



## Non-Deductible Gifts That Save Taxes Anyway

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Gift planners have become adept at explaining the tax advantages of Qualified Charitable Distributions, even though there is no income tax charitable deduction involved. But are there advantages for other non-deductible charitable contributions?

Perhaps surprisingly, the answer is yes! Especially these days, with fewer taxpayers itemizing than ever, it is helpful to be prepared to discuss non-deductible contributions with prospective donors.

In this article, we will review three options for charitable gift planning without an income tax charitable deduction:

- Contributions of appreciated property from non-itemizers,
- Gifts of services, and
- Contributions of ordinary income property.

### **Gifts of Appreciated Property from Non-Itemizers**

The number of non-itemizers has nearly tripled to 90% in the years following enactment of the Tax Cuts and Jobs Act of 2017, which doubled the standard deduction amount. Of course, donors who do not itemize their deductions receive no benefit at all from the income tax charitable deduction (aside from the special deduction in 2021, which is limited to \$300 for single filers and \$600 for married couples filing jointly).

However, even non-itemizers can enjoy significant tax savings with a contribution of long-term capital gain assets.

Consider a donor who does not itemize and is contemplating a charitable contribution of \$10,000. If our donor pays her contribution in cash, she will be unable to use the income tax charitable deduction because she does not itemize.

Now, assume that our donor owns appreciated securities, now worth \$10,000, which cost her \$2,000 some years ago. If she were to sell the securities, she would have a long-term capital gain of \$8,000 on which she would owe \$1,200 in tax.

By contributing the appreciated securities instead of selling them, our donor would save \$1,200 in taxes, even though she does not itemize her income tax deductions. In addition, she could use the cash that she had planned to contribute to invest, perhaps taking the opportunity to diversify her portfolio.

### **Gifts of Services (Pro Bono Work)**

Beyond volunteerism, we usually think of gifts of services in terms of professional services, for which the organization would otherwise have to pay, performed without charge. Although usually used to describe contributions of legal services, the term “pro bono” generally applies to professional work undertaken voluntarily and without payment. Unlike traditional volunteering, pro bono work uses the specific skills of professionals to provide services to those who are unable to afford them.

Gifts of services can be very valuable to the organization, because they provide budget relief by reducing expenditures for necessary services. However, there is no income tax charitable deduction for gifts of services. As draconian as that may sound, there is simple logic to this rule: by contributing services, the taxpayer is foregoing the opportunity to produce taxable income, and there should be no income tax deduction for income that was never received.

The same rule and logic applies to rent-free use of space; there is no charitable income tax deduction because the gift foregoes rental income that would have been taxable income.

Sometimes donors propose elaborate workarounds – presenting the organization with a bill for the work but marking the invoice “paid” – hoping this will substantiate a charitable deduction. Nice try, but even if there was a charitable deduction, the net effect would be zero: billing for the service would create additional taxable income in the exact amount of the charitable deduction.

These rules can be especially vexing for artists who contribute their own works. However, the same concept applies: the majority of the market value of a newly created work of art consists of the time and effort of the artist, along with some incidental cost for

materials. This is the reason that an artist who contributes his own work will find his deduction limited to the cost of materials involved in producing the artwork: his cost basis is the materials and the remainder of the fair market value of the work of art is his creative effort in producing it, which would be taxable as ordinary income if he sold the work of art.

### **Gifts of Ordinary Income Property**

In general, “ordinary income property” consists of items that would result in taxable income if sold. Examples include inventory held in the regular course of a business or goods or commodities produced for sale by a business. The income tax charitable deduction for contributions of ordinary income property is limited to the lesser of fair market value or cost basis. In most cases, this significantly diminishes or even eliminates the income tax charitable deduction for contributions of ordinary income property. Consequentially, gift planners are inclined to disregard ordinary income property as a potential gift.

However, even without a charitable deduction, a contribution of ordinary income property directly to a charitable organization can reduce income tax – and perhaps the self-employment tax and state and local taxes as well – because the contribution eliminates the taxable income that would have resulted if the ordinary income property had been sold.

A contribution of ordinary income property can be especially efficient for donors who usually make cash charitable contributions. Instead of selling the ordinary income property, then paying taxes on the proceeds from the sale, and finally using the net proceeds to make a tax-deductible cash contribution, the donor could contribute the ordinary income property directly to charity. This direct contribution eliminates the income from the sale, thereby avoiding the taxes that would have been due upon sale.

Consider a farmer who raises and sells grain or other crops as a part of the family’s farming operation. When the crops are sold, the proceeds from the sale are taxed as ordinary income and may be subject to the self-employment tax and state and local taxes. If the farmer instead contributes the crops to charity, the taxable income and all of the associated taxes are eliminated.

For example, if the farmer makes a \$10,000 cash contribution to charity, the income tax charitable deduction will reduce taxable income by \$10,000 (provided that the farmer can itemize income tax deductions in the year of the gift). Instead, if the farmer were to give 2,000 bushels of corn when the market price is \$5.00 per bushel, the farmer’s taxable income for the year would be reduced by \$10,000, the amount the farmer would have received had those bushels been sold, thus reducing taxes while still enjoying the

tax benefits of deducting the expenses involved in the production of the crops. (Note: In the case of contributions of crops, the donor must be a farm operator or a materially participating landlord. Crop share landlords are not eligible, because shares of crops are deemed to be rental income for tax purposes.)

As with other non-cash gifts, it is important to ensure that the ordinary income property itself is contributed, not just the proceeds from a pre-arranged sale of the property. In order to avoid a pre-arranged sale, the charity must have clear “dominion and control” over the property, and the donor cannot direct when or how the charity sells the property after it has been contributed. Usually, a simple letter from the donor informing the charity that the donor is making the contribution, describing the property and amount, and asking the charity for delivery instructions confirmed by a letter of acceptance from the charity is sufficient to document dominion and control by the charity. Note that the charity need not take physical delivery of the property. Continuing the previous example, the charity could instruct the farmer to deliver the corn to a commodity broker who will sell it on behalf of the charity.

A contribution of ordinary income property can be made at any time during the year, and the gift can be made in the year of production or any subsequent year, as long as the donor has neither sold nor made a commitment to sell the property prior to the contribution. Contributions of ordinary income property can be especially appealing for donors who are unable to itemize their deductions as well as for extraordinarily generous donors whose contributions exceed the annual AGI limits for charitable deductions.

## **Conclusion**

Counterintuitive as it might seem, non-deductible contributions can be a tax-smart way for donors to support your organization. Of course, there is a hierarchy for fundraising: unrestricted contributions of cash provide the most flexibility for the organization. Nevertheless, we should always take the opportunity to discuss gifts of appreciated property with donors, whether or not they itemize their income tax deductions. Gift planners should also be alert for opportunities to suggest contributions of ordinary income property or pro bono work, and organizations should be prepared to welcome and recognize these donors for their valuable, albeit non-deductible, contributions to the mission.