**UNITED STATES TAX COURT**
**WASHINGTON, DC 20217**

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| TOT PROPERTY HOLDINGS, LLC, TOT LAND MANAGER, LLC, TAX MATTERS PARTNER, | ) | |
| Petitioner(s), | ) | |
| v. | ) | Docket No. 5600-17. |
| COMMISSIONER OF INTERNAL REVENUE, | ) | |
| Respondent | ) | |

**O R D E R**

Pursuant to Rule 152(b) of the Tax Court Rules of Practice and Procedure, it is

ORDERED that the Clerk of the Court shall transmit herewith to petitioner and to respondent a copy of the pages of the transcript of the proceedings in the above case before the undersigned judge at Washington, D.C., containing his oral findings of fact and opinion rendered at the trial session at which the case was heard.

In accordance with the oral findings of fact and opinion, decision will be entered for the Commissioner.

**(Signed) David Gustafson**
**Judge**

Dated: Washington, D.C.
December 13, 2019

**SERVED Dec 13 2019**

Bench Opinion by Judge David Gustafson

November 22, 2019

TOT Property Holdings, LLC v. Commissioner

Docket No. 5600-17

THE COURT: The Court has decided to render the following as its oral Findings of Fact and Opinion in this case. This Bench Opinion is made pursuant to the authority granted by section 7459(b) of the Internal Revenue Code (26 U.S.C.), and Tax Court Rule 152; and it shall not be relied on as precedent in any other case.

Petitioner in this case is TOT Land Manager, LLC, the tax matters partner ("the TMP") of TOT Property Holdings, LLC ("TOT"). ("TOT" is the initials of "Trail of Tears", the route of a 19th Century forced relocation of Native Americans, which route passed through or near the property at issue in this case.) In 2013 TOT executed a deed (Ex. 16-J) declaring a conservation easement in favor of a tax-exempt charitable organization; and on its tax return for that year-- Form 1065, "U.S. Return of Partnership Income" (Ex. 2-J)--TOT claimed a charitable contribution deduction of $6.9 million. (In this opinion, numbers are rounded, and the precise numbers are stated in or can be inferred from the parties' stipulations.) By notice of final partnership administrative adjustments dated January 3, 2017 (the "FPAA" (Stip 2; Ex. 1-J)), the

Commissioner disallowed the deduction and determined that penalties were applicable. The issues for the Court to decide are whether TOT was entitled to the deduction, the amount of the deduction, if any, that represented the fair market value of the conservation easement, and whether penalties are applicable. We hold that TOT is not entitled to the deduction, that the fair market value of the conservation easement was $496,000, and that penalties are applicable.

Trial of this case was conducted on November 18 and 19, 2019, in Washington, D.C. At trial, TOT was represented by John Paul Barrie and Kwabena Yeboah. The Commissioner was represented by Christopher Bradley and Kimberly Daigle.

## FINDINGS OF FACT

### The property

At issue in this case are two parcels consisting of 652 acres of rural property ("the subject property") in Van Buren County, Tennessee. (Stip. 11-12.) This acreage is part of larger tracts acquired in 2005 by Mr. George R. Dixson for $745 per acre (see Stip. 7), so that he thereby acquired the 652 acres at issue for about $486,000 in 2005. Mr. Dixson thereafter transferred portions of the property to two limited liability companies ("LLCs") that he owned--"Evergreen" and "Harper". (Stip. 8-9.)

This subject property was at least 32 miles from the nearest interstate highway. It contained no mountains, and none was nearby. It contained two small streams (which were frequently dry) and no lakes. The utilities available on the subject property in 2013 included telephone and electricity, but no access to public water. There is no hospital in the County. The subject property was situated on a larger tract that had formerly been an artillery range. The surrounding area was hardwood forests (containing mostly oaks and hickory), but at some point in the past it had been clear cut and re-planted with row upon row of loblolly pine, a softwood common to the Cumberland Plateau that grows the fastest and is the easiest to manage compared to other softwoods. (Ex. 36-R, p. 12).

Nearby properties

Elsewhere in the county were three intended residential developments that had more or less failed. The most nearly successful was Overton Retreat, located about five miles northwest of the subject property, which had been started and two of its "phases" commenced before the recession of 2009. Of the 90 lots in those two phases, 62 lots sold from July 2002 through January 2013, with the last 3 of those sales occurring between 2009 and 2013; of the lots sold, only 11 were improved as of 2013.

(Ex. 35-R, p. 67.) A previously expected third phase at Overton Retreat was never undertaken. Isha Village was platted in 2006 or 2007 but had no sales until 2017. Indian Trails was a failed development reputed to be a "Ponzi scheme", and no infrastructure was ever built. (A fourth development, Long Branch Lakes, is a master-planned gated community in Spencer, Tennessee, located north of the subject property. Long Branch Lakes was apparently successful prior to 2013, but no evidence was presented regarding whether it was still selling lots in 2013. Because it was an already-developed community, neither party treated it as comparable to the subject property. (See Ex. 33-P, p. 94.))

