OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 18011053
BARRY H. HINDEN AND MARILYN K. HINDEN	Date Issued: May 7, 2019

OPINION

Representing the Parties:

For Appellants: Mark Bernsley, Esq.

For Respondent: David Hunter, Tax Counsel IV

Office of Tax Appeals: William J. Stafford, Tax Counsel III

D. BRAMHALL, Administrative Law Judge: This appeal is made pursuant to section 19045 of the Revenue and Taxation Code (R&TC) from the actions of the Franchise Tax Board (FTB) on appellants' protests of a proposed assessment of $162,400 in additional tax, plus applicable interest, for the 2012 tax year; and a proposed assessment of $23,117 in additional tax, plus applicable interest, for the 2013 tax year.[1]

Office of Tax Appeals (OTA) Administrative Law Judges Douglas Bramhall, Grant S. Thompson and Daniel K. Cho held an oral hearing for this matter in Los Angeles, California, on March 20, 2019. At the conclusion of the hearing, the record was closed, and this matter was submitted for decision.

ISSUE

Whether appellants have demonstrated that they are entitled to deduct a loss in relation to their transfer of property to a charity.

[1] During the appeal process, appellants paid the proposed assessments in full. The FTB states that it will treat this appeal as a claim for refund. All Section references are to the Internal Revenue Code (IRC), unless otherwise designated. All "Regulation" references are to federal Treasury Regulations, unless otherwise provided.

FACTUAL FINDINGS

A. Transfer of Property to Charity

1. In 2012, appellants transferred commercial property located in Orlando, Florida, (property) to the Temple of Israel of Hollywood, a qualified Section 501(c)(3) organization (charity).[2] Appellants paid off the mortgage on the property before transferring it to the charity; thus, the charity took the property debt-free.
2. On the date of transfer, the fair market value of the property was $950,000 and appellants had an adjusted basis in the property of $2,343,291.
3. The trustee's deed for the transfer states that appellants transferred the property to the charity for a nominal sum of $10, which was paid, and "other good and valuable consideration."
4. Appellants reported the fair market value of the property (i.e., $950,000) as a charitable contribution for on their 2012 tax year return; however, due to an adjusted gross income (AGI) limitation, appellants' charitable deduction for the 2012 tax year was limited to $755,232 and appellants reported a carryover charitable contribution of $222,302 to the 2013 tax year.[3] In addition to the charitable deduction of $950,000, appellants claimed an ordinary loss for the 2012 tax year of $1,393,291, which represented the difference between appellants' adjusted basis in the property of $2,343,291 and its fair market value of $950,000.

B. Audit

5. Upon audit, FTB allowed the $950,000 charitable contribution for the 2012 tax year but disallowed the loss of $1,393,291. FTB's disallowance of the loss of $1,393,291 increased appellants' AGI for the 2012 tax year, such that FTB allowed the full charitable contribution of $950,000 for the 2012 tax year, which eliminated appellants' charitable contribution carryover of $222,302 for the 2013 tax year.
6. On September 2, 2016, FTB issued Notices of Proposed Assessment (NPAs) that conformed to the above-listed adjustments. The NPA for the 2012 tax year set forth an

[2] The charity took title to the property through TIOH Orlando, LLC. For sake of discussion, we shall reference the acquisition of the property by TIOH Orlando, LLC, as an acquisition by the charity itself.

[3] Appellants made other charitable contributions for the 2012 tax year that are not at issue in this appeal.

additional tax of $162,400, plus applicable interest. The NPA for the 2013 tax year set forth an additional tax of $23,117, plus applicable interest.

7. Appellants filed timely protests, which FTB denied by issuance of Notices of Action on May 12, 2017. This timely appeal followed.

DISCUSSION

I. Applicable Law

Income tax deductions are a matter of legislative grace, and a taxpayer who claims a deduction has the burden of proving by competent evidence that he or she is entitled to that deduction. (See *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.)

