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U.S. Tax Court: No charitable contribution deduction for facade easement, not "in perpetuity"

The U.S. Tax Court today issued a "reviewed opinion" holding that a facade easement failed to qualify as a charitable conservation contribution under section 170(h) because the easement deed failed to satisfy the "in perpetuity" requirements of the statute.

The case is: *Palmolive Building Investors, LLC v. Commissioner*, 149 T.C. No. 18 (October 10, 2017). Read the Tax Court's **opinion** [PDF 187 KB] as agreed to by the majority. There were no separate concurring or dissenting opinions.

Background

As briefly explained in a summary prepared by the Tax Court, a partnership in 2004 transferred a facade easement on a building in Chicago, by executing an easement deed in favor of a qualified organization. The easement deed placed restrictions on the partnership and its successors with respect to the facade easement and the building.

The partnership's building was subject to two mortgages. Before executing the easement deed, the partnership obtained "ostensible" mortgage subordination agreements from its mortgagee banks. The easement deed provided that in the event the facade easement was extinguished through a judicial proceeding, the mortgagee banks would have claims prior to that of the donee organization to any proceeds received from the condemnation proceedings, until the mortgage was satisfied.

The partnership claimed a charitable contribution deduction for 2004 for the facade easement contribution.

In a notice of final partnership administrative adjustment, the IRS disallowed the partnership's claimed charitable contribution deduction for the donation of the facade easement and also determined that the partnership was liable for a gross valuation misstatement penalty or, alternatively, for a substantial understatement of income tax, negligence or disregard of rules or regulations, or a substantial valuation misstatement penalty.

Tax Court's opinion

The partnership's tax matters partner filed a petition challenging these determinations, and the IRS filed a motion for partial summary judgment.

The IRS asserted that the easement deed did not satisfy the perpetuity requirements of section 170 and the regulations because it provided the mortgagees with prior claims to extinguishment proceeds in preference to the donee organization.

The partnership countered that if the easement deed did violate the perpetuity requirement, the easement deed included a "saving clause" that retroactively reformed the deed to comply with the perpetuity requirements of Reg. section 1.170A-14(g)(6)(ii).

The Tax Court granted summary judgment for the IRS, noting that this case would be appealable to the Seventh Circuit and thus finding that:

- The partnership's easement deed failed to satisfy the "in perpetuity" requirement of section 170(h)(5) because: (1) the mortgages on the building were not fully subordinated to the easement and (2) the donee organization was not guaranteed to receive the share of proceeds (as required by Reg. section 1.170A-14(g)(6)(ii)) in the event that the easement was extinguished and the donor subsequently conveyed the property and received proceeds for it.

- Thus, the facade easement contribution was not a qualified conservation contribution under section 170(h), and the partnership was not entitled to a charitable contribution deduction.

- The defects in the easement deed were not cured by a provision that purported to retroactively amend the deed because the requirements of section 170 must be satisfied at the time of the gift.

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