Recent Changes To Charitable Contribution Rules For Patents And Other IP

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On October 22, 2004, President Bush signed into law the "American Jobs Creation Act of 2004" (the "Jobs Act"). This highly publicized legislation includes numerous tax law modifications, including significant changes to the rules governing charitable contributions of patents and most other forms of intellectual property. This article discusses some of those changes and the issues they raise for donors and donees.

Deductions

Prior Law

Under prior law (which continues to apply to contributions made prior to June 3, 2004) a taxpayer generally could deduct charitable contributions of property, including patents and other intellectual property, in the year when the charitable contribution was made. Under most circumstances, if the property had been held for more than one year this deduction was equal to the fair market value of the property. Because of the subjective nature of the valuation of patents and other intellectual property, this rule was subject to abuse and certain aggressive taxpayers claimed tax deductions that appeared to be inflated.

New Law

Under the Jobs Act, if a taxpayer contributes a patent (or, with certain exceptions, other forms of intellectual property) to a charitable organization, the taxpayer's initial deduction is limited to the lesser of (a) the taxpayer's basis in the contributed property, or (b) the fair market value of the property. The taxpayer is also permitted to deduct additional amounts in the year of contribution or in subsequent tax years based on a specified percentage of the income that is earned by the recipient with respect to the contributed intellectual property in those years.

The additional charitable deduction is limited to income that is directly attributable to the intellectual property itself, and not merely related to an activity in which such property is used. Furthermore, the additional charitable deduction is allowed only to the extent that (a) the aggregate of the amounts calculated according to the following schedule exceed (b) the amount of the deduction claimed on the initial contribution of the patent or intellectual property. Finally, the additional deduction is not allowed for intellectual property contributed to most private foundations, or with respect to any revenue or income received or accrued by the donee after the expiration of the legal life of the patent or intellectual property, or after the 10th anniversary of the date the contribution was made.

The amount of the additional charitable deduction allowed per year is shown in Table 1.

At the time of the contribution, the taxpayer is required to inform the donee that it intends to treat the contribution as a contribution subject to the additional charitable deduction provisions of the Jobs Act. At that time, the taxpayer must also obtain written substantiation from the recipient of the amount of any income properly allocable to the contributed property during the charity's tax year. The recipient must file an annual information return, reporting the income that is directly attributable to the contributed intellectual property.

Effective Date

The provision is effective for contributions made after June 3, 2004.

Reporting Requirements

Prior Law

Previously, if the charitable deduction claimed by a corporation for the contribution of noncash property exceeded $500, the taxpayer filed Form 8283, Noncash Charitable Contributions. C corporations filed Form 8283 if the deduction exceeded $5,000. Additionally, although appraisals were generally required for donations of property by individuals, partnerships, and S Corporations (the claimed-value of which exceeded $5,000), C Corporations were excluded from this requirement unless they contributed artwork valued at more than $20,000, in which case they were required to attach an appraisal to their tax return.

New Law

The Jobs Act requires increased donor reporting for charitable contributions of property other than cash, such as intellectual property. It extends to all C corporations the requirement previously applicable to individuals, partnerships, or S corporations that the donor must obtain an appraisal of the property if the deduction claimed exceeds $5,000. The provision also requires that if the claimed value of the contributed property exceeds $500,000,

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Table 1.

Tax Year of Donor	Deduction Allowed
1st year ending on or after year of contribution	100% of qualified donee income
2nd year ending on or after year of contribution	100% of qualified donee income
3rd year ending on or after year of contribution	90% of qualified donee income
4th year ending on or after year of contribution	80% of qualified donee income
5th year ending on or after year of contribution	70% of qualified donee income
6th year ending on or after year of contribution	60% of qualified donee income
7th year ending on or after year of contribution	50% of qualified donee income
8th year ending on or after year of contribution	40% of qualified donee income
9th year ending on or after year of contribution	30% of qualified donee income
10th year ending on or after year of contribution	20% of qualified donee income
11th year ending on or after year of contribution	10% of qualified donee income
12th year ending on or after year of contribution	10% of qualified donee income
Tax years thereafter	No deduction permitted

the donor (whether an individual, partnership, or corporation) must attach the appraisal directly to the tax return. If the contributor of the property fails to substantiate a charitable contribution of property by attaching an appraisal corroborating the value of the contributed property, the charitable deduction is denied.

Effective Date

This provision of the Jobs Act is effective for contributions made after June 3, 2004.