

## Steve Leimberg's Charitable Planning Email Newsletter Archive Message #286

Date:01-Jul-19

Subject: Richard L. Fox on *RERI Holdings I* - DC Court of Appeals Affirms Denial by Tax Court of \$33 Million Claimed Charitable Income Tax Deduction for Failure to Include Information on Tax Basis on IRS Form 8283

*“This commentary provides a discussion of the case decided on May 24, 2019, where the United States Court of Appeals for the District of Columbia affirmed the decision of the Tax Court in RERI Holdings I, LLC, where the failure of the taxpayer to include the income tax cost basis information on Form 8283 resulted in the complete denial of a claimed charitable income tax deduction of \$33 million for property it has acquired 17 months earlier for only \$2.95 million. The taxpayer in this case showed no amount in the space provided on Form 8283 for the ‘Donor’s cost or other adjusted basis.’ Leaving that space blank, in and of itself, caused the complete denial of any charitable income tax deduction. This is another important lesson for taxpayers to comply with all substantiation requirements with respect to claiming a charitable income tax deduction or face the prospect of a total denial of a claimed charitable contribution deduction.”*

**Richard L. Fox** provides members with his commentary on [RERI Holdings, I, LLC](#).

**Richard L. Fox** is an attorney and shareholder at **Buchanan Ingersoll & Rooney** ([www.bipc.com](http://www.bipc.com)). Richard is the author of the treatise, *Charitable Giving: Taxation, Planning and Strategies*, a Thomson Reuters/Warren, Gorham and Lamont publication, writes a national bulletin on charitable giving, and writes and speaks frequently on issues pertaining to nonprofit organizations, estate planning and philanthropy. Richard is also a Fellow of the American College of Trust and Estate Counsel (ACTEC).

Now, here is Richard’s commentary:

## EXECUTIVE SUMMARY:

In *RERI Holdings I, LLC*, the Tax Court, in a 2017 decision, held that the taxpayer was not entitled to a charitable income tax deduction based solely on its failure to include the income tax cost basis of the donated property on the IRS Form 8283 (Noncash Charitable Contributions) filed with the income tax return claiming a \$33 million deduction for property it has acquired 17 months earlier for only \$2.95 million. By not including the tax cost basis on Form 8283, and therefore not alerting the IRS to the disparity between the fair market value of the claimed deduction and its tax cost basis, the Tax Court held that the partnership failed to meet the substantiation requirements of Regulation § 1.170A-13(c) and was not entitled to any deduction.

On May 24, 2019, the United States Court of Appeals for the District of Columbia affirmed the decision of the Tax Court in denying the entire charitable income tax deduction. The Court of Appeals rejected the arguments of RERI that the taxpayer's income tax basis in donated property is not necessary to evaluate the taxpayer's charitable contribution because the deductible amount is the fair market value of the property and the tax basis is not an input in calculating the fair market value, and that leaving a space blank on Form 8283 should be construed as a zero and that a zero provides the same red flag as does an unusually low tax cost basis. The Court of Appeals refused to apply the "substantial compliance" doctrine that has been applied by courts in certain cases where a failure to strictly comply with reporting requirements has been excused where the donor demonstrates "substantial compliance."

## **FACTS:**

In *RERI Holdings I, LLC*, 149 TC 1 (2017), the Tax Court held that the taxpayer (RERI), which was treated as a partnership for federal income tax purposes, was not entitled to a charitable income tax deduction for a charitable contribution of property based solely on its failure to include the income tax cost basis of the donated property on the IRS Form 8283 (Noncash Charitable Contributions) filed with the income tax return claiming a \$33 million deduction. By not including the tax cost basis, the Tax Court held that the partnership failed to meet the substantiation requirements of Regulation § 1.170A-13(c) and was not entitled to any deduction.

Reg. § 1.170A-13(c) sets forth the substantiation requirements applicable to charitable contributions of property valued at more than \$5,000 and, under Reg. § 1.170A-13(c)(1)(i), the failure to satisfy these requirements results in a total denial of a deduction for the contribution. To meet the substantiation requirements, Reg. § 1.170A-13(c)(2)(i)(B) requires that the donor attach a “fully completed” appraisal summary, which is embodied in IRS Form 8283 (Noncash Charitable Contributions), to the income tax return on which the deduction is first claimed (or reported). Under Reg. § 1.170A-13(c)(4)(ii)(E), the appraisal summary must provide, among other things, the “cost or other basis of the property.” This requirement is incorporated in Form 8283, Section B, Part I, line 5, column (f), which requires inclusion of the “Donor’s cost or adjusted basis.”

