

UNITED STATES TAX COURT

ESTATE OF GREGORY T. MOUNT, )  
DECEASED, ALLISON H. COOK, )  
EXECUTOR & ALLISON H. COOK )

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)  
Petitioners, )

v. )

Docket No.: 17390-09

COMMISSIONER OF INTERNAL )  
REVENUE, )

FILED ELECTRONICALLY

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)  
Respondent. )

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**PETITIONERS' RULE 50(c) STATEMENT IN SUPPORT OF PETITIONERS'  
MOTION FOR PARTIAL SUMMARY JUDGMENT AS TO THE APPLICABILITY OF  
TREASURY REGULATION § 1.170A-14(g)(6) TO INSURANCE PROCEEDS  
RESULTING FROM A CASUALTY, HAZARD OR ACCIDENT OR THE PROCEEDS OF  
CONDEMNATION IN NEW YORK**

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**PRELIMINARY STATEMENT**<sup>1</sup>

On August 11, 2011, Petitioners filed Petitioners' Motion for Partial Summary Judgment as to the Applicability of Treasury Regulation § 1.170A-14(g)(6) to Insurance Proceeds Resulting from a Casualty, Hazard or Accident or the Proceeds of Condemnation in New York ("Petitioners' Motion") and a memorandum of law in support of Petitioners' Motion. To avoid duplication, Petitioners incorporate Petitioners' Motion.

On October 3, 2011, Respondent filed Respondent's Opposition to Petitioners' Motion and a memorandum of law in support thereof. This Court ordered the parties to appear at the United States Tax Court, Washington, D.C. on November 23, 2011 to present oral arguments. Pursuant to Rule 50(c), Petitioners submit this statement in lieu of the oral argument that would have been presented on November 23, 2011.

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<sup>1</sup> To avoid duplication, unless otherwise defined, all capitalized terms have the meaning given to them in Petitioners' Motion and Petitioner's Memorandum.

**DISPUTED FACTS**

The facts necessary to decide Petitioners' Motion are not in dispute. See Resp. Opposition to Pet. Motion.

**ISSUES**

1. Does the Conservation Deed create a property right, immediately vested in the Trust that is enforceable in perpetuity within the meaning of Treas. Reg. § 1.170A-14(g) (6)?

*Yes. Under New York law "the right of the grantee of the easement is superior to that of the owner of the land, and the legal title in the land is subservient to the use of the land necessary to render the easement effective . . ." Baker v. Mayor, 31 A.D. 112, 114-115 (1st Dep. 1898). N.Y. Evtl. Conserv. L. § 49-0305 supplemented New York's common law and made conservation easements "perpetual." N.Y. Evtl. Conserv. L. § 49-0307 limits a donor's ability to terminate a conservation easement (i.e., a conservation easement can only be terminated through one of the three methods set forth in N.Y. Evtl. Conserv. L. § 49-0307).*

2. Are insurance proceeds "proceeds" for purposes of Treas. Reg. § 1.170A-14(g) (6)?

*No. Treas. Reg. § 1.170A-14(g) (6) applies to the proceeds from the sale, exchange or involuntary conversion of the property following a judicial proceeding that extinguishes an easement. Under the applicable New York law, N.Y. Evtl. Conserv. L. § 49-0307, a casualty, hazard or accident occurring to or about the Property will not judicially extinguish an easement. Furthermore, the Trust's rights in the Property would be "completely extinguished" following a judicial proceeding to extinguish the easement. Thus, in New York, the Local Law Exception applies and insurance proceeds from a casualty, hazard or accident occurring to or about the Property are not "proceeds" for purposes of Treas. Reg. § 1.170A-14(g) (6).*

3. Does condemnation of an easement encumbered property, "judicially extinguish" a conservation easement, so that the "proceeds" of the easement's condemnation are proceeds for purposes of Treas. Reg. § 1.170A-14(g)(6)?

*No. First, Treas. Reg. § 1.170A-14(g)(6) applies to the proceeds from the sale, exchange or involuntary conversion of the property following a judicial proceeding that extinguishes an easement. In New York, condemnation is not a judicial proceeding that extinguishes an easement for purposes of Treas. Reg. § 1.170A-14(g)(6). Second, under the applicable New York law (i.e., N.Y. Real Prop. Act L. § 1951) a New York cy pres proceeding "completely extinguishes" an easement. As a matter of law, the Trust would not have a right to seek "proceeds" in a subsequent condemnation proceeding. Consequently, under New York law, the Local Law Exception applies and condemnation proceeds are never proceeds for purposes of Treas. Reg. § 1.170A-14(g)(6).*

4. In New York, is an action pursuant to N.Y. Real Prop. Act L. § 1951 the only action that constitutes a "judicial proceeding" for purposes of Treas. Reg. § 1.170A-14(g)(6)?

*Yes. Treas. Reg. § 1.170A-14(g)(6)(ii) only applies to judicial proceedings that: (a) extinguish the perpetual conservation restrictions (i.e., the conservation easement) and (b) allow the donor to retain an interest in a formerly easement encumbered property so that he can provide a donor with a right to "proceeds" from a subsequent sale, exchange or involuntary conversion. In New York, an action pursuant to N.Y. Real Prop. Act L. § 1951 is the only judicial proceeding that can extinguish a conservation easement for purposes of Treas. Reg. § 1.170A-14(g)(6).*

5. Does the Local Law Exception of Treas. Reg. § 1.170A-14(g)(6) apply to the payment of insurance or condemnation

proceeds following an action brought pursuant to N.Y. Real Prop. Act L. § 1951?

