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Securing Charitable Contribution Deductions



By Paul G. Schloemer, Ph.D., CPA

Issues regarding charitable contributions have been a frequent source of contention between the IRS and taxpayers - the charitable contribution deduction was identified as one of the most litigated issues in the National Taxpayer Advocate's latest report to Congress.¹ Thus, a review of the key issues taxpayers encounter in claiming this deduction is warranted.

Several recent articles highlight court decisions involving taxpayers who incurred significant additional tax burdens and penalties due to errors in claiming charitable contribution deductions.² These decisions illustrate how errors perceived to be minor when the taxpayer's return was submitted resulted in onerous consequences.

This article reviews the rules for substantiating a charitable contribution deduction. In addition, recent court decisions are reviewed to provide insight into IRS enforcement of these rules and their interpretation by the courts. This review of the applicable tax law and how the law has been applied by the courts will assist taxpayers and professional advisors in complying with the law and securing deductions.

Decisions from the 2016 NTA Report

Each year, the National Taxpayer Advocate (NTA) submits a report to Congress regarding taxpayers' experience in complying with tax law and the key issues taxpayers face in this endeavor. In the latest report (2016), charitable contributions was listed as the eighth most litigated issue.³ This issue was also listed as one of the top 10 issues in the previous three reports.

The latest NTA Report reviewed court decisions during the period from June 1, 2015 through May 31, 2016. Twenty-six decisions on charitable contributions were identified: two appellate court, two district court and 22 tax court decisions. Three recurring issues were

identified: the value of contributed property, substantiation of the deduction and meeting the requirements for a conservation easement. In 58 percent of these decisions, substantiation of the deduction was a key issue.

The next section provides details on the requirements for substantiating contributions of cash and property along with recent court decisions that apply these requirements to specific fact patterns. These decisions illustrate the importance of strict compliance with the substantiation requirements for contributions of property with a value greater than \$500. Even minor deviations can result in loss of the entire deduction.

Documentation Rules for Deduction of Charitable Contributions

Internal Revenue Code (IRC) section 170 provides the basic rules for deduction of charitable contributions. IRC section 170(a) states that the Secretary of the Treasury has authority to prescribe regulations for verifying deductible contributions. By codifying this statement, Congress puts IRS regulations in this area almost on par with the IRC. These regulations are fairly detailed and they frequently have been a stumbling block to taxpayers seeking a deduction.

Three basic items are required to substantiate a cash contribution under \$250: the date of the contribution, the amount and the name of the donee organization.⁴ The taxpayer's cancelled check fulfills all three requirements as does a receipt from the donee that includes these items. Documentation for these smaller cash contributions must be maintained by the taxpayer and a contemporaneous record is considered ideal.⁵

For contributions of property, taxpayers must obtain an acknowledgement from the donee that provides the name of the donee, a description of the property and date and

location of the contribution.⁶ The donor should maintain records showing the name and address of the donee organization, the property's estimated value and how this value was derived.⁷ This documentation is indispensable in the event that the deduction is audited. As contributions reach \$250, documentation standards increase.

Contributions of \$250 or Higher Require Contemporaneous Written Acknowledgment

IRC section 170(f)(8) requires the donor to obtain contemporaneous written acknowledgement (CWA) from the donee for contributions greater than or equal to \$250. In this CWA, the donee specifies the donor's name, the amount of cash received and whether the donor received goods or services in exchange for the donation and the value of these goods or services. If the donor received only "intangible religious benefit," the CWA should have a statement to this effect.⁸ If property is contributed, the following additional information should be provided in the CWA:

- a description of the property received
- the name and address of the organization
- the date of the contribution
- the location where the property was contributed⁹

To be contemporaneous, the acknowledgement must be received by the earlier of: the date the taxpayer files the return or the due date (including extensions) for filing the return.¹⁰ The CWA requirements place a substantial burden on organizations receiving donations. Failure by the donee organization to include the specified information in the CWA has resulted in disallowance of deductions for some taxpayers. Even minor deviations from the requirements of the regulations can result in loss of the deduction.

