IRS ISSUES

Charitable Deduction Substantiation: Redux

10.19.17 | Linda J. Rosenthal, JD

"Redux": Something "brought back." (Merriam-Webster Dictionary)

Back in February 2017, we posted "…a cautionary tale for everyone out there who wants to take a $65-million charitable deduction. Or a $250 deduction. Or whatever."

Follow the rules, we advised. *"'It is not exactly rocket science.'"* There are hoops to jump through – not particularly complex or onerous ones – to substantiate a claimed deduction. Sources like Publication 1771, "Charitable Contributions: Substantiation and Disclosure Requirements " and the IRS website, "Substantiating Charitable Deductions" explain in plain English what needs to be done.

In *15 West 17th Street LLC, Isaac Mishan, Tax Matters Partner v. Commissioner*, 147 T.C. 19 (Dec. 22, 2016), the donor group failed to include the required 3-part "contemporaneous written acknowledgment required to substantiate any contributions of $250 or more. They failed the "contemporaneous" requirement by missing the deadline. They, and their high-powered lawyers, and the Trust for Architectural Easements, and their legal team, dropped the ball on this pesky substantiation requirement, and – poof! – a $65-million deduction was disallowed.

All of these heavy hitters "failed at the simple task of timely generating the contemporaneous written acknowledgment with the 3-part magic language."

The $33-Million Deduction Up In Smoke

More recently, in July 2017, the United States Tax Court handed down a decision in a case that "should remind charities and their donors of the importance of full compliance with the substantiation rules and the potential costs of aggressive tax planning."

In *RERI Holdings I, LLC et al. v. Commissioner, 149 T.C. 1 (Jul. 3, 2017),* a taxpayer-partnership fought the IRS's disallowance of a charitable deduction of some $33 million on grounds that the fairly simple substantiation rules had not been met.

The convoluted facts boil down to this: A partnership owning an LLC owns certain real property; the partnership splits the LLC into two pieces, and sells one piece to a donor – (another partnership) – for $3 million. The next year, the donor gives that interest to a university, claiming a $33 million tax deduction.

Under the applicable substantiation rules, "if a donor claims a deduction in excess of $500 for a noncash gift, the donor must file Form 8283. If the gift exceeds $5,000 and is a noncash gift other than publicly traded securities, the donor, in addition to obtaining a qualified appraisal (with limited exceptions), must completely fill out Section B of Form 8283 and have the charity sign the Form 8283 acknowledging the gift."

Needless to say, it doesn't take a tax expert to understand the IRS's skepticism when a donor takes a deduction for $30 million more than the donor just paid for the donated property. Perhaps that explains why, when the donor filled out Form 8283, it left blank the line for "donor's cost or adjusted basis." Typically, this line shows what the donor paid to acquire the property. Intentional or not, that omission became extremely costly.

In *RERI Holdings*, the donor jumped through all of the fairly straightforward hoops except reporting how much it had paid – just the year before – for the donated property interest. Unlike certain other cases, which apparently involved *inadvertent* omissions, this one appears deliberate. (Sometimes the "substantial compliance" doctrine will be a safety net to protect a taxpayer for a "minor procedural error." Here, though, neither the IRS nor the Tax Court gave the taxpayer-donor a pass. This omission "hid a critical 'red flag' (i.e., that the donor had just purchased the property for 1/11th of what it claimed was the actual value.)"

The icing on the cake presented to the hapless donor is a Section 6662(h) "gross valuation misstatement" penalty. "So, the donor not only lost a $33 million deduction but also had to pay millions of dollars in penalties for even trying to claim the deduction in the first place."

Conclusion

"*RERI Holdings* stands as a reminder to all to satisfy the substantiation requirements and that the IRS and courts may be unforgiving of a donor caught trying to get away with an unwarranted deduction."

More simply put: Follow the simple substantiation rules to the letter; they are "not rocket science." Don't pretend you "forgot" to follow a step, when you're actually trying to hide some monkey business. IRS officials and Tax Court judges did not just fall off turnip trucks.

— Linda J. Rosenthal, J.D., FPLG Information & Research Director