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Editor: Paul L. Caron, Dean
Pepperdine University School of Law
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Lesson From The Tax Court: *The Substantial Substantiation Rules In §170*

By Bryan Camp

The great philosopher George Carlin understands the problem of stuff. My wife and I have too much stuff. My wife, however, hates yard sales. And we cannot afford a bigger house. So we give a lot of stuff away.

When Congress ratcheted up the substantiation requirements for deducting non-cash charitable contributions in 1993, we stopped giving to Goodwill. That is because Goodwill did not change their pre-printed receipt form to say the now-required magic language "no goods or services were given in exchange for this donation." While some of our donations were below the $250 threshold, the aggregate value of our donations of similar items regularly exceeded that amount. I remember one year I had to go up several layers of management to even get a letter with that language sent to me before I could file my taxes. So we now favor other charities.

I was not just being picky in wanting a proper contemporaneous receipt, as the recent case of *Estelle C. Grainger v. Commissioner*, T.C. Memo. 2018-117 (July 30, 2018) demonstrates. The taxpayer there was massively confused about the basic valuation rules for donations of property. That's one lesson here. But I think another important lesson in this case is just how difficult the substantiation rules in §170 can be for substantial amounts of non-cash charitable contributions. It was certainly an eye-opener for me, particularly the lesson about Form 8283.

Ms. Grainger apparently thought she had found a sure-fire tax shelter: buy clothes at heavily discounted prices, then donate them to charity and claim a charitable deduction for the amount on their original undiscounted price tag. Her basic method was to buy hundreds of items off the clearance rack at Talbot's, thus accruing loyalty reward points. She would then use those points to pay even less on discounted items she bought later. She then gave all the stuff away, valuing it at the original, undiscounted, retail price.

Using this method, Ms. Grainger took charitable contribution deductions of over $18,000 in 2010, of over $32,000 in 2011, of over $34,000 in 2012, of over $40,000 in 2013 and of just under $49,000 in 2014. All of this for clothes, mostly from Talbot's.

The IRS selected her 2012 return for examination. She had reported a donation of $34,401 and had supported that with six Forms 8283 on which she listed the donations as having been made to Goodwill and stating that she was valuing them at their fair market value. The IRS determined that Ms. Grainger spent $2,520 of her own money to buy the clothes she donated that year. In addition, she used $3,257 worth of loyalty points.

When attempting to argue her case before Judge Lauber, Ms. Grainger ran into two problems with her claimed deductions: a valuation problem and a substantiation problem. Each teaches a lesson.

1. Valuation Lesson

Section 170(e) provides that to value all donations of personal property, taxpayers always start with the fair market (fmv) of the property donated. Actually, that rule is only implied in the statute, but the regulations make it explicit. See Treas. Reg. 170A-1(c)(1). The regulations also tell us that the fmv is what a willing buyer would pay a willing seller, neither under a compulsion to buy or sell and both having knowledge of the relevant facts. Treas. Reg. 170A-1(c)(2). In practice, many folks use their local thrift stores to value donations. Others use online resources like the Salvation Army's valuation guide. Others use valuation software provided by Turbo Tax ("It's Deductible") or H&R Block ("Deduction Pro") for those who buy those tax preparation programs. For non-standard items I personally do a "sold items" search on eBay and grab a handful of recent sales data.

If the fmv is *greater* than the taxpayer's basis in the property, §170(e) requires, in certain circumstances, that the taxpayer must reduce the value of the contribution to the taxpayer's basis amount. When the fmv is *less* than basis, however, there is no corresponding rule that allows taxpayers to increase the value of the contribution. Taxpayers must use fair market value.

The most important circumstance requiring taxpayers reduce the value of their contribution to their basis is when the donated personal property is made to a public charity that plans to sell the property to raise money rather than use the property as part of its charitable function or purpose. §170(e)(1)(B)(i)(I). Thus, taxpayers should rarely be donating appreciated property to Goodwill or similar organizations that simply re-sell donated items to raise money.

