Charitable Contributions vs. Charitable Contribution Deductions

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Charitable Contributions and Charitable Contribution Deductions: Not Created Equal

Section 170(c) of the Internal Revenue Code\(^1\) (IRC) provides that the term “charitable contribution” means a contribution or gift to, or for the use of, a governmental entity made exclusively for public purposes or a qualified charity to be used exclusively for its charitable purposes. Section 170(c) is not, however, the end of the inquiry in determining whether a charitable contribution deduction can actually be claimed. Section 170(a)(1) provides that a “charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary.”

Thus, to take a charitable deduction, the taxpayer must be able to substantiate the donation. Many taxpayers and their advisors assume that an indisputable gift to a charitable organization automatically qualifies for a charitable contribution deduction. In fact, in addition to intuition that an undisputed contribution should not be refused a deduction, there is older case law that provides some basis for that view; e.g., Buck v. Commissioner, T.C. Memo 1978-324 (1974) (taxpayers tithed to their church, but did not receive records from the church regarding all of their tithes; Tax Court concluded based on the tithed record notations on taxpayers’ calendar that the taxpayers had made charitable contributions in excess of those allowed by the Internal Revenue Service (IRS)).

However, the statutory and regulatory regime under section 170 has tightened, and the IRS has recently been aggressive in requiring, as far as possible, strict compliance with all substantiation requirements, even where such substantiation is simply for the substantiation’s sake. In particular, the contemporaneous written acknowledgement requirement of section 170(f)(8), discussed further below, is statutory and thus not subject to substantial compliance arguments. For example, in Durden v. Comm’r, T.C. Memo 2012-140, the taxpayers
claimed a deduction of $25,171 for contributions made to their church, supported by cancelled checks and a contemporaneous letter from the church. The letter from the church, however, failed to include a statement that no goods or services were provided in consideration for the contributions to the church (the church did furnish such a statement after the IRS's first audit inquiry). The Tax Court held that the deductions were properly disallowed because the first written acknowledgment did not state that no goods or services were provided, and the second acknowledgment was not contemporaneous. Do not make the mistake of assuming that because your client indisputably gave money or property to a charity, the IRS will not challenge a deduction. Full substantiation of the deduction is required to insulate your client's deduction from challenge.

The Code itself and Regulations issued by the Secretary thus now form a minefield that must be successfully navigated to substantiate and confidently claim a charitable deduction. In this context, where the IRS is aggressively seeking to disallow deductions based not on challenges to the contributions themselves but instead based wholly on substantiation deficiencies, CPAs must be more diligent than they may have been in the past with respect to making certain that substantiation requirements are met.

**SUBSTANTIATION DEPENDS ON CONTRIBUTION AMOUNT AND TYPE (E.G., MONEY OR PROPERTY)**

The means by which a taxpayer must substantiate a charitable donation varies depending on the value of the donation and whether the donation was property or money. The substantiation rules are detailed and complex, but following them to the letter can save a great deal of time and money. Note also that the Code section and corresponding regulations are often not identical. This article is intended to provide a basic outline of the substantiation rules and the general considerations that should be given to the claiming of a charitable contribution deduction, but it is not an exhaustive treatise on all possible substantiation rules and should not be taken as such.²

**Contributions of Money of Under $250**

The Code provides that "[n]o deduction shall be allowed ... for any contribution of a cash, check or other monetary gift unless the donor maintains as a record of such contribution a bank record or a written communication from the donee showing the name of the donee organization, the date of the contribution, and the amount of the contribution." §170(f)(17). Thus, in order to substantiate a charitable contribution of money under $250, the taxpayer must maintain at least one of the following for each charitable contribution: (i) a cancelled check or (ii) a receipt from the donee charitable organization showing the name of the donee, the date of the contribution, and the amount of the contribution. §1.170A-13(a)(1)(i)-(ii).³

**Contributions of Property Under $250**

To substantiate a charitable deduction for contributions of property valued less than $250, the taxpayer must maintain a receipt from the donee for each contribution that includes all of the following: (i) the name of the donee; (ii) the date and location of the contribution; and (iii) a description of the property in detail reasonably sufficient under the circumstances (the fair market value of the property need not be stated on the receipt). §1.170A-13(b)(1). However, in circumstances where it is impractical to obtain a receipt from the donee organization (e.g., by depositing property at a charity's unattended drop site), the taxpayer must maintain reliable written records with respect to the donated property to substantiate the charitable contribution. §1.170A-13(b)(1); also see §1.170A-13(a)(2) and §1.170A-13(b)(2)(ii) (detailing such requirements).

**Contributions of Money or Property of $250 or More: Section 170(f)(8) Contemporaneous Written Acknowledgement Requirement**

The Code provides that "[n]o deduction shall be allowed ... for any contribution of $250 or more unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgement of the contribution by the donee organization." §170(f)(8)(a). A contemporaneous written acknowledgement is an acknowledgement of the donor's contribution that usually consists of a letter from the donee organization to the donor, but may be in any form so long as it is contemporaneous and contains the requisite information.

