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David J. Beausejour  
*Bryant University*

Tim Krumwiede

Raymond Zimmerman

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# Reporting and Substantiation Requirements for Charitable Contributions

*Tim Krumwiede, David Beausejour, and Raymond Zimmerman explain the additional burdens to be met by charities.*

## Introduction

**E**ffective January 1, 1994 the substantiation and reporting requirements for charitable contributions will be significantly increased. Two provisions in the *Revenue Reconciliation Act of 1993*<sup>1</sup> (the "Act") result in these additional requirements. The first provision, under Section 6115, requires charitable organizations to disclose certain information to the donor via a written statement for any *quid pro quo* contribution received by the organization which exceeds \$75. The second provision, under Section 170(f)(8), requires the donor taxpayer to obtain from the donee organization written substantiation for any contribution of \$250 or more. Substantiation will not be required if the donee organization files a return including all relevant information with the Internal Revenue Service (Service). Both of these provisions, along with current provisions dealing with reporting and substantiation requirements for charitable contributions, are discussed below.

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Tim Krumwiede is an Assistant Professor and David Beausejour is an Associate Professor of Accounting at Bryant College. Raymond Zimmerman is an Assistant Professor of Accounting at the University of Texas at El Paso.

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<sup>1</sup> P.L. 103-66 103rd Cong., 1st Sess.

## Quid Pro Quo Contributions

*Quid pro quo* contributions, such as payments made to a charitable organization partly as a contribution and partly in consideration for goods and/or services received, impose a heavy, and sometimes difficult, compliance burden on the organization. An example of a *quid pro quo* contribution is the payment of \$1,000 for a ticket to a local charity ball. Part of the \$1,000 payment is a charitable contribution and part is payment for admission to the ball.

*Quid pro quo* contributions were previously addressed in several revenue rulings and procedures. In Revenue Ruling 67-246,<sup>2</sup> the Service defined the applicable rules in determining the deductible amount of such a contribution. Under this ruling, charities were asked to make a reasonable estimate of the fair market value of benefits offered prior to solicitation of the contributions. It was required that the estimate of the fair market value, along with the appropriate deductible amount, be stated in any solicitation materials, tickets, receipts or other documentation connected with the contribution. If it was not possible to determine the fair market value of the benefit received by the donor, a reasonable estimate of the fair market value should be used. Many charities complained that determining a reasonable estimate of the fair market value was extremely burdensome, especially when token items or small benefits were provided to the donor in connection with the contribution.

In the late 1980's, Congress expressed a concern that charities were failing to provide sufficient information for the donors to determine the deductible portion of a "contribution".<sup>3</sup> In response, the Service issued Publication 1391 in 1988. This publication contains a request from the Commissioner asking cooperation from the charities in assisting donors in determining the correct deductible amount under Section 170. It also repeats the guidelines discussed in Revenue Ruling 67-246.

To help mitigate this problem, the Service ruled that if the token item or benefit had insubstantial value, the donee could notify the contributor that the contribution was fully deductible. However, "insubstantial value" was to be a source of confusion if not properly defined. To preclude this problem, guidelines were necessary to define what constitutes

"insubstantial value". In Revenue Procedure 90-12,<sup>4</sup> guidelines are established defining "insubstantial value". These guidelines are intended to provide charitable organizations (and revenue agents) with help in determining the deductible portion of a *quid pro quo* contribution. Under these provisions, a token item or a service is considered to have an "insubstantial value" if:

- (1) the payment is made in conjunction with a fund-raising activity in which the donee informs the donor of the proper deductible amount of a contribution; and either
- (2a) the fair market value of the benefits received is the lesser of not more than 2% of the contribution or \$50, or
- (2b) the payment is \$25 (adjusted for inflation) or more and the only benefits received from the charity or donee are token or "low-cost" items such as calendars, coffee mugs, bookmarks, key chains, tee shirts, etc., bearing the name or logo of the charitable organization. The cost (as opposed to the fair market value) of these benefits is, however, limited to specific guidelines set forth under Section 513(h)(2) of the Code. This cost could not exceed \$5, increased by cost-of-living adjustments for years after 1987.<sup>5</sup>

