

Revised IRS Rules for Substantiation, Disclosure and Business Sponsorship

In December 1996 the Internal Revenue Service issued final regulations clarifying the federal tax rules on valuing and substantiating charitable contributions. These regulations focused on contributions made to a charity in return for goods, services, or other benefits. The regulations governing these actions are referred to as "quid pro quo" and "substantiation" rules and are based on statutory provisions that were added to the Internal Revenue Code in 1993.

For many years, Independent Sector has been distributing a useful handbook called "How Much Really Is Tax Deductible?" which helps nonprofit organizations and donors understand the rules that govern tax deductions for gifts, incentive programs, fundraising events, corporate sponsorship, and other challenging situations. An updated edition of the booklet has just been published, and it includes answers to questions about the new quid pro quo and substantiation regulations.

In the following excerpts, a charity's responsibility for substantiation and disclosure are spelled out, and the new "safe harbor" provisions for business sponsorship payments are interpreted.

Substantiation and Disclosure: The Charity's Responsibilities

Q: What statements must the charity provide to the donor?

A: For a charitable contribution of more than \$75, a charity must provide a written statement to the donor if a benefit is provided in return for the contribution. The written statement must advise the donor that only the amount by which the total contribution exceeds the fair market value of the benefit(s) provided by the charity is deductible as a charitable contribution. The statement must also provide the charity's good faith estimate of the fair market value of the benefit(s) provided.

Q: Is this written statement required if the value of the charitable contribution minus the value of a benefit received in return for the contribution is \$75 or less?

A: Yes. The amount of the charitable contribution determines whether the \$75 limit has been exceeded without consideration of the value of the benefit received in return for the contribution.

For example, if a donor makes a charitable contribution of \$85 and receives in return a CD that retails at \$20, the charity would be required to provide a written statement advising the donor that his or her deduction is limited to \$65 (\$85 minus the \$20 fair market value of the CD).

Q: When must this written statement be provided?

A: No explicit requirement is provided in the IRS statutes or regulations. At a minimum, the statement should be provided within the same time frame as a written acknowledgment of a \$250 or greater charitable contribution, that is on or before the earlier of

- the date the donor files the original tax return for the taxable year in which the contribution was made; or
- the due date (including extensions) for filing the donor's original tax return for that year.

Q: If no written statement is required (that is, if the charitable contribution is \$75 or less) does the donor still have to reduce the deduction by the amount of the benefit received in return for the contribution?

A: Yes, as long as the benefit is substantial. For example, if a donor makes a \$60 contribution to a charity and receives benefits with a value of \$20 in return, the donor can only deduct \$40 as a charitable contribution.

Q: What are the penalties for not providing or obtaining the contemporaneous written acknowledgment needed for a donor's records if a charitable contribution is \$250 or more?

A: Donors who fail to obtain contemporaneous written acknowledgment of their gifts of \$250 or more will lose their deduction for that gift. If they claimed the deduction on their tax returns, they will be required to pay the additional tax due, plus interest, and may also be required to pay a penalty.

There is no penalty on charities that fail to provide contemporaneous written acknowledgment of gifts of \$250 or more, but they will want to provide the

statements so that their donors will not be denied a deduction for their gifts. However, charities that provide false statements will be subject to penalties.

Q: What are the penalties for not providing the required written statement when a substantial benefit is provided to the donor?

A: Charities that fail to provide the written statement required where there is a substantial benefit provided in return for a contribution of \$75 or more are subject to a \$10 penalty for each failure to provide the required statement, up to a maximum of \$5,000 per solicitation. Charities that provide false statements will be subject to additional penalties.

Donors who overstate their deductions by not taking into account the benefits they receive will be required to pay the additional tax due, interest, and penalties.

The Safe Harbor for Qualified Sponsorship Payments

As part of the Taxpayer Relief Act of 1997, Congress created a new safe harbor for charities that wish to acknowledge their business sponsors. Acknowledgment of business sponsors can sometimes be problematic because some forms of "acknowledgment" are considered by the IRS to be advertising, with the effect that the "donations" of the business sponsors are considered by the IRS to be payments for this advertising. This result is undesirable because charities are required to pay tax on payments for advertising as such payments are considered unrelated business income.

The safe harbor created by Congress, known as "qualified sponsorship payments," provides that donations made in exchange for use or acknowledgment of a business name, logo, or product line will not be considered unrelated business income as long as the use or acknowledgment meets the following conditions:

- contains no qualitative or comparative language;
- contains no price information or other indicators of savings or value;
- contains no endorsement or other inducement to purchase, sell, or use the products or service; and

- is not contained in regularly produced printed material unless the material is related to a specific, sponsored event.

However, any acknowledgment may contain promotional slogans or logos that are an established part of the sponsor's identity.

The amount of a qualified sponsorship payment must not be contingent on the level of attendance, broadcast ratings, or other factors indicating the degree of public exposure. A donation that is associated with a specific event, however, may be contingent on the event occurring.

The following activities will not affect whether payments by a business are considered qualified sponsorship payments:

- distribution and/or display of the sponsor's products at a sponsored event, either by the business or the charity; and
- the provision of facilities, services, and/or other privileges to the business by the charity.

These activities may have other negative ramifications, however. For example, the provision of facilities or services that constitute a substantial benefit will reduce the amount of its charitable contribution that the business sponsor can deduct.

The safe harbor provision is available after December 31, 1997. An acknowledgment or use that does not fall within this safe harbor may still not be advertising, depending on all the facts and circumstances.