Interestingly, although not mentioned in the Tax Court decision (most likely because it didn’t apply in this case), under Reg. § 1.170A-13(c)(4)(iv)(C)(1), “[i]f a taxpayer has reasonable cause for being unable to provide the information ... relating to the manner of acquisition and basis of the contributed property” in the appraisal summary, the deduction will not be disallowed if the donor attaches “an appropriate explanation” to the appraisal summary. Similarly, the Instructions to Form 8283 for Section B, Part I, provide that “If you have reasonable cause for not providing the information in columns (d), (e), or (f),” which includes the income tax basis information in column (f), **“attach an explanation so your deduction will not automatically be disallowed.”** (Emphasis added.)

RERI paid \$2.95 million in March 2002 to acquire the contributed property. On August 27, 2003, RERI conveyed the property to the University of Michigan. On its 2003 partnership income tax return, Form 1065, RERI claimed a \$33 million charitable income tax deduction. The Form 8283 that RERI attached to its 2003 tax return indicated that it acquired the donated property by purchase on March 22, 2002. However, it showed no amount in the space provided for the “Donor’s cost or other adjusted basis.” Therefore, the IRS was not alerted to the fact the property for which RERI paid \$2.95 million in March 2002 was valued at \$33 million when it was donated only seventeen months later. As a result, RERI’s Form 8283 did not satisfy the requirement of Regulation § 1.170A-13(c)(4)(ii)(E). Nor did the donor meet the “reasonable cause” exception found in the regulations by attaching “an appropriate explanation” for failing to include the income tax basis information on the Form 8283.

The Tax Court emphasized that RERI's omission of its income tax basis in the donated property on the Form 8283 it attached to its 2003 return prevented the appraisal summary from achieving its intended purpose, and that RERI's failure to meet the requirement of the regulations could not be excused by the doctrine of "substantial compliance," stating:

Congress directed the Secretary to adopt stricter substantiation requirements for charitable contributions to alert the Commissioner, in advance of audit, of potential overvaluations of contributed property and thereby deter taxpayers from claiming excessive deductions in the hope that they would not be audited ... RERI acquired the [donated property] for about \$3 million in March 2002 and claimed a charitable contribution deduction of about \$33 million for its assignment of the [donated property] to the University in August 2003. The significant disparity between the claimed fair market value and the price RERI paid to acquire the [donated property] just 17 months before it assigned the SMI to the University, had it been disclosed, would have alerted respondent to a potential overvaluation of the [donated property]. Because RERI failed to provide sufficient information on its Form 8283 to permit respondent to evaluate its reported contribution ... we cannot excuse on substantial compliance grounds RERI's omission from that form of its basis in the [donated property]. Therefore, RERI did not "[a]ttach a fully completed appraisal summary" to its 2003 return as required by section 1.170A-13(c)(2)(i)(B), Income Tax Regs. Because RERI did not meet the substantiation requirements provided in section 1.170A-13(c)(2), Income Tax Regs., it is not entitled to any deduction under section 170 for its contribution of the [donated property] to the University.

The Tax Court, citing *Bond v. Com'r*, 100 TC 32 (1983), noted that the principle of "substantial compliance" has been applied by the courts so that a failure to strictly comply with reporting requirements "can be excused if the donor demonstrates 'substantial compliance.'" The court stated, however, that because "RERI failed to provide sufficient information on its Form 8283 to permit respondent to evaluate its reported contribution ... we cannot excuse on substantial compliance grounds RERI's omission from that form of its basis in the SMI. Therefore, RERI did not "[a]ttach a fully

completed appraisal summary” to its 2003 return as required by section 1.170A-13(c)(2)(i)(B), Income Tax Regs. Because RERI did not meet the substantiation requirements provided in section 1.170A-13(c)(2), Income Tax Regs., it is not entitled to any deduction under section 170 for its contribution.”

### ***DC Court of Appeals Affirms Tax Court Decision in Denying Deduction in Full***

On May 24, 2019, the United States Court of Appeals for the District of Columbia affirmed the decision of the Tax Court in *RERI Holdings I, LLC* (No. 17-1266, D.C. Court of Appeals, May 24, 2019) fully denying the claimed charitable income tax deduction. In its decision relating to the “substantial compliance” issue, the court noted that “We have not, however, previously decided whether substantial compliance rather than literal compliance suffices under § 1.170A-13 (or, for that matter, under any other federal tax regulation) ... Whether a taxpayer may satisfy the substantiation requirements through substantial compliance is a purely legal question, which we decide de novo. *Byers v. Comm’r*, 740 F.3d 668, 675 (D.C. Cir. 2014).”

