

UNITED STATES TAX COURT
WASHINGTON, DC 20217

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

ORDER

Now pending before the Court is one issue in a motion for summary judgment (Doc. 116) filed by petitioner (“Palmolive”). This order assumes familiarity with this Court’s first opinion in this case, Palmolive Bldg. Invs, LLC v. Commissioner, 149 T.C. __ (Oct. 10, 2017) (“Palmolive I”), and this Court’s order, dated November 13, 2018 (Doc. 135).

Our order of November 13, 2018 (Doc. 135), ruled on all issues in Palmolive’s motion and the Commissioner’s cross-motion (Doc. 129), except for two, which we took under advisement. We will later address the issue whether the IRS complied with section 6751(b). In this order, we address the issue of whether Palmolive had reasonable cause and good faith, within the meaning of section 6664(c)(1), for the underpayment determined by the IRS and sustained in Palmolive I. Palmolive advances a number of reasons why the Court should grant summary judgment on this issue (see Docs. 117 and 138). For the following reasons, we will deny this aspect of Palmolive’s motion for summary judgment.

SERVED Dec 14 2018

Background

Palmolive's appraisal and tax return

In the parties' First Joint Stipulation of Facts (Doc. 130), the parties agreed that:

41. Palmolive engaged Mr. Michael M. Ehrmann, MAI, of Jefferson & Lee Appraisers, Inc. to value the Building and the façade easement.

42. Mr. Ehrmann prepared an appraisal (the "Ehrmann Appraisal"), which concluded that * * * the estimated market value * * * façade easement * * * was \$33,410,000. * * *

50. Mr. Ehrmann was a qualified appraiser within the meaning of Treas. Reg. § 1.170A-13(c)(5).

51. The Ehrmann Appraisal is a qualified appraisal within the meaning of Treas. Reg. § 1.170A-13(c)(3). * * *

58. On the 2004 return, Palmolive claimed a charitable contribution deduction of \$33,410,000 * * * based on the Ehrmann Appraisal.

IRS audit and penalties

The IRS subsequently audited Palmolive's return, and disallowed that deduction. The IRS also determined the following four penalties (Doc. 1):

- (1) a 40% penalty for gross valuation misstatement under sections 6662(a) and (h); or, in the alternative,
- (2) a 20% penalty due to negligence or disregard of the rules or regulations, under sections 6662(a) and (b)(1); or
- (3) a 20% penalty due to a substantial understatement of income tax, under sections 6662(a) and (b)(2); or

(4) a 20% penalty due to a substantial valuation misstatement, under sections 6662(a) and (b)(3).

Palmolive refers to the sections 6662(b)(1), and (b)(2) penalties as “non-valuation penalties”, and refers to the sections 6662(b)(3), and 6662(h) penalties as “valuation penalties”.

Palmolive I

In Palmolive I we held that Palmolive is not entitled to a charitable contribution deduction for the contribution of that easement because it did not comply with certain requirements of section 170. We did not address Palmolive’s liability for penalties.

Motion for partial summary judgment

Palmolive argues that the Court should grant summary judgment in its favor and should hold that Palmolive prevails on its reasonable cause and good faith defense against all of the penalties asserted by the Commissioner. Palmolive argues: that the substantive issues in this case were ones of first impression, that there was a lack of guidance in the substantive areas of law, on which the Court based its decision in Palmolive I (Doc. 117 at 14-21); that Palmolive attempted to assess the proper amount of tax liability; and that in its effort to do, it so relied upon the advice of professionals (including Mr. Ehrmann) (Doc. 117 at 23-31).

The Commissioner has submitted, for eventual use at trial, an expert appraisal opining that the value of the facade easement was not \$33.4 million but rather zero. The Commissioner argues: that Palmolive was negligent and disregarded the rules and regulations; that Palmolive took a position on its return that was too good to be true; and that it has failed to show that it consulted any case law or other authorities when it prepared the return (Doc. 128 at 24). With respect to Palmolive’s assertion that it relied on the advice of professionals, the Commissioner argues (Doc. 128 at pp. 18-24, 30-34) that Palmolive could not have reasonably relied on Mr. Ehrmann’s appraisal, and that examinations at trial of key witnesses are necessary to determine whether Palmolive acted in good faith.

