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The Business Lunch: Uncommon Facts About Charitable Deductions

"Let's do lunch." This short, seemingly innocuous invitation can carry a multitude of hidden meanings: Let's talk about my upcoming project. Let me tell you about the changes in my company. Let's work together soon. I really don't want to talk to you right now but want to appear polite. Is it a brush-off, an opportunity, or simply an invitation to dine? Parsing these subtleties can leave us wishing for a written explanation of the speaker's intent.

On the surface, charitable income tax deductions seem similarly straightforward. Many donors believe it is common knowledge that when a person makes a contribution to a school, house of worship, or any qualified charitable organization, the donor can take a charitable income tax deduction if they itemize on their federal income tax return. However, here too, there are subtleties. In particular, potential donors must keep in mind the rules for substantiating and valuing charitable gifts if they intend to deduct their charitable contribution.

The Do's and Don'ts of Business Lunches and Charitable Deduction Substantiation

As with most other aspects of business (and life), there is no shortage of articles, books, podcasts, and videos explaining what a business person should and should not do during a business lunch. Despite conflicting advice, some tips are common sense:

- Do be polite and on time
- Don't overindulge in either food or drink
- Do keep the conversation going and focused on the other person
- Don't try to establish a personal connection by venting about personal problems
- Do pick up the check

Luckily, when considering the deductibility of a charitable donation, we don't need to wade through online sources and conflicting opinions—we can simply turn to the Internal Revenue Code (IRC) to find a definitive source of "do's and don'ts." IRC §170 states the general rule: "There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year."[1] In other words, a taxpayer who makes a contribution to a qualified charity can deduct the gift in the year in which it is made.

The two basic requirements that all donors must meet in order to claim a charitable income tax deduction are:

- Determine the fair market value of the property donated to the charity.
- Retain documentation to substantiate the donation (as prescribed in the Treasury regulations as maintaining adequate records to substantiate the gift).[2]

In this issue, we are going to focus on the second requirement—substantiation.

Substantiating a Gift

It is common knowledge that taxpayers must maintain records related to their taxes, so it shouldn't surprise donors that a gift to charity must be substantiated with a record of the contribution.[3] This record can be:

- a cancelled check
- an electronic fund transfer receipt from a financial institution
- a receipt or written letter from the charitable organization showing the donee name, the date, and the amount of the contribution
- some other reliable written record showing the same information[4]

If a receipt from the charity is impractical (such as for a donation made at a charity drop-box), the taxpayer must keep a reliable written record (including all information required in the regulations) of each item donated.[5]

A Gift of $250 or More

If the donation is $250 or more, the Code requires a "contemporaneous written acknowledgment" (CWA).[6] The Ninth Circuit Court of Appeals noted that this requirement is placed directly on the taxpayer seeking the deduction, not on the charity.[7] A CWA is considered contemporaneous if the donor obtains it before the earlier of (1) the filing of the donor's tax return, or (2) the due date of the donor's tax return in the year in which the charitable donation was made.[8] If the taxpayer files an extension, extensions are included.[9]

A Gift of $500 to $5,000

As charitable donations increase in value, the IRS requires additional information in order to allow the taxpayer to deduct the donation. For gifts of property over $500 but not more than $5,000, the taxpayer must use IRS Form 8283 to include a description of the donated property with the federal income tax return.[10]

A Gift of $5,000 or More

For a gift of property worth $5,000 or more, the taxpayer must obtain a qualified appraisal and include the appraisal summary with the tax return.[11] If the donation is non-publicly traded stock, certain publicly traded securities, or a contribution by a C corporation, the donor must maintain additional records.[12] However, publicly traded stock that exceeds $5,000 but is less than $10,000 and non-publicly traded stock with a value less than $10,000 do not need a qualified appraisal.[13]

The taxpayer making a gift over $5,000 must also maintain the general substantiation records required by Treas. Reg. §1.170A-13(b)(2)(ii):

- The name and address of the donee organization
- The date and location of the contribution
- A description of the property in reasonable detail (descriptions of securities must include the name of the issuer, the type of security, whether the stock is publicly traded, and where it is traded)
- The fair market value (FMV) of the property at the time of the contribution and how this FMV was determined
- The basis of the property, if the contribution involved certain ordinary income and capital gain property (see IRC 170(e))

A Gift of $500,000 or More

For a charitable donation of $500,000 or more, the taxpayer must attach a copy of a qualified appraisal (not just an appraisal summary) to the income tax return for that year.[14]

The Ins and Outs of Qualified Appraisals

Viewers of the TV show *Antiques Roadshow* know that the best way to determine an item's approximate value is for an expert to appraise it. For tax items, though, appraisals aren't necessarily common knowledge, since the IRC only requires them for gifts above $5,000. However, for donors who reach that threshold, the IRC has a number of specific requirements for a gift appraisal to qualify a gift for a charitable deduction.