*Yes. Upon the payment of damages, an action pursuant to New York Real Prop. Act. L. § 1951 completely extinguishes a conservation easement. Once terminated, the easement holder does not have standing to seek additional compensation in a subsequent insurance or condemnation litigation. Because a cy pres proceeding is a judicial proceeding, res judicata also bars the easement holder from participating in subsequent condemnation or insurance litigation. Thus, because a cy pres proceeding is a judicial proceeding that completely extinguishes an easement, New York 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.*

6. Is 1982 East, LLC v. Commissioner, T.C. Memo. 2011-84, controlling?

*No. The Taxpayers did not argue and the Court in 1982 East, LLC did not address the application of the Local Law Exception in New York. Because New York has its own regime for guaranteeing that conservation easements are perpetual, the Local Law Exception overrides the Donee's Proceeds requirement of Treas. Reg. § 1.170A-14(g) (6).*

**SUMMARY OF ARGUMENT**

To avoid duplication, Petitioners incorporate their previously filed Memorandum of Law. Petitioners respectfully restate the following points:

1. Kaufman v. Commissioner, 136 T.C. No. 13 (2011), was not based on New York Law.
2. The Post-Extinguishment Proceeds requirement is inapplicable in New York because of the Local Law Exception set forth in Treas. Reg. § 1.170A-14(g)(6)(ii).
3. The taxpayers in 1982 East, LLC v. Commissioner, T.C. Memo. 2011-84, did not address the Local Law Exception. To date, the Court has not considered the interplay of the Local Law Exception of Treas. Reg. § 1.170A-14(g)(6)(ii) and state laws applied to extinguish a conservation easement.
4. The Conservation Deed created a perpetual conservation easement pursuant to New York Environmental Conservation Law. See N.Y. Evtl. Conserv. L. § 49-0301 *et. seq.* Under New York law, a conservation easement is the equivalent to and in some ways superior to a fee estate in land. Stonegate Family Holding Inc. v. Revolutionary Trails, Inc., 73 A.D.3d 1257, 1261 900 N.Y.S.2d 494, 499 (App. Div. 2010); Baker v. Mayor, 31 A.D. 112, 114-115

(1st Dep. 1898). Consequently, under New York law, the Conservation Deed gives rise to a property right, immediately vested in the Trust, 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.

5. Unless the Local Law Exception applies, the only "proceeds" relevant to the issue of whether the Lender Agreement violates Treas. Reg. § 1.170A-14(g)(6)(ii) are the proceeds from the subsequent sale, exchange or involuntary conversion of the Property following a judicial proceeding that extinguishes an easement.

A. Under N.Y. Envtl. Conserv. L. § 49-0307, neither casualty, hazard nor accident result in the judicial extinguishment of the Easement. Insurance proceeds payable because of a casualty, hazard or accident are not proceeds from the sale or exchange of the property following a judicial proceeding that extinguishes an easement. Thus, insurance proceeds resulting from a casualty, hazard or accident are therefore never Post-Extinguishment Proceeds for purposes of Treas. Reg. § 1.170A-14(g)(6).

B. In New York, condemnation does not result in the judicial extinguishment of the Easement.

C. In New York:

1. The only action that can judicially extinguish an easement is a cy pres action brought pursuant to N.Y. Real Prop. Act L. § 1951.

2. N.Y. Real Prop. Act L. § 1951 provides that an easement adjudged unenforceable shall be "completely extinguished" upon payment of damages.

3. Because a cy pres action pursuant to N.Y. Real Prop. Act L. § 1951 completely extinguishes an easement, as a matter of law, there can never be proceeds from the sale or exchange of the property following the judicial proceeding that extinguished the easement.

4. After an easement is extinguished pursuant to N.Y. Real Prop. Act L. § 1951, the donor is entitled to the full proceeds from the subsequent conversion without regard to the terms of the prior perpetual conservation restriction (i.e., the Local Law Exception applies to the payment of these proceeds).

5. The Local Law Exception set forth in Treas. Reg. § 1.170A-14(g) (6) applies in New York.

Thus, the Local Law Exception makes Citimortgage's prior claim to condemnation or insurance proceeds following a N.Y. Real Prop. Act. L. § 1951 proceeding irrelevant to whether the Lender Agreement violates Treas. Reg. § 1.170A-14(g)(6). Consequently, Citimortgage's prior claim to insurance and condemnation proceeds does not violate Treas. Reg. § 1.170A-14(g)(6).

6. Under New York law, the only judicial proceeding relevant to the issue of whether the Lender Agreement violates Treas. Reg. § 1.170A-14(g)(6) is a proceeding brought pursuant to N.Y. Real Prop. Act. L. § 1951. See N.Y. Envtl. Conserv. L. § 49-0307. Citimortgage did not reserve a prior claim to the proceeds of a proceeding brought pursuant to N.Y. Real Prop. Act. L. § 1951.

**ARGUMENT**

**POINT I**

**THE CONSERVATION DEED CREATES IN THE TRUST A PERPETUAL  
CONSERVATION RESTRICTION AS CONTEMPLATED BY TREAS. REG. § 1.170A-  
14(g) (6)**

Respondent contends that the Conservation Deed does not give 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. See Res. Memorandum of Law in Support of Respondent's Opposition to Petitioners' Motion (hereinafter "Respondent's Memo"), at 17-19. Respondent is wrong. See N.Y. Envtl. Conserv. L. § 49-0301 et. seq.

**A. Under New York Law, the Conservation Deed Created a Conservation Easement.**

The Conservation Deed:

"convey[s] to the Grantee, TO HAVE AND TO HOLD, an EASEMENT IN GROSS, in, on, and to the Property, the Building and the Facade, being an Open Space and Architectural Facade Easement on the Property.

