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APPLYING A SAFE HARBOR UNDER THE QUALIFIED APPRAISAL RULES

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[1] The comments contained in this paper are the individual views of the author who prepared them, and do not represent the position of the California Lawyers Association. Although the author might have clients affected by the rules applicable to the subject matter of this paper and have advised such clients on applicable law, the author has not been specifically engaged by a client to participate on this project.

EXECUTIVE SUMMARY

Section 155 of the Deficit Reduction Act of 1984 ("DEFRA") sets forth the substantiation requirements for certain noncash charitable contributions. As the Senate Finance Committee noted, Section 155 was enacted to reduce incidents of overvaluation:

> The committee recognizes that the tax benefits provided to taxpayers who contributed appreciated property to charities create opportunities for overvaluations . . . One way to reduce these opportunities to overvalue would be to eliminate the advantage that charitable gifts of appreciated property have over gifts of cash. The committee recognizes, however, that many charitable organizations depend on this tax benefit for fund-raising and as a means of acquiring valuable property. At the same time, the committee understands that in recent years, opportunities to offset income through inflated valuations of donated property have been increasingly exploited by tax shelter promoters.
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> (Deficit Reduction Tax Bill of 1984, Explanation of the Senate Finance Committee, 98th Cong. (April 2, 1984).)

DEFRA section 155 further instructs the Treasury to issue regulations requiring taxpayers to obtain a "qualified appraisal" and submit an appraisal summary to sustain a charitable deduction under Code section 170. These regulations are contained in Treasury Regulations section 1.170A-13.

Treasury Regulations (the "Reg" or "Regs") section 1.170A-13 sets forth the reporting requirements for a taxpayer seeking to take a charitable deduction for noncash donations of property in excess of $5,000. Specifically, the taxpayer must obtain a qualified appraisal as well as attach a fully completed appraisal summary to his or her tax return. The taxpayer must also maintain certain specified records. The purpose of the reporting requirements contained in Regs section 1.170A-13 is to provide "the Commissioner with sufficient return information to *effectively monitor the possibility of overvaluations* of charitable contributions." Smith v. Commissioner, T.C. Memo 2007-368; Hewitt v. Commissioner, 109 T.C. at 265 (emphasis added). In other words, the intent and purpose of the reporting requirements is to put the Service on notice of a charitable deduction so that the Service can evaluate the contribution for possible overvaluation.

In determining whether a taxpayer has complied with a given Treasury Regulation, it must first be determined whether the regulation in question requires literal compliance or merely substantial compliance. The question of whether Regs section 1.170A-13 demands literal compliance has been answered squarely in the negative. In the seminal case of Bond v. Commissioner, 100 T.C. 32, this Court confronted this issue head-on:

> The critical question to be answered is whether the requirements [of Regs section 1.170A-13] relate 'to the substance or essence of the statute.' If so, strict adherence to all statutory and regulatory requirements is a precondition to an

> effective election. On the other hand, if 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, they may be fulfilled by substantial, if not strict, compliance. Bond, 100 T.C. at Code 41.

The Bond court examined Code section 170 and determined that the reporting requirements contained therein were directory with respect to the underlying statutory purpose because they did not relate to the essence or substance of the statute:

> [I]t is apparent that the essence of section 170 is to allow certain taxpayers a charitable deduction for contributions made to certain organization. It is equally apparent that the reporting requirement of section 1.170A-13, Income Tax Regs, are helpful to respondent in the processing and auditing of returns on which charitable deductions are claimed. However, *the reporting requirements do not relate to the substance or essence of whether or not a charitable contribution was actually made*. We conclude, therefore, that the reporting requirements are directory and not mandatory. Bond, 100 T.C. at 41. (Emphasis added.)

The Bond court determined that because Reg 1.170A-13 is directory in nature (in that its purpose is to streamline paperwork processing rather than to adequately identify whether a charitable contribution has actually been made), strict compliance with said Reg 1.170A-13 is not required. Instead, so long as the taxpayer can show that he or she has substantially complied with the Regs, the taxpayer is entitled to the charitable deduction.

