United States Tax Court
Washington, DC 20217

Little Horse Creek Property, LLC, Little Horse Creek, LLC, Tax Matters Partner,	)	
Petitioner	)	
v.	)	Docket No. 7421-19.
Commissioner of Internal Revenue,	)	
Respondent	)	

ORDER

This case involves a charitable contribution deduction claimed by Little Horse Creek Property, LLC (Little Horse), for a conservation easement. Currently before the Court are respondent's motion for partial summary judgment, filed March 5, 2020, and petitioner's cross-motion for partial summary judgment, filed August 10, 2020. We shall deny both motions.

Background

The following facts are derived from the parties' pleadings, motion papers, and exhibits attached thereto. They are stated solely for purposes of deciding the parties' cross-motions for summary judgment and not as findings of fact in this case. Sundstrand Corp. v. Commissioner, 98 T.C. 518, 520 (1992), aff'd, 17 F.3d 965 (7th Cir. 1994).

Little Horse was formed as a Georgia LLC in September 2014. For its short tax year beginning December 24, 2014, and ending December 31, 2014, it was treated as a partnership for Federal income tax purposes. Little Horse is subject to the TEFRA unified audit and litigation procedures, and petitioner Little Horse Creek, LLC, is its tax matters partner.

Served 03/02/21

On December 23, 2014, Little Horse acquired from Horse Creek Partners, LLC (HCP), one of its members, 645 acres of land in Liberty County, Georgia (Property). The Property was a portion of a larger tract that HCP had acquired from third parties in 2005, 2009, and 2010. On December 29, 2014, Little Horse granted to Georgia Land Trust (GLT) a conservation easement over 642 acres of the Property. The Deed of Conservation Easement (Deed) was recorded that same day.

Little Horse filed a timely return on Form 1065, U.S. Return of Partnership Income, for its short taxable year ending December 31, 2014. On that return it claimed a charitable contribution deduction of $21,619,000 for its donation of the easement. Following examination of that return the IRS issued petitioner, on February 26, 2019, a notice of final partnership administrative adjustment (FPAA), which disallowed the claimed deduction. The FPAA determined that "the deduction of $21,690,000 * * * does not meet the requirements of section 170 of the Internal Revenue Code (IRC), and is not allowed in its entirety." Alternatively, if it were determined that the deduction met the requirements of section 170, the FPAA stated that the fair market value (FMV) of the easement "is determined to be $18,355,000 rather than the $21,619,000 reflected on the Schedule K. Therefore, any allowable deduction is reduced by $3,264,000."

Discussion

A. Summary Judgment Standard

The purpose of summary judgment is to expedite litigation and avoid costly, unnecessary, and time-consuming trials. See FPL Grp., Inc. & Subs. v. Commissioner, 116 T.C. 73, 74 (2001). We may grant summary judgment regarding an issue as to which there is no genuine dispute of material fact and a decision may be rendered as a matter of law. Rule 121(b); Sundstrand Corp. v. Commissioner, 98 T.C. 518, 520 (1992), aff'd, 17 F.3d 965 (7th Cir. 1994). In deciding whether to grant summary judgment, we construe factual materials and inferences drawn from them in the light most favorable to the nonmoving party. Sundstrand Corp., 98 T.C. at 520. However, the nonmoving party "may not rest upon the mere allegations or denials" of his pleadings but instead "must set forth specific facts showing there is a genuine dispute" for trial. Rule 121(d); see Sundstrand Corp., 98 T.C. at 520.

B. Appraisal Summary

Where a contribution of property (other than publicly traded securities) is valued in excess of $5,000, the taxpayer must "obtain[] a qualified appraisal of such property and attach[] to the return * * * such information regarding such property and such appraisal as the Secretary may require." Sec. 170(f)(11)(C). The required information includes "an appraisal summary" that must be attached "to the return on which such deduction is first claimed for such contribution." Deficit Reduction Act of 1984 (DEFRA), sec. 155(a)(1), Pub. L. No. 98-369, 98 Stat. at 691; see sec. 1.170A-13(c)(2), Income Tax Regs. The IRS has prescribed Form 8283 to be used as the "appraisal summary." Jorgenson v. Commissioner, T.C. Memo. 2000-38, 79 T.C.M. (CCH) 1444, 1450. Failure to comply with this requirement generally precludes a deduction. See sec. 170(a)(1) ("A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary.").

We have previously held that a taxpayer's failure to disclose on Form 8283 the "cost or adjusted basis" of charitable contribution property may be fatal to the claim of a deduction. See, e.g., Belair Woods, LLC v. Commissioner, T.C. Memo. 2018-159. Respondent does not contend that Little Horse failed to disclose the cost or adjusted basis. Rather, respondent contends that the Form 8283 did not adequately disclose the date on which Little Horse acquired the Property and the manner of acquisition.