(Pet. Motion, Exhibit A, at 2, § II) (emphasis added). Thus, the Conservation Deed created a conservation easement pursuant to New

York Environmental Conservation Law. See N.Y. Eenvtl. Conserv. L. § 49-0301 et. seq.

**B. Under New York Law, a Conservation Easement is Perpetual.**

Unless otherwise provided in the instrument creating the conservation easement, New York conservation easements are, as a matter of law, perpetual. See N.Y. Eenvtl. Conserv. L. § 49-0305(1); see also Pet. Motion, Exhibit A, at 1-2, §§ I.F., II. Here, the Conservation Deed expressly provides that it is binding on Petitioners, their successors in interest and the Trust and its successors in interest. (Pet. Motion, Exhibit A, at 4, § IV.A.) Thus, the conservation purpose is "protected in perpetuity."

**C. Under New York Law, the Conservation Deed Gives Rise to a Property Right, Immediately Vested in the Trust.**

Under New York law, a conservation easement is the equivalent of a fee estate in land. Stonegate Family Holding Inc. v. Revolutionary Trails, Inc., 73 A.D.3d 1257, 1261 900 N.Y.S.2d 494, 499 (App. Div. 2010). In fact "*the right of the grantee of the easement is superior to that of the owner of the land, and the legal title in the land is subservient to the use of the land*

*necessary to render the easement effective . . .”* Baker v. Mayor,  
31 A.D. 112, 114-115 (1st Dep. 1898) (emphasis added).

**D. Under New York Law, the Manner in Which a Conservation Easement Can be Extinguished is Limited.**

The New York Legislature has limited the applicability of laws that may affect the enforceability of a conservation easement to those laws that “expressly state the intent to defeat the enforcement of such easement.” N.Y. Eenvtl. Conserv. L. § 49-0305(5); see also N.Y. Eenvtl. Conserv. L. § 49-0307. N.Y. Eenvtl. Conserv. L. § 49-0307 provides that the only methods to extinguish an easement are:

- (a) as provided in the instrument creating the easement; or
- (b) in a proceeding pursuant to section nineteen hundred fifty-one of the real property actions and proceedings law; or
- (c) upon the exercise of the power of eminent domain.

N.Y. Eenvtl. Conserv. L. § 49-0307.

**E. Under New York Law, a Judicial Extinguishment of a Conservation Easement Requires the Payment of Damages, if any, to the Easement Holder Pursuant to a N.Y. Real Prop. Act. L. § 1951 Proceeding.**

As discussed below, a N.Y. Real. Prop. Act. L. § 1951 proceeding is the only method for extinguishing an easement that

requires a "judicial proceeding" in New York. New York Real Prop. Act. L. § 1951(2) provides:

When relief against such a restriction is sought in an action to quiet title or to obtain a declaration with respect to enforceability of the restriction or to determine an adverse claim arising from the restriction, or is sought by way of defense or counterclaim in an action to enforce the restriction or to obtain a declaration with respect to its enforceability, **if the court shall find that the restriction is of no actual and substantial benefit to the persons seeking its enforcement or seeking a declaration or determination of its enforceability, either because the purpose of the restriction has already been accomplished or, by reason of changed conditions or other cause, its purpose is not capable of accomplishment,** or for any other reason, it may adjudge that the restriction is not enforceable by injunction or as provided in subdivision 2 of section 1953 **AND THAT IT SHALL BE COMPLETELY EXTINGUISHED UPON PAYMENT,** to the person or persons who would otherwise be entitled to enforce it in the event of a breach at the time of the action, of such damages, if any, as such person or persons will sustain from the extinguishment of the restriction.

(emphasis added). The complete extinguishment of the easement terminates the easement holder's property rights. Moreover, since cy pres is a judicial proceeding, res judicata precludes the easement holder from seeking additional compensation in a subsequent sale, exchange or involuntary conversion of the encumbered property. See N.Y. Ins. L. § 3401, N.Y. Em. Dom. L. §§ 103, 501, 501; see also Parker v. Blauvelt Volunteer Fire Co., 93

N.Y.2d 343, 712 N.E.2d 647 (1999). Thus, proceeds received from a subsequent sale or exchange of the property belong to the property owner, regardless of the terms of the prior conservation deed.

**F. Because the Conservation Deed Incorporates Treas. Reg. § 1.170A-14(g) (6), if the Conservation Easement Is Judicially Extinguished, the Trust Will Receive Damages.<sup>2</sup>**

The Conservation Deed satisfies Treas. Reg. § 1.170A-14(g) (6) by incorporating its terms. Indeed, the Conservation Deed provides:

**In the event this Easement is ever extinguished through a judicial decree,** Grantor agrees on behalf of itself, its heirs, successors and assigns, that Grantee, or its successors and assigns, will be entitled to receive upon the subsequent sale, exchange or involuntary conversion of the Property, a portion of the proceeds from such sale, exchange or conversion equal to the same proportion that the value of the initial Easement donation bore to the entire value of the property at the time of donation as estimated by a state licensed appraiser, **unless controlling state law provides that the Grantor is entitled to the full proceeds in such situations, without regard to the Easement.** Grantee agrees to use any proceeds so realized in a manner

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<sup>2</sup> The Deed incorporates the Extinguishment Provisions of the Regulation. The Easement can only be judicially extinguished in a N.Y. Real Prop. Act. L. § 1951 proceeding. The Lender Agreement does not give Citimortgage a priority interest in the proceeds of a cy pres proceeding. Thus, under NY law, the Trust will either receive (a) the amount necessary to trigger the Local Law Exception; or (b) the amount required by Treas. Reg. § 1.170A-14(g) (6).

consistent with the conservation purposes of the original contribution.