Section 170(a) allows a deduction for any charitable contribution, as defined in Section 170(c).[4] In general, the amount of a charitable contribution made in property other than money is the fair market value of the property at the time of contribution. (Treas. Reg. § 1.170A-1(c)(1).)

Section 1001(a) provides that the amount of gain or loss realized from a sale or other disposition of property shall be the excess of the amount realized over the adjusted basis provided for in Section 1011. Section 1011(a) generally provides that the adjusted basis for determining the gain from the sale of property shall be the property's initial basis (determined under Section 1012 or other applicable sections of that subchapter) adjusted as provided for in Section 1016.[5] Under Section 1016, the property's initial basis must be adjusted for capital expenses and capital recoveries.[6]

Section 1001(c) provides the general rule that the entire amount of gain or loss on the "sale or exchange" of property is "recognized" unless otherwise provided.

[4] California generally conforms to Section 170 at R&TC section 17201. Section 170(c) states, in part: "the term 'charitable contribution' means a contribution or gift to or for the use of" any entity listed in the statute.

[5] California generally conforms to Sections 1001 and 1011-1016 at R&TC section 18031.

[6] The adjusted basis of the donated property is not in dispute in this appeal.

Section 165(a) provides that to be deductible, a loss must be "sustained" during the taxable year.[7] Further, if the taxpayer is an individual, Section 165 provides that the loss allowed is limited to losses: (1) incurred in a trade or business; (2) incurred in a transaction entered into for profit; and (3) arising from fire, storm, shipwreck, or other casualty, or from theft. In addition, Regulation 1.165-1(b) provides that, to be deductible, a loss must be: (a) evidenced by a closed and completed transaction; (b) fixed by an identifiable event; and (c) with certain exceptions, sustained in the applicable taxable year.

II. Preliminary Matters[8]

A. Part Gift, Part Sale Provisions

As a preliminary matter, we must decide whether the transfer of the property to the charity constituted a "charitable contribution" (i.e., a gift of property to the charity)—or a part gift, part sale of property to the charity. If the transfer constituted a part gift-part sale, then any calculation of gain or loss on the portion consisting of a sale would be subject to the part gift-part sale provisions of Regulation section 1.1001-1(e).

As applicable to the facts at hand, we note that the trustee's deed for the transfer of the property states that appellants transferred the property to the charity for the nominal sum of $10 and "other good and valuable consideration," which could suggest that appellants' charitable contribution should be viewed as part gift, part sale. Given such a de minimis amount in comparison to value, we view such recital as merely evidence of compliance with deed transfer protocol and not as evidence of an intended or actual sale of the property for $10.

We also note FTB's evidence that appellants' return reported the loss element of the transaction as a sale of business property on Form 4797, and the consideration received as $950,000, the amount of the charitable contribution claimed. As such, FTB argues that the transaction at issue is as appellants reported, a sale, or a charitable contribution, but not both. And having acknowledged that the transaction is a charitable contribution, it cannot also be a sale which generates a loss.

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[7] California generally conforms to Section 165 at R&TC section 17201.

[8] Appellants argue that we should consider the overall transaction to be an abandonment of business property via a transfer to a charitable organization. However, appellants' own representations are inconsistent with that result, and the argument will therefore be considered no further.

However, IRS Chief Counsel Advice (CCA) 201105010, dated October 27, 2010, states the following:

> The tax benefit of a federal or state charitable contribution deduction is not regarded as a return benefit that negates charitable intent, reducing or eliminating the deduction itself. (See *McLennan v. United States*, 23 Cl. Ct. 99 (1991), subsequent proceedings, 24 Cl. Ct. 102, 106 n.8 (1991), aff'd, 994 F.2d 839 (Fed. Cir. 1993); *Skripak v. Commissioner*, 84 T.C. 285, 319 (1985); *Allen v. Commissioner*, 92 T.C. 1, 7 (1989), aff'd, 925 F.2d 348 (9th Cir. 1991).) Similarly, when the contribution is in the form of property, the value of the deduction has not been treated as an item of income under § 61, in the form of an amount realized on the transfer under § 1001. (See *Browning v. Commissioner*, 109 T.C. 303 (1997) [value of state and federal tax benefits not part of the amount realized from a bargain sale of donated property].) [¶] . . . [¶] . . . Based on our analysis of existing authorities, we conclude that the position reflected in *McLennan*, *Browning*, and similar case law generally applies. There may be unusual circumstances in which it would be appropriate to recharacterize a payment of cash or property that was, in form, a charitable contribution as, in substance, a satisfaction of tax liability.[9] Generally, however, a state or local tax benefit is treated for federal tax purposes as a reduction or potential reduction in tax liability. As such, it is reflected in a reduced deduction for the payment of state or local tax under § 164, not as consideration that might constitute a quid pro quo, for purposes of § 170, or an amount realized includible in income, for purposes of §§ 61 and 1001.

While the CCA is not precedential and deals specifically with state and local tax benefits flowing from charitable contributions, we find its analysis persuasive on the question of consideration from a tax benefit, and we see no distinction when the tax benefit is a federal benefit flowing from a charitable contribution.

Accordingly, we find that appellants' reporting of the economic loss component of the transaction to be consistent with an effort to report their loss, rather than reflective of an actual sale for consideration, since the consideration shown on Form 4797 is not in fact consideration for the transfer by gift at all.[10]

[9] We are aware of Notice 2018-54, IR-2018-122, May 23, 2018, in which the Department of the Treasury and the Internal Revenue Service (IRS) announced pending regulations to address the potential recharacterization of purported charitable contributions. The circumstances addressed in that Notice have no application to the issue in this appeal.

[10] Appellants argue that their reporting position is consistent with the economic realities of their situation; to wit, from a policy perspective, they should be treated the same as if they sold the property at fair market value, sustained a loss, and then donated the sale proceeds to the charity. We do recognize that economic equivalent; however, that is not the actual transaction that occurred and thus provides no technical authority for the outcome in this appeal.

Accordingly, we find that the transfer did not constitute a sale (either in whole, or in part). Further, because the transfer did not constitute a sale, either in whole or in part, the bargain-sale provisions of Regulation section 1.1001-1(e) and Section 1011(b) are not applicable.[11]

B. The Loss Is Not Recognized

Insofar as the statutory context is concerned, Section 1001(a) is the principal section defining gain or loss from the sale or other disposition of property for federal income tax purposes. A gift is a disposition of property. (*Estate of Levine v. Commissioner* (1979) 72 T.C. 780, 789, affd. (2d Cir. 1980) 634 F.2d 12; *Withers v. Commissioner*, (1978) 69 T.C. 900, 904.)

Further, Section 1002 requires that the entire amount of gain or loss on the sale or exchange of property be recognized unless otherwise provided. There are numerous exceptions and qualifications to the general rule contained in Section 1002, and one argued by FTB here is that a taxpayer who disposes of property by gift may not also recognize a loss. "This exception stems from the perception that in the usual case a taxpayer receives nothing in exchange for making a gift, and thus his section 1001(a) 'amount realized' is zero." (*Guest v. Commissioner* (1981) 77 T.C. 9, 21.) From that perception, one would conclude there is no sale or exchange (even though there may have been a disposition).

The facts at hand are significantly similar to the facts in *Withers v. Commissioner, supra*. In *Withers*, the taxpayers contributed corporate stocks that had bases exceeding their fair market value to a qualified charity. The taxpayers asserted that under Section 170 they were entitled to a charitable contribution deduction equal to their bases of the corporate stocks on the date of contribution. Alternatively, the taxpayers argued that they were entitled to a charitable deduction under Section 170 equal to the stocks' fair market value and, additionally, under Section 165, to a loss deduction equal to the difference between the stocks' higher adjusted basis and fair market value at the time of contribution. (*Withers, supra,* 69 T.C. at p. 903.)