For example, in *French*¹¹ the taxpayers executed a conservation deed granting an easement to the Montana Land Reliance to preserve the scenic quality and natural habit of land. This deed was executed in December 2005. However, the deed did not contain a statement that no goods or services had been provided in exchange for the easement, nor did it state whether the deed constituted the entire agreement between the parties.

The tax court denied deductions totaling \$350,971 (taken over four years) because there was no valid CWA. A statement about receipt of goods and services by the donor was lacking and could not be implied through the language in the conservation deed. Although a letter from the Montana Land Reliance dated June 6, 2006 stated that "no goods or services were furnished in respect of your easement donation," it was not considered contemporaneous because it was received after the taxpayers had filed their return.

Documentation for Contributions of Property Exceeding \$500

Additional documentation standards are applicable to

donations of property valued at more than \$500.¹² A CWA from the donee is still required. In addition, the IRS requires taxpayers to file Form 8283, disclosing substantial details including:

- the date of the contribution
- a description of the property
- the name and address of the donee
- the taxpayer's cost or other basis in the property
- the date of acquisition and how the property was acquired
- the property's estimated value and how this estimate was derived¹³

Generally, no deduction is allowed for used clothing and household items unless their condition would be evaluated as "good" or better. However, if these items are contributed and the deduction exceeds \$500, the items must be appraised and the appraisal attached to the return.¹⁴

A recent tax court decision illustrates the deleterious consequences of failing to meet these substantiation requirements. In *Ohde*,¹⁵ a husband and wife allegedly donated 20,000 items to Goodwill in one year, claiming a deduction of \$145,250. Documentation for items donated was deficient; records produced by the taxpayers did not provide the market value or cost basis for items and were not prepared contemporaneously. The IRS allowed a deduction of only \$250. The tax court sustained the IRS's determination and upheld the IRC section 6662 underpayment penalty due to the taxpayer's failure to keep adequate records.

Documentation for Contributions of Property Exceeding \$5,000

For donations of property valued at more than \$5,000, a qualified appraisal must be completed in addition to the requirements listed in the previous section.¹⁶ The appraisal must be prepared, signed and dated by a qualified appraiser within a period that begins 60 days before the contribution and ends on the date the return is due or filed.¹⁷ The appraisal requirement is waived for contributions of non-publicly traded stock valued at more than \$5,000 but less than \$10,000,¹⁸ publicly-traded securities and vehicles donated under the rules set forth below.¹⁹

The filing of Form 8283 is required and serves as documentation of the contribution and a summary of the appraisal. The form includes detailed information about the donor, appraiser, donee and the donated property. The filing of this form requires diligence, including a careful review of the instructions. Failure to attend to details can lead to complete disallowance of the deduction.

In *RERI Holdings I LLC*,²⁰ a partnership donated a remainder interest in California real estate to the University of Michigan, claiming a deduction of \$33,019,000. The partnership included Form 8283 with the tax return as required, but did not provide the cost basis for the property

contributed as required by Treasury Reg. 1.170A-13(c)(4)(ii)(E).

Due to the taxpayer's failure to fully substantiate the contribution, the entire deduction was disallowed. The court noted that disclosing the low cost basis of the property would have alerted the IRS to the substantial appreciation being deducted by the taxpayer, implying that failure to disclose this information may have been purposeful. In addition, since the court determined the value of the interest to be \$3,462,886, the taxpayer was subject to a 20 percent penalty for gross valuation misstatement under IRC section 6662(e)(1)(A)(h)(2).

Disputes regarding contributions of valuable property center on the determination of market value, but the IRS will also raise issues regarding substantiation of the deduction. Court decisions examine the appraiser's qualifications and the integrity of the appraisal process to verify that a reasonable value has been obtained. In addition, the courts assess the taxpayer's documentation against standards set by the IRC and regulations. Two recent decisions provide illustrations of the tax court's decision process in these disputes.

In Mohamed,²¹ the donor/taxpayer, a certified real estate appraiser, conducted his own appraisal of several parcels of donated land. However, the regulations state that neither the taxpayer claiming the deduction nor the donor are qualified appraisers.²² Thus, Mohamed's charitable contributions of more than \$18 million were denied. Mohamed's response to the IRS determination was to obtain appraisals by two independent appraisers, who placed a higher value on the parcels. However, the court was not swayed by these tardy appraisals, stating that a qualified appraisal must be "completed before the due date of the return."

