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## Charitable Deductions Under IRC § 170

## SUMMARY

Subject to certain limitations, taxpayers can take deductions from their adjusted gross incomes for contributions of cash or other property to or for the use of charitable organizations.<sup>1</sup> In order to take a charitable deduction, taxpayers must contribute to a qualifying organization<sup>2</sup> and substantiate contributions of \$250 or more. Litigation generally arises over one or more of these four issues:

- Whether the donation is made to a charitable organization;
- Whether contributed property qualifies as a charitable contribution;
- Whether the amount taken as a charitable deduction equals the fair market value of the property contributed; and
- Whether the taxpayer has substantiated the contribution.

We reviewed 30 cases decided between June 1, 2013 and May 31, 2014 with charitable deductions as a contested issue. The IRS prevailed in 25 cases, with taxpayers prevailing in no cases and the remaining five resulting in split decisions. Taxpayers represented themselves (appearing *pro se*) in 13 of the 30 cases (43 percent), with two of these *pro se* cases resulting in split decisions and the IRS prevailing in the remaining 11 cases.

## PRESENT LAW

Taxpayers must itemize in order to claim any charitable contribution deduction<sup>3</sup> and generally are able to take a deduction for charitable contributions made within the taxable year. Transfers to charitable organizations are deductible only if they are contributions or gifts<sup>4</sup> and not if they are payments for goods or services.<sup>5</sup> A contribution or gift will be allowed as a deduction under IRC § 170 only if it is made “to” or “for the use of” a qualifying organization.<sup>6</sup>

For individuals, charitable contribution deductions are generally limited to 50 percent of the taxpayer’s contribution base (adjusted gross income computed without regard to any net operating loss carryback to the taxable year under IRC § 172).<sup>7</sup> 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.<sup>8</sup> Corporate charitable deductions are generally limited to ten percent of the taxpayer’s taxable

1 Internal Revenue Code (IRC) § 170.

2 To claim a charitable contribution deduction, a taxpayer must establish that a gift was made 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 §§ 63(d) and (e); 161; 170(a).

4 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).

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

6 IRC § 170(c).

7 IRC § 170(b)(1)(A), (G).

8 IRC § 170(d)(1).

income.<sup>9</sup> 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.<sup>10</sup>

### 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.<sup>11</sup> Deductions for single charitable contributions of \$250 or more are disallowed in the absence of a contemporaneous written acknowledgement from the charitable organization.<sup>12</sup>

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 charitable organization;
- The amount of any cash contribution;
- A description (but not the value) of any 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.<sup>13</sup>

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.<sup>14</sup> When property other than money is contributed, the amount of the allowable deduction is the fair market value of the property at the time of the contribution.<sup>15</sup> This general rule is subject to certain exceptions that in some cases limit the deduction to the taxpayer's cost basis in the property.<sup>16</sup> Moreover, for claimed contributions exceeding \$5,000, a qualified appraisal prepared by a qualified appraiser is required.<sup>17</sup>

## ANALYSIS OF LITIGATED CASES

We reviewed 30 decisions entered between June 1, 2013 and May 31, 2014, involving charitable contribution deductions claimed by taxpayers. Table 9 in Appendix III contains a detailed list of those cases. Of the 30 cases, 13 involved the taxpayers' substantiation (or lack thereof) of the claimed contribution,

<sup>9</sup> IRC § 170(b)(2).

<sup>10</sup> 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).

<sup>11</sup> Treas. Reg. § 1.170A-13(a)(1).

<sup>12</sup> IRC § 170(f)(8); see also Treas. Reg. § 1.170A-13(f).

<sup>13</sup> IRS Pub. 1771, *Charitable Contributions Substantiation and Disclosure Requirements* (Rev. 7-2013).

<sup>14</sup> Treas. Reg. §§ 1.170A-13(b)(1)(i) to (iii).

<sup>15</sup> Treas. Reg. § 1.170A-1(c)(1).

