FEATURE:
PHILANTHROPY

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Substantiating Charitable Deductions at The IRS

"Close" only counts in horseshoes, hand grenades and nuclear war

Charitable deductions in the millions of dollars are lost for failure to strictly comply with the Internal Revenue Code and the Internal Revenue Service's substantiation and appraisal rules. Substantial compliance (much more on this later) never cuts it at the IRS—and hardly ever in the courts.

We'll summarize the rules and alert you to pitfalls—and we'll toss in some cases. While it's true that every client is entitled to his decade in court, we all want our clients to breeze through at the IRS.

Timing is Key

You'll be shocked, shocked to read how an eager beaver can lose his charitable deduction. David Donor mails his $100,000 check to charity on Dec. 31, 2016. He mails his 2016 tax return, claiming the charitable deduction, to the IRS on Jan. 2, 2017. David receives the most beautiful receipt from the charity on Jan. 3, 2017, acknowledging and thanking him for his $100,000 cash gift. The receipt states, "No goods or services were given in consideration for your gift."

The IRS can deny his deduction on the ground that he didn't have a qualified written acknowledgment (QWA) for his gift before he filed his income tax return.

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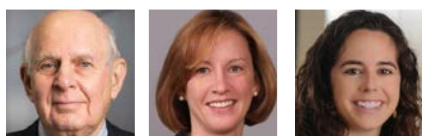

QWA Requirements

A charitable deduction isn't allowable for any contribution of $250 or more unless the taxpayer substantiates the contribution by a QWA of the contribution by the donee charity. A written acknowledgment may be either in paper or electronic form.[1]

The written acknowledgment is contemporaneous if the taxpayer gets it from the charity on or before the earlier of the due date for taxpayer's tax return (including extensions) or the date on which he files a return for the year in which the contribution was made.[2] A taxpayer may not get around this rule by amending his return if he receives the acknowledgment after filing his return.[3]

The acknowledgment must contain:

- The amount of cash contributed or a description of any property contributed (but the charity shouldn't place a value on the donated property, even if marketable securities).
- The date of contribution.
- A statement that the organization provided no goods or services in exchange for the contribution or a description and good faith estimate of the value of any goods or services that were provided.[4]
- If goods or services provided consist solely of intangible religious benefits, the receipt should so state. A religious organization needn't quantify the value of the religious benefit received.
- The acknowledgment should also contain the donor's and the charity's names; however, the IRC doesn't mention this as a requirement. The Tax Court nonetheless disallowed a charitable deduction when the donor's receipts omitted the recipient's name and the dates of contributions.[5] The donor's taxpayer identification number isn't required.

Charity not required to provide acknowledgment. An IRS training manual states that while there's no obligation for the charity to give the donor a receipt, the donor will likely punish the charity for not doing so by making no future contributions.[6] The requirement that the donor have a QWA, but no reciprocal requirement for the charity to provide one, brings to mind Dickens: "If the law supposes that . . . the law is a ass—a idiot."[7] So, the burden is on the donor to obtain a written acknowledgment to meet IRC Section 170's substantiation requirements. A charity that knowingly provides a false written receipt may be subject to penalties for aiding and abetting an understatement of tax liability.[8]

Regardless of the amount contributed, a donor should maintain a bank record or a written communication from the charity showing the charity's name, contribution date and the amount contributed.

Substantiation requirements for life income gifts? It isn't required for charitable remainder and charitable lead trusts;[9] it is required for pooled income fund gifts and charitable gift annuities.[10]

Warning: An exception that's not an exception. Relying on an exception will be dangerous to your client's wealth. For example, in a recent case, *15 West 17th Street LLC v. Commissioner,*[11] a taxpayer incurred a loss of a $64.49 million charitable deduction.

