Nathaniel A. Carter and Stella C. Carter v. Commissioner of Internal Revenue, T. C. Memo. 2020-21; Ralph G. Evans v. Commissioner of Internal Revenue, T. C. Memo. 2020-21 (U. S. Tax Court 2020)

In a significant ruling, the U. S. Tax Court disallowed charitable contribution deductions for conservation easements where the donors retained development rights in unspecified building areas. The court held that such rights violate the requirement for perpetual use restrictions on real property. Additionally, the court ruled that the IRS failed to timely secure supervisory approval for proposed gross valuation misstatement penalties, thus invalidating them. This decision impacts how conservation easements are structured and how penalties are assessed by the IRS.

Parties

Nathaniel A. Carter and Stella C. Carter (Petitioners) and Ralph G. Evans (Petitioner) v. Commissioner of Internal Revenue (Respondent). The cases were consolidated at the trial, briefing, and opinion stages.

Facts

In 2005, Dover Hall Plantation, LLC (DHP), owned by Nathaniel Carter, purchased a 5,245-acre tract of land in Glynn County, Georgia. In 2009, Ralph Evans purchased a 50% interest in DHP. In 2011, DHP conveyed a conservation easement to the North American Land Trust (NALT) over 500 acres of the property. The easement generally prohibited construction or occupancy of dwellings but allowed DHP to build single-family dwellings in up to 11 two-acre "building areas," the locations of which were to be determined subject to NALT's approval. DHP claimed a charitable contribution deduction for the easement on its 2011 tax return, and the Carters and Evans claimed deductions on their individual returns based on their shares of the partnership's deduction. The IRS disallowed these deductions and proposed gross valuation misstatement penalties.

Procedural History

The IRS issued notices of deficiency to the Carters and Evans on August 18, 2015, disallowing the charitable contribution deductions and determining gross valuation misstatement penalties. The cases were consolidated for trial, briefing, and opinion. The Tax Court reviewed the case de novo, applying the preponderance of the evidence standard.

Issue(s)

Whether the conservation easement granted by DHP to NALT qualifies as a "qualified real property interest" under I. R. C. sec. 170(h)(2)(C), thus entitling petitioners to charitable contribution deductions? Whether the IRS timely secured written supervisory approval for the initial determination of the gross valuation misstatement penalties as required by I. R. C. sec. 6751(b)(1)?

Rule(s) of Law

I. R. C. sec. 170(h)(2)(C) defines a “qualified real property interest” as including “a restriction (granted in perpetuity) on the use which may be made of real property. ” I. R. C. sec. 170(h)(5)(A) requires that the conservation purpose be protected in perpetuity. I. R. C. sec. 6751(b)(1) mandates that no penalty under the Internal Revenue Code shall be assessed unless the initial determination of such assessment is personally approved in writing by the immediate supervisor of the individual making such determination.

Holding

The Tax Court held that the conservation easement did not meet the perpetual restriction requirement of I. R. C. sec. 170(h)(2)(C) because the retained development rights in the unspecified building areas allowed uses antithetical to the easement’s conservation purposes. Consequently, petitioners were not entitled to charitable contribution deductions. The court further held that the IRS’s supervisory approval of the gross valuation misstatement penalties was untimely under I. R. C. sec. 6751(b)(1), as it was granted after the initial determination of the penalties had been communicated to petitioners, thus invalidating the penalties.

Reasoning

The court followed its precedent in Pine Mountain Pres. , LLLP v. Commissioner, 151 T. C. 247 (2018), which established that retained development rights in unspecified areas violate the perpetual restriction requirement of I. R. C. sec. 170(h)(2)(C). The court reasoned that the building areas allowed for residential development, which is antithetical to the conservation purposes of preserving open space and natural habitats. The court distinguished this case from Belk v. Commissioner, 140 T. C. 1 (2013), where the easement allowed for substitution of property, noting that the issue here was the lack of a defined parcel subject to perpetual use restrictions. Regarding the penalties, the court applied its interpretation of I. R. C. sec. 6751(b)(1) from Clay v. Commissioner, 152 T. C. 223 (2019), requiring supervisory approval before the first communication of the penalty determination. The court found that the IRS’s communication to petitioners via Letters 5153 and accompanying RARs constituted the initial determination of the penalties, and the subsequent supervisory approval was untimely.

Disposition

The Tax Court disallowed the charitable contribution deductions claimed by petitioners and invalidated the gross valuation misstatement penalties proposed by the IRS.

Significance/Impact

This decision reinforces the strict requirements for conservation easements to qualify for charitable contribution deductions, particularly the need for perpetual use restrictions on a defined parcel of property. It also underscores the importance of timely supervisory approval for penalties under I. R. C. sec. 6751(b)(1), impacting IRS procedures for assessing penalties. The ruling may influence how conservation easements are drafted and how the IRS handles penalty assessments in future cases.

