MLI #8 Charitable Contribution Deductions Under IRC § 170

SUMMARY

Subject to certain limitations, taxpayers can take deductions from their adjusted gross incomes (AGIs) for contributions of cash or other property to or for the use of charitable organizations.[1] To take a charitable deduction, taxpayers must contribute to a qualifying organization[2] and substantiate contributions of $250 or more.[3] Litigation generally occurred in this reporting cycle in the following three areas:

- Substantiation of the charitable contribution;
- Valuation of the charitable contribution; and
- Requirements for a qualified conservation easement.

TAS identified and reviewed 28 cases decided between June 1, 2016, and May 31, 2017, with charitable deductions as a contested issue. The IRS prevailed in 20 cases, taxpayers prevailed in two cases, and the remaining six cases resulted in split decisions. Taxpayers represented themselves (appearing *pro se*) in 14 of the 28 cases (50 percent). In *pro se* cases, no taxpayers prevailed in full, the IRS prevailed in 11 cases, and three cases resulted in split decisions.

TAXPAYER RIGHTS IMPACTED[4]

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

PRESENT LAW

Charitable contributions made within the taxable year are generally deductible by taxpayers, but in the case of individual taxpayers, a taxpayer must itemize deductions from income on his or her income tax return in order to deduct the contribution.[5] Transfers to charitable organizations are deductible only if they are contributions or gifts,[6] not payments for goods or services.[7] A contribution or gift

1 Internal Revenue Code (IRC) § 170.

2 To claim a charitable contribution deduction, a taxpayer must establish that he or she made a gift to a qualified entity organized and operated exclusively for an exempt purpose, no part of the net earnings of which inures to the benefit of any private shareholder or individual. IRC § 170(c)(2).

3 IRC § 170(f)(8)(A).

4 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the IRC. See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

5 IRC §§ 63(d) and (e), 161, and 170(a).

6 The Supreme Court of the United States has defined "gift" as a transfer proceeding from a "detached and disinterested generosity." *Comm'r v. Duberstein*, 363 U.S. 278, 285 (1960).

7 See also Treas. Reg. § 1.170A-1(g) (no deduction for contribution of services).

will be allowed as a deduction under IRC § 170 only if it is made "to" or "for the use of" a qualifying organization.[8]

For individuals, charitable contribution deductions are generally limited to 50 percent of the taxpayer's contribution base (AGI computed without regard to any net operating loss carryback to the taxable year under IRC § 172).[9] However, subject to certain limitations, individual taxpayers can carry forward unused charitable contributions in excess of the 50 percent contribution base for up to five years.[10] Corporate charitable deductions are generally limited to ten percent of the taxpayer's taxable income and are also available for carryforward for up to five years, subject to limitation.[11] Taxpayers cannot deduct services that they offer to charitable organizations; however, incidental expenditures incurred while serving a charitable organization and not reimbursed, may constitute a deductible contribution.[12]

Substantiation

For cash contributions, taxpayers must maintain receipts from the charitable organization, copies of cancelled checks, or other reliable records showing the name of the organization, the date, and the amount contributed.[13] Deductions for single charitable contributions of $250 or more are disallowed in the absence of a contemporaneous written acknowledgement from the charitable organization.[14]

The donor is generally required to obtain the contemporaneous written acknowledgment no later than the date he or she files the return for the year in which the contribution is made, and it must include:

- The name of the organization;
- The amount of cash contribution;
- A description (but not the value) of non-cash contribution;
- A statement that no goods or services were provided by the organization in return for the contribution, if that was the case;
- A description and good faith estimate of the value of goods or services, if any, that an organization provided in return for the contribution; and
- A statement that goods or services, if any, that an organization provided in return for the contribution consisted entirely of intangible religious benefits, if that was the case.[15]

For each contribution of property other than money, taxpayers generally must maintain a receipt showing the name of the recipient, the date and location of the contribution, and a description of the property.[16] When taxpayers contribute property other than money, the amount of the allowable deduction is the fair market value of the property at the time of the contribution.[17] This general rule

8 IRC § 170(c).

9 IRC §§ 170(b)(1)(A) and (G).

10 IRC § 170(d)(1).

11 IRC § 170(b)(2) and (d)(2).

12 Treas. Reg. § 1.170A-1(g). Meal expenditures in conjunction with offering services to qualifying organizations are not deductible unless the expenditures are away from the taxpayer's home. *Id*. Likewise, travel expenses associated with contributions are not deductible if there is a significant element of personal pleasure involved with the travel. IRC § 170(j).

