T. FUND-RAISING ISSUES

Part I - Car Donation Programs

by Ray Seeley, Michael Seto, Debra Kawecki and Dave Jones

> ***"We know that there are people that donate cars that have no wheels, no glass, the hood's gone, the transmission's in the trunk, and there's grass growing out of the floorboards."***
>
> Steve Spriggs, director of development for the Sierra Vista Children's Center; quoted from the September 28, 1998, issue of the Chronicle of Philanthropy

The purpose of this article is to alert Exempt Organizations Tax Law Specialists about certain practices that occur in some car donation programs. The National Office views this as a growing area of noncompliance.

It is now common to turn on your radio, television or the internet and be exposed to an advertisement encouraging you to donate your car to charity. Many of these advertisements are from charities that receive cars so that they can use them in a sheltered workshop, refurbish them to give to the needy and other direct uses of the automobiles in the organization's charitable program. Some advertisements are from small organizations who receive a few cars that they resell themselves. This article is does not concern those organizations.

The focus of this article is on organizations who have permitted third party entrepreneurs to use their names to solicit contributions of cars; to plan and to place advertising for donations; to take delivery on the cars (or pick them up if they are not in running condition); to complete the legal paper work; and to sell them typically at auction or to junk yards or to scrap dealers.

Some small percentage of the amount recovered or a flat fee may be provided to the charity that lent its name to this program. Often charities perform no oversight in the process, leaving it up to the third party entrepreneurs to operate the program as they see fit. Perhaps because the charities have no control over the advertising practices of the third party they are dealing with, many claims we see are more outrageous than the ones that preceded it. If there is a common characteristic of these programs, it is that many charities have abdicated responsibility for the things that are done in their names.

This article refers to these practices as "suspect vehicle donation plans or programs" in order to distinguish them from the programs run by organizations that use the vehicles directly in their charitable programs or take an active role in the donation process. A typical advertisement for a suspect vehicle donation plan contains the following statements.

Turn Your Junk Into Jewels

Let ABC EO turn your old car into cash for you.

Take full BLUE BOOK Value!!!!!!

1. The Problems

There are potential negative tax consequences both for the donor and for the exempt organizations participating in suspect vehicle donation programs. While this article refers to charities, it applies to any exempt organization that can receive deductible contributions.

The difficulty for the donor is obvious. Most donors, relying on the representations in the advertising, assume that the donations are deductible under IRC 170. But are they? If they are, how much is deductible? The standard books available for evaluating the worth of a car, the "Blue Books", are based on the condition of the car. Most, if not all of the methods presume that the car is running and then evaluate it according to its condition, mileage, etc.

Many of the car donation advertisements claim that the donor can deduct full Blue Book value. It is well settled law that a deduction cannot exceed the fair market value of the item donated. The donor may not be entitled to a deduction or, if he is entitled to a deduction, the deduction may be overstated if the vehicle is not in running order.

The problems for the charity may be even greater. In a handful of situations, promoters may be using the program to enrich themselves. This article discusses issues of private benefit, inurement, substantial nonexempt purposes and the possible involvement of IRC 4958.

In order for this arrangement to meet requirements of IRC 170, the charity will most likely have to provide the substantiation statements required under IRC 170(f)(8); and to acknowledge that qualified written appraisals relating to the vehicles if donations worth more than $5000 are made. The donor must produce both the statement and the acknowledgement (if necessary) to substantiate a claimed contribution. Whether it does the paperwork itself, or whether the paperwork is done on its behalf; the charity must ensure that this paperwork is done accurately because there are penalties for aiding and abetting in the preparation of a false return.

There is a question of how to characterize the income received by the charity. If the charity receives a payment from a third party, the donated goods exception of IRC 513(a)(3) will not be available. The exclusion of royalty payments from unrelated business income rules exception may be available in some cases. However, where contributions are not deductible, an exempt organization may not be able to make a claim that the income is exclusively a royalty payment if it flows from the sale of a right which the taxpayer cannot license - the right to receive deductible contributions.