The Tax Court and other courts with jurisdiction to hear federal income tax matters have been inundated with cases for years and continue to be, where the Taxpayer failed to comply with the Regs discussed herein. There also have been multiple substantial compliance cases tried in the courts as well. Unfortunately, many Taxpayers do not realize the complexity of the Regs in the charitable arena when donating non-cash assets on charitable donations in excess of $5,000. If a qualified appraisal is not timely attached to the return then no deduction is allowed and to make matters worse, penalties can apply for negligence or a substantial understatement. Many Taxpayers trapped in this situation have prepared their own returns, as they have been told by the government that they can do so, and of course many have no concept of the strict qualified appraisal requirements.

To continue to avoid abuses of overvaluations by Taxpayers on non-cash charitable donations, but to bring fairness to the tax system, the author proposes that a safe harbor be instituted under the Regs. The safe harbor will provide guidance on when a Taxpayer has substantially complied with the qualified appraisal requirements under Reg 1.170A-13. Substantial compliance will occur if a Taxpayer ¨(1) provides sufficient information on his, her or their Individual Federal Income Tax Return in question to establish that a charitable contribution had been made, (2) provides sufficient information on his, her or their Individual Federal Income Tax Return in question to alert the Service to the claimed deduction so that the Service can easily monitor the possibility of an overvaluation and (3) if the property is sold within two (2) years of the donation it is sold for either a value not less than ninety percent (90%) of the charitable contribution claimed; or a qualified appraisal is provided within sixty

(60) days of when the audit begins and the value determined in the qualified appraisal is not less than ninety percent (90%) of the charitable contribution claimed.

I DISCUSSION

A. The Applicable Statutes and Regulations

1. Internal Revenue Code section 170 and DEFRA section 155. Internal Revenue Code ("Code") section 170 allows a taxpayer to deduct the fair market value of property contributed to a qualified charitable organization so long as the deduction is verified under regulations prescribed by the Secretary of the Treasury. Thus, the taxpayer must substantiate his or her charitable contributions to be allowed the deduction.

Section 155 of the Deficit Reduction Act of 1984 ("DEFRA") sets forth the substantiation requirements for certain noncash charitable contributions. As the Senate Finance Committee noted, Section 155 was enacted to reduce incidents of overvaluation:

> The committee recognizes that the tax benefits provided to taxpayers who contributed appreciated property to charities create opportunities for overvaluations... One way to reduce these opportunities to overvalue would be to eliminate the advantage that charitable gifts of appreciated property have over gifts of cash. The committee recognizes, however, that many charitable organizations depend on this tax benefit for fund-raising and as a means of acquiring valuable property. At the same time, the committee understands that in recent years, opportunities to offset income through inflated valuations of donated property have been increasingly exploited by tax shelter promoters. (Senate Finance Committee, 98th Cong., *General Explanation of the Deficit Reduction Tax Bill of 1984* (Apr. 2, 1984) Commerce Clearing House 1984. The "Senate Finance Committee Report").

DEFRA section 155 instructs the Treasury to issue regulations requiring taxpayers to obtain a "qualified appraisal" and submit an appraisal summary to sustain a charitable deduction under Code section 170. These regulations are contained in Treasury Regulations section 1.170A-13.

2. Treasury Regulations section 1.170A-13. Treasury Regulations ("Regs") section 1.170A-13 sets forth the reporting requirements for a taxpayer seeking to take a charitable deduction for noncash donations of property in excess of $5,000. Specifically, the taxpayer must obtain a qualified appraisal as well as attach a fully completed appraisal summary to his or her tax return. The taxpayer must also maintain certain specified records.

The purpose of the reporting requirements contained in Regs section 1.170A-13 is to provide "the Commissioner with sufficient return information to *effectively monitor the possibility of overvaluations* of charitable contributions." Smith v. Commissioner, T.C. Memo 2007-368; Hewitt v. Commissioner, 109 T.C. at 265 (emphasis added). In other words, the

intent and purpose of the reporting requirements is to put the Service on notice of a charitable deduction so that the Service can evaluate the contribution for possible overvaluation.

