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Is the 'Ultimate Tax Plan' Nearing Ultimate Rejection by the Tax Court?

by Hale E. Sheppard

Hale E. Sheppard (hale.sheppard@chamberlainlaw.com) is a shareholder in the tax controversy section of Chamberlain, Hrdlicka, White, Williams & Aughtry in Atlanta.

In this article, Sheppard discusses a recent Tax Court decision involving purported charitable donation abuses, explaining how the ongoing case offers insights into how the IRS and courts approach similar issues in other contexts, such as conservation easement disputes.

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I. Introduction

Anything involving valuation, which entails a degree of subjectivity, is susceptible to disputes with the Internal Revenue Service. That is certainly true when it comes to charitable donations of property other than money. Battles centered on altruistic gifts have different facts, but the legal issues often are the same. Thus, each case — regardless of how narrow it appears on the surface — might render broader lessons. That applies to the most recent Tax Court case addressing supposed charitable donation abuses, *Lim and Chu*.[1]

II. Overview of Charitable Donations

Taxpayers normally can deduct the value of charitable donations they make during a year.[2] If the donations consist of something other than money, the amount of the tax deduction is the fair market value of the property at the time the taxpayers make the donations.[3] The term FMV means the price on which a willing buyer and willing seller would agree, with neither party being obligated to participate in the transaction, and with both parties having reasonable knowledge of the relevant facts.[4]

When the value of donated property exceeds $500,000, taxpayers cannot claim a deduction unless they obtain a "qualified appraisal" and attach it to the relevant tax return.[5] For an appraisal to be qualified, it must satisfy a long list of requirements. It must (1) be prepared no earlier than 60 days before the date of donation and no later than the due date of the tax return on which the deduction is first claimed; (2) be prepared, signed, and dated by a qualified appraiser; (3) include a significant amount of information about the appraiser, including his or her background, experience, education, and membership in professional associations; and (4) not involve a "prohibited appraisal fee."[6] Those requirements are meant to provide the IRS with sufficient information to evaluate deductions and assist it in detecting overvaluations of donated property.[7]

Properly claiming tax deductions triggered by charitable donations involves significant actions aside from obtaining a qualified appraisal. The

[1] *Lim and Chu v. Commissioner*, T.C. Memo. 2023-11.

[2] Section 170(a)(1); reg. section 1.170A-1(a).

[3] Section 170(a)(1); reg. section 1.170A-1(c)(1).

[4] Reg. section 1.170A-1(c)(2).

[5] Section 170(f)(11)(D).

[6] Section 170(f)(11); reg. section 1.170A-13(c)(3)(i); Notice 2006-96, 2006-2 C.B. 902; T.D. 9836, 83 F.R. 36425 (July 30, 2018); reg. section 1.170A-17. For these purposes, a qualified appraiser is one who (1) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations, (2) regularly performs appraisals for which the individual receives compensation, and (3) meets such other requirements as may be prescribed in regulations or other guidance. *See* section 170(f)(11)(E)(ii)(I).

[7] *Smith v. Commissioner*, T.C. Memo. 2007-368.

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main ones are: A taxpayer must (1) demonstrate that the recipient of the donation is a qualified organization; (2) complete a Form 8283, "Noncash Charitable Contributions," and have it executed by all relevant parties, including the taxpayer, appraiser, and charity; (3) file a timely tax return, enclosing the qualified appraisal and Form 8283; and (4) receive from the charity a so-called contemporaneous written acknowledgement (CWA).[8]

III. Historical Challenges to Charitable Donations

Challenging charitable donations is nothing new; the IRS has been doing it for many years, for many reasons, using many theories. The challenges include IRS attacks on technical matters, legal issues, valuation, and more. Below are just a few examples.

The taxpayers in *Skripak*[9] participated in a program whereby they executed a series of documents purporting to buy scholarly books for one-third of their retail price. They held the books long enough to create long-term capital gain property, donated the books to small rural public libraries, and claimed charitable donation deductions based on the retail price of the books, which was about three times higher than what the taxpayers had paid a short time earlier. The IRS audited, fully disallowed the claimed deductions, and imposed penalties.