13 Treas. Reg. § 1.170A-13(a)(1).

14 IRC § 170(f)(8). *See also* Treas. Reg. § 1.170A-13(f).

15 IRS Pub. 1771, *Charitable Contributions Substantiation and Disclosure Requirements* (Rev. 3-2016).

16 Treas. Reg. §§ 1.170A-13(b)(1)(i) to (iii).

17 Treas. Reg. § 1.170A-1(c)(1).

is subject to certain exceptions that in some cases limit the deduction to the taxpayer's cost basis in the property.[18] For claimed contributions exceeding $5,000, the taxpayer must obtain a qualified appraisal prepared by a qualified appraiser.[19]

ANALYSIS OF LITIGATED CASES

TAS reviewed 28 decisions entered between June 1, 2016, and May 31, 2017, involving charitable contribution deductions claimed by taxpayers. Table 8 in Appendix 3 contains a detailed list of those cases. Of the 28 cases, the most common issues were: substantiation (or lack thereof) of the claimed contribution (25 cases), valuation of the property contributed (four cases), and contribution of an easement (five cases).[20]

Substantiation

Twenty-five cases involved the substantiation of deductions for charitable contributions. When determining whether a claimed charitable contribution deduction is adequately substantiated, courts tend to follow a strict interpretation of IRC § 170. As noted earlier, deductions for single charitable contributions of $250 or more are disallowed in the absence of a contemporaneous written acknowledgement from the charitable organization.[21]

In *15 West 17th Street LLC v. Commissioner*, the taxpayer, a limited liability company, purchased a property in New York City in 2005 for $10 million.[22] The taxpayer initially intended to demolish one of the buildings on the property that had historic significance. However, in 2007, after lobbying from a historic preservation society, the building was placed on the National Register of Historic Places, and thus became a certified historic structure within the meaning of IRC § 170(h)(4)(C)(i). Later in 2007, the taxpayer executed a historic preservation deed of easement in favor of the Trust for Architectural Easements ("Trust"), a IRC § 501(c)(3) organization and "qualified organization" under § 170(h)(3), thereby contributing the easement to the Trust for federal tax purposes in 2007.

In 2008, the Trust sent a letter to the taxpayer acknowledging receipt of the easement, but critical to this case, the letter did not state whether the Trust had provided any goods or services to the taxpayer or otherwise given anything of value in exchange for the easement donation.[23] Also in 2008, the taxpayer obtained an appraisal that the property it purchased for $10 million in 2005 had a fair market value of $69,230,000 before contribution of the easement and was worth only $4,740,000 after the easement contribution, a $64,490,000 decline in value. When the taxpayer filed its 2007 tax return in 2008, it deducted $64,490,000, the purported value of the easement, as a charitable contribution to the Trust. The taxpayer also included with its return an appraisal report, the letter of acknowledgement from the Trust, and Form 8283, *Noncash Charitable Contributions*, executed by the appraiser and a representative

18 Treas. Reg. § 1.170A-1(c)(1). Note that the deduction is reduced for certain contributions of ordinary income and capital gain property. *See* IRC § 170(e).

19 IRC § 170(f)(11)(C). "Qualified appraisal" and "qualified appraiser" are defined in IRC §§ 170(f)(11)(E)(i) and (ii), respectively.

20 Cases addressing more than one described issue are counted for each issue. For example, cases addressing the valuation of easements are counted once as a valuation issue case and again as a conservation easement issue case. As a result, the breakdown of case issues above will not add up to the total number of cases reviewed by TAS.

