Current Federal Tax Developments

Week of May 30, 2022

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WEEK OF May 30, 2022
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SECTION 170
CHARITABLE DEDUCTION DISALLOWED FOR FAILURE TO MEET CONTEMPORANEOUS WRITTEN ACKNOWLEDGMENT RULES

Citation: Albrecht v. Commissioner, TC Memo 2022-53, 5/25/22

A taxpayer found her deduction for a donation of property to a museum was denied entirely for failing to meet the substantiation requirements of IRC §170(f)(8)(B) in the case of *Albrecht v. Commissioner*, TC Memo 2022-53.[1]

Substantiation Requirements

In order to obtain a charitable contribution deduction, various substantiation requirements must be made that vary based on the type of gift (cash, noncash, autos, etc.) and the amount being claimed. This case involves the substantiation provisions Congress placed in IRC §170(f)(8). The provision reads:

> (8) Substantiation requirement for certain contributions.
>
> > (A) General rule. No deduction shall be allowed under subsection (a) for any contribution of $250 or more unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgment of the contribution by the donee organization that meets the requirements of subparagraph (B).
> >
> > (B) Content of acknowledgement. An acknowledgement meets the requirements of this subparagraph if it includes the following information:
> >
> > > (i) The amount of cash and a description (but not value) of any property other than cash contributed.
> > >
> > > (ii) Whether the donee organization provided any goods or services in consideration, in whole or in part, for any property described in clause (i).
> > >
> > > (iii) A description and good faith estimate of the value of any goods or services referred to in clause (ii) or, if

[1] *Albrecht v. Commissioner*, TC Memo 2022-53, May 25, 2022, https://www.taxnotes.com/research/federal/court-documents/court-opinions-and-orders/individual-can%e2%80%99t-deduct-museum-donation%2c-tax-court-says/7dj70 (retrieved May 26, 2022)

> > such goods or services consist solely of intangible religious benefits, a statement to that effect.
>
> For purposes of this subparagraph, the term "intangible religious benefit" means any intangible religious benefit which is provided by an organization organized exclusively for religious purposes and which generally is not sold in a commercial transaction outside the donative context.
>
> (C) Contemporaneous. For purposes of subparagraph (A), an acknowledgment shall be considered to be contemporaneous if the taxpayer obtains the acknowledgment on or before the earlier of--
>
> > (i) the date on which the taxpayer files a return for the taxable year in which the contribution was made, or
> >
> > (ii) the due date (including extensions) for filing such return.
>
> (D) Regulations. The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations that may provide that some or all of the requirements of this paragraph do not apply in appropriate cases.[2]

In this case the IRS was questioning the content of the acknowledgement. Reg. §1.170A-13(f)(2) provides the following additional guidance for the content of this written acknowledgement:

> (2) Written acknowledgement. Except as otherwise provided in paragraphs (f)(8) through (f)(11) and (f)(13) of this section, a written acknowledgment from a donee organization must provide the following information--
>
> > (i) The amount of any cash the taxpayer paid and a description (but not necessarily the value) of any property other than cash the taxpayer transferred to the donee organization;
> >
> > (ii) A statement of whether or not the donee organization provides any goods or services in consideration, in whole or in part, for any of the cash or other property transferred to the donee organization;

[2] IRC §170(f)(8)

> (iii) If the donee organization provides any goods or services other than intangible religious benefits (as described in section 170(f)(8)), a description and good faith estimate of the value of those goods or services; and
>
> (iv) If the donee organization provides any intangible religious benefits, a statement to that effect.[3]

In this case, the ultimate question was if the documentation in question provided a statement regarding whether any goods or services were received as part of the donation, more specifically did it establish that no goods or services were received.