<sup>16</sup> *Id.*

<sup>17</sup> IRC § 170(f)(11)(C). "Qualified appraisal," and "qualified appraiser" are defined in IRC §§ 170(f)(11)(E)(i) and (ii), respectively.

eight cases involved a dispute over the valuation of property contributed,<sup>18</sup> at least eight involved the contribution of an easement, one case involved the issue of whether the recipient was a qualified charitable organization, and one case involved whether the taxpayer actually bore the burden of the contribution.<sup>19</sup>

### Qualifying Charitable Organization

A gift will qualify as a deductible contribution under IRC § 170 only if it is made “to” or “for the use of” a qualifying organization.<sup>20</sup> The Tax Court rejected a claimed charitable deduction in one case for the taxpayer’s failure to establish that the donee organization qualified as a charitable organization under IRC § 170(c).<sup>21</sup>

In *Golit v. Commissioner*, the taxpayer claimed a deduction for cash contributions to the Church of the Immaculate Conception (Immaculate Conception), a Catholic church in Jos, Nigeria within the Catholic Archdiocese of Jos.<sup>22</sup> Section 170(c) defines “charitable contribution” as a contribution or gift “to or for the use of” an organization “created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States.”<sup>23</sup> The taxpayer did not prove that Immaculate Conception was created or organized within the United States or any of its possessions, or under any law of the United States, any State, the District of Columbia, or any possession of the United States. Therefore, the taxpayer failed to show the donee was a qualifying organization within the meaning of section 170(c) and the court sustained the IRS’s disallowance of the deduction.<sup>24</sup>

### Qualified Contribution

For a gift to constitute a qualified contribution under IRC § 170, the donor-taxpayer 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.<sup>25</sup> Taxpayers generally are not permitted to deduct gifts of property consisting of less than the taxpayers’ entire interest in that property.<sup>26</sup> Nevertheless, taxpayers may deduct the value of a contribution of a partial interest in property that constitutes a “qualified conservation contribution,”<sup>27</sup> 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 to a “qualified organization” “exclusively for conservation purposes.”<sup>28</sup>

18 In several of the eight valuation cases, the key issue surrounding the valuation of the contribution was the appropriateness of the taxpayer’s appraisal on the donated property.

19 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 an 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.

20 IRC § 170(c).

21 *Golit v. Comm’r*, T.C. Memo. 2013-191.

22 *Id.*

23 IRC § 170(c)(2)(A).

24 *Golit*, T.C. Memo. 2013-191.

25 IRC § 170(f)(3).

26 *Id.*

27 IRC § 170(b)(1)(E).

28 IRC § 170(h)(1)(A)-(C). IRC § 170(h)(4)(B)(i) provides that, in the case of a contribution that consists of a restriction with respect to the exterior of a certified historic structure, the contribution must satisfy two requirements in order to be considered “exclusively for conservation purposes”: 1) the interest must include a restriction which preserves the entire exterior of the building; and 2) the interest must prohibit any change to the exterior of the building that is inconsistent with the historic character of the exterior.

In *61 York Acquisition, LLC v. Commissioner*, the taxpayer (a partnership) purchased a partial interest in a property in Chicago, Illinois that has a Chicago landmark designation.<sup>29</sup> The property was used for both office and residential purposes; the taxpayer owned the office portion, but not the residential portion of the building.<sup>30</sup> Further, the property was subject to a declaration of Covenants, Conditions, Restrictions, and Easements agreed to by the prior owner of the office portion of the building and the owner of the residential portion of the property. The declaration set out the rights and responsibilities of each owner. The declaration specified the taxpayer, as owner of the office portion of the property, owned the “Facade” but not the entire exterior of the property; the owner of the office property is responsible for “Maintenance of the Facade and maintenance of other portions of the facade of the building;” and an owner who wishes to make an addition, improvement, or alteration that “materially alters the Facade of the Building” must obtain prior written consent of the other owner.

