

Charity auctions

A charity-sponsored auction can be a great fundraiser; successful auctions have already raised millions of dollars. Donors provide the goods; bidders receive valuable property or services; everyone has a good time; and the charity receives the proceeds. Plus, there are tax breaks all around, right?

Not necessarily.

As with all matters of taxation, there are rules, and they can be complicated. The tax rules don't take all the fun out of the party, but they do put a damper on it, and they mustn't be ignored.

Rules for donors

A donation of cash to a charity to purchase items to auction generally will be fully deductible. Otherwise, the usual restrictions that apply to noncash charitable gifts apply.

Inventory. Donations of items from inventory are a common method for a business to participate in an auction. Generally, the charitable deduction will be limited to the donor's cost.

Part gift, part sale. With very valuable property, such as automobiles, the charity may purchase the item to be auctioned. There is no deduction for the business unless the purchase was a bargain sale, in which case the deduction is limited to the bargain element.

Ordinary income property. The charitable deduction is limited to the donor's tax basis in the property.

Tangible personal property. Because the property will be sold by the charity, not used by it in the course of its charitable mission, the deduction is normally limited to the taxpayer's basis in the donated property, not its fair market value.

Capital gain property. A donation of capital gain property may be deductible by the donor at its full fair market value. Unfortunately, such property typically is not very attractive as auction property.

Depreciated property. If the fair market value of donated property is less than its tax basis, the charitable deduction is limited to the lower figure.

Services. Professional services can be an excellent item for auction. Donation of services for an auction yields no charitable deduction at all.

Rules for bidders

One who purchases something at a charitable auction may have the impression that, because the check is made out to the charity, the full amount is deductible as a charitable gift. Not so. There is no charitable gift unless the amount paid exceeds the fair market value of the property purchased. What's more, there is a presumption that the amount paid for the item fairly represents its value, and that there is no gift. It's up to the taxpayer to prove otherwise.

Example: An unusual bottle of wine from a local winery is being auctioned by Charity. The fair market value of the item is estimated to be \$250.

Tom bids \$150 for the wine. If his is the winning bid, there will be no charitable deduction—he has received a bargain. Dick's bid of \$250, the market value, similarly generates

no deduction. A winning bid of \$400 by Harry will secure for him a charitable deduction, but only for \$150, the excess of the bid price over the fair market value.

Rules for the charity

Sponsoring charities have tax responsibilities associated with their auctions as well. The charity should provide advance estimates of fair market value for each item being auctioned. Receipts provided to successful bidders should identify the item, note the amount paid and include an estimate of the fair market value.

Donors must file Form 8283 and have a qualified appraisal for contributions of property worth more than \$5,000, and the donee charity also must sign the form and acknowledge its own reporting requirements. If the property is sold within three years (as auction property almost certainly would be), the charity must file Form 8282 to report the sale. The purpose of the filings is to keep the amount claimed as a deduction and the amount realized by the charity in harmony.

A charity sponsoring an auction should take steps to make certain that both donors and bidders are not overestimating the tax benefits of their participation. Clearing the air early can avoid misunderstandings and hard feelings down the road.

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