The taxpayers in *Hunter*[10] learned of a tax reduction program involving the purchase of "limited edition prints" and subsequent donation of such artwork to museums. Apparently, the promoter, through one of his entities, purchased a large number of prints from a gallery for a low price because the gallery had owned them for a long time, failed to sell them to visitors, and now considered them excess inventory. The promoter bought the prints for one-sixth of their retail price, sold them to the taxpayers for one-third of their retail price, and soon thereafter assisted the taxpayers in donating the prints and claiming charitable deductions for their full retail price. The taxpayers expected a tax deduction equal to three times the amount they paid the promoter. The IRS disagreed, of course, suggesting that the proper deduction amount was $0.

The taxpayers in *Weitz*[11] participated in a program in which they pooled funds with several other investors, had their agent purchase medical equipment in their names at bankruptcy auctions for low prices from distressed sellers, stored such equipment for more than one year, donated the equipment to hospitals, and claimed charitable deductions based on the retail value of the equipment. The taxpayers expected a four-to-one return on their investment, even after paying the agent's commission. The IRS raised a laundry list of arguments in an attempt to award the taxpayers a charitable deduction of $0.

The taxpayers in *Weintrob*[12] were partners in a limited partnership that combined investor money, purchased unimproved land, allowed the partners to "withdraw" land from the partnership in proportion to their capital account ratios, donate that land to charity, and claim charitable donation deductions that far exceeded the amount of money invested. The IRS disallowed the deductions on several grounds.

In recent years, most disputes implicating charitable donations involve syndicated conservation easements transactions (SCETs).[13] Hundreds of cases are awaiting reconsideration by IRS Appeals or litigation in the Tax Court, with many more to come. The onslaught of future cases is clear from the proclamations by the IRS that it plans to attack every single SCET. The IRS announced, for example, that it "will not stop in [its] pursuit of everyone involved," it will use "every available enforcement option," and it is "committing significant examination and investigative resources to vigorously audit the entities and individuals involved in this scheme."[14]

[8] *See* IRS Pub. 1771, "Charitable Contributions — Substantiation and Disclosure Requirements"; IRS Pub. 526, "Charitable Contributions"; section 170(f)(8); section 170(f)(11); reg. section 1.170A-13; and Notice 2006-96; T.D. 9836.

[9] *Skripak v. Commissioner*, 84 T.C. 285 (1985).

[10] *Hunter v. Commissioner*, T.C. Memo. 1986-308.

[11] *Weitz v. Commissioner*, T.C. Memo. 1989-99.

[12] *Weintrob v. Commissioner*, T.C. Memo. 1990-513.

[13] Notice 2017-10, 2017-4 IRB 544.

[14] IRS, "IRS Increases Enforcement Action on Syndicated Conservation Easements," IR-2019-182 (Nov. 12, 2019).

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If that were not clear enough, the IRS confirmed that it "examines 100 percent of these deals and plans to continue doing so for the foreseeable future."[15] The National Fraud Counsel, likewise, admonished that "the IRS is auditing 100 percent of these cases."[16] Piling on, chief counsel for the IRS explained that his troops are prepared "to take each of these [pending easement cases] and all other cases being developed by the IRS to trial."[17]

IV. Recent Tax Court Case

It is time to turn to the most recent charitable donation dispute: *Lim and Chu*.

A. Summary of the Pertinent Facts

The taxpayers were the sole shareholders in Integra Capital Group Inc. (Integra) during the relevant years. A gentleman named Michael L. Meyer made a presentation to the taxpayers on December 22, 2016, regarding what he called The Ultimate Tax, Estate, and Charitable Plan (Ultimate Tax Plan). The taxpayers clearly liked what they heard, as they immediately signed an agreement with Meyer. The contract indicated that Meyer would form a special charitable limited liability company (CLLC) for the taxpayers, create documents to transfer specific assets from the taxpayers to the CLLC, generate additional documents to memorialize the transfer of "units" in the CLLC to a charity, supply an appraisal to establish the value of the charitable donation, and defend the taxpayers if the IRS were to audit their gift.

With the year-end fast approaching, Meyer quickly formed a CLLC for the taxpayers: ABC Foundation Legacy LLC (Legacy). Just over a week later, on December 30, 2016, the taxpayers and their original company, Integra, executed another agreement. It named the taxpayers managers of Legacy, Integra as the sole owner, and Meyer as its registered agent (Legacy agreement).

Attached to the Legacy agreement were five promissory notes that obligated Integra to pay Legacy about $2 million over seven years.