IRC Section 170(f)(8)(D) provides that a donor doesn't need to obtain a QWA of the donation from a donee charity if the charity files a return with the information otherwise contained in a written acknowledgment "on such form and in accordance with such regulations as the Secretary may prescribe." Nevertheless, because the IRS hadn't issued regulations (and will likely never do so), the Tax Court held in *15 West 17th Street* that the waiver of the requirement is inapplicable. The limited liability company contributed an easement to a charitable trust. The QWA from the charitable trust failed to disclose that no goods or services had been provided in exchange for the donation. The trust did file an amended return (Form 990 — Return of Organization Exempt from Tax) including the information specified in Section 170(f)(8)(B). But, that filing didn't help!

Property Donations

Gifts of more than $500. A donor completes and attaches Form 8283 (Noncash Charitable Contributions) to his tax return for the year of the gift.[12] In determining the dollar thresholds, all similar items of property donated to one or more charitable donees are treated as one property.[13] If the charity disposes of the property within three years of donation, it must complete and file Form 8282 (Donee Information Return).[14] The IRS uses this form to evaluate whether the donor's claimed valuation is accurate. Conrad Teitell is proud to have given the rule its nickname—the "tattletale rule." While the sales price is persuasive of fair market value (FMV), it isn't conclusive.

Exception. Form 8282 isn't required if the property sold is worth $500 or less, even if a Form 8283 was filed. To avoid filing Form 8282 in this case, the appraisal summary the charity signed must contain the donor's signed statement that the appraised value of the item doesn't exceed $500. This happens when similar items of property are donated in a particular year and in the aggregate are worth more than $5,000, but individually, a particular item doesn't exceed $500.[15]

Gifts of more than $5,000. FMV is always an issue when donating nonmarketable assets. For donations of noncash items worth more than $5,000, a donor must obtain a qualified appraisal from a qualified appraiser.[16] That's an appraisal prepared by a qualified appraiser (makes sense) and which complies with statutory and regulatory requirements.[17] A qualified appraiser is one who's earned an appraisal designation from a recognized professional appraiser organization or has otherwise met the minimum educational and experience requirements, regularly performs appraisals for compensation and can demonstrate verifiable education and experience in valuing the relevant type of property.[18] Also, there can't

be a relation between a qualified appraiser and the donor or charitable donee.[19] The appraisal fee shouldn't be based on a percentage of the property's appraised value.[20] *Bond v. Comm'r*,[21] discussed below, indicates that the qualified appraisal requirements are merely procedural and may be fulfilled by substantial compliance; however, most cases hold otherwise.[22]

A special rule applies for gifts of non-publicly traded stock with a claimed value over $5,000 but not over $10,000. A qualified appraisal isn't required, but the donor must attach a partially completed appraisal summary form to the return on which the deduction is first claimed.

Is the appraisal fee deductible? It isn't considered a charitable gift. But, if a donor itemizes his deductions, the fee is deductible as a miscellaneous itemized deduction (subject to the 2 percent of adjusted gross income floor).

Pitfall alert. Although gifts of publicly traded securities aren't subject to the appraisal rules, check the definition of "publicly traded securities" to make sure the securities your client wants to donate meet that definition.[23] Securities subject to Securities and Exchange Commission Rules 144 and 145 don't meet the appraisal rule definition of "publicly traded securities" because the SEC rules apply restrictions on the public resale of otherwise unrestricted or marketable securities. Thus, confirm that stock that appears to be marketable isn't subject to restrictions on its sale.

Gifts over $500,000 and artwork over $20,000. The qualified appraisal must be attached to the Form 8283 and the donor's tax return for the tax year of the donation.[24] If a qualified appraisal isn't required to be attached to a donor's tax return (because the value is under the thresholds), the appraisal should be maintained in the donor's records if he's later audited or questioned by the IRS.

Art for deductibility's sake. Additional requirements for artwork worth over $20,000 include a completed Schedule B of Form 8283, an appraisal and a photo of the donated property.[25] The return should include a copy of the signed qualified appraisal. Also, a donor should keep an 8 x 10 color photo (or a 4 x 5 color slide) on file.[26] The donor needn't submit the photo with his tax return.

Substantial Compliance Cases

The IRS has disallowed millions of dollars in charitable deductions for donors' failures to strictly comply with the substantiation and appraisal requirements.

