Valuation Reporting Requirements for Charitable Contribution Tax Deductions

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This discussion summarizes what the valuation analyst, tax counsel, and taxpayer need to know with respect to the valuation reporting requirements for charitable contribution income tax deductions. This discussion specifically focuses on the charitable contribution income tax valuation reporting requirements related to the noncash contribution of private company stock.

Charitable Contribution Income Tax Deduction Overview

Affluent households, that is, households with a net worth of $1 million or more (excluding the value of their personal residence) and/or annual household income of $200,000 or more, provide the largest share of charitable donations in the United States. In 2020, 88.1 percent of affluent households gave to charity, as compared with only 48.4 percent of the general population.

Affluent households on average gave $43,195 to charity in 2020 as compared to the general population of $2,581. About 59 percent of affluent donors reported that giving was motivated in part by the income tax benefit; whereas, about 41 percent reported that giving was never a motivation to their charitable philanthropy.[1]

The majority of affluent households (79.1 percent) gave directly to charity in 2020 from their personal assets and income; whereas, one in five (20.1 percent) gave to charity through a charitable trust, donor-advised fund, family foundation, or other charitable giving vehicle.

Approximately 7.4 percent of the affluent donors in the survey noted that either a family-owned business or a company that they started were the source of their net worth.[2]

One avenue for making a charitable contribution to a qualified charity, charitable trust, donor-advised fund, family foundation, or other charitable giving vehicle is to contribute shares of a private company rather than giving cash alone. The shares of the private company may be equally valuable to that of the cash the taxpayer may be interested in giving to charity, but if the stock has a lower cost basis, the after-sale net proceeds would be lower than if the taxpayer had simply transferred the appreciated private company shares.

The charity would then be able to liquidate the private company stock (e.g., a redemption by the private company) without incurring the same taxation that the taxpayer would otherwise be required to pay.

Many affluent households use private company stock to make annual charitable gifts. However, this type of asset is considered to be a noncash charitable contribution that requires additional documentation by the Internal Revenue Service (the “Service”).

Unlike publicly traded stock, an independent valuation is required by the Internal Revenue Code (the “Code”) to secure a charitable tax deduction from the private company stock charitable gift.

If documented properly, and in most instances, an income tax deduction of the fair market value of the private company stock would apply to the

taxpayers' adjusted gross income ("AGI"). In general, contributions to charitable organizations may be deducted up to 50 percent of AGI (computed without regard to net operating loss carrybacks). Contributions to certain private foundations, veteran organizations, fraternal societies, and cemetery organizations are limited to 30 percent of AGI (computed without regard to net operating loss carrybacks).[3]

From time to time, the Service encourages more charitable giving by temporarily suspending the limits on charitable contribution deductions, such as was the case in 2020 and 2021 where deductions were adjusted to 100 percent of AGI for those tax years.

The purpose of this discussion is to present (1) the valuation reporting requirements under the Code for noncash charitable contribution deductions, (2) the valuation professional organization ("VPO") standards that apply directly to charitable income tax reporting compliance, and (3) the valuation analyst ("analyst") and taxpayer penalties that may apply for both substantial and gross valuation misstatements for charitable contributions.

Charitable Contribution Income Tax Deduction Requirements

According to the Section 170(a)(1), noncash charitable contributions to qualified organizations are deductible by individuals and corporations for income tax reporting purposes.

The analyst, tax counsel, and taxpayer should be aware of and comply with the specific valuation reporting requirements for noncash charitable income tax deductions, which are different than those that apply for estate and gift tax valuation reporting purposes under the Code.

To claim any deduction for any charitable contribution of $250 or more in value,[4] the taxpayer needs to substantiate the gift with a contemporaneous written acknowledgement of the charitable contribution with the following information:[5]

1. The amount of cash and a description (but not value) of any property other than cash contributed
2. Whether the donee organization provided any goods or services in consideration, in whole or in part, for any property described in one above
3. A description and good faith estimate of the value of any goods or services referred to in number two above or, if such goods or services consist solely of intangible religious benefits, a statement to that effect

To claim a charitable deduction of more than $5,000 under Section 170(f)(11)(C), the taxpayer must obtain a qualified appraisal report for the donated property and attach that appraisal report with Form 8283 to claim an income tax deduction.

