2013 Charitable Tax Guide

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With new rules changing the tax picture for many clients, it's a good time to review IRS regulations surrounding charitable donations. Here's what to keep in mind when deciding on donations in 2013.

For much of 2012, the pending fiscal cliff clouded client tax planning, creating uncertainty around tax rates, deductions, and other issues. An agreement between President Obama and Congress permanently continued the expiring tax cuts for most income earners, although there are some new limitations to consider when giving to charities.

Here's an overview of the regulations covering charitable giving in 2013, although you should consult your advisor before making any final decisions.

Fiscal cliff impact

The fiscal cliff deal reinstituted a limitation on itemized deductions for taxpayers with high incomes known as the "Pease Provision." This was first enacted as part of the 1990 bipartisan deficit reduction deal. This provision affects less than 2% of all taxpayers.

Taxpayers who are married and filing jointly with incomes exceeding $300,000 and those who are single with incomes of more than $250,000 will find that their ability to benefit from itemized deductions such as charitable deductions will be reduced by 3% of the amount that their adjusted gross income (AGI) exceeds that threshold.

Here's an example: A married couple filing jointly with $350,000 in AGI claiming $40,000 in itemized deductions will have those deductions reduced by $1,500 — 3% of the $50,000 that AGI exceeds $300,000 — to $38,500.

The other potential impact on charitable deductions is the increase in the top marginal tax rate from 35% to 39.6% for taxpayers with incomes of $450,000 and above who are married, filing jointly; $400,000 for single taxpayers; and $425,000 for those filing head of household. While taxes for those groups will increase because of the overall increase in their tax rate, that also means that the value of itemized deductions will increase proportionally to the overall tax increase.

For most high net worth clients, these changes don't do much of anything to discourage charitable giving. In most cases, charitable deductions will still produce an important tax benefit.

Qualified charities

Before donating, make sure that the organization is a qualified charity under IRS rules. These include corporations, trusts, community organizations, funds, or foundations organized and operated in the United States for religious, charitable, scientific, literary, or educational purposes.

Other qualified charities include cemetery companies, veterans' organizations, fraternal organizations, and organizations designed to prevent cruelty toward children or animals. Certain charities in Canada, Mexico, and Israel also qualify. You can search for qualified charities using the IRS's online search tool. Be sure to check the addendum for listings not yet included in the electronic search version.

Gift criteria

If you receive any consideration in exchange for the gift, there's a limit on how much of the gift you can deduct. For example, if you make a $200 donation to a qualified charity and receive a gift in return valued at $50, you can deduct $150. A major exception to this rule is athletic tickets purchased from colleges and universities, where the allowable deduction is 80% of the price paid for such tickets.

Mileage

When volunteering for a charity, you can deduct the costs of gas and oil that are directly related to the places you go to volunteer. If you don't want to keep track of those actual costs, you can deduct mileage at the rate of 14 cents a mile.

Donation documentation

For donations of more than $250, there must be written substantiation of the gift, which can include a letter documenting the gift from the charity. If cash is contributed, a canceled check, a bank statement, or a credit card statement can serve as documentation according to the IRS.

For donations made via payroll deduction, a pay stub, Form W-2, or pledge card to a charitable organization suffices. For donations of less than $250, maintain a record that states the name of the charitable organization, the date of the donation, and what was donated.

Deduction limits

Deductions are limited to a certain percentage of adjustable gross income (AGI), depending on the type of property that is donated and what type of organization receives it. Below is a general rundown on donations, but you and your advisor should check with a tax professional for confirmation on your specific situation.

Charitable Deductions for Property			
Type of Donated Property	**Type of Charity**	**Proof of Donation**	**General Deduction Limit**
Cash	Public charities	Canceled check, bank or credit union statement, credit card receipt, or written communication from charity if under $250; substantiated by charity if over $250	50% of AGI
	Private non-operating foundations, veterans' organizations, fraternal societies, and nonprofit cemeteries	Canceled check, bank or credit union statement, credit card receipt, or written communication from charity if under $250; substantiated by charity if over $250	30% of AGI
	Out-of-pocket expenses paid for a foreign or U.S. student living with you under an agreement with a qualified charitable organization	Considered a contribution for the use of a qualified organization and valued as such	$50 for each month the student lives with you subject to the 30% limit above
Capital gain property	Public charities	Fair market value	30% of AGI
	Private non-operating foundations, veterans' organizations, fraternal societies, and nonprofit cemeteries	Property basis, unless fair market value is less	Whichever is less: 20% of AGI or 50% of AGI minus contributions to charities
Ordinary income property	Public charities	Property basis, unless fair market value is less	50% of AGI
	Private non-operating foundations, veterans' organizations, fraternal societies, and nonprofit cemeteries	Property basis, unless fair market value is less	30% of AGI

Source: IRS

Capital gain property is any property that long-term capital-gain tax rules apply to—such as stocks and real estate—when sold. Ordinary income property is any property that ordinary income tax rules apply to when sold. Fair market value is the current value of the property if sold; the property basis is the price it was purchased for. Any donations that exceed the limitations in the table can be carried forward for up to five years.