Value of pre-easement property

The Commissioner's expert was Mr. Gerald Barber, an expert in the field of real estate valuation and conservation easements, as well as landscape architecture and land planning. Persuaded by his report (Ex. 35-R) and testimony (discussed below), we find that as of December 2013 (and before the conservation easement at issue in this case), the highest and best use of the subject property was not residential development but was instead recreational use and timber harvesting, and the fair market value of the subject property was $1.128 million.

Transfer of ownership

Sometime before November 2013, TOT and the TMP were formed as LLCs entirely owned by Mr. Dixson's LLCs, Evergreen and Harper. In November 2013 Evergreen and Harper transferred the subject property to TOT. (Stip. 11-12.) As of that time, the subject property was still owned by Mr. Dixson--but indirectly, through his several LLCs. (Ex. 14-J.)

PES Fund VI, LLC ("PES"), was formed by persons other than Mr. Harper in order to acquire (indirectly) the subject property by acquiring interests in TOT (the entity that owned that property). (Stip. 13.) PES accomplished this acquisition by purchasing almost all of the ownership interests in TOT that had previously been owned by various of Mr. Dixson's LLCs. Mr. Dixson's LLCs retained a total of 1 percent of the ownership of TOT, and PES acquired the other 99 percent of TOT. (Ex. 15-J.) PES thereby indirectly acquired 99 percent of the subject property. That is, PES owned 99 percent of TOT, and TOT owned the subject property. Immediately prior to PES's acquisition of 99 percent of TOT, the assets of TOT consisted of the subject property and $100.

To acquire its 99 percent of TOT (and, thereby, its 99 percent indirect ownership of the subject property), PES paid $717,200 in cash (see Ex. 13-J, sec. 2(c)(1)) and assumed the obligation to make capital

contributions of $322,000 (see Ex. 5-J, sec. 7.01(a); cf. Ex. 13-J, sec. 2(c)(ii)), for total consideration of $1,039,200. (That total payment to acquire 99 percent of the property suggests a 100 percent value of roughly $1.05 million.)

Deed of easement

TOT donated to the Foothills Land Conservancy ("Foothills") a conservation easement over the subject property. The easement extends over 637 acres, not the entire 652 acres of the subject property, because the easement excludes three 5-acre "inholdings". (Doc. 27, para. 2.) The deed of conservation easement (Ex. 16-J) was dated December 27, 2013. (Stip. 17.) Foothills is a qualified organization under section 170(h)(1)(B) and (h)(3); the conservation easement serves a conservation purpose under section 170(h)(4); and TOT received from Foothills a contemporaneous written acknowledgment for the donation of the conservation easement, within the requirements of section 170(f)(8). (Doc. 27, paras. 3-5.)

Section 9 of the deed is pertinent to a "proceeds" issue that we address in this opinion. Section 9.1 of the deed contemplates the possibility of judicial extinguishment of the easement and invokes section 9.2 to calculate the proceeds due to Foothills if such an event were to occur. Section 9.2 of the deed provides: "This

Easement constitutes a real property interest immediately vested in Grantee, which, for the purposes of Section 9.1, the parties stipulate to have a fair market value determined by multiplying (a) the fair market value of the Property unencumbered by this Easement (minus any increase in value after the date of this grant attributable to improvements) by (b) a fraction, the numerator of which is the value of this Easement at the time of the grant and the denominator of which is the value of the Property without deduction of the value of this Easement at the time 6 of this grant.... It is intended that this Section 9.2 be interpreted to adhere to and be consistent with 26 C.F.R. Section 1.170A-14(g)(6)(ii)." (Section 9.3, addressing eminent domain or condemnation, has an equivalent provision.)

Value of post-easement property

Again persuaded by the report (Ex. 35-R) and testimony of the Commissioner's expert, Mr. Gerald Barber (discussed below), we find that as of December 2013 but after the conservation easement at issue in this case, the highest and best use of the subject property remained recreational use and timber harvesting, and the fair market value of the subject property, encumbered by the easement, was $632,000. The difference between that post-easement value and the pre-easement value of $1.128

million--i.e., $496,000--is the fair market value of the easement.

Tax return and examination

TOT timely filed its tax return for the short calendar year beginning December 11, 2013 (Stip. 3, Ex. 2-J). On that return TOT reported a charitable contribution of a qualified conservation easement of $6.9 million and attached to its return a qualified appraisal, by David R. Roberts, a qualified appraiser, as required by section 170(f)(11). (Doc. 27, para. 6.) That appraisal valued the easement at $6.9 million. (Ex. 17-J, p. 2).