According to Section 170(f)(11)(D), no charitable contribution deduction is allowed for charitable gifts by an individual or corporation for which a deduction of more than $500,000 is claimed unless the taxpayer attaches a qualified appraisal of the property to his or her income tax return.

Form 8283 should also be signed by the qualified appraiser responsible for the qualified appraisal of the donated property.

For noncash charitable gifts that (1) do not have a market quotation that is readily available or (2) are certain exempt assets (such as certain annuity contracts), the value of noncash charitable gifts is appraised under the "fair market value" standard of value.

Fair market value is defined as the price that property would sell for in the open market. That is, the price at which property would change hands between a willing buyer and a willing seller, with neither being required to act, and both having reasonable knowledge of the relevant facts.

If the donor imposes a restriction on the use of property donated, then the fair market value should reflect that restriction.[6]

Furthermore, noncash charitable income tax gifts are limited to the net amount contributed to charity. That is, noncash charitable contributions are determined as the difference between (1) the fair market value of the charitable gift and (2) the fair market value of anything received in return.

Qualified Appraisals for Noncash Charitable Income Tax Deductions

According to Section 170(f)(11)(E)(i), the term qualified appraisal means an appraisal that is conducted by a qualified appraiser and in accordance with generally accepted appraisal standards.

The definition for a qualified appraiser is defined under Section 170(f)(11)(E)(ii) as an individual who: (1) has earned an appraisal designation from a recognized VPO or has otherwise met minimum education and experience requirements outlined in regulations prescribed by the Service, (2) regularly performs appraisals for which the individual receives compensation, and (3) meets such other

requirements as may be prescribed by the Service in regulations or other guidance.

In addition, an appraiser is not considered to be qualified unless (1) he or she demonstrates verifiable education and experience in valuing the type of property valued and (2) he or she has not been prohibited from practicing before the Service by the Secretary under Section 330(c) at any time during the three-year period ending on the date of the donated property valuation.

The following individuals cannot be a qualified appraiser with respect to the donated property:[7]

1. The donor of the property or the taxpayer who claims the deduction.
2. The donee of the property.
3. A party to the transaction in which the donor acquired the property being appraised, unless the property is donated within two months of the date of acquisition and its appraised value is not more than its acquisition price. This requirement applies to the person who sold, exchanged, or gave the property to the donor, or any person who acted as an agent for the transferor or donor in the transaction.
4. Any person employed by any of the above persons. For example, if the donor acquired a painting from an art dealer, neither the dealer nor persons employed by the dealer can be qualified appraisers for that painting.
5. Any person related under Section 267(b) to any of the above persons or married to a person related under Section 267(b) to any of the above persons.
6. An appraiser who appraises regularly for a person in requirements 1, 2, or 3 above, and who does not perform a majority of his or her appraisals made during his or her tax year for other persons.
7. An individual who receives a prohibited appraisal fee for the appraisal of the donated property.
8. An individual who is prohibited from practicing before the Service under Section 330(c) at any time during the three-year period ending on the date the appraisal is signed by the individual.

In addition, an individual is not a qualified appraiser for a particular donation if the donor had knowledge of facts that would cause a reasonable person to expect the appraiser to falsely overstate the value of the donated property.

For example, if the donor and the appraiser make an agreement concerning the amount at which the property will be valued, and the donor knows that amount is more than the fair market value of the property, the appraiser is not a qualified appraiser for the donation.

Generally accepted appraisal standards are defined in Section 170(a)(17)(a)(2) as the substance and principles of the *Uniform Standards of Professional Appraisal Practice*, as developed by the Appraisal Standards Board of the Appraisal Foundation.