(Pet. Motion, Exhibit A, p.4, § IV.C.) (emphasis added).

The Conservation Deed unambiguously incorporates Treas. Reg. § 1.170A-14(g)(6). When the terms of the deed are unambiguous, the nature and extent of the easement are determined according to the plain language of the deed. See Stonegate Family Holding Inc., 73 A.D.3d at 1261, 900 N.Y.S.2d at 499, quoting Hopper v. Friery, 260 A.D.2d 964, 966, 689 N.Y.S.2d 305 (App. Div. 1999).

Under New York law the Conservation Deed, including those provisions that incorporate Treas. Reg. § 1.170A-14(g)(6) and its Local Law Exception, will be strictly enforced.

**G. Absent an Agreement Whereby the Trust Waives its Rights under Treas. Reg. § 1.170A-14(g)(6), the Conservation Deed Satisfies Treas. Reg. § 1.170A-14(g)(6)**

The Conservation Deed incorporates Treas. Reg. § 1.170A-14(g)(6) and under New York law, the Conservation Deed will be enforced according to its terms. See Stonegate Family Holding Inc., 73 A.D.3d at 1261, 900 N.Y.S.2d at 499.

Consequently, absent an agreement whereby the Trust waives its rights under the Conservation Deed, Petitioners easement donation satisfied Treas. Reg. § 1.170A-14(g)(6).

**POINT II**

**THE LENDER AGREEMENT DOES NOT ABROGATE THE CONSERVATION DEED'S  
COMPLIANCE WITH TREAS. REG. § 1.170A-14(g) (6)**

Respondent contends that the Lender Agreement between the Trust and Citimortgage overrides the Conservation Deed's literal compliance with Treas. Reg. § 1.170A-14(g) (6). See Kaufman v. Commissioner, 136 T.C. No. 13 (2011); 1982 East, LLC v. Commissioner, T.C. Memo. 2011-84.

Respondent's contention is based on the following provision of the Lender Agreement:

The Mortgagee/Lender and its assignees shall have a **prior claim to all insurance proceeds as a result of any casualty, hazard or accident occurring to or about the Property and all proceeds of condemnation**, and shall be entitled to same in preference to Grantee until the Mortgage/the Deed of Trust is paid off and discharged, notwithstanding that the Mortgage/the Deed of Trust is subordinate in priority to the Easement.

(Motion, Exhibit A at 7) (emphasis added). Respondent's analysis ignores that under New York law neither (a) insurance proceeds as a result of any casualty, hazard or accident occurring to or about the Property, nor (b) proceeds of condemnation are "Post-Extinguishment Proceeds" for purposes of Treas. Reg. § 1.170A-14(g) (6) (ii).

As explained below, the plain language of Treas. Reg.

§ 1.170A-14(g) (6) limits its application to the:

1. proceeds of
2. a "sale or exchange of the property" following
3. a "judicial proceeding" that
4. extinguishes an easement (sometimes

"Post-Extinguishment Proceeds").

In New York, the only proceeding that fits within the "judicial proceeding" language of Treas. Reg. § 1.170A-14(g) (6) is a cy pres proceeding pursuant to N.Y. Real Prop. Act. L. § 1951. See N.Y. Evtl. Conserv. L. § 49-0307; see also Points IV, VII, *infra*.

Because:

1. The Lender Agreement does not grant Citimortgage a priority claim to the proceeds of a cy pres proceeding brought pursuant to N.Y. Real Prop. Act. L. § 1951; and

2. Insurance or condemnation proceed paid prior to a N.Y. Real Prop. Act. L. § 1951 proceeding are not Post-Extinguishment Proceeds; and

3. The Trust's rights in the Property are completely extinguished subsequent to a N.Y. Real Prop. Act. L. § 1951 proceeding; and

4. Neither: (a) insurance proceeds as a result of any casualty, hazard or accident occurring to or about the Property,<sup>3</sup> nor (b) proceeds of condemnation<sup>4</sup> are "Post-Extinguishment Proceeds" for purposes of Treas. Reg. § 1.170A-14(g)(6)(ii), it follows that

5. The Lender Agreement does not abrogate the Trust's entitlement to proceeds as defined by Treas. Reg. § 1.170A-14(g)(6)(ii).

### **POINT III**

#### **INSURANCE PROCEEDS RESULTING FROM A CASUALTY, HAZARD OR ACCIDENT OCCURRING TO OR ABOUT THE PROPERTY ARE NOT RELEVANT TO THE TREAS. REG. § 1.170A-14(g)(6) PROCEEDS ANALYSIS**

Petitioners' Memorandum explains that absent a cy pres proceeding brought pursuant to N.Y. Real Prop. Act. L. § 1951, insurance proceeds resulting from a casualty, hazard or accident occurring to or about the property are not relevant to the Post-Extinguishment Proceeds analysis required by the regulations. See Petitioners' Memo of Law at 19-23. Respondent disagrees. See Respondent's Memo at 8-11. Respondent's arguments ignores both

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<sup>3</sup> See Point III, *infra*.

<sup>4</sup> See Point IV, *infra*.

the plain language of Treas. Reg. § 1.170A-14(g) (6) and New York law.

The first rule of statutory or regulatory construction is to begin with the language of the statute or regulation. See United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241 (1989). The inquiry ends when the plain language of the regulation is clear and unambiguous. Id. A plain language analysis requires that each word used by the drafter be given effect so that no one word is rendered meaningless. Reiter v. Sonotone Corp., 442 U.S. 330, 339 (1979).

