Whitehouse Hotel Limited Partnership v. Commissioner of Internal Revenue, 131 T. C. 112 (2008)

The U. S. Tax Court ruled on the valuation of a conservation easement donated by Whitehouse Hotel Limited Partnership, affirming the IRS's reduction of a claimed $7. 445 million charitable deduction to $1. 792 million. The court rejected the partnership's valuation methods, favoring a comparable sales approach. Additionally, the court upheld a 40% gross valuation misstatement penalty due to the significant overvaluation, finding no reasonable cause for the misstatement. This decision clarifies the importance of accurate property valuation in tax deductions and the application of penalties for substantial misstatements.

Parties

Whitehouse Hotel Limited Partnership (Petitioner), represented at trial and appeal by Gary J. Elkins and Andrew L. Kramer. Commissioner of Internal Revenue (Respondent), represented by Linda J. Wise, Robert W. West, III, and Susan S. Canavello.

Facts

Whitehouse Hotel Limited Partnership (the Partnership) acquired a historic building, the Maison Blanche Building, in New Orleans in December 1995. In October 1997, the Partnership also purchased the adjacent Kress Building. On December 29, 1997, the Partnership conveyed a facade easement (servitude) to the Preservation Resource Center of New Orleans (PRC), a qualified organization. The Partnership claimed a $7. 445 million charitable contribution deduction on its 1997 tax return based on the value of this easement. The IRS examined the return and reduced the deduction to $1. 15 million, asserting the Partnership made a gross valuation misstatement and applied an accuracy-related penalty.

Procedural History

The Partnership petitioned the U. S. Tax Court to contest the IRS's determination. The court reviewed the case, considering the Partnership's claim for a charitable deduction and the IRS's valuation and penalty assessment. The court heard testimony from expert witnesses Richard J. Roddewig for the Partnership and Richard Dunbar Argote for the IRS. The court's decision involved determining the value of the easement and whether a penalty should apply.

Issue(s)

Whether the value of the conservation easement donated by Whitehouse Hotel Limited Partnership was properly assessed at $7. 445 million, and whether the IRS correctly applied a gross valuation misstatement penalty?

Rule(s) of Law

“If a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution. ” Sec. 1. 170A-1(c)(1), Income Tax Regs. “The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. ” Sec. 1. 170A-1(c)(2), Income Tax Regs. “There is a gross valuation misstatement if the value is 400 percent or more of the value determined to be the correct amount. ” Sec. 6662(h)(2)(A)(i)

Holding

The court held that the value of the conservation easement was $1. 792 million, not $7. 445 million as claimed by the Partnership. The court also upheld the IRS’s application of a gross valuation misstatement penalty, finding no reasonable cause for the Partnership’s overvaluation.

Reasoning

The court rejected the cost and income approaches used by the Partnership’s expert, Richard J. Roddewig, due to their speculative nature and lack of reliable evidence. Instead, the court adopted the comparable sales approach used by the IRS’s expert, Richard Dunbar Argote, finding it the most reliable method for determining the easement’s value. The court noted the Partnership’s failure to demonstrate a change in the highest and best use of the property due to the easement, which impacted the valuation. Additionally, the court found the Partnership’s overvaluation of the easement by more than 400% constituted a gross valuation misstatement, warranting a 40% penalty under Sec. 6662(h)(2)(A)(i). The Partnership’s failure to conduct a good faith investigation into the easement’s value precluded the application of the reasonable cause exception under Sec. 6664(c)(2).

Disposition

The court sustained the IRS’s adjustment of the charitable contribution deduction to $1. 792 million and upheld the application of the 40% gross valuation misstatement penalty. The decision was to be entered under Rule 155.

Significance/Impact

This case underscores the importance of accurate property valuation in claiming tax deductions for conservation easements. It establishes that the comparable sales approach may be preferred over cost or income approaches when determining the value of such easements. Additionally, it clarifies the application of gross valuation misstatement penalties under Sec. 6662(h)(2)(A)(i) and the stringent requirements for invoking the reasonable cause exception under Sec. 6664(c)(2). This decision has implications for taxpayers and their advisors in ensuring compliance with valuation standards and avoiding significant penalties.