B. The Reporting Requirements Currently Do Not Demand Literal Compliance

In determining whether a taxpayer has complied with a given Treasury Regulation, it must first be determined whether the regulation in question requires literal compliance or merely substantial compliance. The question of whether Regs section 1.170A-13 demands literal compliance has been answered squarely in the negative. The Tax Court had originally determined the substantial compliance doctrine with respect to charitable contribution deductions in Columbia Iron & Metal Co. v. Com'r, 61 T.C. 7 (1973). In this decision, the Tax Court considered whether a taxpayer was entitled under Code Section 170 to a charitable contribution deduction. Under paragraph (a)(2) of Section 170, accrual basis corporations are entitled to take a charitable contribution deduction donation for the year if paid by the 15th day of the third month of the following tax year provided the deduction is claimed on the tax return in a manner signified pursuant to the Service's regulations.[2]

This statute was supplemented by Treasury Regulation Section 1.170-3, now presently restated as 1.170A-11(b)(2). These regulations identified the steps to signify the election under Section 170(a)(2) and, more specifically, required an attachment of a written declaration, containing several items. This declaration consisted of three parts, (i) a statement that the resolution authorizing the contribution was adopted by the board of directors during the taxable year, (ii) a signature, i.e., verification, by a corporate officer, and (iii) a statement ascribed to by the officer that the verification was being made under penalties of perjury. Regulations further required an attachment to the return of a copy of the corporate resolution authorizing the contribution.[3]

In the Columbia decision, the corporate taxpayer, reported a charitable contribution deduction under Section 170(a)(2), but never attached the written declaration or the corporate resolution to the original return as required by the regulations. However, taxpayer was on an accrual basis, had donated to a charity, had a resolution and paid the donation by the 15th day of the 3rd month of the following year. In addition, during the audit proceedings, Columbia Iron, in response to concerns raised by the audit examiner, handed over to the Service both (i) a verified written declaration and (ii) a copy of the corporate resolution.

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[2]The statute states as to the election *to treat such contribution as paid during such taxable year:*

The election may be made only at the time of the filing of the return for such taxable year, and shall be signified in such manner as the Secretary or his delegate shall by regulations prescribe.

[3] The regulations stated:

The election must be made at the time the return for the taxable year is filed, by reporting the contribution on the return. There shall be attached to the return when filed a written declaration that the resolution authorizing the contribution was adopted by the board of directors during the taxable year, and the declaration shall be verified by a statement signed by an officer authorized to sign the return that it is made under penalties of perjury. There shall also be attached to the return when filed a copy of the resolution of the board of directors authorizing the contribution.

The Service disallowed the deduction and argued that Columbia Iron had clearly failed to comply with the regulations covering attachments required with the original return. The Tax Court, however, rejected the Service's position. In upholding Columbia Iron's right to take a charitable contribution deduction, the Tax Court held under the substantial compliance doctrine that the failure to attach documents with the original return was not fatal. The Tax Court first found that Columbia Iron had satisfied the following statutory elements to be entitled to claim a charitable contribution deduction under that paragraph: Taxpayer was a corporation; Taxpayer reported under the accrual method; Taxpayer's board authorized by resolution the charitable contribution during the tax year; Taxpayer made the donation as required by March 15 of the following year; and the election was made as required by statute. As to the last item, the making of the election, the claiming of the election was made by taking the deduction on the return.

In addition, because paragraph (a)(2) of Section 170 served to assist with the Service's audit examination, the regulations thereunder were to be treated as directory as to the procedures and were not mandatory upon the taxpayer. If the documents later provided to the Service during the audit examination, even several years after the return had been filed (but not with the original returns) were sufficient to support the charitable contribution deduction and to allow the Service to complete its examination, compliance with the regulations was not necessary. Furthermore, as to the Service's arguments that there was noncompliance with the regulations due to the *lateness* of the information, the Tax Court responded that the Services' position was unreasonable, unduly harsh, and must be rejected:

> "*To deny the deduction merely because the petitioner failed to provide the proof of the acts at the time required by the Respondent would establish a sanction which is out of proportion to the shortcoming and not warranted or justified under the circumstances. Although the requirements of the regulations may have an in terrorem effect which aids in securing compliance with the law, nonetheless, such requirements are merely procedural, and even they have been satisfied, albeit not at the time required by the Respondent. Moreover, neither the statute nor the regulations clearly make the submission of the resolution and written statement a sine qua non for the deduction. Unlike the provisions of section 170(a)(1), in which Congress explicitly provided that a charitable contribution is deductible only if verified in the manner required by the Respondent, Congress has not conditioned a corporation's right to deduct a contribution under section 170(a)(2) on proof satisfactory to the Respondent that the contribution was authorized in the taxable year at issue." (Id at page 10)*

As to the element of lateness, the Tax Court further stated that this was irrelevant because:

> *[A] verified statement of an officer has now been furnished to the Respondent. Thus, the Respondent now has the documents which he requires be submitted to support the deduction.*