Facts of the Case

The decision describes Ms. Albrecht's donation as follows:

> On or around December 19, 2014, petitioner donated approximately 120 items from this collection (donation) to the Wheelwright Museum of the American Indian (Wheelwright Museum). In connection with the donation the Wheelwright Museum and petitioner executed a "Deed of Gift" (deed) dated December 19, 2014, that consisted of five pages. The first page stated that petitioner "hereby donates the material described below to the Wheelwright Museum of the American Indian under the terms stated in the Conditions Governing Gifts to the Wheelwright Museum of the American Indian." Immediately under this clause was the heading "Description of Material: See Attached List." The first page also included the museum's logo, petitioner's address, and her donor identification number, as well as the signatures of petitioner and a museum official.
>
> The second page of the deed was titled "Conditions Governing Gifts to the Wheelwright Museum of the American Indian" and specified conditions governing gifts to the museum. One of these conditions stipulated in relevant part that "the donation is unconditional and irrevocable; that all rights, titles and interests held by the donor in the property are included in the donation, unless otherwise stated in the Gift Agreement." The final three pages of the deed listed items of donated property. Despite "the Gift Agreement" reference on the second page of the deed, no such agreement was included with the deed, and the Wheelwright Museum did not provide petitioner with any further written documentation concerning the donation.[4]

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[3] Reg. §1.170A-13(f)(2)

[4] *Albrecht v. Commissioner*, TC Memo 2022-53, May 25, 2022

The IRS argued that a failure to provide the Gift Agreement referenced on the deed meant the deed itself did not contain the necessary statement regarding goods or services being provided in exchange for the contribution. Thus, on exam, the IRS denied the deduction and the case ended up before the Tax Court.

Tax Court's Decision

The Tax Court begins by noting that the requirement to obtain proper contemporaneous written acknowledgement (CWA) of a charitable contribution must be strictly followed or the entire deduction is lost:

> A CWA is not required to take any particular form but the requirement that a CWA be obtained "is a strict one." *15 W. 17th St. LLC*, 147 T.C. at 562; see also *Izen v. Commissioner*, 148 T.C. 71, 78 (2017) (noting that a deed of gift can serve as a de facto CWA). A taxpayer may not deduct the contribution if the donation acknowledgment fails to meet these strict demands. See *15 W. 17th St. LLC*, 147 T.C. at 562 (emphasizing that the doctrine of substantial compliance does not apply for purposes of section 170(f)(8)); see also *Addis v. Commissioner*, 374 F.3d 881, 887 (9th Cir. 2004) ("The deterrence value of . . . [a] total denial of a deduction [in the case of an improper CWA] comports with the effective administration of a self-assessment and self-reporting system."), *aff'g* 118 T.C. 528 (2002).[5]

The IRS argues that what Ms. Albrecht provided failed to meet these requirements:

> Specifically, respondent points out the reference in the deed to the "Gift Agreement" as creating ambiguity as to whether additional terms, including donee provision of goods or services, were part of the donation.[6]

The taxpayer argues that the failure to provide a Gift Agreement is not fatal to the documents that were provided meeting the CWA requirements:

> Petitioner contends that the Gift Agreement is irrelevant to the issue of whether the Wheelwright Museum provided goods or services in exchange for the donation because the sole purpose of the Gift Agreement was to describe the extent to which petitioner retained certain rights, titles, or interests in the donation. Petitioner also insists that the Wheelwright Museum's failure to provide her with a Gift Agreement "indicates the presumption that all [of] [p]etitioner's

[5] *Albrecht v. Commissioner*, TC Memo 2022-53, May 25, 2022

[6] *Albrecht v. Commissioner*, TC Memo 2022-53, May 25, 2022

> right[s], title[s] and interest[s] in the donated property [are] included in the donation."[7]

It is possible, clearly, that no such Gift Agreement exists and that, therefore there would be no modification. But the Court wasn't willing to accept that view. The Court states:

