T.C. Memo. 1995-275

Strict adherence to qualified appraisal requirements is mandatory for charitable deductions of nonpublicly traded stock exceeding $10,000; substantial compliance does not apply when a qualified appraisal is entirely absent.

Summary

Petitioners claimed charitable deductions for donations of nonpublicly traded Jackson Hewitt stock, valuing the stock based on private transactions without obtaining a qualified appraisal. The IRS allowed deductions only up to the stock's basis, arguing noncompliance with appraisal regulations. The Tax Court upheld the IRS, emphasizing that DEFRA section 155 and Treasury Regulations mandate a qualified appraisal for nonpublicly traded stock donations exceeding $10,000 to deduct fair market value. The court rejected the substantial compliance argument, finding petitioners failed to provide essential information necessary for the IRS to evaluate potential overvaluation, which the appraisal requirement is designed to address.

Facts

Petitioners donated Jackson Hewitt Tax Service, Inc. stock to a foundation and a church in 1990 and 1991. At the time of donation, Jackson Hewitt stock was not publicly traded, with transactions occurring primarily through private sales facilitated by the company or Wheat, First Securities, Inc. Petitioners claimed charitable deductions based on the average per-share price from these private transactions, valuing the donated stock at $33,000 in 1990 and $88,000 in 1991. Petitioners did not obtain a qualified appraisal for the donated stock. On their tax returns, they disclosed the donations but did not include a qualified appraisal or appraisal summary.

Procedural History

The Internal Revenue Service (IRS) determined deficiencies in petitioners' federal income taxes for 1990 and 1991, disallowing the charitable deductions for the donated stock exceeding petitioners' basis in the stock. Petitioners contested the IRS deficiency determination in the Tax Court.

Issue(s)

1. Whether petitioners' valuation of nonpublicly traded stock based on average per-share price from private transactions constitutes substantial compliance with the qualified appraisal requirements for charitable deductions under section 170 and related regulations.

2. Whether petitioners are entitled to charitable deductions for the fair market value of donated nonpublicly traded stock exceeding $10,000 without obtaining a qualified

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appraisal as required by DEFRA section 155 and Treasury Regulations.

Holding

1. No. The court held that using the average per-share price does not constitute substantial compliance because the statute and regulations explicitly require a qualified appraisal, and this fundamental requirement was not met.

2. No. The court held that petitioners are not entitled to deduct amounts exceeding their basis because they failed to obtain a qualified appraisal, a mandatory requirement for deducting the fair market value of nonpublicly traded stock donations over $10,000.

Court's Reasoning

The court reasoned that DEFRA section 155 and its implementing regulations under section 170(a)(1) clearly mandate obtaining a qualified appraisal for donations of nonpublicly traded property, including stock, where the claimed value exceeds $10,000. The legislative history of DEFRA section 155 emphasizes the intent to provide the IRS with sufficient information to effectively address overvaluation of charitable contributions. The court distinguished this case from *Bond v. Commissioner*, 100 T.C. 32 (1993), where substantial compliance was found because the taxpayer provided an appraisal summary containing most required information. In this case, petitioners failed to provide any qualified appraisal or substantially equivalent information. The court stated, "pursuant to present law (sec. 170(a)(1)), which expressly allows a charitable deduction only if the contribution is verified in the manner specified by Treasury regulations, no deduction is allowed for a contribution of property for which an appraisal is required under the conference agreement unless the appraisal requirements are satisfied." The court concluded that the absence of a qualified appraisal was not a minor technicality but a failure to meet a fundamental statutory requirement, precluding the application of substantial compliance.

Practical Implications

Hewitt v. Commissioner underscores the critical importance of strictly adhering to the qualified appraisal requirements for charitable donations of nonpublicly traded stock and other noncash property. It clarifies that for donations exceeding $10,000 of nonpublicly traded stock, a qualified appraisal is not merely a procedural formality but a substantive prerequisite for deducting the fair market value. Taxpayers cannot rely on demonstrating fair market value through other means, such as comparable sales data, to circumvent the appraisal requirement. The case reinforces that substantial compliance is a narrow exception and does not excuse the complete failure to obtain a qualified appraisal when explicitly mandated by statute and regulations. Legal practitioners must advise clients to secure qualified appraisals before claiming deductions for such donations to ensure compliance and

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avoid potential disallowance of deductions and penalties. This case serves as a strong precedent for the IRS to strictly enforce appraisal requirements, even if the donated property's value is not in question.

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