Discussion

I. Summary judgment

Where the material facts are not in dispute, a party may move for summary judgment to expedite the litigation and avoid an unnecessary trial. Fla. Peach Corp. v. Commissioner, 90 T.C. 678, 681 (1988). A partial summary adjudication is appropriate if some but not all issues in the case are disposed of summarily. See Rule 121(b); Turner Broad. Sys., Inc. v. Commissioner, 111 T.C. 315, 323-324 (1998). The party moving for summary judgment bears the burden of showing that there is no genuine dispute as to any material fact, and factual inferences are to be drawn in the manner most favorable to the party opposing summary judgment. Dahlstrom v. Commissioner, 85 T.C. 812, 821 (1985); Jacklin v. Commissioner, 79 T.C. 340, 344 (1982). On the issue before us, Palmolive is the moving party, and for purposes of its motion we will therefore assume true the facts that the Commissioner has supported, and will draw factual inferences in favor of the Commissioner.

II. Reasonable cause and good faith

A. Generally

Section 6664(c)(1), and the regulations promulgated thereunder, provide that if a taxpayer otherwise liable for an accuracy-related penalty shows, first, that there was reasonable cause for a portion of an underpayment and, second, that the taxpayer acted in good faith with respect to such portion, then no accuracy-related penalty shall be imposed with respect to that portion. “The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances”, including “the taxpayer’s effort to assess the taxpayer’s proper tax liability”, its “experience, [and] knowledge”, and the extent to which it “[r]eli[ed] on * * * the advice of a professional tax advisor or an appraiser”. 26 C.F.R. sec. 1.6664-4(b)(1).

B. Valuation misstatements of charitable property

As for the “valuation penalties” in particular, section 1.6664-4(h)(1) provides that “[t]here may be reasonable cause and good faith with respect to a portion of an underpayment that is attributable to a substantial (or gross) valuation misstatement of charitable deduction property (as defined in paragraph (h)(2) of

this section) only if-- (i) The claimed value of the property was based on a qualified appraisal * * * by a qualified appraiser * * *; and (ii) * * * the taxpayer made a good faith investigation of the value of the contributed property.”

C. Ambiguous language and lack of precedent

The negligence accuracy-related penalty is inappropriate where an issue to be resolved by the Court is one of first impression involving unclear statutory language. Bunney v. Commissioner, 114 T.C. 259, 266 (2000) (citing Everson v. United States, 108 F.3d 234 (9th Cir.1997); Lemishow v. Commissioner, 110 T.C. 110 (1998)); see also Avrahami v. Commissioner, 149 T.C. __ (August 21, 2017) (finding that it was “a case of first impression” and explaining that “we have previously declined to impose accuracy-related penalties when there is no clear authority to guide taxpayers).

III. Analysis

A. Facts and circumstances

For the purposes of deciding Palmolive’s motion, its argument that there is no genuine dispute of material fact and that it is entitled to summary judgment on the issue of whether it had reasonable cause and good faith for its understatement is for the most part unpersuasive. “Reasonable cause” is a fact-intensive issue (see part II.A, supra), and the parties’ submissions show that many of the facts and circumstances are contested by the parties. These questions of fact are the type that should be addressed at trial, where both parties may proffer evidence on these issues. Accordingly, we will deny Palmolive’s motion for partial summary judgment for the reasons stated in the Commissioner’s response (Doc. 128). See Dahlstrom v. Commissioner, 85 T.C. 812, 821 (1985); Jacklin v. Commissioner, 79 T.C. 340, 344 (1982). However, we offer the following additional comments that may assist the parties in their preparation for trial.