The IRS examined the return. (Stip. 22.) Revenue Agent Adrienne Thomas did the examination. She prepared a revenue agent's report ("RAR", in this instance consisting of Forms 4605-A, 886-Z, and 886-A). The RAR proposed the disallowance of the charitable contribution deduction for the conservation easement, proposed the 40 percent penalty for gross overvaluation misstatement, and proposed in the alternative a 20 percent penalty for substantial valuation misstatement or for negligence. Group Manager Tomika Mickles signed a Letter 1807 addressed to TOT's TMP, dated May 10, 2016, that transmitted Agent Thomas's RAR and that invited the TMP to attend a "closing conference". The letter stated: "We enclosed a copy of our summary report .... The report

explains all proposed adjustments ...." (Ex. 21-J.)

The parties have stipulated that Agent Thomas "made the initial determination" as to penalties and that Group Manager Mickles "was her immediate supervisor". (Stip. 23-24.)

Ms. Mickles signed a "Civil Penalty Approval Form" dated July 8, 2017 (Ex. 24-J).

On January 3, 2017, the Commissioner timely issued the FPAA to TOT's TMP. (Stip. 2, Ex. 1-J.)

Tax Court proceedings

The TMP timely filed a petition in this Court on March 7, 2017. At that time, the principal place of business of both TOT and the TMP was in Georgia. (Stip. 1.)

David R. Roberts, the appraiser whose $6.9 million appraisal was attached to the tax return, is now deceased. TOT therefore hired another appraiser, Mr. Thomas Wingard, an expert in valuation of conservation easements, who testified at trial. He ascribed to the subject property a highest and best use of "residential development". Mr. Wingard's before-easement value was $3.9 million; his after-easement value was $1.2 million; and he opined that the value of the easement--the difference between those before and after values--was $2.7 million.

The Commissioner's expert witness, Mr. Barber, opined that the highest and best use of the subject property was recreational use and timber harvesting. Mr. Barber's before-easement value was $1.128 million; his after-easement value was $632,000; and he opined that the value of the easement--the difference between those before and after values--was $496,000.

DISCUSSION

I. Burden of proof

As a general rule, the Commissioner's determinations in an FPAA are presumed correct, and a party challenging an FPAA bears the burden of proving that the Commissioner's determinations are in error. Rule 142(a); Welch v. Helvering, 290 U.S. 111, 115 (1933).

II. Deduction for qualified conservation contribution

A. General rules

Section 170(a)(1) allows a deduction for any charitable contribution made within the taxable year. If the taxpayer makes a charitable contribution of property other than money, the amount of the contribution is generally equal to the fair market value of the property at the time the gift is made. See 26 C.F.R. sec. 1.170A-1(c)(1). The Code generally restricts a taxpayer's charitable contribution deduction for the donation of "an

interest in property which consists of less than the taxpayer's entire interest in such property." Sec. 170(f)(3)(A). But there is an exception to this rule for a "qualified conservation contribution." Sec. 170(f)(3)(B)(iii).

Section 170(h)(1) defines a "qualified conservation contribution" as a contribution of a "qualified real property interest" to a "qualified organization" "exclusively for conservation purposes". The parties stipulated prior to trial that Foothills is a qualified organization under sections 170(h)(1)(B) and (h)(3). (Doc. 27; para. 3). Under 170(h)(2)(C), a "qualified real property interest" includes an interest in real property that is a restriction granted in perpetuity on the use of the real property. Section 170(h)(5)(A) provides that a contribution is not treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.

B. Disputed issues

The Commissioner advances three grounds for the denial of the deduction for the charitable contribution of the conservation easement, the first two of which relate to the requirement that the conservation purpose must be protected in perpetuity. First, the Commissioner contends that sections 9.1 and 9.2 of the deed of easement, which

specify the allocation of the proceeds from a sale of the easement if it is ever extinguished as a result of judicial proceedings, fail to protect the conservation purpose in perpetuity. Second, the Commissioner asserts that section 17.12 of the deed impermissibly permits extinguishment of the easement pursuant to a state law merger which would occur if the easement was "returned by specific conveyance to the holder of the fee", a circumstance explicitly contemplated by rather than precluded by the language of the deed. Finally, the Commissioner argues that certain rights reserved to TOT as the donor-- specifically, the right to conduct commercial forestry under section 4.6--are inconsistent with the conservation interests of the easement to the extent that they defeat its conservation purpose. We address the first ground the Commissioner asserts as the basis for denial of the deduction and find that our determination on this issue is dispositive, so that we need not address the other two.

C. Proceeds from extinguishment

1. The proportionality requirement

In order to satisfy the requirement that the conservation purpose be protected in perpetuity, any interest in the property retained by the donor must be subject to legally enforceable restrictions that will

prevent uses of the retained interest inconsistent with the conservation purpose of the donation. 26 C.F.R. sec. 1.170A-14(g). It is possible that an easement may be extinguished by a court order, and in such an instance the easement would not have lasted in perpetuity. However, the regulations provide that if, an extinguishment does occur, the donation will nonetheless be deemed to have been in perpetuity if the proceeds of the extinguishment are paid to the donee organization and the donee uses them for its conservation purposes. The regulation requires as follows: "[F]or a deduction to be allowed under this section, at the time of the gift the donor must agree that 12 the donation of the perpetual conservation restriction gives rise to a property right, immediately vested in the donee organization, with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction at the time of the gift, bears to the value of the property as a whole at that time.... [T]hat proportionate value of the donee's property rights shall remain constant.... [T]he donee organization, on a subsequent sale, exchange, or involuntary conversion of the subject property, must be entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction ...." Id. sec. - 14(g)(6)(ii).

