Introduction: Fundraising is one of the most important responsibilities for a nonprofit because public donations fund the nonprofit's causes. An exciting and popular method for nonprofits to raise funds is by hosting events such as galas and auctions. These fundraising events allow donors to interact with each other and give the nonprofit the opportunity to engage directly with their donors. While these events are meant to be entertaining, there are often misunderstandings regarding the tax implications of attending, donating or purchasing an item during the event.

Part one of this article series provided an overview of the often overlooked rules surrounding purchasing tickets to charitable events. Part one highlighted how donors can ensure compliance by understanding both the tax treatment of these purchases and the appropriate assets donors can use to purchase tickets. Part two gives an overview of the rules for donating and purchasing items at charity auctions, as well as the rules surrounding business donations. This information will equip advisors to better assist donors who wish to claim a charitable deduction.

Charity Auction Considerations: Charity auctions can be a fun and exciting way for donors to support their favorite nonprofit and engage with other donors. Auctions are very straightforward transactions in which the person with the highest bid wins and purchases the auctioned item. However, in a charitable auction setting, there are some additional considerations that the nonprofit must address prior to dropping the gavel on the auction block.

Acknowledgement: Many nonprofits rely on donations from their supporters to fill the auction block. Since these are charitable donations, they should be recognized by the nonprofit through a contemporaneous written acknowledgement (CWA). The CWA typically states that no goods or services were exchanged for the gift. For donated items valued at $250 or more, the donor is required to obtain a CWA from the nonprofit. Reg. 1.170A-13(f). An acknowledgment letter from the nonprofit in the form of a thank you letter will typically suffice as a CWA, if the legal requirements are present.

There are additional substantiation requirements depending on the value of the donated goods. IRS Publication 1771, Charitable Contributions: Substantiation and Disclosure Requirements, provides examples of CWAs. In general, the CWA should state that no goods or services were received in exchange for the donation and that the nonprofit has exclusive control over the gift. Typically, the nonprofit should refrain from placing a value on the donated item in the CWA as the donor is the party responsible for valuing the item.

Similarly, an acknowledgement letter should be sent to purchasers at the auction. As a best practice, charities should send a CWA whenever a bidder spends $250 or more on an item, regardless of the item's fair market value. While it is the donor's responsibility to determine the deductible portion of their bid, issuing a CWA for all purchases of $250 or more helps simplify administrative burdens and supports compliance with the tax rules.

Information to include in a CWA: **1.** Name of the Nonprofit – Name of the nonprofit that received the contribution, **2.** Nonprofit's Tax-Exempt Status – A statement certifying the nonprofit's exempt status, **3.** Nonprofit's Contact Information – Address, phone number, website and email address, **4.** Date of the Auction – Specify when the auction took place

5. Contribution Amount or Description – For bidders, include the price paid for the auction item. For donors donating an item to be auctioned, provide a description of the contributed property (although it is not necessary to include the fair market value)

6. Donor's Information – Name and contact information for a winning bidder or name and contact information for the donor who contributed the item to the auction

7. Statement that no goods or services were exchanged for the donation and that the nonprofit has exclusive control over the donation

Catalog: It is important that nonprofits provide documentation on the fair market value of the items available at the auction. For donors who intend to claim a deduction for purchasing an auction item, the donor must know at the time of the auction that their bid is more than the fair market value to claim a deduction. Therefore, it is imperative that the nonprofit provide fair market value prior to the start of bidding. The nonprofit may decide to list each auction item and its fair market value in a program or catalog. The nonprofit should also include a statement that charitable deductions are only permitted for purchases that exceed the fair market value.

Establishing Fair Market Value: While it is essential for the nonprofit to provide bidders with the fair market value of the auctioned items, this figure is simply a good faith estimate of the value of the item being offered. For tangible personal property, the fair market value is typically the retail price of the item. For experiences such as the use of a vacation home, the fair market value can be established by comparing rental rates for similar properties or checking the current rental rates for the property. While donors can aid in establishing the fair market value, it is important that the nonprofit verifies the value and has documentation that supports the fair market value. If the donated item is worth more than $5,000, a qualified appraisal will be necessary to substantiate the deduction. Reg. 1.170A-13(c).

The Cost of Priceless Items: It is common to see unique items up for auction, ranging from one-of-a-kind experiences to a naming opportunity. Nonprofits sometimes describe auction items as "priceless" in their programs to emphasize the asset's unique qualities. However, for a winning bidder to claim a charitable deduction, the fair market value of the item must be known at the time of bidding, and the final bid must exceed that amount. While listing an item as "priceless" may be a helpful strategy to attract bids, a deduction is only available if the bidder knows the fair market value at the time of bidding and purchases the item for more than the fair market value. In the case of purchasing something listed as "priceless," the winning bid establishes the value of the item, and the bidder is receiving something of equal value to their winning bid. Thus, no deduction is permitted. As a result, organizations should exercise caution when advertising an item as "priceless."

Deduction Rules for Auction Items: The charitable auction setting presents questions for those who may be attempting to claim a charitable deduction. The donor who contributed the auction item will be interested in claiming a charitable deduction for their contribution, while the winning bidder will be interested in claiming a deduction for the amount paid to acquire the item.