B. Reasonable cause and good faith based on lack of precedent

Palmolive argues (Doc. 117 at 14-21) that the application of penalties is inappropriate in this case because the issues addressed in Palmolive I were issues as to which there was no guidance or precedent when it filed its 2004 return. It asserts that Palmolive I is the first case to interpret 26 C.F.R. sec. 1.170A-14(g)(2), and only the second case to interpret 1.170A-14(g)(6), which was first analyzed in Kaufman v. Commissioner, in which the Court of Appeals disagreed with the Tax

Court's reasoning.¹ Palmolive further argues that, other than the regulations, there was no published guidance by the Commissioner on these issues. (Doc. 117 at 19.)

1. 26 C.F.R. section 1.170A-14(g)(2)

Section 1.170A-14(g)(2) requires that in the event that the underlying property of a donated conservation easement is subject to a mortgage, then that mortgage must be subordinated to the right of the donee to enforce the conservation purposes of the gift in perpetuity. Palmolive I, slip op. at *22. We explained that actual subordination is required, and found that Palmolive had failed to comply with that requirement. See Palmolive I, slip op. at *24-25.

Palmolive contends that it has a reasonable cause and good faith defense for the portion of underpayment attributable to its failure to comply with this regulation. Though this contention is insufficient to entitle Palmolive to partial summary judgment on "reasonable cause", we do accept Palmolive's argument that our analysis of its non-compliance with section 1.170A-14(g)(2) was an issue of first impression in Palmolive I. See Avrahami v. Commissioner, 149 T.C. ___ (Aug. 21, 2017). However, that alone does not result in our holding that Palmolive had reasonable cause and acted in good faith. See sec. 1.6664-4(b)(1), Income Tax Regs. Deciding whether Palmolive had reasonable cause and good faith for its understatement based, in part, on an alleged honest misunderstanding of law, will require the Court to determine whether that misunderstanding was "reasonable in light of all of the facts and circumstances, including the experience, knowledge, and education of the taxpayer." Id. (emphasis added). Some of those facts and circumstances are disputed by the parties. (See Doc. at 31-34.) Accordingly, and for additional reasons stated in the Commissioner's response (Doc. 128), we cannot grant summary judgment on this issue. See Rule 121; see also Dahlstrom v.

¹In Palmolive I we explained that this Court previously analyzed section 1.170A-14(g)(6) in Kaufman v. Commissioner ("Kaufman I"), 134 T.C. 182 (2010), and found that the donated easement failed to satisfy the proceeds requirement of paragraph (g)(6)(ii). We denied the Kaufmans' motion for reconsideration. Kaufman v. Commissioner ("Kaufman II"), 136 T.C. 294 (2012). We held in Kaufman I and Kaufman II that "absolute entitlement to proceeds was the donee's entitlement vis-a-vis the donor and her mortgagee--i.e., the parties who had interests in the property at the time of the donation." The Court of Appeals for the First Circuit disagreed with that analysis and held in Kaufman v. Shulman ("Kaufman III"), 687 F.3d 21 (1st Cir. 2012), that the Kaufmans had satisfied section 1.170A-14(g)(6)(ii). Subsequently, we determined in Kaufman v. Commissioner ("Kaufman IV"), T.C. Memo. 2014-52, that the valuation of the Kaufmans's donation was zero, and the First Circuit affirmed that conclusion in Kaufman v. Commissioner ("Kaufman V"), 784 F.3d 56 (1st Cir. 2015).

Commissioner, 85 T.C. 812, 821 (1985); Jacklin v. Commissioner, 79 T.C. 340, 344 (1982).

2. 26 C.F.R. section 1.170A-14(g)(6)

Section 1.170A-14(g)(6) sets forth the requirement that “at the time of the gift the donor must agree that the donation of the perpetual conservation restriction gives rise to a property right, immediately vested in the donee organization, with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction at the time of the gift, bears to the value of the property as a whole at that time”; and in the event of extinguishment of the conservation easement, that the donee organization receive proceeds at least equal to that proportionate value of the perpetual conservation restriction. Sec. 1.170A-14(g)(6)(i)-(ii), Income Tax Regs.

