

H. Reform Rules for Charitable Contributions of Property (sec. 170)

Present Law

Deductibility of charitable contributions

In general

In computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct the amount of cash and the fair market value of property contributed to an organization described in section 501(c)(3) or to a Federal, State, or local governmental entity.⁶²⁰ The amount of the deduction allowable for a taxable year with respect to a charitable contribution of property may be reduced or limited depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer.⁶²¹ In general, more generous charitable contribution deduction rules apply to gifts made to public charities than to gifts made to private foundations. Within certain limitations, donors also are entitled to deduct their contributions to section 501(c)(3) organizations for Federal estate and gift tax purposes. By contrast, contributions to nongovernmental, non-charitable tax-exempt organizations generally are not deductible by the donor,⁶²² though such organizations are eligible for the exemption from Federal income tax with respect to such donations.

In general, if a donor receives a benefit or quid pro quo in return for a contribution, any charitable contribution deduction is reduced by the amount of the benefit received. For contributions of \$250 or more, no charitable contribution deduction is allowed unless the donee organization provides a contemporaneous written acknowledgement of the contribution that describes and provides a good faith estimate of the value of any goods or services provided by the donee organization in exchange for the contribution.⁶²³

Contributions of property

The amount of the deduction for charitable contributions of capital gain property generally equals the fair market value of the contributed property on the date of the contribution.

⁶²⁰ The deduction also is allowed for purposes of calculating alternative minimum taxable income.

⁶²¹ Secs. 170(b) and 170(e).

⁶²² Exceptions to the general rule of non-deductibility include certain gifts made to a veterans' organization or to a domestic fraternal society. In addition, contributions to certain nonprofit cemetery companies are deductible for Federal income tax purposes, but generally are not deductible for Federal estate and gift tax purposes. Secs. 170(c)(3), 170(c)(4), 170(c)(5), 2055(a)(3), 2055(a)(4), 2106(a)(2)(A)(iii), 2522(a)(3), and 2522(a)(4).

⁶²³ Sec. 170(f)(8).

Capital gain property means any capital asset, or property used in the taxpayer's trade or business, the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of capital gain property are subject to different percentage limitations than other contributions of property.

For certain contributions of property, the deductible amount is reduced from the fair market value of the contributed property by the amount of any gain, generally resulting in a deduction equal to the taxpayer's basis. This rule applies to contributions of: (1) ordinary income property, e.g., property that, at the time of contribution, would not have resulted in long-term capital gain if the property was sold by the taxpayer on the contribution date;⁶²⁴ (2) tangible personal property that is used by the donee in a manner unrelated to the donee's exempt (or governmental) purpose; and (3) property to or for the use of a private foundation (other than a foundation defined in section 170(b)(1)(E)).

In general, a charitable contribution deduction is allowed only for contributions of the donor's entire interest in the contributed property, and not for contributions of a partial interest.⁶²⁵ If a taxpayer sells property to a charitable organization for less than the property's fair market value, the amount of any charitable contribution deduction is determined in accordance with the bargain sale rules.⁶²⁶ If a taxpayer pays more than fair market value for property acquired from a charitable organization, the excess above fair market value may be deductible assuming that the donor intended to make a gift of such excess.

In general, if the total charitable deduction claimed for non-cash property exceeds \$500, the taxpayer must file IRS Form 8283 (Noncash Charitable Contributions) with the IRS. C corporations (other than personal service corporations and closely-held corporations) are required to file Form 8283 only if the deduction claimed exceeds \$5,000. Information required on the Form 8283 includes, among other things, a description of the property, the appraised fair market value (if an appraisal is required), the donor's basis in the property, how the donor acquired the property, a declaration by the appraiser regarding the appraiser's general

⁶²⁴ For certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciated value (i.e., basis plus one half of fair market value in excess of basis) or (2) two times basis. Sec. 170(e)(3). To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer, contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must: (1) use the property consistent with the donee's exempt purpose and solely for the care of the ill, the needy, or infants; (2) not transfer the property in exchange for money, other property, or services; and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. A similar enhanced deduction is available for contributions of scientific property and equipment (sec. 170(e)(4)) and for contributions of computer technology used for educational purposes made in taxable years beginning before January 1, 2006 (sec. 170(e)(6)).

⁶²⁵ Sec. 170(f)(3).

