Receiving an Appropriate Charitable Deduction for Donations of Tangible Personal Property to Charitable Organizations

Stephan J. Lipskis, Esq., Wolcott Rivers Gates

Estate and gift counsel encounter the following fact pattern frequently. A client has accumulated a significant amount of valuable tangible personal property (art, jewelry, cars, boats, collections, etc.) and would like donate the property to charity. Client maintained records of the purchase prices for some of the property but lacks complete records for other items. Client hopes to receive income tax deductions for donations, to the extent possible. Tangible personal property raises many unique problems when planning charitable donations because it is hard to value, some charitable organizations are unable or unwilling to accept it, and the owner often has a strong emotional connection to the property.

Importantly, the requirements for receiving taxable deductions for donations may make certain types of gifts more complicated than others. Parsing through the different options for each client helps them understand the required steps to make a tax-deductible donation of tangible property to charity.

GENERAL RULES ON DEDUCTABILITY OF TANGIBLE PERSONAL PROPERTY

The highest possible annual deduction attainable through contribution of personal property to charity is fifty percent of adjusted gross income (“AGI”) per year, but that amount may be limited by how the personal property is valued, the charity’s use of the donated property, and the classification of the donee organization. Most clients interested in donating tangible personal property wish to donate: artwork, jewelry, cars and household items. For the purposes of discussion all personal property has been held in excess of a year and is long-term capital gain property.

The IRS recognizes two different classes of organizations that may receive deductible charitable gifts: 50% limit organizations ("FLO") and 30% limit organizations ("TLO"). The general 50%-of-AGI limit described above applies to all donations to FLOs and a lower 30% limit applies to TLOs *except* for when taxpayers elect to use fair market value ("FMV") for their donations of related-use capital gain property instead of using the default method of valuation, which is the lesser of FMV or the taxpayer's basis in the property ("Lesser Value"). Such FMV donation of related-use capital gain tangible personal property is limited to a 30% deduction rather than the ordinary 50% deduction when donated to FLOs and 20% rather than 30% for TLOs. The limit frequently applies where a client is able to donate property for a related use and either does not have data regarding the basis they hold in their property or wish not to recognize the property's appreciation.

The following is an example illustrating the difference between electing to value a related-use tangible personal property donation at FMV and valuing a donation using Lesser Value. If a taxpayer with an AGI of $140,000 donates a painting originally purchased for $10,000 with a current FMV of $50,000 to a charity for a related use and elects to use FMV for the donation, the taxpayer may take a charitable deduction of $42,000 dollars (30% of $140,000) if it is made to a FLO and $28,000 (20% of $140,000) if made to a TLO. While both deductions in the current tax year would be less than the full FMV of the piece of art, the excess amount of deduction may be carried over to future tax years and remains subject to the respective thirty percent and twenty percent limits. On the other hand, if the donation was valued using the Lesser Value standard, the allowable deduction would be $10,000 (the taxpayer's basis) regardless of the recipient organization and the taxpayer would have the opportunity to make further deductible donations in the same tax year.

CHARACTERIZATION OF FLOs AND TLOs

Charitable organizations should be able to tell taxpayers if they qualify as a FLO or TLO. The IRS provides guidelines related to the different charitable purposes that fall into each category and offers an online list of charitable organizations at www.irs.gov/charities. Generally, FLOs are more restricted by charitable purpose than TLOs and may not be: Veterans' societies; fraternal societies; non-profit cemeteries; and certain private non-operating foundations.

ADVANTAGE OF DONATING PROPERTY FOR A "Related Use"

As explained above, tangible personal property donated for a use related to a charity's purpose may allow for a larger deduction because the FMV of the property may be used. To the extent basis or appreciation in any personal property may not be ascertainable or such personal property has appreciated significantly in value, it may be advisable to make donations of such property for a related use. In order to protect the taxpayer from potential recapture of a deduction the charity should certify the related use using IRS Form 8282. Such certification by the charity provides a rebuttable presumption in favor of the taxpayer. Finally, in many cases the value of the property being donated must be evidenced by a signed appraisal.

CALCULATING VALUE OF DIFFERENT TYPES OF PERSONAL PROPERTY

In order to compute the deduction for related- use or non-related use donations of personal property it is critical to ascertain the FMV of donated property. Donations made for Lesser Value require a FMV determination to establish any loss or gain associated with the property. Tangible personal property is generally difficult to value and the IRS has issued guidance on how different categories of property may be valued.

Appraisals are frequently used to determine the FMV of donated property. Importantly, the cost of appraisals of tangible personal property (which are often required by the IRS)are not deductible as a

charitable deduction but may be deducted as a miscellaneous itemized deduction on Schedule A (Form 1040) which are limited to the excess of 2% of adjusted gross income.

Appraisals must be submitted to the IRS on a completed Form 8283, Section B, and attached to the tax return for that year along with any other required supporting documents. The IRS is not bound to any appraisal and may make its own determination as to FMV, except where the IRS has issued a Statement of Value. A Statement of Value is only available from the IRS for items of art appraised at $50,000 or greater.