The Service is not alone in its concern about abuses in this area. California, for example, is in the forefront in having recently enacted legislation in an attempt to curtail the abuse of inflated appraisals. The September 28, 1998, issue of the Chronicle of Philanthropy, describes the passage of the new law.

> Gov. Pete Wilson of California has approved a measure passed by the Legislature that is intended to crack down on donors who take excessive charitable tax deductions for gifts of used cars, boats, and airplanes.
>
> The new law requires a charity -- or a "commercial fund raiser" working for a charity -- to provide a receipt to the donor within 90 days of the date the gift was made that describes the condition of the gift. If the charity sells the vehicle to a dismantler before it issues the receipt, it has to include in the receipt the amount the dismantler paid for the vehicle.

2. Typical Relationships

At the heart of the problems just discussed in suspect car donation cases, is the relationship between the charities and the for-profit entrepreneurs. The relationships are generally determined by contract. The legal status of the parties is often a useful key to their tax status. The relationships vary widely - program to program. Possible relationships are: agent and principal; joint venturers; licensor and licensee; and employer and independent contractor hired to perform a service.

These issues are made even more complex because certain terms may have different meanings under state law. For example, titling and its exact meaning may very from state to state.

3. Deductibility

To be deductible, a contribution must be "to" or "for the use of" an organization described in IRC 170(c). Whether a contribution is "to" an organization is based on whether the donee organization has full control of the donation and discretion as to its use. See Rev. Rul. 62-113, 1962-2 C.B. 10.

The following fact pattern is typical in many suspect vehicle donation plans. Example I - A is an IRC 501(c)(3) organization. A has entered into a contract with professional fund-raiser Z. The fund-raising is to take place in the State of M. M's titling laws require owners' to appear in the chain of title. Owners cannot appoint agents to hold title for them.

The contract contains the following terms: 1. Z is given the right to advertise and solicit donations of motor vehicles and to give "tax deductible receipts" in the name of "A" to the donors of the items.; 2. Z will receive and keep proceeds from the sales of the donated items.; 3. Z pays all of the costs related to the solicitation and sales of the donated items.; 4. Z will hold A harmless from any liability of any kind.; 5. A is not responsible for any facet of the project except to provide endorsement when requested.; 6. Z is appointed A's agent to sign all documents and handle matters relating to dealer's licensing.; 7. As full consideration for the rights under this contract Z pays A a fixed amount of $4,000 per month.

Both A and Z hold M Class 'B' Used Vehicle Dealer licenses. In operating the program, the donor assigns the vehicle's title to the charity. Z, in its capacity of A's agent, reassigns it to itself. A never takes possession of the vehicle.

In this fact pattern, A has neither control over the donated vehicles, or discretion as to their use. Under the contract, A is not involved in reviewing the advertising or exercising any discretion as to the solicitations. Once Z takes possession, A plays no role in any decision as to their use.

The titling process, while nominally designed to incorporate A in the chain of title in order to satisfy the legal requirements of M is insufficient to show agency. A does not take possession of a vehicle or even oversee that aspect of the transaction. In fact, A has abdicated any oversight in titling them.

Another factor, weighing against the idea that these vehicles have been donated to A, is the way A is compensated under the contract. A, or an employee or agent of A properly delegated, could have conducted the program. In the agency situation, A would normally bear the risk of loss. While this one factor may not by itself be determinative, it combined with the others indicate that donations of the vehicles hasn't been made to A.

A exercises no discretion as to the vehicles' disposition. It makes no decisions over whether they are sold as used cars or sold at auction. It is difficult to see that disposition isn't an important part of their use.

These facts, when read together indicate that A does not exercise the kind of control and discretion required by Rev. Rul. 62-113.

"For the use of" generally refers to donations made in trust or similar arrangement. Davis v. United States, 495 U.S. 472, 481 (1990). Under the situation discussed in the example, the donations are not made in trust or similar arrangement so they cannot be "for the use of" A.

