Charitable Deductions Under Internal Revenue Code Section 170

SUMMARY

Subject to certain limitations, taxpayers can take a deduction from their adjusted gross income for contributions of cash or other property to charitable organizations.¹ Taxpayers must contribute to certain qualifying organizations,² and are required to substantiate contributions of $250 or more.³ Litigation generally arises over one of four issues:

- Whether the organization receiving the contribution is charitable in nature;
- Whether the property contributed qualifies as a charitable contribution;
- Whether the amount deducted equals the fair market value of the property contributed; and
- The extent to which the taxpayer has substantiated the contribution.

We reviewed 27 cases from June 1, 2010, through May 31, 2011, with charitable deductions as a contested issue. The IRS prevailed in 22 cases (81 percent) and there were five split decisions (i.e., the court ruled partially in favor of the taxpayer and partially in favor of the government). Taxpayers appeared pro se in 13 of the 27 cases (48 percent).

PRESENT LAW

Taxpayers can generally take a deduction for charitable contributions made within the taxable year.⁴ For individuals, these deductions are generally limited to 50 percent of the taxpayer’s contribution base (adjusted gross income computed without regard to any net operating loss carryback to the taxable year under IRC § 172).⁵ However, subject to certain limitations, individual taxpayers can carry forward unused charitable contributions in excess of the 50 percent base for up to five years.⁶ Corporate charitable deductions are generally limited to ten percent of the taxpayer’s taxable income.⁷ Taxpayers cannot deduct services that they offer to charitable organizations; however, incidental expenditures

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¹ Internal Revenue Code (IRC) § 170.
² To claim a charitable contributions deduction, a taxpayer must establish that a gift was made to a qualified entity organized and operated exclusively for an exempt purpose, no part of the net earnings of which inures to the benefit of any private shareholder or individual. IRC § 170(c)(2).
³ IRC § 170(f)(8).
⁴ IRC § 170(a)(1).
⁵ IRC §§ 170(b)(1)(A), (G). While the 50 percent contribution base limitation applies to most charitable organizations, deductions are limited to 30 percent of the taxpayer's contribution base for gifts to certain specific types of organizations, including veterans' organizations, fraternal societies, nonprofit cemeteries, and certain private non-operating foundations. IRC § 170(b)(1)(B). Moreover, the allowable deduction is reduced if the charitable gift is a capital gain property for which the deduction is calculated using fair market value without a reduction for appreciation; in this case, the allowable deduction is reduced to 30 percent for 50-percent organizations and to 20 percent for 30-percent organizations, respectively. IRC §§ 170(b)(1)(C), (D).
⁶ IRC § 170(d)(1).
⁷ IRC § 170(b)(2).
incurred while serving a charitable organization and not reimbursed may constitute a deductible contribution.\(^8\)

**Substantiation**

Deductions for charitable contributions of $250 or more are disallowed in the absence of a contemporaneous written receipt from the recipient.\(^9\) For cash contributions, taxpayers must maintain receipts from the charitable organization, copies of cancelled checks, or other reliable records showing the name of the organization, the date, and the amount contributed.\(^10\) For each contribution of property other than money, taxpayers generally must maintain a receipt showing the name of the recipient, the date and location of the contribution, and a description of the property.\(^11\) When property other than money is contributed, the amount of the allowable deduction is the fair market value of the property at the time of the contribution.\(^12\)

**Cohan Doctrine**

In cases where taxpayers have provided credible evidence they made a charitable contribution but have difficulty substantiating the precise amount, a judicial doctrine has evolved that allows courts to determine, based on the best evidence at hand, the amount of the contribution.\(^13\) The Cohan doctrine does not relieve the taxpayer of the responsibility of substantiating his or her charitable contribution, although it can assist taxpayers who can demonstrate that contributions were made, but have not kept records of the amounts.\(^14\)

**ANALYSIS OF LITIGATED CASES**

We reviewed 27 opinions entered between June 1, 2010, and May 31, 2011, involving the allowance of a charitable contribution deduction. Table 10 in Appendix III contains a detailed list of those cases. Of the 27 cases, one involved the issue of whether the recipient was a

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\(^8\) Treas. Reg. § 1.170A-1(g). Meal expenditures in conjunction with offering services to qualifying organizations are not deductible unless the expenditures are away from the taxpayer’s home. Id. Likewise, travel expenses associated with contribution are not deductible if there is a significant element of personal pleasure involved with the travel. IRC § 170(j).