A contemporaneous written acknowledgement must include the following information: (i) the amount of cash and a description (but not value) of any property other than cash the taxpayer transferred to the donee organization; (ii) a statement of whether or not the donee organization provides any goods or services in consideration, in whole or in part, for any of the cash or other property transferred to the donee organization; (iii) if the donee organization provides any goods or services other than intangible religious benefits (as described in section 170(f)(8)), a description and good faith estimate of the value of those goods or services; and (iv) if the donee organization provides any intangible religious benefits, a statement to that effect. §1.170A-13(f)(2) and §170(f)(8)(B). A written acknowledgement is contemporaneous if it is obtained by the taxpayer before the earlier of: (i) the date on which the taxpayer files a return for the taxable year in which the contribution was made, or (ii) the due date (including extensions) for filing such return. §1.170A-13(f)(3).

"Goods or services means cash, property, services, benefits, and privileges." §1.170A-13(f)(5). Certain goods or services that have insubstantial values may be disregarded and excluded from a contemporaneous written acknowledgement. §1.170A-13(f)(8). Goods or services provided in consideration for a taxpayer's payment include items the taxpayer expects to receive in a future year. §1.170A-13(f)(6).

**Contributions of Money of $250 or More**

If a charitable deduction is taken for contributions of money of $250 or more, the taxpayer must, for each contribution, maintain either (i) a cancelled check or (ii) a receipt from the donee charitable organization showing the name of the donee, the date of the contribution and the amount of the contribution. §1.170A-13(a)(1) (i)-(ii). In addition, the taxpayer must have a contemporaneous written acknowledgement from the donee organization. §170(f)(8)(A).

**Contributions of Property of $250 to $500**

If a charitable deduction is taken for contributions of property valued from $250 to $500, the taxpayer must maintain a receipt for each contribution that includes the name of the donee, the date and location of the contribution and a description of the property in detail reasonably sufficient under the circumstances. §1.170A-13(b)(1). In addition, the taxpayer must have a contemporaneous written acknowledgement from the donee organization. §170(f)(8)(A).
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Contributions of Property in Excess of $500 but Less Than $5,000

If a charitable deduction is taken for contributions of property in excess of $500 but less than $5,000, the taxpayer must maintain a receipt for each contribution that includes the name of the donee, the date and location of the contribution and a description of the property in detail reasonably sufficient under the circumstances. §1.170A-13(b)(3). In addition, the taxpayer must have a contemporaneous written acknowledgement from the donee. §1.170(f)(8)(A). The taxpayer must also maintain written records that include the manner in which and the date on which the taxpayer acquired the property, and the cost or other adjusted basis of the property, and must state any such information in his/her income tax return if required by the return form or its instructions. §1.170A-13(b)(3).

Under section 170(f)(11), no deduction for a contribution in excess of $500 shall be allowed unless "the individual, partnership or corporation includes with the return for the taxable year in which the contribution is made a description of such property and such other information as the Secretary may require." §170(f)(11)(B). However, such requirements do not apply to a C corporation that is not a personal service corporation or a closely held C corporation. §170(f)(11)(B).

Contributions of Property in Excess of $5,000

If a charitable deduction is taken for contributions of property in excess of $5,000, the taxpayer must: (i) obtain a qualified appraisal for the contributed property; (ii) attach a fully completed appraisal summary to the tax return on which the deduction for the contribution is first claimed by the donor; and (iii) maintain all of the information required for written records, §1.170A-13(c)(2). In addition, the taxpayer must have a contemporaneous written acknowledgement from the donee organization. §1.170(f)(8)(A).

Under section 170(f)(11), no deduction for a contribution in excess of $5,000 shall be allowed unless "the individual, partnership, or corporation obtains a qualified appraisal of such property and attaches to the return for the taxable year in which such contribution is made such information regarding such property and such appraisal as the Secretary may require." §170(f)(11)(C).

Contributions of Money or Property in Excess of $500,000

Under section 170(f)(11), no deduction for a contribution in excess of $500,000 shall be allowed unless "the individual, partnership, or corporation attaches to the return for the taxable year a qualified appraisal of such property." §170(f)(11)(D).

A qualified appraisal is defined in sections 170(f)(11)(E)(i) and 1.170A-13(c)(3); a qualified appraiser is defined in sections 170(f)(11)(E)(ii) and 1.170A-13(c)(5); and an appraisal summary is defined in section 1.170A-13(c)(4).

SUBSTANTIAL COMPLIANCE

A taxpayer's failure to substantiate a charitable contribution will
generally result in the deduction being disallowed. However, the Code itself provides that a taxpayer may make a reasonable cause argument for failing to comply with the provisions under section 170(f)(11) (pertaining to information to be included with tax returns) discussed above if such failure is not the result of the taxpayers willful neglect.

Further, a taxpayer may make a substantial compliance argument if the taxpayer failed to comply with the requirements set forth in the regulations. The Tax Court has held that the reporting requirements of section 1.170A-13 of the regulations are directory and are subject to substantial compliance. Bond v. Comm'r, 100 T.C. 32, 41 (1993). Where requirements relate to “the substance or essence of the statute,” strict adherence to all statutory and regulatory requirements is mandatory; but where the requirements are procedural or directory in that they are not of the essence of the thing to be done but are given with a view to the orderly conduct of business, then they may be fulfilled by substantial compliance. Bond v. Comm'r, 100 T.C. 41.