The aggregated cost of all the benefits received by a single donor may not exceed the limit established for "low-cost items". If the benefit received exceeds these limits, or is substantial, the deductible amount is determined by taking into account the fair market value of the benefits received.<sup>6</sup> If only insubstantial benefits are received in return for the donation, the organization should include a statement in the fund-raising materials to the effect that the estimated benefits received are not substantial and the full amount of the contribution is deductible. If it is not possible to state the proper deduction in every solicitation for contributions, or if it is impractical to do so, the charity should seek a ruling from the Service concerning an alternative.

For purposes of paragraph (2b), newsletters, program guides, and so forth will be treated as having insubstantial value if they do not have a measurable fair market value or cost, provided that the primary purpose of the newsletter is merely to inform members of the activities of the organization.

<sup>2</sup> Rev. Rul. 67-246, 1967-2 CB 104.

<sup>3</sup> See H.R. Rep. No. 100-39, 100th Cong., 1st Sess. 1608 (1987).

<sup>4</sup> Rev. Proc. 90-12, 1990-1 CB 471.

<sup>5</sup> See Rev. Rul. 92-102, 1992-2 CB 106. For tax years beginning in 1993, the "\$50 benefit" limitation is \$62, the "\$25 payment" limitation is \$31, and the "low cost" limitation is \$6.20.

<sup>6</sup> The excess of the amount paid over the amount that would ordinarily be paid for the benefit received is deductible. See Rev. Rul. 56-120, 1956-1 CB 514.

Generally, it will not include articles for which compensation has been paid or professional journals.

Revenue Procedure 90-12 provides examples of transactions or donations which qualify under these provisions, e.g., a pin embossed "Friends of the Small City Zoo" with a fair market value of \$.25 in exchange for a \$15 contribution qualifies under paragraph (2a) above. Even the inclusion of a zoo newsletter that keeps the patrons informed of the happenings at the zoo will qualify, as long as the newsletter is within certain guidelines. One example presented gives the situation of a donor making a \$30 contribution to a nonprofit broadcast organization. In a *quid pro quo* exchange, the donor received a coffee mug that cost \$3 and had a fair market value of \$5, and a listener's guide that cost \$4 and had a fair market value of \$6. The guide does not qualify as merely a newsletter since it accepts paid advertisements. It is essentially a "commercial quality publication". Since the aggregate cost is in excess of the "low-cost" limitation, the organization is obligated to notify the donor that only \$19 of the contribution is deductible. A total of \$11 (i.e., \$5 + \$6 fair market values) is nondeductible. Under Section 513(h)(2), the cost of all low-cost items received in one year is aggregated to determine if the limitation is exceeded.

In a further effort to insure accurate compliance, the Service issued Revenue Procedure 92-49.<sup>7</sup> The purpose of the revenue procedure was to amplify Revenue Procedure 90-12 and provide additional guidelines for charitable organizations engaged in fund-raising. These additional guidelines provide that when charitable solicitations are accompanied by free, unordered, low-cost inducement materials, the benefits accrued to a donor will be considered insubstantial and the charity may advise the donor that all contributions qualify for deduction under Section 170 of the Code. Essentially, there are two qualifications or requirements that must be met under this revenue procedure:

- (1) the organization must distribute the free, unordered items to the potential donor or patron. It cannot be sent at the patron's re-

quest. In addition, the "gift" must be accompanied by a request for a charitable contribution, along with a statement that the donor is free to keep the "gift" at no charge, regardless of whether a contribution is made; and

- (2) the cost must meet the guidelines for "low cost articles" as set forth in Section 513(h)(2) of the Code.

In the "Act",<sup>8</sup> Congress attempted to insure greater compliance. Under this act, charitable organizations receiving a *quid pro quo* contribution in excess of \$75, that is a contribution made partly as a contribution and partly in consideration for a benefit received, in connection with a solicitation must provide a written statement to the donor. The statement issued should inform the donor of the amount of the "contribution" qualifying for a deduction under Section 170, along with a good faith estimate of the value of goods or services furnished by the donee to the donor.<sup>9</sup> It should be noted that for purposes of the \$75 threshold, separate payments at different times shall not be aggregated unless circumstances indicate that the contributions are part of the same transaction.

