TAX COURT CASE UPDATE

Citation:

Ben Alli, et ux. v. Commissioner, T.C. Memo 2014-15, January 27, 2014.

Overview:

The Tax Court has denied a married couple's charitable deduction claimed for their donation of a rundown apartment building to a charitable organization. Among other defects, the taxpayers' return contained false information regarding the property, and their appraisals fell far short of satisfying the qualified appraisal requirement. And, they couldn't establish either that they substantially complied with the relevant requirements or that they had reasonable cause for their failure to do so.

The Facts:

Dr. Ben Alli was the sole shareholder of BSA Corp. (BSA), a Michigan corporation that owned several apartment buildings in Detroit. In 1983, the Allis purchased two apartment buildings from the U.S. Department of Housing and Urban Development (HUD) for $353,000. The buildings participated in HUD's Section 8 housing program, and the Allis agreed to keep the properties in a decent, safe, and sanitary condition. In 1988, the Allis transferred the buildings to BSA.

Starting in the early 1990s, HUD became aware of significant problems at the two buildings including fire hazards, roach infestation, and water damage. HUD ordered Dr. Alli to make repairs on several occasions, but he failed to do so. Eventually, in 2000, HUD began relocating tenants and initiating foreclosure proceedings and terminated their contract with the Allis.

In 2001, the Allis and BSA sued the U.S. and HUD for breach and termination of the Section 8 housing agreement. As part of the HUD litigation proceedings, the Allis and BSA stipulated that BSA currently owned and operated the buildings. The U.S. Court of Federal Claims held in favor of the U.S. and HUD.

On September 29, 2008, BSA and the Allis executed a quitclaim deed of one of the buildings (Building 1) to Volunteers of America (VOA), a Code Sec. 501(c)(3) organization. On October 29, 2008, VOA sent Dr. Alli a letter thanking him for the contribution and stating that he "received no goods or services as a result of this donation," and enclosed a donation receipt. VOA entered a contract to sell Building 1 for $60,000 on September 10, 2008, to the single investor who expressed an interest in it.

In 1999, for HUD-related purposes, a "market rent survey" concluded that the buildings had an annual gross income potential of $390,940, but the survey did not estimate their fair market values.

In April 2008, the market rent survey was updated with an appraisal, the stated purpose of which was to establish the properties' values after renovations and remodeling have taken place. The cost approach and income approach were used in appraising the properties. The cost approach yielded a $531,250 estimate of Building 1's value. Under the income approach, Building 1 was determined to have a "market value" of $664,062.50. However, the "reconciliation and conclusion" section of the 2008 appraisal stated that $664,062.50 was the estimate reached under the income, market, and cost approaches.

On their 2008 tax return, the Allis included Form 8283 reporting a charitable contribution of a “34 Unit Apartment Building” in “Good Condition.” They claimed an appraised fair market value of $499,000. In addition, they reported that the building had been purchased in June 2000 for a price of $1,200,000. Form 8283 did not include any information about an appraiser including an appraiser declaration, and did not include the donees’ signature or other identifying information.

Discussion:

The Tax Court determined that the Allis were not entitled to a deduction for the charitable contribution of Building 1.

First, The Court found that Building 1 was solely owned by BSA at the time of contribution, based largely on the fact that the Allis admitted as much during the HUD litigation proceedings in 2007. The Court then found that, although BSA was the owner, the IRS's treatment of BSA as an S corporation meant that Dr. Alli, as BSA's sole shareholder, would be entitled to the entire charitable contribution deduction if all of Code Section 170's requirements were met. However, the Court determined that these requirements were not met.

With respect to the market rent survey, the Court found that it failed the 60-day timeliness requirement, did not include the date or expected date of the contribution, did not include the terms of any relevant agreement regarding the property, did not state that it was prepared for tax purposes, and did not actually provide a fair market value appraisal of Building 1 or use any of the acceptable methods to measure this value. Additionally, although the appraiser included his qualifications, he did not include a declaration in the appraisal summary that he was qualified, not ineligible, understood the consequences of overvaluation, and regularly held himself out as an appraiser.

Regarding the 2008 appraisal, the Tax Court noted that the biggest deficiency was that it was not an appraisal of the contributed property but rather of a "hypothetical, fully renovated version of the contributed property." It did not contain an accurate description of the property's condition; it determined the market value of the property instead of its fair market value (and the distinction was clearly shown in the appraiser's definition of the term, which omitted key principles such as requiring that the buyer and seller have reasonable knowledge of relevant facts); it was not timely; it omitted the appraiser's qualifications, identifying number, and declaration as described above; and it did not include the date or expected date of contribution, the terms of the agreement, or a statement that it was prepared for tax purposes.

The Tax Court then examined the Allis' appraisal summary and concluded that it did not satisfy the requirements under the regulations. Namely, it provided false information as to the Allis' basis and date of acquisition, the physical condition of the property, and the appraised value of the property. It also omitted key information on the donee, appraisers' declarations and other information required under Regulation Section 1.170A-13(c)(4)(ii), and a statement on the amount of any consideration received from the donee for the contribution.

The Court then concluded that the substantial compliance doctrine, which excuses strict compliance in certain cases, did not help the Allis in this case. The Court noted that the doctrine generally applied in instances where information was omitted (as opposed to falsely reported) or where there were minor technicalities like using one form instead of two (versus substantive failures). It further observed that the substantial compliance doctrine is one that should be applied narrowly, and that the errors in this case precluded a finding of substantial compliance.

Finally, the Court determined that the Allis did not show that their failure to satisfy the qualified appraisal and other documentation requirements was due to reasonable cause and not willful neglect. The Allis claimed that they acted reasonably because they relied on the advice of their return preparer. However, the Court found that although their return was professionally prepared, the Allis failed to show that the preparer was qualified, that they provided him with complete information, what his advice was, and whether they relied on it. They also failed to establish that they reasonably relied on the survey or the appraisal where they did not show that either appraiser had the sufficient expertise to justify reliance, and in any event, they did not actually rely on the figures provided by either.

Conclusion:

The Tax Court disallowed the taxpayers' charitable contribution for failure to follow the Code Section 170 regulations that require a qualified appraisal by a qualified appraiser, along with other substantiation requirements.