⁶²⁶ Sec. 1011(b) and Treas. Reg. sec. 1.1011-2.

qualifications, an acknowledgement by the donee that it is eligible to receive deductible contributions, and an indication by the donee whether the property is intended for an unrelated use. If a donee organization sells, exchanges, or otherwise disposes of contributed property with a claimed value over \$5,000 (other than publicly traded securities) within two years of the property's receipt, the donee is required to file a return (Form 8282), and furnish a copy of the return to the donor, showing the name, address, and taxpayer identification number of the donor, a description of the property, the date of the contribution, the amount received on the disposition, and the date of the disposition.⁶²⁷

Taxpayers are required to obtain a qualified appraisal for donated property with a value of \$5,000 or more, and to attach an appraisal summary to the tax return.⁶²⁸ In the case of contributions of art valued at \$20,000 or more, taxpayers are required to attach the appraisal to the tax return. Under Treasury regulations, a qualified appraisal means an appraisal document that, among other things: (1) relates to an appraisal that is made not earlier than 60 days prior to the date of contribution of the appraised property and not later than the due date (including extensions) of the return on which a deduction is first claimed under section 170;⁶²⁹ (2) is prepared, signed, and dated by a qualified appraiser; (3) includes (a) a description of the property appraised; (b) the fair market value of such property on the date of contribution and the specific basis for the valuation; (c) a statement that such appraisal was prepared for income tax purposes; (d) the qualifications of the qualified appraiser; and (e) the signature and taxpayer identification number of such appraiser; and (4) does not involve an appraisal fee that violates certain prescribed rules.⁶³⁰

Vehicles and Intellectual Property – American Jobs Creation Act

The American Jobs Creation Act (“AJCA”) established new rules for charitable contributions of qualified vehicles⁶³¹ and qualified intellectual property.⁶³² A deduction for a contribution of a qualified vehicle with a claimed value in excess of \$500 generally may not

⁶²⁷ Sec. 6050L(a)(1).

⁶²⁸ Pub. L. No. 98-369, sec. 155(a)(1) through (6) (1984) (providing that not later than December 31, 1984, the Secretary shall prescribe regulations requiring an individual, a closely held corporation, or a personal service corporation claiming a charitable deduction for property (other than publicly traded securities) to obtain a qualified appraisal of the property contributed and attach an appraisal summary to the taxpayer's return if the claimed value of such property (plus the claimed value of all similar items of property donated to one or more donees) exceeds \$5,000).

⁶²⁹ In the case of a deduction first claimed or reported on an amended return, the deadline is the date on which the amended return is filed.

⁶³⁰ Treas. Reg. sec. 1.170A-13(c)(3).

⁶³¹ Sec. 170(f)(12).

⁶³² Sec. 170(e)(1)(B)(iii) and 170(m).

exceed the gross proceeds received by the donee upon the sale of the vehicle. If the donee does not sell the vehicle or performs a significant intervening use or material improvement of the vehicle prior to sale, the deduction generally is the fair market value of the vehicle at the time of the contribution. The deduction for a charitable contribution of qualified intellectual property generally is the donor's basis in the property (or fair market value, if less). The donor is eligible for additional charitable deductions in certain future years based on the net income received by or accrued to the donee that is properly allocable to the contributed intellectual property.

Reasons for Change

The determination of fair market value creates a significant opportunity for error or abuse by taxpayers making charitable contributions of property. To the extent that taxpayers claim inflated valuations that are not corrected by the IRS, the Treasury loses revenue that should be collected under present law because charitable contribution deductions are greater than are warranted. Whether due to mistake, incompetence, misunderstanding of the law or facts, or efforts to evade taxes, valuation misstatements are common.

In addition, valuation is a difficult and resource intensive issue for the IRS to identify, audit, and litigate. The IRS must determine which values are suspect, prepare its own appraisal of the questioned property, and persuade a court that the IRS's value, and not the taxpayer's, is correct. Such hurdles often mean, as a practical matter, that attacking valuation misstatements in the charitable contribution context is not a high priority for the IRS because the probable revenue collected does not compare favorably with the resource cost (at least when compared to other tax compliance areas).

Another contributing factor to problems in this area is that unlike in an arm's length negotiation to arrive at a price between unrelated parties, for a charitable contribution the interests of a donor and a donee organization are not adverse. A donee organization has no incentive to question a donor's inflated value because there is no countervailing tax consequence to the donee if a donor inflates the value of contributed property, i.e., the donee generally does not pay tax on the receipt of the contribution or a subsequent disposition of the contributed property. Some donees may even directly or indirectly support an inflated value in order to secure a desired gift. Such circumstances cause the valuation of property in the charitable contribution context to be a particularly difficult determination.