In a recent opinion of this Court, Coal Property Holdings v. Commissioner, 153 T.C. __, __ (Oct. 28, 2019), we addressed the deductibility of a conservation contribution where the easement deed contained a proportionality formula identical to the formula in the easement at issue here. In Coal Property, as in the instant case, the deed provided that the donee's share of the proceeds of a judicial extinguishment would be calculated by using the easement's proportion of value, as determined at the time of the gift (so far, so good), but multiplying it not against the property's total fair market value at the time of sale but rather against the property's fair market value at the time of sale "minus any increase in value after the date of th[e] grant attributable to improvements". This subtraction, which diminishes the donee's share of the proceeds, is not permitted. Under the regulation, a "donee must be entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction"; or else this limited exception to the perpetual use restriction of the conservation easement is not satisfied and the donor has failed to satisfy the requirement that the conservation purpose of the contribution be protected in perpetuity. See 26 C.F.R. sec. 1.170A-14(g)(6)(ii). The donee's entitlement to a

proportionate share of the extinguishment proceeds must be absolute. See Coal Property, slip op. at 18 (citing Carroll v. Commissioner, 146 T.C. 196, 212 (2016). In Coal Property, we held that a formula identical to that found at section 9.2 of the deed of easement in this case (Ex. 16-J, pp. 17-18) fails to accomplish the regulatory requirement that the donee receive a proportionate share of the proceeds in the event of a sale. (Slip op. at 22.)

2. The "Treasury Regulation override"

TOT advances the same defense as the petitioner in Coal Property, arguing that the perpetuity requirement of the regulation is not violated by TOT's deed because, under the deed, the formula for allocating proceeds must be applied consistently with what TOT characterizes as a "Treasury Regulation override" in sections 9.1 and 9.2 of the deed:

Section 9.1 provides that the "proportionate part" of the value to which the donee is entitled is "determined in accordance with Section 9.2 or 26 C.F.R. Section 1.170A-14, if different." And section 9.2 provides: "It is intended that this Section 9.2 be interpreted to adhere to and be consistent with 26 C.F.R. Section 1.170A-14(g)(6)(ii)." TOT contends that this language overrides any aspect of the proceeds provision that violates the regulation.

TOT acknowledges that a donor cannot reserve an impermissible right in an easement deed but then save his charitable contribution by mentioning the rule he has violated and calling for that rule to kick in and save the day if his violation subsequently comes to light. If this language in section 9.2 constitutes such a savings clause, then it is not enforceable and cannot salvage what would otherwise be a failure of the formula to provide Foothills with the proportional value of the proceeds from a future sale of the easement to which it is entitled. See Coal Property, slip op. at 26, citing Belk v. Commissioner, 774 F. 3d 223 (4th Cir. 2014), aff'g 140 T.C. 1 (2013).

TOT disputes, however, that section 9.2 contains a savings clause triggered by an impermissible condition subsequent. It contends, rather, that the provisions in section 9 are interpretive provisions. The parties agree that Section 9.2 is identical, word for word, to the "Treasury Regulation override" that was present in Coal Property; but TOT argues that Coal Property is distinguishable because the procedural posture of that case was a decision on summary judgment and because no evidence was presented to explain the intent behind the drafting of the provision. However, the evidence TOT presented on the supposed intent behind the provision does not persuade us of TOT's position.

Mark Jendrick, the attorney responsible for drafting the deed, testified that he included sections 9.1 and 9.2 in the deed from a standard form that he used as a starting point to draft many similar easements for Foothills, and that the reason for its inclusion was to protect Foothills' interests in the transaction. He further explained that, as a fundamental rule of contract drafting, a statement of the parties' intent should be included if there is ever a question that a court would conduct a hindsight analysis on that issue.

The language at issue will constitute a savings clause if it applies "to retroactively reform the deed to comply with the regulations." Palmolive Bldg. Inv'rs, LLC v. Commissioner, 149 T.C. 380, 404 (2017). Sections 9.1 and 9.2 of the deed contain a complete and unambiguous expression of the formula to apply to the proceeds and the conditions under which it is implicated. Accordingly, to the extent that Mr. Jendrick's testimony attempts to state the intentions of the parties that they wanted these provisions to operate other than as explicitly set forth in the language of the deed, that testimony is not admissible and cannot be considered for that purpose. See Tenn. Code Ann. sec. 47-2-202; In re Tom Woods Used Cars, Inc., 23 B.R. 563, 567 (Bankr. E.D. Tenn. 1982) (where a writing is intended as a final expression of the parties'

agreed terms, proof of inconsistent terms outside of the written agreement is barred by the parol evidence rule). To the extent that Mr. Jendrick's testimony simply expresses his own intentions as the drafter of the deed, it has little, if any bearing on the legal question of the operation of the contract language. See Belk v. Commissioner, 774 F. 3d at 229-230.

