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Of Unrequited Deductions (and Lost Hopes)

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As for the grenade lobbed in the Conservancy’s direction, the Court in effect snagged it before detonation and threw it back, declining to exercise jurisdiction, since the IRS had taken no action to revoke the Conservancy’s tax-exempt status. (Note that the Justice Department, not the IRS, is responsible for the Government’s case in the Claims Court.) We believe it is safe to predict that there will be no further skirmishing on this front.

But on the government’s final contention, that benefits to the McLennans (other than tax benefits) defeated the deduction, the court was unwilling to render summary judgment. Unable to determine whether such alleged benefits were “merely incidental to a greater public conservation benefit,” the court determined that the facts underlying the issues of donative intent and exclusive conservation purpose “warrant further ventilation.” At trial, then, the McLennans were to bear the burden of proving that those requirements were met.

If you are puzzled about the Government’s stance in this matter, dear reader, you are in good and substantial company. The Claims Court opinion hints that the Government intended to assert that the McLennans were motivated to preserve property values and achieve, by the voluntary easement conveyance, the equivalent of zoning restrictions. Preserving property values by giving up substantial and valuable elements of ownership (as the court has already determined to have occurred), seems a rather peculiar way to go. And as for the achievement of zoning restrictions through an easement program, that is the inevitable object and purpose of any successful conservation effort which uses the conservation easement as a major strategy.

As to the necessary “exclusive conservation purpose”, which the court also required to be “ventilated” at trial, we should note that the McLennan case involves the predecessor to the present conservation easement statute. But if the Government insists upon a subjective application of that requirement, as it would seem it intends to do, a decision in its favor would have dire implications for interpreting the present conservation easement provisions as well. See §170(h)(1)(C).

The posture of the Government’s case is discouragingly reminiscent of the attitude of Treasury at the time the current conservation easement provisions were in gestation. It was then the Treasury’s profound belief that no charitable contribution deduction should obtain when a donor, by conveying an easement, advanced his ardent desire to see his property preserved in perpetuity. Under those circumstances, went the Treasury line, there can be no gift at all. Fortunately, Congress opted for an objective determination of what constitutes a donation in a conservation easement setting. But, as the entanglement of the McLennans with our public servants proves, it is often possible to get a second opinion after Congressional incentives have inspired socially desirable conduct. About the best that can be said about all of this is that it is probably good for us, now and then, to confront these fundamental issues. (The McLennans went back to court in May; the second decision has not yet been reported. We shall keep you posted.)

**McLennan v. U.S., 91-1 USTC §50,230 (Cl. Ct. 1991).**

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**Of Unrequited Deductions (and Lost Hopes)**

*by William T. Hutton*

The Back Forty Chutzpah Award, bestowed at irregular intervals for breathtaking aspirations in income tax planning, goes this month to Grover and Mary Hope of Dallas, Texas. In 1984, the Hopes, dissatisfied with an administrative condemnation award attributable to the taking of their property for an extension of the Dallas North Tollway, decided to go to court.

In 1986, by judicial decree, their initial award of $4,038,623 was amplified by an additional $1,650,137. Happy ending? Might well have been, but for the fact that, against this discordant theme of condemnation and confrontation, the taxpayers heard a sweeter melody, the clinking of tax benefits. (Like a dog whistle, it may not have been audible to all listening ears.)

