

Tax Rules for Deducting Donations

Bischoff: The IRS can deny deductions -- and even impose a steep fine -- if you don't follow the rules.

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THE TAX GUY

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If you make a donation worth \$250 or more to an IRS-approved charity, you must receive a qualified "contemporaneous written acknowledgement" from the charity to claim a charitable deduction. If you don't get a qualified acknowledgement, you cannot legitimately claim a deduction even if your donation was worth millions. Here's what you need to know to avoid this fate.

Qualified Acknowledgement Basics

A qualified acknowledgement generally must include the following three items of information: (1) the amount of cash that you donated and a description (but not the value) of any assets other than cash that were donated; (2) whether the charity provided you with any goods or services in exchange for the donation (other than intangible religious benefits); and (3) a description and good-faith estimate of the value of any goods or services provided by the charity in exchange for your donation. If your acknowledgement doesn't supply this information, it is not a qualified acknowledgement, and your deduction goes bye-bye.

According to the tax law, an acknowledgement is considered to be contemporaneous if you obtain it on or before the earlier of: (1) the date when you file your Form 1040 for the year you made the donation or (2) the due date (including any extension) for filing that return. If you don't have a qualified acknowledgement in hand by the applicable magic date, your charitable deduction goes bye-bye.

These qualified acknowledgement rules are statutory requirements enacted by Congress, rather than more-debatable requirements issued by the IRS. Even so, it may seem unreasonably harsh to permit the IRS to completely disallow charitable write-offs for folks who fail to obtain qualified acknowledgements. Unfortunately, the Tax Court recently confirmed that the IRS can indeed do just that. (Source: Marshall Cohan, TC Memo 2012-8 (2012).)

Recent Tax Court Decision Confirms IRS Can Impose Harsh Punishment

In the Tax Court case, the taxpayers transferred to a charity rights of first refusal to purchase valuable property on Martha's Vineyard for a bargain price. In exchange, the taxpayers received certain assets from the charity including cash, real property, leases and beach rights. The assets received by the taxpayers were purportedly worth less than the rights transferred to the charity. Therefore, the transaction resulted in a partial sale of the rights for proceeds equal to the value of the assets received from the charity and a partial charitable donation of the rights. The donation part was worth about \$2

million (the difference between the value of the rights transferred to the charity and the value of the assets received from the charity). So far, so good. However, the written acknowledgement provided by the charity did not include a complete list of the assets that were received by the taxpayers.

After conducting an audit, the IRS denied the entire \$2 million charitable donation deduction on the grounds that the charity's acknowledgement did not provide said complete list. This omission resulted in understating the taxpayers' gain on the sale part of the transaction (the IRS claimed the taxpayers should have reported about a \$15 million gain instead of the \$9 million gain they actually reported). The unhappy taxpayers disagreed and took their case to the Tax Court.

The Tax Court ruled that the IRS was justified in completely denying the charitable deduction due to a lack of any credible explanation for omitting some of the assets received by the taxpayers from the charity's acknowledgment and a belief that the assets were deliberately omitted to allow the taxpayers to calculate a smaller gain on the sale part of the transaction.

The Tax Court also sustained the government's assessment of a 20% negligence penalty on the disallowed \$2 million charitable donation deduction. Ouch!

The Bottom Line

The requirement that you must receive a qualified contemporaneous written acknowledgement to claim a charitable deduction for a donation worth \$250 or more is absolute unless you have some credible excuse for failing to follow the rules. Because there's so little margin for error here, I recommend contacting your tax adviser before making any really big donations. Better safe than sorry.