> We do not find these arguments persuasive when construing the plain text of the deed. By referencing another document that superseded the terms of the deed with respect to the donor's rights in the donation, the deed provided the donor with the ability to retain an interest in the donation, including under a potential quid pro quo arrangement.
>
> Petitioner cited no authority for the proposition that a separate agreement referenced in a deed but unattached thereto creates a presumption that the deed alone satisfies section 170(f)(8). We are unwilling to create such a rule, especially when the deed did not indicate it constituted the entire agreement of the parties or that any prior discussions, negotiations, or understandings between them were merged into the deed. When looking exclusively at the deed and considering it as a whole, it leaves open a significant question about whether the parties had entered into a side agreement that included additional, superseding terms. See *French*, T.C. Memo. 2016-53, at *10-12 (refusing to uphold as a CWA a deed that, when analyzed as a whole, did not represent the entire agreement between the donee and donor).[8]

The Court did not indicate it believed that Ms. Albrecht had, in fact, received goods or services in exchange for the donation or had retained a substantial interest—but that wasn't the issue that would decide the case:

> We appreciate what appears to have been a good faith attempt by petitioner to substantially comply with the Code by executing the deed with the Wheelwright Museum. Substantial compliance, unfortunately for petitioner, does not satisfy the strict requirements of section 170(f)(8)(B). See *15 W. 17th St. LLC*, 147 T.C. at 562. Thus, for the reasons given above, petitioner is not entitled to a charitable contribution deduction with respect to the donation as the deed does not satisfy these requirements.[9]

This is an area where being very detail oriented and double checking documents to assure they strictly meet the requirements is key. It matters not that the contribution

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[7] *Albrecht v. Commissioner*, TC Memo 2022-53, May 25, 2022

[8] *Albrecht v. Commissioner*, TC Memo 2022-53, May 25, 2022

[9] *Albrecht v. Commissioner*, TC Memo 2022-53, May 25, 2022

was actually made and no goods or services were received unless the acknowledgment contains that statement and is received by the time prescribed.

An even more arguably unfair result is found in the 2012 case of *Durden v. Commissioner*, TC Memo 2012-140.[10] There the taxpayer had two different acknowledgments. The first, received by the taxpayer prior to the date the taxpayer timely filed his return, omitted the statement that no goods or services were received for the donation. The second, obtained when the IRS agent pointed out the flaw in the original document, added the required language but was obtained well after the date the return had been timely filed—after all, the exam didn't start until well after that date.

The Tax Court found that, in those facts, the taxpayer had not met the substantiation rules. The first acknowledgement was missing the required statement, so it could not be a proper CWA. The second, while containing all necessary information, was issued too late to be a proper CWA. With no proper CWA, the taxpayer was denied nearly $25,000 in deductions for contributions all parties agreed were made by the taxpayer to the charity in the year in question and for which he received no goods or services in exchange for making.

SECTION 1202
RETAIL SALE OF DRUGS FOUND TO BE A QUALIFIED TRADE OR BUSINESS FOR §1202 PURPOSES

Citation: PLR 202221006, 5/27/22

In PLR 202221006[11] a corporation whose shareholders were negotiating a sale of their stock to an unrelated third party asked the IRS to rule that the business is a *qualified trade or business* under IRC §1202(e)(3).

§1202 Status and Benefits

IRC §1202 provides for a full or partial exclusion of gain from the disposal of *qualified small business stock* held for more than five years. The amount of the exclusion varies depending on when the stock was acquired, with stock acquired after September 27, 2010 being eligible for a 100% exclusion of gain on the sale[12] of up to the greater of $10 million or 10 times the aggregate adjusted bases of qualified small business stock issued by such corporation and disposed of by the taxpayer during the taxable year.[13]

[10] *Durden v. Commissioner*, TC Memo 2012-140, May 17, 2012

[11] PLR 202221006, May 27, 2022, https://www.irs.gov/pub/irs-wd/202221006.pdf (retrieved May 27, 2022)

[12] IRC §1202(a)(4)

[13] IRC §1202(b)(1)(A)

Only certain types of businesses can qualify as a *qualified trade or business*, something necessary for gain on the sale of the stock to qualify for a §1202 exclusion. IRC §1202(e)(3) contains the definition of a *qualified trade or business* and reads:

> (3) Qualified trade or business
>
> For purposes of this subsection, the term "qualified trade or business" means any trade or business other than--
>
> > (A) any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees,
> >
> > (B) any banking, insurance, financing, leasing, investing, or similar business,
> >
> > (C) any farming business (including the business of raising or harvesting trees),
> >
> > (D) any business involving the production or extraction of products of a character with respect to which a deduction is allowable under section 613 or 613A, and
> >
> > (E) any business of operating a hotel, motel, restaurant, or similar business.[14]

In this case the question was whether the business of the corporation was performance of services in the field of health or the principal asset of the business was the skill or reputation of one or more employees.[15]

Facts as Represented in the Ruling Request

The taxpayer in this case is involved in the sale of certain drugs:

> Taxpayer is only involved in the retail sale of a limited number of drugs and does not manufacture them. The manufacturers of these drugs prefer entering into exclusive distribution arrangements with companies such as Taxpayer.[16]

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[14] IRC §1202(e)(3)

[15] IRC §1202(e)(3)(A)

[16] PLR 202221006, May 27, 2022

The employees involved in the business are both pharmacists and various other employees:

> Employees of Taxpayer include several pharmacists who fill prescriptions received from physicians. Other employees coordinate the insurance coverage with respect to such prescription orders. Once the insurance process is complete and the prescription is filled by the pharmacist, Taxpayer mails the prescription to the patient's home. The non-pharmacist employees will also occasionally contact individuals receiving prescriptions to inquire as to any side effects of the prescriptions and to schedule refills. Such non-pharmacist employees are not subject to state licensing requirements or classified as healthcare professionals by any applicable state, Federal or regulatory authority.[17]

The nature of the employees' interactions with the patients and physicians is outlined as follows:

> Pharmacists and other employees of Taxpayer have no contact or interaction with physicians, other than to receive prescriptions from them. With respect to patients, pharmacists interact with patients only if a patient has a question about a particular prescription. Employees are never involved in diagnosing any medical issues or recommending any treatment or drug to individuals. Their interaction with patients is limited to the filling and maintenance of prescriptions as ordered by a physician. Therefore, none of Taxpayer's employees diagnose, treat or manage any aspect of any patient's care. Taxpayer's revenues are strictly related to the sale of such drugs, and Taxpayer earns no revenues in connection with the medical care of patients.[18]

Analysis and Ruling

The analysis section of the ruling begins with a discussion of the two categories that the taxpayer was concerned the IRS might on exam argue their business falls into that would bar treatment as a *qualified trade or business*, making their gain on sale fully taxable:

> Section 1202(e)(3) excludes businesses from being a qualified trade or business if they offer value to customers primarily in the form of certain specified services, or in the form of individual expertise. A question arises as to whether Taxpayer is (i) involved in the performance of services in the field of health or (ii) where the principal

[17] PLR 202221006, May 27, 2022

[18] PLR 202221006, May 27, 2022

> asset of the trade or business is the reputation or skill of one or more of its employees.[19]

The ruling concludes that this business is not a health business as contemplated by IRC §1202(e)(3)(A) since the employees actions don't rise to the level of diagnostic services or medical care provided to either patients or physicians:

> Taxpayer's employees are not engaged in the provision of medical services. Other than the pharmacists, such employees are not certified healthcare providers and are not otherwise regulated under state or Federal law. Taxpayer's pharmacists fill prescriptions provided by health care professionals, and other employees help manage the insurance process and occasionally communicate with patients regarding prescription issues and timely refill requests. Any interaction with patients regarding their prescriptions is merely incidental to ensuring receipt of their required prescriptions or answering a patient's question about them. Taxpayer's employees do not provide any diagnostic services or medical care to either patients or physicians, and all revenues are generated by the sale of the drugs.[20]

The IRS also found that the principal asset of the business was not the employees' reputation or skill:

> Also, Taxpayer's principal asset is not the reputation or skill of one or more employees, but its exclusive pharmaceutical distribution rights.[21]

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[19] PLR 202221006, May 27, 2022

[20] PLR 202221006, May 27, 2022

[21] PLR 202221006, May 27, 2022