RERI Holdings I, LLC v. Comm'r, 143 T. C. 41 (2014)

In RERI Holdings I, LLC v. Comm'r, the U. S. Tax Court rejected the IRS's motion for partial summary judgment, affirming the use of actuarial tables for valuing a charitable contribution of a future interest in a limited liability company (LLC). The court clarified that the LLC's future interest could be valued using the same tables applied to the underlying real property, despite IRS arguments that the tables were inapplicable. This ruling underscores the importance of adhering to established valuation methods for charitable contributions, impacting how taxpayers and the IRS approach such deductions.

Parties

RERI Holdings I, LLC (Petitioner), represented by Randall Gregory Dick and Rebekah E. Schechtman, and Harold Levine, Tax Matters Partner, versus Commissioner of Internal Revenue (Respondent), represented by Travis Vance III, Kristen I. Nygren, John M. Altman, and Leon St. Laurent. The case was heard at the trial level in the U. S. Tax Court and on appeal would lie to the Court of Appeals for the D. C. Circuit.

Facts

RERI Holdings I, LLC (RERI) was formed as a Delaware LLC on March 4, 2002, and dissolved on May 11, 2004. RERI contributed a future interest (Successor Member Interest or SMI) in RS Hawthorne Holdings, LLC (Holdings) to the University of Michigan (University) on August 27, 2003. Holdings indirectly owned the Hawthorne property through its wholly-owned subsidiary, RS Hawthorne, LLC (Hawthorne). The SMI was set to become possessory on January 1, 2021, following a term of years interest (TOYS interest) held by Red Sea Tech I, Inc. (Red Sea). RERI claimed a charitable contribution deduction of $33,019,000 for the SMI, which was appraised using actuarial tables under IRC section 7520 by Howard C. Gelbtuch. The IRS challenged the valuation, asserting that the actuarial tables were inapplicable and that RERI failed to substantiate the value with a qualified appraisal.

Procedural History

The IRS issued a notice of final partnership administrative adjustment to RERI, challenging the valuation of the charitable contribution and imposing an accuracy-related penalty. RERI filed a petition in the U. S. Tax Court on April 15, 2008, contesting the IRS's determinations. The IRS moved for partial summary judgment, arguing that the actuarial tables under IRC section 7520 did not apply to the SMI and that RERI's appraisal did not meet the standards for a qualified appraisal under the regulations. The Tax Court denied the IRS's motion, finding genuine disputes as to material facts concerning the applicability of the actuarial tables and the qualification of the appraisal.

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Issue(s)

Whether the actuarial tables under IRC section 7520 apply to value the future interest (SMI) that RERI contributed to the University?
Whether RERI substantiated the value of its charitable contribution with a qualified appraisal as defined in 26 C. F. R. 1. 170A-13(c)(3)?

Rule(s) of Law

IRC section 170(a)(1) allows a deduction for charitable contributions if verified under regulations prescribed by the Secretary. 26 C. F. R. 1. 170A-1(c)(1) states that the amount of a contribution in property is its fair market value at the time of the contribution. IRC section 7520(a) and 26 C. F. R. 1. 7520-1(a)(1) provide that the value of any remainder interest shall be determined using tables prescribed by the Secretary and an interest rate based on the Federal midterm rate. 26 C. F. R. 1. 7520-3(b)(1)(ii) defines a restricted beneficial interest as one subject to a contingency, power, or other restriction, for which standard section 7520 tables may not apply. 26 C. F. R. 1. 170A-13(c)(3) defines a qualified appraisal as one that includes specific information about the donated property and its valuation.

Holding

The Tax Court held that the actuarial tables under IRC section 7520 could be used to value the SMI, applying the rationale from *Pierre v. Commissioner* that disregarded entities under the check-the-box regulations cannot be disregarded for valuation purposes. The court also held that there were unresolved factual issues regarding whether RERI's appraisal was a qualified appraisal under the regulations, particularly concerning whether the appraisal accurately described the donated property and considered all relevant restrictions and encumbrances.

Reasoning

The court reasoned that the SMI was the property transferred to the University, not a hypothetical remainder interest in the Hawthorne property, based on the principle from *Pierre v. Commissioner*. However, the court allowed for the possibility that the value of the SMI could be equivalent to the value of a hypothetical remainder interest in the Hawthorne property if certain conditions were met, such as no restrictions burdening the SMI. The court found that genuine disputes of material fact existed regarding the impact of the two-year hold-sell requirement imposed on the University, the risk of foreclosure due to the balloon payment on the mortgage, and the applicability of the actuarial tables given these restrictions. The court also considered whether the significant disparity between the appraised value and the actual sale prices of the SMI violated the unrealistic and unreasonable fair market value standard. Regarding the qualified appraisal issue, the court determined that the appraisal's failure to discuss certain restrictions or encumbrances did not automatically disqualify it as a qualified appraisal under the regulations, but rather

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depended on whether these omissions affected the donated asset's value.

Disposition

The Tax Court denied the IRS's motion for partial summary judgment, finding that genuine disputes of material fact precluded a ruling on the applicability of the actuarial tables and the qualification of the appraisal.

Significance/Impact

This case is significant for clarifying the application of IRC section 7520 actuarial tables in valuing charitable contributions of future interests in LLCs. It reinforces that such tables can be used for valuation purposes, provided that the donated interest is not subject to restrictions that would render the tables inapplicable. The decision also highlights the importance of ensuring that appraisals for charitable contributions meet the regulatory requirements for qualified appraisals, particularly in describing the donated property and considering all relevant factors affecting its value. The ruling may influence future cases involving the valuation of charitable contributions and the use of actuarial tables, as well as the IRS's approach to challenging such valuations.

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