We need not decide the consequences of failure to disclose these items on Form 8283, because Little Horse was guilty of no such failure. In Section B, Part 1, lines 5(d), (e), and (f), Form 8283 has boxes captioned "Date acquired by donor," "How acquired by donor," and "Donor's cost or adjusted basis." In those boxes Little Horse wrote "06/2010," "Purchase," and "$1,318,647," respectively. Immediately above these boxes Little Horse wrote: "See attached appraisal and supplemental statement for detailed description." Appended to the Form 8283 was a "Supplemental Attachment to Form 8283." On this attachment Little Horse supplied complete information about when and how it acquired the Property:

(d) Date Acquired by Donor

The Donor acquired the property on December 23, 2014. Donor's holding period is deemed to have begun no later than June 29, 2010,

> when the property was acquired by Horse Creek Partners, LLC, who further contributed the property to the Donor.
>
> (e) <u>How Acquired by Donor</u>
>
> The Donor acquired the property by limited warranty deed, as a capital contribution, from Horse Creek Partners, LLC on December 23, 2014. Horse Creek Partners, LLC acquired the property by limited warranty deed from Plum Creek Timberlands, LP on March 10, 2005; by limited warranty deed from Sea Island Bank on March 30, 2009; and by general warranty deed from Quinnco Hinesville, LLC on June 29, 2010.

Respondent does not contend that any of this information was incorrect. But he urges that all of this information needed to appear on the Form 8283 itself, rather than as an attachment to that form. This argument is wholly unpersuasive: The boxes on lines 5(d), (e), and (f) are extremely small, and portions of the Property were acquired at different times in different ways from different persons. While it is true that the numbers in the boxes told only part of the story, the full story appeared in the attachment. That is what attachments are for.

C. <u>Judicial Extinguishment</u>

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 for a "qualified conservation contribution." Sec. 170(f)(3)(B)(iii), (h)(1). For the donation of an easement to be a "qualified conservation contribution," the conservation purpose must be "protected in perpetuity." Sec. 170(h)(5)(A).

The regulations set forth detailed rules for determining whether this "protected in perpetuity" requirement is met. Of importance here are the rules governing the mandatory division of proceeds in the event the property is sold following a judicial extinguishment of the easement. <u>See</u> sec. 1.170A-14(g)(6), Income Tax Regs. The regulations recognize that "a subsequent unexpected change in the conditions surrounding the [donated] property * * * can make impossible or impractical the continued use of the property for conservation purposes." <u>Id.</u> subdiv. (i). Despite that possibility, "the conservation purpose can nonetheless be treated as protected in perpetuity if the restrictions are extinguished by judicial proceeding,"

and the easement deed ensures that the charitable donee, following sale of the property, will receive a proportionate share of the proceeds and use those proceeds consistently with the conservation purposes underlying the original gift. Ibid. In effect, the "perpetuity" requirement is deemed satisfied because the sale proceeds replace the easement as an asset deployed by the donee exclusively for conservation purposes.

In Coal Property Holdings, LLC v. Commissioner, 153 T.C. 126, 137-140 (2019), we held that a deed of easement failed to satisfy these regulatory requirements where the donee's share of post-extinguishment sale proceeds was improperly reduced by carve-outs for donor improvements and prior claims. Respondent contends that the Deed in this case has these and other defects, and petitioner vigorously resists these contentions. The parties have advanced several arguments and sub-arguments, which we consider in turn.

1. State Law Override

The regulation entitles the grantee to a proportionate share of post-extinguishment proceeds "unless state law provides that the donor is entitled to the full proceeds from the conversion without regard to the terms of the prior perpetual conservation restriction." Sec. 1.170A-14(g)(6)(ii), Income Tax Regs. Petitioner contends that Georgia law (the law applicable here) dictates that GLT "would not receive any proceeds if a court later extinguishes, terminates, or condemns GLT's contractual rights under the Deed." According to petitioner, therefore, the Deed's provision governing apportionment of sale proceeds is meaningless boilerplate, and any defects in that provision are beside the point.

We have previously addressed and rejected essentially the same argument about the effect of Georgia law with respect to conservation easements. See Belair Woods, LLC v. Commissioner (Belair Woods III), T.C. Memo. 2020-112, at *18-*21; Cottonwood Place, LLC v. Commissioner, T.C. Memo. 2020-115, at *11-*13; Red Oak Estates, LLC v. Commissioner, T.C. Memo. 2020-116, at *11-*13. We reject petitioner's argument here for the reasons stated in those opinions.

