



Client Alert: Congress Clamps Down on Car Donation Programs

January 1, 2005

Does your charity accept donated cars? Congress just changed the rules for donors who donate vehicles to charity, shifting the burden of valuation to the charity and potentially lowering the charitable deduction the donor can actually take. Starting January 1, 2005, the charitable deduction a donor may take for donating a used vehicle that will be resold by the charity will be limited to the charity's actual proceeds from the sale. The legislation also sets forth specific requirements for the contents of charities' written acknowledgments of such donations, which vary depending on the charity's use of the donated vehicle.

The changes were intended to address increasing concern among lawmakers, the IRS and state Attorneys General regarding potential abuses of car donation programs. In particular, lawmakers and regulators have been increasingly concerned that donors, sometimes encouraged by charities or their agents, were inflating the value of donated vehicles for charitable deduction purposes. While the new legislation creates a bright-line rule for valuing certain donated vehicles, it also lowers the deduction most donors could take.

Current Law

Under current law, a person who donates a used car, boat or airplane to a charity may deduct the fair market value of the donated vehicle from their individual income taxes as a charitable contribution. For vehicles with a value of greater than \$250 but less than \$5,000, the donor must have a contemporaneous written acknowledgement of the donation that provides certain basic information about the vehicle donated, the date of the donation, and the name of the charity. To be "contemporaneous" the written substantiation must generally be obtained by the donor no later than the date the donor actually files a return for the year the contribution is made.

Importantly, under current law the acknowledgment need not contain an estimate or other statement by the charity of the value of the donated vehicle. Instead, donors are responsible for determining the fair market value of the donated vehicle, taking into account the age, make and condition of the vehicle, and must document the basis for their determination. For donations of items with a value of \$5,000 or greater, current law requires the donor to obtain a qualified appraisal of the vehicle in order to deduct the contribution.

These rules apply whether the charity subsequently uses the vehicle in pursuit of its charitable purposes or resells the vehicle for fundraising purposes.

New Provisions

Section 884 of the American Jobs Creation Act of 2004 changes these rules for vehicles donated to charities after December 31, 2004, that have a value of \$500 or more. To take a charitable contribution deduction the donor must substantiate the donation by a contemporaneous written acknowledgment from the recipient charity that meets certain new requirements. The content and timing of the acknowledgment will be different depending on whether the charity simply resells it with no or little improvement, materially improves the vehicle before reselling it, or uses the vehicle for its own charitable purposes. Each of these variables is discussed in turn below.

If the charity resells the donated vehicle with little or no improvements or repairs, the written acknowledgment of the donation must be provided within 30 days of the date of sale and include (1) the donor's name and taxpayer identification number (usually a social security number); (2) the vehicle identification or similar number; (3) a certification that the vehicle was sold in an arm's length transaction between unrelated parties; (4) the gross proceeds from the sale; and (5) a statement that the deductible amount may not exceed the amount of such gross proceeds. Congress stated in its conference committee report that if a charity cleans the vehicle, makes minor repairs or conducts routine maintenance, these rules would apply.

If the charity makes material improvements to the vehicle before selling it, the written acknowledgment of the donation must be provided within 30 days of the date of donation and include (1) the donor's name and taxpayer identification number (usually a social security number); (2) the vehicle identification or similar number; (3) a certification of the intended material improvement of the vehicle; and (4) a certification that the vehicle will not be sold before completion of such improvements are made. The acknowledgement need not contain any information about the value of the vehicle. Instead, current law would continue to apply, which requires the donor to make a good faith determination of the value of the vehicle at the time of donation taking into account its age and condition, and to document the basis for the donor's determination. The conference committee report states that Congress intends "material improvements" to include major or other repairs to a vehicle that improve the vehicle in a manner that it significantly increases the vehicle's value.

If the charity will instead make "significant" use of the vehicle in the conduct of its charitable activities, the acknowledgment must be provided within 30 days of the donation and must include (1) the donor's name and taxpayer identification number (usually a social security number); (2) the vehicle identification or similar number; (3) a certification of the intended use of the vehicle and intended duration of such use; and (4) a certification that the vehicle will not be sold before the completion of such use. The conference committee report indicates that in order to claim "significant use," the charity must actually use the vehicle to substantially further its regularly conducted activities and the use must be significant. The report cites as examples daily use of a vehicle to deliver meals to the needy over the course of one year to be significant,



while use amounting to only several hundred miles to not be significant. For these donors, current law will continue to apply, which requires that they make a good faith determination of the fair market value of the vehicle taking into account its age and condition, and document the basis of their determination.

Charities will be required to provide the information for donor acknowledgements to the IRS upon request, so should ensure that they maintain adequate records of each donation to comply with this requirement. For donations of vehicles with a value of \$5,000 or more, the requirement that a donor obtain a qualified appraisal continues to apply. The legislation also added penalties for knowingly furnishing false or fraudulent acknowledgements and for knowingly failing to furnish required acknowledgments. Also, the IRS is given the authority to issue regulations or other guidance to clarify and implement the new rules. One such clarification could be to exempt certain donations to charities that will be used in furtherance of the charity's exempt purposes rather than sold for fundraising purposes. The IRS has not stated whether it will exercise this authority.

For more information contact: Sarah Duniway (612) 632-3055 or Jennifer Reedstrom Bishop (612) 632-3060.

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