The literal language of Regs section 1.170A-13 requires that when a taxpayer is claiming a deduction for a noncash charitable contribution in excess of $5,000, the taxpayer must obtain a qualified written appraisal of the donated property in order to substantiate the valuation of the property. However, in Bond v. Commissioner, 100 T.C. 32, the court indicated that the substantiation of the value by a knowledgeable individual, not the obtaining of the written report, is the essence of the requirement. In Bond, the taxpayers had donated two blimps to a charity. Prior to the donation, the taxpayers had the blimps appraised by an individual who had extensive experience and knowledge of that particular type of airship. Although the individual who valued the airships did not prepare a written appraisal, he completed Parts II and IV of the appraisal summary contained in Section B of the Form 8283 which taxpayers attached to their return. In Part II of the Form 8283, he identified the property and stated its appraised fair market value. He then completed and signed the Certification of Appraiser in Part IV. However, he did not include information regarding his qualifications to appraise the property.

The taxpayers in Bond claimed a charitable deduction in the amount of $60,000 on their income tax return. In support of the deduction, they attached a Form 8283. Thereafter, the Petitioners were audited. As part of the audit, the appraiser who had valued the airships provided further information regarding his qualifications and his appraisal of the blimps. Despite this, the taxpayers were issued a deficiency notice by the Service. The Service contended that the taxpayers were not entitled to a charitable deduction because they did not obtain and attach a qualified appraisal to their return as required by DEFRA section 155 and Regs section 1.170A-13. The taxpayers disagreed, contending that despite the fact they had not obtained a qualified appraisal, they had substantially complied with the reporting requirements mandated by DEFRA section 155 and the Regs.

In this seminal case the Court confronted this issue head-on:

> The critical question to be answered is whether the requirements [of Regs section 1.170A-13] relate 'to the substance or essence of the statute.' [Citation.] If so, strict adherence to all statutory and regulatory requirements is a precondition to an effective election [Citation.] On the other hand, if 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, they may be fulfilled by substantial, if not strict, compliance. Bond, 100 T.C. at Code 41.

The Bond court examined Code section 170 and determined that the reporting requirements contained therein were directory with respect to the underlying statutory purpose because they did not relate to the essence or substance of the statute:

> [I]t is apparent that the essence of section 170 is to allow certain taxpayers a charitable deduction for contributions made to certain organization. It is equally apparent that the reporting requirement of section 1.170A-13, Income Tax Regs, are helpful to respondent in the processing and auditing of returns on which charitable deductions are claimed. However, the reporting requirements do not relate to the substance or essence of whether or not a charitable contribution was

> actually made. We conclude, therefore, that the reporting requirements are directory and not mandatory. Bond, 100 T.C. at 41. (Emphasis added.)

The Bond court determined that because Regs section 1.170A-13 is directory in nature (in that its purpose is to streamline paperwork processing rather than to adequately identify whether a charitable contribution has actually been made), strict compliance with said Regs section 1.170A-13 is not required. Instead, so long as the taxpayer can show that he or she has substantially complied with the Regs, the taxpayer is entitled to the charitable deduction.

The Bond court agreed with the taxpayers. Stating that substantial compliance, not literal compliance, was all that was necessary to secure the deduction, the court noted that (1) there was no question that the taxpayers had donated the blimps in question; (2) the subject of the donation was appraised at the amount claimed by taxpayers by a qualified appraiser; and (3) the donee was qualified to receive a charitable contribution. The court further noted that all pertinent information was included on the Form 8283 that taxpayers submitted with the income tax return and that the missing information regarding the appraiser's qualifications was provided during the audit. The court held:

> [T]his is not a case where petitioners failed to obtain a timely appraisal of the donated property and thereby failed to establish its value for claiming a contribution deduction on their return. Instead petitioners... met all of the elements required to establish the substance or essence of a charitable contribution, but merely failed to obtain and attach to their return a separate written appraisal containing the information specified in respondent's regulations even though substantially all of the specified information... appeared in the Form 8283 attached to the return. The denial of a charitable deduction under the circumstances would constitute a sanction which is not warranted or justified. Bond, 100 T.C. at 42. (Emphasis added.)