In Bond, the taxpayers donated two blimps to a charitable organization and in the same month, obtained a professional appraisal of the blimps. Though the appraiser completed the Form 8283 for inclusion with the taxpayers’ return, he did not provide a separate written report of the appraisal, and the Form 8283 did not include the appraiser’s credentials. The taxpayers did provide those credentials to the IRS at audit. The Tax Court held that the taxpayers had substantially complied with the regulations, despite the absence of a separate written appraisal report existing or being attached to the return. Id. at 42. Also see Simmons v. Comm'r, TC Memo 2009-208. (The court found that appraisals, although not strictly qualified appraisals, substantially complied and that, combined with filing the Form 8283, the petitioner had complied with the substantiation requirements of section 170.) The Tax Court has declined to find substantial compliance where the taxpayers have failed altogether to obtain an appraisal. E.g., Hewitt v. Comm'r, 109 T.C. 258 (1997), affd. 166 F.3d 332 (4th Cir. 1998).

One important thing to be noted about cases such as Bond and Simmons is that, while the taxpayers were ultimately successful in establishing substantial compliance with the regulations, many other taxpayers have not been so fortunate. Additionally, the litigation required to establish such a finding is expensive and time consuming. Substantial compliance may well be a valid position to take in a tax controversy, but it is not a sufficient substitute for strict compliance in planning and reporting.

SECTION 170(F)(8) – NOT SUBJECT TO SUBSTANTIAL COMPLIANCE

As explained above, for a contribution of $250 or more, the taxpayer must also substantiate the contribution through a contemporaneous written acknowledgement by the donee organization. The writing must (i) describe the property donated, (ii) state whether the donee organization provided any goods or services in consideration for the property, and (iii) if so, a description and good faith estimate of the value of such goods or services. §170(f)(8).

Section 170(f)(8) can be a landmine for taxpayers, even if they have indisputably given money or property to a charitable organization. E.g., supra, Durden v. Comm'r, TC Memo 2012-140. Because section 170(f)(8) is statutory, it is not subject to substantial compliance. Averyt et al. v. Comm'r, TC Memo 2012-198.

Congress enacted the substantiation requirements of section 170(f)(8) because many organizations were failing to inform donors that portions of the amounts donors paid to those organizations were not deductible because they were part of quid pro quo exchanges. Id. at *10. While the statutory requirements must be met, the acknowledgment “need not take any particular form.” Id. For example, in Averyt, the Tax Court held that, with respect to a conservation easement, the underlying deed itself was a “contemporaneous written acknowledgment” satisfying the section 170(f)(8) requirement.

Section 170(f)(8) raises a number of issues for taxpayers. First, where a taxpayer receives goods or services in partial consideration for a donation, such consideration must be described, and its value must be estimated. Additionally, if it is even discussed that the taxpayer might receive any preferences or considerations in exchange for the donation, the transaction must be carefully papered to document exactly what the taxpayer did or did not receive. Any discussions about potential consideration that is not ultimately exchanged could wholly disqualify a donation if the taxpayer cannot prove to the IRS's or the court's satisfaction that the potential consideration was not ultimately received.

AN OUNCE OF PREVENTION

IRS enforcement in the area of charitable contributions is very active. As unfair as it may seem, taxpayers, their advisors and their tax return preparers should not assume that an indisputable gift to a charity necessarily qualifies for a charitable deduction.

Following the substantiation steps is very important, especially given that the IRS’s current posture is to disallow undisputed gifts to charities based on nothing but substantiation failures. Certain requirements are statutory in nature and not subject to substantial compliance arguments, and even where substantial compliance arguments can be made, an ounce of prevention is worth a pound of cure.

FOOTNOTES
1. All section references herein are to the Internal Revenue Code of 1986, as amended, and the Treasury Regulations promulgated thereunder, unless otherwise noted.
2. By way of example, in addition to the requirements enumerated here, there are many special rules that apply to specific types of deductions (e.g., conservation easements, contributions of property that constitutes inventory, contributions of capital gain property, contributions of scientific property used for research, contributions of stock for which market quotations are readily available, etc.).
3. This regulation also provides in (iii) that the contribution may be substantiated by maintaining “other reliable written records.” This regulation has not been amended to reflect the addition of section 170(f)(17) by the Pension Protection Act of 2006. Subsequent to its passage, the recordkeeping requirements may not be satisfied by maintaining other written records, such as a log of contributions. Joint Committee Staff, Technical Explanation of Pension Protection Act of 2006 (JCX-38-06), at p. 305 (8/3/2006) Revenue (September 22, 2009) TC Memo. 2009-220 United States Tax Court
4. For purposes of determining the threshold amounts of $500, $5,000, and $500,000, all similar items of property (e.g., paintings, books, coin collections, land, clothing, etc.) donated to one or more donee shall be treated as one property and the values shall be aggregated. §170(f)(11)(F).

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