In Ms. Grainger's case, she misapplied those basic valuation rules. She decided to claim that her donated items had an fmv far, far above her basis. For example, if she paid $10 for for an item (using $8 cash and $2 in loyalty points) and the item had been originally tagged at $100, she valued the item at $100. Both the IRS and Judge Lauber apparently believed that her purchase set the fair market value. Perhaps they believe so because of her immediate donation of such items to Goodwill, or else perhaps it was too difficult to determine the fmv otherwise for the volume of items that she donated. I am not sure. The original Revenue Agent, however, determined that her basis was only the cash she paid and not the value of any loyalty points she used and so the RA reduced her contribution amounts to just the amount of cash she paid. In my example, the amount of the donation would thus be $8. The IRS Office of Appeals, however, decided to include the loyalty points in her basis. In my example, the valuation would now be $10.

The eventual NOD, however, added together the cash she paid and the value of the loyalty points she used. So in my example the NOD would give her a $10 basis in the item. Using that method, the IRS NOD determined that Ms. Grainger's aggregate basis in her 2012 donations was $6,117 and not the over $34,000 that she claimed. But Ms. Grainger had a more substantial problem with her deduction. She did not meet the substantiation rules.

Lesson 2: Substantiation

Judge Lauber does a very nice job in explaining the substantiation rules. The two substantiation rules that I think are the take-away lessons here are (1) the aggregation rule and (2) the Form 8283 rules. In general, the substantiation rules get stricter and stricter as the value of a taxpayer's donations increases.

For all donations of either money or personal property, taxpayers have to maintain adequate records to show the date, location and valuation of all such donations. For each donation of either money or personal property that exceeds $250, the taxpayer must also obtain a contemporaneous written acknowledgement that meets several requirements. §170(f)(8). For donations that aggregate more than $500, the statute requires taxpayers to provide additional information "as the Secretary may require." §170(f)(11)(B). The regulations tell taxpayer that to include such information "if required by the return form or its instructions." Treas.Reg. 1.170A-13(b)(3)(i). That's the Form 8283 and its instructions. For donations that aggregate more than $5,000, the taxpayer must also provide a qualified appraisal that supports the value claimed for the donated property. §170(f)(11)(C).

Remember, folks, the statute applies these substantiation requirements not only to individual and discrete donations of personalty but to *aggregate* donations of "similar items of property" to "1 or more" charity. §170(f)(11)(F). Treas. Reg. 1.170A-13(c)(7)(iii) tells you that "similar items of property" mean property of the same generic category or type and lists a bunch of categories. One of the categories is just this word: "clothes."

That means that even taking the IRS valuation of Ms. Grainger's clothing donations, Ms. Grainger was over the $5,000 threshold for needing an appraisal. She did not have one and thus §170(f)(11)(A) kicked in and denied her any deduction.

Even if the value of Ms. Grainger's donations had aggregated to less than $5,000, but still more than $500, she needed to submit a properly filled out Form 8283. Judge Lauber said she did not because her Forms "were not executed by an official of the donee organization, as Form 8283 explicitly requires." Whatever other problems Ms. Grainger had, I don't think this was one of them and since this part of the opinion was not necessary for the decision, I would treat it as dicta.

I am doubtful this signature requirement is either a requirement of law or even of IRS practice. It seems more like a trap for taxpayers, a "gotcha." As usual when I get into an area I did not actually practice in, I invite folks to tell me if they think my analysis is off and, if so, why.

The Form 8283 is one of the less successful IRS Forms. It's very confusing mostly because it tries to do too much work. It permits taxpayers to report up to six discrete donations of personalty. The instructions then say that taxpayers must obtain the signature on the Form of a qualified representative of each charity to which items were donated. But the Form has only one place for such a signature.

So, for example, if you donate three boxes of clothing to three different charities at three different times of the year, and you value each box at $200, you have exceeded the $500 threshold and must submit at Form 8283. Actually, you will apparently need to submit three Forms if you take the signature requirement seriously because each charity must sign the form (or else you must have a good reason why you did not get the signatures).

