FCG VALUATION CASE E-FLASH

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Issue 15:3

Michael S. Mountanos, Petitioner v. Commissioner of Internal Revenue
T.C. Memo. 2013-138, Docket Nos. 8158-10, Judge: Hon. Diane L. Kroupa, Filing date June 3, 2013

Citing two issues, the IRS asserted deficiencies exceeding $1.1 million for the taxpayer's 2006, 2007, and 2008 personal income tax returns:

- Taxpayer was not eligible for carryover deductions for a conservation easement charitable deduction, and
- Taxpayer was liable for an accuracy related penalty for each of the three years.

TAKEAWAY
While not a primary focus of the case facts or ruling, the court's failure to recognize the testimony of an untrained expert having no relevant professional credentials provides taxpayers and their professional advisors valuable insight that should not be ignored.

THE FACTS
Through a living trust, taxpayer owned a California ranch which was used for related-family recreational purposes. In 2005, taxpayer claimed a $4,691,500 charitable deduction for a conservation easement placed on the ranch, but section 170(b)(1)(B) limited his deduction to $1,343,704 for that year. The unused portion of the charitable deduction was claimed in the subsequent three years.

DISCUSSION
Although the IRS acknowledged that the deduction was a "qualified conservation contribution" under section 170(f)(3)(B)(iii), it denied the subsequent deductions because they were overstated.

The court indicated the "before-and-after" approach of *Stanley Works & Subs. v. Commissioner*, 87 T.C. 389, 399 (1986), is often used to value such easements because actual sales are rarely available.

The taxpayer provided three experts who testified to the current and expected highest and best use of the property. The IRS provided no such expert testimony and instead relied on cross examination.

While the court agreed with the experts' assessments of highest and best use after implementation of the conservation easement, it disagreed with the taxpayer-experts' pre-easement assessments. Regarding the pre-easement uses, the taxpayer failed to:

- Demonstrate that he had the right to access the land (access was controlled by a third party) for its asserted use,
- Had adequate water rights to develop the land for its highest and best use,
- Show adequate demand existed for one of the uses, and
- Address legal limitations imposed by subdivision statues.

Additionally, the court noted that the taxpayer failed to provide evidence that the alleged pre-easement highest and best uses were economically viable.

Furthermore, one taxpayer-expert's testimony was disregarded because he failed to establish that he was qualified to appraise real estate, saying:

"Although [taxpayer's expert] has been a real estate broker for a number of years, he does not hold an appraisal designation from a recognized professional appraiser organization. Additionally, the record does not reflect that Mr. Lazaro has any formal training or education in appraising real estate or that he regularly performs real estate appraisals." [insertion substituted in original]

The author notes the court's criticism was similar to its criticism of finance and accounting professors who performed business appraisals in *Estate of Ray A. Ford v. Commissioner*, T.C. Memo 1993-580, and *Estate of Edgar A. Berg v. Commissioner*, T.C. Memo 1991-279.

CONCLUSION

Ultimately, the court concluded "that the taxpayer failed to show that the before and after highest and best use of the ranch differed," and more specifically, the taxpayer failed to show the conservation easement had any value. Hence, the taxpayer was not entitled to the claimed charitable deduction carryover deductions for 2006, 2007 and 2008.

Because the ranch was worth no more after implementation of the conservation easement, the court upheld the IRS assertion that it had met the burden of production associated with fair market value exceeding 400% or more of the correct fair market value.

Additionally, the court ruled that the taxpayer had not acted with reasonable cause or in good faith, and therefore was not eligible for an accuracy related exemption under Sec. 6664(c)(1) or Income Tax Regs. 1.6664-4(a). Hence, the asserted accuracy related penalty was upheld.
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