

Charitable Organizations and Donors Have Significant Documentation and Reporting Requirements When it comes to Contributions

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Charitable organizations hold a unique position in the United States. Because they provide a valuable benefit to society, they are exempted from paying income taxes on their net earnings. This exemption was incorporated in the U.S. federal tax code in 1913. In 1924, the U.S. supreme court supported charitable entities exemption based on the fact, as they stated, that the public derives a benefit from their activities which is not conducted for private interest or gain. In addition, in 1917, because there was no financial incentive to support charitable organizations, the government allowed income tax deductions for contributions made. However, with more privileges came more scrutiny by the government over charitable organizations activities and reporting.

As the government agency most responsible for ensuring that charitable organizations comply with their mandate and that the public is protected, it is the IRS' responsibility to monitor charitable organizations operations. They accomplish this oversight obligation by requiring that charitable organizations comply with a number of reporting requirements and that donors maintain appropriate written or other supporting documentation of their contributions. The following describes some of the documentation and reporting requirements that donors and charitable organizations must comply with.

Substantiation for Tax Deductibility

In order for a donor to claim a tax deduction for any cash or non-cash contributions, he or she must maintain written documentation in the form of a canceled check, receipt or letter from the recipient charitable organization. For any single cash or non-cash contribution of \$250 or more the donor must obtain a contemporaneous, written acknowledgement of the contribution from the recipient charitable organization. If the contribution is in the form of non-cash goods the written statement must contain the following information:

- Name of recipient charitable organization and date of contribution
- A description of the non-cash contribution (value of the contributions is not required unless there is an objective basis of valuation)

In the case of donations in excess of \$75, where the donor receives something of value in return for their contribution (known as a quid pro quo contribution), a charitable organization must provide the donor with a written statement informing the donor of the amount of the contribution that is deductible for federal income tax purposes and a good faith estimate of the value of the goods or services that the donor received. A typical example of a quid pro quo charitable contribution is the purchase of a ticket for a fundraising event. If the ticket cost is \$100 but the ticket purchaser receives food and drinks with a fair value of \$65 then the portion that is deductible as a charitable contribution is \$35 (\$100-\$65). Since the total donor's payment exceeded \$75 then the charity must provide a written statement that states something like: "*Dear Mr. Doo Gooder - Thank you very much for your purchase of a ticket at our Annual Fundraiser Event in the amount of \$100. Be advised that the exchange value for goods received equaled \$65. As such, \$35 is eligible for a charitable contribution.*"

Reporting Charitable Contributions on Annual Returns (990 & 990-EZ) and Validating Tax-Exempt Status

Reporting charitable contributions properly on an annual basis is necessary to validate the reason for an organization's tax exemption and to ensure that payments received are in-fact contributions and not hidden quid pro quo or related party transactions.

When a charitable organization applies with the IRS for tax exemption as a public charity (form 1023 or 1023-EZ), it must state its reason (i.e. status) for wanting to be treated as a public charity. Despite the general belief that the term “public charity organization” means an organization that provides beneficial services to the public, although true, the designation “public charity”, according to the IRS, means an organization that receives a substantial portion of its income from the general public.

Many people are aware that public charities are classified by the IRS as a code section 501(c)(3) public charitable organization. But there are a number of different IRS code sections or subsections that charitable organizations can fall under, each with different levels of required public support. For example, an organization that applies for tax exemption under code sections 509(a)(1) and 170(b)(1)(A)(iv) must receive over 33 1/3 of its financial support in the form of contributions from publicly supported organizations, from a governmental unit or from the general public. However, an organization that applies for tax exemption under code sections 509(a)(2) must receive over 33 1/3 of its financial support in the form of contributions, membership fee and gross receipts from activities related to its exempt functions, and it cannot receive more than one-third of its financial support from gross investment income. Both of these categories (and there are a number of others) require annual reporting of charitable contributions to substantiate and maintain organizations’ charitable status. Annual reporting of charitable contribution details is done on Schedule A (Public Charity Status and Public Support) and Schedule B (Schedule of Contributions) and if applicable, these schedules are attached to either IRS form 990 (Return of Organization Exempt from Income Tax) or form 990-EZ (Short Form - Return of Organization Exempt from Income Tax).

In order for the IRS to ensure that charitable organizations are complying with tax laws and their reason for being tax-exempt, they require that charitable organization track and report donations by individual donors. This is done in several ways.

Form 990, Schedule A - To support the fact that an exempt organization is not a Private Foundation supported but a small number of donors, but rather a public charity supported by many donors, organizations exempted under IRS code section 170(b)(1)(A)(iv) and 170(b)(1)(A)(vi) must report on Schedule A of IRS form 990 or 990-EZ, all donations received during the year from individuals, trusts or corporations who donate more than 2% of total contributions received over the last five years. The amount that exceeds 2% is excluded from their public support test and dilutes their public support ratio. For organizations exempted under IRS code section 509(a)(2), the excludable amount is donations received during the year from individuals, trusts or corporations who donate more than 1% of total contributions received over the last five years.

Form 990, Schedule B – The IRS requires that charitable organizations disclose the names, addresses and amounts of donations received from individuals, trusts or corporations and foreign NGOs, over a certain dollar threshold on Schedule B. This is done to ensure the public support test mentioned above is being met and that multiple gifts from the same donor are not being hidden. This is also done to substantiate that donations are not related party or quid pro quo transactions. The dollar threshold for reporting donations is \$5,000 unless a charitable organization is exempted under IRS code sections 509(a)(1) and 170(b)(1)(A)(iv). For those charitable organizations the dollar threshold is the greater of \$5,000 or 2% of the total contributions, grants and membership income received during the year. For example, if total contributions, etc. for the operating year equals \$700K, only donations from a single donor over \$14K would be included on the form ($\$700K \times 2\% = \$14K$).

It is no surprise that many donors are uncomfortable with the fact that their names and addresses, not to mention the dollar amount of donations, are reported on Schedule B. Many donors would

like to remain anonymous and not have their donation reported to anyone. However, as previously mentioned the IRS is mandated with the responsibility of fair reporting, tax compliance and enforcement and as such, requires that charitable organizations report to them the source and amount of certain contributions on an annual basis. The IRS does recognize that disclosing certain information to the general public could have negative consequences to donors and therefore mandates that Schedule B is not be open to public inspection.

As you can see from the above discussion, charitable organizations have an increased obligation and responsibility to track all cash and non-cash contributions it receives, and depending on the dollar amount and type of donation it receives, and depending on the IRS code section it falls under, has legally mandated reporting requirement to both donors and the IRS.