

FEDERAL SUBSTANTIATION AND DISCLOSURE REQUIREMENTS

The tax code imposes a set of substantiation and disclosure requirements on 501(c)(3) charities and their donors. A useful summary of these requirements is contained in IRS Publication 1771, Charitable Contributions -- Substantiation and Disclosure Requirements.

DISCLOSURE: QUID PRO QUO TRANSACTIONS IN EXCESS OF \$75

501(c)(3) charities often provide donors with valuable benefits in return for their contributions: meals, key chains, tickets to athletic events, publications, preferred admission to museums -- the list of examples is practically limitless. In this type of "quid pro quo" transaction, the amount the donor can claim as a charitable contribution deduction is limited to the excess of the contribution over the fair market value of any benefit received in return.

As of January 1, 1994, a charity receiving a quid pro quo payment in excess of \$75 must give the donor a statement in writing:

- 1) notifying the donor that the deductible amount for federal income tax purposes is limited to the amount by which the payment exceeds the value of the benefits received in return; and
- 2) providing a good-faith estimate of the value of goods or services provided for the contribution.

The statement must be provided "in connection with the solicitation or receipt" of the quid pro quo contribution. An acknowledgment mailed out upon receipt of a contribution will suffice; waiting until the end of the year to provide the disclosure to all donors will not.

The disclosure statement is only required when the payment to the charity exceeds \$75. However, regardless of the amount of the donation, the donor's deduction is reduced by the value of any quid pro quo goods or services received -- a contributor of \$35 to a public radio station who receives a \$10 book is only entitled to a deduction of \$25. It is thus probably good practice to disclose the value of such benefits to all contributors, regardless of amount.

An organization's failure to make the required disclosures can result in penalties of \$10 per contribution, up to a maximum of \$5000 per fundraising event or mailing.

SUBSTANTIATION: CHARITABLE CONTRIBUTIONS OF \$250 OR MORE

Donors wishing to claim a charitable contribution deduction for a donation of \$250 or more must obtain from the charitable recipient "contemporaneous" written substantiation of the contribution.

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"Contemporaneous" means no later than the time of filing the return claiming the deduction. Although the legal obligation falls on the taxpayer, charities wishing to maintain good donor relations should be motivated to assist their supporters by providing adequate substantiation.

The substantiation must state the amount of any cash contribution, whereas donated property must be described, but need not be valued. The substantiation must further state whether any goods or services were provided in return for the contribution, and if so must provide a description and good faith estimate of the value of any such benefits. Moreover, if there were no quid pro quo benefits, the substantiation statement must affirmatively say so.

Even if a donor's total payments for the year exceed \$250, the substantiation requirement applies only to individual contributions of \$250 or more. Substantiation of multiple contributions in a single year can be combined in one statement, so long as it is provided before the due date for filing the return and adequately describes the total contributions.

Out-of-pocket volunteer expenses can qualify for a charitable deduction, but are subject to the substantiation requirement if an expense exceeds the \$250 threshold. The volunteer must maintain records to substantiate the amount of the expenses, and obtain a statement from the organization describing the services provided by the donor and indicating whether or not any goods or services were provided to the donor in return.

Contributions made by payroll deduction may be substantiated with a combination of a pay stub, W-2 or other document from the employer indicating the amount withheld for payment to the charity and a pledge card or other document from (or prepared at the direction of) the charity including a statement that no quid pro quo benefits were provided in return.

VALUATION ISSUES FOR BOTH DISCLOSURE AND SUBSTANTIATION

IRS regulations provide that a good faith estimate of value may be based upon any reasonable methodology. If the goods or services are not commercially available, the charity may look to similar or comparable goods or services, or add a reasonable mark-up over wholesale cost. In applying this standard, the value of intangibles such as celebrity presence need not be considered in identifying comparable services. However, fair market value is the price for which an item would change hands between a willing buyer and a willing seller; it is not the same as the cost to the organization. Donated items likely have a measurable value above zero, even though the charity paid nothing to acquire them. The Service has conceded that in some instances, such as a commemorative plaque or trophy, fair market value may actually be less than cost.

By statute, "intangible religious benefits" (such as admission to a religious service, but not including tuition at a religious school) may be treated as having no measurable value and thus

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disregarded in calculating the fair market value of benefits provided to contributors. A charity may also disregard certain benefits that are treated as having "insubstantial value."

Perhaps most intriguingly, certain benefits available to members paying \$75 or less for annual membership are treated as having a value of zero. So long as at least one class of members at the level of \$75 or less receives these benefits, the value is disregarded for all levels of membership. Included in this category are:

- rights or privileges that the member can exercise frequently during the membership period, such as discounted admission to the organization's facilities, gift shop discounts, or discounted rates on publications; and
- admission to events open to members only and which are projected to cost the organization less than the amount established for "low cost articles" (for 2016 the amount is \$10.60, indexed annually for inflation).

Other items treated as having insubstantial value are:

- token items costing less than the "low cost" limits (\$10.60 in 2016) provided in return for a payment of at least \$54.00 (also indexed annually for inflation);
- benefits whose fair market value (as distinct from cost to the organization) are less than 2% of the contribution amount up to a maximum of \$106 in 2016 (again, indexed for inflation); and
- newsletters that have the primary function of informing members about the organization's activities, so long as they are not available to nonmembers through paid subscription or newsstand sales (and so long as they are not "commercial quality publications" -- generally, those that accept advertising and have articles written for compensation).

Some unresolved questions include how to reach a good faith estimate of the value of discounts available only to members paying over \$75; what precisely qualifies as an "intangible religious benefit"; and how to properly value benefits provided to lifetime members.