Apart from the issues of valuation and enforcement, the fair market value deduction for property contributions raises separate policy questions. The fair market value deduction for property generally places gifts of cash and gifts of property on an equal footing. A primary goal of the charitable deduction, however, should be to encourage gifts that are most useful to a charitable organization, and should not be to encourage gifts that entail significant diversion of resources from the charitable mission or that require a charity to incur substantial transaction costs. Cash, publicly traded securities, and arguably property that can be used directly in substantial furtherance of exempt purposes meet this standard. Other gifts of property generally do not and so need not be as favored.

Description of Proposal

Option 1

Under Option 1, the deduction for charitable contributions of property (including capital gain property) is the donor's basis in the property or, if less, the fair market value of the property. Thus, the proposal generally extends the "basis not to exceed fair market value" rule presently applicable to contributions of certain tangible personal property to all in-kind property. The proposal does not apply to charitable contributions of publicly traded securities, which continue to be eligible for a fair market value deduction.⁶³³

The proposal does not apply to qualified intellectual property (as defined in section 170(m)(9)), a qualified vehicle (as defined in section 170(f)(12)(E)), or a qualified conservation contribution (as defined in section 170(h)(1)).⁶³⁴ The proposal also does not apply to charitable contributions that meet the requirements of sections 170(e)(3), (e)(4), or (e)(6), i.e., contributions eligible for an enhanced deduction.

The information return requirement imposed on a donee organization upon a disposition of contributed property (Form 8282, sec. 6050L) is eliminated under Option 1.

Option 2

In general

Option 2 follows the general rule of Option 1 (i.e., basis not to exceed fair market value), with an exception for contributions of property to be used to substantially further exempt purposes ("exempt use" property). Like Option 1, Option 2 retains a fair market value deduction

⁶³³ Publicly traded securities are defined as securities for which (as of the date of the contribution) market quotations are readily available on an established securities market. See sec. 6050L(a)(2)(B).

⁶³⁴ Congress recently enacted special rules for contributions of qualified vehicles and intellectual property, which are tailored to the circumstances pertaining to such property contributions. Thus, such contributions are excepted from Option 1 and Option 2. See Part VIII.F. of this report, "Modify Charitable Deduction for Contributions of Conservation and Facade Easements," for a proposal to change the charitable deduction rules for qualified conservation contributions. If the present-law special rules for qualified conservation contributions are not separately addressed, Option 1 could be modified to apply to such contributions. The merits of applying Option 1 to qualified conservation contributions are not discussed in this report. See Part VIII.G. of this report, "Limit Charitable Deduction for Contributions of Clothing and Household Items," for a proposal on the treatment of contributions of clothing and household items.

for publicly traded securities, and does not apply to contributions of qualified intellectual property, qualified vehicles, or contributions eligible for an enhanced deduction.⁶³⁵

Unlike Option 1, for charitable contributions of exempt use capital gain property, Option 2 retains the present-law fair market value deduction. In addition, for exempt use property with a claimed value of more than \$500 that the donee identifies as exempt use property on the Form 8283, the proposal generally provides for a reduced tax benefit to the donor if such property is disposed of by the organization within three years of the contribution.

The information return requirement imposed on a donee organization upon a disposition of contributed property (Form 8282, sec. 6050L) is eliminated for property that is identified by the donee organization on the Form 8283 as not intended for use in substantial furtherance of an exempt purpose (“nonexempt use” property), but is retained and expanded for exempt use property.

The revenue effect of Option 2 is not estimated in the revenue table include in this Report due to insufficient data at this time for such an estimate.

Reduction of tax benefit upon subsequent disposition of exempt use property

Under Option 2, with respect to exempt use property for which a deduction of more than \$500 is claimed, and which is identified as exempt use property by the donee organization on the Form 8283, present law rules generally apply⁶³⁶ except that, if the donee organization disposes of such property within three years of the contribution date, the property is deemed to be nonexempt use property with the result that the deductible amount with respect to such property is adjusted, as follows.⁶³⁷ If the disposition occurs in the same taxable year of the donor as the contribution date, the donor’s deduction generally is basis (or if less, the fair market value), and no subsequent adjustment is required.⁶³⁸ If the disposition occurs in a subsequent year, the donor must include as ordinary income for its taxable year in which the disposition occurs an amount

⁶³⁵ Because they are not excepted from Option 2, qualified conservation contributions generally would receive the same deduction as under current law (fair market value) because such contributions generally are exempt use property. See Part VIII.F. of this report, “Modify Charitable Deduction for Contributions of Conservation and Facade Easements,” for a proposal to change the charitable deduction rules for qualified conservation contributions.

