



James H. Sutton, Esquire
CEO and Chief Counsel
23 Olive Avenue
San Rafael CA 94901
Telephone/Fax 415-456-1960
jamie@v-dac.com

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TO: Distribution

RE: The Vehicle Donation "Direct Furtherance" Clause in Section 884 of the American Jobs Creation Act: 2004

Legislative Summary

The vehicle donation provisions (Section 884) of the JOBS Act emerged from conference committee as the Senate version with House amendments incorporated into it. Section 884 contains a new rule, that a vehicle donor may only deduct the amount of the actual "gross proceeds received" from the sale of the vehicle. The previous standard, and the one applied for all other in-kind donation, permitted donors to take the retail "fair market value" of their donation; that is the amount they would realize if they sold the car themselves and gave the cash to their charity. [Most donated vehicles are converted by the charity into cash at wholesale auto auctions, for 5 to 80% of their retail "fair market value."] The original Senate version had 2 exceptions ("significant intervening use" and "material improvement.") Contained within the House amendments was a third exception ("direct furtherance") to this new "gross proceeds received" rule.

Actual Legislative Language

The critical parts of Section 884: Vehicle Donation Programs read:

- (A) IN GENERAL.—In the case of a contribution of a qualified vehicle the claimed value of which exceeds \$500—
- (ii) if the organization sells the vehicle without any significant intervening use or material improvement of such vehicle by the organization, the amount of the deduction allowed under subsection (a) shall not exceed the gross proceeds received from such sale.
- (F) REGULATIONS OR OTHER GUIDANCE.—The Secretary shall prescribe such regulations or other guidance as may be necessary to carry out the purposes of this paragraph. The Secretary may prescribe regulations or other guidance which exempts sales by the donee organization which are in direct furtherance of such organization's charitable purpose from the requirements of subparagraphs (A)(ii) and (B)(iv)(II).

These exceptions are discussed in the "Conference Agreement" published at the time of the bill's passage. The "Conference Agreement" separately and equally addresses the 3 exceptions to the new "charity's sale price" standard for deductions. In a separate paragraph, it addresses the House's addition [contained in Section (F) above]; the "direct furtherance" exception as follows:

The conference agreement also provides that the Secretary may prescribe regulations or other guidance that exempts sales of vehicles that are in direct furtherance of the donee's charitable purposes from the requirement that the donor may not deduct an amount in excess of the gross proceeds from the sale, and the requirement that the donee certify that the vehicle will not be transferred in exchange for money, other property, or services before completion of a significant use or material improvement by the donee. The conferees intend that such guidance

may be appropriate, for example, if an organization directly furthers its charitable purposes by selling automobiles to needy persons at a price significantly below fair market value.

The full text of Section 884 and the Conference Agreement is attached.

Analysis

Result of “Direct Furtherance” Exception Legislation

The conferees provide that vehicles that are “in direct furtherance of the donee’s charitable purposes” may be exempted by the Secretary’s regulations and guidance from (1) the requirement that the donor may not deduct an amount in excess of the gross sales proceeds and (2) the requirement that the donee/charity certify the non-sale or transfer of the received vehicle until after a significant use or improvement by the charity has been completed. That is, if a vehicle is given to and then is sold by a donee/charity and that sale directly furthers the specific charitable purposes of the donee/charity, then two things happen. First, the donor may deduct the fair market value of the vehicle and he/she is freed from the limitation requiring a deduction that equals the gross sales proceeds. Second, the donee/charity is not required to certify that it won’t sell the car until after significant use or material improvement. After all, the donee/charity is going to sell the car right away, without this use or improvement. It is part of the charity’s purpose to sell the car and it, as a matter of course, intends to sell it immediately. That is the business it is in and, therefore, no certificate is called for.

Charities Covered by “Direct Furtherance” Exception

The “direct furtherance” exemption, then, depends on the nature of the donee/charity that sells the donated vehicle. The question is, for which donee/charities are the sales of donated vehicles within the direct furtherance of their charitable purpose?

The question of “direct” involvement has been previously clarified in Unrelated Business Income Tax (UBIT) regulations and guidance. Some activities are forbidden (or taxed) if done by one charity but permitted if done by another. This depends on whether the activities were in “direct” furtherance of the charity’s purpose. The activity (trade or business) is permitted if “substantially related to the charitable, educational or other purposes that are the basis of the organization’s tax exemption.” The actual sales of the vehicles by the charity must “directly” advance its purpose without any intervening steps. So, vehicle sales would not qualify if done by a charity for the purpose of generating money to support the charitable activities of an AIDS research charity or animal rights advocates or an environmental land trust or a university as the sale of vehicles is a secondary activity.

