TAX COURT CASE UPDATE

Citation:

Michael S. Mountanos v. Commissioner, T.C. Memo 2013-138, June 3, 2013.

Overview:

The Tax Court has concluded that a taxpayer was not entitled to a carryover of a claimed charitable contribution deduction because he failed to show that a conservation easement had any value. The taxpayer failed to demonstrate that there was any reduction in the highest and best use valuation of the property as a result of the restrictions imposed under the conservation easement.

The Facts:

In December 2005, Mr. Mountanos conveyed a conservation easement on 882 acres of largely undeveloped land that he owned in Lake County, California (known as the Blue Lakes Ranch) to a non-profit corporation, Golden State Land Conservancy. Federal land surrounded Blue Lakes Ranch except for one small area. The access roads to the property ran through neighboring properties, including Federal land that the Bureau of Land Management managed. The neighboring property owners granted easements to the taxpayer to pass over their land for purposes of accessing Blue Lakes Ranch. The Bureau of Land Management's easement granted limited access to Blue Lakes Ranch for single-family use.

The Black Oak Springs Creek traverses the property. A permit is required to divert water from the Black Oak Springs Creek for private use (which the taxpayer did not have). However, Blue Lakes Ranch also included other springs and two ponds.

At the time the taxpayer established the conservation easement on Blue Lakes Ranch, it was under a contract with Lake County that limited Blue Lakes Ranch's use and development according to the California Land Conservation Act of '65.

On his 2005 return, the taxpayer claimed a $4,691,500 charitable contribution deduction for the conservation easement. As he could only use $1,343,704 of the deduction in 2005 because of the charitable deduction ceiling for individuals, he carried over the deduction for the unused portion to 2006, 2007, and 2008. On audit, the IRS challenged the carryover.

The taxpayer contended that as a result of establishing the conservation easement, Blue Lakes Ranch could no longer be used for its highest and best use, in other words, residential development and vineyard use (as one of his experts claimed) or subdivision and vineyard use (as another of his experts claimed). On the other hand, the IRS contended that the conservation easement did not diminish Blue Lakes Ranch's fair market value.

Discussion:

The Tax Court concluded that the taxpayer was not entitled to the claimed charitable contribution carryover deductions for the years at issue because he failed to show that the conservation easement had any value. The taxpayer did not show that Blue Lakes Ranch's fair market value after he established the conservation easement was less than its fair market value before he established the conservation easement.

While The Court agreed that the property's highest and best use was for recreation after the taxpayer established the conservation easement, it found that he failed to show that, before the easement, either residential development and vineyard use, or subdivision and vineyard use, were the highest and best uses of Blue Lakes Ranch.

The Court also found that the taxpayer failed to show that vineyard use was a legally permissible, physically possible, or economically feasible use of Blue Lakes Ranch. Access to the property required a right-of-way easement over Federal land, and the Bureau of Land Management had granted only a restricted single-family use easement. The taxpayer also failed to show that water from sources on the property, other than the Black Oak Springs (for which he did not have a permit), was sufficient to support vineyard use. He failed to show that it was likely that either a more expansive access easement or a water permit would be granted. In addition, he failed to introduce objective data and analysis showing demand for 287 acres of vineyard-suitable property.

The taxpayer also failed to show that the contract that had been executed permitted the residential development or subdivision of Blue Lakes Ranch (or for that matter, vineyard use). This contract made the property subject to the California Land Conservation Act of ‘65 at the time the conservation easement was placed on Blue Lakes Ranch. The Act's purpose was to preserve agricultural and open space land and to discourage premature urban development. It accomplished this by authorizing local governments to establish agricultural preserves and then to enter into long-term land conservation contracts with landowners within the preserves who receive preferential property tax rates in return for accepting the restrictions on the development and use of their land. These land conservation contracts limit the land to agricultural and compatible uses for 10 or more years and may also include terms and conditions more restrictive than those required by the contract. The conservation contracts automatically renew for an additional year absent notice of non-renewal and may be cancelled only if certain stringent conditions are met.

The Tax Court also found that the taxpayer was liable for a gross valuation misstatement penalty for the underpayments for the years at issue. While a taxpayer generally is not liable for an accuracy-related penalty if he acted with reasonable cause and in good faith with respect to any portion of the underpayment, Code Section 6664(c)(3) provides that the reasonable cause exception does not apply in the case of a gross valuation overstatement with respect to property for which a charitable contribution deduction was claimed under Code Section 170.

Conclusion:

The Court determined that the taxpayer was not entitled to carryover deductions from the contribution of a conversation easement, and that he was subject to an accuracy related penalty for each year at issue.