This requirement does not apply if only *de minimis*, token goods or services are provided to the donor in accordance with Revenue Procedures 90-12 and 92-49, discussed above. Also, the requirement does not apply to a contribution in which the contributor receives only intangible religious benefits that are generally not sold in a commercial context.<sup>10</sup> Failure to comply with this requirement will result in a penalty of \$10 per contribution, with a \$5,000 cap, being imposed on the charity. No penalty will be imposed if nonperformance was due to a reasonable cause. The penalty is imposed for either a failure to make the disclosure in a *quid pro quo* exchange or for an inaccurate or inadequate disclosure. An example of an inaccurate or inadequate disclosure is a "bad-faith" estimate of the value of goods and/or services transferred by the donee to the donor.

<sup>7</sup> Rev. Proc. 92-49, 1992-1 CB 987.

<sup>8</sup> Act §13173(a), adding new Code Section 6115 and redesignating former Code Section 6115 as Code Section 6116 and Act §13173(b), adding Code Section 6714.

<sup>9</sup> Under Code Section 6115, the "Act" specifically states that the written statement must "inform the donor that the amount of the contribution that is deductible for federal income tax purposes is limited to the excess of the amount of any money and the value of any property other than money contributed by the donor over the value of the goods or services provided by the organization", and must "provide the donor with a good faith estimate of the value of such goods and services".

<sup>10</sup> See Rev. Rul. 70-47, 1970-1 CB 49. In this ruling pew rents, building fund assessments, and periodic dues of church or syn-

agogue are deductible. However, payments to a church for wedding celebrations are non-deductible. See *James Summers v. Com.*, CCH Dec. 30,618(M), 30 TCM 58. Tuition payments to a parochial school are not deductible, see *McLaughlin v. Com.*, 69-2 USTC ¶ 9467.

## Other Contributions

Currently, taxpayers are not required to provide specific information for contributions made by cash or check when they file an income tax return. The total of all cash or check contributions is simply reported on the tax return (schedule A for an individual taxpayer). Under the "Act", taxpayers will not be allowed a deduction for any contribution in excess of \$250, unless the taxpayer has obtained written substantiation from the donee organization. A check will not represent substantiation.

The substantiation requirement, which falls under new Section 170(f), is applicable for contributions made on or after January 1, 1994.<sup>11</sup> It is the responsibility of the donor taxpayer to request from the donee organization the required substantiation. In the event that the donor is unable to obtain the required substantiation from the donee organization, Section 170(f)(8)(A) provides that the deduction will not be allowed.

According to the Senate Committee Report, separate payments to the same organization will not be aggregated for purposes of applying the \$250 threshold. Rather, each payment will be treated as a separate contribution. Thus, a taxpayer could contribute \$200 to a charitable organization on January 5, 1994, and \$200 to the same organization on June 19, 1994, and not be subject to the new substantiation requirement. Furthermore, if contributions are made in the form of payroll deductions, the deduction from each paycheck should be treated as a separate payment. Practitioners should anticipate that regulations will be issued in this area to prevent anticipated abuses. For instance, in an attempt to avoid the \$250 threshold, a taxpayer could write out five \$200 checks on five consecutive days to one charitable organization.

Assuming that a taxpayer's contribution exceeds the \$250 threshold and that the contribution is made on or after January 1, 1994, the taxpayer is considered to comply with the substantiation requirement by obtaining from the donee organization a contemporaneous written acknowledgment of the contribution. Pursuant to Section 170(f)(8)(B)(i), the acknowledgment from the donee organization must contain at least the following:

1. The amount of cash and a description, but not value, of any property other than cash contributed;

2. Whether the donee organization provided any goods or services in consideration, in whole or in part, for any property contributed; and,
3. Either a description and good faith estimate of the value of any goods or services provided in consideration for the contribution or, if such goods or services consist solely of intangible religious benefits, a statement to that effect.

