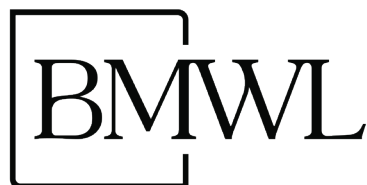


FEDERAL TAX GUIDELINES FOR DEDUCTING CHARITABLE CONTRIBUTIONS OF APPRECIATED NONCASH ASSETS VALUED AT MORE THAN \$5,000

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Federal Tax Guidelines for Deducting Charitable Contributions of Appreciated Noncash Assets Valued at More Than \$5,000

By Mike Batts, CPA & Michele Wales, CPA

For purposes of this article, all references to charity or charities are intended as references to public charities such as churches, schools, hospitals, and other publicly supported organizations described in Section 501(c)(3) of the Internal Revenue Code. The rules for contributions to other types of 501(c)(3) organizations, including but not limited to private foundations, may be different from those described in this article. Regardless of the scenario, taxpayers should consult their own tax advisors to determine the rules that apply to their situation.

Donating Appreciated Property Can Be a Highly Effective Tax Strategy

Making a charitable contribution of appreciated property like real estate, stock, virtual currency, and certain other assets can not only benefit the recipient charity and its constituents, it can also provide a significant tax-savings opportunity for donors.

The Advantage of Donating Rather Than Selling the Asset and Donating the Sales Proceeds

If a taxpayer donates appreciated property directly to a qualified charity, he/she will not be taxed on the appreciation in value. And the even better news....neither will the charity! That is because capital gains of U.S. 501(c)(3) public charities are not typically subject to federal income tax. The amount deductible by the donor will vary depending on the facts, but if the donor holds the property for more than a year prior to donating it, he/she may be entitled to a deduction of the full fair market value of the property contributed, with no tax on the gain! (Note that it is generally not a wise tax strategy for a taxpayer to donate property that has

declined in value since the taxpayer acquired it.)

Special Rule for Donations of Tangible Personal Property

Note that a special rule applies to the amount a donor can deduct for contributions of “tangible personal property” to charity. The term “tangible” refers to items you can see and touch (which distinguishes such property from intangible personal property – like stocks, bonds, virtual currency, and other assets constituting an ownership interest, rights, or a debt obligation). It is true that such assets may be represented by certificates or other documents, but the actual asset – such as an ownership interest in a company or the right to receive payments – is not the certificate. It is a legal interest or right – and thus, intangible. The term “personal” refers to any kind of property other than real estate. So, “tangible personal property” is any item you can see or touch that isn’t real estate. Examples of tangible personal property include books, jewelry, art, and furniture.

When a donor makes a charitable contribution of tangible personal property that has appreciated in value, the amount deductible depends on whether the donor has held the property for more than a year and whether the recipient charity will use the donated property in conducting its exempt activities. If the charity plans to use the donated tangible personal property in conducting its exempt activities, and if the donor has held the property for more than a year, the donor may be able to deduct the appreciated fair market value of the donated property.

As an example, assume that a taxpayer owns a set of rare books that he purchased five years ago for \$4,000. Assume that the books are worth \$12,000 today. The taxpayer donates the books to a local library that plans to keep the books and make them available to scholars for special research projects. In such a scenario, the donor will likely be able to deduct the full fair market value of \$12,000 in the year of the donation (subject to the substantiation and documentation requirements described below). If, on the other hand, the donor gave the books to a local charitable homeless shelter that

planned to sell them, the donor's deduction for the gift would be limited to his cost for the books of \$4,000.

The Rules for Substantiating a Noncash Charitable Contribution Deduction

The IRS is a stickler

Federal income tax law requirements for substantiating charitable contribution deductions are strict – especially for noncash contributions. A donor who plans to take a charitable contribution deduction on his or her tax return should carefully follow the substantiation requirements. The IRS frequently limits charitable deductions or denies them altogether where it finds that the donor (and his/her tax preparer) have not closely followed the law. Courts generally back the IRS in strictly applying the charitable contribution substantiation rules to donors.

The substantiation requirements that apply to noncash donations depend upon the nature and amount of the gift, as described further below. If a group of similar items (for example, books) is donated, the total value of the entire group of items should be used to determine which substantiation rules apply to a particular donation. The similar items do not all have to be donated at the same time or even to the same organization for the higher substantiation thresholds to be triggered.

Special rules apply to contributions of automobiles, boats, and airplanes – a subject outside the scope of this article.

Noncash contributions valued by the donor at \$5,000 or less

Specific rules apply to charitable contributions of property valued at \$5,000 or less. Those rules, while detailed, are not as robust as the rules for noncash contributions valued at more than \$5,000. Our focus in this article is on the rules for

substantiating gifts valued at more than \$5,000. For more information about smaller gifts, taxpayers may consult IRS Publication 526, IRS Publication 561, and their own tax advisors.^{1,2}

Noncash contributions valued at more than \$5,000

In order to properly substantiate a deduction on the donor's tax return of a noncash contribution valued in excess of \$5,000, the donor must:

1. Obtain a qualified appraisal (*an exception applies for donations of publicly traded securities*),
2. Obtain a contemporaneous written acknowledgment from the donee organization,
3. Prepare and submit Form 8283 with his/her tax return, and
4. Maintain specific records.

Each of these requirements is described further below.

1. Obtain a qualified appraisal

Note: an exception to the appraisal requirement applies to donations of publicly traded securities.