4. Private Benefit in General

Reg 1.501(c)(3)-1(c) provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. (emphasis added).

Reg. 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for charitable purposes unless it serves a public rather than a private interest. Accordingly, the regulations provide,

> it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

If an organization serves a public interest and also serves a private interest other than incidentally, it is not entitled to exemption under section 501(c)(3). This proposition is simply an expression of the basic principle underlying the enforcement of charitable trusts and exemption from federal income taxation under section 501(c)(3).

It is a settled principle of charity law that a charity's property is devoted to purposes which are considered beneficial to the community in general, rather than particular individuals. See, IV A. Scott on Trusts, Sec. 348 (3d ed. 1967). Thus, although an organization's operations may be deemed to be beneficial to the public, if it also serves private interests other than incidentally, it is not entitled to exemption.

The word ‘incidental’ in this context has both qualitative and quantitative meanings. To

be incidental in a qualitative sense the benefit to the public cannot be achieved without necessarily benefitting certain private individuals. An example of this qualitative aspect is provided by Rev. Rul. 70-186, 1970-1 C.B. 128.

In Rev. Rul. 70-186 an organization was formed to preserve a lake as a public recreational facility and to improve the condition of the water in the lake to enhance its recreational features. Although the organization clearly benefitted the public, there necessarily was also significant benefit to the private individuals who owned lake front property. It was determined that the private benefit was incidental in a qualitative sense. Any private benefit derived by the lake front property owners did not lessen the public benefit flowing from the organization's operations. In fact, it would have been impossible for the organization to accomplish its purposes without providing benefits to the lake front property owners.

There is also a quantitative meaning to the term 'incidental' private benefit. If the organization's activity provides a substantial benefit to private interests, even indirectly, it will negate charitability and exemption under IRC 501(c)(3). The substantiality of the private benefit is measured in the context of the overall public benefit conferred by the activity.

In Rev. Rul. 76-152, 1976-1 C.B. 151, a group of art patrons formed an organization to promote community understanding of modern art trends. The organization selected modern art works of local artists for exhibit at its gallery, which was open to the public. If an art work was sold, the gallery retained a commission of ten percent and paid the remainder to the artist. Direct economic benefit was conferred on the individual artists by the gallery's sale and rental of the art works that defeated exemption even though the organization's other activities furthered the arts.

5. Captive Programs

Present in vehicle donation programs, as in some other fund-raising situations is the possibility that promoters can take advantage of the format, solicit vehicles publicly, do little or no charity with the primary object of enriching themselves. This raises the question of whether the organization is operated for a private benefit in both a qualitative and a quantitative sense.

Consider the following example of a captive program. Example 2: Y is an automobile dealer in the state of M who is familiar with the automobile business. He sees the car donation programs as a way to make additional revenue. To this end, he creates charity B. Charity B applies for and receives recognition of exemption under IRC 501(c)(3). In its application for recognition, it represents that is going to be involved in educating the public on health issues.

After recognition Y enters into a contract with B, which he controls, similar to the contract in Example 1. One major difference, however, is a provision that hires Y as B's "agent" to run one aspect of its overall charitable program. Under the arrangement Y will set up a web page that has links to the national disease prevention programs. The bulk of the web page is devoted to soliciting vehicle donations. Potential donors are offered significant premiums for participating in the program. These include discount books and tickets in new car raffles.

Needless to say, this prize structure greatly increases the cost of the program and reduces the amount that B receives. While B retains a small percentage of the gross (as opposed to a flat fee) at the end of each month, it has yet to devote the proceeds to any charitable endeavor.

The true beneficiary of this suspect vehicle donation program seems to be Y, the automobile dealer. He arranges the transaction, takes delivery on or picks up the vehicles, resells the vehicles or cannibalizes them for their parts, and turns over a prearranged percentage to the charity. None of this could happen without the charity. If the charity did not participate and lend its tax exempt status to the transactions, there would be no trading in donated cars. If B does nothing with the proceeds during the years under examination, can one argue that B is not operated for private benefit during those years in a qualitative sense? Is it operated to serve a private benefit in a quantitative sense?

