PERSPECTIVE

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Which is Better Tax-Wise, Selling or Giving to Charity?

By Robert W. Wood

This isn't a trick question, but it shows that the tax laws can sometimes give people unusual incentives. Classically, you are supposed to give to charity because you are generous and want to help others, out of detached and disinterested generosity. Yet it is hard to ignore the fact that the tax laws play a part. If you give $1,000 to a qualified charity, you get a tax deduction. So, if you are in a combined 50% tax bracket considering federal and state taxes, that $1,000 donation really only costs you $500.

Are there ways to ratchet up the tax benefits you get, so you might even be more charitably inclined? You bet, but there are plenty of guard rails too. For example, let's start with the quicksand of quid pro quo donations. The tax law is clear that you cannot write off a charitable contribution if it *wasn't* really a charitable contribution. Charitable contributions by real estate developers are one classic context in which this quid pro quo issue can arise.

When faced with a big tax write-off for a "donation," the IRS may try to sniff out suspect motives. If so-called "gifts" to charity are actually more like business deals in which one item is exchanged for some other item of value, the deduction may be denied. How does the IRS determine if a purported gift is really a transfer for value, rather than being purely motivated by charity?

Consider the donor's business and whether other property is benefited. If you donate a city park in exchange for the rights to build a skyscraper, was that really a charitable contribution of the park land to the city? The quid pro quo problem can arise with a charitable contribution for something in return now, or a promised benefit in the future. Conservation easements are another area ripe for the quid pro quo issue to come up.

Conveying an asset to a charitable organization as part of a deal or arrangement to get something back from the organization may taint the contribution. One way a donation might not qualify for a tax deduction is if you are paying for services, expecting something back in return. How about "donating" to a school or college where your child happens to attend, instead of paying "tuition?" You get the idea, the IRS can and does just say no.

And yet there are plenty of donations that qualify for a tax deduction, maybe even a whopping one, that seem to involve special benefits. Not long ago, after reportedly not being able to sell his DC area mansion, former NFL owner Dan Snyder donated his $35 million mansion to charity. That's a nice tax write-off, and it created some talk about this unusual strategy. There was more talk when it developed that the American Cancer Society that received the mega-house was selling it two months later.

Of course, the idea of donating appreciated property to charity is hardly a new tax strategy. In fact, on a smaller scale, many people do this with real estate and many other kinds of property. Just think of Warren Buffett, a famously savvy taxpayer, who wisely likes to donate highly appreciated stock to charity. Here are some of the key tax rules that govern these contributions.

The big benefit of charitable contributions in kind is claiming the fair market value of the property as a deduction, *plus* not having to pay capital gain tax on all the appreciation. If you have held your property for over a year, you should have long term capital gain if you sell. It's the same concept with something that is usually very easy to sell, stock in a public company.

Tax Deduction Plus No Capital Gain Tax

Let's say you bought something for $100,000. It could be stock in Amazon or Apple, stock in a private company, or it could even be your home or other real estate. Let's say it's worth $1M today. You can sell it, and pay capital gain tax on the $900,000 gain, although if it was your primary residence, you might qualify to exclude up to $500,000 of your gain on a joint tax return.

Rather than paying tax on your up to $900,000 gain, what if you donate it to a qualified public charity instead? You can write off the whole $1M. But exactly *when* you get the entire tax benefit depends on your income, as there are percentage limits on how much of a deduction you can claim in any one year. The primary rule is that you can only take a deduction of up to 60% of your adjusted gross income for most charitable contributions.

But there are exceptions, and you may be subject to a 30% limit. What if your income isn't high enough to claim all your deduction in the year of the donation? All is not lost. You can use the rest of your deduction the next year, or the next. You have five years to use up your deduction.

A key issue, not surprisingly, is valuation. Amazon or Apple stock presents no problem, but how about real estate? Or Art? If it is real estate and you were having trouble selling, is your listing price really the fair market value? You'll need a qualified appraisal, a term defined in the tax law that is discussed below.

Of course, any time you make a donation, it is important to make sure that your chosen organization is qualified. Seinfeld fans may remember an episode called the ''The Truth,'' which aired Sept. 25, 1991. The IRS questioned Jerry about a $50 charitable contribution to rescue the people of Krakatoa. The IRS normally doesn't require extra substantiation of charitable donations less than $250, so Jerry's check or bank statement should have sufficed. But when the charity turns out to be fake, Jerry says the IRS is "like the mafia. They can take anything they want."

You can't deduct contributions to individuals, political organizations or candidates. Verify the tax status of the organization by asking the charity for their IRS exemption letter or checking with the IRS. The IRS maintains a list of all charities. To check whether particular organizations are on the IRS list, Search for Charities or you can also check our IRS Publication 78, Cumulative List of Organizations.

Donations of stock or other property are usually valued at fair market value. But there are special rules for donations of vehicles. Clothing and household items must generally be in good used condition or better to be deductible. Cash contributions of $250 and up must be supported by even more. Here, you'll also need a statement by the charity showing whether the charity provided any goods or services in exchange for the gift. If you make a property contribution worth $250 or more, you must also retain a statement by the charity, describing the property and its value.

Get a Qualified Appraisal

If your noncash contributions for the year total over $500, you must complete IRS Form 8283, Noncash Charitable Contributions, and attach it to your tax return. IRS Form 8283, Noncash Charitable Contributions is important, as are the Instructions to this form. If you donate an item (or a group of similar items) worth more than $5,000, you must also complete Section B of Form 8283, which requires an appraisal by a qualified appraiser. A "qualified appraiser" must meet IRS criteria, so allow time for these formalities.

What if the Charity Sells It?

Suppose that you donate real estate to charity you say is worth $1M, and you include your qualified appraisal form with your tax return. All is good, right? Well, what if the charity turns around a short time later and sells the real estate for $500,000. Might the IRS say, hey wait a minute, that was not worth $1M? The IRS has thought of this one.

In fact, if an organization receives charitable deduction property and within 3 years sells, exchanges, or disposes of the property, the organization must file an IRS Form 8282, Donee Information Return. An organization is not required to file Form 8282 if the property is valued at $500 or less, or if the property is distributed for charitable purposes. Form 8282 must be filed within 125 days after the disposition. A copy of Form 8282 must be given to the previous donor, too. If the organization fails to file the required information return, penalties may apply.

There are many other rules governing charitable contributions. For example, you can't deduct the value of your time or your services. This is so even if you bill by the hour and donate many hours of otherwise billable time to charity. If your donations entitle you to merchandise, goods or services, you can only deduct the amount *exceeding* the fair market value of the benefits you received. So, if you pay $500 for a charity dinner ticket but receive a dinner worth $100, you can deduct $400, not the full $500.

The IRS has helpful materials explaining the charitable contribution rules in IRS Publication 526, Charitable Contributions. If you want the IRS's take on valuation issues and how to value noncash items, see IRS Publication 561.

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