⁶³⁶ Under present law, the donor’s deduction generally is the fair market value of the property. There are exceptions for contributions to private nonoperating foundations and for contributions of tangible personal property not intended to further exempt purposes. The deduction for such contributions generally is the donor’s basis or, if less, fair market value. Option 2 does not change the rules for contributions to nonoperating foundations.

⁶³⁷ Present-law rules continue to apply to any contribution of exempt use property for which a deduction of \$500 or less is claimed.

⁶³⁸ The disposition proceeds are regarded as relevant to a determination of fair market value.

equal to the excess (if any) of (i) the amount of the deduction previously claimed by the donor as a charitable contribution with respect to such property, over (ii) the donor's basis in such property at the time of the contribution. The donee's use of proceeds from the disposition of property in a manner that furthers exempt purposes is not an exempt use.

Upon a disposition of exempt use property subject to the recapture tax, a donor is not required to adjust the deductible amount from the amount claimed if the donee organization certifies to the Secretary, by written statement signed under penalties of perjury by an officer of the organization, that the property disposed of was used for a significant intervening exempt use. The certification must explain the use of the property and how such use substantially furthered the purpose or function that constitutes the organization's basis for exemption. The organization must furnish a copy of the certification to the donor (as part of the present-law requirement to furnish the Form 8282 to the donor).

Reporting for exempt use property

In addition to the present-law requirement that the donee organization identify on the Form 8283 whether property for which an amount of more than \$500 is claimed is exempt use property, Option 2 requires that the donee explain the intended use of such property. A penalty of \$1,000 applies to any person that agrees to identify property as exempt use property while having a reason to know that the property is not intended for such use.⁶³⁹ A penalty of \$10,000 applies to a person that identifies property as exempt use property knowing that it is not intended for such use.

The proposal modifies the present-law information return requirements that apply upon the sale of contributed property by a charitable organization (Form 8282, sec. 6050L). For property identified by the donee organization on the Form 8283 as exempt use property, the return requirement is extended to dispositions made within three years after receipt (from two years) and to property for which an amount of more than \$500 is claimed (as compared to the present-law amount of more than \$5,000). The donee organization also must provide, in addition to the information already required to be provided on the return, a description of the donee's use of the property, a statement of whether the property was used to substantially further exempt purposes, a certification of such use (described above), and if such certification is provided, a statement of whether a copy of the certification was provided to the donor of the property.

Effective Date

The proposal is effective for contributions made in taxable years beginning after the date of enactment.

⁶³⁹ Other present-law penalties also may apply, such as the penalty for aiding and abetting the understatement of tax liability under section 6701.

Discussion

In general

Options 1 and 2 eliminate the value-based deduction for certain charitable contributions of property because of both valuation issues and independent policy concerns. Retaining the fair market value deduction while attempting to improve the method for determining value is not adequate because a system based on appraisals and other estimates of value will continue to be open to abuse and costly to administer properly. Reducing the fair market value deduction, for example, by providing that the deduction is a certain percentage of fair market value, would address valuation abuses in part by reducing the amount of the deduction, but would retain the need for fair market value determinations and their enforcement. Elimination of the value-based deduction is preferable to either approach because it eliminates the need for estimates of value, is easy to enforce, and by disfavoring property contributions generally, promotes contributions that a charitable organization needs most: cash, publicly traded securities (which present no valuation problem and are easily converted to cash), and arguably, property that substantially furthers exempt purposes. Providing for a basis deduction instead of a fair market value deduction already is the general rule for tangible personal property not intended for exempt purposes and for contributions to private nonoperating foundations. Thus, the proposal extends this general rule to other property contributions. Some contributions affected by the basis rule of the proposal include contributions of the following types of appreciated property: closely held stock; partnership interests; other securities that are not publicly traded; land; and, under Option 1 but not Option 2, property for use to further exempt purposes. To the extent any of such listed property is for exempt purposes, the fair market value deduction is preserved under Option 2.

Option 1: Deduction for property contributions is the lesser of basis or fair market value

Option 1 provides that for contributions of property that is not excepted by Option 1, the deduction is basis, or if less, fair market value. This is the rule under present law for charitable contributions to nonoperating private foundations and for charitable contributions of nonexempt use tangible personal property. Thus, Option 1 generally extends the nonexempt use tangible personal property rule to all property not excepted by the proposal.⁶⁴⁰

In general, the proposal is a simple and effective solution to overvaluation of property. The rule is easy to apply, requiring that the taxpayer substantiate its basis in the property. By providing a basis deduction for appreciated property instead of a fair market value deduction (or a deduction based on a percentage of fair market value) the proposal eliminates the need to rely on appraisals or other means of determining value for all such property. The proposal also reduces the filing burden on donee organizations by eliminating the present-law information return requirement with respect to property disposed of by the donee within two years of contribution. Under Option 1, the return requirement is no longer necessary because the IRS