Wolfe²³ provides an example of a taxpayer who devoted sufficient effort toward substantiation of a charitable contribution of land. Although the IRS argued that several items were missing, the court ruled in favor of the taxpayer, stating that substantial compliance with the regulations had been achieved. Issues raised by the IRS were the appraiser's qualifications, the appraised value and the fact that the date of the appraisal differed from the date of the contribution.

First, the appraisal had been prepared and signed by two individuals, but only one signed Form 8283 and only one appraiser disclosed his qualifications. Under a strict interpretation of the regulations, both should have signed and provided evidence of being a qualified appraiser.²⁴ Second, the appraisal was dated 21 days after the contribution of the property. Third, the IRS placed a lower valuation on the land because access to the property was restricted.

The court dismissed the first two issues as minor. On the third issue, the court sided with the taxpayer, stating that the IRS's assumption of no legal access was incorrect; the taxpayer had been granted access in the past and it was reasonable to assume that this access could be secured by the new owner. Thus, although the taxpayer's compliance

with the regulations was not perfect, the court noted that the taxpayer made substantial efforts to comply and that deviations were minor.

Documentation for Contributions of Property Exceeding \$500,000 and Artwork Exceeding \$20,000

Contributions of property exceeding \$500,000 and artwork valued at \$20,000 or higher must be substantiated with a qualified appraisal and CWA. The appraisal must be attached to the return along with Form 8283.²⁵ For artwork, the taxpayer should maintain a photograph of the donated item that can be made available to the IRS upon request.²⁶

Special Rules for Contributions of Conservation Easements

Contributions of conservation easements allow a taxpayer a charitable deduction for restricting his/her use of land or preserving a historic structure. The individual retains title to the property, but contributes a real property interest to a qualified organization, granting a perpetual restriction on use of the property. These contributions have recently been the source of much scrutiny by the IRS. Deductions have been denied for lacking a CWA and for incomplete appraisals.²⁷

Contributions of easements to preserve historic structures (façade easements) require the filing of Form 8283 and a qualified appraisal. Receipt of a CWA is also required. IRC section 170(h)(4)(B)(iii) requires the appraisal be attached to the return along with photos of the exterior of the building and a description of all restrictions on development of the building. Contributions of real property easements for purposes such as the public's scenic enjoyment, preservation of open space and protection of a natural habitat must also be substantiated with a qualified appraisal and receipt of a CWA. Form 8283 must be attached to the return.

In Gemperle²⁸ the IRS claimed that the taxpayer had overvalued the contribution of a façade easement on their Chicago residence. However, the decision turned on the taxpayers' failure to include a copy of the appraisal of the easement with their tax return. The court disallowed the deduction and granted a 40 percent penalty for gross valuation misstatement under IRC section 6662(h). The Gemperles failure to meet a basic substantiation requirement resulted in disastrous consequences.

In 15 West 17th Street LLC,²⁹ the taxpayer failed to obtain a CWA from the donee for contribution of a conservation easement. The donee acknowledged the donation via a letter, but this letter did not state whether any goods or services had been provided in exchange for the easement as required by IRC section 170(f)(8). The taxpayer's deduction was disallowed in its entirety. The court stated that, "the requirement that a CWA be obtained for charitable contributions of \$250 or more is a strict one." Thus, even a partial deduction was not permissible.

Special Rules for Motor Vehicles, Boats and Airplanes

IRC section 170(f)(12) provides rules for charitable contributions of motor vehicles, boats and airplanes with a value exceeding \$500. Perceived abuse regarding valuation of these vehicles prompted Congress to impose additional requirements on donors and donees. The vehicle may be sold by the donee or kept for the organization's use. The donee must file Form 1098-C with the IRS and provide detailed information about the donor and the vehicle, duplicating much of the information provided to the donor in the CWA. Frequently, a copy of Form 1098-C will be provided to the donor as the CWA.

