2010

Excerpt from Kaufman Brief

submitted Halpern Bills Case 9-13-10 as

ORIGINAL

UNITED STATES TAX COURT

GORDON & LORNA KAUFMAN,	)	
	)	
Petitioners,	)	
	)	
v.	)	Docket No. 15997-09
	)	
COMMISSIONER OF INTERNAL REVENUE,	)	Judge Halpern
	)	
Respondent.	)	

OPENING BRIEF FOR RESPONDENT

Petitioners have not made any argument (unlike the arguments that have been advanced in connection with the Lender Agreement at issue in this case) that such an "abandonment" provision is necessary to make easements workable or practical. Indeed, the Model Historic Preservation and Conservation Easement drafted by the National Trust for Historic Preservation offered by petitioners as a model document does not contain any clause like Article IV.B. of the Rutland Square agreement in this case, allowing the donee organization to abandon some or all of its rights in an easement. (RFF 48)

In sum, even if the Court determines that it erred in granting respondent's motion for summary judgment on the grounds that the façade easement donation does not comply with Treas. Reg. § 1.170A-14(g)(6)(ii), it should nevertheless hold as a matter of law that the Rutland Square agreement does not protect a conservation purpose in perpetuity and that the deduction for the donation of the easement is therefore disallowed.

C. Even if the Court determines that it erred in determining that the façade easement does not comply with Treas. Reg. § 1.170A-14(g)(6)(ii), it should nevertheless disallow the deduction as a matter of law because petitioners did not satisfy the substantiation requirements of the Deficit Reduction Act of 1984 or I.R.C. § 170.

In the alternative, if the Court determines that it erred in granting respondent's motion for summary judgment and that

the easement protected a conservation purpose in perpetuity, the deduction should still be disallowed as a matter of law because the substantiation requirements of I.R.C. § 170 were not met.

A deduction for a charitable contribution is allowed only if verified by the taxpayer under regulations prescribed by the Secretary. I.R.C. § 170(a)(1). In section 155(a) of the Deficit Reduction Act of 1984 (DEFRA), Pub. L. 98-369, 98 Stat. 691, Congress provided a mechanism for the Commissioner to obtain sufficient return information to deal more effectively with the prevalent use of charitable contribution overvaluations. Hewitt v. Commissioner, 109 T.C. 258, 265 (1997) (citing S. Comm. on Finance, Deficit Reduction Act of 1984, S. Rep. 98-169 (Vol. I), at 444-445 (S. Comm. Print 1984), and Staff of Joint Committee on Taxation, General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984 (J. Comm. Print 1985)), aff'd without published opinion, 166 F.3d 332 (4th Cir. 1998).

In section 155(a) of DEFRA, Congress addressed the potential for abuse in valuing noncash contributions, directing the Secretary to prescribe regulations under I.R.C. § 170(a)(1) requiring taxpayers claiming charitable contribution deductions under I.R.C. § 170 in excess of $5,000 to obtain qualified appraisals of the property contributed. Section 155(a)(1) of

DEFRA. Pursuant to detailed direction in section 155(a) of DEFRA, the Secretary issued Treas. Reg. § 1.170A-13(c), stating that a deduction for a noncash contribution in excess of $5,000 will not be allowed unless the taxpayer obtains a "qualified appraisal" of the property contributed and requiring that an "appraisal summary" be attached to the return. DEFRA § 155(a)(1)(A) and (B); Treas. Reg. § 1.170A-13(c)(2)(i)(A) and (B).

No deduction is allowed for a contribution of property for which an appraisal is required unless the "statutorily imposed" requirements of DEFRA § 155(a)(1)(A) and § 170(a)(1) for a qualified appraisal are satisfied. Hewitt v. Commissioner at 263-264. The obligation to substantiate charitable contributions is clear and unambiguous. Blair v. Commissioner, T.C. Memo. 1988-581.

Petitioners rely upon Mr. Hanlon's appraisal to support the claimed deductions. As discussed below, this document is not a "qualified appraisal" as defined by DEFRA § 155(a)(4) and Treas. Reg. § 1.170A-13(c)(3) and Mr. Hanlon is not a "qualified appraiser" within the meaning of Treas. Reg. § 1.170A-13(c)(5). Further, the appraisal summary attached to petitioners' 2003 return did not comply with DEFRA § 155(a)(3) and Treas. Reg. § 1.170A-13(c)(4).