2. Propriety of Apportionment Fraction

The Deed's apportionment fraction properly makes (1) the numerator equal to the value of the easement on the date of the grant and (2) the denominator equal

to the value of the entire unencumbered Property on the date of the grant. See sec. 1.170A-14(g)(6)(ii), Income Tax Regs. But respondent faults the Deed because it states that these two values are to be taken from the appraisal report that Little Horse secured to support its return position, as opposed to being based on the actual FMVs of the easement and the unencumbered Property. In his appraisal report the appraiser opined that the value of the easement (numerator) was $21,619,000 and that the value of the unencumbered Property (denominator) was $22,264,000. This produces an apportionment fraction under which 97.1% of the extinguishment proceeds would go to the grantee.

We reject respondent's argument. In Coal Property Holdings, as shown by our calculation of the proceeds due to the grantee, we assumed that the apportionment fraction would be based on the FMVs reported by the taxpayer. See 153 T.C. at 137-138. In a summary judgment posture--the situation in Coal Property Holdings and here--we have no way of knowing the actual FMVs of the easement or the unencumbered land, because there has been no trial. And in the large universe of cases that never get litigated, it would be very difficult to determine--where an easement was extinguished (say) 50 years after it was granted--what the easement and the unencumbered land were worth 50 years previously. The only practical approach, which is perfectly consistent with the text of the regulation, is to treat these values as equal to the values claimed by the taxpayer unless other values have been judicially determined. This mode of calculation ensures that the grantee will get at least its full proportionate share of the proceeds, because the taxpayer is very unlikely to have understated the numerator, i.e., the claimed value of the easement.

3. Carve-Out for Donor Improvements

a. Relevance of Post-Donation Improvements

The regulation requires that the grantee must be entitled to a proportionate share of proceeds from a subsequent sale, exchange, or involuntary conversion "of the subject property." Sec. 1.170A-14(g)(6)(ii), Income Tax Regs. The "subject property" means "the property that is the subject of a donation under this paragraph," as to which the surrounding conditions have unexpectedly changed. Id. subdiv. (i). Petitioner urges that this regulation does not require the grantee to receive any proceeds attributable to post-donation improvements because they are not part of "the property that is the subject of a donation under this paragraph."

Ibid. Rather, petitioner contends that the "property that is the subject of [the] donation" is the Property "as it existed at the time of the gift."

We rejected essentially the same argument in Belair Woods III, which involved an easement deed with provisions substantially identical to those here. See T.C. Memo. 2020-112, at *14-*16. Here as there, the conservation restrictions imposed by the Deed are imposed on the entirety of the conserved area--both the land and any improvements that Little Horse makes to it. The "property that is the subject of * * * [the] donation" thus includes both the land and its improvements. Sec. 1.170A-14(g)(6)(i), Income Tax Regs.; see Hewitt v. Commissioner, T.C. Memo. 2020-89, at *18 ("The subject property refers to the property that is sold that generates the proceeds after the easement is extinguished.").

This construction is consistent with a commonsense understanding of the regulatory language referring to proceeds from sale "of the subject property." Sec. 1.170A-14(g)(6)(ii), Income Tax Regs. Owners of real estate do not typically sell sheds, barns, or roadways separately from the real estate on which those improvements are situated. If the Property is sold, the sale proceeds would necessarily be attributable both to the land and to the attached improvements.

b. Value of Improvements

The Deed provides that, if the Property is sold following judicial extinguishment of the easement, GLT's share of the proceeds will be determined by multiplying the Property's FMV--an amount presumably equal to the sale proceeds--by a fraction. That fraction is "the ratio of the value of the Conservation Easement at the time of th[e] conveyance to the value of the Property at the time of th[e] conveyance without deduction for the value of the Conservation Easement." This fraction is consistent with the formula set forth in the regulation. See sec. 1.170A-14(g)(6)(ii), Income Tax Regs.

Before applying the regulatory apportionment fraction, however, the Deed at issue here--like the deed in Coal Property Holdings--reduces the multiplicand (viz., the sale proceeds) by "any increase in value after the date of th[e] grant attributable to improvements." See Coal Property Holdings, 153 T.C. at 138. As we explained in that opinion, any such increase in value would be attributable to (1) appreciation in the value of the improvements existing when the easement was granted, plus (2) the FMV of any new improvements that the donor later made to the property. Ibid. We held in Coal Property Holdings that reducing the grantee's

share in this way violated the "granted in perpetuity" requirement because it prevented the grantee from receiving its full proportionate share of any future sale proceeds. Id. at 137-140.

In Coal Property Holdings the improvements existing when the easement was granted "included 20 natural gas wells, two cell phone towers, various roads, and various electricity installations." Id. at 138. The donor reserved the right to make future improvements, including utility installations, roads, and driveways "for vehicular access to areas of the Property on which the existing and additional structures and related ancillary improvements are and may be constructed." Ibid. These existing and contemplated future improvements had obvious value. Cf. Englewood Place, LLC v. Commissioner, T.C. Memo. 2020-105, at *10 n.4 ("[T]he deed reserved to * * * [the donor] the right to make post-contribution improvements to the conserved area, including the rights (for example) to construct barns, sheds, roads, a residential driveway, and utilities (including water, septic, and power lines)."); Maple Landing, LLC v. Commissioner, T.C. Memo. 2020-104, at *10 n.4 (same).