Rather than litigate the time-consuming, costly and difficult issue of FMV, the IRS chooses to disallow what it perceives to be overvaluations by not overlooking minor foot faults in complying with the substantiation and appraisal requirements.

Donors have argued in court that substantial compliance suffices. Let's look at a few cases; donors win sometimes, but rarely.

Significant defect? The predominant question in substantial compliance cases, according to the Tax Court, is whether a taxpayer has provided most of the information required. A single defect in furnishing everything required isn't always significant.[27] In one case, donors bargain sold their 45-foot boat to Associated Marine Institutes. Their failure to supply information on the boat's cost basis was insignificant.[28] The donors attached to their tax return: an appraisal of the boat from two qualified appraisers; a copy of the bargain sale agreement; a statement that the charity was a tax-exempt organization; a copy of the deed transferring the boat to the charity; and a copy of the acknowledgment letter from the charity. The court found the cost basis information was irrelevant to calculating the charitable deduction and didn't need to be included in the donor's return.[29]

But, other donors didn't fare as well when they made gifts of stock, claiming $121,000 in charitable deductions. In *Hewitt v. Comm'r*,[30] the Hewitts didn't obtain a qualified appraisal for the stock, but rather based their valuations on the average per share price of the stock traded in bona fide, arm's-length transactions at approximately the same time the donors made the gifts. The IRS conceded that the values claimed represented FMV of the contributed stock; however, failure to comply with the appraisal requirements proved fatal. The Tax Court gave this rationale for the strict rules: "the principal objective of [the law is] to provide a mechanism whereby [the IRS] would obtain sufficient information in support of the claimed valuation of charitable contributions of property to enable [the IRS] to deal more effectively with the prevalent use of overvaluations."[31] On appeal, the U.S. Court of Appeals for the Fourth Circuit stated, "it is not the role of the Tax Court, nor of this court, to provide equitable concessions to a taxpayer."[32] The Fourth Circuit reasoned that since the Hewitts claimed values for their contributions exceeding $10,000, Treasury Regulations Section 1.170A-13(c)(1)(l) provides that no deduction shall

be allowed unless the appraisal requirement is satisfied. Interestingly enough, had the Hewitts claimed a $10,000 charitable tax deduction for stock having a lower basis, they wouldn't have needed an appraisal (because you don't need a qualified appraisal for gifts of privately held stock worth $10,000 or less, only a partially completed appraisal summary). The Hewitts raised this argument in the appellate court, but it was too late. The court upheld the IRS' disallowance, and the charitable contribution was limited to the Hewitts' $6,542 basis in the stock.[33]

Going to the principal's office didn't help a CPA. A donor claimed a deduction for art supplies donated to a high school and submitted a Form 8283 and a letter of appraisal that the school's principal prepared. In *D'Arcangelo v. Comm'r*,[34] the Tax Court disallowed the donor's $40,000 deduction because the CPA failed to obtain a qualified appraisal that met the regulatory requirements. The appraisal by the school principal didn't suffice. You might say that CPA doesn't stand for "Certified Philanthropic Advisor."

Similarly in *Jorgenson v. Comm'r*,[35] donors gave a sliding wall partition to a charity and claimed a $10,000 charitable deduction. The donors also gave a car to a church and claimed a $14,850 deduction. They attached page 2 of Form 8283 to their tax return, along with a letter from the charity acknowledging the donation of the partition. The donors failed to list the car on Form 8283 and failed to obtain qualified appraisals for both items. The Tax Court disallowed both deductions for failure to substantially comply with Treasury regulations.

Ripley's believe it or not. In *Mohamed v. Comm'r*,[36] the Tax Court disallowed deductions even though the gifted property was worth more than donors claimed. A couple donated real estate to a charitable remainder trust in 2003 and 2004; however, they didn't follow the substantiation requirements. The donated property was worth millions of dollars. The court found that the property was likely more valuable than the couple reported. However, the donors didn't obtain qualified appraisals and attach them to their Form 8283. The court found that the couple didn't substantially comply with the regulations substantiating charitable deductions. The court also noted that substantial compliance requires a qualified appraisal (and not just an estimate of what the property costs or an appraisal that doesn't meet the definition of "qualified appraisal").