There are three charity structures that would qualify:

1. “Employment Charities” that exist to employ drug addicts or the disabled or those otherwise unemployable and that use selling vehicles as a way to provide employment would qualify (example: Goodwill.)
2. “Transportation Charities” that exist to sell low cost vehicles to the disadvantaged would qualify (example: None known - most simply give vehicles to deserving individuals, and see the example from the conference agreement.)
3. “Conversion Charities” that exist specifically to gather gifts from donors (in-kind donations, stocks, credit card contributions, payroll deductions and others), to convert them efficiently into cash and then to pass that cash on to other legitimate charities would qualify.

For illustrative purposes (and in tribute to Christopher Reeve) we will look at how these three special structures might affect a charity that benefits quadriplegics. A normal charity structured to raise funds to provide medical or other benefits to quadriplegics or to further quadriplegic research will not qualify. Selling vehicles would clearly be a secondary activity. If the charitable purpose of the donee/charity is to employ quadriplegics, then vehicle sales are exempted as long as they provide employment of quadriplegics and are no more extensive than necessary to achieve this employment. If the charitable purpose is to provide inexpensive transportation to quadriplegics, then donated vehicles sold at a reduced cost to the families of quadriplegics to help them would qualify for the exemption. Finally, vehicle sales would qualify for the exemption if the specific purpose of the donee/charity was to take on the responsibility and liability of converting in-kind donations into cash and, then, passing that cash on to separate quadriplegic charities so that they, in turn, can do their good works.

Discussion of “Conversion Charities”

Conversion charities are recognized, chartered and granted tax-exempt status by the IRS. They are specifically designed to help individual charities with matters often beyond their financial and staff resources and to instill efficiency and accountability. These charities collect a number of different types of gifts that are not directly useable by most charities. They convert them into the cash that charities need to run their programs. The recognized purpose of conversion charities is to provide expertise in sophisticated and complex transactions; to undertake legal liability and shield individual charities from tort exposure; to effect conversions efficiently so as to save local administrative costs; and finally to provide oversight of the recipient charities to ensure that they meet their financial and administrative responsibilities to their constituents and to the Government that has granted them tax-exempt status. Federated giving charities like United Way may qualify as conversion charities if their charters are broadly written so that they can include vehicle donations (for example: Collect “gifts” rather than “payroll deductions”). One of the functions provided by “conversion charities” is that they police recipient non-profits. They certify their legitimate charitable purpose, eliminating the IRS concern that donors make sure that vehicle donations are made to legitimate charities.

Purpose of the American Jobs Creation Act

One of the stated and repeated intentions of the American Jobs Creation Act was to impose legitimacy and accuracy upon the vehicle donation industry and upon the advice given to taxpayers by donee/recipients. Congress clearly intended that vehicle donations be reformed and restricted but not eliminated. Congress estimated that this Act will increase individual taxpayer taxes \$2.4 billion over 10 years, a reduction of 36% in the \$6.54 billion tax saving that taxpayers currently get (see GAO Report: 04-73.) Failure to issue regulations will mean all vehicle donations fall under the “donee sale price” rule, which are estimated to result in a 90% reduction in tax savings (\$5.9 billion tax increase) as higher value vehicles will no longer get a tax benefit in excess of trade-in offers. [In addition to the \$5.9 billion tax increase, there will be a wealth transfer effect to automobile dealers as trade-in values drop because of the lack of a floor price that is currently set by the tax benefits that owners can currently receive.]

Conclusion

In conclusion, the Conferees clearly intent a specific “direct furtherance” exemption from the deduction limits and certification that the Act generally imposes. One class of donee that falls

within that exemption is “conversion charities.” Their specific purpose is to provide the complicated, expensive, high-liability vehicle-to-cash conversions on behalf of recipient charities.

Finally, it is now critically important that the Treasury quickly issue the called for regulations and other guidance that activate this exemption so that economic, tax and charitable damage can be avoided. Failure to act before the December 31, 2004 implementation date of Section 884 will result in higher tax rates on individual taxpayers and an interruption, even devastation, of the legitimate vehicle donation programs. Action by Treasury will also allow the more responsible “conversion charities” to implement a system of accurate donation valuations that has to date been sorely lacking.