Qualified Appraisals

According to Treasury Regulations, a "qualified appraisal" is an appraisal document that is not more than 60 days old, done by a qualified appraiser, includes the required information, and does not involve a prohibited fee.[15] The qualified appraisal must be conducted in accordance with generally accepted appraisal standards and should assess value as of the proposed date of the gift.[16] The required appraisal information includes:[17]

- A sufficiently detailed description of the property
- The physical condition of any tangible property
- The contribution date (or expected date)
- The terms of any agreement or understanding that restricts or reserves rights to or use of the property
- The name, address, and other identifying information and/or the identifying number of the qualified appraiser
- The appraiser's qualifications, including background, experience, education, and professional association membership (if any)
- A statement that the appraisal was prepared for income tax purposes
- The date on which the property was appraised
- The appraised fair market value (see Treas. Reg. §1.170A-1(c)(2)) of the property on the date (or expected date) of contribution
- The method of valuation used to determine the FMV
- The specific basis for the valuation

Qualified Appraisers

The IRC defines a qualified appraiser as someone who:[18]

1. Has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements
2. Regularly performs appraisals for which the individual receives compensation
3. Meets any other requirements prescribed by the Secretary in regulations or other guidance
4. Demonstrates verifiable education and experience in valuing the type of property subject to appraisal
5. Has not been prohibited from practicing before the IRS by the Secretary at any time during the three-year period ending on the date of the appraisal

Specifically excluded from this list are the donor or taxpayer who wants to claim the deduction, as well as any relative or employee of the donor,[19] any person party to the transaction in which the donor acquired the property (unless the property is donated within two months of acquisition for an amount that does not exceed the acquisition price),[20] or anyone who regularly performs appraisals for one of these excluded parties and who does not perform a majority of their appraisals for other people.[21]

Appraisal Summaries

While the taxpayer must attach the actual appraisal when deducting a gift over $500,000, for gifts from $5,000 to $500,000, only an appraisal summary is required. This summary is an IRS form signed and dated by both the donee and the appraiser that includes:

- The donor's name and taxpayer identification number (Social Security number for individuals, employer identification number for partnerships or corporations)
- The donee's name, address, and taxpayer identification number
- The date the donee received the property
- A description of the property (detail must be such that a person who is not generally familiar with the type of property can ascertain that the appraised property is the contributed property)
- A brief summary of the overall physical condition of the tangible property at the time of the contribution
- The manner of acquisition (e.g., purchase, exchange, gift, or bequest)
- The date the donor acquired the property (or the date the property was created, produced or manufactured by or for the donor)
- The cost or other basis of the property, adjusted as provided by IRC §1016
- A statement explaining whether or not the charitable contribution was made by means of a bargain sale and the amount of any consideration received from the donee for the contribution
- The name, address, and identifying number (if a taxpayer identification number is otherwise required by IRC §6109 and the regulations thereunder) of the qualified appraiser who signs the appraisal summary and of other persons as required
- The appraised fair market value of the property on the date of contribution
- Any other required information[22]

Furthermore, the appraiser must delare that he or she is qualified, is not prohibited from performing the appraisal, understands the civil penalties for overstating the valuation,[23] did not charge a prohibited type of fee, and is not currently having his or her appraisals disregarded pursuant to 31 U.S.C. 330(c) on the date he or she signed the appraisal summary.[24]

Common Knowledge vs. Knowledge of Subtleties

People understand the advantages of the business lunch, but may have developed their own successful style that doesn't exactly match tips from the experts. Similarly, donors understand the advantages of taking a charitable income tax deduction. But to be successful, donors cannot develop "their own style" that ignores the requirements of the IRS—rather, success hinges on following every detail prescribed in federal tax law.

Knowledgeable financial professionals can provide an essential service by guiding donors to properly substantiate their gifts according to the law. Understanding and applying these subtleties will help donors achieve a successful, properly deductible charitable donation. And when that happens, you won't have to wonder about the underlying intention when the donor says, "Let's do lunch"—it will assuredly be a celebration of a successful, well-documented transaction.

ENDNOTES

1 IRC §170(a)(1).
2 Treas. Reg. §1.170A-13(a)(1).
3 *Id.*
4 *Id.*
5 Treas. Reg. 1.170A-13(b)(1)(iii) and (b)(2)(ii).
6 IRC 170(f)(8)(A).
7 *Addis v. Commissioner of Internal Revenue*, 374 F3d 881 (9th Cir. 2004).
8 IRC §170(f)(8)(C).
9 IRC §170(f)(8)(C)(ii).
10 IRC §170(f)(11)(B).
11 Treas. Reg. §1.170A-13(c)(2)(i)(B).
12 Treas. Reg. §1.170A-13(c)(2)(ii).
13 Treas. Reg. §1.170A-13(c)(2)(ii)(A).
14 IRC §170(f)(11)(D).
15 Treas. Reg. §1.170A-13(c)(3).
16 IRC §170(f)(11)(E) and Treas. Reg. §25.2512-3.
17 Treas. Reg. 1.170A-13(c)(3)(ii).
18 IRC §170(f)(11)(E)(ii).
19 Treas. Reg. §1.170A-13(c)(5)(iv).
20 Treas. Reg. §1.170A-13(c)(5)(iv)(B).
21 Treas. Reg. §1.170A-13(c)(5)(iv)(D).
22 Treas. Reg. §1.170A-13(c)(4)(i)(A)-(D).
23 Treas. Reg. §1.170A-13(c)(5)(i)(D).
24 Treas. Reg. §1.170A-13(c)(4).

Access more information now!

An electronic copy of our companion booklet with a more details including a discussion of valuation of charitable gifts, plus a look at court cases that have dealt with both substantiation and valuation issues. Professional Advisor section of our webite at **www.catholicfoundation.com.**

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THE
CATHOLIC
FOUNDATION

12222 Merit Drive, Suite 850 • Dallas, TX 75251 • Phone 972-661-9792 • Fax 972-661-0140

www.catholicfoundation.com