

# ITRA – WHAT'S IN THE NEWS

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**Title: New Law Limits Income Tax Deductions for Trophy Donations**

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Congress has enacted a "Special Rule" to limit the amount of income tax deduction a donor can claim for donation of hunting or fishing trophies. The new law limits the valuation "basis" to the costs of the taxidermy regardless of the real value.

The "Special Rule" governing the tax deductibility of charitable contributions of trophies is part of a charitable tax reform package that was tacked onto the Pension Protection Act of 2006, HR4. It passed the House of Representatives and was then adopted by the Senate verbatim. It has an effective date provision that specifies it "shall apply to contributions made after July 25, 2006."

There is no denying that the "special rule" is considered reform legislation to correct perceived abusive tax practices. It is part of a larger reform package, follows some well publicized hearings and IRS has been targeting trophy donation deductions for more than a decade. In many audits, IRS has been zeroing deductions for trophy donations and assessing as much as 200 percent penalties. IRS has not even allowed the costs of taxidermy in many of its audits, so in that narrow sense, this new special limitation is a gain. The exaggerated advertising claims of at least one well known appraiser have been repeatedly cited and used against the hunting community. Those misrepresentations have been so bold as to paralyze the hunting community from defending donation practices. Outrageous advertising claims of some appraisers invited Congressional review, made trophy donations a reform target, and made it hard to defend. This may have been one of those instances in which some in the hunting community are its own worse enemy.

There was a growing perception of abuse. One advertisement suggested that you could hunt again with the income tax savings from your trophy donation. That implied that you could hunt forever for free by donating your trophies each time. To the contrary, the courts have generally not accepted the costs of even one hunt as the valuation basis of mounts even if you went on five hunts to take the animal and it was the world record. Moreover, tax savings are not dollar for dollar. Because taxes are only a percentage of your income, you must donate or give more value than you gain to get the relatively smaller income tax savings.

The new limit is rather severe considering the true value of some trophies such as a record whitetail deer, mounts of rare and even extinct species, and the high cost of replacement in some instances. The cost to shoulder-mount a markhor and an impala may be the same but their real values are not the same. Now, the tax deductions for a donation of the two will be the same for each (presuming the two shoulder mounts cost the same)

The new rule is not a challenge to taxidermy as such because it fully recognizes the cost of the taxidermy. No matter how elaborate the taxidermy, that cost is now recognized but the greater value of the finished work is no longer valued, as are other forms of art (Pub. 561). This reflects the longstanding argument that IRS auditors have made to courts with varying, limited success that the costs of replacement, cost of acquisition, cost of the underlying hunt for the trophy is not the value of the trophy, rather it is the value of the total hunting service. IRS experts have repeatedly argued

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that the individual hunter has gotten his money's worth from the hunting experiences and the trophy is incidental. The cost of a hunt is the cost of the hunt, not the value of the trophy.

The valuation of trophies has been difficult as well as controversial. Normally, the "market value" at the time that a donation is made is the amount of the allowable income tax deduction. When an item such as a work of art is unique and there is no established market value, the courts have taken into consideration everything that has bearing upon its true value. IRS has used law enforcement agents as experts to cite low black market values of illegal contraband as well as junk dealers, flea market prices, and forced bankruptcy and succession sale prices. Donors and their appraisers have argued that those are forced, not "fair" market values or even the market in issue. Before you can appraise something you must first determine which market. Museums, educational and scientific markets are higher-end markets and legally the only markets relevant. These differences of view have raged for years in courts.

The "special rule" at first appears to put an end to the valuations dispute but, on closer examination, not in all cases. Though the "special rule" fixes the amount of the deduction for trophy donations to the costs of the taxidermy, this limitation only applies to two classes of donors. The rule only applies to donations of mounts from the person who mounted the taxidermy (we presume that means the taxidermist) and to the individual person who paid for the mounting (presumably the hunter who is believed to have already gotten value from the hunt himself). As such, it may not apply as a limit to heirs of estates and other third persons, such as those who buy an already mounted trophy at full value and then later decide to donate it to a qualified charitable institution.

One inequity to limiting the "basis" to the taxidermy costs is the fact that the rule only applies to valuation for income tax purposes, not valuation for inheritance tax purposes, which are governed differently. Although, you can no longer deduct your trophy donations for their "fair market" or "unique" value, your estate will be taxed at their real value.

There is another tax rule that must be considered that may make the cost of taxidermy limit even more unfair. Taxidermied mounts, like other property, can decrease in value through wear and tear, use and aging. The cost of taxidermy is only the tax "basis," not the deduction. The basis of property that has decreased in value has to be adjusted. If the market value is less than the original taxidermy cost because of its condition, you can only deduct the lower amount. (IRS Publication 551, Basis of Assets). This is an existing separate rule that does not appear directly in the new special rule for taxidermied mounts. The staff report explaining the Pension Protection Act of 2006 does state that donors' deductions will now be limited "to the costs of the taxidermy or the fair market value, whichever is less".

Here is the new legislation:

### SEC. 1214. CHARITABLE CONTRIBUTIONS OF TAXIDERMY PROPERTY.

(a) Denial of Long-Term Capital Gain. Subparagraph (B) of section 170(e)(1) is amended by striking 'or' at the end of clause (ii), by inserting 'or' at the end of clause (iii), and by inserting after clause (iii) the following new clause: "(iv) of any taxidermy property which is contributed by the person

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who prepared, stuffed, or mounted the property or by any person who paid or incurred the cost of such preparation, stuffing, or mounting,'.

(b) Treatment of Basis. Subsection (f) of section 170, as amended by this Act , is amended by adding at the end the following new paragraph: '(15) SPECIAL RULE FOR TAXIDERMY PROPERTY.'(A) BASIS. For purposes of this section and notwithstanding section 1012, in the case of a charitable contribution of taxidermy property which is made by the person who prepared, stuffed, or mounted the property or by any person who paid or incurred the cost of such preparation, stuffing, or mounting, only the cost of the preparing, stuffing, or mounting shall be included in the basis of such property.

'(B) TAXIDERMY PROPERTY. For purposes of this section, the term 'taxidermy property' means any work of art which— '(i) is the reproduction or preservation of an animal, in whole or in part, '(ii) is prepared, stuffed, or mounted for purposes of recreating one or more characteristics of such animal, and '(iii) contains a part of the body of the dead animal.' (c) Effective Date - The amendment made by this section shall apply to contributions made after July 25, 2006. – John J. Jackson, III.