Let's win this one for the giver. In *Cave Buttes, LLC v. Comm'r*,[37] the donor sold property at a discount to the Maricopa Flood Control District, a charity, for what it claimed was less than FMV (a bargain sale). The donor had the property appraised and took a charitable deduction for the difference between the sales price and FMV. The IRS denied the deduction because the donor failed to attach a qualified appraisal to its return and failed to use a qualified appraiser. The taxpayer did attach an appraisal report, which included a description of the appraised property by address and characteristics and one of the two required appraisers' signatures. The appraisal report indicated that the appraisal was conducted to value the property for "filing with the IRS." Additionally, the IRS conceded that the appraisal report's definition of FMV substantially complied with the one in Treas. Regs. Section 1.170A-1(c)(2). The Tax Court found that the donor's report substantially complied with the regulations. The Tax Court noted that, "these express delegations of authority to the Secretary to issue regulations create 'the hoops that a taxpayer must crawl through to claim a deduction.' And when it comes to noncash charitable deductions greater than $5,000, the substantiation requirements become particularly extensive."[38] As a result, the deduction of $2.167 million was allowed.

Similarly, in *Bond v. Comm'r*,[39] a donor who contributed two thermal airships to a charity won in the Tax Court. He obtained an appraisal, and the appraiser completed Form 8283. But, the appraiser didn't give the donor the underlying appraisal. The Tax Court sided with the donor, stating that the donor substantially complied with the regulations.

Quid Pro Quo Contributions

A donor who makes a contribution over $75 and receives more than an insubstantial benefit in return has made a quid pro quo contribution.[40] For example, a donor pays $1,000 to attend a charity's banquet and gets a chicken dinner valued at $100. This is a quid pro quo gift, and the donor may deduct only $900. The charity's receipt should acknowledge the $1,000 payment and state that the donor received a dinner valued at $100. Thus, his contribution is $900.

Exception. Charities offering small items or benefits of token value to donors may treat those items as having insubstantial value; thus, the entire contribution is deductible. Benefits are considered to have insubstantial value if the donation occurs in a fundraising campaign

in which the charity informs patrons of how much of their payment is deductible and either: (1) the FMV of all benefits received in connection with the donation isn't more than 2 percent of the payment or $50 (adjusted for inflation, $107 in 2017), whichever is less, or (2) the donation is $25 or more (adjusted for inflation, $53.50 in 2017), and the only benefits received are token items—for example, mugs, key chains and bookmarks.[41] The cost (not the FMV) of all benefits received by the donor must be considered "low cost articles" as defined in IRC Section 513(h)(2). The cost is adjusted for inflation annually. In 2017, that amount is $10.70.[42] Newspapers and program guides, but not commercial quality publications, are treated as having no cost if their primary purpose is to inform members about the activities of an organization and if they aren't available to nonmembers by paid subscription or through newsstand sales.

Does donor recognition jeopardize his deduction? Listing a donor's name in a program or newsletter—no problem. That's an inconsequential benefit. But, giving a donor a trophy or plaque inscribed with his name may have some value, according to the IRS.[43]

Don't take a "chance" on losing deduction. When a donor makes a charitable gift, he shouldn't accept a raffle ticket. Sometimes a charity includes a raffle at a fundraising event. Accepting that raffle ticket can result in the loss of an entire deduction, even if the donor can win less than he gives. The IRS has ruled that if a ticket to a dinner includes a raffle ticket to win a prize, the opportunity to win the prize has a value.[44] For example, a donor attends a fundraising banquet and pays $1,000. The value of the meal is $100. The event ticket includes the entry into a raffle to win a weeklong vacation in St. Thomas. The IRS would rule that the entire $1,000 isn't deductible.[45]

But, sweepstakes, or donations not tied to a raffle, are deductible. No payment is generally required to enter a sweepstakes—so payment made to a charity that's offering a sweepstakes would generally be a charitable gift.[46]

If a charity plans a raffle at a fundraising event, the charity should sell the raffle tickets separately as a non-deductible transfer. It shouldn't include a raffle ticket with the purchase of the event ticket.[47]

Additional Rules

Contributions under $250. A donor should maintain substantiation documents in case he's audited. Regardless of the amount contributed, a donor should maintain a bank record or a written communication from the charity showing the charity's name, contribution date and the amount contributed. Bank records include canceled checks (do these still exist?), bank statements and credit card statements.[48] Credit card or gift card gift rules are the same as the cash gift rules.

