

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

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

ORDER

This is scheduled for trial at a special session beginning on December 16, 2019 (Doc. 152). The parties filed a joint status report proposing a schedule for pretrial activities and filing deadlines (Doc. 153). By our order dated March 25, 2019 (Doc. 154), we instructed the parties to follow the schedule proposed in that status report. The parties’ pretrial memoranda are to be filed no later than November 1, 2019. We will order the parties to address an issue in those pretrial memoranda.

Background

This order assumes familiarity with the parties’ previous submissions and our previous orders. Those submissions show that a series of transactions occurred, during which Palmolive Building Investors, LLC (“Palmolive”), acquired the entire ownership interest in the facade of a building. Palmolive contributed an easement on that facade to LPCI and claimed a charitable contribution deduction. The Commissioner subsequently disallowed the deduction and determined a tax deficiency and penalties. Two of the penalties that remain at issue in this case require the Court to determine the value of the facade easement on the building. (See Docs. 135, 144, and 152). We will order the parties to

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comment in their pretrial memoranda on our understanding, expressed below, of that series of transactions. The following description does not constitute findings of fact but rather our current impressions, as to which we invite correction.

Original ownership structure

In May 2001, Draper & Kramer, Inc. (“D&K”) through Palmolive, and the National Electric Benefit Fund (“NEBF”), acquired the building for \$58.5 million, using a limited liability company structure.

Initially, Palmolive and NEBF created and used three LLCs to hold varying amounts of the building’s floors. Immediately after acquiring the building, Palmolive owned (via its membership interests in three entities): 15% of floor 1 via its 15% membership interest in Palmolive Building Retail LLC (“Retail LLC”), 15% of floors 2-14 via its 15% membership interest in Palmolive Building Base LLC (“Base LLC”), and 100% of floors 15-37 via its 100% membership interest in Palmolive Tower Condominiums LLC (“Tower LLC”); and the NEBF owned (via its membership interests in two entities): 85% of floors 1-14, via its 85% membership interests in Retail LLC and Base LLC (i.e., it did not have any equity interest in floors 15-37). (See Doc. 145 at 8-9; Doc. 146 at 10-12.).

Another entity, Palmolive Building Residual LLC (“Residual LLC”) was originally (in addition to Palmolive and NEBF) a member in Retail LLC and Tower LLC, although its relationship and also its membership interests in the respective entities is unclear. (See Doc. 127, Ex. D).

Subsequent 2003 restructuring

In June 2003, the building’s ownership, capital structure, and financing were rearranged in a series of transactions (“2003 restructuring”). (Doc. 145 at 8-9; Doc. 146 at 13-15). In the course of the 2003 restructuring, Palmolive acquired NEBF’s 85% membership interest in floors 5 through 14 (including the facade) and its 85% membership interest in the facade of floors 1 through 4. The property rights to 100% of the building’s facade were conveyed from the entities that had owned the building’s various floors, to a newly created entity that was wholly owned by Palmolive, Palmolive Building Facade LLC (“Facade LLC”). During

the 2003 restructuring, Palmolive also paid NEBF \$6.75 million.¹ (See Doc. 145 at 8-9; Doc. 146 at 13-15.)

Other than their respective membership interests in the building, Palmolive and NEBF appear to be unrelated parties. Accordingly, we assume that they were dealing with each other at arm's length during the 2003 restructuring and that NEBF did not convey any of its property rights to Palmolive at a below-market rate.

At the conclusion of the 2003 restructuring, Palmolive owned 15% of floors 1-4 sans the facade via Retail LLC (which perhaps owned only some portions of floors 1 and 2, rather than owning them in their entirety²), 100% of floors 5-37 sans the facade via Tower LLC, and 100% of the facade of the building through its 100% ownership of Facade LLC. NEBF retained an 85% equity interest in floors 1-4, sans the facade.³

We cannot tell which entity owned the building's three basement floors or whether any equity interest in the basement floors was exchanged during the 2003 restructuring. (Doc. 145 at 9). During the 2003 restructuring, it also appears that

¹On page 12 of the "Financial Statements and Independent Auditors Report" for "Palmolive Tower Condominiums, LLC", Palmolive represents that, "On June 11, 2003, the Company consolidated the first and second mortgages from NEBF in the original amount of \$14,000,000 and \$16,359,750, respectively, along with accrued interest, and the note payable of \$6,776,200 to NEBF for the purchase of NEBF's ownership in Base and Façade." (Doc. 142, Ex. B at 12; emphasis added). The latter part of that sentence appears inconsistent with representations made elsewhere in the parties' filings concerning the amount paid by Palmolive to NEBF (i.e., whether the amount paid was \$6.75 million, or \$ 6.776 million).

²In due course the parties can clarify, as necessary, which entities owned what portions of the building's floors and can provide details concerning any transaction that resulted in a changed property interest.

³It appears that Palmolive may not agree with our understanding of the equity ownership of the building that resulted from the 2003 restructuring, although its contentions are unclear because it states that "[a]s a result of the 2003 restructuring and refinancing, NEBF had no equity interest in the portion of the Building that was being converted to condominiums." (I.e., that statement is silent concerning NEBF's interest in floors that were not converted to condominiums.) But then in the very same paragraph, Palmolive asserts that "after the 2003 restructuring and refinancing, NEBF had no equity interest in the Building." (Doc. 145 at 9). We invite Palmolive to clarify its contention regarding this issue.