The donor is responsible for obtaining a qualified written appraisal prepared by a qualified appraiser. A qualified appraiser for this purpose is an individual who has earned an appraisal designation from a recognized professional appraiser organization for demonstrated competency in valuing the type of property being appraised, or that has met certain minimum education and experience requirements. Further, the appraiser generally cannot be the donor, the charity receiving the donation, or an employee or agent of the donor or charity.

A qualified appraisal must be prepared in accordance with generally accepted appraisal

¹ Source: <https://www.irs.gov/forms-pubs/about-publication-526>

² Source: <https://www.irs.gov/pub/irs-pdf/p561.pdf>

standards and must include certain information, including: a description of the type and condition of the property, the valuation effective date, the fair market value of the contributed property on the valuation date, the method and basis of valuation, the terms of any agreement between the donor and the charity regarding the future use or sale of the donated property, identifying information regarding the qualified appraiser and the appraiser's qualifications, and a statement that the appraisal was prepared for income tax purposes.

The qualified appraisal must be made, signed, and dated no earlier than 60 days prior to the date the appraised property was donated and no later than the due date of the taxpayer's return (including extensions) for the year of the donation. Further, the appraisal fee generally cannot be based on a percentage of the appraised value of the property.

2. Contemporaneous written acknowledgment

It is important to note that a donor must obtain a written acknowledgment from the charity for all cash and property contributions of \$250 or more, including those for which an appraisal must also be obtained. The acknowledgment must be obtained by the earlier of the date on which the donor files his/her income tax return for the year in which the contribution was made or the due date (including extensions) of the return. The acknowledgment should include the legal name of the charity, the name of the donor, the date and amount of the contribution, a description (but not the value) of any noncash contributions, and a statement (if true) that no goods or services were received by the donor in exchange for the donation. If the donor received anything from the charity in return for the donation (other than certain de minimis items), the acknowledgment must include a "good faith estimate" of the value of the goods and services the donor received and a disclosure indicating that the donor may only deduct as a charitable contribution the excess of the amount donated over the fair market value of the items or services received in exchange for the donation.

3. Prepare and submit Form 8283 with the donor's tax return

In addition to the above requirements, a donor of noncash property valued at over \$5,000 must complete Section B of Form 8283 and submit it with the donor's income tax return for the year in which the contribution was made. Section B of Form 8283 must be signed by both the qualified appraiser and the charitable organization that received the donation. Both the appraiser and the charitable organization must also provide their address and tax identification number. Additionally, the following information must be reported in Section B of Form 8283: a description of the donated property, a brief summary of the overall physical condition of the property (if the donated property is tangible personal property), the appraised fair market value of the property, the date and manner of acquisition by the donor of the property, the cost or adjusted basis of the donated property, the amount claimed by the donor as a charitable contribution deduction, and the date of the contribution. Generally, the qualified appraisal itself is not required to be submitted with the donor's tax return unless the value of the property contributed exceeds \$500,000.

Note that completing Form 8283 – even one signed by the recipient charity – does not eliminate the requirement to obtain a contemporaneous written acknowledgment as described above.

4. Maintain records

The donor is required to maintain certain records in connection with the charitable contribution deduction taken on the return. Generally, these records must include the contemporaneous written acknowledgment obtained from the charity, as well as the information included in Section B of Form 8283 outlined above. A copy of the qualified appraisal should also be retained by the donor.

A Special Note about Gifts of Virtual Currency

Whatever you may think about virtual currencies, one reality is that a significant number of people have invested in them. A sizable portion of those investors have seen their investments increase in value dramatically (despite extreme volatility).

And a growing number of investors holding virtual currencies that have appreciated in value are considering donating some of their holdings to their church or their favorite charitable organization.

The Internal Revenue Service considers virtual currencies to be noncash property.³ So, if a taxpayer buys units of a virtual currency and later sells them at a gain, the taxpayer will be subject to tax on the gain...pursuant to the rules for taxing capital gains. Therefore, as outlined above, the advantage of donating virtual currency that has appreciated in value, rather than selling the virtual currency and donating the sales proceeds, is that the taxpayer will not be taxed on the appreciation in value of the virtual currency. The amount deductible by the donor will vary depending on the facts, but if the donor holds the virtual currency for more than a year prior to donating it, he/she may be entitled to a deduction of the full fair market value of the virtual currency contributed. (As mentioned above, it is generally not a wise tax strategy for a taxpayer to donate virtual currency that has declined in value since the taxpayer acquired it.)

Under current law, the rules related to the substantiation of noncash gifts (described above) also apply to gifts of virtual currency. So, for donations to charity of virtual currency valued at more than \$5,000, a taxpayer must meet all the requirements described above...including the requirement to obtain a qualified appraisal. One may wonder why a qualified appraisal is required

for a donation of virtual currency, since, arguably, the market value of many virtual currencies may be available from publicly accessible sources. The answer is because the IRS considers virtual currency to be noncash property. And neither Congress nor the IRS has enacted guidance making the substantiation rules for donations of virtual currency any different from the rules applicable to donations of other types of noncash property.

Conclusion

Charitable donations of noncash property, including virtual currency, can present a unique tax-advantaged way for donors to give to charity. Strict substantiation and documentation requirements apply for charitable deductions related to such donations...particularly those valued at more than \$5,000. Donors and their tax preparers must carefully follow the rules in order to justify and sustain their deductions in the event of an IRS examination.

The following IRS Publications provide additional useful information:

- Publication 526 – Charitable Contributions⁴
- Publication 561 – Determining the Value of Donated Property⁵

³ Source: <https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions>

⁴ Source: <https://www.irs.gov/forms-pubs/about-publication-526>

⁵ Source: <https://www.irs.gov/pub/irs-pdf/p561.pdf>