Sections 9.1 and 9.2 apply a specific formula (including an explicit subtraction) to calculate the proceeds due to Foothills in the event of a sale, and those sections direct a different result only if or when there is an adverse determination as to the deductibility of the prior conservation contribution under sec. 1.170A-14(g)(6). If the terms of section 9 of the deed had never come to light in a tax proceeding, and if later the easement had ever been judicially extinguished, there is no reason to suppose that a court distributing proceeds would have overruled the express terms of section 9.2. TOT has not satisfied us that the language in sections 9.1 and 9.2 serves merely as an expression of the intent of the parties. We therefore hold that section 9.2 of the deed contains a condition subsequent savings clause that will not remedy the failure of that section to afford Foothills the right to a "portion of the proceeds at least equal to that proportionate value of the perpetual

conservation restriction", as required by section 1.170A-14(g)(6)(ii). Therefore, the conservation purpose of the easement that TOT granted to Foothills was not "protected in perpetuity" within the meaning of section 170(h)(5)(A). For this reason, we find that the Commissioner properly denied the deduction; and we therefore need not reach the other grounds advanced on that issue.

III. Valuation of the Conservation Easement

Even though we hold that the deduction for the conservation easement was properly denied, the fair market value of the easement at the time of its donation must still be established in order to determine, pursuant to section 6221, the issue of what penalties, if any, are "applicab[le]". See PBBM-Rose Hill, Ltd. v. Commissioner, 900 F. 3d 193, 214 (5th Cir. 2018).

A. Valuation principles

In general, the valuation of a perpetual conservation restriction such as the easement at issue in this case is the fair market value at the time of the contribution; however, where no substantial record of sales of easements comparable to the donated easement is available to provide a meaningful or valid comparison, the regulations authorize valuation of the easement by determining the difference between the fair market value of the property before, as compared to after, the donation

of the easement. 26 C.F.R. sec. 1.170A-14(h)(3)(i), (ii). The "before and after" method of valuation was employed by both valuation experts in this case. When this method is used, the appraisal of the property before the easement "must take into account not only the current use of the property but also an objective assessment of how immediate or remote the likelihood is that the property, absent the restriction, would in fact be developed, as well as any effect from zoning, conservation, or historic preservation laws that already restrict the property's potential highest and best use." Id., sec. -14(h)(3)(ii). The appraisal after the easement "must take into account the effect of restrictions that will result in a reduction of the potential fair market value represented by highest and best use but will, nevertheless, permit uses of the property that will increase its fair market value above that represented by the property's current use." Id.

As is typical in such cases, both parties relied on expert testimony. The determination of whether expert testimony is helpful to the trier of fact is a matter within the Court's sound discretion. See Laureys v. Commissioner, 92 T.C. 101, 127 (1989). The Court evaluates expert opinions in light of each expert's demonstrated qualifications and all other evidence in the record. Parker v. Commissioner, 86 T.C. 547, 561 (1986).

The appraiser must use common sense and informed judgment to analyze all the facts and circumstances of each case, maintaining "a reasonable attitude in recognition of the fact that valuation is not an exact science." Rev. Rul. 59-60, sec. 3.01, 1959-1 C.B. 237, 238. We are not bound by an expert's opinions and may accept or reject an expert opinion in full or in part, in the exercise of sound judgment. Helvering v. Nat'l Grocery Co., 304 U.S. 282, 295 (1938); Parker v. Commissioner, 86 T.C. at 561-562.

B. Competing contentions

TOT's expert, Mr. Wingard, opined that the fair market value of the property before the donation of the easement was $3.9 million and that the value of the property after the easement was $1.2 million, thereby valuing the easement at $2.7 million. (Ex. 33-P). The Commissioner's expert, Mr. Barber, opined that the fair market value of the property before the donation of the easement was $1.128 million and that the value of the property after the easement was $632,000, thereby valuing the easement at $496,000. (Ex. 35-R).

C. Highest and best use

Central to the disparity in the valuation experts' testimony is their disagreement over the highest and best use of the property before TOT's donation of the easement to Foothills. Mr. Wingard concluded that the

highest and best use of the property before the donation of the easement was for residential development, specifically, "low density, destination mountain resort residential development". (Ex. 33-P, p. 49). We find that use to have been highly unlikely because of the property's characteristics and the failed developments that surrounded it.