Paragraph 3(d) of the Deed in this case, captioned "Improvements," provides that "[t]he construction or maintenance on the Property of any buildings, structures (including mobile homes), or other improvements is prohibited, except as described in Paragraph 4 and as otherwise expressly permitted herein." Paragraph 4(e) indicates that the "existing structures" on the Property, as of the date the easement was granted, consisted of "a shed (~12' x 15'); a bridge over Horse Creek; a dog kennel (~6' x 9'); a fenced in dog kennel; a trailer kennel; and a dog kenneling materials storage area with materials." Little Horse reserved the right to kennel "a reasonable number of hunting dogs on the [P]roperty," so long as such kenneling "is for noncommercial use only." Little Horse reserved the right to maintain these existing structures and to "construct reasonable appurtenances typically associated with such kenneling of hunting dogs, such a[s] dog houses, fencing, and sheds within the Kennel Area," and to "construct utilities and permeable-base roads to serve the Kenneling Area." No other future improvements are permitted by the Deed.

The existing and permitted future improvements thus consist almost entirely of structures relating to the noncommercial kenneling of hunting dogs. Petitioner may be able to establish that the existing improvements were unlikely to appreciate in value and that any future improvements would be unlikely to increase the Property's FMV in a meaningful way (if at all). In assessing whether any future

increase in value would be de minimis, the value of the entire Property (which the parties seem to agree exceeded $18 million) would be a relevant fact. If any increase in value attributable to improvements would be de minimis, petitioner may plausibly contend that the Deed's "donor improvements" clause would not cause GLT to receive less than its proportionate share of the proceeds in the event the Property were sold following judicial extinguishment of the easement. Viewing the facts and inferences to be drawn from the facts in the light most favorable to petitioner, we conclude that genuine disputes of material fact dictate that we deny respondent's motion for partial summary judgment on this point.

4. Carve-Out for Prior Claims

Respondent contends that the Deed in this case has a second problem that was also present in Coal Property Holdings--namely, that the grantee's proceeds could be further reduced by the requirement that its share be calculated "after the satisfaction of prior claims." Coal Property Holdings, 153 T.C. at 130. "It is not necessarily unreasonable," we said, "for a deed to provide that prior claims may be paid from sale proceeds. What is unreasonable, and what violates the 'judicial extinguishment' regulation, is the requirement * * * that all prior claims be paid out of the * * * [grantee's] share of the proceeds, even if those claims represent liabilities of * * * [the grantor]." See id. at 145 n.5 (emphasis omitted); Belair Woods III, T.C. Memo. 2020-112, at *10-*11. Other deeds that we have considered possessed a similar defect. See Englewood Place, T.C. Memo. 2020-105, at *11 (providing that grantee's share would be determined "after the satisfaction of any and all prior claims"); Maple Landing, T.C. Memo. 2020-104, at *11 (same).

The "prior claims" clause in the instant Deed is meaningfully different. It provides that "[a]ny and all prior claims shall first be satisfied by Grantor's portion of the proceeds before Grantee's portion is diminished in any way." This provision appears quite favorable to GLT: Read literally, it means that Little Horse's share of the proceeds will be used to discharge, not only claims originating from its own activities, but also any claims originating from GLT's activities.

Respondent observes that GLT's share might nonetheless be invaded if Little Horse's share were insufficient to satisfy all claims against the Property. But this scenario raises uncertain questions of fact, as well as questions of contract interpretation and state law that respondent has not addressed. For example, if the term "claims" as used in the deed means "claims against the Property in rem," state law might require that all such claims be defrayed from the proceeds as a

condition of closing the sale. Viewing the facts and inferences to be drawn from the facts in the light most favorable to petitioner, we conclude that summary judgment is inappropriate on this question as well.

5. Validity of the Regulation

Finally, petitioner contends that the "judicial extinguishment" regulation is substantively invalid under Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837 (1984), and constitutes "arbitrary and capricious" rulemaking in violation of the Administrative Procedure Act. We comprehensively addressed and rejected these arguments in a recent Court-reviewed Opinion. See Oakbrook Land Holdings, LLC v. Commissioner, 154 T.C. 180, 189-200 (2020). We need not repeat that analysis here.

In consideration of the foregoing, it is

ORDERED that respondent's Motion for Partial Summary Judgment, filed March 5, 2020, is denied. It is further

ORDERED that petitioner's Motion for Partial Summary Judgment, filed August 10, 2020, is denied. It is further

ORDERED that, on or before March 30, 2021, the parties shall file a status report expressing their views as to the conduct of further proceedings in this case.

(Signed) Albert G. Lauber
Judge