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APPRAISAL OF WRONG ASSETS FATAL TO DONOR'S DEDUCTION

Court finds "gaping holes" in Form 8283.

Chateau Apartments, Inc. owned two apartment buildings in Arizona. Harvey Evenchik owned 72% of Chateau's shares. In 2004, he contributed his stock to Family Housing Resources (FHR) to create an endowment fund to help low- to moderate-income individuals and families obtain affordable housing.

The Form 8283 that Evenchik attached to his 2004 tax return indicated that the gift was 15,534.67 Chateau shares. The appraisals included with his return were of the two apartment buildings, valued at $1,100,000 and $345,000. Evenchik claimed a deduction of $1,045,289.30, representing approximately 72% of the appraised value of the apartment buildings. The IRS challenged the carryover deduction on Evenchik's 2006 income tax return and disallowed the deduction, claiming he had failed to provide a qualified appraisal.

The Tax Court found that the appraisals did not determine the value of the shares Evenchik donated, but instead valued the underlying assets. Further, the appraisals did not reflect the fact that FHR received only a partial interest in the shares of Chateau. But, said the court, not appraising the asset that was given "is a big problem, but not the only one." The appraisals Evenchik attached to his return failed to describe the property in sufficient detail to ascertain that a partial interest was given [Reg. §1.170A-13(c)(3)(ii)(A)], failed to state the date of the gift [Reg. §1.170A-13(c)(3)(ii)(C)], failed to state that the appraisal was prepared for income tax purposes [Reg. §1.170A-13(c)(3)(ii)(G)], and failed to give the appraised value on the date of the gift [Reg. §1.170A-13(c)(3)(ii)(G)].

Evenchik argued that he was entitled to the deduction because he had substantially complied with the requirements. The court rejected the argument, saying that a taxpayer can't substantially comply if the appraisal submitted fails to meet the "essential requirements" of the statute. An appraisal of the wrong asset prevents the IRS from verifying the claimed deduction. The court also noted that the deduction was overvalued – by as much as 35% – because FHR received only a partial interest in Chateau. The "gaping holes" in Evenchik's appraisals prevented the IRS from evaluating the interest contributed, the court concluded (*Estate of Evenchik v. Comm'r.*, T.C. Memo. 2013-34).

BAD TIMING NOT A PRETTY PICTURE FOR DONOR

Deduction limited to basis where artwork held one year or less.

Joseph Williams entered into an agreement with Abbey Art Consultants in 1996, under which he would buy art at a steep discount, with the intention of donating the works to charity after the pieces had been held more than one year. Abbey was to act as Williams' agent, selecting the art, storing it, arranging for appraisals and shipping the works to the charity Williams designated.deduction.

In late 1997, Williams signed a deed giving three works to Drexel University. The total appraised value was $425,625. Abbey included an invoice showing Williams had made a $3,600 deposit and owed a balance of $98,400 – $102,000 in total. Williams claimed a charitable deduction on his 1997 return for the appraised value.

In 1999, he contacted Abbey about making another gift of approximately $250,000 from the remaining art stored with Abbey. Williams sent a check for $57,500 for artwork with an appraised fair market value of $250,525 to be sent to Florida International University. He again claimed the fair market value as a charitable deduction.

In 2000, Williams sent two checks totaling $21,758 to Abbey to make an additional gift to Drexel University. The appraised value was $98,900, which he claimed on his 2000 tax return. In December of that year, Abbey sent Williams a letter indicating that he still had more than $200,000 of appraised artwork stored in their warehouse.

The IRS issued a notice of deficiency in 2007, reducing his charitable deductions for 1997, 1999 and 2000 to his basis in the artwork. Williams argued that he entered into the agreement with Abbey in 1996, obligating himself to purchase the artwork that Abbey then segregated in its warehouse. The IRS did not challenge the agreement or the payments made by Williams. It also did not dispute that he made the gifts or the appraised value of the gifts. Rather, the IRS claimed that Williams did not own the artwork he donated for more than one year prior to the gifts. Therefore, under Code §170(e), his charitable deduction was limited to basis, not fair market value.

The Tax Court said that although Williams' agreement with Abbey was titled an art purchase agreement, his deposit was in effect an option to buy art. Abbey was obligated to sell, but Williams was not obligated to buy, the works. The holding period for the art did not begin until Williams exercised the option by committing himself to pay for the art. In each case, said the court, this happened within less than one year of the donations. While Williams purported to believe that Abbey had artwork segregated at its warehouse, the court said that Williams did not have "actual personal knowledge" of the timing of Abbey's acquisition of art. He never visited the warehouse or received an inventory of the items segregated on his behalf. While the artwork certainly existed long before the gift dates, the court found no evidence that even Abbey owned them prior to the dates of appraisals. Williams acquired a present interest in the art only when he agreed to pay Abbey for pieces contributed to charity, said the court, adding that this always occurred within a year of the gifts. Therefore, the court ruled, Williams was not entitled to long-term capital gain treatment and his deductions were limited to his basis (*Williams v. Comm'r.*, 101 T.C.M. 1408).