The partnership granted a “Conservation Deed of Easement” (easement) in the property to the National Architectural Trust, Inc. (NAT). The easement terms required the grantor to obtain prior written consent from the NAT before making any change to the “Protected Facades,” which included “the existing facades on the front, sides and rear of the Building and the measured height of the Building.”<sup>31</sup>

The court held that the taxpayer could not assign an easement in the entire exterior of the property to the NAT, because its ownership right to the exterior was restricted by the declaration of Covenants, Conditions, Restrictions, and Easements. Specifically, the court held the partnership only had rights to the Facade, as defined by the agreement, and not to the entire exterior. The taxpayer argued that the partnership had an assignable right in the entire exterior because the partnership had an obligation under the declaration to maintain the entire facade of the building. However, the court was unconvinced an obligation created a right.<sup>32</sup>

In sum, the taxpayer’s contribution was not a “qualified conservation contribution” under section 170(h)(1) because the easement granted to the NAT did not restrict and preserve the entire exterior of the certified historic structure and therefore did not satisfy the requirement that the contribution be “exclusively for conservation purposes.”<sup>33</sup>

## Valuation

To receive a deduction for most contributions of property in excess of \$5,000, taxpayers must provide a qualified appraisal of the property that is donated.<sup>34</sup> In *Kaufman v. Commissioner*, the taxpayer contributed a facade easement to the NAT and claimed a charitable deduction for the contribution.<sup>35</sup> Since there was no market by which the easement could be valued (*i.e.*, there was no substantial record of sales of easements comparable to the donated easement), the appraisers and the Tax Court determined the value (if any) of the facade easement by applying the before-and-after method. Under this method, the fair market value of the easement “is equal to the difference between the fair market value of the property it encumbers before the granting of the restriction and the fair market value of the encumbered property

29 T.C. Memo. 2013-266.

30 *Id.*

31 *Id.*

32 *Id.*

33 *Id.*

34 IRC § 170(f)(11)(C).

35 T.C. Memo. 2014-52, *appeal docketed*, No. 14-1863 (1st Cir. Aug. 20, 2014).

after the granting of the restriction.”<sup>36</sup> Both the taxpayer and the IRS relied heavily on expert opinion testimony as to the pre- and post-contribution values of the property. Because the restrictions of the easement were no more burdensome than the local zoning restrictions already applicable to the property, due to its location in a historic district, the court held the value of property was unchanged after the taxpayers granted easement, and therefore the court further held the facade easement had no fair market value when conveyed to the NAT.<sup>37</sup>

When using the before-and-after test to determine the value of an easement placed on property that is later claimed as a charitable contribution, the property’s “highest and best use” is used when determining the property’s value before an easement. In *Esgar Corp. v. Commissioner*, the taxpayers donated a conservation easement on three parcels of property to the Greenland Reserve, granting them the right to preserve the natural condition of the land and protect its biological, ecological, and environmental characteristics.<sup>38</sup> The grant specifically prohibited the mining of sand, gravel, rock, or any other minerals on the properties. The taxpayers hired an appraiser who determined that had the conservation easements not been granted, the properties would have realized their greatest potential as a gravel mining operation, even though the properties were currently being used for agriculture. The taxpayers claimed a charitable deduction for the contribution based on the property’s before easement value, which the taxpayers figured by using gravel mining as the property’s best potential use. The IRS disallowed the charitable deduction on the basis that the value of the conservation easement was improper and specifically disputed the property’s “before restriction” value determination.<sup>39</sup>

The appellate court upheld the Tax Court’s ruling that using gravel mining as the property’s best potential use to determine before value was improper.<sup>40</sup> The appellate court further held the properties’ current use—agriculture—was its highest and best use. It affirmed the Tax Court’s conclusions it was unlikely the properties would have been developed into gravel mines in absence of the easement, because the market in the region would not support another gravel mine nor was an increase in future demand reasonably foreseeable.<sup>41</sup>

### Substantiation

Thirteen 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. Treasury Regulation §1.170A-13(a)(1) requires the taxpayer to maintain a canceled check or a receipt from the donee organization to substantiate a cash contribution. In the absence of a canceled check or a receipt from the donee organization, the taxpayer must maintain other reliable written records showing the name of the donee and the date and the amount of the contribution.

In *Brooks v. Commissioner*,<sup>42</sup> the taxpayer testified to being a Jehovah’s Witness and to making cash contributions in 2005 and 2006 to the Jehovah’s Witnesses. The taxpayer also testified she contributed \$3,000 to a tsunami relief fund in 2006 through the Jehovah’s Witnesses.

36 Treas. Reg. § 1.170A-14(h)(3)(i).

37 T.C. Memo. 2014-52, *appeal docketed*, No. 14-1863 (1st Cir. Aug. 20, 2014).

38 744 F.3d 648, 651 (10th Cir. 2014), *aff’g* T.C. Memo. 2012-35.