The documents identified the Indiana Endowment Foundation (Foundation) as the charitable organization to which Integra would transfer various units in Legacy. The Tax Court noted that Meyer was involved at this level, too, serving as the Foundation's registered agent.

Let's review to ensure that readers are up to speed: The case thus far involves the taxpayers; their original business, Integra; the special purpose CLLC, Legacy; the charitable recipient of the units, the Foundation; and Meyer.

Taxpayers claimed that Integra, as the sole owner of Legacy, donated units of Legacy to the Foundation on the last day of the year, December 31, 2016. The Tax Court did not disguise its skepticism regarding the purported transfer, underscoring that the taxpayers did not provide copies of the alleged units, did not explain when or how such units were created, and did not supply a letter, email, or other form of communication showing any transfer to the Foundation.

After some wrangling during the pretrial discovery process, the taxpayers acknowledged that the *only* evidence of the supposed transfer was the CWA issued by the Foundation on January 1, 2017. The CWA merely said that the Foundation had received 1,000 units in "C&H Family LLC" in 2016 and that the Foundation had not provided any goods or services in exchange for the units.

The Tax Court observed some problems with the CWA. First, the CWA was not addressed to the supposed donor, Integra, but rather to the taxpayers individually. Second, no human being signed the CWA. Third, based on its format, the Tax Court pondered whether "it may have been prepared by Meyer, not by the Foundation." Fourth, the "most suspect feature" of the CWA was that it did not refer to the property that Integra supposedly donated to the Foundation (1,000 units in Legacy) but rather to units in "C&H Family LLC." To make matters worse, the Tax Court caught onto the fact that C&H Family LLC did not even exist at the time of the purported donation on December 31, 2016; it was not formed

[15] IRS, "IRS Announces Proposed Regs on Qualified Transportation Fringe Benefit Expenses," IR-2020-125 (June 10, 2022).

[16] Nathan J. Richman, "IRS Shifting Tack on Fighting Syndicated Conservation Easements," *Tax Notes Federal*, Feb. 7, 2022, p. 898.

[17] IRS, "IRS Touts Favorable Conservation Easement Decision," IR-2019-213 (Dec. 20, 2019).

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until more than two weeks later, on February 16, 2017.

On January 31, 2017, Meyer issued a document characterized as an appraisal of the FMV of the units in Legacy that were donated to the Foundation (appraisal). The only assets that Legacy held at the time of the donation were the five promissory notes. The Tax Court commented that the appraisal enjoyed the "form" of an appraisal while lacking any of its "substance." It then highlighted several flaws with the document, including that it named incorrect parties, contained grammatical faults, did not specify the number of units donated, failed to value the promissory notes, omitted the fact that the notes were not due for seven years, and applied a discount rate for lack of control when the Foundation supposedly held all the units.

The appraisal concluded that the units, and thus the corresponding tax deduction, were worth about $1.6 million. Meyer attached his resume to the appraisal, indicating that he was an attorney, certified public accountant, and certified valuation analyst. He also attached a document that claimed he had "no present or prospective bias with respect to the parties involved" and that his fees were "not contingent on any action or event resulting from the analysis, opinions, or conclusions in, or use of, the [appraisal]."

Meyer advocated philanthropic donations by the taxpayers, but his work was no act of charity. The contract indicated that his fee would be $25,000 or an amount based on the value of the assets that the taxpayers transferred to Legacy, whichever figure was higher. The contract stated that Meyer would get 6 percent of the "deductible amount" up to $1 million and 4 percent thereafter. The contract further explained that the taxpayers transferred five promissory notes to Legacy with a total face value of about $2 million. It also contemplated that Meyer would be entitled to a fee of $84,000.

Using some deductive reasoning, the contract assumed that the "deductible amount" of the assets that would be transferred to the charity would be $1.6 million (that is, $1 million multiplied by 6 percent, plus $600,000 multiplied by 4 percent). The Tax Court noted that this was interesting from a timing perspective, given that the parties executed the contract on December 22, 2016, yet Meyer did not issue the appraisal until about a month and a half later, January 31, 2017.