ATTACHMENT I

SEC. 884. DONATIONS OF MOTOR VEHICLES, BOATS, AND AIRPLANES.

(a) IN GENERAL.—Subsection (f) of section 170 (relating to disallowance of deduction in certain cases and special rules), as amended by this Act, is amended by inserting after paragraph (11) the following new paragraph:

(12) CONTRIBUTIONS OF USED MOTOR VEHICLES, BOATS, AND AIRPLANES.—

(A) IN GENERAL.—In the case of a contribution of a qualified vehicle the claimed value of which exceeds \$500—

- (i) paragraph (8) shall not apply and no deduction shall be allowed under subsection (a) for such contribution unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgement of the contribution by the donee organization that meets the requirements of subparagraph (B) and includes the acknowledgement with the taxpayer's return of tax which includes the deduction, and
- (ii) if the organization sells the vehicle without any significant intervening use or material improvement of such vehicle by the organization, the amount of the deduction allowed under subsection (a) shall not exceed the gross proceeds received from such sale.

(B) CONTENT OF ACKNOWLEDGEMENT.— An acknowledgement meets the requirements of this subparagraph if it includes the following information:

- (i) The name and taxpayer identification number of the donor.
- (ii) The vehicle identification number or similar number.
- (iii) In the case of a qualified vehicle to which subparagraph (A)(ii) applies—
 - (I) a certification that the vehicle was sold in an arm's length transaction between unrelated parties,
 - (II) the gross proceeds from the sale, and
 - (III) a statement that the deductible amount may not exceed the amount of such gross proceeds.
- (iv) In the case of a qualified vehicle to which subparagraph (A)(ii) does not apply—
 - (I) a certification of the intended use or material improvement of the vehicle and the intended duration of such use, and
 - (II) a certification that the vehicle would not be transferred in exchange for money, other property, or services before completion of such use or improvement.

(C) CONTEMPORANEOUS.—For purposes of subparagraph (A), an acknowledgement shall be considered to be contemporaneous if the donee organization provides it within 30 days of—

- (i) the sale of the qualified vehicle, or
- (ii) in the case of an acknowledgement including a certification described in subparagraph (B)(iv), the contribution of the qualified vehicle.

(D) INFORMATION TO SECRETARY.—A donee organization required to provide an acknowledgement under this paragraph shall provide to the Secretary the information contained in the acknowledgement. Such information shall be provided at such time and in such manner as the Secretary may prescribe.

(E) QUALIFIED VEHICLE.—For purposes of this paragraph, the term 'qualified vehicle' means any

- (i) motor vehicle manufactured primarily for use on public streets, roads, and highways,
- (ii) boat, or
- (iii) airplane. Such term shall not include any property which is described in section 1221(a)(1).

(F) REGULATIONS OR OTHER GUIDANCE.—The Secretary shall prescribe such regulations or other guidance as may be necessary to carry out the purposes of this paragraph. The Secretary may prescribe regulations or other guidance which exempts sales by the donee organization which are in direct furtherance of such organization's charitable purpose from the requirements of subparagraphs (A)(ii) and (B)(iv)(II).

(b) PENALTY FOR FRAUDULENT ACKNOWLEDGMENTS.—

(1) IN GENERAL.—Part I of subchapter B of chapter 68 (relating to assessable penalties), as amended by this Act, is amended by inserting after section 6719 the following new section:

SEC. 6720. FRAUDULENT ACKNOWLEDGMENTS WITH RESPECT TO DONATIONS OF MOTOR VEHICLES, BOATS, AND AIRPLANES. Any donee organization required under section 170(f)(12)(A) to furnish a contemporaneous written acknowledgment to a donor which knowingly furnishes a false or fraudulent acknowledgment, or which knowingly fails to furnish such acknowledgment in the manner, at the time, and showing the information required under

section 170(f)(12), or regulations prescribed thereunder, shall for each such act, or for each such failure, be subject to a penalty equal to—

- (1) in the case of an acknowledgment with respect to a qualified vehicle to which section 170(f)(12)(A)(ii) applies, the greater of—
 - (A) the product of the highest rate of tax specified in section 1 and the sales price stated on the acknowledgment, or (B) the gross proceeds from the sale of such vehicle, and
- (2) in the case of an acknowledgment with respect to any other qualified vehicle to which section 170(f)(12) applies, the greater of—
 - (A) the product of the highest rate of tax specified in section 1 and the claimed value of the vehicle, or
 - (B) \$5,000..
- (2) CONFORMING AMENDMENT.—The table of sections for part I of subchapter B of chapter 68, as amended by this Act, is amended by adding at the end the following new item: Sec. 6720. Fraudulent acknowledgments with respect to donations of motor vehicles, boats, and airplanes..