In the appeal, the IRS urged the Court of Appeals to affirm the Tax Court decision on the ground that substantial compliance with the regulations does not suffice, so that RERI’s failure to include the income tax basis information on Form 8283 was automatically fatal. RERI maintained that the substantial compliance doctrine does apply to the case, and that providing its basis in the donated property is not necessary for compliance. It emphasized that both the Second Circuit and the Tax Court have concluded the substantiation requirements can be satisfied by substantial compliance, citing *Scheidelman v. Com’r*, 682 F.3d 189, 199 (2d Cir. 2012); *Bond v. Com’r*, 100 TC 32 (1983).

The Court of Appeals noted that the Tax Court formulated the test for substantial compliance as “whether the donor provided sufficient information to permit the Commissioner to evaluate the reported contributions, as intended by Congress.” On appeal, the IRS advocated a significantly more stringent test under which anything short of complete compliance is excused only if “(1) the taxpayer had a good excuse for failing to comply with the regulation and (2) the regulation’s requirement is unimportant, unclear, or confusingly stated in the regulations or statute.”

The Fourth, Fifth, and Seventh Circuits have adopted this formulation of the substantial compliance standard, albeit for different provisions of the tax code. See *Volvo Trucks of N. Am., Inc. v. United States*, 367 F.3d 204, 210 (4th Cir. 2004); *McAlpine v. Comm’r*, 968 F.2d 459, 462 (5th Cir. 1992); *Prussner v. United States*, 896 F.2d 218, 224 (7th Cir. 1990).

In its holding, the Court of Appeals stated that it need not determine whether “substantial compliance suffices,” although it stated that it assumed it does, or need to determine the standard that did apply assuming that it did, because it held that the failure of a taxpayer to supply income tax basis information on Form 8283 (or an explanation for failing to do so), in and of itself, was sufficient to support the denial of the entire deduction, stating “In short, we agree with the Tax Court that RERI fell short of the substantiation requirements by omitting its basis in the donated property.”

In disallowing the claimed deduction, the Court of Appeals rejected each argument asserted by RERI in favor of the allowance of the deduction. In this regard, RERI first argued that the taxpayer’s basis in a donated property is not necessary to evaluate the taxpayer’s charitable contribution because the deductible amount is the fair market value (FMV) of the property, and the basis is not an input in calculating the fair market value. In rejecting this argument, the court stated:

But RERI fails to recognize that the purpose of the substantiation requirements is not merely to collect the information necessary to compute the value of donated property. The requirements have the broader purposes of assisting the IRS in detecting and deterring inflated valuations. Because the cost or other basis in property typically corresponds with its FMV at the time the taxpayer acquired it, an unusually large difference between the claimed deduction and the basis alerts the IRS to a potential over-valuation, particularly if the acquisition date, which must also be reported, is not much earlier than the date of the donation.

In addition, as the Tax Court recognized, there are circumstances under which the basis affects the amount of the deduction allowed. under which the amount of a deduction must be reduced by “the amount of gain which would not have been

long-term capital gain,” had the property “been sold ... at its fair market value”). It is therefore unsurprising that the [regulations] expressly lists “the cost basis ... of the contributed property” as information to be provided in substantiation of a charitable deduction. Though the Congress left it to the discretion of the Secretary of the Treasury to impose additional reporting requirements, the Congress specifically identified the basis and the date of acquisition as the bare minimum that a taxpayer must provide. We should be very reluctant to set to naught what the Congress deemed essential. (Citations omitted.)

The Court of Appeals noted that the Tax Court found there was in fact a significant disparity between the claimed fair market value of \$33 million for the contributed property and the \$2.95 million RERI paid to acquire it just 17 months before the contribution and, therefore, the Tax Court did not, as RERI claims, merely “hypothesize” that providing its basis would have alerted the IRS to a potential over-valuation.

RERI also contended in the alternative that the omission of a number in a tax filing is typically construed as a zero, and that a zero provides the same red flag as does an unusually low basis. In response, the court stated that the “point would have some force had the Secretary not provided for the donor to substitute an explanatory statement if it is “unable” to provide information on the cost basis. § 1.170A-13(c)(4)(iv)(C)(1). Because a taxpayer may lack information about its basis, the IRS reasonably chose not automatically to treat a blank box as a zero. RERI did not lack information about its basis or have any other excuse for its failure to report its basis.”

