

**UNITED STATES TAX COURT
WASHINGTON, DC 20217**

PALMOLIVE BUILDING INVESTORS, LLC,)
DK PALMOLIVE BUILDING INVESTORS)
PARTICIPANTS, LLC, TAX MATTERS)
PARTNER,)
)
Petitioner,)
)
v.) Docket No. 23444-14.
)
COMMISSIONER OF INTERNAL REVENUE,)
)
Respondent)

ORDER

We issued an opinion in this case, 149 T.C. No. 18 (Oct. 10, 2017), holding that petitioner (“Palmolive”) is not entitled to a charitable contribution deduction for the contribution of a facade easement because of petitioner’s failure to comply with certain requirements of I.R.C. section 170. Still at issue in the case is petitioner’s liability for penalties that the IRS has asserted. Now before the Court is the Commissioner’s motion (Doc. 110) for leave to file a “Second Amendment to Answer”, by which the Commissioner would add to his answer the allegation that Palmolive’s appraiser was a “promoter” (and therefore not a qualified appraiser). We will grant the motion for leave.

BACKGROUND

FPAA and pleadings

In a Notice of Final Partnership Administrative Adjustment (“FPAA”) issued July 28, 2014 (Doc. 1, Ex. A), the IRS disallowed Palmolive’s deduction for an alleged charitable contribution of a facade easement and asserted a 40% penalty under section 6662(h) for a “gross valuation misstatement” or, in the alternative, a

20% penalty “due to negligence or intentional disregard” under sections 6662(a) and 6662(b)(1), 6662(b)(2), or 6662(b)(3). (Doc. 1, Ex. A, page 9 of 9).

On October 1, 2014, Palmolive filed its petition with this Court, challenging the FPAA, both as to the disallowance of the charitable contribution deduction and as to the alternative penalty determinations. The petition (Doc. 1) alleged that Palmolive retained Michael Ehrmann to appraise the easement and produce a valuation report. (Para. 7(l)-(m).) In paragraph 7 the petition alleged:

- n. Ehrmann is a qualified appraiser as defined in Treas. Reg. § 1.170A-13(c)(5).
- o. The Ehrmann Appraisal is a qualified appraisal as defined in Treas. Reg. § 1.170A-13(c)(3).

(The petition did not explicitly assert a defense of “reasonable cause” pursuant to section 6664(c)(1). Palmolive has never sought leave to amend the petition to assert such a defense.)

On December 10, 2014, the Commissioner filed his answer (Doc. 4). In paragraphs 7(n)-(o), the Commissioner denied Palmolive’s allegations as to Mr. Ehrmann’s being a “qualified appraiser” and his appraisal being a “qualified appraisal”. (Doc. 4, p.3).

On February 29, 2016, the Commissioner filed (without objection from Palmolive) an “Amended Answer” (Doc. 46), which continued to deny, in paragraphs 7(n)-(o), Palmolive’s allegations as to Mr. Ehrmann’s being a “qualified appraiser” and his appraisal being a “qualified appraisal”.

November 2017 status reports

In a status report (Doc. 92) filed in November 2017, Palmolive reported:

4. The parties continue to discuss the remaining issues involved in the case. Although the central concern is application of penalties and Petitioner’s defense of reasonable cause, Respondent’s assertion of a Section 6662(e) valuation misstatement penalty would require a determination of the proper valuation of the easement.

5. The parties are currently cooperating with each other through informal discovery, and Petitioner has provided substantial information and documents in response to Respondent's assertion of penalties, including in support of Petitioner's reasonable cause defense. * * *

7. * * * Petitioner reasonably relied upon * * * (iii) Michael Ehrmann's valuation appraisal, which appraisal was reviewed and believed to be reasonable at the time of the gift * * *. [Emphasis added.]

The Commissioner's status report filed at the same time stated that "respondent's counsel has not seen any credible evidence that would support petitioner's reasonable cause defense." (Doc. 91, p.7, ¶19) (emphasis added).)

The Commissioner's motion

The parties agreed to a schedule, under which "Motions with respect to the pleadings, including leave to amend" were to be filed by September 26, 2018. (See Doc. 108, p. 2.) Our order of May 14, 2018 (Doc. 109), confirmed that schedule.

On September 24, 2018, consistent with that schedule, the Commissioner filed his motion (Doc. 110) for leave to file a "Second Amendment to Answer". That proposed amendment (Doc. 111) would add to the answer the following paragraph 10:

10. FURTHER ANSWERING the petition, respondent alleges that petitioner may not rely, either directly or indirectly, upon the appraisal performed by Mr. Ehrmann for its reasonable cause defense under I.R.C. § 6664 because Mr. Ehrmann was a promoter as defined by the Tax Court in 106 Ltd. v. Commissioner, 136 T.C. 67, 79-80 (2011), aff'd, 684 F.3d 84 (D.C. Cir. 2012). [Emphasis added.]

On October 12, 2018, Palmolive filed its Notice of Objection to the Commissioner's motion for leave to file Second Amendment to answer. (See Doc. 113). The Commissioner filed his reply on October 31, 2018 (Doc. 120), and Palmolive filed a response to the reply on November 6, 2018 (Doc. 122).

DISCUSSION

I. Palmolive's non-pleading of its reasonable cause defense

Not featured in the parties' briefing of the motion for leave is an anomaly that informs our judgment about granting the Commissioner's motion for leave: Palmolive has never explicitly pleaded, as a defense against penalty, "that there was a reasonable cause for [the underpayment] * * * and that the taxpayer acted in good faith with respect to [the underpayment]". Sec. 6664(c)(1).