Inurement, a particular form of private benefit is discussed in the next session. The distinct characteristic of inurement is that it involves an inappropriate diversion of funds.

6. Inurement

To meet the operational test, an organization must not be operated for the benefit of designated individuals or the persons who created it. Regs. 1.501(c)(3)-1(d)(1)(ii). An organization's trustees, officers, members, founders, or contributors may not, by reason of their position, acquire any of its funds. If funds are diverted from exempt purposes to private purposes exemption is in jeopardy.

The Code specifically forbids the inurement of earnings to the benefit of insiders, private shareholders or individuals. Further, the regulations state that an organization is not operated exclusively for the statutory purposes if its net earnings inure to the benefit of individuals. Regs. 1.501(c)(3)-1(c)(2).

The prohibition of inurement, in its simplest terms, means that a private shareholder or individual cannot misappropriate the organization's funds to himself except as reasonable payment for goods or services.

Deferred or retained interests in the organization's assets may be a form of indirect benefit not permitted by the statute. Where the officers of a school leased property to the school and caused it to erect expensive improvements which would benefit them individually when the lease expired, exemption was denied. Texas Trade School, 30 T.C. 642 (1968), aff'd. 272 F.2d 168 (5th Cir. 1959). In the suspect vehicle program, if the broker is an insider and causes the organization to enter into a transaction that is economically detrimental to the exempt organization and good for the insider, inurement issues arise.

In Rev. Rul. 66-259, 1966-2 C.B. 214, the creator of a charitable trust retained a reversionary interest in trust assets, and exemption was denied. Under the terms of the trust agreement, any increase in the value of the trust assets would become part of principal and would return to the creator at the time he took possession of his reversionary interest. Similarly, with the suspect vehicle donation program the donor and broker are receive the lion's share of the benefits while the charity is providing the acknowledgment that makes the deal possible.

IRC 501(c)(3) does not prohibit all dealings between a charitable organization and its founder or with those in controlling positions. However, where individuals controlling the organization receive funds that rightfully belong to the organization, exemption is precluded because of inurement. Suppose, for example, Y, in example 2, understated the income to the program, this would reduce B's income and because Y is an insider, constitute inurement.

7. IRC 4958

Section 4958 was added to the Code by the Taxpayer Bill of Rights 2, P.L. 1044-168. It generally applies to excess benefit transactions occurring on or after September 14, 1995.

An excess benefit transaction (EBT) is any transaction in which an economic benefit provided by an applicable tax-exempt organization to, or for the use of, any disqualified person exceeds the value of consideration received by the organization in exchange for the benefit. A disqualified person is any person who was, at any time during the 5-year period ending on the date of the excess benefit transaction, in a position to exercise substantial influence over the affairs of the organization.

There are three taxes under IRC 4958. Disqualified persons are liable for the first two taxes, under IRC 4958(a)(1), a tax of 25 percent of the excess benefit must be paid by any disqualified person who benefits from an EBT. Under IRC 4958(b), a tax of 200 percent must be paid by any disqualified person who benefits from an EBT if the transaction is not corrected. Under IRC 4958(a)(2) a tax of 10 percent of the excess benefit must be paid by any organization manager who participates in an EBT knowingly, willfully, and without reasonable cause.

Does IRC 4958 tax apply to example 2?

8. Unrelated Business Income Tax

IRC 512(b)(2) excludes from unrelated business taxable income:

> [A] all royalties (including overriding royalties) whether measured by production or by gross or taxable income from the property, and all deductions directly connected with that income.

The term "royalties" is not defined in either the Internal Revenue Code or the regulations. Reg. 1.512(b)-1 provides that whether a particular item of income falls within any of the modifications provided in IRC 512(b) (which includes "royalties") shall be determined by all the facts and circumstances of each case.

The issue of whether income under certain types of arrangements constitutes a "royalty" has been the subject of revenue rulings and numerous court decisions.

