

# Navigating Tax Rules for Property Donations

Property donations introduce complexity that cash gifts simply don't. This course examines the tax rules governing noncash charitable contributions, including how donated property is valued, what substantiation and reporting requirements apply, and how different types of property affect the deduction available to donors. Tax professionals advising clients who donate real estate, securities, vehicles, or other assets will find this course directly applicable to real-world situations they encounter in practice.

CREDIT HOURS 2 | FIELD OF STUDY TAXES | EXAM QUESTIONS 10

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## LEARNING ASSIGNMENTS AND OBJECTIVES

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### Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

### Course Objectives

- Recognize how to treat vehicles and other non-monetary donations.

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Publication Date: August 2026

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## Chapter 1: PROPERTY DONATIONS

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### *Chapter Objective*

After completing this chapter, you should be able to:

- Recognize how to treat vehicles and other non-monetary donations.

Most nonprofits spend the bulk of their fundraising efforts seeking contributions of cash. This tactic is understandable because it's the easiest way to both give and receive a donation. However, the vast majority of the world's wealth consists of property, not cash. Noncash property includes tangible things like cars, real estate, household goods, business inventory and equipment, clothing, jewelry and artwork, and intangible items like stocks, bonds, and Bitcoins. It shouldn't be surprising, then, that charitable contributions of property (called "noncash donations" by the IRS) are very popular.

Property donations can represent a great fundraising opportunity for your nonprofit. However, they can also present challenges that don't exist with donations of hard cash. For one thing, it can be hard to fairly value property donations for tax purposes. For another, it's easy (and tempting) for taxpayers to try to overvalue their property donations to get higher tax deductions. In fact, concern about these kinds of abuses has led the IRS to adopt tough valuation rules for property donations. These rules make property donations much more complicated than cash contributions. Just how complicated depends on the type and value of the property being donated.

### *Caution!*

**Your nonprofit doesn't have to accept property donations.** Property donations can be more trouble than they are worth—for example, where an item has little or no value or is hard to resell. You also need to consider the costs involved in accepting, processing, storing, and selling property donations. Your nonprofit never has to accept an offer of a property donation. Indeed, many nonprofits refuse to accept property donations, except for publicly traded stock (and, possibly, Bitcoins and other cryptocurrency). If you don't want to get involved with property donations, you can always ask donors to sell the property themselves and give you the cash. This is easy to do through websites such as eBay and Craigslist.

### **Establishing a Gift Acceptance Policy**

The IRS advises nonprofits to adopt a formal written gift acceptance policy—a document explaining which types of gifts will and won't be accepted by your nonprofit, and describing any

special acceptance procedures for certain types of gifts such as real estate. This may seem like overkill for a very small nonprofit, but is an excellent idea for most others. You can find links to many examples of gift acceptance policies on the Council of Nonprofits website at [www.councilofnonprofits.org/tools-resources/gift-acceptance-policies](http://www.councilofnonprofits.org/tools-resources/gift-acceptance-policies). Take a look at several policies. They aren't all the same. What yours should include depends on your nonprofit's particular circumstances—for example, whether you have the expertise and desire to deal with hard-to-sell items like nonpublicly traded stock, or unusual or specialized items, such as vacation timeshares.

## ANNUAL DEDUCTION LIMIT FOR PROPERTY DONATIONS

Overall limits apply to how much donors can deduct each year for charitable contributions. (See “Annual Ceilings on Charitable Deductions” in Chapter 1 of course 33804D.) These limits are generous and only donors who make extremely large donations relative to their incomes would be affected by them.

### Long-Term Capital Gain Property

Many property gifts to charitable organizations are gifts of long-term capital gain property (also referred to simply as “capital gain property”). Long-term capital gain property is capital gain property (see “Capital Gain Property,” later) owned for one year or longer before it is donated, sold, or otherwise disposed of.

### Capital Gain Property

The term “capital gain property” can be confusing. To begin, it refers only to property, not cash. Capital gain property is any capital asset that has increased in value since it was created or acquired. So what's a “capital asset”? Capital assets include all the property a person or business owns except for: business inventory (property held for sale to customers), business equipment and other property used in business that is owned for more than one year, and a few other items. So, most everything an individual owns is a capital asset—for example, vehicles, household furnishings, a home occupied by the individual, coin or stamp collections, jewelry, gold, and silver.

There are special rules for artistic works like paintings, books, and inventions. Such works aren't capital assets while owned by their creators; but they are capital assets when they are acquired by someone else.

Donors can deduct the full fair market value of gifts of long-term capital gain property in a single year only if the total value of the gifts is less than 30% of the donor's AGI for the year. If the property is worth more than this, the excess can be deducted over the following five years.

*Example*

Jasmine purchased stock for \$10,000 in 1990 that has a fair market value of \$40,000. She decides to donate the stock to the United Way. Her AGI that year is \$50,000. The stock is long-term capital gain property and is thus subject to the 30% of AGI annual deduction limit. As a result, Jasmine can deduct \$15,000 of the stock's value ( $30\% \times \$50,000 \text{ AGI} = \$15,000$ ) and deduct the remaining \$25,000 over the next five years.

