

Doug's Insights

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Category: Income Tax

Non-cash Charitable Contributions ***“Fair Market Value vs. Donation Value”***

Most of us make multiple trips each year to charitable organizations like Goodwill, Salvation Army, or the Disabled Veterans just to name a few. Many times the effort and gift occur without taking the time to document what is given, obtain a receipt, or take the tax deduction. Unless the gift is only a couple of items and their original cost is small, it may be worth reconsidering the effort to take the deduction.

While many different items can be donated, this Insight will cover the items most frequently donated when closets and homes are cleaned out. Examples include clothing, household items, electronics, and bedding. For the used item to be deductible, it must be in good or better condition and in working order.

Maximizing the tax deduction only requires a few steps.

1. Make a list of the items donated. This should include quantity, type, brand, description, and condition. As an example: 3, men's long sleeve dress shirt, Ralph Lauren, 100% cotton, excellent
2. To the best of your recollection, add the original cost of the item if known, or an estimate based upon purchase history. Then extend the value to create the total original cost for each item on the list. For any item on the list whose condition is less than good, include it only if it is usable without any repair. The items total original cost should also be calculated but the fair market value should be zero.

With the above information, you are now able to determine the amount of the charitable deduction. The problem occurs when the estimated current value is too low. In IRS publication 526, it states the fair market value (FMV) should be determined as follows: “Fair market value is the price at which property would change hands between a willing buyer and a willing seller, neither having to buy or sell, and both having reasonable knowledge of all the relevant facts.” Clearly the IRS is saying the fair market value is the value for which it could be sold and the value that should be used for the deduction amount.

The mistake most taxpayers make is to use one of the value estimators found on the Internet. Per one estimator, the deductible value of a man's shirt is between \$2.50 and \$12.00. For some taxpayers this may be appropriate based upon the original cost of the shirt purchased. But, for many this may not be representative of the items donated.

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Visiting consignment stores in the area can help determine the fair market value since all items in the store are used and priced to sell. Back to my example of the dress shirt, based upon past visits a dress shirt still in good condition might be priced between \$13 and \$18. The high value represents thirty percent (30%) of an estimated \$62 original cost.

While there are shirts costing less, per IRS instructions the value to be used is the FMV of the item donated. By using \$18 rather than \$6 which many taxpayers elect to use to be conservative, the deduction is \$12 higher. In the twenty-five percent (25%) tax bracket, this reduces the tax liability by \$3 additional dollars. Using the proper FMV for all items donated will increase the charitable deduction value and permit a more accurate return to be filed.

When the total of all the non-cash items donated during the year is \$500 or more, then each recipient must be detailed on IRS form 8283. The recipient's name and address and the date of the donation is required. This can be met easily by collecting a receipt when the items are dropped off. Plan on visiting a *manned* collection facility. A summary of the items given including the total original cost and current FMV then goes on the form. In my opinion, it's a smart move to add the total number of items donated to the description line permitting the service to determine the average value of the donated items reducing the chances of an inquiry by the IRS. .

Without the number of items, the service is only seeing the total deduction being claimed, a value that could range from \$200 to \$2,000 or more depending the number of items delivered. The service may question a \$1,600 claim hoping to find an error in the value used. However, by permitting this average value to be calculated, the service may decide questioning the value of a \$16.84 item is not worth the effort. For this to be the average value, it only requires 95 items to be donated ($\$1,600 / 95 = \16.84).

As documentation final documentation measure, use your phone to snap photos of the items donated. Visual proof will further support the value and the occurrence of the gift. Following these steps may increase the value of charitable deductions substantially and reduce the annual income tax bill by a couple hundred dollars or more. It is important to use accurate values. Claiming an amount too small is as much an error as too large.