1. The Hanlon appraisal is not a qualified appraisal.

DEFRA § 155(a)(4) requires that a qualified appraisal be prepared by a "qualified appraiser" and include (1) a description of the property appraised; (2) the fair market value of the property on the date of contribution and the specific basis for the valuation; (3) a statement that the appraisal was prepared for income tax purposes; (4) the qualifications of the appraiser; (5) the signature and tax identification number of the appraiser; and (6) such additional information as the Secretary prescribes in regulations.

Treas. Reg. § 1.170A-13(c)(3)(ii) requires a qualified appraisal to include the following information:

> (A) A sufficiently detailed description of the property so a person who is not generally familiar with the type of property can determine that the property contributed is the same property appraised;
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> (B) In the case of tangible property, the physical condition of the property;
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> (C) The date (or expected date) of contribution to the donee;
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> (D) The terms of any restrictions, use, or any other agreement by or on behalf of the donor or donee made on the property contributed;
>
> (E) The name, address, and identifying number of the qualified appraiser;
>
> (F) The qualifications of the appraiser who signs the appraisal;

(G) A statement that the appraisal was prepared for income tax purposes;

(H) The date on which the property was appraised;

(I) The appraised fair market value (within the meaning of Treas. Reg. § 1.170A-1(c)(2)) of the property on the date (or expected date) of contribution;

(J) The method of valuation to determine the fair market value, such as the income approach, the market-data approach, and the replacement-cost-less-depreciation approach; and

(K) The specific basis for the valuation, such as specific comparable sales transactions or statistical sampling, including a justification for using sampling and an explanation of the sampling procedure employed.

In this case, the appraisal fails to meet the statutory and regulatory requirements for a qualified appraisal. The appraisal is deficient because the requirements of DEFRA § 155(a)(4)(B) (requiring the appraisal to include "the specific basis for the valuation") and Treas. Reg. § 1.170A-13(c)(3)(ii)(J) & (K) (requiring the appraisal to identify the method of valuation and to include the specific basis for the valuation") are not met.[15] See D'Arcangelo v. Commissioner, T.C. Memo. 1994-572 (disallowing a charitable contribution, in part, because the appraisal did not provide "the specific basis of the

[15] In addition, the appraisal does not comply with the requirements of DEFRA § 155(a)(4)(B) (requiring the appraisal to include the fair market value "on the date of contribution") and § 155(a)(4)(C) (requiring the appraisal to include "a statement that the appraisal was prepared for income tax purposes"). See also Treas. Reg. § 1.170A-13(c)(3)(ii)(C) and (G).

valuation"). Because the appraisal does not comply with the statutory requirements of DEFRA § 155(a)(4), the substantial compliance doctrine set forth in Bond v. Commissioner, 100 T.C. 32, 40-41 (1993) is not applicable here. See Friedman v. Commissioner, T.C. Memo. 2010-45 (Bond inapplicable where taxpayers did not merely fail to attach evidence of a qualified appraisal; they never obtained a qualified appraisal).

Treas. Reg. § 1.170A-14(h)(3)(i) provides that, in the absence of a substantial record of sales of comparable easements, as a general rule the fair market value of a conservation easement is equal to the difference between the fair market value of the underlying fee before the granting of the easement and the fair market value of the underlying fee after the granting of the easement.

In Hilborn v. Commissioner, 85 T.C. 677 (1985), this Court engaged in a "before and after" analysis to determine the value of a facade easement. The Court noted at 689-690 that "before" value is reached by determining the highest and best use of the property in its current condition unrestricted by the easement, and that "after" value is calculated by first determining the highest and best use of the property as encumbered by the easement and then by comparing the burdens of the easement with existing zoning regulations and other controls (such as local

historic preservation ordinances) to estimate whether, and the extent to which, the easement will affect current and alternate future uses of the property. In Hilborn, the Court adopted the government expert's analysis because it was more objective than that of the taxpayer's expert, who had used his "wholly subjective" judgment to conclude that the easement had caused a 12% diminution in the before value of the property. Id. at 698.

In Nicoladis v. Commissioner, T.C. Memo. 1988-163, the Court accepted, "for lack of evidence to the contrary," a 10% diminution proposed by both parties but explicitly stated that it did "not mean to imply that a general '10-percent rule' has been established with respect to facade donations." Hilborn and Nicoladis rely on the "before and after" method of valuation as an acceptable method of valuing easements, and confirm that valuation is a question of facts and circumstances. Neither decision supports a deduction for an easement donation based on a set percentage of the value of the property before the donation. Moreover, in Nicoladis, the Court clearly states (1) that Hilborn did not establish a 10-percent rule, and (2) there is no set percentage to determine easement valuations.