The IRS conceded that the taxpayers were entitled to a charitable deduction equal to the fair market value of the corporate stocks on the date of contribution, but the IRS asserted that no deductible loss was created by the contribution. In short, the IRS only disputed the claimed loss. (*Withers, supra,* 69 T.C. at p. 901.)

[11] The bargain-sale provisions of Section 1011(b) apply to a *sale* of a good or service to a charity for less than fair market value.

After reviewing the matter, the Tax Court held that, although the taxpayers "realized" a loss on the contribution of debt-free property (corporate stocks) to the charity, the loss was not "recognized" because (i) the loss was not "sustained" under Section 165(a), and (ii) the loss did not meet the requirements of Section 165(c), which limits recognition of losses by individuals to trade or business losses, losses incurred in transactions entered into for profit, and casualty and theft losses. (*Withers, supra,* 69 T.C. at p. 905.)

Appellants argue that under Section 1001(c), a gain or loss on a "sale or exchange" is generally recognized. We note, however, that the general recognition rule of Section 1001(c) specifically addresses a "sale or exchange" of property—not a "gift" of debt-free property. Again, the general rule for gifts is that a taxpayer who disposes of debt-free property by gift, without receiving in return money or other property, does not "recognize" gain or loss. (*Guest v. Commissioner, supra*; *Taft v. Bowers* (1929) 278 U.S. 470.)

Appellants also argue that unlike in *Withers,* here the appellants donated the property because they could not sell it in a bad real estate market and thus avoided the continuing expenses of maintaining a vacant property. We do not view that motivation to negate appellants' personal donative intent even though the disposition also made good economic sense.

We find *Withers* controlling in this matter. Appellants argue that the court's reasoning, differentiating a "sustained" loss from a "realized" loss, was faulty analysis. (See *Withers, supra,* 69 T.C. at p. 903.) However, no contrary authority was cited, and we are aware of none. In fact, this differentiation is supported by the view that with no value received in a disposition, there is no sale or exchange and thus no recognition mandate under Section 1001(c).

Additionally, the *Withers* court found the taxpayers' realized loss under Section 1001 did not fit any criteria for loss recognition under Section 165(c). (*Withers, supra,* 69 T.C. at p. 903.) We view this finding supported insofar as a gift transaction does not constitute a trade or business transaction, a transaction entered into for profit, or a casualty. Further, appellants have cited no authority directly allowing a loss in a comparable transaction, nor are we aware of any such authority.

As an alternative argument, appellants contend that for tax purposes the transaction at hand might be treated as two transactions: a contribution to a charity (under which appellants might claim a charitable deduction) and a sale of an asset (under which appellants might deduct the loss)—and appellants assert that there is no sound "policy reason" for not doing so. Again,

deductions are a matter of legislative grace, and a taxpayer who claims a deduction has the burden of proving by competent evidence that he or she is entitled to that deduction. (*New Colonial Ice Co. v. Helvering*, *supra*.) Here, appellants have not demonstrated that the loss at hand should be recognized, whether as a part of two transactions, or otherwise, for tax purposes. Further, case law provides otherwise. (See *Withers*, *supra*.)

In summary, appellants have not demonstrated that they are entitled to deduct a loss in relation to their transfer of property to a charity.

HOLDING

Appellants have not demonstrated that they are entitled to deduct a loss in relation to their transfer of property to a charity.

DISPOSITION

FTB's actions are sustained.

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Douglas Bramhall
Administrative Law Judge

I concur:

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Daniel K. Cho
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Daniel K. Cho
Administrative Law Judge

CONCURRING OPINION

G. Thompson, Administrative Law Judge, concurring.

I concur in the holding and generally concur in the majority opinion's analysis; however, I do not join in the analysis regarding Form 4797 and Chief Counsel Advice 201105010.

Concurring:

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Grant S. Thompson
Administrative Law Judge