

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:SB:7:SJ:TL-N-79-01

PKWebb

date: **JAN 30 2001**

to: Fred Chynoweth, Revenue Agent

from: Area Counsel (SBSE), Area 7, San Jose, CA

subject: [REDACTED]
Qualified Charitable Deduction Issue

NOTICE: SHORT STATUTE OF LIMITATIONS DATE ([REDACTED]).

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice may also contain confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, may be subject to the attorney work product privilege. Accordingly, any recipient of this document, including Examination or Appeals, may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to the taxpayer or his or her representatives.

Issue: Whether a taxpayers' otherwise qualified gift of real property fails to substantially qualify with the requirements of Treasury Regulation § 1.170A-13(c)(3)(i)(A) because the actual transfer took place more than 60 days after the qualified appraisal.

Conclusion: An otherwise qualifying charitable gift made [REDACTED] days after an appraisal, in technical violation of Treas. Reg. § 1.170A-13(c)(3)(A), substantially complies with that provision in the Regulation.

Facts

██████████ and ██████████ (hereafter "the ██████████") joined together with certain other parties known as the ██████████ to purchase real property. On or about ██████████, the ██████████ purchased ██████████ acres in ██████████ County. The purchased property consisted of three parcels, numbered ██████████, ██████████ and ██████████ (hereafter "the ██████████ property"). The title to these parcels was held in the names of the individuals, not the investment group. The ██████████ owned approximately ██████████% of the total value of the ██████████ property.

In taxable year ██████████, the various individuals owning the ██████████ property determined that they would donate the land to the ██████████ (hereafter "the donee"), a donee qualified to accept charitable gifts under I.R.C. § 170. Prior to the transfer of the land, the donee commissioned an appraisal of the property from a local real estate appraisal company. The appraisal states that it was prepared in accordance with Federal Deposit Insurance Corporation (FDIC) Regulation 12 CFR, Part 323(f); the Ethics and Standards of Professional Appraisal Practice (USPAP); Office of Thrift Supervision (OTS); and Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA). The appraisal document further states that the "appraisal and the value reported herein, will be used by the client, ██████████ for internal valuation considerations only. Any other use of this appraisal report is invalid."¹

The ██████████ property was appraised at a value of \$██████████. The Land Appraisal Report, which provides a summary of the appraisal, was dated ██████████. The cover letter which accompanied the report was dated ██████████.

On ██████████, the various owners of the ██████████ property transferred various ownership interests to the donee. Based upon a LEXIS search of property transfer records and information from the ██████████ representative, the following transactions took place:

- On ██████████ the ██████████ transferred ██████████% of the value of the ██████████ property to the donee, i.e., ██████████ of their ownership interest in the ██████████ property. The grant deed reflecting this transfer was recorded on ██████████.

¹ This appears to violate Treas. Reg. § 1.170A-13(c)(3)(ii)(G), which requires a statement that the appraisal was prepared for income tax purposes.

- On [REDACTED] the [REDACTED] transferred their remaining [REDACTED] interest in the [REDACTED] property to the donee. The grant deed reflecting this transfer was recorded on [REDACTED].
- On [REDACTED], the [REDACTED] filed a corrective deed regarding the original [REDACTED] interest that they transferred to the donee. This corrective deed apparently only corrected the description of the real property.

The donee issued a total of two Form 8283s in response to its receipt of the [REDACTED] property. An initial Form 8283 was issued on [REDACTED], to the [REDACTED] individually due to the fact that they did not donate all of their interest in the property in a single transaction. This first Form 8283 lists the total property value of \$[REDACTED] and states that the interest given by the [REDACTED] on [REDACTED], was an undivided [REDACTED] interest in the [REDACTED] property.

At the end of taxable year [REDACTED], the donee issued a second Form 8283 to the [REDACTED] group, providing with it a copy of the property appraisal. This Form 8283 reflected a transfer of the entire value of the [REDACTED] property, i.e., \$[REDACTED]. This Form 8283 was attached to the information return filed by [REDACTED] for its [REDACTED] taxable year. A copy of this Form 8283 was also provided to the [REDACTED] and an additional statement was typed on to the form stating that the [REDACTED] donated interest in the contribution totaled \$[REDACTED], which amount equals % [REDACTED] of the total value of the property.

The [REDACTED] deducted a charitable contribution in the amount of \$[REDACTED] on their Federal income tax return for taxable year [REDACTED] in regards to the transfer of their interest in the [REDACTED] property. The [REDACTED] attached a copy of the second Form 8283 to their Federal income tax return.

Analysis

Your request for advice is limited to whether the [REDACTED] charitable contribution of their interest in the [REDACTED] property should be disallowed because it was untimely in relation to the appraisal of the land. This advice, as does your request, assumes that all requirements of Section 170 and Treas. Reg. § 1.170A-13 have been met, other than technical violations of Treas. Reg. § 1.170A-13(c)(3)(i)(A)(60 day requirement) and Treas. Reg. § 1.170A-13(c)(3)(ii)(G)(statement that appraisal done for income tax purposes).

