By Rebecca L. Smitherman

As I write these comments, it is sunny after several days of rain, and the good weather is making me antsy for spring. Sometimes, I remind myself not to wish my life away – not to wish that it was Saturday already, and not to wish that it would fast forward to spring. There is a lot of life to be had in those in-between times, and we should not look over it.

Our section has made the most of the winter months. Your Council met in January at Wake Forest School of Law. Plans are underway for a great annual meeting at Kiawah Island this year. Our CLE Committee stays hard at work planning great programs, and I think that this year’s annual meeting will be extra special. After all, it is the fortieth annual meeting of our section. Book your accommodations now at Kiawah Island Resort in order to receive the discount for the NCBA block of rooms. The conference dates are July 25-27.

Membership in our Section comes with some good benefits – the outstanding articles in The Will & The Way (Chair’s Comments notwithstanding), excellent CLE, pro bono opportunities, member socials, and scholarship opportunities. If you or someone you know could benefit from a scholarship to attend a section CLE – maybe the annual meeting? – please apply or encourage someone else to apply. Contact Andrea Bradford at the NCBA for scholarship details (abradford@ncbar.org). This is just one way that members of our section support one another.

Last year at the annual meeting, our section gave its first ever Distinguished Service Award to Graham

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How Charitable Contribution Deductions Can Vanish Into Thin Air

By Elie J. Foy

On July 27, 2018, the Treasury issued final regulations regarding substantiation requirements for cash and noncash charitable contributions. T.D. 9836 (2018). The final regulations reflect amendments to Section 170 of the Internal Revenue Code made by both the American Jobs Creation Act of 2004 and the Pension Protection Act of 2006. These substantiation rules are a trap for unwary donors and advisors and, as recent cases show, can make substantial charitable deductions vanish into thin air. This article will summarize the maze of substantiation rules and discuss several recent cases which should serve as a warning to donors and advisors, alike.

2018 Final Regulations

Substantiation Requirements for Cash, Check or Other Monetary Gift. The general rule under the final regulations is that no deduction is allowed for a cash gift (including a gift made by check) unless the donor substantiates the deduction with a bank record or written communication showing the name of the donee, the date of the contribution, and the amount of the contribution. Treas. Reg. § 1.170A-15(a). A “bank record” includes a statement from a financial institution, electronic fund transfer receipt, cancelled check, scanned check images from a bank website, or credit card statement. Treas. Reg. § 1.170A-15(b). Email qualifies as a “written communication.” Id.

For cash charitable contributions of $250 or more, the Regulations impose additional substantiation requirements. In those cases, the donor must also have a “contemporaneous written acknowledgement” from the donee. Treas. Reg. § 1.170A-15(a). A “bank record” includes a statement from a financial institution, electronic fund transfer receipt, cancelled check, scanned check images from a bank website, or credit card statement. Treas. Reg. § 1.170A-15(b). Email qualifies as a “written communication.” Id.

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Substantiation Requirements for Noncash Contributions of Less Than $250 or More But Not More Than $500. No deduction is allowed for noncash contributions of more than $250 or more but no more than $500 unless the donor has contemporaneous written acknowledgement of the contribution from the donee. Treas. Reg. § 1.170A-16(b). In other words, for a noncash donation of between $250 and $500, a reliable written record prepared by the donor is not going to be enough.

Substantiation Requirements for Noncash Contributions of More Than $500 But Not More Than $5,000. No deduction is allowed for a noncash contribution of more than $500 but no more than $5,000 unless the donor substantiates the contribution with a contemporaneous written acknowledgement, and completes Section A of Form 8283 and files the same with his or her income tax return. Treas. Reg. § 1.170A-16(c). Completion of Section A of Form 8283 includes providing: (1) the donor’s name and tax identification number; (2) the name and address of the donee; (3) the date of the contribution; and (4) certain information regarding the donated property including: (a) a description of the property; (b) in the case of real or tangible personal property, a description of the condition of the property; (c) in the case of securities, the name of the issuer, type of security and whether the security is publicly traded; (d) the fair market value of the property on the date of contribution and a description of the method used to determine value; (e) a description of the manner in which the donor acquired the property and the approximate acquisition date; and (f) the cost basis of the property. Id.