The CWA must be provided to the donor within 30 days of the sale of the vehicle or within 30 days of the contribution if the donee does not sell the vehicle. This CWA must contain the name and taxpayer identification number of the donor and the identification number of the vehicle (e.g. VIN of the auto). In addition, the CWA must state whether the donee provided any goods or services in exchange for the donation and if so, the value of such goods or services.

For vehicles subsequently sold by the donee, the CWA must certify the vehicle was sold in an arms-length transaction, disclose the amount received upon sale and state that the donor's deduction is limited to the proceeds received from the sale. For vehicles not sold by the donee in an arms-length transaction, the CWA must state the intended use of the vehicle by the organization and that it will not be sold until the intended use is fulfilled. In this case, the donor deducts the fair market value of the vehicle. For autos, an objective value can be determined using one of the many used-car pricing guides. Taxpayers that contribute vehicles must attach the CWA to their return along with a completed Form 8283.

The taxpayer in Izen³⁰ attempted to comply with the above rules when he donated his 50 percent interest in a vintage airplane to an aircraft museum. His amended return included a Form 8283 executed by the museum's director, an acknowledgement letter addressed to the partnership that owned the other 50 percent interest in the airplane, an Aircraft Donation Agreement signed only by the president of the museum and an appraisal valuing Izen's interest in the aircraft at \$338,080.

The documents attached to the taxpayer's return were deficient because they were not addressed to the taxpayer, did not include the taxpayer's name or Taxpayer Identification Number and did not state whether the taxpayer received goods or services in exchange for the gift. In addition, there was no acknowledgement that a gift had been made and none of the documents were signed by the taxpayer. These omissions caused the court to rule that the CWA requirements of IRC section 170(f)(8) had not been met resulting in disallowance of the entire deduction.

Advice for Tax Professionals

The tax professional is a crucial party in ensuring taxpayer

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compliance with tax law. One of the value-added services tax professionals can promote is their knowledge of substantiation requirements and the procedures they use to assure deductions survive IRS audit. Based on recent court decisions, assuring compliance with the substantiation requirements for charitable contributions is a valuable service provided to clients.

The documentation requirements for contributions of property have been an obstacle for taxpayers seeking to secure deductions. Knowledge of these requirements and utilizing processes that assist clients in complying with them is a competitive advantage of the tax professional. The following paragraphs provide ways tax professionals can help clients secure deductions for charitable contributions.