The "before and after" approach was approved in the legislative history of the 1980 amendments to section 170(f)(3). See S. Rep. No. 96-1007 (1980), 1980-2 C.B. 599, 606 (report).

The report contains numerous examples of factors that should be taken into account in determining the value of each easement. These factors, which have been incorporated in Treas. Reg. § 1.170A-14(h)(3) & (4), suggest that, because each property is unique, the specific, individual attributes of the property both before and after the granting of the easement must be examined, and confirm that a mechanical application of any valuation methodology is unacceptable. This regulatory language follows the report, which states that where the before and after test is used, "it should not be applied mechanically." Id.; Scheidelman v. Commissioner, T.C. Memo. 2010-151 ("the application of a percentage to the fair market value before conveyance of the façade easement, without explanation, cannot constitute a method of valuation as contemplated under [Treas. Reg.] Section 1.170A-13(c)(3)(ii)").

The Hanlon appraisal fails to provide an acceptable valuation methodology because it fails to consider qualitative factors specific to the Rutland Square property to determine an "after" value. (RFF 54). See Scheidelman, supra (appraisal report that "failed to outline and analyze qualitative factors" of a property is inadequate). Instead of describing specific, individual attributes of the property to separately support the "before" value and the "after" value, Mr. Hanlon relies on an

observation made by an IRS employee based on other façade easements donated by other taxpayers. (RFF 56) This statement, which Mr. Hanlon mischaracterizes as a "guideline" for homeowners and appraisers to follow, is: "Internal Revenue Service Engineers have concluded that the proper valuation of a façade easement should range from approximately 10% to 15% of the value of the property." (RFF 57, 58) Reliance on such a statement is not a "method of valuation" within the meaning of Treas. Reg. § 1.170A-13(c)(3)(ii)(J) and not a "basis for the valuation" within the meaning of DEFRA § 155(a)(4)(B) and Treas. Reg. § 1.170A-13(c)(3)(ii)(K).[16] See Scheidelman v. Commissioner, supra.

This is all the more true given that the appraisal contains no discussion or disclosure of the population of properties upon which the Primoli memorandum's observation is based. Thus, there is no information on whether this population has any relation or connection to properties located in Boston's South End and whether, consequently, the observation has any applicability to the Rutland Square property. (RFF 59).

[16] Mr. Hanlon also cites Tax Court cases in the appraisal to support his valuation. Just as the citation of an IRS memorandum is not a valid method of, or basis for, valuation, the citation of Tax Court cases is also not a valid methodology for the appraisal of a partial interest (or any interest) in property. (RFF 69, 70)

Ultimately, rather than determining an "after value" based on the specific characteristics of the Rutland Square property and the relevant market conditions, Mr. Hanlon determines that "[t]he property is considered to have a reduction in fair market value of 12% of the property's value prior to the easement donation." (RFF 52) In short, he simply applies a percentage to the before value to arrive at the "after value." This is not acceptable under DEFRA and Treas. Reg. § 1.170A-13(c)(3)(ii). Scheidelman v. Commissioner, supra. See also Smith v. Commissioner, T.C. Memo. 2007-368 ("terse" appraisal providing only limited details of the analysis and underpinnings for the value conclusion is unacceptable), aff'd without published opinion, 364 Fed.Appx. 317 (9th Cir. 2009).

Moreover, Mr. Hanlon's testimony at trial confirms the conclusion that he did not use a valid appraisal methodology. Mr. Hanlon testified that he started with the 15% figure mentioned in the Primoli memorandum and assigned percentage values adding up to 15% to 13 criteria that Mr. Hanlon believed might affect the value of property burdened with a façade easement. (RFF 61, 62) In assigning percentages to the 13 criteria, Mr. Hanlon admitted that he did not rely on any data and did virtually no analysis. Rather, he relied on what he "felt" and his "judgment." (RFF 63) Based on what he "felt,"

Mr. Hanlon assigned the largest percentage value, 4.5%, representing 38% of the total claimed 12% diminution in value of the property caused by the imposition of the façade easement, to the factor "Loss of right of future owners to receive tax benefits of easement." (RFF 64, 65) However, according to respondent's expert, John Bowman, tax savings are not a significant factor in a buyer's decision to purchase a particular property. (RFF 66)

