Graev v. Commissioner, 140 T. C. No. 17 (U. S. Tax Court 2013)

In Graev v. Commissioner, the U. S. Tax Court ruled that charitable contributions of cash and a facade conservation easement were not deductible due to a side letter that made the gifts conditional. The court held that the possibility of the IRS disallowing the deductions and the charity returning the contributions was not negligible, thus violating IRS regulations. This decision underscores the importance of ensuring charitable gifts are unconditional to qualify for tax deductions, impacting how donors and charities structure such transactions.

Parties

Lawrence G. Graev and Lorna Graev, petitioners, challenged the Commissioner of Internal Revenue, respondent, in the U. S. Tax Court, seeking a redetermination of deficiencies in tax and penalties assessed for the tax years 2004 and 2005.

Facts

Lawrence Graev contributed cash and a facade conservation easement to the National Architectural Trust (NAT), a charitable organization. Before the contribution, NAT, at Graev's request, issued a side letter promising to refund the cash contribution and remove the easement from the property's title if the IRS disallowed the charitable contribution deductions. Graev claimed deductions for the cash and easement donations on his tax returns. The IRS contended that the side letter made these contributions conditional gifts, which are not deductible under I. R. C. § 170 because the likelihood of divestiture was not negligible.

Procedural History

The IRS issued a notice of deficiency to the Graevs, disallowing their charitable contribution deductions for 2004 and 2005 and determining additional tax liabilities and penalties. The Graevs petitioned the U. S. Tax Court for a redetermination of these deficiencies and penalties. The case was submitted fully stipulated under Tax Court Rule 122, with the burden of proof remaining on the taxpayer. The Tax Court considered only the conditional gift issue at this stage.

Issue(s)

Whether the deductions for the Graevs' charitable contributions of cash and a facade conservation easement to NAT should be disallowed because they were conditional gifts?

Rule(s) of Law

Under I. R. C. § 170 and 26 C. F. R. §§ 1. 170A-1(e), 1. 170A-7(a)(3), and 1. 170A-14(g)(3), a charitable contribution deduction is not allowed if, at the time of the gift, the possibility that the charitable interest would be defeated by a subsequent event is not “so remote as to be negligible. “

Holding

The Tax Court held that the Graevs’ charitable contribution deductions were not allowed because the possibility that the IRS would disallow the deductions and NAT would return the contributions was not “so remote as to be negligible,” as required by the applicable regulations.

Reasoning

The court’s reasoning focused on the non-negligible risk of IRS disallowance due to heightened scrutiny of easement contributions, as evidenced by IRS Notice 2004-41 and the Graevs’ own awareness of this risk. The court found that the side letter issued by NAT, promising to refund the cash and remove the easement in case of disallowance, created a condition that could defeat NAT’s interest in the contributions. The court rejected the Graevs’ arguments that the side letter was unenforceable under New York law and a nullity under federal tax law, finding that NAT had the ability to honor its promise to abandon the easement as per the recorded deed. The court also emphasized that the possibility of NAT voluntarily returning the contributions was non-negligible, given NAT’s promises and the context of its solicitations.

Disposition

The Tax Court disallowed the Graevs’ charitable contribution deductions for the cash and easement contributions and upheld the IRS’s determination of deficiencies in tax for the years 2004 and 2005.

Significance/Impact

The decision in Graev v. Commissioner has significant implications for the structuring of charitable contributions, particularly those involving conservation easements. It reaffirms the IRS’s position that conditional gifts, where the charity’s interest may be defeated by a non-negligible subsequent event, are not deductible. This ruling may lead to increased scrutiny of side letters and similar arrangements in charitable giving, affecting how donors and charities approach such transactions. The case also highlights the importance of ensuring that charitable contributions are unconditional to qualify for tax deductions, impacting future tax planning and compliance efforts.

