Charitable Giving: Income Tax Deduction

Charitable giving not only supports causes important to the donor but also provides potential income tax deductions. For taxpayers who itemize deductions, contributions of money or property to qualified organizations can reduce taxable income. However, the deduction is only applicable if the contributions are made by the end of the tax year. It is important to note that contributions of time or services are not deductible, though out-of-pocket expenses incurred while providing charitable services may qualify.

Qualified Organizations

To claim a charitable contribution deduction, donations must be made to organizations that meet the qualifications under Section 170(c) of the Internal Revenue Code. These include:

- Federal, state, and local governments if the contribution is for public purposes
- Charitable, religious, educational, scientific, or literary organizations
- Churches, synagogues, and other religious organizations
- War veterans' organizations
- Nonprofit volunteer fire companies
- Civil defense organizations
- Domestic fraternal societies (for charitable purposes only)
- Nonprofit cemetery companies (for perpetual care)

Contributions to individuals or restricted contributions for specific persons are not deductible.

Limitations on Deductions

The allowable deduction for charitable contributions depends on the type of organization and the nature of the property donated. Contributions to public charities and certain private foundations are generally limited to 60% of Adjusted Gross Income (AGI). For donations to other qualified organizations, such as private foundations, the deduction is capped at 30% of AGI.

- **Capital Gain Property:** Capital gain property is defined as property that would generate long-term capital gains if sold at fair market value. A 30% AGI limit applies to contributions of capital gain property to 60% limit organizations, while a 20% AGI limit applies to contributions to other organizations. Typically, the deduction for capital gain property is based on its fair market value unless specific conditions require it to be reduced to the property's basis.

- **Ordinary Income Property:** Ordinary income property includes assets that would generate ordinary income or short-term capital gains if sold. Examples include inventory, manuscripts, or securities held for one year or less. Deductions for ordinary income property are generally limited to the donor's basis in the property.

- **Carryovers:** If the total amount of charitable contributions exceeds the allowable deduction for the current year, the excess may be carried over for up to five years. The same percentage limitations that applied in the year of the contribution apply to the carryover years as well.

Substantiation Requirements

Taxpayers must maintain records to substantiate their charitable contributions. The type of records required depends on the value and type of contribution.

- **Cash Contributions:** A bank record, receipt from the charity, or payroll deduction records are required. Contributions of $250 or more require an acknowledgment from the charity.

- **Noncash Contributions:** For noncash contributions, the requirements depend on the value of the donation. Contributions valued at less than $250 require a receipt from the charity. Contributions between $250 and $500 require additional documentation, and donations exceeding $500 require records showing how and when the property was obtained, among other details. For contributions over $5,000, a qualified appraisal is generally required.

- **Preserving Inheritance:** Because the policy proceeds go directly to charity, heirs do not experience a reduction in the assets they inherit.

Dual Character Contributions

In cases where donors receive something of value in return for their charitable contribution, only the amount that exceeds the value of the item received is deductible. The IRS allows exceptions for token items and certain benefits provided by charitable organizations.