Substantiation Requirements for Noncash Contributions of More Than $5,000. There is no deduction for a noncash charitable contribution in excess of $5,000 unless the donor: (1) substantiates the contribution with a contemporaneous written acknowledgement from the donee; (2) obtains a qualified appraisal, prepared by a qualified appraiser; and (3) completes Section B of Form 8283. Treas. Reg. § 1.170A-16(d). There are certain types of property for which a qualified appraisal is not needed. Those include publicly traded securities, certain intellectual property and certain inventory or goods sold in the normal course of business of the donor. Id.

Section B of Form 8283 contains the same information as Section A, described above, but also requires the appraiser’s name, address, tax identification number, appraiser declaration, signature, and the date signed. Id. The appraiser declaration is as follows:

I understand that my appraisal will be used in connection with a return or claim for refund. I also understand that, if there is a substantial or gross valuation misstatement of the value of the property claimed on the return or claim for refund that is based on my appraisal, I may be subject to a penalty under Section 6695A of the Internal Revenue Code, as well as other applicable penalties. I affirm that I have not been at any time in the three-year period ending on the date of the appraisal barred from presenting evidence or testimony before the Department of the Treasury or the Internal Revenue Service pursuant to 31 U.S.C. 330(c).

Additional Notes About the Substantiation Rules. For items of contributed property for which a Form 8283 is required to be filed, a donor must attach a separate Form 8283 for each donated item. Treas. Reg. § 1.170A-16(f). Additionally, the substantiation requirements apply to any return for carryover deductions. Filing Form 8263 with only the return filed in the year of the gift will not be enough to substantiate the carryover of an excess deduction to later years. Id. Finally, in determining the dollar thresholds and filing requirements, donors should aggregate the value of “similar items of property.” Id. The phrase “similar items of property” means property of the same general category or type, such as stamp and coin collections, paintings, books, nonpublicly traded stock, land, buildings, clothing, jewelry, furniture, and appliances. Treas. Reg. § 51.170A-13(c)(7)(iii). This means that if a donor donates three items of jewelry, none of which is worth over $5,000 on its own, but when taken together totals over $5,000, the donor will have to meet the more strict substantiation rules.

Qualified Appraiser and Qualified Appraisal. For noncash donations over $5,000, a taxpayer must obtain a qualified appraisal.
A qualified appraisal must be prepared by a qualified appraiser in accordance with generally accepted appraisal standards (i.e. the substance and principles of the Uniform Standards of Professional Appraisal Practice). Treas. Reg. § 1.170A-17(a). The qualified appraisal must include: (1) a description of the property contributed; (2) if the contributed property is real or tangible personal property, a description of the condition of the property; (3) the valuation effective date; (4) the fair market value, within the meaning of Section 1.170A-1(c)(2), of the contributed property on the valuation effective date; (5) the terms of any agreement between the donor and the donee regarding the use, sale or other disposition of the contributed property; (6) the date or expected date of the contribution; (7) the name, address, taxpayer identification number and qualifications of the appraiser; (8) if the appraiser is acting in his or her capacity as a partner in a partnership or an employee of an entity, the name, address and taxpayer identification number of the partnership or employer; (9) the appraiser's signature and date signed; (10) the declaration by the appraiser; (11) a statement that the appraisal was prepared for income tax purposes; (12) the method of valuation used to determine the fair market value; and (13) the specific basis for valuation. Id. Further, the appraisal must be timely – it may be dated no earlier than 60 days before the charitable contribution and no later than the due date (with extension) for the return. Id.

Note that an appraisal will not be a qualified appraisal, even if all requirements are met, if the donor either failed to disclose or misrepresented facts to the appraiser and a reasonable person would expect that the failure or misrepresentation would cause the appraiser to misstate the value of the contributed property. Id.

The Regulations define a qualified appraiser as an individual with verifiable education and experience in valuing the type of property for which the appraisal is performed. Treas. Reg. § 1.170A-17(b). The appraiser should have successfully completed coursework in valuing the specific type of property and have two (2) or more years’ experience or have earned a recognized appraiser designation. Id. This should go without saying, but the donor of the property is not a qualified appraiser. Id.

Recent Cases on Substantiation Requirements

Several cases recently have shown just how costly it can be if a donor does not follow the letter of the law with regard to substantiation of a charitable donation. In RERI Holdings I, LLC v. Comm’r, 149 T.C. 1 (2017), not only did a partnership see its $33 million charitable contribution deduction erased, but the partners also faced significant five-year periods.

