Lawrence G. Graev and Lorna Graev v. Commissioner of Internal Revenue, 140 T. C. 377 (U. S. Tax Court 2013)

In Graev v. Commissioner, the U. S. Tax Court disallowed the taxpayers' charitable contribution deductions for a facade easement and cash donation to a charity, ruling that the contributions were conditional and thus non-deductible. The court found that the charity's promise to return the contributions if the IRS disallowed the deductions created a non-negligible risk that the charity would not retain the donations, violating the requirement that charitable gifts be unconditional to qualify for a tax deduction. This decision highlights the importance of ensuring that charitable contributions are not contingent on favorable tax treatment.

Parties

Lawrence G. Graev and Lorna Graev, Petitioners, v. Commissioner of Internal Revenue, Respondent.

Facts

In 2004, Lawrence Graev purchased a property in a historic district in New York City for $4. 3 million. The property was listed on the National Register of Historic Places. Graev donated a facade conservation easement and cash to the National Architectural Trust (NAT), a charitable organization dedicated to preserving historic architecture. Before the donation, NAT issued a side letter to Graev promising to refund the cash donation and remove the easement if the IRS disallowed the charitable contribution deductions. Graev claimed deductions for the cash and easement donations on his 2004 and 2005 tax returns. The IRS disallowed these deductions, asserting that the side letter made the contributions conditional gifts, not deductible under I. R. C. sec. 170.

Procedural History

The IRS issued a notice of deficiency to Graev for the tax years 2004 and 2005, disallowing the charitable contribution deductions and determining deficiencies in tax. Graev petitioned the U. S. Tax Court for redetermination of the deficiencies. The case was submitted fully stipulated under Tax Court Rule 122, reflecting the parties' agreement that the relevant facts could be presented without a trial. The Tax Court held that the Graevs' charitable contribution deductions were not allowed because the possibility that the deductions would be disallowed and the contributions returned was not "so remote as to be negligible. "

Issue(s)

Whether the Graevs' charitable contribution deductions for the facade easement and cash donation to NAT should be disallowed because the contributions were conditional gifts under I. R. C. sec. 170 and the corresponding Treasury Regulations?

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Rule(s) of Law

Under I. R. C. sec. 170 and 26 C. F. R. secs. 1. 170A-1(e), 1. 170A-7(a)(3), and 1. 170A-14(g)(3), a charitable contribution deduction is allowable only if the gift is unconditional. If an interest in property passes to charity on the date of the gift but could be defeated by a subsequent event, the deduction is allowable only if the possibility of the event's occurrence is "so remote as to be negligible. "

Holding

The Tax Court held that the Graevs' charitable contribution deductions for the facade easement and cash donation were not allowable because the contributions were conditional gifts. The court determined that the possibility that the IRS would disallow the deductions and NAT would return the contributions was not "so remote as to be negligible," thus failing to meet the requirements of the applicable regulations.

Reasoning

The court analyzed the side letter's impact on the contributions, concluding that it created a non-negligible risk that the contributions would be returned if the deductions were disallowed. The court rejected the taxpayers' 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 promises to return the contributions. The court considered the increased IRS scrutiny of easement contributions, as evidenced by IRS Notice 2004-41, and the taxpayers' awareness of this scrutiny as factors indicating that the risk of disallowance was not negligible. The court also noted that the side letter was an inducing cause for Graev to make the contributions, further supporting its conclusion that the contributions were conditional.

Disposition

The Tax Court disallowed the Graevs' charitable contribution deductions for the facade easement and cash donation, upholding the IRS's determination of deficiencies in tax for the years 2004 and 2005.

Significance/Impact

The Graev decision underscores the importance of ensuring that charitable contributions are not contingent on favorable tax treatment to qualify for a deduction. It highlights the need for donors and charities to structure their transactions to avoid creating non-negligible risks of the charity's divestment of the donated property. The case has implications for the validity of "comfort letters" or side agreements in charitable giving, as such agreements may render contributions conditional and non-deductible. Subsequent cases have cited Graev in analyzing the permissibility of conditional charitable contributions, reinforcing its doctrinal

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importance in the area of tax law concerning charitable deductions.

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