The IRS has also determined that the value of the right to purchase tickets to college or university athletic events will be treated as being worth 20% of the amount that must be paid to receive such right.

Many donors may not realize that their deduction is reduced by the value of benefits (such as a meal) provided at a fundraising event even if they opt not to attend the event. The IRS considers the quid pro quo value to lie in the right to attend, regardless of whether the donor exercises the right. In order to maintain full deductibility, the donor must affirmatively refuse the benefit; merely failing to show up will not suffice. While the IRS has declined to provide specific

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guidance on how a benefit can be effectively refused, it seems that checking off a box on a reply card indicating that the donor will not attend the event for which s/he is paying would suffice.

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EXAMPLES OF LANGUAGE

There is no "magic language" required to include a substantiation and/or disclosure statement; charities are free to adopt any language they choose, so long as it contains all the necessary elements. Because substantiation must be provided after receipt of a contribution, and disclosure must be made in connection with its solicitation or receipt, both requirements can be met with a statement such as the following on a written receipt sent to donors:

Thank you for your generous donation of [amount] that we received on [date]. Because no goods or services were provided to you in return for your gift, the full amount is deductible as a charitable contribution for federal tax purposes. [**OR**] Goods or services valued at [x] were provided to you in connection with this donation; therefore [amount minus x] is deductible as a charitable contribution for federal tax purposes.

While this suggestion contains elements not required in every case, by including this or similar language on all receipts an organization can be sure it has met the legal requirements without making an individual evaluation of each case.

Q & A

Q: Our membership dues are \$35. We offer all members a coffee mug with our logo that costs us \$2.50, although equivalent mugs usually sell for \$8. What should we tell donors about deductibility?

A: Because the payment is less than \$75, the organization has no affirmative disclosure obligation. However, if you choose to say anything to members about deductibility, you must tell them that the deductible portion of their dues is \$8 less than the total paid (assuming that represents fair market value). Because the payment is less than \$53, you cannot take advantage of the "low cost items" exception.

Q: We offer a double-CD set worth \$35 to donors who contribute \$100. Since the deductible amount is less than \$75, do we need to make the disclosure statement?

A: Yes. The \$75 threshold applies to the amount of the payment, not the part of the payment deductible as a charitable contribution.

Q: A donor made three separate \$100 contributions during the past year and received nothing in return from us. What is our responsibility to this donor? Can he claim the deduction if we do not provide a receipt?

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A: Legally, the donor does not need the special substantiation statement, although he will need to retain some evidence that the contribution was made. Since each payment was under \$250, his canceled checks should suffice. Of course, if the donor requests a substantiation statement, the organization may be better off simply providing it even though it is not technically required.

Q: We have calculated that the value of the dinner served at our fundraising banquet is \$25 per person. If a donor buys an entire table for \$3000, she can invite nine friends and we will list her name in the program as a patron. What should we tell her about deductibility?

A: The benefits the donor has received are worth \$250 -- ten \$25 dinners. Although she did not consume the food herself, she benefited from it by being able to invite her friends. Being identified in the program is not a valuable benefit that reduces the deductibility of her payment. Therefore, the organization should give the donor a statement acknowledging receipt of \$3000 in exchange for ten tickets to the event worth a total of \$250, and advising her that \$2,750 is deductible.

Q: Our members pay at least \$300 annually. We provide them with a newsletter updating them about our activities, and a membership directory. What are our obligations?

A: The newsletter probably can be disregarded as having insubstantial value under the criteria outlined above. Valuing the membership directory is tricky, as it is probably difficult to identify a comparable item for sale. Lists of names are, of course, bought and sold by mail brokers, who could provide a source for estimating the fair market value of the directory. However, if the directory is provided for personal use only, the value from a commercial perspective would be severely limited. If restrictions are placed on the use of information in the membership directory sufficient to prevent any commercial use, there is probably a good argument to be made that it has no real market value and can therefore be disregarded. In any case, it is likely that the cost to the organization is less than \$10.20 per copy, so the directory can be treated as having insubstantial value under the "low cost" exception.

If all benefits provided can be disregarded, there is no quid pro quo situation, and the charity has no legal disclosure obligation. However, it should provide substantiation statements to its members indicating the amount paid and stating that no goods or services were provided in return.

Q: In return for a one-time payment of \$1000, we offer life members the opportunity to attend our annual fundraising banquet. Last year, the value of the meal served was \$10. What should we tell these people about deductibility?

A: There is no clear answer on this. The IRS response has simply been that the organization must adopt a reasonable methodology and apply it in good faith. One suggestion

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might be to multiply the value of the most recent dinner by the estimated life expectancy of the average life member. Of course, this is a very imprecise method, dependent upon a number of suppositions about the future and unverifiable estimates, but it may represent a good faith effort at compliance. In situations where there is this uncertainty, the organization should take care to document the basis for its estimate as best it can.

DISCLOSURE OF NON-DEDUCTIBILITY

Exempt organizations that are not eligible to receive charitable contributions (generally non-501(c)(3)s) must include in all fundraising solicitations an express statement that gifts to the organization are not deductible as charitable contributions. A fundraising solicitation includes any solicitation of contributions or gifts made in written or printed form or by television, radio, or telephone (excluding letters or telephone calls not part of a coordinated campaign soliciting more than 10 persons during a calendar year). Smaller organizations, with annual gross receipts that do not normally exceed \$100,000, are exempt from this requirement. Nonetheless, it is good practice to prevent your donors from claiming charitable deductions to which they are not entitled.

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