In Jorgenson v. Commissioner, T.C. Memo 2000-38, the court declined to accept testimony from an appraiser not because it was offered after the fact, but because the appraiser had insufficient knowledge of the Property he was appraising. Had the appraiser's testimony been prohibited simply because he had performed the appraisal after the fact, the court would not have spent the time and effort to delve into the manner in which the appraiser conducted the appraisal. Therefore, another important element seems to be the substance of the information and not the timing of its disclosure which is controlling.

Indeed, the issue of the acceptance of information provided by a taxpayer after the fact was addressed in Cary v. Commissioner, 41 T.C. 214 (1963). Although Cary did not deal with Regs section 1.170A-13, the Bond court relied on Cary in determining that substantial, not strict compliance was all that was needed under the Regs. In Cary, Code section 302(c)(2)(A)(iii) required a taxpayer to attach a statement "in the form and manner determined by the Secretary" to exempt from the family attribution rules a taxpayer who completely liquidated his interest in a corporation for purposes of classifying the distribution as either a dividend or a sale or exchange. The applicable regulation required the statement to be attached to the taxpayer's return timely filed for the year in which the distribution occurred. However, the

taxpayer did not file the statement until his return was audited two years later, when the taxpayer filed an amended return for the applicable year with the statement attached. The Cary Court found that the filing of the agreement was merely a procedural detail to the statute's overall purpose of ensuring that the taxpayer retained the records necessary to substantiate that his entire interest in the corporation had been liquidated. Accordingly, even though filed late, the statement filed by the taxpayer was held to be substantial compliance with the regulation because the taxpayer substantially complied with the overall purpose of the statutory provision.

For instance, in D'Arcangelo v. Comm'r., TC Memo 1994-572, the Court's holding that substantial compliance was not met, was premised on the taxpayers' failure to establish the qualifications of the principal as an expert in the value of artwork and the fact that the principal's letter did not state the method used to determine the fair market value of the contributed property or the specific basis of the valuation. The second purported appraiser in D'Arcangelo, Carl Thompson, testified that he had no knowledge of what was contributed to the high school and no experience in appraising paintings. The appraisers in D'Arcangelo, were completely unqualified individuals hence substantial compliance could not be met.

In Smith v. Comm'r., TC Memo 2007-368, substantial compliance was also properly denied. The property contributed involved interests in a family limited partnership ("FLP"), which owned stock in a non-publicly traded corporation. At the outset of its discussion, the Court noted that the FLP interests were never valued, and that only the "underlying" corporate stock had been valued. The appraisal in Smith was done by the taxpayer's certified public accountant ("CPA"), who the taxpayers could not show had any appraisal expertise. Furthermore, although the CPA's appraisal was done in 1995, the taxpayers in Smith attempted to use it to substantiate contributions made in 1998 through 2000, three to five years after the CPA's appraisal was done. A second appraisal was made of the corporate stock after the tax return filing deadline for the year of the applicable contribution. The Forms 8283 in Smith also failed to disclose the existence of transfer and other restrictions on the FLP interests. Furthermore, the contributed property interests were not fully or adequately described to permit the valuation methodology and the documentation submitted did not explain the bases for the values claimed. Perhaps most significant in Smith is the fact that the property subject to the valuations was not even the property contributed. Smith is full of multiple and significant failings by the taxpayers to substantially comply with DEFRA section 155 and/or Regs section 1.170A-13.

Similarly, in Hewitt, 109 TC 258 (1997), the taxpayers had donated stock of a privately held corporation to a charity. The taxpayers did not seek an appraisal for the value of the stock but calculated the fair market value of the stock based upon previous sales of the stock to third parties. The court held that the taxpayers did not substantially comply with the Regs because they failed to have the stock appraised and in fact, no appraisal was ever done. Specifically, the return did not identify what was contributed including lacking the corporation whose stock was contributed or the number of shares contributed.

While Columbia, Bond, Hewitt, D'Arcangelo, Smith, and Jorgenson specifically addressed charitable contribution deductions, decisions involving the substantial compliance doctrine and consistently allowed both (i) consideration of information contained on other parts

of a return and (ii) later information provided to the Service. Other non-charitable cases not cited above allowed substantial compliance as well such as: John P. Reaver v. Com'r, 42 T.C. 72, 80-83 (1964) where the taxpayer failed to elect installment reporting on the original return, but did so on the amended return; Taylor v. Com'r, 67 T.C. 1071 (1977), an accrual basis farming operation was entitled to capital gains reporting on the sale of farm property under Section 1251(b)(4)(b)(B); and in American Air Filter Company, Inc. v. Com'r., 81 T.C. 709 (1983), under Code Section 963, allowing a U.S. Shareholder to exclude subpart F (foreign) income from U.S. income taxation even though the US parent never filed a statement, as required by the regulations on the original return, and only did so, when told by the revenue agent, years after the return was originally filed.