Treas. Reg. § 1.170A-14(g) (6) (i) provides that:

***If* a SUBSEQUENT UNEXPECTED CHANGE IN THE CONDITIONS SURROUNDING THE PROPERTY THAT IS THE SUBJECT OF A DONATION UNDER THIS PARAGRAPH CAN MAKE IMPOSSIBLE OR IMPRACTICAL the continued use of the property for conservation purposes, the conservation purpose can nonetheless be treated as protected in perpetuity *if* the restrictions are EXTINGUISHED BY JUDICIAL PROCEEDING<sup>5</sup> and all of the DONEE'S PROCEEDS (determined under paragraph (g) (6) (ii) of this section)**

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<sup>5</sup> Respondent contends, without explanation, that "judicial extinguishment" is not a condition precedent to the applicability of Treas. Reg. § 1.170A-14(g) (6) (ii). See Resp. Response to Pet. Req. for Ad., p.6, ¶ 18; see also Respondent's Memo at 12. Respondent's position is contrary to the plain language of Treas. Reg. § 1.170A-14(g) (6) and to Respondent's guidance regarding the interpretation of this regulation. See IRS Ch. Couns. Mem. 200950037 (Dec. 11, 2009); IRS Ch. Couns. Mem. 201002038 (Jan. 15, 2010); IRS Priv. Ltr. Rul. 08-36-014 (Sep. 5, 2008).

**from a SUBSEQUENT SALE OR EXCHANGE OF THE PROPERTY** are used by the donee organization in a manner consistent with the conservation purposes of the original contribution.

(emphasis added).

Treas. Reg. § 1.170A-14(g)(6) says nothing about insurance proceeds. Rather, it applies only when an easement is judicially extinguished and a subsequent sale or exchange generates "proceeds." Based on the plain language of Treas. Reg. § 1.170A-14(g)(6), insurance proceeds resulting from a casualty, hazard or accident occurring to or about the property are not relevant to the Treas. Reg. § 1.170A-14(g)(6) proceeds analysis.

Along the same lines, under New York law, the methods available for the extinguishment of an easement do not include casualty, hazard or accident. See N.Y. Env'tl. Conserv. L. § 49-0307. A casualty, hazard or accident occurring to or about the Property does not extinguish an easement.

Against this background, insurance proceeds as a result of any casualty, hazard or accident occurring to or about the Property are not "Post-Extinguishment Proceeds" for purposes of Treas. Reg. § 1.170A-14(g)(6)(ii). Furthermore, insurance

proceeds paid subsequent to a N.Y. Real Prop. Act. L. § 1951 proceeding are governed by the Local Law Exception.<sup>6</sup>

Citimortgage's prior claim to insurance proceeds as a result of any casualty, hazard or accident occurring to or about the Property does not violate Treas. Reg. § 1.170A-14(g)(6).

#### POINT IV

#### **IN NEW YORK, CONDEMNATION IS NOT A JUDICIAL PROCEEDING, THE PROCEEDS RESULTING FROM THE CONDEMNATION OF A CONSERVATION EASEMENT ARE NOT POST-EXTINGUISHMENT PROCEEDS**

#### **A. In New York, Condemnation of a Conservation Easement Does Not Require the Commencement of a Judicial Proceeding.**

As explained above, (a) the rules of construction require that each word of Treas. Reg. § 1.170A-14(g)(6) be given effect so that no one word is rendered meaningless. See Reiter, 442 U.S. at 339; and (b) Treas. Reg. § 1.170A-14(g)(6) only applies to the proceeds of a sale or exchange following a judicial proceeding that extinguishes the easement (i.e., Post-Extinguishment Proceeds).

A "judicial proceeding" generally refers to a proceeding in court. See Black's Law Dictionary 1222 (7th ed. 1999). Condemnation, by contrast, is the process by which a governmental