LIFETIME GIFTS IN ADDITION TO, NOT IN PLACE OF, BEQUESTS

No evidence testator intended to adeem gifts.

Charles Walgreen amended his living trust in 1999 to provide that his trustees were to distribute shares of Walgreen Co. stock according to a list he was to prepare prior to his death. Walgreen's "beneficiary list" designated more than 900,000 shares to individuals and 33 charities. Among the charities were Rotary/One Foundation, Inc. and Rotary Foundation of Rotary International, each of which was designated to receive 10,000 shares. The beneficiary list was given to Walgreen's financial adviser to keep sealed until his death.

Later in 1999, Walgreen began making gifts of stock to many of the charities on his beneficiary list, including the Rotary Foundations. Some of these were listed as "prebequest" donations, "prepayment on my bequest" or "advance payment" of Walgreen shares.

Following Walgreen's death in 2007, the trustees of his trust sought declaratory judgment regarding the proper beneficiaries. Walgreen's family filed a counterclaim for declaratory judgment, arguing that many of the charitable bequests had been adeemed by lifetime gifts that Walgreen intended to take the place of bequests. They said that the lifetime gifts created a latent ambiguity in the trust, requiring the examination of extrinsic evidence. They pointed to a "charity list" found among Walgreen's papers that corresponded to the lifetime gifts. Family members said that the bequests to the Rotary Foundations in September 1999 were adeemed by his October 1999 outright gifts of stock.

The Rotary Foundations argued that the doctrine of ademption does not apply to trusts under Illinois law, and that even if it did, there was no evidence Walgreen intended to adeem the bequests on the beneficiary list. Family members said ademption did apply to trusts and that the prebequest gifts to other charities established the same intent with respect to the Rotary Foundations. The trial court granted the Rotary Foundations' motion for summary judgment, finding no ambiguity in any of the trust documents. Family members appealed.

The Appellate Court of Illinois, looking first at whether the doctrine of ademption applies in a trust setting, found that courts use the same principles to ascertain intent when interpreting a trust document as they do a will. Therefore, there is "no reason why the concept should not be considered" in a trust. The Rotary Foundations did not dispute that Walgreen adeemed his bequests to some of the charities, but said the doctrine of ademption could not be applied to them based on the evidence before the court. The court agreed, saying that while in certain instances the act of disposing of property during lifetime indicates an intent to adeem, it does not seem to be the case here. Based on written communications between Walgreen and the charities, when he "wished that his lifetime gift satisfy a specific bequest, he stated as much." If Walgreen had intended to adeem the bequests to the Rotary Foundations, his family would be able to present direct evidence of this, the court stated. The court declined to presume Walgreen's intent, saying it would be contrary to the plain language of the trust (*Koulogeorge v. Campbell*, 2012 IL App. 112812).

COURT FINDS NO WRITTEN PROOF OF PLEDGE

Spreadsheets shows lifetime gifts, not promise to pay.

Chabad of California filed suit for promissory estoppel against Dawn Arnall, claiming her husband, Roland, had made an $18 million oral pledge to the organization prior to his death. The funds were to be used for the construction of a new facility. Arnall had made three $180,000 donations to Chabad that were purportedly installments against the pledge. The trial court found that Chabad had failed to prove the existence of the promise to pay anything other than the amounts already given.

Chabad appealed, arguing that the trial court erred in refusing to draw any negative inferences from Dawn Arnall's alleged withholding of evidence. Chabad claimed that as administrator of the estate, Dawn had spreadsheets on which Arnall's charitable con- tributions were recorded, along with the purpose of the gifts.

The Court of Appeals of California held that Chabad's reliance on the withholding of the spreadsheets was "misplaced," adding that it did not appear Chabad made a diligent search and reasonable inquiry. The court agreed with Dawn that even the elimination of her testimony would not provide affirmative evidence of a promise to pay $18 million. Chabad argued that Dawn's "suppression" of the spreadsheet led to the unavoidable inference that the three payments were reflected as payment on Arnall's pledge. The court, which found nearly every witness "was lacking in credibility to one degree or another," said Chabad failed to prove the existence of a promise to pay $18 million _ an essential element of its case (*Chabad of California v. Arnall*, B234059).

NO CARRYFORWARD FROM PHANTOM TAX RETURN

Failure to file in year of gift dooms taxpayer's charitable deduction.

Robert Naylor is, according to the Tax Court, a "habitual nonfiler." He failed to timely file tax returns from 2000 to 2009, although only his 2003 and 2007 returns were before the court. Lacking returns from Naylor, the IRS prepared substitute returns for him [Code §6020(b)(1)].

Naylor claimed that he was entitled to a carryover charitable contribution deduction of nearly $90,000 for 2003. The contribution was made by Midway Industrial Campus, Co., Ltd., an Ohio LLC, and flowed to Naylor through a family partnership of which he was a partner. The IRS disallowed the carryover deduction.