SELECTED APPRAISAL RULES

The use of qualified appraisals is required for art and antiques if a deduction of greater than $5,000 is claimed for an item or group of similar items. Other non-art properties generally require an appraisal if they are valued at more than $500. If a claim of $20,000 or more is claimed for donations of art a copy of the signed appraisal must be attached to the tax return. Individual objects of art, valued at $20,000 or more also must have a photograph submitted with the return. Finally, if any items of art we appraised at $50,000 or more a Statement of Value may be requested from the IRS. The request for a Statement of Value must include the qualified appraisal of the item; a $2,500 check payable to the IRS for one to three pieces of art (add $250 for each additional item in excess of three); a completed Form 8283, Section B; and the location of the IRS territory that has responsibility for examination of your return.

Cars, boats, and aircraft are generally valued at an amount not in excess of the price listed for a like vehicle in a “used vehicle pricing guide” for private sale, discounted due to excessive wear or other issues with the vehicle. Boats should be appraised by a marine surveyor unless they are relatively inexpensive and small. Vehicle valuations diverge from these general guidelines when the donation is for a use related to the charity’s purpose or the vehicle has appreciated in value.

PENALTIES FOR MISSTATED VALUE

A taxpayer and the appraiser will likely incur a penalty if the value of donated property is significantly misstated. The penalty for a significant understatement is an additional 20% or 40% of the understated tax amount. The 20% penalty applies where the value or adjusted basis claimed is 200% or more of the correct amount, as determined by the IRS, and the underpaid tax exceeds $5,000. The 40% penalty applies if the claimed value or adjusted basis is 400% or more of the correct amount and the underpaid taxes were in excess of $5,000. The IRS assesses penalties on appraisers where the 20% or 40% penalties apply and the appraiser knows or should have known the appraisal would be used in connection with a return or claim for refund. The penalty imposed on the appraiser is either of the following: the greater of 10% of the underpayment due to them misstatement or $1,000; or 125% of the gross income received for the appraisal. Additionally, the appraiser may be subject to civil penalties for falsely or fraudulently overstating value of property.

DIFFERENT METHODS OF DONATING

Individuals donate to charities in many ways, but not all methods of donating are available for donations of tangible personal property. Generally, a donor-advised fund may be used to make a client's charitable contribution. This method of donating allows for a charitable deduction so long as the charitable organization notifies the donor that charity has exclusive legal control over the assets contributed and the charity is not in a specific subset of organizations not allowed to offer donor-advised funds. The ability to donate tangible personal property may be limited in the context of a donor-advised fund because the fund administrator may not accept that type of donation because of the difficulty in valuing such property. Furthermore it may be impractical or impossible to give a statement to the taxpayer that the property will be used for a related use.

Charitable remainder trusts ("CRTs") present certain difficulties for receiving deductible donations of tangible personal property. Primarily, it is not possible to take a related-use deduction when the donation is to a CRT because the end beneficiary organization does not have immediate control and use of the property. Furthermore, the taxpayer may not be able to take any deduction until the CRT has disposed of the tangible personal property in a sale. One potential benefit of donating tangible personal property to a CRT is that it potential avoids the recognition of capital gains on a tangible personal property asset, which are taxed at a higher rate than capital gains from real estate or securities.

A taxpayer may donate fractional interests in tangible personal property, but such donations are problematic. Firstly, the donation may only be made if all interests in the property are held by taxpayer or the taxpayer and the donee organization prior to the contribution. Secondly, if the organization has not taken useful possession of the property or the remainder of the interest in the property is not contributed by the earlier of taxpayer's death or ten years after the date of the fractional contribution, the deduction must be recaptured and interest and an additional tax of 10% must be paid. Therefore, the gift should either automatically be complete upon the earlier of the aforementioned events or the gift should not be made in a fractional manner.

Outright donations of tangible personal property are allowed with many charitable organizations. The ability to donate for a related use is limited by the charitable purpose of the donor's favored charities. For example, donating a piece of modern art to a charity founded to preserve and restore 17th century buildings would likely not be for a related purpose. Therefore, it is important for donors to consider both their favored charities and the tax benefits of making related-use donations when gifting tangible personal property.

Given the foregoing concerns, the highest potential value for donating tangible personal property usually occurs where the taxpayer makes donations of appreciated property for related uses early enough to use the deduction from such contributions in the current tax year or in subsequent tax years. Decreased income and limited available taxable years severely limit the ability to make deductible donations in this manner. Also, the cost of appraisal may be prohibitive for some tax payers. The taxpayer's desire to hold on to items before donating them may raise further issues for fractional gifts. The ability to use Lesser Value for donated personal property (up to the 50% limit) may provide a significant deduction for the taxpayer even if the taxpayer elects to wait until donating. One significant advantage in donating in earlier tax years is the ability to claim deductions when the taxpayer's adjusted gross income is higher than it may be in retirement. Counsel should help their respective clients weigh the foregoing concerns before planning significant gifts of tangible personal property, otherwise, the client risks losing tax savings, outliving the opportunity to take carry-over deductions, or parting with personal property before they are emotionally ready.

About the Author: Stephan J. Lipskis is a Hampton Roads native currently practicing law as an Associate with Wolcott Rivers Gates in Virginia Beach. He focuses his practice in the areas of Estate Planning, Taxation, and Business Law.

This article is intended by the author for informational purposes only and should not be relied on as legal or tax advice. Pursuant to the requirements of IRS Circular 230, the tax advice contained herein cannot be used, for the purpose of (i) avoiding tax-related penalties under federal, state or local tax law or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.