UNITED STATES TAX COURT
WASHINGTON, DC 20217

ROCK CREEK PROPERTY HOLDINGS, LLC, ROCK CREEK LAND MANAGER, LLC, TAX MATTERS PARTNER,	)	
Petitioner,	)	
v.	)	Docket No. 5599-17.
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent	)	

ORDER

In 2013 Rock Creek Property Holdings, LLC ("Rock Creek Holdings"), executed a deed declaring a conservation easement in favor of a charitable organization; and on its tax return for that year--Form 1065, "U.S. Return of Partnership Income"--Rock Creek Holdings claimed, pursuant to section 170(h),[1] a noncash charitable contribution deduction of $7,875,000. By notice of final partnership administrative adjustment ("FPAA") dated January 4, 2017, the Commissioner disallowed the deduction and determined accuracy-related penalties under section 6662. On March 7, 2017, Rock Creek Land Manager, LLC ("RCLM"), the tax matters partner ("TMP") for Rock Creek Holdings, filed a petition for readjustment of partnership items under section 6226, challenging these determinations.

The Commissioner has now filed a motion for partial summary judgment (Doc. 7) on the issue of whether (as he contends) Rock Creek Holdings was not entitled to the deduction since the easement failed to satisfy the requirement of

[1]Unless otherwise indicated, all section references are to the Internal Revenue Code ("26 U.S.C."; "the Code") in effect for the relevant times, and all Rule references are to the Tax Court Rules of Practice and Procedure. Dollar amounts are rounded, and the precise amounts are undisputed in the parties' submissions.

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section 170(h)(5)(A) that the conservation purpose of the contribution be protected in perpetuity, because the deed fails to provide the donee with the proportionate share of proceeds to which it should be entitled upon extinguishment.[2] Rock Creek Holdings has filed a response in opposition (Doc. 13), to which the Commissioner has filed a reply (Doc. 14). The undisputed material facts on this issue, as set forth in the parties' filings, are the same as the facts in Railroad Holdings, LLC, v. Commissioner, T.C. Memo. 2020-22 (Feb. 5, 2020), and we will follow the reasoning of the opinion in that case and will grant the Commissioner's motion.

Background

The following facts are not in dispute.

Rock Creek Holdings and its property

Rock Creek Holdings and its TMP, RCLM, were formed and continue to exist as limited liability companies under the laws of the state of Georgia. Rock Creek Holdings is treated as a partnership for federal income tax purposes and RCLM is a disregarded entity for federal income tax purposes.

On January 23, 2008, Robert B. Aiken ("Aiken"), an individual, had acquired by inheritance various tracts of land located in Wilkes County, Georgia, which included a 748 acre parcel of real estate ("the subject property"). Aiken is the sole member of Rock Creek Property Manager, LLC ("RC Manager"), a limited liability company organized under the laws of Georgia on September 20, 2013, and treated as a disregarded entity for federal income tax purposes.

On September 23, 2013, the following events occurred: (1) Aiken transferred a 51% undivided interest in the subject property to RC Manager;

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[2]The Commissioner's motion also advances his contention that the deduction should be disallowed because Rock Creek Holdings failed to properly execute the summary appraisal report, Form 8283, submitted with its tax return and did not properly report on its tax return required information about the property, including tax basis and the manner and date of acquisition, as required by the income tax regulations. However, Rock Creek Holdings contends that the copy of the return on which the Commissioner's contention relies is incomplete. Since resolution of this second issue might require the Court to resolve disputed facts, the second issue is not addressed in this order.

(2) Aiken and RC Manager jointly transferred their respective 49% and 51% undivided interests--i.e., the entire interest in the subject property--to Rock Creek Holdings; and (3) in exchange for their interests in the subject property, Aiken received 49% and RC Manager received 50.99% of the membership interests in Rock Creek Holdings. RCLM held the remaining .01% interest in Rock Creek Holdings.

