



Charitable Regulations Meet the Cases  
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Sometimes taxpayers, when told about rules like the ones we discussed a couple of weeks back on charitable contributions, shoot back that the IRS would never really force them to produce such records. However, two taxpayers found out that, in fact, the IRS will question such items.

## The Charity Cases

Two recent cases show that the Tax Court does take Regulation §1.170A-13 seriously. While we knew that for large contributions the Tax Court was willing to penalize the taxpayer for failing to follow the rules from the *Hewitt* case<sup>1</sup>, but in two recent cases taxpayers were denied deductions for smaller amounts because they also failed to follow the requirements of Regulation §1.170A-13. In *Hewitt* the problem was a failure to obtain an appraisal for shares of stock that were donated, despite the fact that the taxpayer did have what appeared to be a reasonable alternative method of valuing the stock.

In the first case, a former IRS agent is called on the carpet for her charitable contributions

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<sup>1</sup> 109 TC 258

in *Kendrix v. Commissioner* (TC Memo 2006-9), officially based in many cases on inadequacies of the receipts that she had (though clearly the court was skeptical in general about her claims).

In the second case, the Tax Court went after the old “I put money in the plate at church each week” deduction, as well as inadequately documented noncash contributions in the case of *Haas v. Commissioner* (TC Summary 2006-9).

## **Kendrix Case**

The first case involved taxpayer who worked with the IRS for 30 years, both in the criminal investigation division and as a revenue officer for the final 12 years of her career there. No doubt her IRS background caused both the IRS and the courts to hold her to a higher standard, though other facts in her case made her less than the most sympathetic plaintiff in the eyes of the court.

The taxpayer had claimed substantial charitable contributions on her 2000 and 2001 income tax returns. On the original 2000 return she had listed \$12,000 worth of charitable contributions on her return as “gifts by cash or check” but during the examination she corrected that to state the \$12,000 was for noncash contributions she made that year.

The taxpayer had receipts from various organizations that purported to support these contributions, as well as a list of specific items donated and her values that added up to the amounts claimed.

She also claimed a cash contribution for \$6,655 for contributions to a church for which she had a receipt, though it was not listed on Schedule A on the original return.

For the 2001 return, the taxpayer again submitted amended returns to modify her original filings. She changed the source of her charitable noncash contributions and added a couple of receipts from what appears to be churches, one of which had language indicating that no goods or services had been provided, while the other did not.

The court noted that in 1998 she had filed a bankruptcy petition that showed total assets of \$4,100, liabilities of over \$118,000 and reported no monthly expenditures for charitable contributions. However, her 1998 and 1998 individual income tax returns had reported cash charitable contributions of \$15,000. The court also noted that she had been employed by the IRS for 30 years, both in the criminal investigations division and as a revenue officer. It likely did not bode well for the taxpayer that the court decided to recite these facts just before going into the opinion.

At the beginning of the opinion, the court cites the provision that were discussed recently in a prior podcast on the requirements for documentation for a contribution in excess of \$250 found at §170(f)(8)(A), including the necessity of having the charity indicate that no benefit was received. The court then goes on to cite the regulations for contributions

below that level, including the requirements imposed there for the taxpayer to have a canceled check, a receipt or other written records. Similarly, the court recites the requirements for noncash contributions, including those of less than \$500.

The court then goes on to apply these detailed requirements to the taxpayer's facts, and the results are not good for the taxpayer. The court first lectures the taxpayer about her attempt to get a receipt for a \$732 contribution to the West Angeles Church of God considered only as an attachment to a brief, though it was not shared with the IRS before trial nor brought up during the trial, pointing out that the court had noted during trial that she had to bring forth all facts on the record.

But after indicating the document could not be considered, the court continues to point out that the document is inadequate anyway because it does not explicitly state whether the organization provided any goods or services in exchange for the contribution—thus it would fail to be adequate to support a greater than \$250 contribution. Since the receipt only gave a total, the court indicated that it doesn't support a finding that any particular contribution was less than \$250, and thus the stricter standard would apply

The court next went on to consider a receipt from the Gospel Temple Baptist Church and notes that this receipt also failed to indicate if goods or services were provided. Thus, all individual contributions shown as in excess of \$250 were disallowed and only a single individual contribution that was less than \$250 was allowed. In the end, the court found that only \$125 of her contributions for 2000 were allowed—and the entire disallowance was based on documentation rules.

For the 2001 return, the taxpayer's documentation was again examined. She again had a receipt from the West Angeles Church, but this time it appears it did indicate that she did not receive any goods or services in exchange for her contribution—so she was allowed her \$713 contribution deduction for this charity.

Again there was a Gospel Temple Baptist Church receipt, and it suffered from the same flaw as the 2000 receipt and got the same treatment from the court.

