

Logan M. Chandler and Nanette Ambrose-Chandler v. Commissioner of Internal Revenue, 142 T. C. No. 16 (U. S. Tax Court 2014)

In *Chandler v. Commissioner*, the U. S. Tax Court ruled that the taxpayers could not claim charitable contribution deductions for facade easements on their historic homes, as they failed to prove the easements had any value beyond existing local restrictions. The court upheld a portion of the taxpayers' basis increase for home improvements but imposed penalties for unsubstantiated deductions and overstated basis, highlighting the complexities of valuing conservation easements and the importance of proper substantiation in tax reporting.

Parties

Logan M. Chandler and Nanette Ambrose-Chandler (Petitioners) v. Commissioner of Internal Revenue (Respondent). The petitioners filed their case in the U. S. Tax Court under Docket No. 16534-08.

Facts

Logan M. Chandler and Nanette Ambrose-Chandler, residents of Massachusetts, owned two historic homes in Boston's South End Historic District. In 2003 and 2005, they purchased the homes at 24 Claremont Park and 143 West Newton Street, respectively. They granted facade easements on both properties to the National Architectural Trust (NAT), claiming charitable contribution deductions for the years 2004, 2005, and 2006 based on the appraised values of these easements. The deductions for 2005 and 2006 included carryforwards from 2004. In 2005, they sold the Claremont property for \$1,540,000, reporting a basis that included \$245,150 in claimed improvements. The Commissioner disallowed the deductions and the full basis increase, asserting that the easements were valueless and the improvement costs unsubstantiated, and imposed penalties on the resulting underpayments.

Procedural History

The case was filed in the U. S. Tax Court under Docket No. 16534-08. The Commissioner determined that the easements had no value and disallowed the deductions, imposing gross valuation misstatement penalties for the underpayments in 2004, 2005, and 2006, and an accuracy-related penalty for the underpayment in 2005 related to the unsubstantiated basis increase. Petitioners conceded liability for a delinquency penalty for their 2004 return but contested the disallowance of the deductions and the imposition of penalties. The court reviewed the case *de novo*, applying the preponderance of the evidence standard.

Issue(s)

Whether the charitable contribution deductions claimed by petitioners for granting conservation easements exceeded the fair market values of the easements?

Whether petitioners overstated their basis in the property sold in 2005?

Whether petitioners are liable for accuracy-related penalties under section 6662?

Rule(s) of Law

Under section 170 of the Internal Revenue Code, taxpayers may claim charitable contribution deductions for the fair market value of conservation easements donated to qualified organizations, subject to meeting specific criteria. The burden of proving the deductions' validity, including the easements' fair market values, rests with the taxpayer. For basis adjustments, taxpayers must substantiate their claims under section 1016, and the burden of proof generally lies with them unless credible evidence shifts it to the Commissioner. Section 6662 imposes accuracy-related penalties for underpayments resulting from negligence, substantial understatements of income tax, or gross valuation misstatements, with specific rules governing the application of these penalties.

Holding

The court held that petitioners failed to prove their easements had any value beyond existing local restrictions, thus sustaining the disallowance of the charitable contribution deductions. The court allowed a portion of the basis increase claimed by petitioners for the Claremont property, substantiating \$147,824 of the claimed \$245,150 in improvements. Petitioners were found liable for an accuracy-related penalty for the unsubstantiated portion of the basis increase claimed on the 2005 return, but not for gross valuation misstatement penalties for their 2004 and 2005 underpayments due to reasonable cause and good faith. However, they were liable for the gross valuation misstatement penalty for their 2006 underpayment, as the amended rules effective after July 25, 2006, precluded a reasonable cause defense for returns filed after that date.

Reasoning

The court rejected the valuation report provided by petitioners' expert, Michael Ehrmann, due to methodological flaws and the inclusion of non-comparable properties, concluding that the easements did not diminish the properties' values beyond the restrictions already imposed by local law. The court distinguished between the impact of easements on commercial versus residential properties, noting that the value of residential properties is less tangibly affected by construction restrictions. The court found that petitioners had substantiated a portion of their claimed basis increase with receipts, allowing that amount but disallowing the unsubstantiated remainder due to lack of proof and the failure to demonstrate that the loss of records was beyond their control. Regarding penalties, the court applied the pre-Pension Protection Act (PPA) rules for the 2004 and 2005 returns, finding that petitioners acted with reasonable cause and good faith in relying on professional advice for the easement valuations. However, for the 2006

return filed after the PPA's effective date, the amended rules applied, eliminating the reasonable cause defense for gross valuation misstatements of charitable contribution property. The court also imposed an accuracy-related penalty for negligence in substantiating the basis increase, as petitioners failed to maintain adequate records.

Disposition

The court's decision was to be entered under Rule 155, reflecting the disallowance of the charitable contribution deductions, the partial allowance of the basis increase, and the imposition of penalties as determined.

Significance/Impact

This case underscores the challenges taxpayers face in valuing conservation easements, particularly when local restrictions already limit property development. It emphasizes the necessity of credible, market-based valuation methodologies and the importance of substantiating claimed deductions and basis adjustments with adequate documentation. The decision also clarifies the application of the Pension Protection Act's amendments to the gross valuation misstatement penalty, affecting how taxpayers can defend against penalties for returns filed after the effective date. The case serves as a reminder to taxpayers and practitioners of the stringent substantiation requirements and the complexities involved in claiming deductions for conservation easements.