Rev. Rul. 81-178, 1981-2 C.B. 135, holds that payments an exempt labor organization receives from various business enterprises for the use of the organization's trademark and similar properties are royalties within the meaning of section 512(b)(2) of the Code and are not taken into account in determining unrelated taxable income. However, payments the organization receives for personal appearances and interviews by its members are not royalties but are compensation for personal services and must be taken into account in computing the organization's unrelated business taxable income.

> To be a royalty, a payment must relate to the use of a valuable right. Payments for the use of trademarks, trade names, service

> marks, or copyrights, whether or not payment is based on the use made of such property, are ordinarily classified as royalties for federal tax purposes.

The ruling also noted that, although excluded from UBIT as a royalty, the income from the licensing activity was income from unrelated trade or business since the licensing agreements did not directly promote the group's exempt purposes.

There are many different forms the arrangement between the exempt organization and the promoter can take. For purposes of this discussion, we are only considering the arrangement where by the exempt organization permits the third party broker to use its name in marketing its donation program. In return, the exempt organization receives a fee which is calculated as a percentage of gross receipts.

If this was the entire agreement, royalty treatment might be appropriate. But that is not all that is happening here. Promoters are typically given the right to claim that contributors to the program can take deductions for their donations. The fact that contributions other than to the charities or their agents are not deductible raises questions as to whether the income is a royalty. Second, by providing the substantiation required by IRC 170(f)(8) and acknowledging appraisals of donations worth more than $5000, the organization is providing services that may preclude royalty treatment as well. See Rev. Rul. 81-178, 1981-2 C.B. 135.

9. Penalties

Under the Tax Equity and Fiscal Responsibility Act of 1982, Congress enacted IRC 6700 and IRC 6701 as penalties for the abuse of tax shelters. IRC 6700 imposes a penalty on anyone -- promoters, salesmen and their assistants -- for organizing and selling abusive tax shelters. IRC 6701 is the aiding and abetting provision, and it imposes a penalty on those who aid and assist in the preparation of false or fraudulent tax documents that would result in an understatement of tax liability. (See 1999 CPE, Topic M, Application of IRC 6700 and IRC 6701 To Charitable Contribution Deductions, p. 261, for further discussion).

These two provisions could be applicable in the exempt organizations area. Charities often receive gifts of property from contributors either as a fund-raiser or so that they may carry out their charitable endeavors. IRC 170(c) provides that such contributions are tax deductible for federal income tax purposes provided that certain requirements are met. One requirement, under IRC 170(f)(8)(A), is that a contribution of $250 or more, whether in cash or property, is tax deductible only if that contributor has a contemporaneous written acknowledgment from the donee organization. (See 1997 CPE, Topic G, Updates on Disclosure and Substantiation Rules, p. 67, for further discussion of this provision.)

Another is contained in Reg. 1.170A-13(c). This regulation requires that contributors of property worth more than $5000 receive "qualified written appraisals." The donee organization must sign the appraisal summary. In this situation, the charity is not attesting the validity or accuracy of the appraisal, but is acknowledging that it has received the donated property.

Failure to satisfy these provisions can lead to the loss of the tax deduction.

The current working supposition is that these two requirements interplay with IRC 6701 in the vehicle donation situation, where no deductible contribution is appropriate. There a charity's attempted delegation of its paperwork obligations under IRC 170(f)(8) and with respect to qualified written appraisals result in documents that individuals can use to understate income tax liability. The only factual question is whether a charity "knows (or has reason to believe (IRC 6701(a)(2)) that its actions result in an understatement.

The same reasoning applies where a charity has not delegated its obligations. In other words, where a charity itself prepares the IRC 170 substantiation statements and signs the qualified written appraisal summaries, it also may be involved in aiding and abetting the understatement of tax liability if no deduction is appropriate.

Even where a contribution is appropriate, failure to properly supervise excessive claims concerning deductibility (e.g. cars without motors can result in deductions equal to blue book value) may result in an overstatement of a tax deduction under IRC 6701 (or so it would seem if a principal is responsible for the actions of his agent under IRC 6781).