Finally, RERI argued the Tax Court’s ruling “conflicts with ... its prior holding in *Dunlap v. Com’r*, 103 T.C.M. (CCH) 1689 (2012).” In *Dunlap*, the court excused the petitioners’ failure to supply their basis on Form 8283 on the ground that supplying the basis was not “necessary to substantially comply with the Instructions.” The Appeals court rejected this argument as well, noting that the decision was a non-binding memorandum opinion and that the Tax Court’s statement in this regard went only to the issue of the imposition of qualification for reasonable cause and good-faith exception to accuracy related penalties, not to whether the taxpayer had satisfied the substantiation requirements, stating:

A memorandum opinion, such as the one in *Dunlap*, does not bind the Tax Court. See, e.g., *Dunaway v. Comm’r*, 124 T.C.

80, 87 (2005). In any event, Dunlap is quite different from the present case. There the Tax Court discussed the completeness of Forms 8283 only in deciding whether the taxpayers had “made a good-faith attempt to report their contributions” so as to qualify for the reasonable cause and good faith exception to accuracy-related penalties. Dunlap, 103 T.C.M. at 1707; see also *Belair Woods, LLC v. Comm’r*, T.C. Memo 2018-159, slip op. at 21 n.8 (Sept. 20, 2018). The court did not consider whether the taxpayers satisfied the substantiation requirements. Nor did the Dunlap court find there was in fact a significant disparity between the basis and the claimed deduction; there indisputably is such a disparity in this case.

## COMMENT:

This case is a reminder of the importance of ensuring that all of the substantiation requirements with respect to charitable contributions are adhered or face the potential consequences of having a claimed charitable income tax deduction denied in full. In this case, the failure of simply not completing one box on Form 8283 to indicate the “Donor's cost or other adjusted basis,” in and of itself, caused the total denial of the claimed deduction.

In 2003, the year in which the contribution was made in *RERI Holdings I, LLC*, the only authority for the disallowance of a charitable contribution deduction for the failure to comply with the substantiation requirements was Reg. § 1.170A-13(c)(1)(i), under which the failure to satisfy the requirements results in a total denial of a deduction for the contribution. Subsequently, IRC § 170(f)(11)(A)(i) was enacted under the American Jobs Creation Act of 2004, effective for contributions made after June 3, 2004, providing statutory authority for the denial of a charitable income tax deduction for failing to meet the substantiation requirements subject, however, to IRC § 170(f)(11)(A)(ii), under which the denial of the deduction does not apply if it is shown that the failure to meet such requirement “is due to reasonable cause and not willful neglect.”

As discussed above, under Reg. § 1.170A-13(c)(4)(iv)(C)(1), “[i]f a taxpayer has reasonable cause for being unable to provide the information ... relating to the manner of acquisition and basis of the contributed property”

in the appraisal summary, the deduction will not be disallowed if the donor attaches “an appropriate explanation” to the appraisal summary. Similarly, the Instructions to Form 8283 for Section B, Part I, provide that “If you have reasonable cause for not providing the information in columns (d), (e), or (f),” which includes the income tax basis information in column (f), **“attach an explanation so your deduction will not automatically be disallowed.”** (Emphasis added.)

Of note in this regard is the case of *Belair Woods LLC et al. v. Com’r*, TC Memo. 2018-159, where an explanation for not including income tax cost basis information on Form 8283 did not salvage the charitable income tax deduction where the explanation merely stated that the income tax basis was essentially irrelevant to the calculation of the charitable income tax deduction.

In this case, the Tax Court, in a memorandum opinion, held that a taxpayer who failed to include cost basis information in a qualified appraisal summary (Form 8283, Section B) could not deduct any portion of the value of a charitable contribution of a conservation easement made in 2009, and that the lack of basis information precluded substantial compliance. In this case, Belair contacted a consulting firm about preparing the Form 8283, “Noncash Charitable Contributions,” specifically with reference to reporting its “cost or adjusted basis.” The consulting firm relayed advice that it had previously received from its law firm that concluded that “[i]t should not be necessary to include the basis information ... if you attach an explanation to Form 8283 providing a reasonable cause for why it is not included.” The law firm further stated that “a reasonable cause for not including basis information should be that the basis of the property is not taken into consideration when computing the amount of the deduction.”

