TAX COURT CASE UPDATE

Citation:

Barry S. Friedberg v. Commissioner, T.C. Memo 2011-238, October 3, 2011.

Overview:

The Tax Court denied a charitable contribution deduction for a facade easement based on defects in the appraisal report. However, The Court also denied the IRS's request for summary judgment regarding the charitable contribution of development rights, finding that the taxpayer had substantially complied with the regulations regarding the contents of an appraisal.

The Facts:

In 2003, Mr. Friedberg donated a facade easement and all development rights on a townhouse in a historic district in Manhattan to the National Architectural Trust (NAT). Mr. Friedberg hired an appraiser to appraise the property. The appraisal report compared the potential sales value of the property both before and after the contribution of the facade easement and the development rights. The appraiser reviewed nine comparable sales occurring within the previous two years of similar New York properties. In order to determine the value of the easement, the appraiser considered six sales of property in Washington, DC occurring in the 1980s and two in New Orleans during the 1990s. According to the appraiser, the average reduction in value of the property as a result of the facade easement was 17.4 percent. The appraiser concluded that the percentage that should be used for the New York facade easement would be a reduction in value of 11 percent, but he did not explain how that final percentage was derived.

Mr. Friedberg claimed a charitable deduction on his income tax return and attached the appropriate form signed by the appraiser and the President of NAT. He also attached a copy of the appraisal.

On audit, the IRS determined that the appraisal and Form 8283 did not comply with applicable regulations and denied the charitable deduction in its entirety. Mr. Friedberg filed a petition in Tax Court and the IRS sought summary judgment that both the facade easement and the gift of development rights did not qualify for a charitable deduction.

Discussion:

The Tax Court first considered the facade easement. The Court rejected the appraiser's use of sales in locales other than Manhattan, finding that the use of easement valuations from the 1980s in Washington and New Orleans was not appropriate. In addition, The Court held that the percentage diminution method used by the appraiser was not an acceptable appraisal method. The Court also found that the appraiser made multiple errors in his determination of the Washington easement values. As a result, The Court granted the summary judgment to the IRS and held that the appraisal report was not a qualified appraisal because the report failed to comply with the requirement of Regulation section 1.170A-13(c)(3)(ii)(J) to properly apply the comparable sales method in valuing the subject property after the facade easement.

The Court then looked at the issue of the contribution of development rights and granted summary judgment to Mr. Friedberg because the appraisal was qualified under Regulation Section 1.170A-13(c)(3)(ii)(K) with respect to its valuation of development rights. The Court denied summary judgment to the IRS because it believed that material factual issues were in dispute regarding the value of the development rights. The Court reasoned that while the appraisal contained many errors, it explained the method of valuation and the specific basis for the valuation. The Court said it was a matter of factual determination whether Mr. Friedberg could have been able to transfer or otherwise use the development rights before the donation, and whether the appraisal adequately assessed the market demand for those rights.

With respect to the fact that the date of the report was different from the date of the contribution, the Tax Court denied the IRS's request for summary judgment and held that Mr. Friedberg had substantially complied with the requirements of the regulations because the errors regarding the date of the appraisal report did not relate to the substance or essence of the contribution.

In addition, The Court also held that Mr. Friedberg had substantially complied with the requirement to attach a fully completed appraisal summary to his return even though the summary did not adequately describe the property, its overall physical condition, the manner of acquisition, or the cost or other basis. These flaws were overcome because Mr. Friedberg also attached the appraisal report to his tax return, which did provide the necessary information.

Conclusion:

This case highlights that when a client makes a charitable contribution of a facade easement, it is essential to have a complete "before and after" method appraisal that thoroughly explains the specific comparables and valuation methodology used by the appraiser. Advisors should carefully review the appraisal reports being submitted to the IRS to ensure that all of the requirements of the regulations are complied with to avoid the expense of an audit or litigation.