Topic M of the 1999 CPE article referred to earlier discusses the IRC 6700 penalty and its application to the third party entrepreneurs who actually run the suspect programs.

10. Service Response

On May 27, 1999, the Director, Exempt Organizations Technical Division (OP:E:EO) issued a memorandum to the Regional Chief Compliance Officers entitled Used Car Donation Programs. The memorandum discusses the issue and contains the following alert.

> We are concerned that some of this advertising is misleading or, in some instances, false, and is being used inappropriately. Key districts should be alert to the advertising that is being conducted in their districts and should consider conducting examinations if the facts warrant. Key district should consider using the tax shelter penalties in appropriate cases. it is possible that some abusive contractual arrangements may result is excessive private benefit and thus jeopardize the exempt status of the charities involved...In appropriate cases, referrals of individual donors to the examination function should be

considered.

Part II – Scrip Programs

by Michael Seto and Dave Jones

1. Introduction

Many charities conduct fund-raising activities that offer benefits to their patrons in return for contributions. Traditional activities of this type include bake sales and golf tournaments. One such effort to increase revenue involves participation in “scrip” programs.

2. "Scrip" Programs

A "scrip" program is a fundraiser whereby merchants issue gift certificates at a discount to charities through a "scrip operator". The scrip have face values and can be used to purchase goods or services. The scrip operator administers the scrip program and negotiates with each participating merchant to set the prices that the charities will pay for the scrip. It arranges for the distribution of the scrip to participating charities. It also provides support services for the scrip program, such as telephone operators, toll-free phone and fax, order processing, inventory fulfillment, shipping, tracking, and computerized database accounting systems.

The purchase price that a charity pays for the scrip is a certain percentage (usually ten percent) below the face value of the scrip. The difference between the discounted purchase price and the face value of the scrip represents a charity's proceeds from the fund-raising program. The charity sells the scrip at face value to its members. The scrip operator would receive from the merchants a percentage (one percent, for example) of the face value of the scrip that is sold by the charity.

3. Charitable Contribution or Purchase Price?

IRC 170(c) allows deductions for charitable contributions. The basic rules of whether a payment is made as a gift or as a purchase price for the purchase of goods or services is discussed in Rev. Rul. 67-246, 1967-2 C.B. 104. To qualify as a charitable contribution, a payment to a charity must be a gift with no expectation of receiving a benefit in return. Where a payment is made in return for an item or benefit, the presumption is that such payment is the purchase price and not a gift. The payment represents the fair market value of the item or benefit and, therefore, is not tax deductible. To rebut the presumption, the taxpayer must show that:

- the payment made for the item or benefit exceeds the fair market value of that item or benefit; and

- the excess payment is made with the intent to make a gift.

The first requirement is satisfied by evidence that the payment exceeds the fair market value of the item or benefit received. The second requirement is satisfied if the surrounding facts and circumstances of the payment indicate the taxpayer's knowledge that the payment exceeded fair market value and the intent that it be a gift.

In the scrip program, a taxpayer makes a payment to a charity in return for scrip. The presumption is that the payment made for the scrip is the purchase price. Unless it can be shown that (a) the payment made for the scrip exceeds its fair market value; and (b) the excess payment is made with the intent to make a gift, the payment cannot be considered a gift.

A. Example 1

Charity A purchased one thousand scrip booklets through Y, the scrip organizer, at a ten percent discount from face value. Each booklet has a face value of $100 and contains ten pieces of scrip, each with a denomination of $10. Each scrip is redeemable for goods purchased at X, a store. John Doe purchased a scrip booklet from Charity A for $100. Since the payment equals the market value of the booklet when redeemed at X, the $100 is the purchase price of the scrip and not a gift. John Doe may not deduct any part of the payment to Charity A as a charitable contribution.