Residual LLC “withdrew” its membership interest in Retail LLC, but retained its membership interest in Tower LLC. (See Doc. 127, Ex. D).

The value of the easement, in relation to the total value of the building

Palmolive contends that at the time of the donation, 13% of the building’s value was attributable to the easement. Palmolive Bldg. Inv’rs, LLC v. Commissioner, (“Palmolive I”), 149 T.C. 380, 385 (2017) (“On the basis of an appraisal, Palmolive asserts * * * that at the time of the donation of the easement in 2004, the total value of the property had increased to \$257 million, of which 13%—i.e., \$33.41 million—was attributable to the easement.”).

Analysis

Based on the foregoing assumed facts, we put forth, as a hypothesis, that an approximate value for the building’s facade can be calculated from the transactions that took place between Palmolive and NEBF in the 2003 restructuring.

I. Calculating the facade’s value by reference to the 2003 restructuring and Palmolive’s appraisal

A. What Palmolive paid and acquired

During the 2003 restructuring, it appears that Palmolive paid NEBF \$6,750,200 for NEBF’s 85% interest in the facade of floors 1-14, and for their 85% interest in floors 5-14, sans the facade. (Doc. 127, Ex. D; Doc. 145 at 8-9; and Doc. 146 at 10-12). The Court proposes that it is possible, from this transaction, to calculate an approximate value for the entire facade of the building, as Palmolive and NEBF apparently valued the facade, at the time of the 2003 restructuring. For the following calculations, all dollar values are in millions, and the following letters (variables) correspond to the relevant values in the manner set forth below:

F = the average, per-floor value of the building’s facade

P = the average, per-floor value of the building, sans the facade

B. The total dollar values of the floors and facade in the 2003 transaction

We propose that the 2003 restructuring transaction, as explained above, can be described by the following equation:

$$\begin{aligned} & [85\%(\text{NEBF's interest}) \times 10P(\text{representing floors 5-14})] + \\ & [85\%(\text{NEBF's interest}) \times 14F(\text{representing floors 1-14})] = \\ & [\$6.75 \text{ (amount paid by Palmolive to NEBF)}] \end{aligned}$$

Shortened, that equation is:

$$85\% (10P + 14F) = \$6.75 \text{ million}$$

Dividing each side of the above equation by 85% results in the following:

$$10 P + 14 F = \$7.94 \text{ million}$$

Without knowing the value of “P”, or without having another independent equation, we are unable to determine the value of “F” (i.e., the average per floor value of the facade, for floors 1 through 14).

C. The relative values of the facade and the building sans facade

However, we suggest that a second independent equation can be derived from the relationship between F and P, as proposed by Palmolive in its appraisal of the facade--i.e., that 87% of the building's value is attributable to the floors of the building sans its facade, and 13% of the building's value is attributable to the building's facade. That proportion can be expressed as:

$$P = (87\%/13\%) F$$

Solving the fraction contained in the above equation yields the following formula:

$$P = 6.69231 F$$

D. Solving the dollar values of the floors and facade

Using linear algebra, we can now solve the equations by substituting the formula that describes the relationship between “F” and “P” for the variable “P” in the prior equation, that was derived from the 2003 restructuring:

$$10 P + 14 F = \$7.94$$

$$10 (6.69231 F) + 14 F = \$7.94$$

Then we solve for “F”:

$$66.9231 F + 14 F = \$7.94$$

$$80.92 F = \$7.94$$

$$F = \$0.09812$$

The building has 37 floors (above ground), so (assuming the value for “F”, for Floors 1 through 14, is approximately the same value for “F” of the entire building) we multiply the above value by 37:

$$37 F = \$0.09812 \times 37 = \$3.6309$$

The resulting value suggests that in 2003, the entire building’s facade was worth no more than approximately \$3.6309 million. (The value would be less if the 13% figure proposed by Palmolive’s expert is too high.)

II. Additional comment

It is possible that, in response to this order, one or both of the parties will assert fallacies, errors, or oversights in the foregoing analysis, and will argue that the hypothesized maximum value is erroneous. If so, we would nonetheless benefit from additional comment by the parties on a general observation underlying the foregoing analysis:

It is perhaps fortunate to have in this case a circumstance that seems to be rare in cases involving the valuation of a facade easement--i.e., a transaction in which portions of a facade are transferred separately from the building behind that facade. An arm’s-length transaction in which a facade was sold, separate from the building, might be good evidence of the fair-market value of that facade. As we have shown above, it appears in this case that, in the 2003 transaction, NEBF transferred to Palmolive NEBFs entire interest (both facade and associated building) for floors 5 to 15 but also transferred to Palmolive NEBFs interest in only the facade of floors 1 to 4. The foregoing analysis is the Court’s attempt, unassisted by the parties or their experts, to identify that distinct value. If the Court’s attempt requires correction (e.g., as to the value received by NEBF, or the property rights transferred during the 2003 restructuring), then we would

appreciate receiving that correction in the parties' memoranda and in their presentations at trial.

To give effect to the foregoing, it is

ORDERED that, in their pretrial memoranda to be filed by November 1, 2019, the parties shall correct, comment, clarify, and supplement the Court's understanding, described above, of the initial ownership structure of the building in 2001, the 2003 restructuring transactions, the resulting ownership structure, and the mathematical relationship of the building's facade to the value of the building without its facade.

**(Signed) David Gustafson
Judge**

Dated: Washington, D.C.
June 7, 2019