CHARITABLE CONTRIBUTIONS OF HORSES - 2005

By B. Paul Husband

For many years, charitable contribution deductions have been available to horsemen for contributions of horses to appropriate charities, subject to certain limitations and requirements concerning record keeping, substantiation and valuation. The possibility of such charitable contribution deductions continues, although the American Jobs Creation Act of 2004 added a few additional burdens to taxpayers in order to take these deductions, and, gave the IRS express authority to add other requirements as they may see fit.

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These additional restrictions were not generated in response to any abuse by the horse community, but rather is a part of the "ripple effect" caused by the response of government to perceptions of abuses in connection with overstated charitable contribution deductions based on donations of used cars and trucks and intellectual property.

Doubtless, the vast majority of Americans have heard numerous radio commercials by various charities asking for donations of used cars which give the impression that if one has a used car, even if it has an expired license, no tires, a cracked engine block and massive body damage, that nonetheless if you will agree to donate your car to the "Bake a Fish" charity, you can take a charitable contribution deduction in an amount equal to the high retail Kelly Bluebook value. The charity picks up the car, sells it for parts, to a junkyard, or some other auction for, say, $1,000, the towing and wrecking company take their regular charges, the balance of these proceeds, say $300 to $350 goes to the "Bake a Fish" charity. Meanwhile, the donor takes a $4,500 charitable contribution deduction on his federal income tax return. The IRS did not like the public coffer losing money due to overvalued claims. Nor should they have. Charitable contribution deductions are permitted under the public policy of encouraging contributions to worthy charities. However, some charities were essentially encouraging potential-donor taxpayers to cheat the government by claiming inflated values to the property that they had contributed.

Actually, under the law prior to the American Jobs Creation Act of 2004, deductions of inflated amounts could have been disallowed, but the enforcement problem was enormous. The GAO estimated that for tax year 2000, there were 733,000 tax returns showing a tax deduction for a vehicle donation. Even before Congress took action in the American Jobs Creation Act of 2004, the IRS tried to warn the public concerning this problem. Internal Revenue News Release IR-2003-139, was published on December 15, 2003. In it, the IRS issued a "consumer alert" to help taxpayers avoid reduction or disallowance of overstated charitable contribution deductions in connection with the contribution of used cars. Members of Congress also saw the problem and enacted substantial portions of the American Jobs Creation Act of 2004 to directly address charitable contributions of property. Some of this new legislation specifically addresses deductions of cars, trucks, boats and airplanes. However, some aspects of the American Jobs Creation Act of 2004 address charitable contributions of property more generally, and therefore directly affect charitable contributions of horses. These additional burdens are, at present, relatively minor. However, the American Jobs Creation Act of 2004 also expressly authorized the Secretary of the Treasury (the IRS is a branch of the Treasury) to enact additional regulations and requirements in the future to regulate and limit charitable contributions of property.

Continued on page 4...

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Continued from page 3

The additional burden at present amounts to three items:

1. Under the newly added Internal Revenue Code § 170(f)(11), added by the American Jobs Creation Act of 2004, charitable contribution deductions would be denied to any individual, partnership or corporation that fails to meet specific appraisal and documentation requirements. These requirements now specifically include the obligation to provide whatever information about the contributed property and/or about the appraisal of the property that the IRS prescribes by regulations. The denials of deductions concerning partnerships and S corporations will be applied at the partner/shareholder level.

2. If a charitable contribution is valued at $500,000 or more, then the "qualified appraisal" must be attached to the taxpayer's tax return when filed. Under prior law, the "qualified appraisal" would have to be made, and kept by the taxpayer, but not filed with the return.

3. C corporations must now obtain qualified appraisals of property which exceeds $5,000 in value, upon which charitable contribution deductions are based.

This new requirement for C corporations simply places C corporations in the same position as individuals, partnerships and S corporations under prior law.

The additional requirement to file the qualified appraisal with a return for charitable contributions in excess of $500,000 is not much of an additional burden either, since under prior law the qualified appraisal would have had to have been prepared and kept by the taxpayer, but not necessarily attached to the taxpayer's return. Rather, it is the express delegation of authority to the IRS to promulgate additional regulations which may well result in the most significant additional burden(s) to taxpayers.

For charitable contributions between $5,000 and $500,000, generally the requirements are the same as under prior law. Please see the sidebar for a recap of these requirements.

Reasonably understandable discussion of certain aspects of United States Federal Income Tax law is difficult because of the extremely confusing language which is utilized by the people who draft the Internal Revenue Code and Treasury regulations. The area of charitable contribution deductions is a classic example of this problem.

With charitable contributions, the Internal Revenue Code and the regulations in a sense are written "in reverse". That is to say, instead of saying what is allowed, such as: "charitable contribution deductions for contributions of tangible personal property which is used by the charity in connection with its charitable purpose, may be taken in an amount equal to the amount of long term capital gain income which would have been reported by the taxpayer if the taxpayer had sold the property for its fair market value on the date of the contribution". Such a formulation would be reasonably understandable, however, the Internal Revenue Code gives a vague general rule, followed by convoluted "reductions". Internal Revenue Code Section 170(e) states the concept as follows:

> "GENERAL RULE. – The amount of any charitable contribution of property otherwise taken into account under this section shall be **reduced by** the sum of –
> (A) The amount of gain which would not have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair-market value (determined at the time of contribution) and
> (B) In the case of a charitable contribution –
> (i) a tangible personal property, if the use by the donee is unrelated to the purpose or function constituting the basis for its exemption under § 501 (or, in the case of a governmental unit, to any purpose or function described in subsection (c),
> (ii) to or for the use of a private foundation (as defined in § 509(a), other than a private foundation described in (b)(1)(E), or
> (iii) of any patent copyright (other than a copyright described in section 1221(a)(3) or 1231(b)(1)(C)0, trademark, trade name, trade secret, know-how, software (other than so ftware described in section 197(e)(3)(A)(i)), or similar property, or applications or registrations of such property, the amount of gain which would have been long-term capital gain if the property contributed had been

Continued on page 5...