\(^9\) IRC § 170(f)(8); see also Treas. Reg. § 1.170A-13(f).

\(^10\) Treas. Reg. § 1.170A-13(a)(1).


\(^12\) Treas. Reg. § 1.170A-1(c)(1). Note that the fair market value must be reduced for certain contributions of ordinary income and capital gain property. See IRC § 170(e).

\(^13\) Cohan v. Comm’r, 39 F.2d 540, 543-44 (2d Cir. 1930). In Cohan, a theatrical production manager claimed unsubstantiated deductions for the entertainment of actors, employees, and critics. He did not maintain records of these expenses, but knew they were substantial sums. The Second Circuit determined that the Board of Tax Appeals was authorized to estimate unsubstantiated taxpayer expenses when it is certain that expenses were incurred, but the amount could not be quantified. Id. at 543.

\(^14\) As a general rule, if the trial record provides sufficient evidence that the taxpayer has incurred a deductible expense, but the taxpayer is unable to substantiate adequately the precise amount of the deduction to which he or she is otherwise entitled, the Court may estimate the amount of the deductible expense and allow the deduction to that extent. In these instances, the Court is permitted to make as close an approximation of the allowable expense as it can, bearing heavily against the taxpayer whose inexactitude is of his or her own making. See Cohan v. Comm’r, 39 F.2d 540, 543-44. However, in order for the Court to estimate the amount of an expense, the Court must have some basis upon which an estimate may be made. See Vanicek v. Comm’r, 85 T.C. 731, 743 (1985).
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Most Serious Problems

Legislative Recommendations

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qualified charitable organization, fifteen cases involved a dispute over the valuation of the property, sixteen cases involved the issue of whether the property contributed qualified as a deductible contribution, and sixteen involved the taxpayers' substantiation (or lack thereof) of the claimed contributions. None of the taxpayers were entitled to a charitable contribution deduction in full. However, the court partially allowed the deduction in five cases.

Qualifying Charitable Organization

To be deductible, a contribution must be made to a qualifying organization. In one case, the taxpayers' deductions were rejected for failing to meet this threshold test. The Tax Court held that the taxpayers failed to prove the organization to which they made donations was an entity eligible to receive charitable contributions under IRC § 170.

Qualified Contribution

To constitute a qualified contribution for purposes of IRC § 170, the donor-taxpayer must possess a transferable property interest in the property and intend to irrevocably relinquish all rights, title, and interest to the property without an expectation of some benefit in return. In two of the cases we reviewed, the courts disallowed the deduction because the taxpayers received a substantial benefit from the charitable donation. In Viralam v. Commissioner, the taxpayer-husband sold his medical practice and reported a gain from the sale. He then transferred the proceeds of sale to a foundation. Several years later, the foundation lent the taxpayers' son funds to pay for college. The taxpayers presented no evidence that the foundation exercised any judgment in selecting their son for a student loan. The Tax Court disallowed the charitable deductions to the foundation because the taxpayers maintained dominion and control over the contributions and received a substantial benefit. In another case, the court denied the taxpayers' charitable contribution deduction because the value of the services the taxpayers received exceeded the value of the property donated. In that case, the taxpayers donated their lake house, but no real property, to the fire department so that the fire department could use the house for firefighter training and eventual demolition. The Tax Court held that the taxpayers were not entitled

18 One case contained more than one of these issues. See Viralam v. Comm'r, 136 T.C. No. 8 (2011).
19 Qualifying charitable organizations include: (1) federal, state or local governments, and (2) corporations, trusts or funds organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals, no part of the net earnings of which inure to the benefit of a private individual or shareholder. See IRC § 170(c) for a full description of qualifying organizations.
21 IRC § 170(f)(3) requires that taxpayers relinquish all rights, title and interest in property contributed.
23 Id.
to a charitable contribution deduction because the value of the demolition far exceeded the value of the property donated. 24

Valuation

Five cases involved disputes between the IRS and taxpayers over the value of property contributed. When taxpayers contribute non-cash items, they must determine the fair market value of the property as of the date of the contribution. 25 Fair market value is the price at which the property would change hands between a willing buyer and a willing seller. 26 Determining the fair market value of non-cash property with precision can be difficult for taxpayers, especially when easements are being donated.