In contrast to Mr. Wingard, the Commissioner's expert, Mr. Barber, concluded that the highest and best use of the property before the donation of the easement was "as an investment property held for recreation and timber revenue" and that the highest and best use after the donation of the easement was consistent with its use prior to the easement: i.e., speculative investment property with potential for limited timber harvesting with associated private recreational activities. (Ex. 35-R, p. 70).

Notably, Mr. Wingard and Mr. Barber essentially agree on the "after" assessment of highest and best use of the property, which Mr. Wingard opined was "agricultural and passive recreational uses as permitted by the easement". (Ex. 33-P, p. 174).

D. Petitioner's expert's analysis

Mr. Wingard employed a qualitative analysis in his valuation approach, a "study of the relationships

indicated by market data without recourse to quantification" that "reflects the imperfect nature of real estate markets." (Ex. 33-P, p. 100). To arrive at the "before" value of the property, he compared the subject property to two sales in western North Carolina and three sales in middle Tennessee, with dates of sale ranging from September 2005 through March 2013. Id. He noted that "the search for sales in the middle Tennessee market or even the entire state of Tennessee did not yield sales similar in size or physical attributes as the subject." (Ex. 33-P, p. 99). Notably, given his opinion about highest and best use, all of the supposedly comparable sales he put forward were of intended residential developments in mountainous terrain, or with views of large bodies of water, such as a lake. The subject property lacks either feature, and we think it is not conducive to the same use. Mr. Wingard's report did not include a comparable sale that was "inferior" to, as opposed to "superior" or "similar" to the subject, see Ex. 33-P, p. 141. The significance of this omission is that Mr. Wingard did not offer a conclusive number to serve as a "floor" from which the value of the subject property could be ascertained.

With regard to the factors presented in section 1.170A-14(h)(3)(ii), Mr. Wingard determined that the lack

of zoning restrictions on the property made development legally permissible and that "use as an eventual mountain related residential development" was physically possible, as well as financially feasible and indicative of the maximum economic benefit of the property. The evidence in the record contradicts Mr. Wingard's conclusion regarding the property's use. The evidence--including the photographs in his own report--showed that the subject land is not mountainous and has no significant physical features such as vistas or lake views that would lend itself to such a purpose. The mean value of the five properties to which he compared the subject property was $6,430 per acre, with the supposedly most similar sale valued at $6,057 per acre. (Ex. 33-P, p. 145). Mr. Wingard opined that the subject property had a value of $6,000 per acre, but it is unclear how he arrived at a value for the subject property that is so close to the values of remote properties with such different physical characteristics. We found his valuation to be greatly inflated.

E. The Commissioner's expert

Mr. Barber conducted a sales comparison approach to ascertain the "before" value of the property. He did not consider an income approach to valuation because of the lack of historical use of the property for income

production (Ex. 35-R, pp. 77-78), a judgment we think reasonable. He opined that commercial timbering was economically feasible to some extent, but the potential income stream from any timber harvest conducted for profit was relatively insignificant due to the lack of demand for timber in the area during the relevant time period.

During his visits to the subject property, Mr. Barber was able to capture and present drone video footage that captured its appearance. (Ex. 29-R). Though visually interesting, the drone footage was consistent with Mr. Barber's characterization of the property as being relatively plain and "not pretty," showing no significant features such as dramatic views, colorful foliage potential, or lake frontage that, according to Mr. Barber, might increase the desirability for residential development on the property.

Consistent with his conclusion as to the highest and best use of the subject property, Mr. Barber compared the subject property to eight sales of property used for agricultural and timber recreation that occurred between August 2005 and August 2011, producing a mean value of $1,478 per acre. After removing the lowest and highest sales, the mean value was $1,423 per acre. Mr. Barber settled on a value of $1,734 per acre, utilizing the three comparable sales he qualitatively ranked as similar and

therefore indicative of the best unit value for the property. (Ex. 35-R, p. 102). We think his approach was reasonable.

F. Transactions involving the subject property

As we explained above, in 2005 Mr. Dixson acquired the 652 acres at issue for about $486,000. In December 2013--days before the contribution of the easement--PES indirectly acquired a 99 percent interest in the property for $1,039,200, suggesting a 100 percent value of roughly $1.05 million. Mr. Barber's before value ($1.128 million) corresponds roughly to this figure, and Mr. Wingard's before value ($3.9 million) is not at all close to it.

Mr. Wingard, TOT's expert, acknowledged that he had been aware of the PES purchase of 99 percent of TOT, but he said that he did not take that transaction as a measure of the value of the subject property; rather, he said, owning a partial interest in an entity that owns a property is not the same thing as owning the property itself. That is certainly true, but when the partial interest acquired is a 99 percent interest, and when the property at issue is the only significant asset of the acquired entity, we think that there will likely be a correspondence between a price paid for 99 percent of the entity and the price that the market would pay for the

property itself.