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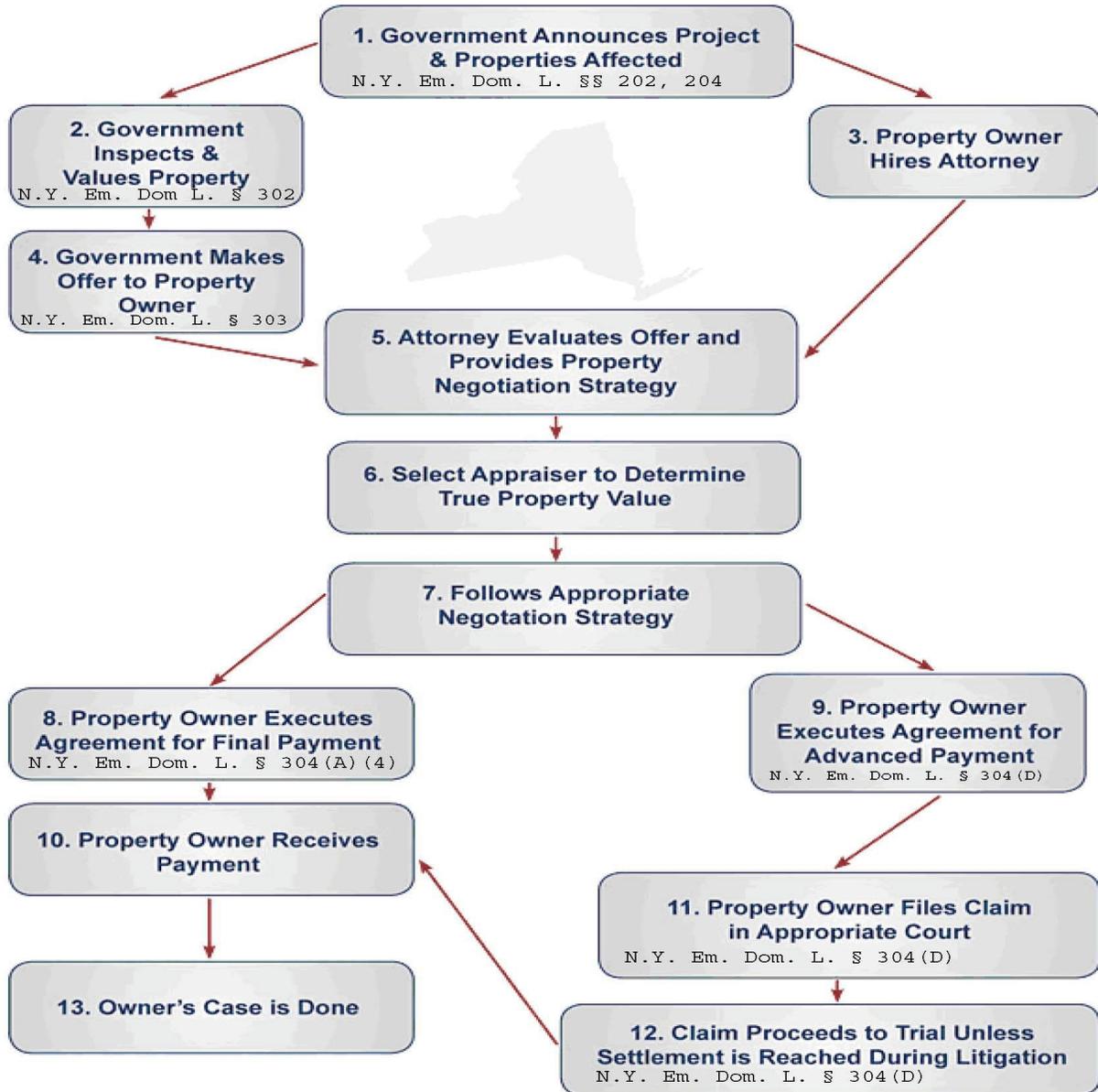
<sup>6</sup> See Point VI, *infra*.

body exercises its right of "eminent domain" to acquire private property for public uses. See Scattergood v. Jamaica Water Securities Corp., 234 A.D.2d 688, 690, 650 N.Y.S.2d 854, 857 (App. Div. 1996).

In New York, the exercise of the power of eminent domain does not require a judicial proceeding to extinguish existing property rights. See People v. Adirondack Ry. Co., 54 N.E. 689, 692 (1899) (Due Process for eminent domain does not require a judicial proceeding for a taking to occur); see also D. Zachary Hudson, Eminent Domain Due Process, 19 Yale L.J. 1280, 1286 (2010) (The process varies from those states that provide notice and pre-condemnation hearings to those that allow a condemnor to exercise its power of eminent domain without any meaningful judicial proceeding prior to the taking).

The chart below illustrates the condemnation process in New York:

## THE EMINENT DOMAIN PROCESS | NY



Because, in New York, eminent domain generally extinguishes an easement without the resort to a judicial proceeding, Treas. Reg. § 1.170A-14(g)(6)(i) does not apply to the proceeds generated by the condemnation of a conservation easement.

**B. Treas. Reg. § 1.170A-14(g)(6)(ii)'s Incorporation of a "Subsequent Sale" Requirement Demonstrates it is Inapplicable to Condemnation**

The plain language of Treas. Reg. § 1.170A-14(g)(6)(ii) provides:

*. . . when a change in conditions give rise to the extinguishment of a perpetual conservation restriction under paragraph (g)(6)(i) of this section, the 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, 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.*

(emphasis added).

At common law, a change in conditions that gave rise to the extinguishment of a conservation restriction did not always result in the payment of compensation to the easement holder. Consequently, traditional cy pres proceedings could result in a windfall to the property owner. See Nancy A. McLaughlin, Rethinking the Perpetual Nature of Conservation Easements, 29

Harv. Envtl. L. Rev. 421, 491-97 (2005) (discussing this issue in context of extinguishment of conservation easements in cy pres proceedings).

To remedy this perceived injustice, the drafters of Treas. Reg. § 1.170A-14(g)(6)(ii) required that the instrument creating the conservation easement convey to the easement holder the right to a pro rata share of any proceeds from the "sale or exchange of the property" following a judicial proceeding (i.e., a cy pres proceeding) that extinguishes an easement (i.e., "Post-Extinguishment Proceeds").<sup>7</sup>

With this history in mind, the "proceeds . . . from **a subsequent sale** or exchange of the property" requirement applies when the "judicial proceeding" (i.e., cy pres proceeding) that extinguished the easement allows the property owner to retain rights in the formerly easement encumbered property. It does not apply to proceedings in condemnation whereby the easement is extinguished and the formerly easement encumbered property is

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<sup>7</sup> The drafters included this requirement in the regulations interpreting § 170(h) to ensure that the full value of the property right conveyed to the public in an easement donation transaction would remain in public hands upon extinguishment of the easement (rather than pass as a windfall to the owner of the land). See Nancy A. McLaughlin, Rethinking the Perpetual Nature of Conservation Easements, 29 Harv. Envtl. L. Rev. at 491-97.

transferred to the government. Stated another way, reserving to an easement holder, a property right in a property condemned by the government, is inconsistent with purpose of "eminent domain" (i.e., to acquire private property for public uses).

