# Tax Court Opinion-Charitable Deduction Case Involving Estate Planning Fraudster

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## Overview

The rules surrounding charitable giving can be rather complicated when the gift is not of cash and is of a significant amount. Those detailed rules were at issue in a recent U.S. Tax Court case. What made the case even more interesting was that it also involved taxpayers that got themselves connected with an estate planning and charitable giving fraudster that the U.S. Department of Justice eventually shut down. This is the second significant Tax Court decision in the past six months involving charitable giving. The Furrer farm family of Indiana was involved with a charitable remainder trust scenario that was structured completely wrong (see my blog article here: https://lawprofessors.typepad.com/agriculturallaw/2022/12/how-not-to-use-a-charitable-remainder-trust.html) and now another case.

The rules on charitable giving and a recent case involving a charitable giving scam. It's the topic of today's blog article.

## Background

The Tax Code allows a deduction for any charitable contribution made during the tax year. *I.R.C. §170(a)(1).* The amount must be "actually paid during the tax year" and the taxpayer bears the burden to prove the surrender of dominion and control over the property that was contributed to a qualified charity. *See, e.g., Pollard v. Comr., 786 F.2d 1063 (11th Cir. 1986); Goldstein v. Comr., 89 T.C. 535 (1987); Fakiris v. Comr., T.C. Memo. 2020-157.*

For charitable contributions consisting of anything other than money, the amount of the contribution is generally the fair market value of the property at the time of the contribution. *Treas. Reg. §1.170A-1(c)(1).* For non-cash contributions exceeding $5,000 (at one time), the taxpayer must obtain a "qualified appraisal" of the property. *I.R.C. §170(f)(11)(C).* This includes attaching to the return a fully completed appraisal summary on Form 8283. *Id.; Treas. Reg. §1.170A-13(c)(2).* When a non-cash contribution exceeds $500,000, a copy of the appraisal must be attached to the return. *I.R.C. §170(f)(11)(D).* If the donor is an S corporation or a partnership, the qualified appraisal requirement is the obligation of the entity and not the members or shareholders. *Id.*

A "qualified appraisal" is one that is conducted by a "qualified appraiser" using generally accepted appraisal standards and otherwise satisfies the applicable regulations. A qualified appraisal is "qualified" only if it is "prepared, signed, and dated by a qualified appraiser." *Treas. Reg. §1.170A-*

*13(c)(3)(i)(B).* There are 11 categories of information that the appraisal must include. Id. subdiv. (ii). One of those is that "[N]o part of the fee arrangement for a qualified appraisal can be based, in effect, on a percentage (or set of percentages) of the appraised value of the property." *Treas. Reg. §1.170A-13(c)(6)(i). See also Alli v. Comr., T.C. Memo. 2014-15.*

There is a reasonable cause exception for failing to satisfy the substantiation requirements. *I.R.C. §170(f)(11)(A)(ii)(II).* To use the reasonable cause exception, the taxpayer must show that willful neglect is not present based on the facts and circumstances. If the exception applies, the charitable deduction may be allowed. *See, e.g., Belair Woods, LLC v. Comr., T.C. Memo. 2018-159.*

**Recent Case**

In *Lim v. Comr., T.C. Memo. 2023-11,* during 2016 and 2017, the petitioners (a married couple) were the sole shareholders of an S corporation. In late 2016, after making a presentation to the petitioners concerning "The Ultimate Tax, Estate and Charitable Plan," an attorney formed a "Charitable Limited Liability Company" for the petitioners to use as a vehicle for making charitable donations. The attorney agreed to transfer assets to the LLC, to transfer LLC unites to a charity and to provide the supporting valuation documentation for the donation. He also agreed to represent them before the IRS and the Tax Court if the return(s) were later examined. His fee would be the greater of $25,000 or 6 percent of the "deductible amount" of assets capped at $1 million, plus 4 percent of the "deductible amount" of assets exceeding $1 million. The assets transferred to the LLC were five promissory notes with a face amount of $2,008,500. This generated a fee for the attorney of $84,000 based on a presupposed "deductible amount" of $1,600,000 even though the assets were not appraised until late January of 2017 which valued them at $1,600,000. The fee was to be paid in installments over six months beginning in January of 2017.

The attorney also created a second LLC in late December of 2016 with the petitioners as the managers, the attorney as the registered agent, and the petitioners' S corporation as the single member. Petitioners promised to pay the second LLC $2,008,500 (the promissory notes) in seven years.