Mr. Barber, the Commissioner's expert, testified that in developing his opinion he did not take account of the December 2013 PES purchase, for the reason (which we believe) that he had not been made aware of that transaction at the time he prepared his report and learned about its details only during the testimony of Mr. Wingard. Thus, he reached his value ($1.128 million) without knowing it was broadly corroborated by the price suggested by the PES ~~25~~ 9 transaction ($1.05 million). We think this bolsters the persuasiveness of Mr. Barber's valuation. DG

G. Conclusion on "before" value

Based on the improbability of Mr. Wingard's choice of highest and best use, the credibility of Mr. Barber's written report and oral testimony, and the evidence in the record--including the arm's-length sale of an interest whose value inhered primarily in the subject property only weeks before the donation of the easement--Mr. Barber's opinion that the "before" value of the land was $1.128 million should be afforded the most weight. We agree with his "before" value.

H. Conclusion on "after" value and easement value

The expert witnesses determined different

"after" values for the property-- Mr. Wingard's $1.2 million and Mr. Barber's $632,000--but both agree that, with respect to the "after" value of the subject property, the highest and best use of the subject property is investment property held for potential timber and recreation revenue, which is consistent with the restrictions of the easement. Neither TOT nor the Commissioner spent much time at trial cross-examining or rebutting the opposing expert's "after" value.

It is in TOT's interest that the "after" value be as low as possible, so that the difference between the two values be as great as possible. Given that we have determined a "before" value of $1,128,236 by using Mr. Barber's value, to now use Mr. Wingard's "after" value of $1.2 million would compare apples to oranges and would have the absurd result of causing the declaration of the easement to produce a slight increase in the value of the property.

For the reasons stated above and because Mr. Barber was a more persuasive witness, the Court accepts his opinion that the value of the easement is $496,000.

## IV. Penalties

### A. Written supervisory approval

Section 6751(b)(1) requires that the "initial determination" of a penalty be approved in writing by the

immediate supervisor of the individual making that initial determination, and it must be approved before "the first formal communication to the taxpayer of the initial determination to assess penalties". Clay v. Commissioner, 152 T.C. __, __ (slip op. at 44) (Apr. 24, 2019).

The parties have stipulated to all material facts relevant to the issue of penalty approval under section 6751(b)(1). (See Stip. 22-30.) In pertinent part, the facts show that on May 10, 2016, a Letter 1807 enclosing an RAR (Ex. 21)-- which RAR included a statement proposing, in the alternative, the same penalties later proposed in the FPAA--was signed by the immediate supervisor of the revenue agent and was sent to TOT. (The same supervisor signed a civil penalty approval form including the identical proposed penalties on July 8, 2016, prior to the issuance of the FPAA that was issued to TOT on January 3, 2017; but these facts are not essential to our analysis of section 6751(b)(1).)

Notwithstanding the fact that the Letter 1807 was signed by the supervisor, TOT argues that this May 10, 2016, communication both constituted the initial determination of the penalty and lacked the required written supervisory approval. The Commissioner urges the Court to hold that the initial determination was embodied instead in the FPAA because that communication notified

TOT of its right to an appeal but, as a fallback position, argues that the Letter 1807 constituted the required written supervisory approval for the penalties asserted against TOT proposed in the letter and the attached report.

Section 6751(b) does not require written supervisory approval to be given on any particular document, see PBBM-Rose Hill, Ltd. v. Commissioner, 900 F. 3d 193, 213 (5th Cir. 2018) (supervisor's signature on a cover letter to a summary report proposing penalties was sufficient); Palmolive Building Investors, LLC v. Commissioner, 152 T.C. ~~__ (slip op. at 17-18) (Feb. 28,~~ 2019) (supervisor's signature on a Form 5401-c containing proposed penalties and directing the FPAA be issued was sufficient).

TOT's position is essentially that the Letter 1807 signed by the supervisor and transmitting the agent's summary report could simultaneously embody the initial determination of the penalty and lack written supervisory approval of it-- even though the written signature of the supervisor appears on the face of the document. The supervisor was the sole signatory of the letter that advised of "all proposed adjustments" and transmitted the report that detailed the penalties (which were later asserted in the FPAA). These facts establish that the

supervisor gave written approval of the initial determination of the penalties. Accordingly, the Court holds that the Commissioner has established compliance with section 6751(b) as to the penalties asserted in this case.

B. Application of penalties

Section 6662(a) imposes a penalty equal to 20 percent of an underpayment due to causes enumerated therein, only three of which are at issue here: negligence, substantial understatement of income tax, and substantial valuation misstatement. To the extent that any portion of an underpayment is attributable to a gross valuation misstatement (as opposed to a substantial valuation misstatement), the penalty is increased to 40 percent under section 6662(h). A gross valuation misstatement exists if the value of the property claimed on the return is 200 percent or more of the amount determined to be the correct amount of such valuation. Sec. 6662(e)(1), (e)(1)(A), (h)(1), (h)(2). The burden is on the petitioner to prove that the penalty is inappropriate because of reasonable cause and good faith. See Higbee v. Commissioner, 116 T.C. 438, 446-447 (2001).

