A MATTER OF GIVING

WORKING PAPER NO. PONC53
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SCHOOL OF ACCOUNTING LEGAL STUDIES
BRISBANE

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© Queensland University of Technology November 1994
Published by Program on Nonprofit Corporations
Queensland University of Technology
G.P.O. Box 2434
BRISBANE QLD 4001
Phone: 864 1268
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ISBN 1-86435-001-6
ISSN 1037-1516
SYNOPSIS

Sometimes we are approached by clients with their hearts in the right place wishing to make tax effective gifts or bequests. This article examines the matter of giving and attempts to ensure that taxpayer's feel good in a tax efficient manner.

Sometimes we are approached by clients with their hearts in the right place wishing to make tax effective gifts or bequests. For the purposes of this article, gifts are donations made during a person's lifetime, bequests are donations made by will after death. This article examines the matter of giving and is divided into parts as follows:

1. the first part examines the taxation consequences of giving during a client's lifetime;
2. the second part of the article examines the taxation consequences of making bequests; and
3. the final part provides a ready reference table in relation to the matter of giving and reiterates tax planning points so that your client may feel good in a tax effective way.

1. TAXATION CONSEQUENCES OF MAKING GIFTS

There are two taxation questions to answer when a gift is made. First, will the taxpayer obtain a deduction for the gift and second will there be any capital gains tax (CGT) consequences associated with making the gift.

(a) **Will the taxpayer obtain a deduction?**

The two major provisions which may allow the deductibility of gifts are sections 51(1) and 78 of the Income Tax Assessment Act (ITAA).

(i) **Section 51(1)**

Section 51(1) will allow a deduction for a gift provided it is incurred in gaining or producing assessable income or is necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income. Deductions for gifts under this section must satisfy the same tests for deductibility as any other business or income-related deduction. Consequently a claim for a deduction under sec 51(1) may be more difficult than under sec 78.

Deductions will only be available where the taxpayer can show a sufficient nexus with income. This may be done for example where the taxpayer has obtained the benefit of advertising from making the gift. This occurred in 8 CTBR Case 34 where a brewery obtained a deduction for recurring donations and membership subscriptions to local...
associations, clubs and societies. The deductions were allowed as the outgoings were incurred for the purpose of securing publicity of the brewery's name. It is difficult to think of many other situations where the deduction would be available.

Unlike the situation outlined below in relation to deductions under sec 78, there is no limitation on claiming deductions for gifts under sec 51(1) in years where the taxpayer has a current year loss.

(ii) Section 78

Section 78 allows taxpayers to claim a deduction for gifts made to one of the associations mentioned in that section provided:

1. the gift is NOT testamentary;¹

2. the value of the gift is $2 or more;²

3. if the gift is property (not being money) it must have been purchased by the taxpayer in the 12 months immediately before the gift is made (this restriction does not apply to gifts of trading stock);³

¹ A testamentary gift is one provided for in a will.

² The gift must be of either money or property. No deduction will be given for the provision of services: Case S43 85 ATC 343.

³ There are different rules for certain gifts of property e.g. a painting gifted to an art gallery - see sections 78(6), (7) and (8).
4. if there are any special conditions attaching to the fund in question, these are met; and

5. the fund, authority or institution is in Australia.

The amount of the available deduction is limited by sec 78(12)(b) to the lesser of:

(a) the value of the property at the time the gift was made; or
(b) the amount paid by the donor for the property.

If the gift was trading stock of the donor the amount of the deduction will be the market value of the stock gifted.

As italicised in point three above, if property is gifted, a deduction will only be available to the taxpayer if it is a gift of property which the taxpayer has previously purchased. If the property came into their hands by way of gift then no deduction will be available if that property is gifted. For this reason, it is advisable for taxpayers to gift property which they have themselves purchased in preference to gifting property which was gifted to them.

The above rules in relation to the amount of the deduction available to a donor taxpayer are subject to the overriding rule that a taxpayer cannot create nor increase a current year loss by claiming a deduction under sec 78. Accordingly, there is no tax benefit for taxpayers in a loss situation making a gift. Such taxpayers should be persuaded to hold their charitable intentions in check until a year in which they are not in a current year loss situation.

Further, if a taxpayer is desirous of making a gift of property it may be necessary to obtain valuations for the asset in order to determine the amount of deduction available.

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4 Some funds listed in section 78(4) contain special conditions relating to precisely what the gift must relate to.

5 Section 78(12).

6 Section 79C.
Denial of Deduction

In some situations taxpayers will be denied the deduction which would otherwise be available under sec 78 will be denied. This is due to the anti-avoidance provisions contained in section 78A. These provisions will not be canvassed here, but advisers should be aware that they exist and may deny deductions in situations where charity is not the entire reason for the taxpayer making the donation or gift.

(b) Will any CGT consequences arise?

Taxpayers who charitably gift assets may be subject to CGT as a result of making the gift.

Provisos

The CGT consequences for both gifts and bequests are outlined below. The CGT consequences outlined are subject to the following provisos:

· If a taxpayer gifts a non-listed personal use asset, a capital loss cannot arise on the transaction. Further, a capital gain will only arise if the market value of the asset gifted is greater than $5,000.

A "non-listed personal use asset" is an asset kept for a person's personal use and enjoyment other than:

— Land and buildings; and
— The following assets if they cost more than $100:
  - Works of art;
  - Jewellery;
  - Rare books;
  - Postage stamps;
  - Coins or medallions; and
  - Antiques.