Payroll deduction gifts. For these gifts, a donor must have in hand both a paystub or other employer-furnished document stating the amount withheld for payment to the charity and a pledge card or other document prepared by or at direction of the charity, showing the charity's name.[49]

Volunteer expenses. Although a volunteer may not deduct the value of his services given to a charity, he may be able to deduct amounts paid in rendering his services. To qualify for deductions, the amounts must be unreimbursed and directly connected with the services. Also, they mustn't be personal, living or family expenses. To substantiate the contribution, a donor should obtain a receipt that contains: a description of the volunteer's services; a statement whether the charity provides goods/services in exchange for unreimbursed expenses; and a description and good faith estimate of the value of any goods/services provided by the charity (or a statement acknowledging any tangible religious benefits provided).[50]

Completed gift. To get to first base, a gift isn't deemed made until it's "delivered." For checks or securities mailed via the U.S. Postal Service, those gifts are deemed "delivered" when mailed. **Caution.** This rule doesn't apply to gifts sent by private couriers, such as FedEx or UPS.[51] It's best to mail via certified U.S. mail, return receipt requested.

Gifts of artwork. The date of delivery is the date the charity receives the property.

Both the physical property and title to the artwork or other tangible property must be transferred to the charity to complete delivery.

Gifts of real estate. The contribution is deductible in the year the property is deemed transferred under state law. Therefore, check state or local law to determine if real estate is delivered when the executed deed is delivered to the charity or if the deed must be recorded to complete delivery.[52]

Parthian shot. "Men must turn square corners

when dealing with the government." U.S. Supreme Court Justice Oliver Wendell Holmes, Jr. must have been looking ahead to claiming a charitable deduction when he wrote this statement in 1920 in *Rock Island A. & L. R. Co. v. United States*.[53]