C. It Is Often Difficult And Too Subjective To Determine When A Taxpayer Substantially Complies with the Reporting Requirements of Regs section 1.170A-13

Relying on Bond or other substantial compliance cases is difficult because the test is very subjective. Bond, Cary, D'Arcangelo, Hewitt, Smith and Jorgenson clearly show that the form of the appraisal is nowhere near as relevant or pertinent as the fact that one was done. Yet, a bad result for the taxpayer occurred in Mohamed v Commissioner, T.C. Memo 2012-152 but with seemingly good facts. There, it appeared that the taxpayers, Joseph and Shirley, met all of the elements "required to establish the substance or essence of a charitable contribution." The taxpayers in Mohamed donated the real property in question to a CRUT, the ultimate beneficiaries of which were three recognized 501(c)(3) charities; thus, they are qualified to receive a charitable contribution. The Form 8283 completed by the Mohamed's and attached to their 2004 Return clearly identified the real property in question and also set forth the appraised value. This appraised value was unfortunately determined by the taxpayer, Joseph – who, like the appraiser in Bond, was not only a certified appraiser, but was also experienced and knowledgeable in the type of property being donated. Thus, the only difference between the Bond and the Mohamed case was the fact that Joseph appraised the property himself which fact was fatal even though Joseph was a licensed real estate broker with over sixty (60) years of experience in buying and selling real property. He became a certified real estate appraiser in 1989, and has personally appraised several hundred properties, both commercial and residential. Thus, Joseph's qualifications to appraise the property in his case, exceeded, those of the appraiser in Bond.

In Mohamed, Joseph appraised the real property at issue on December 31, 2003, prior to donating the property. He prepared the appraisal in anticipation of the transfer. Joseph used the income approach methodology to determine the value of the subject property, the standard appraisal approach for commercial property of this type. He utilized all proper appraisal standards when valuing the property. Joseph then reduced that value even further when he reported it on the Form 8283 in order to ensure that the value was not overstated. The appraisal later prepared by an independent appraiser, substantiated Joseph's valuation, as did the sale of the property three (3) months later, which sale was well in excess of the appraised value.

Clearly, Regs section 1.170A-13 require that a taxpayer wishing to take a deduction as a result of making a noncash charitable contribution must substantiate the value of the property to be donated by first obtaining a value for that property through an appraisal. Bond, Cary, D'Arcangelo, Smith, Hewitt and Jorgenson demonstrate that the form of the appraisal is not anywhere as significant as its substance. The very purpose of the Regs -- that a Taxpayer not perform the appraisal to prevent overvaluation, was simply not present here. Thus, the safeguards of Regs section 1.170A-13 appear to have been satisfied yet the Court found that taxpayers did not substantially comply with the appraisal requirement of those Regs.

Regs section 1.170A-13 also require that taxpayers seeking to claim a noncash charitable deduction in excess of $5,000 must properly complete and file Form 8283. The Service also contended that taxpayers did not properly complete Form 8283, thus, another reason to disallow their charitable deduction. Under substantial compliance and Bond, the Form 8283 appeared to be substantial compliance alone. In Mohamed, it seemed that the taxpayers set forth sufficient information to meet Regs section 1.170A-13's mandate to provide sufficient information to establish that a charitable contribution was made and for the Service to monitor and detect possible overvaluations. The *only* difference between the Form 8283 in Bond and the Form 8283 in Mohamed was the fact that Joseph did not sign the certification of appraiser. (Because, as donor of the property and trustee of the charitable trust/donee, he could not do so.) However, the presence of this signature certainly did not affect the reported value; its only purpose is to assist the government in determining whether there is a potential overvaluation that needs to be explored. This absence of signature did not impair the Service in determining whether the donation needed to be reviewed for possible overvaluation issues – it actually prompted it. Hence it appears that as in Bond, taxpayers provided sufficient information to effectuate the statutory intent and purpose of ensuring that any potential overvaluation would be detected and remedied and substantially complied.

D. The Law Is Complicated And Taxpayers Preparing Their Own Returns or Lacking Proper Professional Advice Are At A Disadvantage.