Toward that end, in New York, just compensation for the easement holder would be determined before the termination of his or her conservation easement. In re (College Point. Indus. Park Urban Renewal Project II, Borough of Queens) City of New York, 51 A.D.2d 798, 798, 380 N.Y.S.2d 285, 297 (App. Div. 1976). Once just compensation is paid, the condemnation of a property divests all interest holders of their rights in the condemned property. See e.g. Application of Cantro, 198 Misc. At 928, 103 N.Y.S.2d at 766.

Subsequent to condemnation, the donor of a conservation easement does not, and by definition cannot have property rights, in the previously easement encumbered property transferred to the government. Therefore, application of Treas. Reg. § 1.170A-14(g)(6)(i) to condemnation in New York gives no meaning to the phrase "proceeds . . . from a subsequent sale or exchange of the property."

Against this background, Treas. Reg. § 1.170A-14(g) (6) applies only if a conservation easement is extinguished by judicial proceeding. In New York, condemnation is not a judicial proceeding. Thus, in New York, Treas. Reg. § 1.170A-14(g) (6) does not apply to the proceeds of an easement extinguished by condemnation. Furthermore, if a condemnation occurs subsequent to a N.Y. Real Prop. Act. L. § 1951 proceeding, the Local Law Exception applies to the payment of those proceeds.<sup>8</sup> Citimortgage's prior claim to proceeds resulting from a condemnation of the easement does not violate Treas. Reg. § 1.170A-14(g) (6).

**POINT V**

**IN NEW YORK, THE ONLY METHOD TO EXTINGUISH A CONSERVATION EASEMENT THAT REQUIRES A JUDICIAL PROCEEDING IS AN ACTION BROUGHT PURSUANT TO N.Y. REAL PROP. ACT. L. § 1951**

In the context of Treas. Reg. § 1.170A-14(g) (6), *cy pres* refers to those judicial proceedings that modify or terminate easements when changed conditions frustrate their purpose. See Restatement (Third) of Property: Servitudes § 7.11, cmt. b (2000); see also N.Y. Evtl. Conserv. L. § 49-0307(1); N.Y. Real

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<sup>8</sup> See Point VI, *infra*.

Prop. Act. L. § 1951. In Kaufman, 136 T.C. No. 13, 21, the Court acknowledged that:

The drafters of section 1.170A-14 . . . provided what appears to be a regulatory version of cy pres to deal with unexpected changes that make the continued use of the property for conservation purposes impossible or impractical.

The New York cy pres procedure is codified by N.Y. Real Prop. Act. L. § 1951. N.Y. Env'tl. Conserv. L. § 49-0307 makes clear that an action pursuant to N.Y. Real Prop. Act. L. § 1951 is the only judicial proceeding available under New York law to modify or terminate an easement when changed conditions frustrate its purpose. See Pet. Motion, Exhibit A; N.Y. Real. Prop. Act. L. § 1951(2).

The Lender Agreement does not reserve to Citimortgage a priority claim to the proceeds of a cy pres proceeding. Under New York law, the Trust has a superior claim to the proceeds of a cy pres proceeding. See Baker v. Mayor, 31 A.D. 112, 114-115 (1st Dep. 1898).

**POINT VI**

**THE LOCAL LAW EXCEPTION OF TREAS. REG. § 1.170A-14(g)(6)(ii)  
APPLIES IN NEW YORK**

As explained above, condemnation and insurance are not Post-Extinguishment Proceeds. Respondent argues that condemnation and insurance proceeds following a judicial proceeding that extinguishes an easement may be Post-Extinguishment Proceeds.

The flaw in Respondent's logic is that Treas. Reg. § 1.170A-14(g)(6)(ii) provides that the Trust must be entitled to the "proceeds . . . from a subsequent sale or exchange of the property:"

**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.**

(emphasis added).

In New York, the only proceeding available to judicially extinguish a conservation easement is an action pursuant to N.Y. Real Prop. Act. L. § 1951. N.Y. Env'tl. Conserv. L. § 49-0307.

N.Y. Real Prop. Act. L. § 1951 provides for the complete judicial extinguishment of the easement upon payment of damages. See N.Y. Real Prop. Act L. § 1951(2).

Indeed, in 1982 East, LLC, T.C. Memo. 2011-84, the Court observed that N.Y. Real Prop. Acts. Law § 1951(2) provides that an easement adjudged unenforceable shall be "**completely extinguished**" upon payment of damages.

Like Respondent, the Court in 1982 East, LLC, failed to appreciate that after a New York Court extinguishes a conservation easement, the easement holder has no standing in a subsequent insurance proceeding<sup>9</sup> or a subsequent condemnation proceeding relating to the Property.<sup>10</sup> Because a proceeding under N.Y. Real Prop. Act L. § 1951 is a judicial proceeding, res judicata precludes the easement holder from seeking additional compensation in a subsequent proceeding involving an exchange of the Property. See e.g. Schuykill Fuel Corp. v. B. & C. Neiberg Realty Corp., 250 N.Y. 304, 307, 165 N.E. 456, 457 (1929) (Res judicata applies when two causes of action have a measure of identity so that a different judgement in the second action would destroy the rights and interests established in the first action).

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<sup>9</sup> See N.Y. Ins. L. § 3401(i.e., only a party with an insurance interest in property may claim insurance proceeds).

<sup>10</sup> See N.Y. Em. Dom. L. §§ 103, 501, 502.

It follows that, after an easement is extinguished pursuant to N.Y. Real Prop. Act L. § 1951, the donor is entitled to the full proceeds from the conversion without regard to the terms of the prior perpetual conservation restriction.

Thus, the Local Law Exception set forth in Treas. Reg. § 1.170A-14(g)(6)(ii) applies in New York.

Consequently, Citimortgage's prior claim to insurance and condemnation proceeds does not implicate Post-Extinguishment Proceeds nor violate Treas. Reg. § 1.170A-14(g)(6).

