

Philanthropic Estate Planning

By Janet Nava Bandera

Fair Market Value and Charitable Contributions

What Is Fair Market Value?

When asked this question, we all can recite the phrase “the price that property would sell for on the open market between a willing buyer and a willing seller.” But what does this really mean?¹ As with many reporting questions, you can start with the IRS Publications (an easy to read, nontechnical resource). IRS Publication 561, *Determining the Value of Donated Property*, gives the basic how-to. But, even the IRS admits in this Publication that it is often not a simple matter to determine the value of donated property. The following are some of the most common methods of valuation for various types of property.

Factors in Determining Fair Market Value

Fair market value is a question of fact to be determined from the entire record.² The factors to consider in making and supporting the valuation of property include (1) the cost or selling price; (2) sales of comparable properties; (3) replacement cost; and (4) the opinion of experts.

Cost or Selling Price

The cost of the property or the selling price received by the charity may be the best indication of the fair market value. This is true, however, only when (1) the purchase or sale took place close to the valuation date in an open market (a gap of up to two years has found to be reasonable³); (2) the transaction was “arm’s-length”; (3) the buyer and seller knew all the relevant facts; (4) the buyer and seller did not have to act; and (5) the market did not change between the date of purchase or sale and the valuation date.⁴



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Cost/selling price method of a property purchased 17 months before the contribution was recently found to be the best indicator by the Tax Court.⁵

Sales of Comparable Properties

When using the price of a comparable property, the weight to be given to each sale depends upon (1) the degree of similarity between the property sold and the donated property; (2) whether the sale was close to the valuation date; (3) whether the comparable sale was “arm’s-length” between a buyer and seller who knew all the relevant facts; and (4) whether the market was unusually inflated or deflated.

Replacement Cost

Although replacement cost can be considered, there is often no relationship to the value of the donated property due to its physical condition and obsolescence. Thus, these deductions for these factors must be taken from the replacement cost to determine the value of the donated property. The donor must be able to show how he arrived at the estimated replacement cost new as well as how the deductions were considered.⁶

Opinions of Experts

For any property for which a deduction of over \$5,000 has been claimed and for which the value cannot be easily determined, an appraisal is needed. For an appraisal to be considered valid, it must be complete; the appraiser must be qualified and have knowledge of the appraised property and it must consider and be consistent with all of the relevant factors.⁷

How to Value Specific Types of Property

Household Goods

According to Publication 561, the price that buyers of used items actually pay in used clothing stores such as consignment or thrift shops is an indication of the value. Some thrift stores will provide you with a receipt that shows the actual selling price of the item. Another resource is the online Donation Value Guide that lists the average prices in the Salvation Army stores for used clothing and household items at www.salvation-armysouth.org/valueguide.htm.

Stocks and Bonds

The value of stocks and bonds are fair market value on the valuation date. If there is an active market, the fair market value is the average price between the highest and lowest selling price on that date. If there is no active market on the valuation date, the fair market value is the average price between the highest and lowest sales price on the nearest date before and the nearest date after the valuation date. These are then weighted in inverse order.⁸

Paintings, Antiques and Other Objects of Art

Any contribution for which a deduction greater than \$5,000 is claimed must be accompanied by an appraisal. If the claimed deduction is greater than \$20,000, a copy of the signed appraisal must be attached to the return and a photograph must be provided on request. The IRS has its own experts to review the submitted appraisals.⁹ If the donated object is valued at greater than \$50,000, one can request a Statement of Value (which is an advance determination) from the IRS.

Collections

The most common collections include stamps, coins and books. In valuing such items as well as other collectibles, the donor may use a published price guide. The guide must be the current edition and adjustments for misleading entries must be made.¹⁰ Comparable sales may also be used.

Inventory

For individual taxpayers, the deductible contribution is the fair market value less any gain that would have been realized if the item had been sold on the date of the gift. Corporate taxpayers (those that pay a tax on their income) can contribute business inventory to certain charities and get a tax deduction in excess of the amount they paid for the property. The amount of the corporation’s deduction for inventory contributions is the lower of (1) the cost of the inventory plus one-half the difference between the cost of the inventory and its fair market value, or (2) twice the cost.

Real Estate

Because each piece of real estate is unique, a detailed appraisal by a professional appraiser is necessary. The appraisal may be based on

comparable sales, capitalization of income or replacement cost new or reproduction cost minus observed depreciation.

Conclusion

The interest of the taxpayer who wants the greatest deduction allowed and the charity that wants the

donation are usually aligned, however, the IRS is often on the other side. Although, even the IRS admits that valuations are sometimes not easy, using common sense and a reasonable approach to valuations is the best method to avoid an IRS challenge. To further the cause, taxpayers, charities and advisors must educate themselves and follow the guidelines.

ENDNOTES

¹ See Reg. §1.170A-1(c)(1) and (c)(2).

² See *G.V. Zmuda*, 79 TC 714, Dec. 39,468 (1982), aff'd, CA-9, 84-1 USTC ¶9442, 731 F2d 1417.

³ *T.L. Kaplin*, 51 TCM 927, Dec. 43,017(M), TC Memo. 1986-167 (two-year window), rev'd on another ground, CA-6, 87-1 USTC ¶9258, 815 F2d 32; *M. Shlensky Est.*, 36 TCM 628, Dec. 34,410(M), TC Memo.

1977-148, (15-month window).

⁴ See *E.S. Spruill Est.*, 88 TC 1197, Dec. 43,904 (1987).

⁵ *R. Wortmann*, 90 TCM 336, Dec. 56,155(M), TC Memo. 2005-227.

⁶ IRS Publication 561.

⁷ *Id.*

⁸ *Id.*

⁹ The Art Advisory Panel is a group of 25 out-

side professionals hired by the IRS to evaluate and challenge taxpayer valuations of artwork in the \$20,000-plus category. Panel members are prominent dealers, museum directors and curators. They discuss each work and provide a conclusive fair market value of an item.

¹⁰ Rev. Rul. 2002-67, 2002-2 CB 873, makes clear that the use of pricing guides is not appropriate in all cases.

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