Integra timely filed a Form 1120-S, "U.S. Income Tax Return for an S Corporation," for 2016, the year of the donation. It attached a copy of the appraisal, prepared by Meyer, and a Form 8283 also prepared by Meyer. The Form 8283 indicated that Integra's basis in the units it donated to the Foundation was about $2 million, and it set the FMV at $1.6 million. The charitable deductions claimed by Integra flowed through to the taxpayers as its sole shareholders. They reported the maximum amount possible on their Forms 1040 for 2016 and carried forward the remainder for use in future years.

The IRS audited the Forms 1040 of the taxpayers for 2016 and 2017 and concluded that they should get a deduction of $0 in both years. The taxpayers disputed the IRS's determinations, filing a petition in Tax Court. At some point before trial, the IRS filed a motion for partial summary judgment, asking the Tax Court to determine that the taxpayers deserve deductions of $0 for various reasons.

B. Tax Court Raises Other Proceedings

Before digging into the federal income tax issues facing the taxpayers, the Tax Court identified two other judicial proceedings in which Meyer had been involved in connection with the Ultimate Tax Plan. The Tax Court started with the complaint filed by the Department of Justice in 2018 alleging that Meyer was a tax shelter "promoter" and should be penalized accordingly, requesting that the district court enjoin him from further marketing the Ultimate Tax Plan and seeking disgorgement of the proceeds that he previously made.[18] Meyer conceded the case in April 2019. The Tax Court next mentioned that the taxpayers and Integra had filed a civil action against Meyer, the Foundation, and others, yet the case was later dismissed for reasons unknown.

[18] Department of Justice, "Federal Court Shuts Down Alleged Nationwide Tax Scheme Involving Charitable LLCs and Charitable Limited Partnerships," Release 19-435 (Apr. 26, 2019); Stipulation for Entry of Final Judgment of Permanent Injunction, *United States v. Meyer*, No. 18-cv-60704-BB, (S.D. Fla. Apr. 25, 2019).

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C. Analysis by the Tax Court

The Tax Court addressed three main issues in rendering its decision on the motion for partial summary judgment filed by the IRS.

1. Failure to prove the donation occurred.

The Tax Court began by explaining that a taxpayer can claim a charitable donation for the year during which it surrenders dominion or control over the relevant property. Thus, Integra had to prove that it adequately transferred units in Legacy to the Foundation in 2016. The taxpayers reluctantly conceded during the pretrial discovery process that the *only* evidence of the alleged transfer was the CWA from the Foundation, which was problematic in itself. As explained above, the CWA was addressed to the wrong party, lacked a signature, might have been issued by an unauthorized person, and improperly describes the property supposedly given to the Foundation.

On this last point, the Tax Court emphasized that the CWA referred to units in "C&H Family, LLC" instead of Legacy. The Tax Court warned that the taxpayers "would face a decidedly uphill task" trying to show that Integra actually transferred anything, much less units in Legacy, to the Foundation in 2016. However, viewing the facts in the manner most favorable to the taxpayers, as the Tax Court must do when ruling on a motion for partial summary judgment filed by the IRS, the Tax Court declined to rule against the taxpayers before trial on this particular issue.

2. Failure to obtain a qualified appraisal.

The Tax Court arrived at a different conclusion when it came to the appraisal, though. The IRS suggested that Meyer was not a qualified appraiser and thus could not have issued a "qualified appraisal" for several reasons. For instance, he was a party to the transaction in which Integra purportedly transferred units in Legacy to the Foundation, he did not disclose the number of units transferred, he misrepresented his qualifications, and he prepared the appraisal in exchange for a "prohibited appraisal fee." The Tax Court had to consider only the last allegation raised by the IRS.

The Tax Court began by citing the regulation establishing 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."[19] It then pointed out that the contract between the taxpayers and Meyer indicated that the latter might get 6 percent of the "deductible amount" up to $1 million and 4 percent thereafter. The contract further stated that Meyer would be paid $84,000, which presupposed that the "deductible amount" would be $1.6 million. Thus, the Tax Court determined Meyer's fee for the appraisal was based on a percentage of the value of the donated property, in direct violation of the applicable regulation.

The Tax Court next explained that the taxpayers attempted to split hairs, arguing that the contract expressly stated that Meyer was valuing the property transferred by Integra to Legacy (the five promissory notes valued at $2 million), not the property transferred by Integra to the Foundation (the units in Legacy valued at $1.6 million). Therefore, suggested the taxpayers, Meyer did not run afoul of the regulation. The Tax Court exhibited little patience for this position, stating that the argument did not pass the "straight-face test" for several reasons.

