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UNITED STATES TAX COURT
WASHINGTON, DC 20217

CHARLES W. HARRIS & JACQUELINE HARRIS,	)	
Petitioners,	)	
v.	)	Docket No. 24201-15.
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent	)	

O R D E R

This case involves a disputed deduction for the contribution of a conservation easement. The Commissioner filed a motion for partial summary judgment (Doc. 17), which argues that petitioners Charles W. Harris and Jacqueline Harris are not entitled to the deduction because the conservation easement deed allowed for subsequent boundary modifications of certain "Reserved Areas", in violation of the perpetuity requirements set forth in section 170(h)(2), (5). See generally Pine Mountain Preserve v. Commissioner, 151 T.C. No. 14 (Dec. 27, 2018).

The Commissioner subsequently moved for leave (see Doc. 30) to supplement his motion by raising another failure to comply with the perpetuity requirement--i.e., that the conservation easement deed's extinguishment proceeds provision does not comply with 26 C.F. R. section 1.170A-14(g)(6)(ii). The Commissioner contends that each easement failed to provide the Grantee, Pacolet Area Conservancy, Inc., with the proportionate share of the entire proceeds to which it should be entitled upon extinguishment, because the deed excludes from the Grantee's share the portion of proceeds attributable to post-gift improvements to the property. We granted leave (see Doc. 33), and the parties have briefed that aspect of the supplemented motion. (See Docs. 34, 37.) The undisputed material facts on this issue, as set forth in the parties' filings, are equivalent to the facts in

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Hewitt v. Commissioner, T.C. Memo. 2020-89 and Oakbrook Land Holdings, LLC, v. Commissioner, T.C. Memo. 2020-54, and we will follow the reasoning of the opinions in those cases and will grant the Commissioner's motion on the basis of the extinguishment proceeds issue.

Background

The following facts relevant to the extinguishment proceeds issue are not in dispute:

Petitioners' property

Petitioners own property in Columbus, North Carolina, consisting of approximately 132 acres.

The easement

In December 2007 petitioners donated to Pacolet Area Conservancy, Inc. ("PAC"), a conservation easement on approximately 95 acres of the Property, by means of a deed of easement ("the Deed"). We assume that PAC is an organization that is exempt from tax under section 501(c)(3) and that is entitled to receive charitable contributions deductible under section 170. We refer to the 95 acres covered by the easement as the "protected property". The prefatory language of the Deed sets forth 8 different conservation purposes enumerated A. through H., which we assume for purposes of this order meet the definition of "conservation purpose" at Section 170(h)(4)(A).

Possible improvements on the Reserved Areas

Of the 95 acres in the protected property, approximately 72 acres consist of the so-called "Natural Area", and approximately 23 acres consist of four "Reserved Areas" that have been partially developed: a 6-acre "Residential Area 1" for single family residential purposes; a 10-acre "Equestrian Area") for equestrian application; a 2-acre "Residential Area 2" for residential purposes; and a 5-acre "Residential Area 3" for residential and equestrian purposes. Under the Deed, various structures and driveways (in addition to those existing at the time of the gift) may be built on these Reserved Areas. Petitioners contend that "any structures built may not otherwise subvert the overall purpose and intent of the Conservation Easement and may not materially threaten the easement's

Conservation Purpose", and for purposes of this order we assume that petitioners are correct.

Paragraph 3.2.2 of the deed otherwise generally prohibits additional structures on the protected property. However, under paragraph 4.3 the owner may install underground utilities, construct structures necessary for drainage, construct bridges foot, horse, bicycle, and maintenance traffic, and construct certain roads, trails, and walkways--all, we assume, subject to the conservation purposes of the deed.

Extinguishment provision

The Deed contemplates the possibility that the easement could be extinguished by judicial proceedings. In the case of extinguishment or condemnation, paragraph 9.4 of the Deed provides the proceeds that the Grantee would be entitled to receive, as follows:

> 9.4 Condemnation and Extinguishment. The donation of this Conservation Easement gives rise to a property right, immediately vested in Grantee, with a fair market value equal to the proportionate value that the Conservation Easement bears to the value of the Protected Property as a whole (minus any increase in value after the date of this grant attributable to improvements). The proportionate value of Grantee's property rights shall remain constant. If a change in conditions makes impossible or impractical any continued protection of the Protected Property for conservation purposes, the restrictions contained herein may be extinguished only by judicial proceeding, Upon such a proceeding, Grantee, upon a subsequent sale, exchange or involuntary conversion of the Protected Property, shall be entitled to a portion of the proceeds at least equal to that proportionate value of the Conservation Easement. [Emphasis added.]

Tax returns and examinations

The petition alleges, and we assume, that petitioners obtained an appraisal that the value of the easement was $1,327,000 and that they claimed a charitable contribution in that amount on their tax return for 2007. Due to deduction limitations, the deduction was only partially used in 2007 and was carried over to

2008 for which only a part of the remainder was used. Apparently the IRS did not examine petitioners' returns for 2007 and 2008.

The petitioners carried forward the remaining charitable contribution deduction attributable to the easement to the years 2009, 2010, and 2011. Petitioners carried back excess deductions from 2009 to 2004. The IRS did examine these years and, on June 30, 2015, issued to petitioners a notice of deficiency denying them the carryover charitable deductions related to the easement for the years 2009, 2010, and 2011, and for the carry back to 2004.

Tax Court proceedings

On September 22, 2015, petitioners timely filed their petition, which alleged an address in North Carolina. Respondent moved for summary judgment, and the petitioners have opposed the motion.

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 petitioners. The critical fact in this case is simply the text of the Deed--in particular, the provision as to calculating the proceeds to be distributed 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). 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 PAC 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.

In order to satisfy the statutory 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).

III. Proceeds from extinguishment

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.]

Under paragraph p.4 of the Deed, the Grantee's share of any extinguishment proceeds is its proportionate share (established at the time of the gift) multiplied not necessarily against the total proceeds but rather only against that portion of the proceeds that is not attributable to improvements made to the property after the gift (i.e., in the words of the parenthetical in paragraph 9.4, "minus any increase in value after the date of this grant attributable to improvements"). Petitioners do not dispute that the Deed so provides.

IV. Analysis

The Commissioner contends that paragraph 9.4 of the Deed, which 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, because the Deed allows the Grantee no share of proceeds attributable to post-gift improvements. This Court agrees.

In Oakbrook Land Holdings, LLC v. Commissioner, T.C. Memo. 2020-54, we held a deed violates the "protected in perpetuity" requirement of section 170(h)(5), as interpreted in 26 C.F.R. sec. 1.170A-14(g)(6), if the donee's share of the extinguishment proceeds is reduced by excluding the value of any improvements made by the donor after the date of gift. We reached the same conclusion in Hewitt v. Commissioner, T.C. Memo. 2020-89, where the deed at issue was equivalent to the Deed at issue here. (The provision allocating the proceeds in the event of a judicial extinguishment in the deed in Hewitt contained language virtually identical to the critical parenthetical in paragraph 9.4 in the Deed at issue here).

Petitioners contend that we misconstrue the regulation. However, we strictly construe Section 1.170A-14(g)(6), Income Tax Regs., see Hewitt, slip op. at *15-17 (and in the cases cited therein), and such construction requires in the context of allocating proceeds from an extinguishment that "the value of posteasement improvements may not be subtracted out of the proceeds before determining the donee's proportionate share." Id. slip op. at *19; see also Oakbrook Land Holdings, slip op. at *37-41.

For these reasons we hold that the Commissioner properly disallowed the deductions. It is therefore

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

ORDERED that on or before July 31, 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.
June 30, 2020