⁶⁴⁰ Much of the discussion regarding Option 1 also is applicable to Option 2, as the two Options are largely identical except with respect to the treatment of exempt use property.

does not need to track the disposition amount of property for which a basis deduction is claimed.⁶⁴¹

Option 1 preserves the fair market value deduction for loss property. Taxpayers would still have an incentive to overvalue any loss property they contribute, although a taxpayer might be better off (as under present law) selling the property, recognizing the loss (if available for tax purposes), and donating the sales proceeds. Nevertheless, short of introducing significant complexity by basing the deduction for loss property on the disposition amount and taxing the donee organization on the gain upon disposition (similar to an approach discussed below), or eliminating the deduction for hard-to-value property entirely, there is no simple comprehensive solution to this problem. In some cases, overvaluation of loss property may best be addressed through adoption of special rules for certain types of loss property, e.g., the new rules enacted by the AJCA for vehicles, which use the selling price as a proxy for value. Another example is to adopt a special rule, such as the aggregate cap proposed in this Report for contributions of clothing and household items, which are another type of commonly contributed loss property.⁶⁴²

The proposal is likely to reduce the amount of contributions of hard-to-value property. In general, donors would be better off selling the property instead of contributing it, paying tax at long term capital gain rates, and contributing (and deducting) all or a portion of the after-tax proceeds to charity. In such a case, the charity might receive less from a donor, but such a shortfall is at least partially offset because the charity would not have any transaction costs associated with disposing of the property. A larger question, however, is whether any loss in fundraising outweighs the loss to the Treasury from excess deductions based on overvalued property, the cost to enforce correct valuations, and the damage to the tax system from generally tolerating taxpayers that claim deductions to which they are not entitled.

There also is a question of whether the tax system should encourage charitable contributions of property. Gifts most useful to charity are cash, gifts readily convertible to cash (like publicly traded securities), and gifts of property a charity can use to substantially further charitable programs.⁶⁴³ Other property contributions generally divert a charity's resources from its charitable mission and toward soliciting and disposing of such contributions. Accordingly,

⁶⁴¹ Option 1 eliminates the return requirement with respect to all property, including loss property. Ideally, returns should continue to be required for dispositions of contributed loss property because donors claim a fair market value deduction for such property and the IRS could benefit from comparing the disposition amount to the amount claimed as a deduction. However, requiring an information return for dispositions of loss property but not for appreciated property could be confusing for donees, and the potential for abusive valuations is limited in such cases because in no event is the taxpayer allowed to claim a deduction in excess of the taxpayer's basis in the property.

⁶⁴² See Part VIII.G. of this report, "Limit Charitable Deduction for Contributions of Clothing and Household Items."

⁶⁴³ Option 2 preserves the fair market value deduction for exempt use property.

reasons independent of valuation difficulties may support discouraging hard-to-value property contributions.

Option 2: Fair market value deduction for exempt use property, with recapture tax on certain dispositions by donee

Option 2 follows Option 1 except that the fair market value deduction generally is preserved for contributions of exempt use property (in addition to publicly traded securities). This is similar to the present law rule providing for a fair market value deduction for contributions of tangible personal property for an exempt use, or a basis deduction if for another use. Thus, the proposal generally retains the tangible personal property rule and extends it to contributions of other property susceptible for use in exempt purposes, such as land, interests in land, and buildings, which under Option 1 receive a basis deduction.

As noted above, contributions generally most useful to charities are cash, property easily convertible to cash, and property that can be used to substantially further charitable programs. Providing an incentive for exempt use property may be viewed as efficient because the charity will not have to expend resources separately to acquire the good. In addition, some types of property, such as artwork, are unique, and some would argue, accessible to charity only because of the fair market value deduction. However, preserving the incentive to make charitable contributions of exempt use property retains the valuation difficulty and introduces the complexity of a recapture tax to prevent misclassification, as compared to Option 1.⁶⁴⁴ The complexity is minimized, however, because a determination of exempt or nonexempt use already is required under present law on the Form 8283, though because of the recapture tax the consequences of such a determination would be greater under Option 2. Some would argue that providing an incentive for exempt use property is unfair to donors who contribute nonexempt use property of equal value but who receive a basis deduction, and that the incentive is not necessary to ensure that unique property be contributed to charity because charities that truly want such property will acquire it by other means.