In most tax years, the IRS has limited the total amount of charitable deductions and itemized deductions for taxpayers with gross income over certain amounts, if the total amount of charitable deductions exceeds 20% of AGI in addition to the limits described in the table above. Those limits were repealed in 2010 and reinstated in 2011. To see if any limits apply to you, consult IRS Publication 526. The alternative minimum tax also affects itemized deductions but does allow affected taxpayers to deduct qualified charitable contributions.

Donated-property rules

The rules surrounding donated property are particularly complex. Rules hinge on the fair market value of the donated goods, which is what that particular item would fetch on the open market in a transaction between a willing buyer and seller. Because fair market value isn't easily determined, there are no specific formulas that work in figuring it out. There are several different ways of determining fair market value, which include:

- The actual cost or selling price of donated property, especially if the purchase or sale happened recently and was at arm's length.
- Sales of comparable properties when the properties being compared are fairly similar and those sales occurred recently.
- Replacement cost when there is a reasonable relationship between the replacement cost and fair market value.

In some cases, it can be difficult to determine fair market value, especially when there are unusual market conditions, such as liquidation, and there aren't many reasonable comparable sales.

If you're donating property and claiming a deduction of more than $5,000, the IRS mandates an appraisal and filing of Form 8283, Section B. You can't take a charitable contribution deduction for the cost of the appraisal, but you can deduct it as a miscellaneous deduction, subject to the 2% limit. For more information, consult IRS Publication 561, "Determining the Value of Donated Property."

Here are some specific details that apply to certain items of donated property:

- **Household goods, including used clothing.** They must be in good used condition or better, and the amount you can deduct depends on the item's fair market value. Both the Salvation Army and Goodwill offer pricing guidelines to help you figure out the fair market value of donated items.
- **Cars, boats, and aircraft.** If the donated value is more than $500, you must either claim the amount that the charity sold the property for, or the fair market value on the date of the contribution. The IRS suggests consulting a car, airplane, or boat resale blue book for data on what a particular vehicle is worth, using data for private party sales. Online resources include the Kelley Blue Book for cars, NADAguides for boats and cars, and the Aircraft Bluebook for planes.

- **Stocks and bonds.** If you donate stocks and/or bonds that have appreciated to a qualified charity, you can take a deduction on the appreciated value of those assets rather than their basis. Use the price on the date of sale, averaging the high and low price to get the fair market value.

If the security is thinly traded or the price is unavailable, take such factors into consideration as the most recent price available, the financial soundness of the company issuing the security, and the value of securities issued by similar companies in the same industry. Sites that offer historical prices for securities include BigCharts for stock prices and BondsOnline for bond prices.

- **Jewelry and gems.** Jewelry and gems are typically so individualized that they require a jewelry appraisal to assess their value. The appraisal should describe the cut and setting of the gem, the style of the jewelry and the stone's coloring, weight, cut and brilliance and any flaws.

- **Paintings and antiques.** When donating paintings, antiques, or objects of art that are worth $20,000 or more, a signed appraisal must be attached to your tax return. The IRS may request an 8" x 10" color photo of the donated item. If the object is valued at $50,000 or more, you can request a Statement of Value from the IRS before filing your return to support your deduction. That request must be made before filing your return, and you must complete Form 8283, Section B, and pay a $2,500 user fee.

- **Collections.** As with cars, boats, and airplanes, the IRS advises anyone considering donating a collection to consult a published guide such as a catalog, dealer's price list, or specialized hobby publication. Use the most current edition and consider other factors when determining the value of a deduction, such as dealers in the industry, prices of comparable items published on the Internet, or an official appraisal by an appraiser experienced with such items.

- **Real estate.** Donations of real estate require an appraisal from a qualified appraiser, which must be included with your tax return. You must include a photo of the property, legal description, address, physical features, and property condition. When selecting a fair market value for donation purposes, an appraisal should consider comparable sales, capitalization of income, and replacement cost new or reproduction cost minus observed depreciation.

When estimating the value of donated property, it's best to err on the conservative side. That's because the IRS will penalize taxpayers for overstating the value of donated property. That penalty will be 20% if the overstatement is 150% or more of the actual value, or if the tax paid was $5,000 less than it would have been if the value had been correctly stated. The penalty rises to 40% if the value of the overstatement is 200% or more of the actual value of the donated property, or if the tax paid was $5,000 less than it would have been if the value had been correctly stated.

What's not deductible

The IRS prohibits charitable contribution donations for money or property given to:

- Groups that lobby for legal changes
- Certain state bar associations
- Labor unions, civic leagues, sports clubs, and chambers of commerce
- Foreign organizations (except for certain organizations in Canada, Mexico, and Israel and certain U.S organizations that transfer funds to charitable foreign organizations)
- For-profit organizations and groups
- Homeowners' associations
- Individuals
- Schools for payment of tuition
- Blood banks for donations of blood
- Organizations for raffle, bingo, or lottery tickets
- Political groups or candidates for public office
- Country clubs, lodges, and fraternal orders for payment of dues, fees, or bills

In determining possible deductions, also take into consideration any state limitations on charitable donations. New York passed legislation in 2010 limiting tax deductions for people who earn more than $10 million annually. Other states are considering similar legislation. Again, check with your advisors for rules specific to your situation.

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