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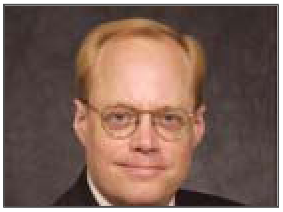

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THE TAX LAWYER

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Getting Taxed Despite Giving To Charity

If you're generous and give all your money to charity, no one can tax you, right? Think again. In fact, the recent story of a Canadian couple who won $11.2 million in the lottery only to give 98% of it to charity—they only kept 2% for emergencies and more lottery tickets!—should make you sit up and take notice. Canadian Couple Wins $11 Million, Gives It Away and Canadian Couple Donates Millions From Lottery Win. Take notice not merely for their notable generosity, but for how they ***weren't*** taxed. It would have been quite different in the U.S.

In Canada, mind you, lottery winnings aren't included in taxable income, so there's no tax problem. Besides, charitable contribution tax rules are more generous in Canada. See Candian Couple Who Gave $11.2m Lottery Winnings To Charity Would Have U.S. Tax Problem.

Had they lived on the U.S. side of the border, prizes and awards are taxed. Plus, charitable giving tax rules are strictly limited, so there's no money-in-money-out simplicity. Why limit charitable giving, you might ask? You'd better ask Congress. Oh, while you're at it, if you could ask what ordinary income and capital gain rates will apply in a little more than a month, I'd appreciate it. See Prospects Dimming For Post Election Tax Cuts.

If you win the lottery or other cash prize and decline it you may be able to avoid the income. That's curious, since the tax law routinely triggers tax when you ***could*** have received a payment but chose not to. The "assignment of income" doctrine usually prevents avoiding the tax hit of income coming your way. (See When You've Got Taxable Income But No Cash.)

"Regifting." Short of declining an award, there's regifting like the generous Canadian couple. Unfortunately, the tax consequences of regifting are problematic. Even if you immediately give it to charity, you can't necessarily write it all off. Why?

You can deduct charitable contributions only up to 50% of your "contribution base"—generally your adjusted gross income. Thus, if you win $1 million and have no other income, you can deduct only half even if you give it all away. The limit is even lower (30%) for gifts to certain charities such as certain private non-operating foundations, veterans organizations, fraternal societies and nonprofit cemeteries. You can carry over any excess deduction from one year to the next, and you have five years to use it up. In the meantime, though, you are paying tax on money you've given away.

Collateral Damage. The fact that you must take the prize money into income means you may lose other deductions and personal exemptions. Even if you give all the prize money to charity, you end up paying more taxes than if you had never received the cash.

Assignment. Fortunately, the IRS has a procedure for assigning a cash prize ***before*** you receive it, thereby avoiding the income. It probably wouldn't work with a lottery payment, but President Obama did this with money from his Nobel Peace Prize. See Tax Consequences of President Obama's Nobel Prize. The idea is to keep the prize moving past you, redirecting it to someone else ***before*** its tax impact hurts you. See Revenue Procedure 85-54.

First, the recipient must be a qualified charity, so you can't push off the award to your brother-in-law. Timing is also important. You must make the assignment to charity before the award is presented to you.

You can, however, make a partial assignment. You can keep the statuette or plaque and even some of the cash, as long as it's clear precisely what amount you are assigning. Finally, some magic language is required in the paperwork so you'll want professional help.

For more about charitable giving tax rules, see:

Charitable Contribution Deductions

Charities And Nonprofits Index

Saving Taxes By Giving to Charity

Resolving Litigation By Payments To Charity

What If A Taxpayer Doesn't Have Receipts?

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