Many donors are unaware of the 30% limit for long-term capital gain property donations. So, someone considering making a substantial property donation might be counting on a much larger deduction than they'll actually get in the current year. To avoid having disappointed donors on your hands, you should always let them know of these limits whenever you are about to receive a large property donation.

There is one exception to the 30% AGI limit for long-term capital gain property donations: It doesn't apply if a donor elects to deduct only the cost of the property instead of its full fair market value. In this event, the property is treated the same as gifts of short-term capital gain property.

### Ordinary Income and Short-Term Capital Gain Property

The 30% of AGI limit for gifts of long-term capital gain property doesn't apply to gifts of short-term capital gain property (capital gain property owned less than one year) or ordinary income property (inventory, works of art, or manuscripts created by the donor). Instead, these donations are subject to a 50% of AGI overall annual limit.

Why is the tax law more generous for these contributions? Because the charitable deduction for this type of property is limited to the cost of the property (its "basis" in tax parlance), not its fair market value. So, the donor gets no deduction for any appreciation the property enjoyed. With most other property donations, donors can deduct the fair market value. (See "Basic Valuation Rule: Fair Market Value," later.) So, these gifts are usually worth less to the donor.

*Example*

Patty donates stock she owned for five months to her church. She paid \$800 for the stock but its fair market value on the day she donated it is \$1,000. The stock is short-term capital gain property, so she can only deduct what she paid for it—\$800.

### VALUING PROPERTY DONATIONS—AN ART, NOT A SCIENCE

The value of most property donations is the item's fair market value on the day of the donation, not its original cost. So, the challenge with property donations is determining the item's fair market

value. In the past, many taxpayers overvalued their donations and took charitable deductions far in excess of what their donated property was actually worth. This cost the government billions of dollars in income taxes.

To prevent these kinds of abuses, the IRS cracked down on many types of property contributions and adopted a series of rules for valuing different kinds of property, such as vehicles, stock, and clothing. These rules are intended to fit the different circumstances and risks for valuation abuses by donors associated with each.

Even though as a nonprofit you aren't responsible for valuing donated property, it's important that you understand these rules if you accept property donations.

### **Your Nonprofit's Role in Determining Value**

It is the donor's responsibility to determine the value of donated property—not the nonprofit's. A nonprofit shouldn't get involved in giving estimates or values for donated property. It's a no-win situation. If the donor thinks your estimate is too low, the donor might decide it's not worth making the donation. If it's high, the IRS could question it later and you could end up with an unhappy donor who is in trouble with the IRS.

Any problem that develops with donated property valuations will always be between the donor and the IRS. It would most likely come up during an audit of the donor. If the IRS found that a property valuation was too high (and the corresponding charitable deduction amount was too much), the IRS could require the donor to pay back taxes, interest, and penalties. You don't want your donors getting into trouble with the IRS over donations to your organization. It pays to know the rules and help your donors understand how the valuation process works. You can also help by referring them to resources for property valuations (discussed later).

### **Basic Valuation Rule: Fair Market Value**

With cash donations, valuation isn't an issue. Donors always get to deduct the amount of cash they contribute. With property donations, it's different because there isn't always an easily ascertainable value for the property being donated. How much is an old computer worth, or an antique clock, or a conservation easement? The IRS has developed rules to address both how to value different types of property donations and how much a donor can deduct.

The basic rule is that a donor may deduct no more than the property's "fair market value" at the time of the donation. But fair market value can be a tricky thing. For IRS purposes, it means the amount that a "willing buyer would pay and a willing seller would accept for the property, when neither party is compelled to buy or sell, and both parties have reasonable knowledge of the relevant facts." In other words, it's a fair price—not too high and not too low.

For property donations of less than \$5,000, the donor can determine the fair market value themselves and no appraisal is required. The IRS recommends that the donor consider all relevant factors, including:

- The item's cost or selling price
- Sales of comparable items
- The item's replacement cost, and
- An expert opinion.

### *Example*

Joe donates a one-year-old computer to his church. He paid \$1,500 for it new, but he knows it's worth much less than that because of its age. He looks at sales of comparable computers on eBay and finds that the average price similar computers are going for is \$500. He decides this amount is its fair market value for tax purposes.

IRS Publication 561, *Determining the Value of Donated Property*, gives a good explanation how these factors should be used to determine an item's fair market value. You can refer donors to this publication, which can be downloaded from the IRS website at [www.irs.gov](http://www.irs.gov).

For any property donations worth \$5,000 or more, the donor must obtain a formal appraisal from a qualified appraiser. The only exception is for marketable securities, because they have a clear market value. (See "Property Valued at \$5,000 or More," later.)

The IRS has created special rules for valuing certain types of property, including clothing, vehicles, easements, and short-term capital gain property. In some cases, this was because the regular fair market value rules are difficult to apply. In others, it was because taxpayers engaged in widespread overvaluation for that type of property. We discuss the rules for these and some of the other more commonly donated items below.

