Charitable Donations and Tax Deductions

A cautionary tale

By Hyman G. Darling with Gina M. Barry

Key Takeaways

- No matter how altruistic your client's intentions, charitable deductions can be denied if appraisals and other valuation paperwork are not in order at the time of the gift.
- When your clients make gifts, especially of significant sums, to charity, they can designate how and for what purpose the money is spent.
- Clients may also choose to contribute to a charity generally and leave the determination about how to use the money up to the charity's governing board.

In a Tax Court case decided a few years ago, a man wanted to help low-income individuals and their families obtain affordable housing—but he was denied the charitable deduction. He had donated approximately 70 percent of a privately held entity to a qualified nonprofit entity. Included in this gift were many apartments, and on his tax return, the donor claimed a charitable gift of more than $1 million.

The value of this gift was supported by an appraisal for each of the buildings. But, surprisingly, the IRS denied the deduction, not based on the valuation but because the donor lacked a "qualified appraisal." The court concluded and agreed with the IRS that neither of the appraisals had the correct assets valued properly. Instead of providing the valuation of the stock, the donor provided appraisals of the apartment buildings themselves.

Unfortunately for the taxpayer, the IRS was correct, and the court held that the appraisals were "… short of meeting all of those requirements" as promulgated by the IRS.

Although the appraisals were not in strict compliance with the Internal Revenue Code, one might think that the man substantially complied with what was required of him in order to take a charitable deduction. The court rejected the man's argument that he had substantially complied with the IRS' requirements and said that the details must be complied with or the deductions would not be granted.

As my colleague Gina Barry noted in an [earlier article], when your clients make gifts, especially of significant sums, to a charity, they can designate how and for what purpose the money is spent. This ensures that their money will be used for the purposes that your client designates. As an alternative, your clients may choose to contribute to a charity generally and leave the determination of how to use the money up to the charity's governing board. Another option is for your clients to establish a fund in their own name and thereby leave a legacy that lives on beyond their lifetime.

In addition to a favorite charity, most people will include family members or friends in their wills. Your clients may give a specific dollar amount to a favorite charity; however, leaving a specific dollar amount to a charity in their will may unintentionally divert remaining funds away from family members or friends whom they also want to benefit. Unless a client is leaving an entire estate to charity, consider leaving a percentage of the estate to a favorite charity, with the remaining percentage divided between family members and/or friends. By leaving a percentage, clients can be certain that regardless of how large or small their estates may be, their family, friends and the charity will receive proportionate shares reflecting their wishes. Leaving money to charity may also help preserve your clients' estates and allow a greater amount of assets to be passed to family or friends.

Conclusion

Unfortunately for the man who wanted to help low-income people obtain affordable housing, his well-intentioned gift did not have the appropriate appraisal paperwork in order to allow him to take the deduction. Although it seems quite unfair, the valuable lesson learned is that one not only must think that he or she complying with regulations but also must be sure that he or she is complying when making gifts or taking charitable deductions.

About the Authors

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