The minimum information requirements outlined in Section 170(a)(17)(a)(3) for a qualified appraisal include the following:

1. **Description of Donated Property**. Every appraisal report should include in sufficient detail a description of key aspects of the donated property; this includes the relevant characteristics of the donated property that are relevant to the type and definition of value as well as key aspects that were relevant for determining the selected valuation method.
2. **Physical Condition of the Tangible Property**. If the donated property being valued is real property or tangible personal property then the appraiser should include details of the physical condition of the property in the appraisal report.
3. **Date of the Charitable Contribution**. The date (or the expected date) of the charitable contribution should be included by the appraiser in the appraisal report.
4. **Terms and Agreements of Charitable Donations**. The terms of any agreement entered into that relates to the use, sale, or other disposition of the property donated should be included by the appraiser in the appraisal report.

   This description should include (a) temporary or permanent restrictions on the donee's right to use or dispose of the donated property, (b) earmarks for the specific use of the donated property, or (c) reserves to, or confers upon, anyone (other than a donee organization or an organization participating with a donee organization in cooperative fundraising) any right to the income from the donated property or to the possession of the property, including the right to vote donated securities, to acquire the property by purchase or otherwise, or to designate the person having the income, possession, or right to acquire the property.

5. **Appraiser's Identification**. The name, address, and taxpayer identification number of the qualified appraiser's firm Federal Employment Identification Number, if conducted on behalf of the firm, or if the valuation is conducted individually, the appraiser's social security number should be included in the appraisal report.
6. **Appraiser's Qualifications**. The qualifications of the appraiser who conducts the valuation should be included in the valuation report. This would include the appraiser's work experience, education, and any professional memberships to any appraisal associations.
7. **Appraiser's Signature and Date**. The appraiser must also sign the report and express the date the appraisal was signed.
8. **Appraiser's Declaration**. An appraisal report performed in connection with a noncash charitable contribution should include the following disclosure:

   > I understand that my appraisal will be used in connection with a return or claim for refund. I also understand that, if there is a substantial or gross valuation misstatement of the value of the property claimed on the return or claim for refund that is based on my appraisal, I may be subject to a penalty under Section 6695A, as well as other applicable penalties. I affirm that I have not been at any time in the three-year period ending on the date of the appraisal barred from presenting evidence or testimony before the Department of the Treasury or the Internal Revenue Service pursuant to Section 330(c).

9. **Appraisal Statement**. A statement that the appraisal was prepared for income tax purposes should be included.
10. **Valuation Date**. The date that the donated property was valued should also be included by the appraiser in the appraisal report. Additionally, an appraiser may also define the date of the valuation as both (a) the "valuation date" and (b) the "effective date of contribution."
11. **Valuation Approaches**. The valuation approaches applied to estimate the fair market value of the donated property should be included by the appraiser in the appraisal report. Generally, the valuation approaches would include an income approach, a market approach, or an asset-based approach. The fair market value of the donated property as of the date valued should be included by the appraiser in the appraisal report.
12. **Basis of the Valuation**. The specific basis for the valuation, such as any specific comparable sales transactions, should be included by the appraiser in the appraisal report.[8]

Additionally, according to Section 170(a)(13)(3), a qualified appraisal should:

1. be prepared, signed, and dated by the appraiser;
2. meet the relevant information requirements of Section 170(a)(17)(a);
3. be dated no earlier than 60 days before the date of the contribution and no later than the date of the contribution; and
4. not involve a prohibited appraisal fee.

A prohibited appraisal fee is a fee arrangement for an appraiser that is based on a percentage of the appraised value of the property.

For property with a value of $5,000 or more contributed to charity with the intent of the taxpayer to take a charitable income tax deduction, the appraiser must complete the Declaration of Appraiser section on Form 8283 to be filed with the taxpayers tax returns.

More than one appraiser may value the property, provided that each complies with the requirements, including signing the qualified appraisal and the Declaration of Appraiser section on Form 8283.[9]

The appraiser should understand the purpose of the appraisal assignment and articulate it clearly in the appraisal report that it will be used for charitable income tax reporting purposes.

An appraiser who fails to accurately define the assignment in the appraisal report and include the items listed above can risk having the appraisal disregarded for income tax purposes and potentially incur penalties under Section 6695A if the value indication results in a valuation misstatement.