21 IRC § 170(f)(8). *See also* Treas. Reg. § 1.170A-13(f).

22 *15 West 17th Street LLC v. Comm'r*, 147 T.C. No. 19 (2016).

23 *Id*.

from the Trust.[24] When the Trust filed its 2007 tax return in 2008, it did not report the receipt of the charitable contribution from the taxpayer nor whether it had provided any goods or services to the LLC in exchange for the easement.

The IRS subsequently selected the taxpayer's 2007 tax return for examination and in 2011, disallowed the charitable contribution deduction taken for the easement contribution because the taxpayer had not met the noncash charitable contribution requirements of IRC § 170 and the related regulations.[25] In 2011, the taxpayer petitioned the Tax Court to challenge the IRS's disallowance of the charitable contribution deduction. In 2014, while this litigation was pending, the Trust amended its 2007 tax return to indicate that it had received the easement contribution from the taxpayer in 2007 and provided no goods or services to the taxpayer in exchange for the easement contribution.

The court noted that the IRC § 170(f)(8)(A) requirement that taxpayers obtain a contemporaneous written acknowledgment (CWA) for charitable contributions of $250 or more is a strict one, and that in the absence of such an acknowledgment, no deduction is allowed.[26] It also pointed out that "the doctrine of substantial compliance does not apply to excuse failure to obtain a CWA meeting the statutory requirements."[27]

The court then examined the CWA requirement under IRC § 170(f)(8). It first noted that IRC § 170(f)(8)(B) provides that a CWA must contain three pieces of information: the amount of cash and a description (but not value) of any property other than cash contributed, whether the donee organizations provided any goods or services, in whole or in part, in consideration for the property contributed, and a description and good faith estimate of the value of these goods or services. It then noted that under IRC § 170(f)(8)(C), an acknowledgement qualifies as contemporaneous only if the donee provides it to the taxpayer on or before the date the taxpayer files a return for the taxable year in which the contribution was made or the due date (including extensions) for filing the return. Finally, the court stated that under IRC § 170(f)(8)(D), the CWA requirement under IRC § 170(f)(8)(A) "shall not apply to a contribution if the donee organization files a return, on such form and in accordance with such regulations as the Secretary [IRS] may prescribe, which includes the information described in subparagraph (B) with respect to the contribution."[28]

In deciding whether the Trust's filing of an amended return in 2014 invoked the donee reporting protections of IRC § 170(f)(8)(D) and made the CWA requirement of IRC § 170(f)(8)(A) inapplicable, the court examined the legislative history of IRC § 170(f)(8), Treasury Department ("Treasury") regulations promulgated under IRC § 170(f)(8) (which did not implement donee reporting under IRC § 170(f)(8)(D)), and proposed donee reporting Treasury regulations issued in 2015 that were ultimately withdrawn in early 2016.[29]

24 *15 West 17th Street LLC v. Comm'r*, 147 T.C. No. 19 (2016).

25 The IRS made an alternative determination that the value of the easement contributed was substantially less than the $64,490,000 the taxpayer claimed on its return.

26 *15 West 17th Street LLC v. Comm'r*, 147 T.C. No. 19 (2016).

27 *Id.*, citing *French v. Comm'r*, T.C. Memo. 2016-53. The Tax Court has described the doctrine of substantial compliance as "a narrow equitable doctrine that courts may apply to avoid hardship where a party establishes that the party intended to comply with a provision, did everything reasonably possible to comply with the provision, but did not comply with the provision because of a failure to meet the provision's specific requirements." *See Samueli v. Comm'r*, 132 T.C. 336, 345 (2009).

28 *15 West 17th Street LLC v. Comm'r*, 147 T.C. No. 19 (2016).

29 *See* IRS, *Withdrawal of Notice of Proposed Rulemaking*, FR Doc. 2016-189 (Jan. 8, 2016). We discussed these withdrawn regulations in our 2016 Annual Report. *See* National Taxpayer Advocate 2016 Annual Report to Congress 501 (Most Litigated Issue: *Charitable Deductions Under IRC § 170*).