A deduction is allowed for any qualified charitable contributions made by a taxpayer during the taxable year. I.R.C. § 170(a)(1). Such charitable contributions are only allowable as a deduction if they are verified under regulations provided by the Secretary. Id. The Secretary has set forth relevant regulations at Treas. Reg. § 1.170A.

If an individual, partnership, etc., claims a charitable deduction for property valued in excess of \$ [REDACTED] such taxpayer must obtain a qualified appraisal and attach a fully completed summary of the appraisal to its income tax return. Treas. Reg. § 1.170A-13(c). To constitute a "qualified appraisal" under the regulation, it must have been made not earlier than 60 days prior to the date of contribution of the appraised property. Treas. Reg. § 1.170A-13(c)(3)(A). Only one qualified appraisal is required for a group of similar items of property contributed in the same taxable year of the donor, although a donor may obtain separate qualified appraisals for each item of property. Treas. Reg. § 1.170A-13(c)(3)(iv)(A); see also Treas. Reg. § 1.170A-13(c)(3)(ii) (defining items of "similar property" and including land in that definition).

Your request for advice points out that the appraisal of the [REDACTED] property is dated [REDACTED]. The grant deed reflecting the [REDACTED] transfer of [REDACTED] of their interest in the [REDACTED] property states that the transfer took place on [REDACTED]. Thus, the transfer took place on the [REDACTED] day after the appraisal. Your request for advice further points out that the [REDACTED] contributed the remainder of their interest in the [REDACTED] property at a later date, which was [REDACTED] according to property records. That transfer took place on the [REDACTED] day after the appraisal.

The Tax Court has determined that the regulations implementing Section 170 are directory rather than mandatory. Bond v. Commissioner, 100 T.C. 32 (1993). As such, the Tax Court requires that taxpayers substantially comply with the requirements of the regulations in order to qualify for a charitable contribution deduction. Id. This "substantial compliance" test allows for a somewhat relaxed review of the requirements set forth by the regulations. See Id. In order to determine if a taxpayer has substantially complied with the regulations, a review of the relevant case law is necessary.

Cases Finding Substantial Compliance

In Bond, *supra*, the Court set forth the rule that taxpayers need only substantially comply with the regulations implementing Section 170 in order to qualify for a deduction. In that case,

the taxpayers had met all of the elements required to show a charitable deduction, including having a qualified appraisal, but had failed to obtain and attach to their return a separate written appraisal summary containing the information required by the regulations. However, the Court found that substantially all of the information which is required to be included on such an appraisal summary was included on the Form 8283 that the taxpayers had attached to their Federal income tax return. The Court found that the taxpayers had substantially complied with the regulations despite the fact that the appraisal summary was not attached and the Form 8283 entirely omitted the qualifications of the appraiser. See Id.

In Fair v. Commissioner, T.C. Memo. 1993-377, the Court found that the taxpayers had substantially complied with the substantiation requirements of Regulation 1.170A-13(b)(3). In that case, the taxpayers had commissioned two appraisals of a yacht which they donated to a charitable organization. However, the taxpayers in that case neglected to maintain all cost basis records as is required by the relevant regulations. The Court found that the taxpayers had substantially complied with the regulations.

Cases Not Finding Substantial Compliance

There are several cases in which the Court has found that various taxpayers did not substantially comply with the regulations implementing Section 170. Following are summaries of some of those cases.

In D'Arcangelo v. Commissioner, T.C. Memo. 1994-572, the Court found that the taxpayers failed to substantially comply with the regulations. In that case, the taxpayers attached a Form 8283 to their Federal income tax return along with a copy of a letter of appraisal. However, the Court found that taxpayers did not substantially comply because, unlike in Bond, supra, where the taxpayers had obtained a qualified appraisal but failed to attach it to their return, these taxpayers had failed to obtain a qualified appraisal in the first place. The taxpayers' purported appraisal was done by an employee of the donee, which is specifically prohibited by Treas. Reg. § 1.170A-13(c)(5)(iv)(D). Additionally, the appraisal letter did not set forth any qualifications of the appraiser or that he held himself out as an appraiser. Furthermore, the appraisal letter did not state the method used to determine the fair market value of the donated property. Finally, no fully completed appraisal summary was provided by the taxpayers. See Id.

In Louderback v. Commissioner, T.C. Memo. 1995-19, the Court

found no substantial compliance when the taxpayers apparently failed to comply with any of the requirements of the regulations and failed to show that the donee was a qualified charitable organization.

In Hewitt v. Commissioner, 109 T.C. 258 (1997), aff'd without op. 166 F.3d 332 (4th Cir. 1998), the taxpayers donated privately held stock in the Jackson Hewitt Company. The taxpayers did not obtain any appraisal of the stock donated but based the values of their donations upon "arm's length" transactions involving the stock at approximately the same time that the taxpayers made the gifts. The taxpayers' Federal income tax returns additionally failed to indicate the number of shares gifted and the method of valuation. See Id.

In Jorgenson v. Commissioner, T.C. Memo. 2000-38, the Court found that the taxpayers had failed to substantially comply with the regulations since they failed to obtain qualified appraisals of the donated property prior to the due dates of their tax returns. The taxpayers did not provide any summary appraisals with their Federal income tax return and did not obtain letters from appraisers until sometime after the filing of their returns.