Bidders: Bidders who purchase items at charitable auctions typically do so with the understanding that their generosity is to help the nonprofit's cause. Nevertheless, some bidders may have the impression that they are able to deduct the full amount paid for the auctioned item as a charitable donation. Bidders are entitled to a charitable deduction so long as the price paid for the auctioned item exceeds the item's fair market value. To claim a deduction, bidders must be able to show that they knew the value of the auctioned item was less than the amount they paid for it. The catalog or program that the nonprofit provides prior to the auction is typically sufficient to establish the donor's knowledge of the item's fair market value prior to the bidding.

Example 1 Bob Bidder attended the gala that his favorite charity hosts every year. As Bob walked into the event, he was presented with a program that listed the available items at the evening's auction. Bob is an avid baseball fan and up for auction was a signed baseball from his favorite player. The program listed the fair market value of the ball at $500 and, as the auction unfolded, Bob won the auction with a $800 bid. Since Bob knew that the value of the ball was $500 and paid over the fair market value for the ball, Bob can claim a $300 deduction for the amount in excess of the fair market value.

Donating Goods or Services for Auction: Many nonprofits often rely on donations of items from their loyal supporters for the nonprofit's fundraising auction. The items donated typically are considered tangible personal property, inventory or personal services. Generally, donors who provide goods to the nonprofit to be later auctioned are limited to a cost basis deduction. Under Sec. 170, a donor is usually limited to a cost basis deduction if the donated items are tangible personal property or inventory of a business. If the nonprofit can use the donated item for a use related to the nonprofit's exempt purpose, then the donor would be entitled to a fair market value deduction. However, an item that is sold by a nonprofit is not considered a related use, thus limiting the donor to a cost basis deduction.

Donors who offer a service to be auctioned are also limited in the deduction they can claim. Examples of services offered at auctions can include tax preparation services or treatments provided by an esthetician. Services such as these are nondeductible contributions of personal services. Sec. 1.170A-1(g). However, a deduction may be permitted for unreimbursed expenses that the donor incurs while rendering services. The expenses cannot include what the donor would have otherwise charged for the services rendered.

One of the most donated auctioned items is the one-time use of a vacation home. While there is a fair market value for the use of the vacation home, the donor is unable to claim a deduction because the IRS does not permit deductions for a contribution of less than an entire interest in the property. Partial interest rules state that the right to use a property is considered a contribution of less than the entire interest and as such is not deductible. IRS Pub. 526. In addition, the rental income would represent ordinary income to the donor, and ordinary income assets are not eligible for deductions even when contributed to a nonprofit.

Example 2 Donna Donor owns a beachside condo that she regularly rents out through vacation rental websites. Donna decides to have her favorite nonprofit auction off a one-time weekend in her beach home for the nonprofit's upcoming fundraising auction. At the auction, the winning bid is more than the fair market value of renting the home, which represents the fee Donna would have normally collected had she rented the home out on a vacation rental website. However, due to the partial interest and ordinary income rules, Donna is unable to claim a deduction.

Business Donations: Businesses often donate services or items to help make a charity auction successful. Similar to the rules for individuals who donate services, a business is unable to deduct contributed services. The IRS deems these services as “lost income” which is considered ordinary income and therefore not deductible under Sec. 170(e). However, a deduction may be permitted for unreimbursed expenses that the business incurs while rendering services, but not the fees that they would have otherwise charged for the services rendered.

Tangible gifts, such as excess inventory from businesses, qualify for a charitable deduction. The business may be able to deduct the gift at its cost basis rather than fair market value. Businesses that make charitable contributions are also subject to a limit on the charitable deduction that they can claim. A business may not claim a deduction greater than 10% of its taxable income in the year of the gift. If the charitable gift exceeds 10% of taxable income, the deduction may be carried forward for an additional five years. Sec. 170(d)(2)(A).

Beware of Sales Tax: While nonprofits are exempt from having to pay sales tax, most states require a nonprofit to collect sales tax on the winning bids. If a winning bid exceeds the fair market value for the item, the bidder may be required to pay sales tax on the fair market value portion of the item. The amount more than the fair market value is non-taxable contribution income. Similarly, if a winning bid is equal to or less than the item’s fair market value, the bidder is required to pay sales tax based on the bid amount.

A nonprofit that does not regularly conduct merchandise sales may need to register with the applicable state to collect sales taxes. While some states carve out narrow exemptions to collecting sales tax, nonprofits should work with their financial advisors to ensure compliance with state and local tax requirements.

Conclusion: Charitable events such as galas and auctions are exciting ways to fundraise while encouraging donor engagement. However, this excitement is accompanied by specific tax rules that affect both the nonprofit and the attendees. Adhering to IRS guidelines enables professional advisors to assist nonprofits in organizing successful events that generate significant donations, while also allowing donors to support their favorite causes and potentially claim tax deductions.

Editor’s Note: Under the OBBBA, starting in 2026, individuals who itemize their taxes will only be able to claim a charitable deduction if the total annual giving exceeds 0.5% of their adjusted gross income (AGI). For businesses, the total annual giving must exceed 1% of their taxable income to be eligible for a charitable deduction. Businesses will still be subject to a deduction limit of 10% of the business’ taxable income with a five-year carry forward. As such, individuals and businesses will have to ensure their donations exceed these new thresholds in order to claim deductions for charitable auction donations.

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