The charitable recipient was a Foundation (an I.R.C. §501(c)(3) organization) for which the attorney was the registered agent. The petitioners claimed that their S corporation donated "units" of the second LLC to the Foundation and claimed a charitable deduction. The IRS denied the deduction, partly on the basis of a lack of evidence that any property was actually transferred to the Foundation. The petitioners did not offer any explanation as to when or how the "units" were created or what physical form they took. The petitioners also claimed that they received an acknowledgement letter of the donation from the Foundation dated January 1, 2017. The letter referred to 1,000 units of an LLC which did not exist during 2016 or as of January 1, 2017. It was not addressed to the S corporation, but to the petitioner (wife) at their residence in a different city than the S corporation. The letter also was not signed by any person and appeared to be a form letter with taxpayer-specific information in bold font. It also did not refer to any property that the S corporation allegedly donated on December 31, 2016.

On January 4, 2017, the attorney submitted an appraisal, but it lacked substance. The appraisal asserted that LLC interests were donated to the Foundation in 2016, but did not denote how many interests had been contributed. The claimed charitable deduction was $1,608,808. The attorney also attached his curriculum vitae stating that he was a CPA, a certified valuation analyst and a licensed attorney in Kentucky. Also attached to the appraisal was a one-page "certification" on which the attorney stated that his fee was not contingent on the report in any manner and that he didn't have any interest or bias with respect to the parties involved. This was despite him having arranged the entire transaction and being the registered agent for the second LLC.

The S corporation filed Form 1120S for 2016 and attached a copy of the appraisal and Form 8283 which described the donated property as "LLC units" with a basis of $2,008,500 that had been acquired by purchase, and an "appraised market value" of $1,608,808. The petitioners reported a non-cash charitable deduction of $1,608,808 on Schedule A that flowed through to them from the S corporation. Because the amount of the deduction exceeded the maximum allowable deduction for 2016, they claimed a $1,195,073 deduction for 2016 and carried the balance of $415,711 to their 2017 return.

The IRS audited the petitioners' 2016 and 2017 returns and disallowed the charitable deductions for lack of substantiation. The petitioners challenged the disallowance in the Tax Court and the IRS moved for partial Summary Judgment. The Tax Court determined that the appraisal was not a "qualified appraisal" within the meaning of I.R.C. §170(f)(11)(C). Treas. Reg. §1.170A-13(c)(6)(i) requires, among other things, that "no part of the fee arrangement for a qualified appraisal can be based, in effect, on a percentage (or set of percentages) of the appraised value of the property." Accordingly, the attorney's fee was a prohibited appraisal fee within the meaning of the regulation. However, the Tax Court held that the petitioners had shown reasonable cause for failure to comply with the substantiation requirements of I.R.C. §170. They had presented sufficient proof that they relied upon professionals in claiming the charitable contribution deduction. Accordingly, the Tax Court denied the IRS summary judgment on this issue. The Tax Court also denied summary judgment to the IRS on the issue of whether the written acknowledgement was a "contemporaneous written acknowledgement" of the contribution in accordance with I.R.C. §170(f)(8)(A). Accordingly, the Tax Court granted the Summary Judgment motion of the IRS in part, while the remaining issues will be set for trial.

**Note:** In 2018 the Department of Justice filed a complaint against the attorney, alleging that he promoted the "Ultimate Tax Plan" as a tax evasion scheme. He was accused of running a $35 million federal tax advice scam offering fake deductions using three bogus charities for 19 years. The complaint alleged that he was at the helm of "a national charitable-giving tax scheme" that targeted "wealthy individuals in high tax brackets facing large tax liabilities." He settled with the Government and agreed to a permanent injunction. On April 26, 2019, the U.S. District Court for the Southern District of Florida entered a final judgment of permanent injunction against him, holding that he had engaged in conduct penalizable under I.R.C. §6700 by promoting the "Ultimate Tax Plan." The court permanently enjoined him from, among other things, promoting "the Ultimate Tax Plan or any plan or arrangement that is substantially similar." The court ordered the attorney to perform other actions as well in relation to the plan.

## Conclusion

When non-cash gifts are made to charity particular rules must be followed for a charitable deduction to be claimed. Unfortunately, there are those engaged in unscrupulous techniques that prospective donors must be on the alert for.