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Claiming and Documenting Charitable Deductions

Just in time for tax season, a recent court decision penalizing taxpayers who failed to document charitable gifts appropriately is a reminder to follow Internal Revenue Service (IRS) guidelines closely when taking charitable tax deductions. To help clients adhere to these guidelines and be eligible for the maximum tax benefit from their donations, advisors should keep in mind the following record-keeping requirements and rates, along with special breaks that apply only to the 2005 return.

How taxpayers went wrong in the latest case

In *Norman John Haas III v. Commissioner* (No. 1234-055), which was decided on January 26 of this year, the tax court agreed with the IRS finding that an Arizona couple could not justify the amounts they had deducted for donations of clothing and various household items.

- The IRS found that the couple couldn't substantiate most of the \$7,000 worth of deductions they had claimed for these contributions because they had neglected to retain documentation.
- In addition, values listed on the 2001 return for certain gifts did not correlate with those later provided to the IRS during the tax court proceedings.

Ultimately, after disallowing the undocumented deductions and an additional theft loss claim, the IRS increased the couple's tax bill by \$3,015 and imposed a 20% "accuracy related" penalty for negligence or disregard of the rules.

Documenting cash contributions

To support a deduction for cash of \$250 or more, clients must generally be able to produce a receipt or letter from the charitable organization showing the charity's name, the date and the amount of the contribution as well as a statement of whether or not the organization provides any goods or services in exchange for the cash donated.

Documenting non-cash contributions appropriately

The IRS requires donors to keep records and report non-cash contributions, such as computers, coin collections, art, books, jewelry and publicly traded securities. How much documentation is necessary will depend on the type of asset being donated and the amount of the deduction.

If the deduction is for more than \$5,000 worth of tangible personal property or real estate, or for non-publicly traded stock, IRS rules require that the donor obtain a "qualified appraisal." The appraisal must be done by someone who is in the business of doing such valuations.

- Under federal regulations, the appraisal cannot be made more than 60 days before the donation, and must be complete by the time the income tax return is due.
- The appraiser must sign Form 8283.
- The charity must sign Form 8283, but only to acknowledge receipt of the gift described in the form.
- When taking a deduction of \$20,000 or more for art, such as paintings, sculptures or antiques, clients must attach a copy of an appraisal to the Form 8283; for other donations, it's enough to summarize the appraisal on the form, but taxpayers should keep this documentation with their tax records.

Documentation Required	Deduction Claimed			
	\$250 to \$500	>\$500 to \$5,000	>\$5,000	Art worth >\$20,000*
Acknowledgement from charity	√	√	√	√
Client record must show how and when property was acquired and the basis		√	√	√
Client must file Form 8283 with federal tax return		√	√	√
Charity that received the asset must sign Form 8283			√	√
Appraiser must sign Form 8283			√	√
Client must attach an appraisal summary to Form 8283			√	
Client must attach complete copy of qualified appraisal to Form 8283				√

*For deductions of less than \$20,000 for art donations, refer to other columns in this table.

Key rates for 2005

Advisors and clients should be aware of the following for tax year 2005:

- *This year's threshold for computing itemized deductions.* Each year taxpayers whose adjusted gross income (AGI) exceeds a certain sum must reduce their itemized deductions by 3% of the amount by which their AGI exceeds the threshold. For the 2005 tax return, the threshold for calculating this 3% "haircut" is \$145,950 for singles and married taxpayers filing joint returns, and \$72,975 for married people filing separately.
- *Mileage deduction for charitable work.* Although normally the standard mileage rate deduction for charitable work is 14 cents per mile, special rates apply to Katrina-related charitable work: 29 cents per mile for August 25-31, 2005, and 34 cents per mile for September through December 2005, reflecting higher gas prices during that period.

Katrina-related tax benefits

For cash donations made to certain public charities (not including supporting organizations or donor-advised funds) between August 28 and December 31, the Katrina Emergency Tax Relief Act of 2005 (KETRA) permits clients to:

- Deduct up to 100% of adjusted gross income (AGI), whether or not the recipient organization is involved in hurricane relief. (To claim this deduction, clients must elect on their personal income tax returns to have Section 301 of the Katrina bill, which contains this provision, apply to their situation.)
- For donations that qualify under KETRA, the 3% "haircut" does not apply.

When and how to raise the usual ceilings on charitable deductions

Instead of the 30% ceiling on charitable deductions for gifts to a public charity of long-term appreciated securities, real estate and tangible personal property, clients can elect, on an annual basis, to deduct up to 50% of AGI related to the charity's exempt purpose.¹ The 50% election will limit the client's deduction to cost basis, rather than the full fair market value of the property, but it might make financial sense when:

- The value of the donated property is so high that your client will not be able to deduct the full fair market value of a 30% gift, even by carrying over the deduction for up to 5 years, as taxpayers are allowed to do.

¹ See Internal Revenue Code Section 170(b)(1)(C)(iii) and the accompanying regulation, Reg. 1.170A-8(d)(2).

- The property being donated has not appreciated much, so there is less benefit to valuing the donation at fair market value.
- The client is elderly or in poor health and might pass away before the end of the carryover period.
- The client has passed away and advisors are preparing the final income tax return (the carryover will be lost after that).

By assisting clients adhere to IRS guidelines, you can help them receive the maximum tax benefit from their donations.

For more information on helping your clients maximize their charitable income tax deductions, contact a Fidelity Charitable Services® representative at **800-280-6357** or visit www.fidelitycharitable.com.

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