To begin with, the documents indicate that Meyer did not value the promissory notes. The appraisal, for instance, does not mention various factors that would affect the value of the notes, such as the seven-year term, interest rates, and creditworthiness of the taxpayers. Moreover, the title of the appraisal specifically states that it was valuing the interests in Legacy, as represented by units.

Finally, the Tax Court pointed out that the appraisal reduced the value because of lack of control and lack of marketability, concepts pertaining to ownership of an entity, not promissory notes. The Tax Court, after noting that it would come to the same conclusion even if Meyer had actually valued the promissory notes as opposed to the units in Legacy, concluded as follows:

> In sum, Mr. Meyer's fee was clearly based, directly or indirectly, on the appraised value of the [Legacy] units allegedly donated to the Foundation on December 31, 2016. His agreement with [the

[19] Reg. section 1.170A-13(c)(6)(i).

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taxpayers] thus constituted a prohibited fee arrangement. For that reason alone his purported appraisal was not a qualified appraisal.[20]

3. Down but not altogether out.

The Tax Court offered the taxpayers a slight reprieve after strongly criticizing the unproven donation and qualified appraisal. The court recognized that the failure to meet all the reporting requirements, including the need to attach a qualified appraisal to the relevant tax return, can be excused if the taxpayers can show that their shortcomings were "due to reasonable cause and not to willful neglect."[21] In other words, if the taxpayers can establish a "reasonable cause" defense, they might avoid a deduction of $0 on grounds of no qualified appraisal.[22] Because neither the relevant statute nor regulations provide guidance on what constitutes reasonable cause when a qualified appraisal is absent, the Tax Court has relied on the definition in other situations.[23]

The Tax Court acknowledged this reality in *Lim and Chu*, explaining that the taxpayers asserted that they relied on another certified public accountant, as well as an attorney specializing in tax planning and asset protection, in gauging the appropriateness of the Ultimate Tax Plan. The Tax Court recognized that the taxpayers might "conceivably" show that they received, and reasonably relied on, acceptable professional advice regarding the appraisal. However, the issue involved disputes between the taxpayers and the IRS regarding material facts, so the Tax Court could not resolve it before a trial by way of a motion for partial summary judgment. Whether sufficient reasonable cause existed is a trial question, with the taxpayers having the burden of presenting the evidence.

V. Conclusion

It appears that *Lim and Chu* is now heading to trial. The Tax Court has determined that the taxpayers never obtained a qualified appraisal, but other interesting issues are still pending. Specifically, the IRS is poised to argue that (1) the taxpayers cannot prove that Integra donated units in Legacy to the Foundation in 2016; (2) even if they were able to demonstrate that a donation occurred, the value would not reach $1.6 million; (3) Meyer was not a qualified appraiser because he was not a licensed attorney, certified public accountant, or certified valuation analyst at the time he issued the appraisal; (4) the Form 8283 was defective because it mischaracterized the manner in which the property was transferred, misstated the basis of the taxpayers in the property, and insufficiently described the property; and (5) Integra failed to meet all the substantiation requirements because the CWA was issued to an improper party, lacked a signature, and inaccurately described the property donated.[24] The IRS might raise other positions, too.

Some might be inclined to hastily dismiss *Lim and Chu* on grounds that it is narrow in scope and pertains only to the Ultimate Tax Plan, which is no longer being offered to taxpayers. That perspective is understandable, but the better approach might be to follow the case closely as it works its way through Tax Court. This is because the IRS has been raising similar "technical" challenges in other contexts, including SCET disputes, alleging fatal deficiencies with appraisals, Forms 8283, CWA letters, and other documents commonly affiliated with charitable donations.[25] ■

[20] *Lim and Chu*, T.C. Memo. 2023-11, at 13.

[21] Section 170(f)(11)(A)(ii)(II).

[22] *See Belair Woods LLC v. Commissioner*, T.C. Memo. 2018-159.

[23] *See Crimi v. Commissioner*, T.C. Memo. 2013-51.

[24] *Lim and Chu*, T.C. Memo. 2023-11, at 4-5, 10, 11-12, nn.3-4.

[25] *See, e.g.*, Hale E. Sheppard, "20 Recent Enforcement Actions in Conservation Easement Disputes: Awareness and Preparation Are Key," 134 *J. Tax'n* 15 (2021).

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