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to contributions made after December 31, 2004.

ATTACHMENT II

Conference Agreement

The conference agreement follows the Senate amendment, except that the penalty on the donee organization for knowingly furnishing a false or fraudulent acknowledgement is determined differently. With respect to a qualified vehicle sold without a significant intervening use or material improvement, the penalty is the greater of the gross proceeds from the sale of the vehicle or the product of the highest rate of tax specified in section 1 and the sales price stated on the acknowledgement. For all other acknowledgements, the penalty is the greater of \$5,000 or the product of the highest rate of tax specified in section 1 and the claimed value of the vehicle.

The conference agreement also provides that the Secretary may prescribe regulations or other guidance that exempts sales of vehicles that are in direct furtherance of the donee's charitable purposes from the requirement that the donor may not deduct an amount in excess of the gross proceeds from the sale, and the requirement that the donee certify that the vehicle will not be transferred in exchange for money, other property, or services before completion of a significant use or material improvement by the donee. The conferees intend that such guidance may be appropriate, for example, if an organization directly furthers its charitable purposes by selling automobiles to needy persons at a price significantly below fair market value.

The conferees intend that in providing guidance on the provision, the Secretary shall strictly construe the requirement of significant use or material improvement. To meet the significant use test, an organization must actually use the vehicle to substantially further the organization's regularly conducted activities and the use must be significant. A donee will not be considered to significantly use a qualified vehicle if, under the facts and circumstances, the use is incidental or not intended at the time of the contribution. Whether a use is significant also depends on the frequency and duration of use. With respect to the material improvement test, the conferees intend that a material improvement would include major repairs to a vehicle, or other improvements to the vehicle that improve the condition of the vehicle in a manner that significantly increases the vehicle's value. Cleaning the vehicle, minor repairs, and routine maintenance are not considered a material improvement.

Example 1. As part of its regularly conducted activities, an organization delivers meals to needy individuals. The use requirement would be met if the organization actually used a donated qualified vehicle to deliver food to the needy. Use of the vehicle to deliver meals substantially furthers a regularly conducted activity of the organization. However, the use also must be significant, which depends on the nature, extent, and frequency of the use. If the organization used the vehicle only once or a few times to deliver meals, the use would not be considered significant. If the organization used the vehicle to deliver meals every day for one year the use would be considered significant. If the organization drove the vehicle 10,000 miles while delivering meals, such use likely would be considered significant. However, use of a vehicle in such an activity for one week or for several hundreds of miles generally would not be considered a significant use.

Example 2. An organization uses a donated qualified vehicle to transport its volunteers. The use would not be significant merely because a volunteer used the vehicle over a brief period of time to drive to or from the organization's premises. On the other hand, if at the time the organization accepts the contribution of a qualified vehicle, the organization intends to use the vehicle as a regular and ongoing means of transport for volunteers of the organization, and such vehicle is so used, then the significant use test likely would be met.

Example 3. The following example is a general illustration of the provision. A taxpayer makes a charitable contribution of a used automobile in good running condition and that needs no immediate repairs to a charitable organization that operates an elder care facility. The donee organization accepts the vehicle and immediately provides the donor a written acknowledgment containing the name and TIN of the donor, the vehicle identification number, a certification that the donee intends to retain the vehicle for a year or longer to transport the facility's residents to community and social events and deliver meals to the needy, and a certification that the vehicle will not be transferred in exchange for money, other property, or services before completion of such use by the organization. A few days after receiving the vehicle, the donee organization

commences to use the vehicle three times a week to transport some of its residents to various community events, and twice a week to deliver food to needy individuals. The organization continues to regularly use the vehicle for these purposes for approximately one year and then sells the vehicle. Under the provision, the donee's use of the vehicle constitutes a significant intervening use prior to the sale by the organization, and the donor's deduction is not limited to the gross proceeds received by the organization.

Effective date.—Effective for contributions made after December 31, 2004.

<http://waysandmeans.house.gov/media/pdf/hr4520/hr4520conreptmgrsstatement3.pdf>