The Court has found that the value of the conservation easement was $496,000. The value TOT claimed for the same item on the return was $6.9 million. Ex. 2-

J, pp. 9, 12. The underpayment attributable to the valuation misstatement for this item was therefore the difference between the two numbers, --i.e., more than $6.4 million, a value that exceeds 200 percent of $496,000, or $992,000. Accordingly the gross valuation misstatement penalty of 40 percent of the underpayment is applicable to the amount of the underpayment attributable to the valuation misstatement of this item. See sec. 6662(e)(1), (e)(1)(A), (h)(1), (h)(2).

The Commissioner asserts that a negligence penalty should apply to the underpayment attributable to the first $496,000 of the deduction at issue, since that portion of the underpayment was not attributable to a valuation misstatement but rather to TOT's claiming on its tax return a charitable deduction to which it was not entitled. Negligence has been defined as lack of due care or failure to do what a reasonably prudent person would do under like circumstances. See, e.g., Ocmulgee Fields, Inc. v. Commissioner, 132 T.C. 105, 123, aff'd, 613 F.3d 1360 (11th Cir. 2010). It also "includes any failure to make a reasonable attempt to comply with the provisions of the internal revenue laws or to exercise ordinary and reasonable care in the preparation of a tax return." 26 C.F.R. sec. 1.6662-3(b)(1).

The Court finds that the negligence penalty is

applicable. It must be noted that TOT did not claim two deductions--one reasonable deduction for $496,000 that corresponded to the actual value of its easement and another unreasonable one for the plainly excessive additional amount of $6.4 million. Rather, TOT claimed a single deduction--for the grossly excessive amount of $6.9 million. The enormous difference between the $6.9 million deduction claimed for the easement alone and the $1.05 million actually paid for the entire property in the recent arm's-length transaction must have been and surely was obvious to TOT.

As recently as its pretrial memorandum, TOT advanced reasonable cause and good faith as a defense to the penalties at issue here, pursuant to section 6664(c). The language of section 6664(c)(3) contains a special rule for an underpayment attributable to a valuation overstatement of charitable deduction property (such as is at issue in this case). While the text of section 6664(c)(3) appears to eliminate the defense as it applies to gross valuation misstatements, the corresponding income tax regulation seems to contemplate its availability, subject to heightened requirements. See 26 C.F.R. sec. 1.6664-4(h). We assume for the sake of discussion that the defense might be available in a case like this.

However, during closing arguments at the

conclusion of trial, when the Court inquired as to TOT's support for its reasonable cause defense, its counsel stated that, in defense against the penalties, TOT relies on section 6751(b)(1) (discussed above). He thus apparently abandoned the reasonable cause defense-- and for good reason:

As to the valuation misstatement penalties, although the parties have stipulated that the appraisal that accompanied the return was a qualified appraisal performed by a qualified appraiser, see sec. 1.6664-4(h)(i), TOT failed to present any evidence that "in addition to obtaining a qualified appraisal, the taxpayer made a good faith investigation of the value of the contributed property." Sec. 1.6664-4(h)(ii). Accordingly, TOT cannot establish the defense of reasonable cause and good faith as to the valuation misstatement penalties.

As the defense of reasonable cause and good faith relates to the negligence penalty, section 6664(c)(1) provides that the accuracy-related penalty shall not be imposed with respect to any portion of an underpayment if it is shown that there was reasonable cause for that portion and the taxpayer acted in good faith with respect to that portion. "The determination of whether a taxpayer acted with ~~32~~ 9 reasonable cause and in

good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances . . . Reliance on * * * professional advice * * * constitutes reasonable cause and good faith if, under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith." 26 C.F.R. sec. 1.6664-4(b)(1); see also sec. 1.6664-4(c).

The parties stipulated that TOT hired an appraiser to appraise the easement and hired accountants to prepare their return, but TOT put on no evidence that it actually relied on any professional advice and put on no evidence as to its efforts to determine and report its proper tax liability. Its grossly exaggerated $6.9 million deduction is starkly contrary to any such efforts. We hold that TOT failed to establish the defense of reasonable cause and good faith as to any portion of its underpayment.

## V. Conclusion

TOT's deduction for a qualified conservation contribution to Foothills is denied in its entirety. The value of the property interest contributed to Foothills was $496,000. The Commissioner proved compliance with the requirements of section 6751(b) to obtain written supervisory approval of the penalties he asserted in the first formal communication to the taxpayer of the initial

determination of the penalties. Accordingly, the gross valuation misstatement penalty is applicable to the underpayment attributable to the valuation misstatement. A negligence penalty is applicable to any remaining portion of the underpayment attributable to the denied deduction. TOT failed to establish reasonable cause and good faith for taking the deduction.

Decision will be entered for the Commissioner.

This concludes the Court's oral Findings of Fact and Opinion in this case.

THE CLERK: All rise.

(Whereupon, at 3:49 p.m., the above-entitled matter was concluded.)