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WHITE PAPER

What Qualified Appraisal Rules Apply to Gifts to Donor-Advised Funds?

Executive Summary:

Donors who give over $5,000 to charity need a Qualified Appraisal if they donate property other than cash or publicly traded securities. A Qualified Appraisal is a detailed document that must adhere to specific requirements. If the charitable deduction exceeds $500,000, the Qualified Appraisal must be included with the Federal tax return claiming the deduction.

The following discussion summarizes in general terms the definition of and need to obtain a qualified appraisal including:

- When must a donor obtain a qualified appraisal for gifts to Donor-Advised Funds?
- What procedures must be followed to produce and file such an appraisal?

To substantiate a charitable income tax deduction under Internal Revenue Code (IRC) §170, certain donors of gifts of hard-to-value property must obtain a qualified appraisal of the property's fair market value by a qualified appraiser before claiming a deduction on their federal income tax return. This FAQ will explore the details of this requirement.

To Whom do the Qualified Appraisal Rules Apply?

The rules apply conditionally with respect to any charitable contribution made after December 31, 1984 by:[1]

- an individual;
- a partnership;
- a personal service corporation;
- a closely-held C-corporation in which more than 50% of the outstanding shares are owned by fewer than six individuals during the last half of the year; or
- an S-corporation.

The American Jobs Creation Act of 2004 added C-corporations to that list for charitable gifts made after June 3, 2004.[2] The Pension Protection Act of 2006 further defined who an appraiser is and increased the penalties on appraisers.[3]

When do the qualified appraisal rules come into play?

Charitable gifts of cash and "publicly traded securities" that can be freely sold don't require a qualified appraisal to claim the income tax charitable deduction.[4] As a general rule, a qualified appraisal is required whenever a deduction in excess of $5,000 is being claimed for gifts of most unmarketable capital assets.[5] The $5,000 threshold increases to $10,000 for gifts of "nonpublicly traded securities".[6] Additionally, special rules apply to gifts of art, tangible personal property, cars, boats and some gifts for the care of the ill, needy or infants.

What is the definition of a "publicly traded" and "nonpublicly traded" security?

A "publicly" traded security is generally one for which market quotations are readily available on an established securities market. Securities, which qualify, include those traded on the New York Stock Exchange, the American Stock Exchange, or any city, regional, over-the-counter, or other exchange for which quotations are published on a daily basis.[7] The exchange is not required to be located in the United States. However, most open-end mutual fund shares qualify only if the market price is published on a daily basis in a newspaper in general circulation in the United States.[8]

A "nonpublicly" traded security is any security that does not meet the definition above of a publicly traded security.[9] *It can also include an otherwise publicly traded security, the transferability of which is so encumbered by restrictions that the security could not be sold freely on a public exchange.*[10]

Must gifts of similar property be aggregated to ascertain whether the $5,000/$10,000 thresholds have been exceeded?

Yes. To determine whether the $5,000 and $10,000 thresholds have been exceeded in a given year, the rules require the aggregation of all similar items[11] of gifted property for which an income tax charitable deduction is being claimed, without regard to the number of different charities who received the donated items. "Similar items" means property of the same generic category or type, e.g., stamp collections, jewelry, land, buildings, nonpublicly traded stock, etc.[12]

A separate qualified appraisal is required for each item of property that is not included in a group of similar items of property.[13]

What is a "Qualified Appraisal?"

A qualified appraisal is an appraisal document that:[14]

1) relates to an appraisal of the donated property made no sooner than 60 days prior to the date of the contribution, nor later (generally) than the due date (including extensions) of the tax return on which an income tax charitable deduction is first claimed;

2) is prepared, signed and dated by a "qualified appraiser";

3) does not involve a prohibited appraisal fee; and

4) includes the required information.

What type of information is required in a qualified appraisal?[15]

1) a description of the property in "sufficient detail";

2) in the case of tangible personal property, its physical condition;

3) the date (or expected date) of the contribution;

4) the terms of any agreement or anticipated agreement between the donor and donee that relate to the latter's use, sale or other disposition of the property;

5) the name, address, taxpayer ID number or other identifying number of the qualified appraiser, together with the capacity in which the appraiser is acting, e.g., as an employee, partner in a partnership, etc.;

6) the qualified appraiser's qualifications, including statement of background., experience, education and membership in any professional appraisers' associations;

7) a statement that the appraisal was prepared for income tax purposes;

8) the date (or dates) the property was appraised;

9) the method used to establish fair market value;

10) the specific basis for the valuation, e.g., comparables, statistical sampling, etc.; and

11) the appraised fair market value on the date of the contribution.

Who may Serve as a "Qualified Appraiser?"