The court considered both years noncash contributions with a similar analysis. The court again lectured the taxpayer about attempting to get an item of evidence (in this case, a list of purported average values of household items donated).

The court then considers the IRS's view that her claims that she made these contributions lack credibility, and used the taxpayer's bankruptcy filing to indicate that it seemed unlikely that she had the goods to make the contribution (or, I suppose, that if had significant assets she had already lied under penalty of perjury once, which would arguably be just as damaging to her credibility).

The taxpayer's attempts at explaining how she obtained the goods didn't seem to go far with the court, but they certainly were unique. She indicated that she obtained most of the goods from the son of a deceased girlfriend who needed \$3,000 to buy drugs or had

purchased or picked the goods up off the street and refurbished them. As well, she pointed to a distribution from her thrift plan, but also testified that she needed and used the funds for living expenses. Needless to say, the court didn't find it credible that, given her shaky financial position per the bankruptcy petition, she would be spending these funds to acquire property to be given away.

However, the court did allow the receipts from the Salvation Army and Goodwill were authentic and that she did contribute the items listed (though the value would be questionable based on her lack of evidence of acquisition costs). Nevertheless, the court then goes on to point out that these receipts did not indicate that no goods or services were provided in exchange for these donations, and based on that disallowed the deductions as each of the claimed donations were greater than \$250. Only one of her receipts for noncash contributions had the "no goods or services" language that allowed to court to continue on the question of the value.

The court found the taxpayer's support for the values inadequate. The court did not accept the estimate of a \$5,000 value found on the charity's receipt, believing that estimate came from the taxpayer and not the charity based on the taxpayer's own worksheets that appeared with her amended return. The fact that it was filed only as part of the amended return, which caused the court to believe it was created after the fact and lacked credibility. As well, the taxpayer provided no evidence of the acquisition cost and her method of valuation seemed to only be that she would claim less than the alleged acquisition price.

The court did then consider whether the *Cohan* rule could be applied in this case. The court notes that if the problems in documentation arose from the taxpayer's own actions, the *Cohan* rule requires that be considered in determining what relief, if any, should be granted. The court raises a potential issue with §170(a)(1)'s requirement that a deduction shall be allowed only if substantiated in accordance with the regulations and the application of the *Cohan* rule and noted that it had not been considered squarely in cases where the court had held for "substantial compliance" with the requirements—but then goes on to note that even if *Cohan* is not blocked by §170(a)(1) in this case, the amount the court would allow under *Cohan* would be less than the amount needed for the taxpayer to clear the standard deduction, making the point moot.

Clearly, this is a case where the court has serious problems with the taxpayer's credibility, as well as believing, given the taxpayer's long tenure with the IRS, that there was little excuse for her lack of records. So some of the language in the case may need to be tempered if applied in general. But there is reason for concern, since many taxpayers would have trouble meeting the standards the court outlines here in order to obtain a deduction (for instance, being able to substantiate in detail the original cost of donated items).

As well, the inadequacies in many of the receipts arose because the charity's own receipts that failed to contain boilerplate that should have existed on receipts for years. Taxpayers

need to be aware that they bear the primary responsibility to assure that language is on the receipts they receive. As well, charities should be made aware that the “no goods or services” language is mandatory and needs to be on all receipts where no goods or services are provided to protect their donors. Tax advisers should be on the lookout for receipts that have these inadequacies.

### ***The Haas Case***

Just in case you were deciding only former IRS agents would be held to literal compliance with those regulations, another case came down later in the week that applied the same regulations with similar results for the taxpayer.

Mr. Haas’s first charitable contribution to face scrutiny was one that most of us have heard quite often—the taxpayer who claims he put money “in the basket” at church and has no receipts or other record of the contribution. The court uses the requirement in Regulation §1.170-13(a)(1) that some form of substantiation must exist—and that Mr. Haas did not have sufficient information to meet that requirement.

For noncash contributions, the court did not find that the taxpayer had adequately substantiated his deductions—he valued the assets based upon his belief of what he would pay at a thrift shop or rummage sale and his list of items donated gave only a general description of the items given. The court found discrepancies between the amounts he valued items at and the amounts claimed—but the court did go ahead and estimate the value (apparently not troubled by the *Cohan* applicability issue raised in the *Kendrix* case).

What this case emphasizes is that these regulations are “real world” since in order for the case to end up in Tax Court, the issue had to arise in an actual, real world exam. As well, the taxpayer’s credibility is also called into question by a number of facts in the case, and that credibility is crucial in this area.

Tax advisers need to remind clients of these documentation requirements and the risks of not meeting those requirements. As well, the cases are good illustrations of the potential “cost” of taking actions that call into question the taxpayer’s credibility. If a taxpayer’s own testimony is deemed not credible, a lot of items will start breaking against the taxpayer.