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Valuing Donated Property

During downturns in the economy, many non-profits experience a decrease in cash donations with an accompanying increase in noncash donations. The IRS has specific rules governing the manner in which fair market value (FMV) should be properly assessed for noncash items.

Overview

Non-profit organizations often receive noncash contributions such as computers, office furniture, real estate and other items. Noncash items are an important vehicle for donors who wish to contribute but who cannot afford to donate cash, or for those who own items of value for which they no longer have use. Organizations should be careful however, to understand the manner in which the IRS requires those items to be assessed and reported.

The fair market value of a noncash donated item must be recorded on an organization's Form 990 and financial statements (and possibly Schedule M, depending on the type and amount of contribution). The IRS defines FMV as the price that a willing, knowledgeable buyer would pay a willing knowledgeable seller for the property, when neither has to buy or sell.

For example, if a donor contributes used clothes, the FMV would be the price that a typical buyer actually pays for clothes of the same age, condition, style and use. Contributions for items such as art, historical pieces or conservation easements valued at $25,000 should also be accompanied by Form 990 and Schedule M, if appropriate.

Consider the Cost or Selling Price

According to the IRS, there are three particularly relevant factors that go into determining a gift’s FMV, and *cost or selling price* is one of them. The cost of the item to the donor or the actual selling price received by your organization may be the best indication of the item’s FMV. Because market conditions can change, though, the cost or price becomes less important the further in time the purchase or sale was from the date of contribution.

For instance, a donor may have paid $1,200 for a top-of-the-line smart phone in 2011. But that phone certainly isn’t worth $1,200 in 2013. It may still have *some* value, though. A documented arm’s-length offer to buy the property — for example, real estate — close to the contribution date may help prove its value to the IRS. The offer must have been made by an independent, unrelated party willing and able to complete the transaction.

Comparable Sales

The sales price of a property similar to the donated property — a *comparable sale* — is often critical in determining FMV. The weight that the IRS gives to a comparable sale depends on:

- Degree of similarity between the property sold and the donated property
- Time of the sale
- Circumstances of the sale (was it at arm's length?)
- Market conditions

The degree of similarity must be close enough that reasonably well-informed buyers or sellers of the donated property would have considered the price. It is important that the transactions not occur between related parties and be considered arm's length sales. The greater the number of similar sales for comparable selling prices, the stronger the evidence of the FMV.

Determine Replacement Cost

FMV can consider the cost of buying, building or manufacturing property akin to the donated item, but the *replacement cost* must have a reasonable relationship with the FMV. And if the supply of the donated property is more or less than the demand for it, the replacement cost becomes less important to its value.

Obtain an Appraisal

When it comes to getting an appraisal of the donated property, potential donors might be deterred because of the time or difficulty involved. Yet appraisals generally aren't needed for items of property for which the donor will claim a deduction of $5,000 or less.

Donors who deduct more than $500 for any single item of clothing or any household item that is not in "good used condition" or better must include a qualified appraisal with their income tax return. In these cases, the donor should understand that the IRS will weigh the appraisal based on the report's completeness and the appraiser's qualifications and demonstrated knowledge of the donated property. The agency requires appraisals to provide all facts applicable to giving an "intelligent judgment" of the property's value, such as purchase price and comparable sales. Donors must follow the requirements for appraisals — even when the value of the property is certain.

Valuing Inventory

Assessing the value of inventory is a different process. For example, it a computer store wishes to provide some computers as a "charitable donation," it can deduct the smaller of its FMV on the day of the contribution or the inventory's basis. (The *basis* of donated inventory is any cost incurred for the inventory in an earlier year that the business would otherwise include in its opening inventory for the year of the contribution.) If the cost of donated inventory isn't included in the opening inventory, its basis is zero and the business can't claim a "charitable deduction." Instead, the cost would be included under "cost of goods sold."

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If you have any questions, please feel free to contact your Seiler professional at (650) 365-4646 or email info@seiler.com. We would be happy to discuss appropriate courses of action for your particular circumstance.

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