Also problematic is that while many taxpayers do not prepare their own income tax return, some do. In fact, tax forms are intended to be completed by taxpayers without the need to seek help from tax professionals and IRS has published data on how long it should take a layperson to prepare these returns. Thus, a layperson could easily misinterpret the rules and not understand the importance of a qualified appraisal or completion of the Form 8283 and be left with a very harsh result when no over statement was intended or present. To add insult to injury, if a charitable deduction is completely denied then significant penalties can apply.

On the current version of Form 8283, revised in 2022 the language of the heading of Section B reads as follows:

> **S**ection B. Donated Property Over $5,000 (Except Publicly Traded Securities, Vehicles, Intellectual Property or Inventory Reportable In Section A)— Complete

> this section for one item (or a group of similar items) for which you claimed a deduction of more than $5,000 per item or group (except contributions reportable in Section A). Provide a separate form for each item donated unless it is part of a group of similar items. <u>A qualified appraisal is generally required for property listed in Section B. See instructions).</u>

Further compounding the issue, last year alone seventeen percent (17%) of the CPA's left the accounting field making it more difficult to find a well versed professional and someone qualified in technical areas of the law including the charitable arena. There is also no relief if a tax return preparer fails to properly advise on the need for a qualified appraisal or how to properly prepare the appropriate forms. Also, the government spends significant resources on litigating these cases when these costs could be minimized if a safe harbor were enacted but one that prevents the abuse outlined by Congress, specifically overvaluations.

E. <u>The Law Was Not Intended To Discourage Charitable Donations Nor To Punish Taxpayers Who Did Not Overstate Charitable Values.</u>

Here, the Treasury Regulations at issue, Regs Section 1.170A-13, is derived from two statutes. The first statute is Code Section 170 which states:

> a) Allowance of deduction
>
> (1) General rule.
>
> There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary.

Thus, Code Section 170 permits a deduction for charitable contributions so long as the deduction is verified. It delegates authority to the Treasury to establish regulations to insure that when contribution deductions are taken they are verified. However, Code Section 170 does not contain any language that calls for the disallowance of verified charitable contribution deductions.

DEFRA Section 155 instructed the Secretary to provide heightened substantiation requirements for certain noncash charitable contributions. The purpose behind DEFRA Section 155 was to make it easier to detect possible overvaluations of donated property without discouraging taxpayers from donating to charities:

> The committee recognizes that the tax benefits provided to taxpayers who contributed appreciated property to charities create opportunities for overvaluations... One way to reduce these opportunities to overvalue would be to eliminate the advantage that charitable gifts of appreciated property have over gifts of cash. The committee recognizes, however, that many charitable organizations depend on this tax benefit for fund-raising and as a means of acquiring valuable property. (Senate Finance Committee Report).

Thus, the intent behind DEFRA Section 155 was to facilitate the detection and disallowance of unverified and/or unsubstantiated deductions without interfering with verified, substantiated deductions. DEFRA Section 155 achieves this by requiring taxpayers to provide specific identification of donated non-cash property, the name of the donee and the date and location of the contribution, an appraisal summary for donated noncash property in excess of $5,000, and a "qualified appraisal" of such non-cash donations. DEFRA Section 155 defines a "qualified appraisal" as follows:

> (4) Qualified appraisal – The term "qualified appraisal" means an appraisal prepared by a qualified appraiser which includes – (A) a description of the property appraised, (B) the fair market value of such property on the date of contribution and the specific basis for the valuation, (C) a statement that such appraisal was prepared for income tax purposes, (D) the qualifications of the qualified appraiser, (E) the signature and TIN of such appraiser, and (F) such additional information as the Secretary prescribes in such regulations.

DEFRA Section 155 sets forth a means of verifying donations and substantiating valuation of donated property in order to make sure that a charitable contribution deduction is not allowed for overvalued property. Nothing in the language of DEFRA Section 155 provides for a disallowance of the charitable contribution deduction where the taxpayer verifies that the contribution has been made and substantiates the value of the donated property.