Of the five cases involving disputes over the value of property contributed, four involved the valuation of easements. 27 In Evans v. Commissioner, 28 the taxpayers claimed a charitable contribution deduction for a donation of façade easements to a qualified conservation organization. The taxpayers failed to provide credible evidence of the fair market value of the easements; thus, the court found the taxpayers were not entitled to deduct them as charitable contributions. Taxpayers may provide expert reports or testimony as evidence of valuation. However, to be admissible in court, expert testimony must be based on sufficient facts or data. Further, the testimony must be based on reliable principles and methods, which must be applied to the facts of the case. 29

In Boltar v. Commissioner, the taxpayer claimed a $3.2 million charitable deduction for an easement donation. 30 Prior to trial, the taxpayer submitted an expert report from an appraisal firm stating that the property’s highest and best use was as a condominium development. 31 The report was found to be inadmissible because, among other things, it failed to determine the highest and best use of the property after the easement was granted. The Commissioner’s valuation engineers concluded that the highest and best use of the property was for the development of single-family detached residential homes.

Substantiation

Sixteen cases involved the substantiation of deductions for charitable contributions. The IRS prevailed in full in 15 cases and one ended in a split decision.

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26 Treas. Reg. § 1.170A-1(c)(2).
28 T.C. Memo. 2010-207.
29 Fed. R. Evid. 702. An expert report that is not based on sufficient facts or data and does not state the facts or data and detailed reasons for the conclusion, as required by U.S. Tax Ct. R. 143(g), is not admissible as expert testimony or as an expert report in a matter before the U.S. Tax Court.
31 The concept of “highest and best use” is an element in the determination of fair market value.
In *Lang v. Commissioner*, the taxpayer (a freelance “voice-over” artist) claimed a charitable deduction for local transportation expenses for a play for which he volunteered services. These deductions were disallowed since the taxpayer offered no other evidence, other than his testimony, to prove how he calculated the claimed amount.

When determining whether or not a claimed charitable deduction is adequately substantiated, courts tend to follow a strict interpretation of IRC § 170. For example, in *Hendrix v. United States*, the taxpayers (husband and wife) reported a charitable deduction for their donated house to the city for fire training. The court denied the deduction because the taxpayers failed to provide a valid appraisal under IRC § 170(f)(11)(E)(ii)(I), and also because they did not provide a contemporaneous acknowledgment that met the requirements of IRC § 170(f)(8). Further, in *Schrimsher v. Commissioner*, the taxpayers granted a facade easement to the Alabama Historical Commission and claimed the property as a charitable contribution. The court denied the deduction because, although the taxpayers produced a written contemporaneous acknowledgement, it did not state whether the taxpayers received any goods or services from the historical commission in consideration of the contribution as required under IRC § 170(f)(8)(B)(i).

**Pro Se Analysis**

In 13 of the 27 cases we reviewed, taxpayers were *pro se*. None of the taxpayers who appeared *pro se* were entitled to a charitable deduction in full, but one of the five taxpayers who received partial relief was *pro se*. With respect to relief, there does not appear to be a correlation between represented taxpayers and those who were *pro se*, since, like *pro se* taxpayers, no represented taxpayers were found to be entitled to a charitable deduction in full.

**CONCLUSION**

IRC § 170 and the applicable Treasury Regulations provide detailed requirements as to what constitutes adequate substantiation for a charitable deduction. Cases such as *Hendrix v. United States*35 and *Schrimsher v. Commissioner*36 demonstrate that courts strictly interpret IRC § 170 and its accompanying regulations.

32 T.C. Memo 2010-152.
34 T.C. Memo 2011-71.
35 T.C. Memo 2010-152.
36 T.C. Memo 2011-71.