The basic facts of the case are as follows: one LLC owned a parcel of real property which had a web hosting facility located on it. Id. at 2. The LLC leased the property to AT&T. The initial lease term was 15.5 years, but AT&T had options to renew for successive five-year periods. Id. The sole member of the LLC assigned its membership interest to another corporation, but reserved an estate for 18 years. Id. at 3. In other words, the interest the corporation received was a remainder interest possessory after the expiration of the 18-year term interest. A few months after acquiring the remainder interest, the corporation sold it to RERI Holdings, I, LLC ("RERI") for $2,950,000. Id. at 4. Approximately 17 months after purchasing the remainder interest, RERI assigned the interest to the University of Michigan. RERI claimed a charitable contribution deduction of $33,019,000, an approximately 1100% increase in value. Id.

RERI substantiated its claimed charitable contribution deduction with an appraisal. Id. The appraiser first determined the value of the fee interest in the property and then multiplied that by an actuarial factor provided in I.R.C. Section 7520 to arrive at the value of the remainder interest. The court had an issue with the valuation method, noting that I.R.C. Section 7520 is not intended to be used to value these types of interests. RERI attached a Form 8283 to its return that showed that it originally acquired the remainder interest by purchase the year before, but the Form did not reflect the cost basis. Id. at 5.

At trial, RERI argued that it substantially complied with the substantiation rules and therefore the deduction should be accepted. RERI based its argument on a Tax Court decision that held that the reporting requirements under Section 1.170-13 of the Regulations are "directory and not mandatory" and that "failure to comply strictly with those requirements can be excused if the donor demonstrates ‘substantial compliance.’" Id. at 10 (quoting Bond v. Comm’r, 100 T.C. 32, 4041 (1993)). In the Bond case, the taxpayers included all necessary information other than the appraiser's qualifications, which the taxpayers supplied to the IRS at the beginning of the audit. Id.

In rejecting RERI's argument, the Tax Court noted that the standard for determining substantial compliance is whether the donor "provided sufficient information to permit . . . [the Commissioner] to evaluate the reported contributions." Id. at 11. The Court held that RERI's failure to provide its cost basis in the donated property could not be excused by substantial compliance. The reporting requirements were put in place to alert the IRS, in advance of an audit, of potential overvaluations of donated property, thereby deterring taxpayers from claiming excessive contribution deductions in the hope that they would not be audited. Id. In fact, back in 1984, the Senate Finance Committee wanted to strengthen the substantiation requirements because of the concern that donors would simply play the “audit lottery.” Id. at 9 (quoting S. Prt. No. 98-169 (Vol 1) at 444 (S. Comm. Print 1984).

The Court noted that the huge disparity between the claimed fair market value of the donated property ($33 million) and the purchase price paid just 17 months before the donation ($3 million) would have certainly alerted the IRS to a potential overvaluation. Because RERI failed to attach a fully completed appraisal summary to its return, as required by the Regulations, it was not entitled to a charitable contribution deduction.

In Belair v. Comm’r, T.C.M. 2018-159 (2018), the Tax Court upheld the denial of a deduction for a conservation easement. In that case, a Georgia LLC acquired a 1,490 acre tract of land in Effingham County, Georgia for $3,881,196 (or $2,605/acre). Belair at 1. That LLC then contributed roughly 10% of the tract to Belair Woods, LLC ("Belair"). Id. at 2. Just over a year later, Belair granted a conservation easement to the Georgia Land Trust and claimed a charitable contribution deduction of $4,778,000 (or $33,707/acre), an almost 1,300% increase in the per-acre value. Id.

On its timely-filed return, Belair included a copy of an appraisal and Form 8283, but the Form did not report Belair’s cost basis in the property covered by the easement on Form 8283. Id. at 3-4. According to Belair, the reason it did not include the basis information on Form 8283 was that it was advised it was not necessary to do so (despite the clear instructions to the contrary) because the basis of the property was not taken in to consideration when determining...
the amount of the deduction. *Id.* at 3. The IRS disallowed the deduction because the requirements of I.R.C. Section 170 were not met.

Belair first argued that it strictly complied with the I.R.C. Section 170 reporting requirements. The regulations under I.R.C. Section 170 provide that if a taxpayer has reasonable cause for being unable to provide the necessary information, the taxpayer should attach an explanation of that cause to the return. *Id.* at 4-5 (citing Treas. Reg. §1.170A-13(c)). The regulations further provide that the taxpayer’s deduction will not be disallowed simply because of the inability (for reasonable cause) to provide these items of information.” *Id.* at 5.