**POINT VII**

**BECAUSE OF THE DIFFERENCES BETWEEN NEW YORK LAW AND MASSACHUSETTS LAW, KAUFMAN DOES NOT ADDRESS THE ISSUES BEFORE THE COURT**

As a matter of law, the creation, enforcement and extinguishment of a conservation easement is determined pursuant to state law. See e.g. N.Y. Env'tl. Conserv. L. § 49-0301 et. seq. Therefore, differences in state law affect federal income tax consequences, particularly where a federal tax provision, like Treas. Reg. § 1.170A-14(g) (6), defers to state law. See e.g. Schottenstein v. Commissioner, 75 T.C. 451, 462 (1980).

Kaufman v. Commissioner, 136 T.C. No. 13 (2011), involved a conservation easement contribution in Massachusetts. The Court concluded that, in Massachusetts, a lender's reservation of a prior claim to condemnation proceeds violated Treas. Reg. § 1.170A-14(g) (6). The Court's decision was based on the taxpayer's concession that under Massachusetts law, the Trust might not receive a proportionate share to any future proceeds paid subsequent to a judicial extinguishment of an easement. Id. at 27-28. Given the taxpayer's concession, the Local Law Exception was not raised or analyzed in Kaufman. New York law precludes a similar concession because of the Local Law Exception

of Treas. Reg. § 1.170A-14(g) (6). Therefore, Kaufman is not binding in New York where the Local Law Exception applies.

**POINT VIII**

**BECAUSE THE COURT IN 1982 EAST, LLC DID NOT ADDRESS THE APPLICABILITY OF THE LOCAL LAW EXCEPTION, THE OPINION IS NOT ISSUE DETERMINATIVE**

In 1982 East, LLC, T.C. Memo. 2011-84, the Court relied on Kaufman to deny a charitable contribution deduction for a conservation easement donation in New York.

1982 East, LLC is not controlling here because it does not address a key differences between Massachusetts and New York law. Id. For example, in Massachusetts a conservation easement may be released in whole or in part pursuant to Mass. Gen. L. ch. 184 § 32. In Massachusetts an easement holder may retain rights in the formerly encumbered property following a proceeding pursuant to Mass. Gen. L. ch. 184 § 32.

By contrast, under New York law, the contrary is true; in New York an easement is "completely extinguished" in a cy pres proceeding. Compare N.Y. Real Prop. Act. L. § 1951(2) with Mass. Gen. L. ch. 184 § 32. Because:

1. Treas. Reg. § 1.170A-14(g) (6) (ii) provides that the Trust must be entitled to the "proceeds . . . from a subsequent

sale or exchange of the property:" **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**" (emphasis added); and

2. **A cy pres proceeding pursuant to N.Y. Real Prop. Act. L. § 1951(2)** "completely extinguishes" the easement, whether or not the damages are in the amount required by Treas. Reg. § 1.170A-14(g)(6)(ii), it follows that:

3. The Local Law Exception applies.

Of relevance, here, is that the taxpayer in 1982 East, LLC did not raise, and the court did not analyze, the applicability of Local Law Exception. Id. at 24-25.

The taxpayer in 1982 East, LLC argued that damages pursuant to N.Y. Real Prop. Act L. § 1951 were the equivalent of proceeds for purposes of Treas. Reg. § 1.170A-14(g)(6). Id. Whether or not this is true is, however, irrelevant.

As discussed above and in Point III, *infra*, a cy pres proceeding pursuant to N.Y. Real Prop. Act. L. § 1951(2) "completely extinguishes" the easement, whether or not the damages are in the amount required by Treas. Reg.

§ 1.170A-14(g)(6)(ii). Thus, the Local Law Exception applies in New York. Consequently, the result in 1982 East, LLC is not issue determinative. The application of the Local Law Exception has never been addressed by this Court.

**POINT IX**

**FOR THE REASONS SET FORTH IN THE PROPOSED AMICUS BRIEF LODGED WITH THE COURT BY THE TRUST, THESE ISSUES WARRANTS REVIEW BY THE FULL COURT**

Subsequent to the filing of Petitioners' Motion, the Trust filed a Motion for Leave to File an Amicus Curiae Brief and lodged an Amicus Curiae Brief with this Court. As reflected in the Trust's filings, the issues before the Court affects hundreds of similarly situated taxpayers in New York. These cases involve hundreds of thousands of dollars of disallowed charitable contribution deductions.

Moreover, Respondent claims that 1982 East, LLC controls the outcome of the issues raised in Petitioners' Motion because the case involved a conservation easement donation in New York. Resp. Memo. at 7-8. 1982 East, LLC did not address the Local Law Exception.

Given the number of taxpayers, the amount of money involved, and Petitioners' position with respect to 1982 East, LLC,

Petitioners respectfully request that the full Court review the report issued at the conclusion of this proceeding. See IRC § 7460 (b) .

**CONCLUSION**

For the foregoing reasons, Petitioners respectfully request that the Court either:

1. Grant Petitioners' Motion and enter an order determining that the Conservation Deed and Lender Agreement annexed to the Petitioners' Motion as **Exhibit A** do not violate Treas. Reg. § 1.170A-14(g)(6); or,

2. Deny Petitioners' Motion and in its Order denying Petitioners' Motion include a statement that the Treas. Reg. § 1.170A-14(g)(6) issue is a controlling issue of law over which a substantial difference of opinion exists and that an immediate appeal may materially advance the ultimate termination of the litigation.

***RESPECTFULLY SUBMITTED,***

Dated: Hackensack, NJ  
November 18, 2011



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