The court then rejected the taxpayer's claim that it did not require a CWA from the Trust because the Trust had filed an information return, which the taxpayer claimed satisfied the donee reporting mentioned in IRC § 170(f)(8)(D). The taxpayer argued that the "regulations" mentioned in this section referred to Treas. Reg. § 1.6033-2, which requires charities to file an annual information return. The court rejected this argument, noting that these regulations had been in existence for over twenty years when Congress enacted IRC § 170(f)(8), and if Congress had intended IRC § 170(f)(8)(D) to refer to these regulations, it would not have used the language "in accordance with such regulations as the Secretary may prescribe." Rather, this language referred to future regulations that the IRS may issue.[30]

The court then analyzed how to address a situation where an IRC provision authorizes the Secretary to promulgate regulations, but Treasury has not done so, and whether the statute is "self-executing" in the absence of regulations. The court distinguished between delegations for mandatory rulemaking (*i.e.*, where Congress orders Treasury to issue regulations, for example by using the word "shall" in the statute) and delegations for permissive rulemaking (*i.e.*, Congress left the decision to issue regulations to Treasury's discretion, for example by using the word "may" in the statute). In delegations for mandatory rulemaking, the court noted that courts have frequently held taxpayer-friendly IRC provisions to be self-executing.[31]

However, in the delegations for permissive rulemaking context, the court noted that neither it nor the taxpayer had identified a single case where a court held that an IRC provision is self-executing in the absence of regulations. The court stated the legislative history of IRC § 170(f)(8) indicated that while Congress left open the possibility of donee reporting under IRC § 170(f)(8)(D), it recognized potential policy concerns, and thus did not intend the statute to be self-executing in the absence of regulations. The court further noted these policy concerns materialized in the 38,000 comments Treasury received, most of which were negative and raised issues such as donor privacy, in response to the proposed IRC § 170(f)(8)(D) regulations it issued in 2015. As a result, the IRS decided to withdraw these proposed donee reporting regulations.[32]

Therefore, the court held that IRC § 170(f)(8)(D) sets forth a discretionary grant of rulemaking authority which permits, but does not require, the IRS to issue donee reporting regulations, and found this provision not self-executing in the absence of regulations. The taxpayer was therefore required to obtain a CWA from the Trust under IRC § 170(f)(8)(A). Because it did not do so, it was not entitled to a charitable contribution deduction.[33]

Value of the Property Contributed

In *Cave Buttes, L.L.C. v. Commissioner*, the taxpayer, a limited liability company, purchased an 11-acre property that overlooked downtown Phoenix as well as a dam owned by the Maricopa County Flood Control District ("District").[34] After the District put up various obstacles concerning access to and development of the property, the taxpayer decided to sell the property to the District for a reduced price

30 *15 West 17th Street LLC v. Comm'r*, 147 T.C. No. 19 (2016).

31 *Id.*

32 *Id. See* IRS, *Withdrawal of Notice of Proposed Rulemaking*, FR Doc. 2016-189 (Jan. 8, 2016).

33 *15 West 17th Street LLC v. Comm'r*, 147 T.C. No. 19 (2016). Generally, the opinion of the Tax Court trial judge becomes the opinion of the court, unless the Chief Judge refers the case for review by all of the Tax Court judges, which was done in this case. As a result of the review, two Tax Court judges wrote dissenting opinions that they would have allowed the taxpayer's charitable contribution deduction based on the Trust's filing of an amended information return in 2014.

34 *Cave Buttes, L.L.C. v. Comm'r*, 147 T.C. No. 10 (2016).

of $735,000 (which was based on an appraisal obtained by the District) and claim the remaining value of the property as a charitable deduction on its tax return.