Three days later, Aiken sold his 49% interest in Rock Creek Holdings for $580,258 to LCV Fund XVIII, LLC ("Fund XVIII"), a limited liability company organized under the laws of Georgia; RC Manager sold a 49.99% interest (retaining 1%) to Fund XVIII for $603,942. When the dust settled, Rock Creek Holdings owned the subject property; Rock Creek Holdings was itself owned 98.99 by Fund XVIII, 1% by RC Manager, and .01% by RCLM. Aiken, by virtue of his ownership of RC Manager, received total consideration of $1,184,200 for the 98.99% of Rock Creek Holdings conveyed to Fund XVIII.

<u>The deed of easement</u>

On December 23, 2013, Rock Creek Holdings contributed a conservation easement covering 719 acres of the subject property to Southeast Regional Land Conservancy, Inc. ("SERLC"). We assume for purposes of resolving the motion for summary judgment that SERLC was an organization qualified to receive the conservation contribution and that, apart from the issue addressed here, the easement qualified for a charitable contribution deduction.

Notwithstanding the "perpetual easement" granted in the deed (set forth in article I), the deed also provides for the possible circumstance in which the easement might have to be extinguished and the subject property sold. As to the distribution of proceeds in such a circumstance, the deed provides as follows in article VI ("Miscellaneous") part B ("Conservation Purpose"):

> (2) This Conservation Easement gives rise to a real property right and interest immediately vested in SERLC. For purposes of this Conservation Easement, the fair market value of SERLC's right and interest (<u>which value shall remain constant</u>) shall be equal to the difference between (a) the fair market value of the Conservation Area as if not burdened by this Conservation Easement and (b) the fair market value of the Conservation Area burdened by this Conservation Easement, as such values are determined <u>as of the date of this Conservation Easement</u>. If a change in conditions makes impossible

or impractical any continued protection of the Conservation Area for conservation purposes, the restrictions contained herein may only be extinguished by judicial proceeding. Upon such proceeding, SERLC, upon a subsequent sale, exchange or involuntary conversion of the Conservation Area, shall be entitled to a portion of the proceeds at least equal to the fair market value of the Conservation Easement (as determined through the equation stated above in this subsection). SERLC shall use its share of the proceeds in a manner consistent with the conservation purposes set forth in the Recitals herein.

(3) Whenever all or part of the Conservation Area is taken in exercise of eminent domain by public, corporate, or other authority so as to abrogate the restrictions imposed by this Conservation Easement, Owner and SERLC shall join in appropriate actions at the time of such taking to recover the full value of the taking and all incidental or direct damages resulting from the taking, which proceeds shall be divided in accordance with the proportionate value of SERLC's and Owner's interests as specified above. All expenses, including attorneys' fees, incurred by Owner and SERLC in such action shall be paid out of the recovered proceeds to the extent not paid by the condemning authority. [Emphasis added.]

Article VI, part D ("Construction of Terms"), reads as follows:

This Conservation Easement shall be construed to promote the purposes of the Georgia Conservation Easement Act (O.C.G.A. section 44-10-2 et seq.), which authorizes the creation of conservation easements for purposes including those set forth in the recitals herein, and the conservation purposes of this Conservation Easement, including such purposes as are defined in Section 170(h)(4)(A) of the Internal Revenue Code. The parties recognize the Conservation Values and have the common purpose of preserving these values. Any general rule of construction to the contrary notwithstanding, this Conservation Easement shall be liberally construed in favor of the grant to protect the Conservation Values and effect the policies and purposes of SERLC. If any provision in this Conservation Easement is found to be ambiguous, an interpretation consistent with its conservation purposes that would render the provision valid should be favored over any interpretation that would render it invalid. If any provision of this Conservation Easement is determined by final

> judgment of a court having competent jurisdiction to be invalid, such determination shall not have the effect of rendering the remaining provisions of this Conservation Easement invalid. The parties intend that this Conservation Easement, which is by nature and character primarily prohibitive (in that the Owner has restricted and limited the rights inherent in ownership of the Conservation Area), shall be construed at all times and by all parties to effectuate the conservation purposes of this Conservation Easement.