Endnotes

1. Internal Revenue Service Publication 1771, "Charitable Contributions." This publication outlines substantiation and disclosure requirements of charitable contributions. **Caution:** IRS publications may not be relied on as binding authority.
2. Internal Revenue Code Section 170(f)(8)(C).
3. The IRS preamble to the IRC Section 170A regulations indicates that no deduction is allowable if the taxpayer obtained a written acknowledgment for a contribution after timely filing an original return and then filing an amended return with receipt in hand, claiming a deduction.
4. IRC Section 170(f)(8)(B) and Treasury Regulations Section 1.170A-12(a)(1)(ii).
5. *Burell Jr. v. Commissioner*, T.C. Memo. 1994-574.
6. *1997 IRS Exempt Organizations CPE Technical Instruction Program Textbook*, Chapter G, "Updates on Disclosure and Substantiation Rules."
7. Charles Dickens, *Oliver Twist*, Ch. 51 (1838).
8. IRC Section 6701.
9. Treas. Regs. Section 1.170A-13(f)(13).
10. Treas. Regs. Section 1.170A-13(f)(16).
11. *15 West 17th Street LLC v. Comm'r*, 147 T.C. No. 19 (2016).
12. Section 170(f)(11)(B).
13. Section 170(f)(11)(F).
14. Instructions to Form 8282.
15. *Ibid.*
16. Section 170(f)(11)(C).
17. Section 170(f)(11)(E).
18. Section 170(f)(11)(E)(ii).
19. Treas. Regs. Section 1.170A-13(c)(6).
20. Treas. Regs. Section 1.170A-13(c)(5).
21. *Bond v. Comm'r*, 100 T.C. 32 (1993).
22. For example, *Jorgenson v. Comm'r*, T.C. Memo. 2000-38 and *D'Arcangelo v. Comm'r*, T.C. Memo. 1994-572.
23. Treas. Regs. Section 1.170A-13(c)(7)(xi) defines in detail "publicly traded securities" that qualify for the appraisal exception.
24. Section 170(f)(11)(D).
25. Instructions to Form 8283.
26. *Ibid.*
27. *Hewitt v. Comm'r*, 109 T.C. 258 (1997), *aff'd*, 166 F.3d 332 (4th Cir. 1998).
28. Treas. Regs. Section 1.170A-13(b)(3)(i)(B) requires such information. However, failure to keep the relevant records on cost basis doesn't bar a deduction if the failure is reasonable. Treas. Regs. Section 1.170A-13(b)(3)(ii).
29. *Fair v. Comm'r*, T.C. Memo. 1993-377.
30. *Supra* note 27.
31. *Ibid.* at p. 265.
32. *Hewitt v. Comm'r*, 166 F.3d 332, 1998 WL 902042 at *4 (4th Cir. 1998).
33. *Ibid.*
34. *D'Arcangelo v. Comm'r*, T.C. Memo. 1994-572.
35. *Jorgenson, supra* note 22. For the current valuation and deductibility rules on vehicle donations, *see* IRS Publication 4303, "A Donor's Guide to Vehicle Donations" (*see* Section 170(f)(12) for statutory requirements). If you represent a charity that receives donated vehicles, *see* IRS Publication 4302, "A Charity's Guide to Vehicle Donations." IRS Notice 2006-1 provides information for charities receiving vehicle donations.
36. *Mohamed v. Comm'r*, T.C. Memo. 2012-152. The court also noted that "the problems of misvalued property are so great that Congress was quite specific about what the charitably inclined have to do to defend their deductions, and we [the court] cannot in a single sympathetic case undermine those rules."
37. *Cave Buttes, LLC v. Comm'r*, No. 5788-11, 2016 WL 5107038, at *6 (T.C. Sept. 20, 2016).
38. *Ibid.*
39. *Supra* note 21. For additional favorable substantial compliance cases, *see Dunlap v. Comm'r*, T.C. Memo. 2012-126; *Louderback v. Comm'r*, T.C. Memo. 1995-19. For additional disallowance cases, *see Estate of Evenchik v. Comm'r*, T.C. Memo. 2013-34; *Smith v. Comm'r*, T.C. Memo. 2007-368; *Estate of Clause v. Comm'r*, 122 T.C. 115 (2004); *Todd v. Comm'r*, 118 T.C. 334 (2002); *Jorgenson supra* note 22; *D'Arcangelo supra* note 22.
40. IRC Section 6115. Failure by the charity to provide the donor with a written acknowledgment can result in a penalty of $10 per contribution with a maximum penalty of $5000 per event or mailing. IRC Section 6714.
41. Revenue Procedure 1990-12 and Rev. Proc. 92-49.
42. Rev. Proc. 2016-55.
43. T.D. 8690, *www.irs.gov/pub/irs-tege/td8690.pdf.*
44. *See* IRM 4.76.51.
45. *Goldman v. Comm'r*, 46 T.C. 136; Revenue Ruling 83-130; 1995 EO CPE Text, Substantiation and Disclosure Rules of OBRA '93, *www.irs.gov/pub/irs-tege/eotopicj95.pdf.*
46. Private Letter Ruling 200012061 (Dec. 21, 1999).
47. *See* IRS Notice 1340 for additional guidance on hosting raffles, *www.irs.gov/pub/irs-tege/notice_1340.pdf.*
48. The term "bank record" isn't defined in Section 170(f)(17); however, it's defined on the IRS website, *www.irs.gov/charities-non-profits/substantiating-charitable-contributions.*
49. Treas. Regs. Section 1.170A-13(f)(11).
50. Treas. Regs. Section 1.170A-13(f)(10).
51. Interestingly, you can use these services under the mailbox rule to mail your tax return, tax court petitions and quarterly payments to the IRS; however, this rule doesn't spill over to date of delivery.
52. *See Ankeny v. Comm'r*, T.C. Memo. 1987-247.
53. *Rock Island A. & L. R. Co. v. United States*, 254 U.S. 141 (1920).