The taxpayer obtained two appraisals for the property, one for $1.5 million and another for $2 million, but chose to use the lower one to report the value of the property on its 2007 tax return. In 2010, the IRS determined that the taxpayer had failed to satisfy the substantiation and qualified appraisal requirements of IRC § 170 for a charitable contribution. The IRS also determined that the taxpayer had not demonstrated that the property was worth $1.5 million and therefore was not entitled to claim a charitable contribution in excess of $735,000, the amount of the District's appraisal of the property.[35] The taxpayer petitioned the Tax Court and hired another appraiser, who determined the fair market value of the property to be $2.167 million.[36]

After finding that the taxpayer obtained a qualified appraisal and therefore met the requirements of IRC § 170, the court addressed the issue of the fair market value of the property. The court noted that both the IRS and the taxpayer used a comparable sales approach to estimating the value of the property and agreed that the highest and best use of the property was for residential development. However, the parties disagreed as to whether residential development was financially feasible.

The court first focused on the issue of access to the property. The court found, contrary to the IRS's position, that the taxpayer had access to the property in a variety of ways, including both express and implied easements. The court also examined the appraisal reports of the taxpayer and the IRS. The court was persuaded by the report of the taxpayer's third appraiser (who appraised the property at trial for $2.167 million) and agreed that his use of comparables and adjustments (both upward and downward) made to fair market value for factors such as time of sale, location, views, access, hillside location, and size were reasonable and appropriate. The court did not find persuasive the appraisal report of the IRS's expert, who valued the property at $505,800, and noted that flaws in his comparables as well as his claim that the property lacked access produced a valuation that was unreasonably low. Therefore, the court adopted the appraisal report of the taxpayer's appraiser and held the property's value to be $2.167 million. The taxpayer was thereby able to claim a larger charitable contribution deduction than what it had originally claimed on its return.[37]

Qualified Conservation Contribution

For a gift to constitute a qualified contribution under IRC § 170, the donor must possess a transferrable interest in the property and intend to irrevocably relinquish all rights, title, and interest to the property without any expectation of some benefit in return.[38] Taxpayers generally are not permitted to deduct gifts of property consisting of less than the taxpayer's entire interest in that property.[39] Nevertheless, taxpayers may deduct the value of a contribution of a partial interest in property that constitutes a "qualified conservation contribution,"[40] also known as a conservation easement. A contribution will constitute a qualified conservation contribution only if it is of a "qualified real property interest" made

35 The IRS also asserted an accuracy-related gross valuation misstatement penalty under IRC § 6662(h).

36 *Cave Buttes, L.L.C. v. Comm'r*, 147 T.C. No. 10 (2016).

37 *Id*.

38 IRC § 170(f)(3).

39 *Id*.

40 IRC §§ 170(b)(1)(E) and (f)(3)(B)(iii).

to a "qualified organization" "exclusively for conservation purposes."[41] All three conditions must be satisfied for the donation to be deemed a "qualified conservation contribution."

In *McGrady v. Commissioner*, the taxpayers participated in a complex conservation plan in Bucks County, Pennsylvania.[42] As part of this plan they made two separate gifts, a donation of qualified conservation easement on their 25-acre homestead property to the township in which they lived and a donation of a fee simple interest in a 20-acre undeveloped parcel of land adjacent to this property to a tax-exempt conservation organization. In addition, the taxpayers agreed to buy back from the tax-exempt conservation organization a 37-acre undeveloped parcel of land for $485,000 to provide sufficient funding for the conservation plan to succeed. The taxpayers reported the gifts of real property as noncash charitable contributions on their 2007 federal income tax return and claimed a charitable contribution deduction for 2007. Because of limitations on charitable contribution deductions in a given year, the taxpayer claimed carryover charitable contribution deductions for 2008 through 2011 tax returns.[43] The IRS audited the taxpayers' returns for these years and disallowed all claimed charitable contribution deductions for the two gifts, asserting that the taxpayers lacked donative intent for their contributions.[44] The taxpayers petitioned the Tax Court to challenge the IRS's disallowance of these deductions.