Under Option 2, a recapture tax applies if exempt use property is disposed of by the donee organization within three years of the contribution date. The recapture tax does not apply, however, if the donee organization certifies to the Secretary under penalties of perjury a significant intervening exempt use of the contributed property. The recapture tax is intended to provide the donor with a net deduction equal to the deduction the donor would have received if the property had been correctly identified as nonexempt use property at the time of contribution, that is, the donor's basis. Option 2 treats a sale or other disposition of exempt use property as evidence that the property was not used substantially to further exempt purposes, and therefore

⁶⁴⁴ Independent of Option 2, the recapture tax could be applied to enforce the present-law rule for contributions of tangible personal property. Under present law, the fair market value deduction may be claimed for such contributions. However, if the donee does not so use the property, there is no automatic recapture of the donor's deduction. Recapture may occur under present law if the IRS audits the taxpayer and the taxpayer cannot show, for example, that at the time of the contribution, it is reasonable to anticipate that the property will not be put to an unrelated use by the donee. Treas. Reg. sec. 1.170A-4(b)(3)(ii).

that an adjustment to the donor's deduction is warranted (assuming the donee does not certify as to a significant intervening exempt use).⁶⁴⁵

Option 2 also provides for a penalty of \$1,000 on any person who identifies property as exempt use property with reason to know that such property is not intended for an exempt use and a penalty of \$10,000 on any person who identifies property as exempt use property with actual knowledge that such property is not intended for an exempt use. The penalties are designed to ensure that donee organizations and their managers assume responsibility for how contributed property is identified and to deter intentional misclassification of property deemed to enable the donor to take the generally more favorable deduction provided for exempt use property.

The recapture tax will result in some additional reporting by the donee organization. The donee will have to report dispositions for property with a claimed value of more than \$500 over a three-year period as compared to present law which requires reporting dispositions of property with a claimed value of more than \$5,000 over a two-year period. This increase in reporting should be offset by the elimination of such reporting for property identified as nonexempt use property. To minimize the overall reporting and compliance burden, the recapture tax does not apply to exempt use property with a claimed value of \$500 or less.⁶⁴⁶ For such property, a fair market value deduction generally is available and rules similar to the present-law rule for contributions of tangible personal property apply, i.e., donors will have to determine whether the property is exempt use property.

As an illustration of the recapture tax, assume at the time of contribution that the value of the property is \$100 and the donor's basis is \$60. The donee organization identifies the property as exempt use property, but sells the property two years later and does not provide a certification of a significant intervening exempt use. In such a case, the donor takes a \$100 ordinary income deduction in the year of contribution but has ordinary income recapture in the year of sale of \$40 (the difference between the fair market value at the time of contribution and the donor's basis) with a resulting net deduction of \$60, or the donor's basis. If the sale occurred in the year that is the same taxable year of the donor as the contribution date, the donor would take a \$60 deduction (basis) for that year. As another example, assume that at the time of contribution the value of the property is \$100, the donor's basis is \$140, and the donee sells the property two years later for \$120 without an exempt use certification. The donor takes a deduction of \$100 in the year of contribution and has no additional income with respect to the contribution in the year of sale (because the \$100 initial deduction does not exceed the donor's basis of \$140).

⁶⁴⁵ If the donee organization certifies as to the property's exempt use and thus the recapture tax does not apply, the disposition amount could still inform the Treasury as to whether an appraised amount for the property, and thus the donor's fair market value-based deduction, was reasonable.

⁶⁴⁶ For property with a claimed value of \$500 or less, information reporting, such as whether property is exempt use property, generally is not required. It would be possible to require that a donee make a determination of use of the property on the substantiation required under present law for contributions of property with a value of \$250 or more (sec. 170(f)(8)).

Other possible approaches to property contributions

Strengthen present-law appraiser and appraisal rules

Present law attempts to address valuation concerns by requiring appraisals of contributed property for which a deduction of more than \$5,000 is claimed.⁶⁴⁷ Appraisals must be conducted by a qualified appraiser, who is defined as a person who holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis, is qualified to make appraisals of the type of property being valued (as determined by the appraiser's background, experience, education, and membership, if any, in professional appraisal associations), is independent, and understands that an intentionally false or fraudulent overstatement of the value of the appraised property may subject the appraiser to civil penalties.⁶⁴⁸ Although professional organizations exist that educate, train, and certify appraisers, and the appraisal community has developed some uniform standards applicable to appraising many types of property, the tax law does not require that a qualified appraiser meet any objective professional qualifications or adhere to any specific appraisal standards.