Specifically, the taxpayers alleged that they had made a charitable contribution to the Texas Turnpike Authority in the form of a bargain sale. Pursuant to their own $4,038,623 estimate of value for the condemned property, they claimed a charitable contribution of $1,781,089 (the approximate difference between the property’s alleged fair market value and the total condemnation award). Not surprisingly, the IRS took exception to this treatment, disallowed the charitable deductions, which spanned three taxable years, and asserted liabilities for additional taxes, penalties, and interest of over $1.4 million. The Hopes paid the assessed deficiencies, filed refund claims, and, upon IRS denial of those claims, took their case to the Claims Court.
It has been our belief that a charitable contribution could indeed be effected in the context of a condemnation proceeding. See Herbert O. Robinson, 33 T.C.M. 1140 (1974) (charitable deduction denied, but on finding that the value of the property did not exceed the condemnation award). If, for example, a landowner, aware of a legitimate threat of condemnation but prior to the institution of proceedings, conveys the subject property to a land trust, there would seem to be no inherent inconsistency between the assertion of a charitable contribution deduction and the reinvestment of the bargain sale proceeds in qualifying replacement property (see IRC §1031). The amount of the charitable contribution would of course be subject to examination, as in any bargain sale case.

The claims court decision in Hope, rendered upon motion for summary judgment, was a complete victory for the Government, and forces us to reexamine our thinking about the condemnation/bargain sale transaction. The court was of “the opinion that a charitable contribution tax deduction should not be based on a completed condemnation proceeding in which the state takes the land for a legitimate public purpose, and the landowner receives compensation...” The opinion seems grounded upon the finding that “just” compensation, as determined by the condemnation proceeding, firmly establishes the value of the property, leaving no room for the assertion of any bargain element. Thus, “once Grover Hope agreed to and was paid the compensation, he retained no further rights in the property.” Or, to put it slightly differently, once Grover had settled with the state, the property’s value was established for all collateral purposes. Thus interpreted, Grover Hope’s travails ought not to be read as precluding the establishment of a charitable deduction on the transfer of property subject to threat of condemnation, so long as there has been no adjudication of property value in the state courts.

Whether or not other courts accept the Claims Court’s categorical rule (no room for charitable deduction once adjudication has established the property’s value), it is likely to prove exceedingly difficult to establish that a gift was intended once the taxpayer and the condemning authority have locked horns on the valuation issue. Message: Assess the contribution strategy as soon as awareness of the threat of condemnation arises, and involve a private charitable organization, the better to bolster evidence of “disinterested generosity”.


Facade Easements and Rehab Credits:
The Code Giveth and The Code Taketh Away

According to a recent Tax Court opinion, the grant of a facade easement intended to protect an historic property constitutes a partial disposition of the rehabilitated property for purposes of the recapture provisions of Internal Revenue Code Section 47. The decision endorses a prior administrative position; Revenue Ruling 89-90, 1989-2 C.B.3.

Rome I, Ltd. (Rome), a limited partnership formed to acquire, rehabilitate and operate commercial property in Rome, Georgia, brought the suit when the IRS granted Rome only part of a 25% rehab tax credit Rome had claimed for restoring a historic building in its community. Within the same tax year, the partnership had deeded a facade and conservation easement to the Georgia Trust for Historic Preservation.

Though the IRS concluded that the easement was a “qualified conservation contribution” under section 170(h), it maintained that the donation constituted a partial disposition of the underlying real property. That disposition, the court held, required Rome to recapture a portion of the rehab tax credit. (Since the rehabilitation and contribution occurred in the same year, that “recapture” was effected by simply reducing the basis of the property with respect to which the rehab credit was computed.)

The case turned on the court’s construction of the term “disposition,” interpreted as “transfer(ing) or otherwise relinquish(ing) ownership of property.” Requiring recapture, the court concluded, gave effect to Congress’ intent to deny double benefits (i.e., rehab credit and charitable contribution attributable to the same expenditures).

The decision is consistent in principle with another, analogous IRS position as to easements on land subject to special-use (usually, farmland) valuation for estate tax purposes under section 2032A. In Letter Ruling 8731001 (March 19, 1987), the Service held that the sale of an agricultural conservation easement with respect to such land will be treated as a disposition per §2032A(c)(1)(A), causing imposition of additional estate tax. (After Rome, the Service would presumably take the same view as to a donated easement.)

Rome I, Ltd., 96 T.C. 697 (May 2, 1991)