39 744 F.3d 648, 651-52 (10th Cir. 2014), *aff’g* T.C. Memo. 2012-35.

40 *Id.* at 658.

41 *Id.* See also Treas. Reg. § 1.170A-14(h)(3)(ii) (discussing fair market value of property before and after restriction).

42 *Brooks v. Comm’r*, T.C. Memo. 2013-141.

To substantiate her \$3,000 contribution, the taxpayer provided a photocopy of two receipts. The first receipt showed DaimlerChrysler Corporation made a payment to the taxpayer in the amount of \$15,782. The second receipt, a customer receipt from Bank of America, showed a deposit of \$12,782 into the taxpayer's account. However, these receipts made no reference to a charitable contribution. The documentation merely established the taxpayer did not deposit into her Bank of America account all of the proceeds from the DaimlerChrysler Corporation payment. The court held the charitable deductions were properly disallowed because the taxpayer provided no other evidence that the \$3,000 withheld from the DaimlerChrysler Corporation check was used to make a charitable contribution. Additionally, the taxpayer had failed to provide documentation for other charitable contributions.

Gifts of charitable contributions of \$250 or more must be substantiated by a contemporaneous written acknowledgement from the donee organization that must include:

- The amount of cash and a description (but not value) of any property other than cash contributed;
- Whether the donee organization provided any goods or services in consideration, in whole or in part; and
- A description and good faith estimate of the value of any goods or services or, if such goods or services consist solely of intangible religious benefits, a statement to that effect.<sup>43</sup>

In *Wachter v. Commissioner*, the IRS moved for summary judgment, asserting that the taxpayers did not satisfy the requirement of a valid contemporaneous written acknowledgment.<sup>44</sup> The taxpayers provided letters to the IRS for substantiation purposes, but the IRS asserted that the letters did not mention the donee provided goods or services to the taxpayers each year, were not addressed to the taxpayers, and did not mention the value of goods and services. One piece of correspondence predated the contribution check by two days and was unsigned.

The taxpayers asserted that the checks and letters for each year, as well as a 2004 donation agreement,<sup>45</sup> could be taken together to meet the requirements of a contemporaneous written acknowledgment. The court denied the IRS motion for summary judgment because a series of documents may constitute a contemporaneous written acknowledgment and the taxpayers may yet be able to authenticate disputed documents and provide additional documents to supplement those they have included with the stipulation of facts.<sup>46</sup>

## CONCLUSION

IRC § 170 and the accompanying Treasury Regulations provide detailed requirements that taxpayers must strictly comply with, and become more stringent as deductions increase in size. As one court has observed, the “hoops become longer and tighter as the value of donated property rises.”<sup>47</sup>

43 IRC § 170(f)(8)(A) and (B).

44 142 T.C. No. 7 (2014).

45 142 T.C. No. 7 at \*2. Owners of Wind River signed an agreement dated February 26, 2004 with North Dakota Natural Resource Trust (NRT) agreeing to donate \$170,000 by March 1, 2004.

46 The case concluded with a stipulated decision entered on Nov. 6, 2014. Taxpayers were ordered to pay deficiencies in income for the years 2004, 2005 and 2006 in the amounts of \$60,381, \$47,163 and \$33,877, respectively. However, no penalties were due for any of these years. See, *Patrick J. Wachter & Louise M. Wachter v. Comm’r*, Tax Court Docket No. 9213-11, (Nov. 6, 2014).

47 *Estate of Evenchik v. Comm’r*, T.C. Memo. 2013-34.

A majority of charitable contribution cases reviewed this year addressed either issues regarding substantiation or the rules surrounding the donation of easements. It is critical that taxpayers include every statutorily required item of information in any mandated agreement and ensure the integrity of any necessary valuations of donated property.

When donating a conservation easement, taxpayers should pay particular attention to the valuation of the easement, ensuring the valuation determination can be adequately supported. Additionally, the cases pertaining to a qualified conservation contribution illustrate the importance of paying close attention to the technicalities. Easement deeds should be reviewed for ambiguity, especially as to whether use restrictions have been granted in perpetuity to the donee.