Accordingly, one approach to address overvaluation would be to tighten the definition of a qualified appraiser explicitly to require certain professional qualifications of appraisers, that appraisals conform to generally accepted uniform appraisal guidelines, and provide that an appraiser subject to disbarment from practice before the IRS may not qualify. The IRS could be charged with enforcing specific appraisal standards for different types of property and with publishing a list of necessary qualifications of qualified appraisers. In addition, the penalty structure could be strengthened so that appraisers, in addition to donors, are penalized for valuation misstatements, with increasing penalties for multiple violations.⁶⁴⁹ Taxpayers could be required to pay a fee for a review appraisal by the IRS prior to a gift of highly valued property.

Strengthening the appraisal regime generally is sensible, and reforms such as those suggested above should be considered; however, as an answer to the issues raised by valuation, tightening appraisal standards and penalties for appraisers does not address the main problem. The very practical difficulty of the IRS finding and enforcing valuation misstatements would remain, as would the incentive to overstate valuations. Under present law there are plausible methods of valuing even the most difficult to value property, but not every appraiser will follow such methods, legitimate disputes will arise about which method is appropriate, and there will be multiple acceptable ways of application and interpretation of a given method to the particular property being valued. In addition, as estimates of value, appraisals inherently involve the judgment of a person who is hired and compensated by the taxpayer and who, no matter how

⁶⁴⁷ The AJCA recently amended the law generally to require that C corporations obtain an appraisal in such cases.

⁶⁴⁸ Treas. Reg. sec. 1.170A-13(c)(5)(i).

⁶⁴⁹ Under present law, appraisers generally are subject to penalties only for aiding and abetting the understatement of tax liability (sec. 6701), but not for providing an appraisal that is determined to be a valuation misstatement under section 6662.

independent or capable of ignoring the reality that the appraiser's economic interests are aligned with the taxpayer's interests, understands the difficulties presented by the tax system to the successful challenge of an appraisal.

Provide that the donor's deduction for nonexempt use property generally is equal to the disposition amount and tax donee on the gain upon disposition

Another approach would be to provide that for property contributions a donor would take an initial deduction of the donor's basis (or if less, fair market value), and the donor would be eligible for an additional charitable contribution deduction in the year the contributed property is disposed of by the donee. The additional deduction would equal the excess (if any) of the disposition amount over the amount of the initial deduction.⁶⁵⁰ This approach would not apply to publicly traded securities⁶⁵¹ or to property that is intended for use to substantially further the donee organization's exempt purpose.⁶⁵²

Such an approach would preserve the fair market value-based deduction by using as determinative of fair market value the disposition amount. The donor might not receive the entire amount of the deduction initially as under present law, but assuming the property is disposed of by the donee shortly after receipt, the timing of the donor's full deduction would not differ significantly, if at all, from present law. Use of the disposition amount as determinative of fair market value would eliminate the need for appraisals and their inherent uncertainty. To the extent that donors receive less as a deduction under this proposal (after taking into account any additional deduction) than under present law, the difference (the amount by which the disposition amount is less than the appraised amount used by the taxpayer) arguably would be equal to the amount by which the appraisal overvalued the property.

One significant issue under this approach would be that of post-contribution appreciation or depreciation in the property. Because the additional deduction would be based on the disposition amount, the donor would receive the benefit of an increase in value of the

⁶⁵⁰ If the property is disposed of on a date within the same taxable year of the donor as the contribution date, the deduction would equal the disposition amount and no additional deduction would be available. If the property was disposed of for less than the taxpayer's basis, the deduction would be adjusted downward.

⁶⁵¹ The approach could carve out qualified intellectual property, or qualified vehicles, which have newly enacted special rules.

⁶⁵² Exempt use property by definition is unlikely to be sold or otherwise disposed of by the organization. Thus, if such an approach applied to exempt use property, additional deductions generally would not be available for contributions of such property with the untenable result that property used for exempt purposes would be disfavored as compared to property not so used. A separate proposal therefore would be required to address overvaluations of exempt use property (perhaps similar to that discussed in Option 2).

property.⁶⁵³ Thus, if property worth \$100 on the date of contribution (with a donor's basis of \$50) increased in value to \$500 on the date of its sale five years later, the donor would reap the benefit with an additional deduction in the year of sale of \$450, which is \$350 more than the donor would receive under present law (not taking into account the time value of money). Some would view this as a windfall to the donor, because the amount of the deduction significantly differs from the value of the property when contributed. One solution would be to impose a time limit to the additional deduction, e.g., no additional deduction would be available for dispositions more than three years after receipt. However, even a three-year time period could create significant windfalls to the donor and to the fisc. A shorter period, e.g., six months, arguably would not give the donee organization enough time to dispose of the property and, in certain cases, could force sales of property in nonoptimal market conditions.