The Court rejected Belair’s strict compliance argument, finding that the attachment that Belair included with its return did not explain why it could not provide the basis information, but simply stated that the information was not necessary. *Id.* The Court held that “[a]sserting that one may ignore a requirement does not constitute strict compliance with it.” *Id.*

Belair went on to argue that even if it did not strictly comply with the regulations, it substantially complied. Again, the Tax Court rejected this argument stating that the requirement to report basis is necessary to give the IRS the opportunity to identify overvalued property before an audit. *Id.* at 7. The Court further noted that “[w]hen a taxpayer claims a charitable contribution deduction for recently purchased property, a wide gap between cost basis and claimed value raises a red flag suggesting that the return merits examination. Unless the taxpayer complies with the regulatory requirement that he disclose his cost basis and the date and manner of acquiring the property, the Commissioner will be deprived of an essential tool that Congress intended him to have.” *Id.*

Belair tried to distinguish the circumstances of its case from those in RERI Holdings, arguing that Belair effectively reported its cost basis on the various attachments to its Form 1065. The Court was not persuaded, saying that the Regulations explicitly require the information to be disclosed on Form 8283 in order to alert the IRS to a potential issue. Revenue agents cannot be expected to review dozens of pages of a partnership return in order to find this needle in a haystack. *Id.* at 8.

In Grainger v. Comm’r., T.C.M. 2018-117 (2018), the Petitioner’s efforts at substantiation fell egregiously short. As the Court described it, “Petitioner is a retired grandmother who is fond of shopping. Seeking to combine her love of shopping with a desire for a tax cut, she developed in 2012 what she described as her ‘personal tax shelter.’” *Grainger* at 2. It is worth noting that Petitioner represented herself at trial! It is difficult to imagine that she would have made such a statement if represented by counsel.

The Petitioner’s scheme was based on her understanding that she could take a charitable deduction for the fair market value of donated property and her assumption that fair market value was the original retail price of such property. *Id.* Petitioner would buy heavily discounted items from retail stores and would sometimes use reward points toward the purchases to realize even steeper discounts. *Id.* at 3. She would purchase an item with an original retail price of $100 for $10, donate the item to charity and claim a $100 deduction for it. In 2010 she reported non-cash charitable contributions of $18,288. In 2011 she reported $32,677 of contributions and in 2012, $34,401 of contributions. To make matters worse, the Petitioner filed a delinquent return in 2012. *Id.*

Petitioner attached Form 8283 to her return and described the donated property as “jackets”, “dresses”, and other items of clothing. *Id.* at 4. She described her valuation method as “FMV” (presumably, fair market value). None of the Forms 8283 were signed by an official of the charitable donee as required for donations in excess of $5,000. *Id.*

Predictably, the IRS denied the full amount of the deductions claimed. The Court agreed, noting that not only did the Forms 8283 fail to comply with the strict requirements of the statute, but also the Petitioner failed to obtain a written appraisal. *Id.* at 9. The Court went on to state that even if the Petitioner had satisfied the substantiation requirements, the deduction would have still been disallowed because she failed to use a legitimate method to determine fair market value of the donated items. Fair market value is what a willing buyer would pay a willing seller, neither being under a compulsion to buy or sell and both having reasonable knowledge of all relevant facts. The Court pointed out that no reasonable buyer with the knowledge that the retailer had marked down the items of clothing would pay a higher price. *Id.* at 9-10.

**Takeaways for Advisors**

Because of the complexity of the substantiation rules, donors will be looking to their attorneys to help them navigate and comply with the requirements under the I.R.C. Section 170 regulations. For larger noncash donations, advisors will need to help their clients fill out Form 8283 and make sure that all necessary information is included to ensure they have an adequate description of the property transferred and the value reported.

What may be an even larger issue is the appraisal. We have all heard the push-back from clients. A client makes a multi-million dollar gift or charitable donation, but balks at the expense of engaging a qualified appraiser to prepare the appraisal. Attorneys will need to prevail upon their clients to spend the money for a qualified appraisal. Attorneys should vet the qualifications of the appraiser and then carefully review the appraisal to ensure every requirement of the Regulations is met. One practitioner routinely prepares an “Attachment” which is provided to the appraiser, to be made a part of the appraisal. That Attachment is designed to ensure that every “i” is dotted and each “t” is crossed, and will include each item required of a qualified appraisal under the Regulations.

These recent cases should serve as a warning to advisors and donors that careful attention to detail and record-keeping is necessary when substantiating a charitable contribution deduction. Gone are the days when a donor may play audit roulette and hope to come up lucky.

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