RERI Holdings I, LLC v. Commissioner, 149 T. C. No. 1 (2017)

The U. S. Tax Court denied RERI Holdings I, LLC's $33 million charitable contribution deduction due to non-compliance with substantiation requirements. The court also ruled that RERI's overvaluation of the contributed property by over 400% triggered a gross valuation misstatement penalty. This decision underscores the strict substantiation rules for charitable deductions and the severe penalties for significant valuation errors.

Parties

RERI Holdings I, LLC, with Jeff Blau as Tax Matters Partner, was the petitioner in this case. The Commissioner of Internal Revenue was the respondent. The case was heard in the United States Tax Court.

Facts

RERI Holdings I, LLC (RERI) acquired a remainder interest (SMI) in a property for $2. 95 million in March 2002. The property was subject to a lease agreement with AT&T, which provided for fixed rent until May 2016. RERI subsequently assigned the SMI to the University of Michigan in August 2003. On its 2003 tax return, RERI claimed a $33,019,000 charitable contribution deduction for the assignment, significantly higher than its acquisition cost. The Form 8283 attached to the return failed to provide RERI's cost or adjusted basis in the SMI.

Procedural History

The Commissioner issued a Notice of Final Partnership Administrative Adjustment (FPAA) in March 2008, reducing RERI's claimed deduction and asserting a substantial valuation misstatement penalty. RERI petitioned the Tax Court in April 2008, contesting the FPAA's adjustments and penalties. The Commissioner later amended his answer to include a gross valuation misstatement penalty.

Issue(s)

Whether RERI's failure to include its cost or adjusted basis on Form 8283 violated the substantiation requirements under Treas. Reg. sec. 1. 170A-13(c)(2)?

Whether RERI's claimed charitable contribution deduction resulted in a gross valuation misstatement under I. R. C. sec. 6662(h)(2)?

Whether RERI had reasonable cause for the claimed deduction, thereby avoiding the valuation misstatement penalties?

Rule(s) of Law

I. R. C. sec. 170(a)(1) allows a deduction for charitable contributions, subject to

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substantiation under Treas. Reg. sec. 1. 170A-13(c)(2), which requires a fully completed appraisal summary, including the donor's cost or adjusted basis. Failure to comply results in disallowance of the deduction.

I. R. C. sec. 6662(e)(1) and (h)(2) impose penalties for substantial and gross valuation misstatements, respectively, where the claimed value of property is 200% or 400% or more of the correct value.

I. R. C. sec. 6664(c) provides an exception to penalties if the taxpayer had reasonable cause and acted in good faith, supported by a qualified appraisal and a good-faith investigation of value.

Holding

The Tax Court held that RERI's omission of its cost or adjusted basis on Form 8283 violated the substantiation requirements under Treas. Reg. sec. 1. 170A-13(c)(2), resulting in the disallowance of its claimed charitable contribution deduction. The court further held that RERI's claimed deduction resulted in a gross valuation misstatement under I. R. C. sec. 6662(h)(2) because the claimed value was over 400% of the SMI's actual fair market value of $3,462,886. The court rejected RERI's reasonable cause defense, finding no good-faith investigation of the SMI's value.

Reasoning

The court reasoned that RERI's failure to report its cost or adjusted basis on Form 8283 prevented the Commissioner from evaluating the potential overvaluation of the SMI, thus violating the substantiation requirements. The court emphasized Congress's intent to strengthen substantiation rules to deter excessive deductions and facilitate audit efficiency.

In determining the SMI's value, the court rejected the use of standard actuarial factors under I. R. C. sec. 7520 due to inadequate protection of the SMI holder's interest. Instead, the court valued the SMI based on all facts and circumstances, considering expert testimonies and projections of future cash flows. The court discounted future cash flows at a rate of 17. 75%, finding the SMI's value to be $3,462,886 on the date of the gift.

The court concluded that RERI's claimed value of $33,019,000 was a gross valuation misstatement, as it exceeded the correct value by over 400%. The court dismissed RERI's reasonable cause defense, noting that the partnership did not conduct a good-faith investigation into the SMI's value, relying solely on an outdated appraisal and the property's acquisition price.

Disposition

The Tax Court's decision will be entered under Rule 155, affirming the disallowance of RERI's charitable contribution deduction and the imposition of the gross valuation

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misstatement penalty.

Significance/Impact

This case underscores the importance of strict compliance with substantiation requirements for charitable contribution deductions. It serves as a reminder to taxpayers of the severe consequences of valuation misstatements, particularly in complex transactions involving remainder interests. The decision also highlights the necessity of a good-faith investigation into the value of contributed property to avoid penalties, even when supported by a qualified appraisal.

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