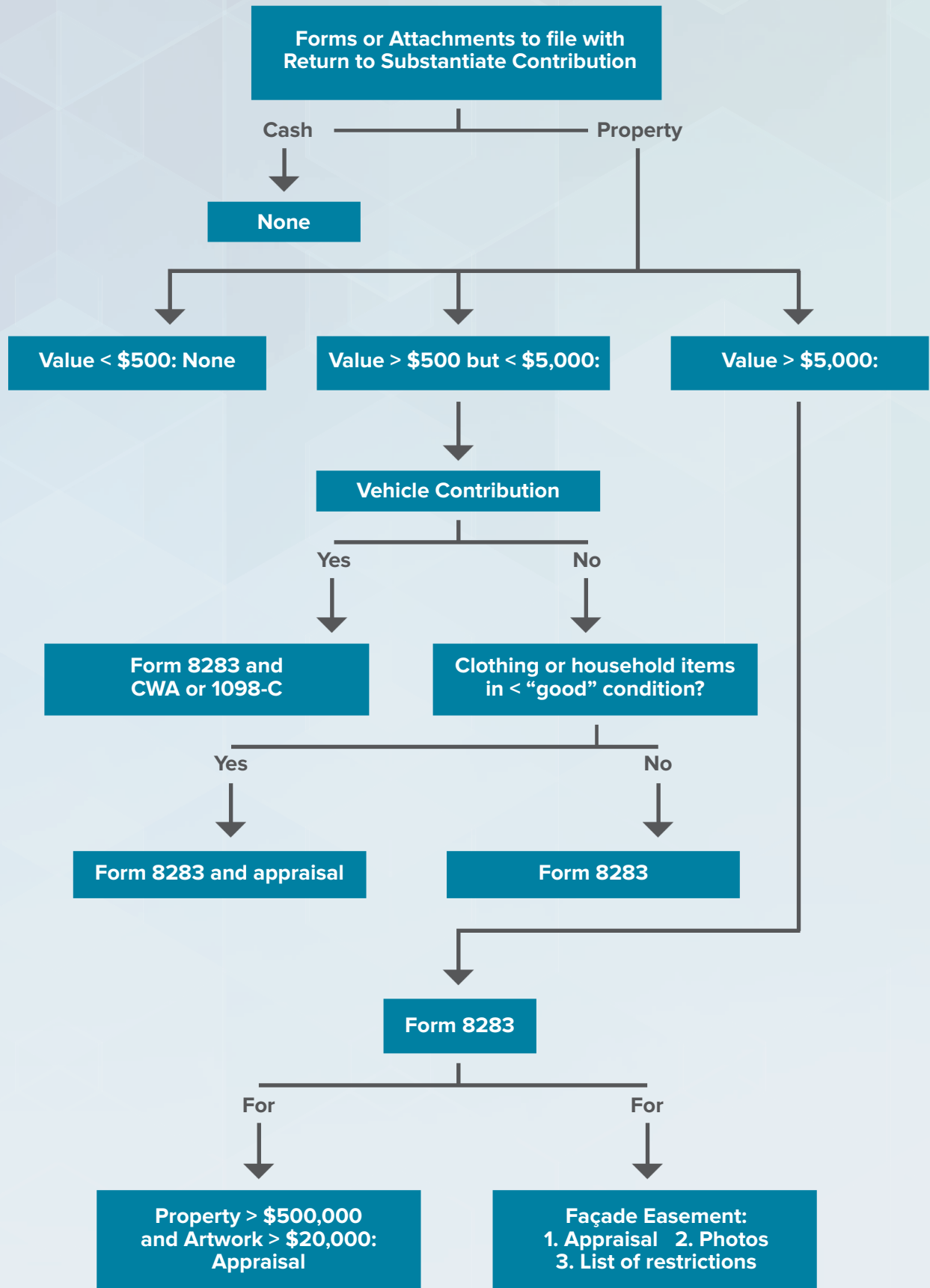
During preparation of the client's tax return, the tax advisor should review the CWAs for large contributions to verify that required information is provided. This additional step can help avoid problems that could arise during an IRS audit. For CWAs with errors or omissions, the tax advisor must work with the donee organization to remedy these before the return is filed.

Contributions of property that exceed \$500 require additional documentation. To assure compliance, tax professionals should devote additional time and diligence preparing Form 8283 and verifying that supporting documentation and attachments (e.g. qualified appraisal) fulfill all requirements. Time devoted to these activities in the initial preparation of the return provides assurance that deductions will survive IRS audit.

Tax consulting firms with clients who frequently donate property should consider developing documentation checklists for staff to assure that all requirements are met. In addition, for all property contributions greater than \$500, firms should subject Form 8283, any attachments and supporting documentation to review by another professional before the return is filed. Additional time devoted to this quality control activity helps avoid the onerous consequences associated with the loss of large deductions. A diagram for determining what forms and attachments must be included with the tax return to substantiate the charitable contribution is shown in **Figure 1** on the next page. It is provided to assist tax advisors in verifying that all required forms and attachments are included.

FIGURE 1

TAX RETURN FORMS AND ATTACHMENTS REQUIRED TO SUBSTANTIATE CHARITABLE CONTRIBUTION



As contributions exceed \$5,000, the tax advisor should consider proactive measures to assure that appraisals are “qualified.” Review of a prospective appraiser’s qualifications may be warranted. The appraiser’s background, education, membership in professional organizations and experience valuing the type of property donated should indicate whether the individual meets the standard of being a “qualified appraiser.”³¹ An appraiser whose prior appraisals have survived IRS audits is the ideal candidate.