As noted above, the acknowledgment must include the amount of cash contributed but need not include the fair market value of any property contributed. Under existing regulations governing recordkeeping for contributions of property other than money, the donor must maintain a receipt from the charitable organization containing the donee's name, the date and location of the contribution, and a description of the property in detail reasonably sufficient under the circumstances.<sup>12</sup> If, in addition to the receipt already required under the regulations, the receipt contains either a statement as to the value of any goods or services provided by the organization for the contribution or a statement that the goods or services provided consist solely of intangible religious benefits, the same receipt could be used to comply with both the regulations and the new Code provision. The new Code provision does not specify any particular format for the required acknowledgment; however, the Senate Committee Report states that the acknowledgment need not take any particular form and, as examples, the Report contemplates acknowledgments by letter, postcard, or computer-generated forms.

The acknowledgment required under the new Code provision for cash contributions is the same as with property contributions, although, under the prior recordkeeping regulations for cash contributions, a canceled check was sufficient. Thus, a more severe burden is placed on cash contributions than on property contributions, since one contributing cash over the threshold amount of \$250 must obtain a written acknowledgment from the donee organization not required before the "Act", whereas one contributing property can simply add to the already required receipt under the regulations in complying with the new provision.

If the donee organization provides goods or services in consideration for the contribution and such goods or services consist of more than an intangible religious benefit to the taxpayer, the re-

<sup>11</sup> Act §13172(b).

<sup>12</sup> Reg. §1.170A-13(b)(1).

quired acknowledgment must include both a description and good faith estimate of the value of the goods and services. Where the goods or services provided by the donee organization to the donor consist solely of an intangible religious benefit, although the donee organization is absolved from providing a value for the intangible religious benefits, the organization must include in its acknowledgment a statement that the goods or services provided to the donor consisted solely of intangible religious benefits.

Section 170(f)(8)(B) defines an intangible religious benefit as any benefit provided by an organization that is organized exclusively for religious purposes and that generally is not sold in a commercial transaction outside of the donative context. The Senate Committee Report gives as an example of an intangible religious benefit the admission to a religious ceremony and further indicates that "tangible benefits furnished to contributors that are incidental to a religious ceremony (such as wine) generally may be disregarded".

An additional requirement of the written acknowledgment is that it must be obtained contem-

poraneously with the related contribution. Under Section 170(f)(8)(C) an acknowledgment will be considered to be contemporaneous where the donor obtains the acknowledgment on or before the earlier of the date the taxpayer files a return for the taxable year in which the contribution was made or the due date (including extensions) for filing such return.

The donor is not required to substantiate a contribution under Section 170(f)(8) if the donee organization files a return that includes the information required in the written acknowledgment. This return, in essence, would be a substitute for the written acknowledgment. The Code does provide for the issuance of Treasury Regulations which would give additional guidance to the donee organization as to any form requirements and/or other requirements in filing the written acknowledgment substitute.

For donee organizations with a substantial number of donors, it may be prudent to file the appropriate return with the Service and then provide all donors with a yearly summary of contributions. This should reduce the frustration for the donor and thus encourage ongoing donations.

### 1994 Standard Mileage Rates Set

The IRS has provided the optional standard mileage rates for employees, self-employed individuals, or other taxpayers to use in computing the deductible costs paid after 1993 in connection with the operation of passenger automobiles for business, charitable, medical, or moving expense purposes.

The standard mileage rate for business use of autos during 1994 is increased from 28 cents to 29 cents per mile. Taxpayers may base their deduction on either the standard mileage rate (plus business-associated

parking fees, tolls, and, to the extent allowable, interest and taxes) or deduct their actual expenses incurred for business use of an auto.

Employers may use the standard mileage rate when computing payments for employees' auto expenses incurred under a reimbursement or expense allowance arrangement and, thereby, substantiate the amount of such expenses, if the accountable plan requirements are satisfied. A 1992 procedure was superseded. Rev. Proc. 93-51, I.R.B. 1993-42, 30.