The court noted that if a taxpayer engages in a transaction with a charity that is a *quid pro quo* exchange (*i.e.*, if the taxpayer receives property or services equal in value to his donation), then there is no contribution or gift within the meaning of IRC § 170. The court also pointed out that if a taxpayer intends to donate property to a charitable recipient but will not do so unless he receives a specific benefit, then such a transfer of property does not qualify for a charitable contribution deduction under IRC § 170.[45]

The court evaluated each transfer independently and found that the taxpayers' donation of a fee simple interest in the undeveloped parcel of land to the tax-exempt organization was an outright gift that they could not take back, was not conditioned on the taxpayers receiving any return benefit, and the taxpayers in fact did not receive any return benefit from the tax-exempt organization. Similarly, with respect to the conservation easement on their homestead property that the taxpayers donated to the township in which they lived, the court found that the taxpayers made this gift "with no strings attached."[46]

The court rejected the IRS's claim that the taxpayers controlled the negotiations with the tax-exempt organization and township and used them to their benefit. The court found that it was necessary for the taxpayers to be heavily involved in the negotiations as they owned the two properties and held an option to purchase a third one that was part of the conservation plan. The court found no evidence that the taxpayers had the ability to manipulate the negotiations or that the other parties involved made meaningful concessions to them.[47]

41 IRC § 170(h)(1)(A)-(C).

42 *McGrady v. Comm'r*, T.C. Memo. 2016-233.

43 *See* IRC § 170(d)(1).

44 *McGrady v. Comm'r*, T.C. Memo. 2016-233. The IRS also claimed that the taxpayers failed to satisfy various reporting requirements, overvalued the donated property, and received return benefits in exchange for their gifts.

45 *Id.*

46 *Id.*

47 *Id.*

The court also dismissed the IRS's claim that the taxpayers' purchase or "buy-back" of a parcel of land surrounding their property as part of the conservation plan was valuable to them because it protected them on all sides from residential development. The court found that this parcel of land was already protected from residential development by a conservation subdivision plan as well as prior placement of conservation easements over the parcel. Therefore, the court found that the taxpayers' only reason for purchasing the parcel of land was to supply the cash necessary to close the conservation plan deal and that the taxpayers probably overpaid for this parcel.

Finally, in further examining whether the taxpayers had the requisite donative intent and if there was a *quid pro quo*, the court noted that the taxpayers, like any taxpayer who places a conservation easement over his or her property (or when a neighbor places a conservation easement over a neighboring property), might benefit by having natural landscapes as opposed to viewing suburban activities. However, it found that any benefit the taxpayers received from the conservation easements put into place as part of the conservation plan was incidental to that of the township and tax-exempt organization, which set up the plan to accomplish their charitable purposes of conserving rural and agricultural land. Therefore, the court held that the taxpayers possessed the requisite donative intent and permitted charitable contribution deductions for their gifts.[48]

The court also found that the taxpayers satisfied their various reporting requirements. However, the court's decision was split as it found for the IRS with respect to certain issues. Specifically, the court found that the fair market value of the gifts was lower than that claimed by the taxpayers and therefore reduced the amount of the charitable contribution deduction. Finally, the court found that the taxpayers received a return benefit of an easement that provided access to their property and reduced their charitable contribution deduction by the value of this easement.[49]

CONCLUSION

IRC § 170 and the accompanying Treasury Regulations provide detailed requirements with which taxpayers must strictly comply. The statutory and regulatory requirements to qualify for a deduction become more stringent as deductions increase in size. Most of the charitable contribution cases reviewed this year addressed issues regarding substantiation of contributions, while several cases discussed the value of the contributed property and the complex rules governing the donation of a conservation easement.

Due to the complex nature of the rules and regulations surrounding charitable contributions, it is likely that litigation will continue in this area of the law and we will continue to see this topic as a most litigated issue. Taxpayers must carefully follow all aspects of the relevant laws and regulations when attempting to make a charitable contribution. Particularly, taxpayers must pay attention to the strict requirements for substantiation of a charitable contribution and to the elements of donating a qualified conservation easement.

48 *McGrady v. Comm'r*, T.C. Memo. 2016-233.

49 *Id*.