charity showing the name of the charity, the date and location of the gift, and a reasonable description (but not value) of the property. If it is impractical to obtain a receipt, the donor must retain "reliable written records" containing the above information, plus information regarding the value of the contribution. In addition to the above basic receipt information for non-cash contributions of less than $250.00 the donor must also keep (1) reliable written records of the fair market value of the property as of the date of contribution and how the FMV was figured, (2) the cost or other basis if the FMV must be reduced by appreciation, (3) the amount claimed as a deduction and any other amounts deducted in previous years if less than the donor's full interest was contributed, and (4) the terms of any conditions attached to the gift of property.

If a deduction is claimed for non-cash donation of $250.00 or more but less than $500.00 the required gift acknowledgement must be obtained from the charity. The acknowledgement must contain the basic receipt information from the preceding paragraph and the donor's written records must contain all other information listed for donations of less than $250.00. In addition the acknowledgement must meet the following tests: (1) it must be written, (2) it must describe the property, disclose whether or not goods or services were provided and provide a good faith estimate of the value of those goods or services provided, and (3) it must be received by the donor on or before the earlier of the date the return is filed in which the deduction is first claimed or the due date, including extensions, for filing the return.

If the deduction claimed for a non-cash charitable contribution exceeds $500.00, but is less than $5,000.00 the donor must maintain a written record including the above information, plus the manner, date of acquisition and cost basis. The donor must also complete Section A of Form 8283 for Non-cash Charitable Contributions.

If a deduction is claimed for non-cash donation of over $5,000.00 for one item or a group of similar items ($10,000.00 if closely held stock) the donor must retain the written records described in previous paragraphs. In addition, generally, the donor must also have a qualified written appraisal for the donated property from a qualified appraiser and retain a copy of Form 8283 Section B.

Substantiation Rules for the Charity

The responsibility for obtaining the "contemporaneous, written acknowledgement" of a charitable gift of $250.00 or more resides with the donor. An organization incurs no penalty for failure to acknowledge such a gift, but its failure to do so will negatively affect its donor relations to the point that donors may cease to support the organization.

The charity can assist its donors by providing a timely, written statement containing the name of the organization, amount of cash contribution, description (but not the value of non-cash contribution), statement that no goods or services were provided by the organization in return for the contribution (if applicable), description and good faith estimate of the value of goods and services, if any, that the organization provided in return for the contribution, and in the case of a contribution to the church, that the goods or services provided the donor consisted entirely of "intangible religious benefits" if that were the case. It is not necessary to include either the donor's social security number or the tax identification number on the acknowledgement.

The charitable organization is required to provide a written disclosure to a donor who receives goods or services in exchange for a single payment in excess of $75.00. A contribution made by a donor in exchange for goods or services is known as a *quid pro quo* contribution. The written disclosure statement must inform a donor that the deductible portion of the contribution for federal income tax purposes is limited to the amount of the contribution that exceeds the value of the goods or services provided by the organization. In addition the organization must provide the donor with a good faith estimate of the fair market value of the goods or services.

The good faith estimate of value of goods and services may be determined by any reasonable method such as comparing the item given to the contributor with similar commercially available goods or services.

A common error made by charities when estimating value of benefits is to value the items given to it to use as premiums for donors at $0. The value of goods or services is its commercially available value. If a charity was given books which it used as premiums to donors, the value for purposes of the disclosure requirement is not $0, the price the charity paid, but is the commercially available price of comparable books.

Three exceptions exist to the written disclosure requirement. First, when the value of the goods or services is of an insubstantial, token or *de minimus* value. Second, a *quid pro quo transaction* does not exist when there is no donative or gift intent in a particular transaction for example, when an item is purchased from a charity's gift shop. Third, a *quid pro quo* transaction does not exist when a donor receives intangible religious benefits from an organization organized exclusively for religious purposes.

Certain goods or services may be disregarded for purposes of the gift substantiation requirements because they are considered inconsequential. Goods or services which are considered "token benefits" may be disregarded and the entire amount transferred to charity is considered deductible under the safe harbor rules. Accordingly, for 2011 a payment is fully deductible if it

is made in a fund raising campaign and (1) the FMV of all benefits received by the donor is not more than the lesser of 2% of the payment or $97 (indexed for inflation); (2) the donor's payment to charity is $48.50 or more and the only benefits received in connection with the payment are token items (bookmarks, calendars, key chains, mugs, posters, tee shirts, etc.) bearing the organization's name or logo and have an aggregate cost of no more than $9.70; or the donee organization mails or otherwise distributes free, unordered items (such as greeting cards). Crescendo Gift Law Pro Section 1.6.2 contains an excellent explanation of the gift premium rules.