Tax return and examination

On its Form 1065 for the year 2013, Rock Creek Holdings claimed a noncash charitable contribution of $7,875,000 for its contribution of the easement to SERLC. (Thus, Aiken had effectively received about $1.2 million for the entire property in September 2013; and Rock Creek Holdings claimed that the easement on the property was worth about $7.9 million three months later in December 2013.) The IRS examined the return. On January 4, 2017, the IRS mailed to Rock Creek Holdings and its TMP an FPAA that set forth the IRS' determination to disallow the full amount of Rock Creek Holdings' deduction of the contribution of the easement on the basis of (among other things) its determination that the donation of the easement is not a qualified conservation contribution under section 170. See Doc. 1, Form 886-A, Explanation of Items.

Discussion

I. Summary judgment

The purpose of summary judgment is to expedite litigation and avoid unnecessary trials. Fla. Peach Corp. v. Commissioner, 90 T.C. 678, 681 (1988). The Court may grant summary judgment when there is no genuine dispute as to any material fact and a decision may be rendered as a matter of law. Rule 121(b); Sundstrand Corp. v. Commissioner, 98 T.C. 518, 520 (1992), aff'd, 17 F.3d 965 (7th Cir. 1994). In deciding whether to grant summary judgment, we draw factual inferences in the light most favorable to the non-moving party, Sundstrand Corp. v. Commissioner, 98 T.C. at 520--in this instance, the petitioner. The critical fact in this case is simply the text of the deed--in particular, the provision as to distribution of proceeds in the event of extinguishment--and there is no dispute about what the deed says.

II. Deduction for qualified conservation contribution

Section 170(a)(1) allows a deduction for any charitable contribution made within the taxable year. If the taxpayer makes a charitable contribution of property other than money, the amount of the contribution is generally equal to the fair market value of the property at the time the gift is made. See 26 C.F.R. sec. 1.170A-1(c)(1), Income Tax Regs. The Code generally restricts a taxpayer's charitable contribution deduction for the donation of "an interest in property which consists of less than the taxpayer's entire interest in such property". Sec. 170(f)(3)(A). But there is an exception to this rule for a "qualified conservation contribution." Sec. 170(f)(3)(B)(iii).

Section 170(h)(1) defines a "qualified conservation contribution" as a contribution of a "qualified real property interest" to a "qualified organization" (which we assume SERLC to be) "exclusively for conservation purposes." Under section 170(h)(2)(C), a "qualified real property interest" includes an interest in real property that is a restriction granted in perpetuity on the use of the real property. Section 170(h)(5)(A) provides that a contribution is not treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.

III. Analysis

The Commissioner contends that article VI, section B, of the deed of easement, which, inter alia, specifies the allocations of the proceeds of the sale of the property if the easement is ever extinguished, fails to protect the conservation purpose in perpetuity. In order to satisfy the requirement that the conservation purpose be protected in perpetuity, any interest in the property retained by the donor must be subject to legally enforceable restrictions that will prevent uses of the retained interest inconsistent with the conservation purpose of the donation. 26 C.F.R. sec. 1.170A-14(g)(1), Income Tax Regs. It is possible that an easement may be extinguished, and in such an instance the easement would not have lasted in perpetuity. However, the regulation provides that if an extinguishment does occur, the donation will nonetheless be deemed to have been in perpetuity if the proceeds of the extinguishment are paid to the donee organization and the donee uses them for its conservation purposes. Section -14(g)(6)(ii) of the regulation requires as follows:

> [F]or a deduction to be allowed under this section, 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. * * * [T]hat proportionate value of the donee's property rights shall remain constant. * * * [T]he donee organization, on a subsequent sale, exchange, or involuntary conversion of the subject property, must be entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction * * *. [Emphasis added.[3]]