· Generally (but not always) there will be no capital gains tax consequences arising out of the gift of a house used as the donor's principle place of residence.

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7 Section 160Z(7).
8 Sections 160ZE and 160ZG.
9 Defined in section 160B.
10 This is subject to the principle place of residence rules found in sec 160ZZQ.
There will generally be no capital gains tax consequences to the donor arising from the gifting or bequeathing of assets acquired by the donor before 20 September 1985.

General capital gains tax consequences of gifts

Where a gift is made by a person during their life the capital gains tax consequences (subject to the provisos outlined above) are as follows:

- The person is deemed to have disposed of the asset for an amount equal to its market value.\(^{11}\) For the purpose of determining market value, taxpayers may either obtain a detailed valuation from a qualified valuer or calculate their own valuation if they have reasonably objective and supportable data;\(^{12}\)

- If the market value of the asset is greater than its indexed cost base or cost base as appropriate, a capital gain equal to the excess arises. The taxpayer may offset this gain against capital losses, if any, otherwise the amount is included in assessable income. The effect of including the capital gain in assessable income may be largely offset if a deduction under sec 78 (equal to the cost of the asset) or sec 51(1) is available.

- If the value of the asset is less than the original cost of the asset the taxpayer will generally be entitled to a capital loss equal to the difference. In addition, they may also be entitled to a deduction under sec 78 or sec 51(1). In a capital loss situation, the deduction under sec 78 will generally be equal to the market value of the asset.

2. A WISE AND CHARITABLE DEATH

This part will examine the taxation consequences associated with making bequests in a taxpayer's will. As for gifts the same two questions require answering i.e. whether the donation will give rise to a deduction and whether it will give rise to any capital gains tax consequences.

(a) Will the deceased or the estate obtain a deduction?

As outlined above, deductions for donations will only arise if the taxpayer can satisfy either sec 51(1) or sec 78. It is unlikely one could show a sufficient nexus with income under sec 51(1) as for example, the bequest would not have been made for advertising purposes. Further, deductions are specifically not available under sec 78 for testamentary gifts.\(^{13}\)

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11 Section 160ZD(2).

12 Taxation Determination TD 10.

13 Section 78(4)(d).
This begins to make testamentary gifts a fairly unattractive idea. If it is at all possible, it would be more beneficial for the taxpayer to make the gift during their lifetime. However, if the taxpayer is in a large carried forward loss situation, they will be indifferent as to whether the donation is made as a gift or a bequest.

(b) **What are the capital gains tax consequences?**

If the bequest is not made to a tax exempt body, there will be no capital gains consequences arising to either the deceased or the estate. There will, however, be taxation consequences arising to the beneficiary of the bequest. These consequences may be found in sec 160X, but will not be explored further in this article.

A tax exempt body is one whose income is exempt by virtue of a relevant exempting provision, for example, sec 23. It is not safe to assume that because donations to the body are deductible, that the body will also have an exemption from income tax. Although this is often the case, the requirements for deductibility of donations and exemption from income tax are different and some bodies may not qualify for both.
Where a bequest is made to a tax-exempt beneficiary the taxation consequences (subject to the provisos outlined above) are as follows:\textsuperscript{14}

- The deceased is deemed to have disposed of the asset for an amount equal to its market value the instant before death;

- If the market value of the asset is greater than its indexed cost base a capital gain equal to the excess arises. This gain may be offset against capital losses if there are any available to the deceased, otherwise the amount is included in assessable income in the date of death return. As the bequest was made by will, no deduction under sec 78 is available to offset the effect of including the capital gain in assessable income.

- If the value of the asset is less than the original cost of the asset the person will generally be entitled to a capital loss equal to the difference. However, as the gift was made by will they will not also be entitled to a deduction under sec 78 equal to the market value of the asset.

A practical consequence of sec 160Y is that it may be preferable to make bequests of cash rather than assets to tax exempt persons. This is particularly so if the asset bequested has an inherent capital gain. Not only will the balance of the estate be decreased by the asset gifted, but it will also be decreased by the cash necessary to pay the CGT upon the gift.

3. SUMMARY OF TAX CONSEQUENCES TO DONORS

The following table provides a quick and ready general reference for determining the taxation consequences of making gifts or bequests. The table should be read subject to the provisos outlined above.

\textsuperscript{14} Section 160Y.
TAXATION CONSEQUENCES TO DONORS

<table>
<thead>
<tr>
<th>{PRIVATE }</th>
<th>Recipient recognised under s78</th>
<th>Recipient not recognised under s78</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gifts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Is a deduction available?</td>
<td>Yes</td>
<td>No, unless sec 51(1) satisfied</td>
</tr>
<tr>
<td>2. Amount of deduction</td>
<td>Lesser of value or cost</td>
<td>N/A unless sec 51(1) applies</td>
</tr>
<tr>
<td>3. Could CGT apply?</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Bequest</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Is a deduction available?</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>2. Could CGT apply?</td>
<td>Only if recipient is tax exempt</td>
<td>Only if recipient is tax exempt</td>
</tr>
</tbody>
</table>

The taxation consequences and tax planning points associated with making gifts and bequests have been outlined. It would appear as a general rule that it is more tax effective for clients to be generous during their lifetime rather than after their death. In the event a bequest is the option most suited to the taxpayer, it is often preferable to bequest cash rather than assets to charitable bodies.