The fine art of valuing donated property

Not-for-profits often struggle with valuing noncash and in-kind donations. Whether for record-keeping purposes or when helping donors understand proper valuation for their charitable tax deductions, the task isn't easy. Although the amount that a donor can deduct generally is based on the donation's fair market value (FMV), there's no single formula for calculating it.

FMV basics

FMV is often defined as the price that property would sell for on the open market. For example, if a donor contributes used clothes, the FMV would be the price that typical buyers pay for clothes of the same age, condition, style and use. If the property is subject to any type of restriction on use, the FMV must reflect it. So, if a donor stipulates that a painting must be displayed, not sold, that restriction affects its value.

According to the IRS, there are three particularly relevant FMV factors:

1. Cost or selling price: This is the cost of the item to the donor or the actual selling price received by your organization. However, note that, because market conditions can change, the cost or price becomes less important the further in time the purchase or sale was from the contribution date.

2. Comparable sales: The sales price of a property similar to the donated property can determine FMV. The weight that the IRS gives to a comparable sale depends on the:

- Degree of similarity between the property sold and the donated property,
- Time of the sale,
- Circumstances of the sale (was it at arm's length?), and
- Market conditions.

3. Replacement cost: FMV should consider the cost of buying or creating property similar to the donated item, but the replacement cost must have a reasonable relationship with the FMV.

Businesses that contribute inventory can generally deduct the smaller of its FMV on the day of the contribution or the inventory's basis. The basis is any cost incurred for the inventory in an earlier year that the business would otherwise include in its opening inventory for the year of the contribution. If the cost of donated inventory isn't included in the opening inventory, its basis is zero and the business can't claim a deduction.

Important reminder

Even if a donor can't deduct a noncash or in-kind donation (for example, a piece of tangible property or property rights), you may need to record the donation on your financial statements. Recognize such donations at their fair value, or what it would cost if your organization were to buy the donation outright. Contact us for more information.