The petition does, in paragraph 6(c), assign as error "[t]he Commissioner's determination that the Company is liable for IRC Section 6662 penalties, including the gross valuation misstatement penalty, the substantial valuation misstatement penalty, or a penalty due to negligence or intentional disregard of the rules and regulations." However, the petition nowhere asserts that, if Palmolive is liable for the tax, it is nonetheless not liable for penalty. It suggests no contention (other than non-liability for the tax) that might require the Commissioner to make any distinct counter-argument as to penalty.

However, the Commissioner evidently does expect to have to defend the penalty determination. His November 2017 status report (Doc. 91) referred to "petitioner's reasonable cause defense"; and his pending motion for leave seeks to add an issue (whether Mr. Ehrmann was a "promoter") that is material here only if Palmolive is asserting a reasonable cause defense premised on reliance on professional advice. We therefore infer that the issue of "reasonable cause" is to be "tried by * * * implied consent of the parties". See Rule 41(b).

Our calculation of what the Commissioner must plead, and when, is informed by Palmolive's own taciturnity. If Palmolive is to be permitted to make contentions on the basis of implied consent to unpleaded issues, then it would hardly be just to require the Commissioner to plead *strictissimi juris*. We take this into account in deciding how to exercise our discretion as to the motion for leave.

II. Alleged prejudice and surprise

Palmolive argues that it is surprised and prejudiced by the proposed amendment to the answer because the motion was filed slightly less than four months before trial. We disagree. The four months after the filing of the motion-- or even just the nearly two months between the issuance of this order and the

upcoming trial--is adequate time for Palmolive to prepare to explain the actions and circumstance of Mr. Ehrmann, who was Palmolive's own expert.

Moreover, Palmolive has been on notice since no later than the time the answer was filed in December 2014 that the Commissioner denies that Mr. Ehrmann was a "qualified appraiser" (a denial repeated in the amended answer filed in February 2016). Admittedly, being a "promoter" is only one of several ways in which an appraiser might fail to be "qualified", but Palmolive has long been on notice that Mr. Ehrmann's status was disputed.

Alleged concession by the Commissioner

As we have noted, in December 2014 and February 2016 the Commissioner explicitly denied that Mr. Ehrmann was a "qualified appraiser". Yet in its opposition to the motion (Doc. 113 at 4), Palmolive alleges: "during a face-to-face meeting between the parties earlier this year, Respondent indicated that he is not challenging that Mr. Ehrmann was a qualified appraiser or that his appraisal was a qualified appraisal." (See also id. at 9.)

Palmolive's allegation of this concession is not substantiated by an affidavit. Palmolive does not name either the individual who made this alleged oral concession nor any individual who heard it. The word "indicated" is not the same as "stated" or "said" and is vague in this context. No date of the meeting is given (other than "earlier this year"). Until filing its opposition to the motion for leave, Palmolive has made no filing in this case that claimed such a concession, and Palmolive does not allege that such a concession was ever reduced to writing in any form by either party. We do not credit this mere assertion in Palmolive's opposition.

III. Lack of factual detail

Palmolive correctly states that "Respondent has provided no facts to support his new promoter allegation." Given the petition's lack of specificity about penalty defenses, this defect does not incline us to deny the motion for leave. However, we will require the Commissioner to communicate to Palmolive detailed allegations about its contention that Mr. Ehrmann was a promoter, so that Palmolive can prepare for trial.

IV. Unamended allegations in the answer

Palmolive complains of assertions in the proposed amended answer other than the new “promoter” allegation. These are assertions, listed in Palmolive’s “Exhibit B”, that are carried over from the original answer (December 2014) and first amended answer (February 2016), which the Commissioner “[d]enies for lack of information or knowledge.” Palmolive cites evidence that, it believes, renders such pleading obsolete and untenable.

Palmolive thus in effect argues that the Commissioner should be required to amend his answer as to those assertions. We disagree, but we will order the Commissioner to treat these assertions as requested admissions and as proposed stipulations.

To give effect to the foregoing, it is

ORDERED that the Commissioner’s motion for leave is granted and that the Clerk of the Court shall file the “Second Amendment to Answer”; but the Clerk shall entitle it “Second Amended Answer” to correspond to the titling of the first “Amended Answer” (Doc. 46). It is further

ORDERED that, as soon as possible and in any event no later than December 17, 2018, the Commissioner shall transmit to Palmolive a detailed written statement of the facts on which it will rely at trial to support its contention that Mr. Ehrmann was a “promoter”, and shall provide to Palmolive copies of all documents not previously provided on which it will rely at trial to prove those facts. The Commissioner should not expect to be able to rely at trial on facts or evidence on this issue that it fails to disclose by December 17, 2018. It is further

ORDERED that the assertions in the left-hand column of Exhibit B to Palmolive's opposition (Doc. 113) shall be deemed to be requests for admission made pursuant to Rule 90(a) (which requests shall be deemed to have been adequately preceded by "informal consultation or communication"). The Commissioner shall respond to those requests, in compliance with Rule 90(c) (and subject to the potential sanctions of Rule 90(g)), by no later than December 17, 2018. The Commissioner shall also treat these assertions as proposed stipulations to be considered for inclusion in stipulations of fact to be filed with the Court by the parties.

(Signed) David Gustafson
Judge

Dated: Washington, D.C.
November 28, 2018