## **DIFFERENT TYPES OF PROPERTY DONATIONS**

Any nonprofit that accepts property donations should have a basic understanding of the IRS valuation, documentation, and reporting rules—particularly for the more commonly donated property items like clothing, furniture, and vehicles. We cover those basics—and more. However, we don't cover the rules for every possible property donation item you might receive. If you need more information on IRS rules on property donations, see IRS Publication 561, *Determining the Value of Donated Property*.

### **Clothing and Household Items**

The most commonly donated property items are clothing and household items. Household items include furniture, furnishings, electronics, appliances, linens, and other similar items. Things that aren't considered household items include food, artwork and other art objects, antiques, jewelry, gems, and collectibles. Valuation abuses by taxpayers have been particularly widespread for donations of clothing and household items. In many cases, people donated used items that were worthless or nearly worthless and valued them for tax purposes as if they were new. To prevent this, the IRS tightened the rules on valuing household donations in 2005.

The first restriction for any donated clothing or household items is that the items must be in "good used condition or better." If they aren't, the donor can't take a tax deduction for the donation. The IRS provides no guidelines for determining what constitutes "good used condition or better." However, some nonprofits have guidelines that describe what they will and won't accept and these can be helpful for providing guidance on what the IRS might consider acceptable. For example, the Salvation Army says it doesn't want torn, dirty, or broken items. Goodwill Industries advises, "If you would give it to a relative or friend, then the item is most likely in good condition and is appropriate to donate." Your nonprofit should follow these examples and not accept items that are in poor condition.

The tax law contains an exception to the good used condition requirement for any *single* item of clothing or *single* household item that is worth \$500 or more. If a donor gives such an item, it can be in less than good used condition. However, the donor must have a qualified appraisal of the item's value and must file IRS Form 8283, *Noncash Charitable Contributions*, with their tax return.

### Example

Caroline donates a vintage French designer ball gown that belonged to her mother to her local symphony orchestra. The gown is more than 30 years old and is in poor condition. Caroline hires an appraiser who determines that the rare item is worth \$2,000, despite its poor condition. Caroline may deduct this amount, provided that she files Form 8283 with her tax return.

Secondly, in addition to the requirement that clothing or household items be in good used condition, a donor must also obtain a receipt from the nonprofit that includes a written description of the donated property (not the value; see "Documenting Property Donations," below). It's a good idea for donors to photograph any items they donate as additional proof of their condition in case any questions come up later with the IRS.

Although you don't want to be the one actually doing the valuation of property, you can recommend that donors use one or more of the following resources to help them determine their property's fair market value.

**Online valuation guides.** Several well-known nonprofits have created value guides for clothing and household goods. It's hard to imagine that the IRS would complain if a donor used one of these guides. They can be found at the following websites (the Salvation Army guide is the most detailed):

- Salvation Army Donation Value Guide: <https://satruck.org/Home/DonationValueGuide>, and
- Goodwill Industries Donation Value Guide: <https://goodwillnne.org/donate/donation-value-guide>.

**Tax software.** Tax preparation software, including *H&R Block Tax Software* and Intuit's *TurboTax*, can provide donors with estimated values for clothing and other household goods based on the condition of each item. You can also use specialized software to determine the fair market value of used property: *ItsDeductible* from Intuit (<https://turbotax.intuit.com/personal-taxes/itsdeductible>). The donor describes the item being donated and the program gives an estimate of its value based on surveys of thrift store sales and online auctions. A comparison of the results obtained using this software and the price guides created by nonprofits found that the software usually gives higher valuations.

**Past sales of similar items.** Prices obtained in the past for the sale of similar items are always a good indicator of value. Good evidence of value would be the price at which similar items are sold in thrift stores, such as Salvation Army Family Stores and Goodwill Industries. Online auction sites, such as eBay, can also provide guidance on what used items are worth. The donor may simply check to see what similar items have sold for and could use the average price of a few recent sales.

### **Vehicles—Used Cars, Boats, and Aircraft**

Vehicles have their own set of rules—different from other property donations. Historically, they have been a very popular donation item, which was in large part because, under the old rules, a taxpayer could donate a used car to a nonprofit and deduct whatever they claimed was the vehicle's fair market value. Hundreds of thousands of taxpayers donated vehicles and then grossly inflated the value to get larger tax deductions. In one case, a taxpayer claimed a \$2,915 deduction for a 1980 Mercury station wagon that was ultimately sold for \$30 by the nonprofit it was donated to. The IRS figured it was losing hundreds of millions of dollars every year because of these kinds of abuses.

The rules changed in 2005. Under current IRS rules, if a person donates a used car to a nonprofit and claims a deduction greater than \$500, the charitable deduction is limited to the amount the nonprofit receives when it sells the car. So, the owner of the Mercury station wagon mentioned above would get a \$30 deduction today. The nonprofit must document the sales price by providing the donor with IRS Form 1098-C, *Contributions of Motor Vehicles, Boats, and Airplanes* (see “Documentation Rules for Cars, Boats, and Airplanes,” later). These rules apply not only to cars, but also to SUVs, trucks, motorcycles, boats, airplanes, and any motor vehicle manufactured primarily for use on public roads.