Finally, in valuing a partial interest in property, starting with a predetermined range of value, such as 10-15% of the value of the fee interest in the property, and then breaking it down into a checklist of criteria is not an approved methodology under USPAP or any professional appraisal organization, is not a generally accepted methodology, and is not a valid methodology. (RFF 67) Indeed, Mr. Hanlon himself agreed that this method of reaching the value for the façade easement was not a generally accepted methodology and was "unique" to him. (RFF 68)

2. Mr. Hanlon is not a qualified appraiser.

Section 155(a)(4) of DEFRA states that a qualified appraisal must be prepared by a qualified appraiser. Treas. Reg. § 1.170A-13(c)(5)(ii), which is a regulation promulgated under DEFRA, provides in relevant part:

> An individual is not a qualified appraiser with respect to a particular donation . . . if the donor had knowledge of facts that would cause a reasonable person to expect the appraiser falsely to overstate the value of the donated property (e.g., the donor and the appraiser make an agreement concerning the amount at which the property will be valued and the donor knows that such amount exceeds the fair market value of the property).

Here, Dr. Kaufman had knowledge of facts that should have caused a reasonable person to realize that Mr. Hanlon had incorrectly overstated the value of the easement donated to NAT. Specifically, Dr. Kaufman did not hire an independent appraiser whom he had found himself, but rather hired someone recommended and "approved" by NAT. (RFF 94-96) Further, Dr. Kaufman knew from NAT's representative, Mr. Bahar, that the easement likely had little or no value. (RFF 150) After receiving this information from Mr. Bahar, Dr. Kaufman never even forwarded it to Mr. Hanlon to get his reaction. (RFF 153) Because a reasonable person with the facts known to Dr. Kaufman would have been aware that Mr. Hanlon was not independent and had falsely overstated the value of the easement, Mr. Hanlon is not a qualified appraiser pursuant to DEFRA § 155(a)(4) and Treas. Reg. § 1.170A-13(c)(5)(ii). Because Mr. Hanlon is not a qualified appraiser, the appraisal he prepared is not a qualified appraisal within the meaning of § 155(a)(4) of DEFRA.[17]

[17] In preparing the appraisal, Mr. Hanlon also violated the USPAP

3. Petitioners Failed to Attach a Fully Completed Appraisal Summary to Their Return as Required by Treas. Reg. § 1.170A-13(c)(2)(B).

Pursuant to DEFRA § 155(a)(1) and (3), Treas. Reg. § 1.170A-13(c)(2)(B) provides that, for charitable contribution deductions in excess of $5,000, a taxpayer must substantiate a claimed charitable contribution deduction by attaching a "fully completed appraisal summary" to the tax return on which the deduction for the contribution is first claimed.

Section 1.170A-13(c)(4) provides that an appraisal summary is a summary of a qualified appraisal made on the form prescribed by the Internal Revenue Service that is signed and dated by both the donee and the qualified appraiser and includes

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Ethics Rule Conduct requirement that "[a]n appraiser must perform assignments with impartiality, objectivity, and independence, and without accommodation of personal interests." USPAP Ethics Rule, Conduct, 2008-2009 Edition, p. U-7. Here, Mr. Hanlon was clearly not independent. He sought and received advice regarding his appraisal from Mr. McClain of NAT. (RFF 72) Moreover, he copied language verbatim from a sample that Mr. McClain provided him into his appraisal of the Rutland Square property. (RFF 73-74; see also RFF 75) It was important for Mr. Hanlon to be in NAT's good graces since NAT referred other Boston clients to him. Specifically, Mr. Hanlon performed eight appraisals for NAT between November 1, 2003 and March 5, 2004, and overall performed nine appraisals for NAT in slightly over one year, from November 2003 through December 2004. (RFF 71) Because of Mr. Hanlon's lack of independence, not only is his appraisal not a qualified appraisal within the meaning of DEFRA § 155(a)(4) and Treas. Reg. § 1.170A-13(c)(3) and he himself not a qualified appraiser within the meaning of Treas. Reg. § 1.170A-13(c)(5), the appraisal should be ignored because it completely lacks credibility.

the information required by § 1.170A-13(c)(4)(ii). Form 8283, Noncash Charitable Contributions, is the form prescribed by the Internal Revenue Service to serve as the appraisal summary.

DEFRA § 155(a)(1)(B) requires an appraisal summary to be attached to a return reporting a noncash contribution in excess of $5,000. DEFRA § 155(a)(3) sets forth certain requirements for the appraisal summary and states that it shall be in such form and include such information as the Secretary prescribes by regulations. DEFRA § 155(a)(1)(C) requires that cost basis and acquisition date of donated property be included in the return.