Continued from page 4

> sold by the taxpayer at its fair market value (determined at the time of such contribution).
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> For purposes of applying this paragraph (other than in the case of gain to which section 617(d)(1), 1245(a), 1250(a), 1252(a), or 1254(a) applies), property which is property used in the trade or business (as defined in section 1231(b)) shall be treated as a capital asset. For purposes of applying this paragraph in the case of a charitable contribution of stock in an S corporation, rules similar to the rules of section 751 shall apply in determining whether gain on such stock would have been long-term capital gain if such stock were sold by the taxpayer. For purposes of this paragraph, the determination of whether property is a capital asset shall be made without regard to the exception contained in section 1221(a)(3)(C) for basis determined under section 1022." [emphasis on "reduced by" was added].

It is difficult to write tax statutes and regulations. Nonetheless, the convoluted nature of the drafting contributes substantially to the difficulty taxpayers and their professionals have in complying with such badly written law.

In sum, check the sidebar for the existing regulations and their interpretation. Charitable contributions are still a wonderful thing, since so much good is done in our country and other parts of the world as a result of the efforts of qualified charities.

The most significant effects of the American Jobs Creation Act on charitable contributions may be yet to be seen, depending upon if, to what extent, and how the new regulations authorized by Congress are drafted by the IRS.

CHARITABLE CONTRIBUTIONS OF HORSES SIDEBAR

In order to deduct the fair market value of a horse contributed to charity the horse must be used by the charity in connection with the charitable purpose of the charity. The horse must have been held for sporting, breeding or draft purposes for at least 24 months prior to the gift. Certain records must be kept and valuation established as described below.

RECORDS TO BE KEPT:

In all cases:

(1) name and address of the recipient charity;
(2) date of the contribution;
(3) location of the contribution;
(4) a description of the horse in "detail reasonably sufficient under the circumstances"; in other words, the greater the value of the horse, the more detail will be required;
(5) the fair market value ("FMV") of the horse at the time of contribution and the method used in determining the FMV, including, if an appraisal is used, a written and signed copy of the appraisal;
(6) the terms of any agreement or understanding relating to the use or disposition of the horse.

When the horse is worth more than $250 but less than $5,000, in addition to the foregoing, the giver must also have a written acknowledgment from the recipient charity. That acknowlegment must include:

(1) a description of the horse;
(2) a statement concerning whether or not any goods or services were provided by the recipient charity to the giver in whole or in part in exchange for the horse; and
(3) a description and good faith estimate of the value and/or services (if any) by the giver in exchange for the horse.

When the horse is worth more than $5,000, the giver must fill out and file Internal Revenue Service Form 8283. In addition to the items described above, Form 8283 requires the following information:

(1) how was the horse acquired?
(2) date of acquisition of the horse.
(3) the cost, or other basis of the horse, including any basis adjustments (generally this means depreciation deductions previously taken).
(4) an appraisal summary.

The "appraisal summary" required by Form 8283

(1) must be signed by the charitable recipient, or

Continued on page 6...

Continued from page 5

at least have been presented to the charitable recipient for signature;

(2) must be signed and dated by the "qualified appraiser" who prepared the "qualified appraisal"; and

(3) must contain information about the donor, the donee, the appraiser and any other information which may be specified in the form.

A separate "qualified appraisal" is required for each horse donated for which a deduction of $5,000 or more is claimed, unless multiple horses, or a herd is donated at one time, provided that each horse must be separately described and a specific value must be assigned to each horse. The qualified appraisal must be prepared, signed and dated by a qualified appraiser, and contain the following information:

(1) a description of the horse;

(2) a description of the physical condition of the horse;

(3) the date or expected date of the contribution;

(4) the terms of any use, sale, or other disposition of the horse;

(5) the identity and qualifications (background experience, education, and professional affiliations, memberships, etc,) of the appraiser;

(6) a statement that the appraisal was prepared for income tax purposes;

(7) the date of the appraisal;

(8) the appraised value of the horse on the date of contribution;

(9) the method used for valuation (e.g., market data);

(10) the specific basis for valuation (e.g., comparable sales).

The qualified appraisal must be made not earlier than 60 days prior to the date of contribution, and not later than the due date of the return (including extensions) on which the charitable contribution deduction is made.

The term "qualified appraiser" is defined as an individual who:

(1) holds himself or herself out to the public as an appraiser or who performs appraisals on a regular basis;

(2) is able to make appraisals of horse appraised because of his or her qualifications as described within the appraisal;

(3) is not within a group of disqualified people, including: the donor, the person who sold, exchanged or gave the horse to the donor, and/or any employee, relative or spouse of such a disqualified person;

(4) has signed the written acknowledgment that intentionally false or fraudulent overstatements of value of the property appraised may subject the appraiser to penalties.

The fee charged for the appraisal may not be based upon a percentage of the appraised value of the property appraised. The appraisal fees paid, as well as any fees paid for tax advice about the charitable contribution are not considered, for purposes of the charitable contribution deduction, to be part of the contribution, so they are not deductible as charitable contributions. Such expenses can be deducted as expenses of preparation of a tax return, but are subject to the limitation on Schedule A deductions.