After the appraisal has been completed, a brief review of the completed appraisal to assure all items have been included provides another level of insurance. The regulations provide a lengthy list of requirements for qualified appraisals. The tax advisor should evaluate the completed appraisal based on the requirements of Treasury Reg. 1.170A-13(c)(3). For higher value contributions, it may be prudent to suggest the client incur the additional expense of obtaining two appraisals.

IRC section 170(f)(11)(A)(ii)(II) provides an exception for taxpayers who fail to meet all the substantiation requirements for property contributions greater than \$500. If the taxpayer can establish that the failure was “due to reasonable cause and not due to willful neglect,” the taxpayer may be able to salvage a deduction even if documentation is incomplete. The tax advisor may have to pursue this course of action with the IRS if an audit identifies deficiencies in substantiation.

Conclusion

Issues regarding deduction of charitable contributions have been a frequent source of contention between taxpayers and the IRS. Based on recent court cases, complying with the substantiation requirements has been an obstacle to taxpayers in securing deductions. Tax professionals’ knowledge of substantiation requirements and the procedures they use to assure deductions are properly documented can assist taxpayers in complying with the law and in securing deductions. 🐦

ABOUT THE AUTHOR

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¹ *Taxpayer Advocate Service, 2016 Annual Report to Congress: Volume One: pg. 410; accessed at: https://taxpayeradvocate.irs.gov/Media/Default/Documents/2016-ARC/ARC16_Volume1_MostLitigatedIssues.pdf*

² *Berry, Ken, Tax Court Denies Deduction for Donation of 20,000 Household Items, CPA Practice Advisor; accessed at: <http://www.cpapracticeadvisor.com/news/12354249/tax-court-denies-deduction-for-donation-of-20000-household-items>; CCHTaxGroup, Deduction for Donation of Aircraft to Museum Denied; No Contemporaneous Written Acknowledgment (Izen, Jr., TC), CCHGroup.com; accessed at: news.cchgroup.com/2017/03/02/deduction-donation-aircraft-museum-denied-no-contemporaneous-written-acknowledgment-izen-jr-tc/.*

³ *Ibid.*, 1

⁴ *Section 170(f)(17).*

⁵ *Treas. Reg. Section 1.170A-13(a)(2).*

⁶ *Treas. Reg. Section 1.170A-13(b)(1).*

⁷ *Treas. Reg. Section 1.170A-13(b)(2)(ii).*

⁸ *Section 170(f)(8)(B).*

⁹ *Treas. Reg. Section 1.170A-13(b)(2).*

¹⁰ *Section 170(f)(8)(C).*

¹¹ *French v. Comm.*, T.C. Memo 2016-53.

¹² *Section 170(f)(11).*

¹³ *Treas. Reg. Section 1.170A-13(b)(3).*

¹⁴ *IRS Instructions to Form 8283.*

¹⁵ *Ohde v. Comm.*, T.C. Memo 2017-137.

¹⁶ *Section 170(f)(11)(C).*

¹⁷ *Treas. Reg. Section 1.170A-13(c)(3).*

¹⁸ *Treas. Reg. Section 1.170A-13(c)(2)(ii)(B)(1).*

¹⁹ *Section 170(f)(11)(A)(ii)(I).*

²⁰ *RERI Holdings I, LLC v. Comm.*, 147 T.C. No. 1.

²¹ *Mohamed v. Comm.*, T.C. Memo 2012-152.

²² *Treas. Reg. Section 1.170A-13(c)(5)(iv).*

²³ *Wolfe v. Comm.*, 147 T.C. No. 10.

²⁴ *Treas. Reg. Section 1.170A-13(c)(7)(iii).*

²⁵ *Section 170(f)(11)(D) and IRS Instructions to Form 8283.*

²⁶ *IRS Instructions to Form 8283.*

²⁷ *Jones, George G. and Luscombe, Mark A., An early look at 2017 year-end planning, Accounting Today (October, 2017): 12-13.*

²⁸ *Gemperle v. Comm.*, T.C. Memo 2016-1.

²⁹ *15 West 17th Street LLC v. Comm.*, 147 T.C. No. 19.

³⁰ *Izen v. Comm.*, 148 T.C. No. 5.

³¹ *Treas. Reg. Section 1.170A-13(c)(5)(i).*



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