Acknowledging Charitable Gifts

Saying Thank You

Nonprofits are sending thank you notes to donors, but sometimes they're not using the magic words. That's what a tax attorney recently told the Wall Street Journal. The paper's front page story warned its philanthropic readers that IRS auditors may deny a deduction if the charity's acknowledgment letter does not contain the prescribed information.

Although Congress made significant changes in the requirements for documenting charitable contributions several years ago, there is still considerable confusion about how they apply.

Why You Should Comply

In her highly recommended book, The Charity's Guide to Charitable Contributions, Pamela McAllister gives four reasons why charities should take the time to learn the rules governing federal income tax deductions for charitable contributions:

1. Charities are being held accountable as never before, and must operate in a businesslike manner.

2. Fund raising is becoming increasingly difficult and competitive. Donors will stay happy when they are given accurate information.

3. The IRS can impose penalties if its rules are ignored.

4. The charitable community's reputation will benefit from reducing abuse, making the possibility for favorable legislation more likely.

McAllister also outlines two fundamental principles:

<u>First,</u> a deduction is allowed only when the contribution is a gift. When the donor receives goods or services in exchange for the contribution, the deduction is the amount of the contribution minus the value of the goods or services received.

<u>Second</u>, while it is up to donors to document their contributions to the satisfaction of the IRS, charitable organizations play an important role in helping their donors meet this burden.

Cash Contributions

Taxpayers who deduct donations of $250 or more on Schedule A of their 1040 federal tax returns must have a written acknowledgment from the charitable organization. Before 1994, a canceled check sufficed as verification, not anymore.

<u>Organizations are required to provide timely written disclosure statements. Separate acknowledgments for each contribution or a cumulative annual statement that lists each donation and the dates received are acceptable.</u>

The written acknowledgment should be dated and may be in the form of a letter, postcard or computer-generated form. Acknowledgments should state the dollar amount of the gift and a statement - those magic words - that no goods or services were provided.

Example: ***For your tax records, please be informed that the entire amount of your $100 gift represents a charitable contribution since no goods or services were provided in return for this donation.***

The taxpayer must have the written acknowledgement before the filing of a current year tax return or the due date, including extensions, for filing the return.

Quid Pro Quo

Tax-exempt organizations that receive donations in excess of $75 in which part of the contribution is a gift and part is in return for goods and services, must give the donor a receipt detailing how much of the "quid pro quo" contribution is a gift (deductible) and how much is in exchange for goods or services such as meals, entertainment, and books (non-deductible).

Example: If the donor gives the organization $100 and receives a concert ticket valued at $40, the donor has made a quid pro quo contribution. The charitable contribution portion of the payment is $60. Even though the part of the payment available for deduction does not exceed $75, a disclosure statement must be furnished because the donor's payment exceeds $75.

The required written disclosure statement must include:

1. a statement that the amount of the contribution the donor may deduct for federal income tax purposes is limited to the excess of the money contributed over the value of the goods provided by the organization in exchange for the contribution;
2. a description of the quid pro quo goods (a concert ticket); and
3. the fair market value of the ticket ($40).

Good Faith Estimates

An organization may use any reasonable methodology in making a good faith estimate of the fair market value of goods or services.

Meals at a hotel or restaurant, for example, would be worth the price of the same meal in a dining room or at a restaurant, including drinks and tip. In other words, the cost actually paid by the charity is irrelevant in determining the fair market value.

What happens when a fundraising dinner is underwritten by a corporation? Only one donor is entitled to the charitable deduction, so the individual who pays to attend the event cannot deduct the cost of the meal.

Advance notice on solicitation materials, such as a reply card for a fund raising dinner, does not satisfy the receipt requirement. But most organizations include a breakdown on invitations to educate their donors and to ensure that solicitations are not misleading or ambiguous.

Example: Tickets for a fund raising luncheon cost $50. The reply card states, "Contributions over the value of this luncheon ($25) are tax deductible." Note that a specific dollar amount must be provided.

It is no longer permissible to simply say, "The price of this ticket is deductible to the full extent permitted by law." Small print should be avoided to ensure that the donor can read the disclosure statement.

Limited Relief

Certain membership benefits can be ignored when the annual payment is $75 or less (or when more than $75 is given and the organization does not require larger payment to receive the benefits). The following membership benefits are covered under this rule:

1. Any rights or privileges that can be used frequently, such as free or discounted admission; free or discounted parking; preferred access to goods or services, and discounts on the purchase of goods or services.

2. Admission to events or receptions that are only open to members, if the organization reasonably projects that the cost per person (excluding any allocated overhead) is not more than $7.40. This amount is adjusted annually for inflation by the IRS.

Token Thank You Gifts

Under certain conditions, small items are considered so insubstantial by the IRS that donors may be advised that the full amount of their donations are deductible.

Premiums can be disregarded if the fair market value is not more than two percent of the contribution or $74 (in 2000), whichever is less.

Low-cost items such as bookmarks, key chains, and mugs bearing the organization's name or logo can be disregarded if the contribution is at least $37 (in 1999) and the organization's total cost (not the fair market value) for all the premiums is not more than $7.40 (in 2000). Again, these amounts are adjusted annually for inflation. The new amounts (Insubstantial Benefit Limitations, Rev. Proc. 90-12) are posted on the web (www.revenueprocedures.com).

Generally, newsletters are treated as if they do not have a measurable fair market value or cost if their primary purpose is to inform members about the activities of an organization and if they are not available to non-members by paid subscription or at newsstands.
For this purpose, publications that contain articles written for compensation and that accept paid advertising are treated as commercial enterprises having a fair market value.

Raffle Tickets

The cost of raffle tickets purchased from a charitable organization is not deductible. Therefore, raffle tickets should not include any misleading language, such as "$5.00 donation."

On a related matter, Missouri voters recently approved a constitutional amendment authorizing sweepstakes and raffles by charitable organizations. Legislation (SB 1021) currently under consideration in Jefferson City would require charitable organizations conducting raffles with prizes valued at more than $5,000 to be licensed.

Auctions

Deductions for items purchased at auctions sponsored by charitable organizations are limited to the excess of the amount paid for the items over the fair market value.

Example. Taxpayer attends an auction held by a charity. Prior to the auction, the organization publishes a catalog that includes its good faith estimate of the value of the items that will be available for bidding. It gives a copy to each individual who attends the auction.

Taxpayer notes that in the catalog the charity's estimate of the value of a vase is $100. Taxpayer has no reason to doubt the accuracy of this estimate.
Taxpayer successfully bids and pays $500 for the vase. Because Taxpayer knew, prior to making her payment, that the estimate in the catalog was less than the amount of her payment, she may deduct $400.

Noncash Gifts

What happens when the donor makes a gift of property - office equipment or furniture, stock and bonds, real estate, or works of art? The rules that govern these donations are complicated, and organizations should avoid giving their donors tax advice.

The acknowledgement or receipt must accurately describe the gift in kind but no monetary amount should be mentioned. It is the donor's responsibility to determine the fair market value.

For details, consult IRS Publication 526 Charitable Contributions and IRS Publication 561 Determining the Value of Donated Property (www.irs.ustreas.gov).