In the relevant boxes on the Form 8283, Belair wrote “see attached” and appended a two-page letter. The letter stated that: (1) the donated property was a conservation easement, (2) the easement covered 141.15 acres of woodlands, (3) the easement had an appraised fair market value of \$4,778,000, and (4) the parcel covered by the easement was acquired on August 1, 2007, by “purchase/exchange.” With respect to “cost or adjusted basis” the letter stated:

A declaration of the taxpayer's basis in the property is not included in ... the attached Form 8283 because of the fact that

the basis of the property is not taken into consideration when computing the amount of the deduction. Furthermore, the taxpayer has a holding period in the property in excess of 12 months and the property further qualifies as “capital gain property.”

The IRS selected Belair's 2009 return for examination and sent the taxpayer an information document request. In December 2012 the IRS issued petitioner a summary report explaining that Belair's claimed deduction would be disallowed because it had not included on its Form 8283 information concerning its “cost or adjusted basis.” About one month later Belair's certified public accountant responded to the summary report and provided cost basis information concerning the easement. The court stated, in sum, that “Belair did not provide cost basis information on its Form 8283, and its attached explanation did not show that it was unable to provide such information. Its appraisal summary therefore did not strictly comply with the regulations.” The court also held that Belair did not substantially comply with the reporting requirements where its failure was the result of a “conscious election not to supply the required information,” as opposed to an “inadvertent omission.”

In connection with the “substantial compliance” issue, the court, citing *Bond*, stated that in appropriate circumstances, the IRS substantiation requirements for charitable contributions “can be satisfied by substantial, rather than by literal, compliance” and that “the doctrine of substantial compliance is designed to avoid hardship in cases where a taxpayer does all that is reasonably possible, but nonetheless fails to comply with the specific requirements of a provision.” Substantial compliance, the court stated, may be shown where the taxpayer “provided most of the information required” or made omissions “solely through inadvertence.”

In assessing whether Belair substantially complied with the regulations in question, the court stated that it should consider whether Belair provided sufficient information to enable the IRS “to evaluate the reported contributions, as intended by Congress.” The court emphasized that the requirement to disclose “cost or adjusted basis,” when that information is reasonably obtainable, is necessary to facilitate the IRS’s efficient identification of overvalued property, stating:

The cost of property typically corresponds to its FMV at the time the taxpayer acquired it. When a taxpayer claims a charitable contribution deduction for recently purchased property, a wide gap between cost basis and claimed value raises a red flag suggesting that the return merits examination. Unless the taxpayer complies with the regulatory requirement that he disclose his cost basis and the date and manner of acquiring the property, the Commissioner will be deprived of an essential tool that Congress intended him to have.

The court further noted in this particular case that the value claimed for the charitable deduction substantially exceeded the basis of the property contributed:

Here, Belair acquired the land in question by contribution from HRH, a related party. HRH had acquired the land in August 2007 for \$2,605 per acre. In December 2009 Belair valued the easement at \$33,707 per acre and the land covered by the easement at \$35,990 per acre (viz., \$5,080,000 ÷ 141.15). This valuation presupposed that the 141.15 acres had increased in value by 1,380% during the previous 2-1/2 years, amid the worst real estate crisis since the Great Depression. This is precisely the sort of information that Congress wished the IRS to have, and Belair's refusal to supply this information contravenes "the essential requirements of the governing statute." (Citations omitted.)

**HOPE THIS HELPS YOU HELP OTHERS MAKE *POSITIVE* DIFFERENCE!**

*Richard L. Fox*

## CITE AS:

**LISI** Charitable Planning Newsletter #286 (July 1, 2019) at <http://www.leimbergservices.com> Copyright 2019 Leimberg Information Services, Inc. (LISI). Reproduction in Any Form or Forwarding to Any Person Prohibited – Without Express Written Permission.

## CITES:

*RERI Holdings I, LLC*, 149 TC 1 (2017), [aff'd, D.C. Court of Appeals, No. 17-1266 \(May 24, 2019\)](#); *Belair Woods LLC et al. v. Com'r*, TC Memo. 2018-159; *Volvo Trucks of N. Am., Inc. v. United States*, 367 F.3d 204, 210 (4th Cir. 2004); *McAlpine v. Com'r*, 968 F.2d 459, 462 (5th Cir. 1992); *Prussner v. United States*, 896 F.2d 218, 224 (7th Cir. 1990); Reg. §§ 1.170A-13(c), § 1.170A-13(c)(1)(i), 1.170A-13(c)(2)(i)(B), 1.170A-13(c)(4)(ii)(E); IRS Form 8283.