To more fully counter the issue of post-contribution appreciation, this approach could, in addition to a time limit on additional deductions, provide for a tax on gain at the time of disposition at the highest unrelated business taxable income tax rate, payable by the donee.⁶⁵⁴ The donor would still reap the benefit of post-contribution appreciation in the form of an additional charitable deduction (but not beyond the time limit), but the Treasury generally would not be worse off because the gain in the property would be fully taxed.⁶⁵⁵ Such a tax could be justified as a tax on the donee organization's unrelated activity of accepting, preparing for sale, and selling property for which the organization had no exempt use.⁶⁵⁶ Alternatively, an excise tax on the gross disposition proceeds could be used, which would reduce administrative complexity associated with tracking gain on the property.

An anti-abuse rule would be required to cover the possibility of a double deduction in the case of a part-gift part sale. For example, assume that a donor gives property to charity (e.g., a compact disc) that is worth \$15 and the donor has a basis of \$15. The charity sells the compact disc for \$100 as part of a membership fundraising drive. Without an anti-abuse rule, the

⁶⁵³ The donor also would receive the detriment of any post-contribution decrease in value.

⁶⁵⁴ The donee would use the donor's basis in the property as reported by the donor on the Form 8283. Such an approach might prohibit a donee from claiming any loss with respect to the property.

⁶⁵⁵ Although the tax could apply only to post-contribution appreciation and not the entire appreciation in the property, imposing tax only on post-contribution appreciation would still require a determination of fair market value at the time of contribution and thus would not eliminate the need for appraisals.

⁶⁵⁶ Taxing donee organizations on the gain realized from the disposition of nonexempt use property could have the salutary effect of encouraging donees that regularly accept nonexempt use property for disposition to better negotiate fundraising contracts with third parties, and discouraging donee organizations from engaging in fundraising practices that provide substantial benefits to non-exempt third parties because such practices, considering the tax effects to the donee, might not be worth it.

disposition amount could be viewed as \$100 providing the donor of the disc with a \$100 deduction, while the buyer of the disc takes a deduction of \$85 (because the purchase of property valued at \$15 for \$100 could be viewed as a charitable contribution of \$85). An anti-abuse rule might provide that a donee organization, in disposing of contributed property, either (1) inform the donor that no portion of the disposition amount is deductible as a charitable contribution; or (2) inform the donor that the disposition amount with respect to the property is \$X and the remainder paid by the buyer of the property may be deductible by the buyer as a charitable contribution. In general, donees would have an incentive to establish a disposition amount for this purpose at or close to the fair market value of the property. If the donee sets the amount too low, the original donor would be displeased. If the donee sets the amount too high, there might be fewer buyers (due to reduced contribution deductions for buyers) and the donee would have more gain on which to pay the proposed unrelated business income tax. Donees that did not want to put a value on property would have the option of informing prospective purchasers that no part of the purchase is deductible as a contribution. To avoid the complexities presented by low value gifts generally, the proposal also could exempt property with a claimed value of \$500 or less.

In sum, under this approach, if the donee organization disposes of nonexempt use property within a certain time period, the donor's deduction (as adjusted) generally would equal the disposition amount. If the donee organization disposes of nonexempt use property after expiration of the time period, no additional charitable deduction would be available to the donor (the donor's deduction would equal the lesser of basis or fair market value, determined at the contribution date). For all dispositions of nonexempt use property, the donee might pay unrelated business income tax on the gain. Additional reporting requirements would be required.

This approach would introduce significant complexity for contributions of property. The approach preserves the fair market value deduction by using the disposition amount as the proxy for value and as determinative of the donor's deduction. As a result, however, the deduction for many charitable contributions of nonexempt use property would take years to determine, and donees would be required to track dispositions of property for the duration of the time period, which is a significantly greater burden than under present law.

Eliminate, in whole or in part, the charitable contribution deduction for property

The simplest alternative would be to eliminate, in whole or in part, the charitable contribution deduction for in-kind property. The main argument in support of such an approach is that the Code should provide incentives only for contributions of cash because cash is of most use to charity, presents no valuation questions, and generally has no transaction costs associated with it. To the extent publicly traded securities or exempt use property should be encouraged, a fair market value deduction could be retained for such property. This approach would discourage much systematic and institutionalized fundraising. Donors with property to contribute would be encouraged to dispose of the property and give all or a portion of the disposition amount to charity. Such a proposal has the benefit of being simple. Some might argue, however, that donors of property should at least recover their basis in appreciated property and to deny a basis deduction is unfair.