In contrasting the cases which found substantial compliance with the cases which found no substantial compliance, one distinguishing factor is clear. In each case finding substantial compliance, the taxpayers had reliable appraisals completed but had failed in some regard thereafter. For example, in Bond, *supra*, the taxpayers failed to include the appraisal summary with their tax returns. However, the government agreed with the Bond's valuation of their gift. Thus, the only challenge in Bond, *supra*, involved a technical violation of the regulations as opposed to a violation which directly addressed the purpose of the regulations, to wit, to set substantiation and valuation standards. In each case finding no substantial compliance, there were fundamental errors with the appraisal itself, or a complete failure to obtain an appraisal. For example, in Jorgenson, *supra*, the taxpayers did not obtain appraisals until after the filing of their Federal income tax returns and in Hewitt, *supra*, the taxpayers failed to obtain any appraisal. Finally, in D'Arcangelo, *supra*, the Court found that the taxpayers did have a completed appraisal prior to making their gift but that there were too many problems with the appraisal such that its validity was questionable (donee's employee was the appraiser; no appraiser qualifications given or showing that appraiser held himself out as such; appraisal letter did not state method of valuation).

From the information you provided, the [REDACTED] apparently

violated two separate provisions of Treas. Reg. § 1.170A-13. The first violation is that the donations of property took place more than 60 days after the appraisal date, which violates Treas. Reg. § 1.170A-13(c)(3)(i)(A). The second violation is that the appraisal includes a statement that it was completed for the donee "for internal valuation considerations only." Thus, the appraisal violates Treas. Reg. § 1.170A-13(c)(3)(ii)(G).

The fact that the gift was made [REDACTED] days after the otherwise qualified appraisal does not raise issues of substantiation of the gift, i.e., that it was in fact given. Additionally, it is unlikely that the value of this real property gift changed considerably during this additional [REDACTED] day period, which is the apparent purpose for the 60 day requirement of Treas. Reg. § 1.170A-13(c)(3)(i)(A). In fact, the government's own independent appraiser accepted the donee's appraised value of the [REDACTED] property. Furthermore, while the appraisal document is dated [REDACTED], the cover letter accompanying that appraisal is dated [REDACTED]. The Court could conceivably find substantial compliance with the regulation as the gift, or at least [REDACTED] of it, was made within 60 days of the transmittal of the appraisal.

As for the gift being made in two parts, the first half on [REDACTED] and the second on [REDACTED] the regulations do not directly address such a situation. The regulations do provide that only one qualified appraisal is required for a group of similar items of property contributed in the same taxable year of the donor. Treas. Reg. § 1.170A-13(c)(3)(iv). Included in the definition of similar items of property is land and buildings. Treas. Reg. § 1.170A-13(c)(7)(iii). However, the regulations do not state that this single appraisal standard applies when a gift is given in two parts, one of which is substantially more than 60 days after the appraisal. The government could argue that new appraisals are needed for each similar item of property if the similar items are contributed more than 60 days after the original appraisal date. However, given the substantial risks of litigation presented in this case, this office is reluctant to take such a position.

As for the statement in the appraisal that it was done for the donee's sole use in its internal valuation process, this provides an additional factor towards a finding of no substantial compliance. However, this statement likewise does not invalidate the effectiveness of the appraisal. This is especially true in light of the fact that the government's appraiser does not dispute the appraised value. Presumably, this provision of the regulation is provided so that the government can determine that the method of valuation used by the appraiser is consistent with

the fair market valuation standard required by the regulation. This office believes that the appraisal statement restricting its use to the donee was included to provide liability protection to the appraiser. For example, because the statement restricts the appraisal's use to the donee, it is likely that the partners in the [REDACTED] group would have no privity with the appraiser such that they could sue the appraiser if the value was later disputed.

In the context of this case, a Court would likely find substantial compliance unless the appraisal did not use a fair method for valuation, did not state the method of valuation, used an unqualified appraiser, was unsigned by the appraiser, did not sufficiently describe the property or the condition of the property or involved a prohibited fee arrangement. See Treas. Reg. § 1.170A-13(c). As the case now stands, the [REDACTED] can substantiate that they made the gift transfers during taxable year [REDACTED], that they did not retain an interest in the gifted property, and that the government does not challenge the valuation of the gift. Such facts would strongly favor the [REDACTED] in trial given the substantial compliance standard imposed by the Court.

Conclusion

If the government discovers additional sufficient violations of the regulations, the taxpayers' charitable gift could potentially be disallowed or adjusted. See e.g., D'Arcangelo, *supra*. A combination of several minor violations of the regulations could ultimately lead to a finding that the [REDACTED] did not substantially comply with the regulations. However, based upon the information provided to this office thus far and the above analysis regarding the substantial compliance standard, we advise that the government not pursue this issue unless additional violations of the regulations are discovered. Such violations would preferably involve a challenge to the valuation of the gift. If additional violations of the regulations are discovered, please notify this office for further analysis of this case.

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