Section 1.170A-13(c)(4)(ii) requires that an appraisal summary include the following information:

> (A) The name and tax identification number of the donor (social security number if the donor is an individual or employer identification number if the donor is a partnership or corporation);
>
> (B) A description of the property in sufficient detail for a person who is not generally familiar with the type of property to ascertain that the property that was appraised is the property that was contributed;
>
> (C) For tangible property, a brief description of the overall physical condition of the property at the time of the contribution;
>
> (D) The manner and date of acquisition of the property by the donor;
>
> (E) The cost or other basis of the property;
>
> (F) The name, address, and taxpayer identification number of the donee;

(G) The date the donee received the property;

(H) A statement explaining whether or not the contribution was made by means of a bargain sale and the amount of any consideration received from the donee for the contribution;

(I) The name, address, and the identifying number of the qualified appraiser who signed the appraisal summary;

(J) The fair market value of the property on the date of contribution;

(K) A declaration by the appraiser stating that he holds himself out to the public as an appraiser or that he performs appraisals on a regular basis, that he is qualified to appraise the type of property appraised, that he is not one of the persons described in Treas. Reg. § 1.170A-13(c)(5)(iv), and that he understands that a false or fraudulent overstatement of value could subject him to a civil penalty;

(L) A declaration by the appraiser stating that the fee charged for the appraisal is not of a type prohibited by Treas. Reg. § 1.170A-13(c)(6), and that his or her appraisals are not being disregarded under 31 U.S.C. § 330(c) on the date the appraiser signs the appraisal summary; and

(M) Such other information required by the form (Form 8283).

See Scheidelman, supra.

An appraisal summary must be signed for the donee by an official authorized to sign the tax returns of the donee, or who is otherwise authorized to sign appraisal summaries for the donee. Treas. Reg. § 1.170A-13(c)(4)(iii).

The Form 8283 attached to petitioners' 2003 income tax

return leaves a number of spaces blank and fails to include key information about the donated property. Specifically, the Form 8283 is not an appraisal summary because it does not comply with the regulations governing appraisal summaries for the following reasons:

1. It does not contain a description of the property in sufficient detail for a person who is not generally familiar with the type of property to ascertain that the property that was appraised is the property that was contributed as required by Treas. Reg. § 1.170A-13(c)(4)(ii)(B). The Form 8283 merely describes the property contributed as "Historic Preservation Easement." (RFF 126) This is not a sufficiently detailed description of the property. It does not describe what portions of the Rutland Square property it affected, or what restrictions it included.

2. It does not state the manner and date of acquisition of the property by the donor, as required by DEFRA § 155(a)(1)(C) and Treas. Reg. § 1.170A-13(c)(4)(ii)(D). (RFF 127)

3. It does not state the cost or other basis of the property, as required by DEFRA § 155(a)(1)(C) and Treas. Reg. § 1.170A-13(c)(4)(ii)(E). (RFF 128)

4. It does not contain a statement as to whether the contribution of the façade easement was made by means of a

bargain sale, and the amount of any consideration received from the donee, as required by Treas. Reg. § 1.170A-13(c)(4)(ii)(H). (RFF 129)

In sum, petitioners' deduction for a purported charitable contribution of the easement on the Rutland Square property should be disallowed because petitioners failed to attach a fully completed appraisal summary to their return.

4. Conclusion

Because the appraisal does not comply with § 155(a)(4)(B) of DEFRA or Treas. Reg. § 1.170A-13(c)(3)(ii)(J) & (K), it is not a qualified appraisal. Further, because Mr. Hanlon is not a qualified appraiser within the meaning of § 155(a)(4) of DEFRA or Treas. Reg. § 1.170A-13(c)(5), the appraisal he prepared is not a qualified appraisal. Finally, petitioners failed to meet the requirements of DEFRA § 155(a)(1)(C) and attach a fully completed appraisal summary to their return as required by § 155(a)(3) of DEFRA and Treas. Reg. § 1.170A-13(c)(4). Therefore, petitioners' charitable contribution deduction for the donation of the easement, which is based on the appraisal and inadequately documented on the Form 8283, must be disallowed for these reasons as well.

exception: They received clear information directly from a representative of NAT that the easement likely had no value and yet nonetheless claimed a charitable deduction for it. They did not act in good faith.

CONCLUSION

It follows that the determination of the Commissioner of Internal Revenue, as modified by respondent's Amendment to Answer, should be sustained.

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