I don't see that this signature requirement is a legal one. I cannot find it in either the statutes or the regulations. I only find it in the instructions. And while the regulations say that taxpayer "shall state such information in his or her income tax return if required by the return form or its instructions" the term "such information" just means the information required by the regulation and I do not see any signature requirement in the regulation.

Nor do I see the IRS enforcing this signature requirement in returns processing. In my experience the IRS accepts the electronic filing of returns that attach Forms 8283 when filled out by Turbo Tax or H&R Block. But those forms do not have the required signatures. If the IRS truly required those signatures, one would expect that it would not accept an electronic filing. And if one actually obtains the required signatures, one can no longer file electronically! So it seems that the IRS's electronic filing requirements in the Form 8382 instructions actually contradict its practice which is to not require the signatures.

Further, that signature requirement seems a needless duplication of the contemporaneous writing requirement and simply a trap for unwary taxpayers. The contemporaneous writing requirement requires the charity to give the donor a written acknowledgement of the donation that states: the name of the donee; the date of the donation; a general description of the items donated; whether the donee gave anything in return and, if so, the value of that given. §170(f)(8)(B). Now, go look at the signature section in Form 8283. You will see that the only statutory or regulatory requirement it satisfies as to a donor's ability to take a §170 deduction duplicates the content of a proper contemporaneous written acknowledgement. Here's the language:

"This charitable organization acknowledges that it is a qualified organization under section 170(c) and that it received the donated property as described in Section B, Part I, above on the following date_______. Furthermore, this organization affirms that in the event it sells, exchanges, or otherwise disposes of the property described in Section B, Part I (or any portion thereof) within 3 years after the date of receipt, it will file Form 8282, Donee Information Return, with the IRS and give the donor a copy of that form. This acknowledgment does not represent agreement with the claimed fair market value."

The only additional language I see there has to do with the §170(e)(a)(B)(i) reduce-to-basis rules that (usually) have nothing to do with donations of used items. Again, while the signature requirement might make sense for donations of valuable items that have appreciated in value, the requirement to file Form 8283 is not limited to those situations.

Frankly, the signature requirement just makes no sense when combined with the aggregation rules. Think again of my example of a taxpayer donating three boxes of clothing to three different organizations, each valued at $200. If you take the language in the form seriously, the charity is promising to track each $200 box! I see no purpose of making each of the three donee organization track a box of used clothing in order for the taxpayer to file Form 8282. If anyone can come up with a reason, I'm all eyes.

Yet that seems to be Judge Lauber's understanding of the law. And maybe it is yours, dear reader. But mine is different.

None of that matters to Ms. Grainger, of course. Even if I am correct, it's only one less reason that she loses. Her valuation problem and other substantiation problems were more than enough to sustain the deficiency. In addition, as I explained above, by assuming that the fmv of the donations actually equaled her basis, and by including her loyalty points in her basis, the IRS was actually pretty darned generous to Ms. Grainger.

Coda: After the IRS selected her 2012 return for audit, Ms. Grainger apparently got some decent tax advice and filed for bankruptcy on October 21, 2015, receiving a Chapter 7 discharge on that day. The date of the bankruptcy petition may not be entirely random. Remember she had pulled this stunt in 2010 and 2011 as well. Assuming she filed those returns timely, or at least filed the 2011 return by October 15, 2012, her bankruptcy petition date would be more than three years from the due date of her returns. That means she could discharge any unpaid tax liabilities for those years. See 11 U.S.C. §727, 523(a)(1)(A). And if the IRS did not select the 2013 or 2014 tax years for audit within the time permitted by §6501, then she's home free for those years as well. While the bankruptcy proceedings would toll the §6502 10-year collection limitation period because of the automatic stay's prohibition on collection action, §6503(h), it would not toll the §6501 3-year assessment limitation period because the automatic stay does not prevent the IRS from opening an examination or making an assessment, thus not triggering §6503(h). See 11 U.S.C. §362(b)(9).

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