To be a qualified appraiser, the individual giving the appraisal must declare in writing that he/she:[16]

1) performs appraisals on a regular basis, or holds himself/herself out to the public as an appraiser;

2) is qualified to make appraisals of the type of property at issue because of the personal qualifications;

3) is not a member of the class of persons who are statutorily disqualified from making an appraisal in this case; and

4) is aware that any intentionally false or fraudulent overstatement of the value of the property at issue may subject the appraiser to federal civil penalties.

For tax returns due after August 17, 2006, the appraiser must also be one who:[17]

1) has earned an appraisal designation from a recognized professional appraiser organization;

2) regularly performs appraisals for compensation; and

3) has verifiable education and experience in valuing the type of property being appraised.

Even if the appraiser makes the above declarations, he/she can be disqualified if the donor had knowledge of facts that would cause a reasonable person to expect the appraiser falsely to overstate the value of the donated property.[18]

Who may NOT Serve as a Qualified Appraiser?

The following persons cannot be qualified appraisers with respect to particular property:

1) the donor or taxpayer who is claiming the income tax charitable deduction for the contribution of the property being appraised;

2) the person who sold, exchanged, or gave the property to the donor, or any person who acted as the agent for the transferor or for the donor with respect to such sale, exchange, or gift unless the property being donated within two months of its acquisition and the appraised value does not exceed the acquisition price;

3) the donee of the property;

4) any person employed by the donor, donee, or person described in item 2 above;

5) any person who is related to any of the above listed persons via the attribution rules of IRC §267(b), e.g., controlled companies, husband, wife, brothers, sisters, ancestors, lineal descendants, etc., plus any such persons related to the donor's spouse;

6) any appraiser who is regularly used by any of the persons described above in items one through three who does not perform a majority of his/her appraisals made during his/her taxable year for other persons; [19] and

7) any appraiser who has been prohibited from practicing before the IRS during the three-year period before the appraisal date[20].

What restrictions are placed on the nature of appraisal fees?

<u>GENERAL RULE</u>: No part of the fee arrangement for a qualified appraisal can be based on a percentage of the appraised value of the property.[21]

<u>THE EXCEPTION</u>: An appraisal fee can be based on a percentage of the appraised value but only if the following four factors are present:[22]

1) the appraisal fee is paid to a generally recognized Association that regulates appraisers;

2) the Association neither is organized for profit, nor pays any part of its net earnings to private shareholders or individuals;

3) the appraiser does not receive any compensation from the Association or any other person for making the appraisal; and

4) the fee arrangement is not based in whole or in part on the amount of the appraised value of the donated property that is allowed as a charitable deduction.

Is the appraisal fee deductible for income tax purposes?

Yes, conditionally. The appraiser's fee is deductible on the donor's personal tax return as a miscellaneous expense to determine the donor's tax liability.[23] Appraisal fees are not part of the charitable contribution and are not limited by the percentage limitations on the charitable deduction. However, as a miscellaneous itemized deduction they can be deducted only to the extent that the taxpayer's total miscellaneous itemized deductions exceed 2% of adjusted gross income.

What are the Filing Requirements with Respect to a Qualified Appraisal?

GENERAL RULES: A donor who is claiming an income tax charitable deduction for property that requires a qualified appraisal must attach a Qualified Appraisal Summary (IRS Form 8283) to the federal income tax return for the year in which the deduction is claimed.[24] Form 8283 must generally be completed in its entirety and signed by the donor, the qualified appraiser and a representative of the charity.

EXCEPTIONS: With respect to gifts of nonpublicly traded stock having a fair market value of $10,000 or less and with respect to charitable gifts of C-corporations (that are neither "closely-held" nor personal service corporations), the appraisal summary sections concerning the appraiser and the qualified appraisal need not be completed because they do not apply.[25] However, the rest of the Form must still be completed. Several unique reporting requirements also exist with respect to appraisal summaries prepared for donors who are S-corporations, partnerships and LLCs taxed as a partnership.

What special filing requirements apply when the income tax charitable deduction exceeds $500,000?

If a donor claims an income tax charitable deduction greater than $500,000 for a gift after June 3, 2004, the donor must attach a copy of the actual Qualified Appraisal to the income tax return.[26] Note that this $500,000 threshold applies to the deduction not the gift.

EXAMPLE: If Joan creates a Donor-Advised Fund with a closely-held business interest valued at $2,000,000, her income tax deduction is $2,000,000. Joan must obtain a qualified appraisal to claim the deduction and file Form 8283. Additionally, because the deduction exceeds $500,000, Joan must attach the qualified appraisal to her tax return.

EXAMPLE: If Max creates a Donor-Advised Fund with real estate valued at $450,000, his income tax deduction is $450,000. Max must obtain a qualified appraisal to claim the deduction and file Form 8283; however, because the deduction does not exceed $500,000, he does not need to attach the qualified appraisal to his tax return.