To implement DEFRA Section 155, the Secretary enacted Regs Section 1.170A-13. These Regs provide numerous "hoops" that a taxpayer must jump through in order to verify that certain contributions have been made and to substantiate the valuation of certain non-cash donations. If the taxpayer is not successful in verifying that the contribution has been made or substantiating the valuation of the donated property in accordance with the requirements of those Regs, the charitable contribution deduction is disallowed. However, even if the taxpayer verifies that the contribution has been made and substantiates the valuation of the donated property, Regs Section 1.170A-13 provides that the taxpayer loses his charitable deduction if he does not jump through all of the Regs' technical valuation hoops. This causes an arbitrary and capricious application of the tax law and is contrary to the intent of the Code.

There is no question that Congress intended by the language of Code Section 170 and DEFRA Section 155 that charitable contribution donations need to be verified and substantiated; and they clearly should be. It is also indisputable that these statutes permit the Secretary to draft and impose regulations outlining what taxpayers need to do to verify and substantiate charitable donations. However, nowhere in the language in either Code Section 170 or DEFRA Section 155 is there the slightest hint that Congress intended that a taxpayer who both verifies that a donation has been made and substantiates the value of donated property should be deprived of the charitable contribution deduction provided under Code Section 170. Indeed, such an effect is contrary to the clear intent of the statute as evidenced by the Senate Finance Committee Report explaining DEFRA Section 155 (supra).

The purpose of Code Section 170 is to encourage charitable donations by permitting taxpayers making charitable contributions to take a deduction based on the value of the donation on his or her tax return. In enacting DEFRA Section 155, Congress clearly

intended to weed out only unverified or unsubstantiated deductions. Indeed, the Senate Finance Committee Report (supra) indicates that Congress was well aware of the importance of encouraging charitable donations and the role that the charitable contribution deduction plays in encouraging such donations. That Senate Finance Committee Report also indicates that Congress had no desire to enact a statutory scheme that would inhibit or preclude a taxpayer from claiming a charitable contribution deduction for property that is not overvalued. Thus, the clear intent of the statute was to provide the Service with additional tools to detect the improper claiming of the deduction. It was not intended to be used to deny taxpayers charitable contribution deductions for verified, substantiated contributions.

II SOLUTION

Because Regs Section 1.170A-13 permits the Service to deny the charitable contribution deduction both in those cases where charitable contributions have been verified and substantiated as well as where such contributions have not been verified or substantiated, i.e., both where an overvaluation has occurred and where it has not, there should be a safe harbor. This is further evidenced by the fact that Regs Section 1.170A-13 has a punitive quality. On the other hand, overvaluation abuses must continue to be stopped and in such cases harshness is well deserved.

Similar to the Tax Court's focus in the substantial compliance cases, it is not about compliance with the regulations, the forms or information attached to the filed return, but concern over whether the Service ultimately received sufficient information in support of the taxpayer's return reporting. Clearly an important element is the substance of the information and not the timing of its disclosure. Hence, there clearly needs to be sufficient information for the Service to be aware (1) that a charitable donation had been made; (2) the identify and type of the property being donated; (3) and the fair market value of the property.

Hence to continue to avoid abuses of overvaluations by Taxpayers on non-cash charitable donations, but to bring fairness to the tax system, the author proposes that a safe harbor be instituted under the Regs which will provide the Service with the substance it needs. The safe harbor will provide guidance on when a Taxpayer has substantially complied with the qualified appraisal requirements under Reg 1.170A-13. Substantial compliance will occur if a Taxpayer ¨(1) provides sufficient information on his, her or their Individual Federal Income Tax Return in question to establish that a charitable contribution had been made (i.e. Form 8283) and (2) provides sufficient information on his, her or their Individual Federal Income Tax Return in question to alert the Service to the claimed deduction so that the Service can easily monitor the possibility of an overvaluation and (3) if the property is sold within two (2) years of the donation it is sold for a value not less than ninety percent (90%) of the charitable contribution claimed; or alternatively a qualified appraisal is provided within sixty (60) days of when the audit begins and the value determined in the qualified appraisal is not less than ninety percent (90%) of the charitable contribution claimed.

III CONCLUSION

It is of upmost importance for the Service to be able to determine whether a charitable contribution was made and/or the value of any such contribution. However, this author proposes that as long as the Service receives sufficient information to satisfy the identification requirements of DEFRA section 155 and Regs section 1.170A-13, to allow it to address Congress' overvaluation concerns, then there should be relief for compliant taxpayers. This relief is proposed to be in the form of a safe harbor which, as described above, will prevent overvaluation abuses but soften the harshness of the qualified appraisal rules. Such relief will allow for a fairer administration of the tax system among all taxpayers.