As described below, both the appraiser and the taxpayer may be subject to penalties as stated under Section 6695A for both substantial and gross valuation misrepresentation.

Potential Appraiser Penalties

As stated in Section 6695A, an appraiser who prepares an incorrect appraisal report may be required to pay a penalty if the appraiser knows or reasonably should have known that the appraisal would be

used in connection with a return or claim for refund that resulted in a valuation misstatement of the donated property.

The penalty imposed on the appraiser under Section 6695A is equal to the greater of $1,000 or 10 percent of the amount of tax attributable to the substantial or gross valuation misstatement, up to a maximum of 125 percent of the gross income received by the analyst.

Additionally, the appraiser who falsely or fraudulently overstates the value of property on Form 8283 that the appraiser has signed may be subject to a civil penalty for aiding and abetting and may have the appraisal disregarded by the tax courts.

The appraiser may also be prohibited from submitting another appraisal report to be used by a taxpayer for up to three years.

Potential Taxpayer Penalties

According to Section 6662, taxpayers may be subject to accuracy-related penalties for both "substantial" and "gross" valuation misstatements of donated property.

Section 6662 defines a substantial valuation misstatement as when the value of the donated property claimed is 150 percent or more of the amount determined to be the correct value of such property. The penalty to the donor in the case of a substantial valuation misstatement is equal to 20 percent of the correct value determined.

Similarly, a gross valuation misstatement is when the value of the donated property claimed is 200 percent or more of the amount determined to be the correct value of such property. In this case, the penalty to the donor of a gross valuation misstatement is equal to 40 percent of the correct value determined by the Service.

These penalties do not apply to the donor if (1) the claimed value of the property was based on a qualified appraisal written by a qualified appraiser and (2) the taxpayer made a good-faith investigation of the value of the donated property.

An appraisal is not a qualified appraisal for a particular contribution if the donor either failed to disclose or misrepresented facts and a reasonable person would expect that this failure or misrepresentation would cause the appraiser to misstate the value of the contributed property.

Summary and Conclusion

The requirements outlined in Section 170(f)(11) provides the valuation requirements for reporting noncash charitable contribution deductions.

The appraiser and the taxpayer that fail to follow the aforementioned requirements, as outlined in the Code, may be subject to both financial and civil penalties by the Service and/or the courts. The appraiser(s) responsible for a valuation misstatement may have the appraisal disregarded and be subject to penalties under Section 6695A.

Similarly, a taxpayer responsible for a valuation misstatement may also incur penalties under Section 6662. However, the taxpayer is protected to the extent that the valuation misstatement is attributable to an error by the appraiser.

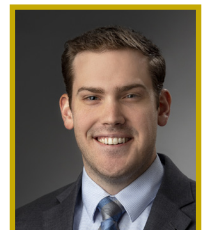
A taxpayer's filing to the Service for a charitable contribution deduction necessitates a complex documentation process, which includes (1) the contemporaneous acknowledgement of the contributed property, (2) a qualified appraisal issued by a qualified appraiser, and (3) a completed Form 8283 signed by both the qualified appraiser(s) and the taxpayer.

The appraiser, taxpayer, and tax counsel should understand the procedural steps and requirements necessary to support the value of the contributed property. Doing so will ensure that the charitable intent of the taxpayer is accomplished without unnecessary hardship.

We make a living by what we get, but we make a life by what we give. – Sir Winston Churchill

Notes:

1. The 2021 Bank of America Study of Philanthropy: Charitable Giving by Affluent Households, Indiana University Lilly Family School of Philanthropy, September 2021.
2. Ibid.
3. https://www.irs.gov/charities-non-profits/charitable-organizations/charitable-contribution-deductions
4. Section 170(8)(A).
5. Section 170(8)(B).
6. Publication 561 (01/2022), Determining the Value of Donated Property, irs.gov, revised January 2022, https://www.irs.gov/publications/p561#en_US_202109_publink1000257999.
7. Ibid.
8. Ibid.
9. Ibid.



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