We held in Kaufman I and Kaufman II that this requirement means that “that taxpayers are obligated to show ‘an absolute right’ to proceeds of a condemnation or other sale.” See Palmolive I, slip op at *33. However, the First Circuit disagreed with this interpretation and found that this “reading of [the] regulation would appear to doom practically all donations of easements” in the hypothetical context it raised concerning tax liens, which have a super-priority even as to prior claims, and could therefore could obtain a superior right to insurance proceeds. Kaufman III, 687 F.3d at 26-27. Palmolive argued that we should adopt the First Circuit’s interpretation, but we declined to do so (citing Golsen v. Commissioner, 54 T.C. 742, 757 (1970), aff’d 445 F.2d 985 (10th Cir. 1971)), and explained that “[w]e disagree with the Court of Appeals’ view [in Kaufman III] that our interpretation of the regulations would ‘doom practically all donations of easements’ because the donor can never subordinate possible future tax liens.” See Palmolive I, slip op at *34-37.

While we declined to adopt the First Circuit’s interpretation of section 1.170A-14(g)(6)(ii), we accept Palmolive’s argument that the First Circuit’s disagreement with this Court shows that there is more than one arguable interpretation of this regulation. See Bunney v. Commissioner, 114 T.C. 259, 266 (2000) (citing Everson v. United States, 108 F.3d 234 (9th Cir.1997); Lemishow v. Commissioner, 110 T.C. 110 (1998)). However, as with section 1.170A-14(g)(2), as discussed above, in considering “reasonable cause” based on the interpretation of -14(g)(6), we are required to take into account all facts and circumstances pertinent to the portion of underpayment attributable to Palmolive’s failure to comply with this regulation. Facts relevant to this issue remain in dispute. (Doc. at

31-34.) Therefore, we cannot grant Palmolive's motion for partial summary judgment on the basis of this issue alone. See Rule 121; see also Dahlstrom v. Commissioner, 85 T.C. 812, 821 (1985); Jacklin v. Commissioner, 79 T.C. 340, 344 (1982).

C. Reliance on professionals

1. Reliance on Mr. Ehrmann

The parties dispute whether Palmolive's reliance on Mr. Ehrmann and his valuation supports a reasonable cause and good faith defense for the valuation penalties. While the parties stipulated the facts that Mr. Ehrmann was a "qualified appraiser", and that his appraisal is a "qualified appraisal" within the meaning of the regulations, those facts do not automatically result in a reasonable cause and good faith defense for Palmolive. See secs. 1.6664-4(b)(1); 1.6664-4(h)(1). Facts and circumstances concerning whether Palmolive could have reasonably relied on Mr. Ehrmann's appraisal remain in dispute. (Doc. 128 at 30-31.) Accordingly, for the reasons set forth in the Commissioner's response, the issue of Palmolive's reliance on Mr. Ehrmann is not susceptible of summary resolution. See Rule 121(b); see also Dahlstrom v. Commissioner, 85 T.C. 812, 821 (1985); Jacklin v. Commissioner, 79 T.C. 340, 344 (1982).

2. Reliance on other professionals

Palmolive supports its motion for summary judgment by showing its use of and reliance on other professionals. (Doc. 117 at 24-28.) The Commissioner disputes whether Palmolive's reliance on these professionals was reasonable. (Doc. 128 at 30-34.) For the reasons set forth in the Commissioner's response, the issue of Palmolive's reliance on these other professionals is not susceptible of summary resolution.

For the foregoing reasons, it is

ORDERED that Palmolive's motion for summary judgment is denied in part, as to the issue that Palmolive had reasonable cause and good faith within the meaning of section 6664(c)(1), for the underpayment determined by the IRS and sustained in Palmolive I. It is further

ORDERED that Palmolive's motion for summary judgment and the Commissioner's cross-motions for partial summary judgment remain pending as to

the issue referred to as “issue 4” in the Court’s order of November 30, 2018 (Doc. 135), i.e., whether the IRS failed to obtain written supervisory approval of the initial determination of the penalties at issue here, in compliance with section 6751(b); but, as we stated in that order, “the parties should prepare for trial on the assumption that issue 4 would not be a subject of trial”.

(Signed) David Gustafson
Judge

Dated: Washington, D.C.
December 14, 2018