Code §170(d)(1) allows a deduction that cannot be fully claimed in the year of the gift to be carried over to the five succeeding years. The Tax Court said that a taxpayer bears the burden of proving that he was entitled to a deduction in the year of the gift and could not use the full deduction in that year. Because Naylor has not proved that he filed a return for 2002, he has no charitable deduction to carry forward to 2003, ruled the court (*Naylor v. Comm'r.*, T.C. Memo. 2013-19).

CONSERVATION EASEMENT, MORTGAGE DON'T COEXIST

Lender didn't subordinate interest in timely manner.

Walter Minnick subdivided a 74-acre parcel of land in Idaho into seven single-family residential lots. In 2006, he granted a conservation easement to the Land Trust of Valley over the land, prohibiting any building outside a "building envelope" designated on each parcel. The easement covered about 80% of the 74-acre parcel. Although Minnick warranted that there were no outstanding mortgages that had not been subordinated to the easement, there was, in fact, a mortgage recorded in 2005.

Minnick and his wife claimed a charitable deduction for 2006 of $941,000, based on an appraisal. They carried over a portion of the deduction to 2007 and 2008. The IRS disallowed the carryover deductions in 2009, shortly after which Minnick filed a petition with the Tax Court. In September 2011, the bank holding the mortgage on the property executed an agreement subordinating its mortgage to the conservation easement. Under the subordination, the conservation easement will remain in place even if the bank forecloses on the property.

The IRS argued that because the mortgage was not subordinated at the time the conservation easement was granted, no deduction is permitted. The Tax Court had held in Mitchell v. Comm'r. (138 T.C. 324) that a subordination agreement must be in place at the time the conservation easement is granted. *Minnick* argued that Mitchell is distinguishable because the warranty provision in the easement demonstrated that he intended that the mortgage be subordinated at the time he granted the easement. In addition, he claimed, the bank would have been willing to subordinate its interest at that time and that there was only a remote possibility that he would default. The court rejected these arguments, ruling that the value of the conservation easement was not deductible because the subordination requirements of Reg. §1.170A-14(g)(2) had not been met (*Minnick v. Comm'r.*, 104 T.C.M. 755).

"FLOATING" CONSERVATION EASEMENT GROUNDED BY TAX COURT

Charity's acquiescence to shifting exact acreage "immaterial."

B.V. and Harriet Belk owned approximately 410 acres of land in North Carolina that they transferred to a newly formed company _ Old Sycamore, LLC. Old Sycamore developed a residential community and golf course on the property. In 2004, Old Sycamore executed a conservation easement over the 184 acres of land on which the golf course is located. The easement prohibits the use of the land for any purpose other than a golf course, but allows Old Sycamore, with the charity's approval, to change what property is subject to the easement. The substitute property must be of the same or better ecological importance, and be of equal or greater fair market value.

Old Sycamore obtained an appraisal that determined the value of the easement to be $10.5 million, which the company claimed as a charitable deduction. The IRS disallowed the deduction for 2004 and the carryovers in 2005 and 2006, arguing that Old

Sycamore did not grant a conservation easement in perpetuity because the agreement permits substitutions.

The Tax Court agreed with the IRS, ruling that it was immaterial that charity had to agree to any substitutions. Old Sycamore has not donated an interest in real property subject to a use restriction granted in perpetuity, said the court. The Code §170(h)(5) requirement that the conservation purpose be protected in perpetuity is separate and distinct from the Code §170(h)(2)(C) requirement that there be real property subject to a use restriction in perpetuity. Nothing in the tax laws permits the restriction on the use of real property be granted in perpetuity unless the parties agree otherwise, the court held (*Belk v. Comm'r.*, 140 T.C. No. 1).

NO FLOWER POWER FOR THIS ORGANIZATION

Charitable status denied, even though profits were to go to charity.

The founders of Zagfly planned to sell flowers over the Internet, allowing customers to choose from a list of charities to receive the profits from the sale. Flowers would be sold at market rates, with the 10% to 20% commission passing to the selected charity. In its application for 501(c)(3) status, Zagfly said that it hoped to expand its options to include travel reservation services.

The IRS denied charitable status, saying Zagfly would not be operated exclusively for religious, charitable, scientific, educational or other exempt purposes. The Tax Court agreed, noting that an organization is not charitable if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. Reg. §1.501(c)(3)-1(e)(1) provides that an organization may meet the requirements of Code §501(c)(3), provided it is not "organized or operated for the primary purpose of carrying on an unrelated trade or business."

Zagfly proposes to engage in activities that others engage in for commercial gain, although its primary motivation is charitable, said the court. Its primary purpose is to facilitate the donation of its profits to charitable organizations. The Internet sale of flowers is a commercial activity that constitutes an unrelated trade or business under Code §513, said the court, noting that selling flowers at market price is not substantially related to an exempt purpose (*Zagfly v. Comm'r.*, T.C. Memo. 2013-29).