In Coal Property Holdings, LLC v. Commissioner, 153 T.C. __ (Oct. 28, 2019), we held that a deed providing a donee with a share of the proceeds from an extinguishment calculated by multiplying the easement's proportion of value as determined at the time of the gift against the fair market value at the time of the sale "minus any increase in value after the date of th[e] grant attributable to improvements" did not comply with the proportionality requirement of section -14(g)(6)(ii). We reached the same conclusion in Railroad Holdings, LLC, v. Commissioner, T.C. Memo. 2020-22 (Feb. 5, 2020), where the text of the deed at issue was identical (with the exception of one immaterial parenthetical clause) to the text of the deed at issue here.

Rock Creek Holdings (like the petitioner in Railroad Holdings) advances the same arguments about the text of the deed, arguing that because the donee is entitled to "at least" an amount, the donee "is not limited to that amount." (Doc. 13 at 19). But, as we have explained, a provision that the donee is not necessarily "limited to that [deficient] amount" is insufficient, because the donee must be entitled to the full amount. A deed that provides for the donee a share of proceeds that may be less than the minimum cannot comply by adding "at least" to its deficient formula. The defect cannot be cured by part D of article VI, which purports to resolve any ambiguities in the conservation easement in favor of its

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[3]The regulation continues: "unless state law provides that the donor is entitled to the full proceeds from the conversion without regard to the terms of the prior perpetual conservation restriction." 26 C.F.R. sec. 1.170A-14(g)(6)(ii), Income Tax Regs. In this case neither party contends that Rock Creek Holdings would be entitled to the full proceeds under applicable State law.

validity. See Railroad Holdings, LLC v. Commissioner, at *17-*18. Even if we assumed ambiguity in the paragraphs regarding extinguishment, a cure to the validity of the deed of easement does not cure the non-deductibility of the contribution, and construing part D as a saving clause would render it unenforceable. Id. at *18 ("A donor cannot reserve in an easement deed a right that section 170(h) does not permit * * * but then save his charitable contribution by mentioning the rule he has violated and calling for that rule to kick in and save the day if his violation subsequently comes to light.")

The donee's entitlement to a proportionate share of the extinguishment proceeds is absolute. See Carroll v. Commissioner, 146 T.C. 196, 212 (2016). Therefore a subtraction or diminution to the donee's share of the proceeds does not comply with this limited exception to the perpetual use restriction. See Railroad Holdings v. Commissioner, T.C. Memo 2020-22, at *11 (citing Coal Property Holdings, LLC v. Commissioner, 153 T.C. at __ (slip op. at 18)). Expressed differently, the share to which the donee is entitled shall include the donee's proportional share of any appreciation in value of the property occurring after the date of the donation. See 26 C.F.R. sec. 1.170A-14(g)(6)(ii) (emphasis added).

Though the deed incorporates from the regulation the phrase "proportionate value", the deed does not create a proportion or fraction that represents the donee's share of the property right, and hence a corresponding fraction of proceeds to which the donee is perpetually entitled. See PBBM-Rose Hill, Ltd. v. Commissioner, 900 F.3d 193, 205-206 (5th Cir. 2018). Exactly like the deed in Railroad Holdings, the deed at issue here establishes only a floor for the amount of proceeds--one that is not required to rise with the value of the property. Fixing a minimum amount that does not provide the donee with the proportionate share of potential appreciation to which the donee is entitled does not satisfy the requirements of section 1.170A-14(g)(6)(ii). For this reason we find that the Commissioner properly disallowed the deduction.

It is therefore

ORDERED that the Commissioner's motion for partial summary judgment is granted. It is further

ORDERED that on or before March 12, 2020, the parties shall file a joint status report (or if a joint report is not expedient, then separate reports) setting forth the issues remaining for trial and recommending a schedule for further proceedings.

(Signed) David Gustafson
Judge

Dated: Washington, D.C.
February 7, 2020