B. Example 2

The facts are the same as above except for the following. Charity A sets the sale price of each booklet at $225. John Doe purchases a booklet from Charity A for $225, knowing that its fair market value is $100 and intending the $125 excess payment to be a gift. At the time of the sale to John Doe, Charity A provides him with a letter that contains the following information: a good faith estimate of the $100 fair market value of the scrip booklet provided in exchange for the $225 (in this case the estimate was simple because the booklet was worth $100 of goods or services); and stating that the amount of the payment that is tax deductible for federal tax purposes is the difference between the fair market value of the scrip booklet and John Doe's payment. Since the payment exceeds the fair market value of the booklet and that excess is intended as a gift, John Doe may claim a charitable contribution of $125.

4. Quid Pro Quo Contributions

The situation described in Example 2 is a "quid pro quo contribution". It is a payment made partly as a contribution and partly as a payment for goods or services. In 1993, legislation was enacted that required charities to advise individuals of the rules relating to "quid-pro-quo" gifts when they were involved in fund-raising programs that feature them. (See IRC 6115(b)). See in the 1997 CPE, Topic G, Updates on Disclosure and Substantiation Rules, at pp. 67-81, for a detailed discussion. For the first time charities were required, in IRC 6115, to inform donors about the requirements of IRC 170 if the charities engage in fund-raising programs using "quid-pro-quo" gifts.

IRC 6115 provides that if a quid-pro-quo contribution involves a payment of more than $75, charities must provide to the contributor in connection with the solicitation a receipt of the contribution and a written disclosure statement that contains the following information:

- A good-faith estimate of the fair market value of the goods or services provided in return for the contribution;

- A statement that the amount of the contribution the donor may deduct for Federal income tax purposes is reduced by the fair market value of the goods or services received in return for the contribution.

In example 2 above, Charity A conformed with the requirements of IRC 6115.

IRC 6714(a) provides that a penalty of $10 per contribution is imposed on organizations that do not meet the disclosure requirement of IRC 6115. This provision also provides that the maximum penalty for a fund-raising event or mailing is $5,000.

5. Donor Substantiation Requirements

In 1993, Congress enacted a second piece of legislation that has some bearing on scrip programs. IRC 170(f)(8)(A) provides that no deduction is allowed under IRC 170 for a contribution of $250 or more in cash or property unless the taxpayer has a contemporaneous written statement from the charity substantiating the donation. IRC 170(f)(8) has less of an impact on scrip programs than IRC 6115 because most scrip programs involve sales of less than $250. For a detailed discussion of substantiation rules in general, see the 1997 CPE article, Topic G.

In example 2 above, Charity A's letter to John Doe contain sufficient information to satisfy the substantiation requirements of IRC 170(f)(8). Although Mr. Doe is not required to have a written letter from Charity A for IRC 170(f)(8) purposes because the contribution was less than $250, Charity A is required to make a disclosure under IRC 6115 because Mr. Doe's payment was a quid pro quo contribution and the amount was more than $75. Where no gift is involved, as was the case in example 1, no substantiation statement is required.

The penalty for failure to obtain the substantiation statement required by IRC 170(f)(8) falls, in the first instance, on the contributor. Although charities are involved in issuing the statement, Congress does not impose on charities a penalty for failure to furnish an IRC 170(f)(8) statement. The belief was that where donors of $250 or more could not take a deduction because they were not given properly completed substantiation statements, the donors would punish the charity by not giving to them in the future. Charities on the other hand would see substantiation as an element in good donor relations. A charity that knowingly provided false written substantiation to a donor might be subject to the penalties for aiding and abetting an understatement of tax liability under IRC 6701.

6. The For-Profit Provider

As indicated earlier, for-profit scrip providers are integrally involved in many of the scrip programs. Although the operators are actively involved in promoting the business, they are not, unlike the car donation promoters discussed earlier, selling scrip to donor/consumers. In scrip programs, the selling/soliciting donation process is done at the grass-roots levels by the charities. Typically they are non-profit schools, local arts organizations, youth organizations, and churches. IRC 6115 and to a lesser extent IRC 170(f)(8) are the primary compliance tools available.