What is the penalty for failing to obtain a qualified appraisal or failing to file a Qualified Appraisal Summary when one is required?

GENERAL RULE: The donor/taxpayer will be denied an income tax charitable deduction if the donor fails to obtain a qualified appraisal. On the other hand, if the donor has the qualified appraisal but simply does not attach the Qualified Appraisal Summary to the tax return claiming the deduction, then the IRS may request production of the Summary within 90-days.[27]

Of what value is a qualified appraisal if the donor's tax return is audited?

A qualified appraisal is one form of evidence of the donated property's value. It is not a guarantee of value and the IRS can (and occasionally does) challenge a donor's qualified appraisal. To lessen the risk of a challenge, the donor's appraisal will be strengthened if:

1) the appraisal meets the requirements of the Internal Revenue Code and Treasury Regulations as briefly described in this FAQ;

2) the appraisal is made as close as possible to the time of the contribution;

3) more than one appraisal is obtained and the multiple appraisers closely agree in the property's fair market value;

4) the qualifications of the appraiser(s) are outstanding with regard to the type of property being appraised and they have a reputation for superior, first-hand knowledge of local business conditions and the market values of similar property; and

5) the qualified appraisal report is extremely detailed and complete in all respects.

What are the penalties for claiming an incorrect value?

For valuation misstatements on tax returns due ***after August 17, 2006***, if the value of donated property claimed on the donor's income tax return is off by 150% or more of the correct value, a 20% penalty will be levied on the understated tax. This penalty doubles to 40% if the value claimed is off by 200% or more of the correct value. However, neither penalty applies unless the underpayment exceeds a *de minimus* amount of $5,000.[28] For gift and estate tax purposes, a misstatement occurs with only a 65% error.

For valuation misstatements on tax returns due ***before August 17, 2006***, taxpayers had a slightly larger margin of error.

For More Information

More than Pensions. . .Planning Opportunities with the Pension Protection Act of 2006, National Underwriter, ISBN: 0-87218-699-7

Planned Giving Design Center's Technical Reports available at www.pgdc.com

Miree, Kathryn, Professional Advisors' Guide to Planned Giving, 2004 Edition, Aspen

IRC §§170, 170(f)(11) and 6664

Treasury Regulation §1.170A-13 (as of August 2006, this was not yet revised for changes made by the American Jobs Creation Act of 2004 or for the Pension Protection Act of 2006)

Bond, Dewayne, 100 TC 32, (1993)
John T. Hewitt, et ux. v. Commissioner, 109 TC 258, (1997)
A. Rick D'Arcangelo, et ux. v. Commissioner, TC Memo 1994-572, (1994)
Jorgenson, Anthony W., TC Memo 2000-38, (2000)

IRS Announcement 85-177, 1985-51 IRB 23

Revenue Ruling 67-461, 1967-2 CB 125

IRS Publication 17, Your Federal Income Tax, Chapter 26

IRS Publication 561, Valuation of Donated Property

Endnotes

1. Treas. Reg. §1.170A-13(c)(1)(i)
2. IRC §170(f)(11)
3. IRC §170(f)(11)(E)

4. IRC §170(f)(11)(A)(ii)
5. IRC §170(f)(11)(C)
6. Treas. Reg. §1.170A-13(c)(2)(ii)(B)(1)
7. Treas. Reg. §1.170A-13(c)(7)(xi)(A)
8. Treas. Reg. §1.170A-13(c)(7)(xi)(A)(3)
9. Treas. Reg. §1.170A-13(c)(7)(ix)
10. Treas. Reg. §1.170A-13(c)(7)(xi)(C) and PLRs 9623018 and 9247018
11. IRC §170(f)(11)(F)
12. Treas. Reg. §1.170A-13(c)(7)(iii)
13. IRC §170(f)(11)(F) & Treas. Reg. §1.170A-13(c)(1)
14. Treas. Reg. §1.170A-13(c)(3)(i)
15. Treas. Reg. §1.170A-13(c)(3)(ii)
16. Treas. Reg. §1.170A-13(c)(5)(i)
17. IRC §170(f)(11)(E)(ii)
18. Treas. Reg. §1.170A-13(c)(5)(ii)
19. Treas. Reg. §1.170A-13(c)(5)(iv)
20. IRC §170(f)(11)(E)(iii)(II)
21. Treas. Reg. §1.170A-13(c)(6)(i)
22. Treas. Reg. §1.170A-13(c)(6)(ii)
23. Revenue Ruling 67-461, 1967-2 CB 125
24. IRC §170(f)(11)(C) & Treas. Reg. §1.170A-13(c)(2)(i)(B)
25. Treas. Reg. §1.170A-13(c)(2)(ii)
26. IRC §170(f)(11)(D)
27. Treas. Reg. §1.170A-13(c)(4)(iv)(H)
28. IRC §6662

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