

NEW TAX DEDUCTION LIMITATIONS ON CHARITABLE CONTRIBUTIONS

By Gerard Fellows

An individual taxpayer is generally able to take an itemized deduction equal to the fair market value of the clothing and household items contributed to an eligible donee organization. The deduction usually provides a benefit to the individual taxpayer by reducing their taxable income and the tax calculated thereon.

While considering new tax deduction limitations on charitable contributions, Congress noted that IRS statistics for the tax year 2003 show that the amount claimed for deductions for clothing and household items exceeded \$9 billion. Congress also recognized the difficult tax administration issues inherent in the fair market value based deduction system for contributions of clothing and household items. In order to address some of these difficult tax administration issues, President Bush signed into law the Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (the "Act") on August 17, 2006.

Under the Act, contributions of clothing and household items made after August 17, 2006 are subject to the following limitations:

- (1) For an individual, partnership, or corporation, no charitable deduction is allowed for any contribution of clothing or a household item unless the clothing or household item is in good used condition or better;
- (2) The IRS may issue regulations denying a charitable deduction for any contribution of clothing or a household item that has minimal monetary value, such as used socks and undergarments; and
- (3) Neither of the limitations apply to any contribution of a single item of clothing or a household item for which a deduction of more than \$500 is claimed if the taxpayer includes with his return a qualified appraisal with respect to the property.

For purposes of the above limitation rules, the term "household item" includes: furniture; furnishings; electronics; appliances; linens; and other similar items. The term "household item" does not include: food; paintings, antiques, and other objects of art; jewelry and gems; and collections.

Congress expects that the IRS, in consultation with affected charities, will exercise its authority to disallow the deduction of some items of low value, consistent with the goals of improving tax administration and ensuring that donated clothing and household items are of meaningful use to charitable organizations.

Only Congress' broad policy statement above provides any guidance as to when clothing and household items will not be considered in "good used condition or better" so as to bar a deduction under rule (1) above.

The IRS has provided guidance on the valuation of donations made prior to August 18, 2006. For donated clothes, the price paid by buyers of used items in used clothing stores, such as consignment or thrift shops, is an indication of value. For used household goods, it says that the value of those items is usually considerably lower than the price paid when new, and that frequently that property has very little or no value due to its worn-out condition and the fact that it is obsolete because of style or utility.

Therefore, taxpayers may still receive an itemized deduction equal to the fair market value of contributed clothing and household items if the item has greater than minimal monetary value and is in at least good used condition. These new charitable contribution limitations continue to emphasize the importance of taxpayers maintaining accurate and complete records to document the deductions taken on their returns.

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