

# Charitable Donations Require Attention to Both Form and Substance

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In the recently decided case of *Mohamed v. Commissioner*, TC Memo 2012-152 (5/29/2012), the Tax Court denied taxpayers a charitable deduction for a donation of real property with a value in excess of \$18 million that a husband and wife contributed to their charitable trust. In his memorandum decision, Judge Mark V. Holmes admitted this was a "harsh" result but one that was required because of the taxpayers' failure to meet the substantiation requirements for charitable contributions contained in the regulations promulgated pursuant to Section 170 (a) of the Internal Revenue Code.

According to the opinion, Joseph Mohamed Sr. is a real estate broker, a certified real estate appraiser and a prominent Sacramento, Calif., entrepreneur. During his career, Mohamed and his wife amassed a fortune in real estate and created a charitable remainder trust for the ultimate benefit of several well-known public charities. In 2003, the Mohameds donated five properties to their charitable trust. Mohamed filled out the couple's 2003 federal income tax return himself, including Form 8283 (Non-Cash Charitable Contributions), the form required to be filed to report noncash contributions to charity. Mohamed admits that he did not read the instructions before completing this form because, as he testified, the form seemed so clear. In 2004, the Mohameds donated additional properties to their charitable trust. Mohamed again filled out the couple's 2004 tax return himself and again did not read the instructions.

In completing the Form 8283 with respect to the 2003 donations, the opinion said, Mohamed used his own appraisals of the properties donated to establish value but did not report the tax basis of each property. Rather, Mohamed stated on the form that he had bought all the properties in the 1970s and 1980s. He left blank the Declaration of Appraiser on Form 8283, which stated, "I declare that I am not the donor, donee, a party to the transaction," since he recognized that he was, in fact, the donor (and the donee, since he was the trustee of his charitable trust). However, Mohamed did sign the Donee Acknowledgement Portion of Form 8283 saying that the trust was a qualified charity as required under Code Section 170(c). Similarly, on the couple's 2004 Form 8283, Mohamed provided a variety of information concerning the donated properties including his own valuation but no independent appraisal of the properties.

The court noted that after the Mohameds transferred the properties to the trust, several of the properties were sold in arm's-length transactions for sale prices that were relatively consistent with the valuations provided by the Mohameds on their tax returns. However, upon audit, the IRS disallowed the deductions claimed by the Mohameds for the contributions to the trust in 2003 and 2004 on the basis that the Mohameds failed to

obtain the requisite qualified appraisals of the contributed properties and the Forms 8283, as filed, were materially deficient.

Code Section 170 (a)(1) governs the deductibility of charitable contributions and states that "a charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the secretary [of the Treasury]." The regulations promulgated under Code Section 170 contain extensive requirements for the substantiation of noncash charitable donations greater than \$5,000. These regulations (Sec. 1.170A-13(c)(1)) provide that "no deduction under Section 170 shall be allowed with respect to a charitable contribution ... unless the substantiation requirements of this section are met." Specifically, Treasury Regulation Sec. 1.170A-13(c)(2) requires that a donor who claims a deduction in excess of \$5,000 with respect to a charitable contribution of property must comply with the following requirements:

- Obtain a "qualified appraisal" of the contributed property.
- Attached to the relevant tax return on which the deduction is claimed, a fully completed appraisal summary containing a variety of information concerning the contributed property, the donor and the donee and which is signed by both the donee and the qualified appraiser who prepared the qualified appraisal.

The regulations define a "qualified appraisal" as an appraisal made no more than 60 days before the charitable donation and no later than the due date of the return on which the donation is claimed and which is signed by a qualified appraiser. Moreover, a qualified appraisal must include specific information concerning the property, certain disclosures by the appraiser and may not involve a prohibited fee, such as a fee based upon the value of the property or the sustainability of the claimed deduction. To be a qualified appraiser, the regulations provide that the appraiser cannot be the donor or taxpayer claiming the deduction or the donee of the property.

Although he was a certified appraiser at the times he and his wife contributed the properties to their charitable trust, Mohamed was not a qualified appraiser since he was the donor (and technically the donee in his capacity as trustee of the charitable trust). Moreover, the Forms 8283 did not contain the requisite information necessary to constitute a required appraisal summary nor were they signed by a qualified appraiser who prepared qualified appraisals of the contributed properties. The Tax Court did take note that Form 8283 was misleading and did not explicitly require a qualified appraiser's signature (the form has since been improved).

The Mohameds challenged the validity of the regulations requiring a qualified appraisal and appraisal summary. They claimed that the regulations were arbitrary and capricious because they allow a taxpayer to enjoy a portion of the deduction if the taxpayer follows the reporting procedures but overvalues the donation, but denies the entire deduction for a taxpayer (such as the Mohameds) who accurately values the donation but fails to follow the reporting procedures.

In upholding the validity of the regulations and granting summary judgment in favor of the IRS, Holmes noted that Code Section 170(a)(1) contains an express delegation of authority to the IRS to create rules about how a donation will be verified. In the context of such an express delegation of authority, regulations can be invalidated only if they are arbitrary, capricious or manifestly contrary to the statute. In this regard, the legislative history of the verification requirements of Code Section 170(a)(1) shows a clear congressional intent that contributions of property with a value greater than \$5,000 must be substantiated by a qualified appraisal to be deductible. Specifically, Section 155 of the Deficit Reduction Act of 1984 directed the secretary of the Treasury to promulgate regulations under Section 170(a)(1) that would require taxpayers claiming a deduction in excess of \$5,000 to obtain a qualified appraisal of any contributed property. Holmes concluded that the regulations requiring a qualified appraisal matched this legislative directive and were a permissible interpretation of the statute.

Holmes conceded that a number of the requirements in the substantiation regulations are "administrative" and failure to strictly comply with those requirements would not necessarily be fatal to the claimed deduction had there been substantial compliance. However, the regulations make a qualified appraisal an "essential requirement" of Code Section 170(a)(1), and substantial compliance is not sufficient to sustain a deduction. In reaching this conclusion, the court cited a number of earlier cases that upheld the denial of charitable deductions based upon the donation of property where qualified appraisals were missing or materially deficient.

Although Holmes noted that he was "sympathetic to the Mohameds' cause" and acknowledged that the instructions to Form 8283 were confusing, he still held that taxpayers ultimately have to comply with the requirements of the law and regulations and may not rely on such "informal publications" as government forms.

There are several lessons to be learned from *Mohamed*. First, reliance only on IRS forms and instructions can be dangerous, especially when reporting complicated and high-value transactions. Second, substantial compliance and good-faith efforts are not always sufficient in those instances where the code requires absolute and strict compliance, as in the need for a qualified appraisal under Code Section 170(a)(1). Third, taxpayers involved with significant transactions are always wise to consult with experienced tax professionals.

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