UNITED STATES TAX COURT

TOWER 570 COMPANY, L.P., BROADWALL INVESTING CORP., TAX MATTERS PARTNER,	)	
Petitioner,	)	
v.	)	Docket No. 15800-09
	)	Judge Marvel
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent.	)	

MEMORANDUM OF LAW IN SUPPORT OF RESPONDENT'S MOTION FOR PARTIAL SUMMARY JUDGMENT

Respondent files this Memorandum of Law in support of its Motion for Partial Summary Judgment on the question of whether Tower 570 Company, L.P. (the "Partnership") is entitled to a charitable contribution deduction for the contribution of a façade easement to the National Architectural Trust ("NAT") in the 2003 tax year.

I. Summary Judgment is Appropriate Where There is No Genuine Dispute as to Any Material Fact.

This Court may grant full or partial summary judgment where there is no genuine issue of material fact and a decision may be rendered as a matter of law. Tax Court Rule 121(b); Sundstrand Corp. v. Commissioner, 98 T.C. 518, 520 (1992), aff'd, 17 F.3d 965 (7th Cir. 1994). Disputes over facts that are not outcome-determinative will not preclude the entry of summary judgment. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986). When ruling on a motion for summary judgment, the Court does not weigh the evidence, but determines "whether there is a genuine issue

for trial." Id. at 249. In making this determination, the Court construes all facts in a light most favorable to the nonmoving party and views all inferences drawn from the evidence in the light most favorable to the party opposing the motion. Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587-88 (1986), citing United States v. Diebold, Inc., 369 U.S. 654, 655 (1962); Sundstrand Corp., 98 T.C. at 520.

II. The Partnership's Charitable Contribution Deduction for the Façade Easement Should Be Disallowed as a Matter of Law Since the Easement's Conservation Purpose is Not Granted and Protected In Perpetuity.

A. The Statute and Regulations.

Section 170 of the Internal Revenue Code (I.R.C.) allows a deduction for any charitable contribution made by the taxpayer that is properly substantiated. A charitable contribution is a contribution or gift to or for the use of an organization described in I.R.C. § 170(c).

I.R.C. § 170(f)(3) provides the general rule that no deduction is allowed for a contribution of an interest in property which consists of less than the taxpayer's entire interest in the property. However, under I.R.C. § 170(f)(3)(B)(iii), a deduction is allowed for a qualified conservation contribution, even though it is a contribution of a partial interest.

I.R.C. § 170(h)(1) and Treas. Reg. § 1.170A-14(a) provide that a qualified conservation contribution is a contribution of a

qualified real property interest to a qualified organization exclusively for conservation purposes. Under I.R.C. § 170(h)(4)(A)(iv), the "preservation of an historically important land area or a certified historic structure" is a conservation purpose.

The Code and regulations make clear that a conservation contribution is not deductible under I.R.C. § 170(h) if it is not granted in perpetuity. I.R.C. § 170(h)(1)(C) states that a qualified conservation contribution must be for exclusively conservation purposes. I.R.C. § 170(h)(5)(A) provides that a contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected "in perpetuity." I.R.C. § 170(h)(2)(C) states that a "restriction (granted in perpetuity) on the use which may be made of real property" is a qualified real property interest, which is considered a "qualified conservation contribution." I.R.C. § 170(h)(1)(A). Treas. Reg. § 1.170A-14(a) states that to be eligible for a deduction, the conservation purpose must be protected "in perpetuity." Similarly, under Treas. Reg. § 1.170A-14(b)(2), a qualified real property interest is a restriction "granted in perpetuity" on the use that may be made of real property, including an easement or similar interest under state law. Moreover, Treas. Reg. § 1.170A-14(e)(1) provides that a donation of a conservation restriction must be "exclusively for

conservation purposes," restating the requirement that the conservation purpose be protected in perpetuity.

B. The conservation purpose is not granted and protected in perpetuity because the NAT is not entitled to a proportionate share of the proceeds in the event the easement is extinguished, as required by Treas. Reg. § 1.170A-14(g)(6).

1. Treas. Reg. § 1.170A-14(g)(6).

Treas. Reg. § 1.170A-14(g)(6)(i) provides that if a subsequent unexpected change in the conditions surrounding an easement-encumbered property make the continued use of the property for conservation purposes impossible or impractical, the conservation purpose can nevertheless be treated as protected in perpetuity if the restrictions are extinguished in a judicial proceeding and all the donee's proceeds from a subsequent sale or exchange of the property (as determined under Treas. Reg. § 1.170A-14(g)(6)(ii))[1] are used by the donee organization in a manner consistent with conservation purposes of the original contribution.

Treas. Reg. § 1.170A-14(g)(6)(ii) provides that for a deduction to be allowed for the donation of a conservation easement, "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,

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[1] Treas. Reg. § 1.170A-14(g)(6)(ii) takes into account proceeds from sales, exchanges and involuntary conversions.

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." Treas. Reg. § 1.170A-14(g)(6)(ii) further provides that:

> [W]hen a change in conditions give rise to the extinguishment of a perpetual conservation restriction . . . 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.

2. Transamerica's prior claim and preference over proceeds.

When the easement was donated to the NAT, Transamerica Life Insurance and Annuity Company ("Transamerica") held an existing mortgage on the underlying property, located at the corner of Lexington Avenue and East 51st Street, in New York City, as improved by the 49-story office building sometimes known as the General Electric Building (the "Property"). Under the mortgage, Transamerica had a right to receive and apply casualty insurance and condemnation proceeds against its loan balance. Exhibit 3-R, Section 8.3.[2]

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[2] Assuming various conditions were met, the mortgagor had the right to use insurance or condemnation proceeds to rebuild the improvements on the Property. The mortgagee could condition the disbursement of the proceeds upon its approval of plans, together with other restrictions being met. Exhibit 3-R, Section 8.3.

A "Lender Agreement" signed by the Vice President of Transamerica purports to subordinate its rights in the Property to the right of the NAT (and its successor and assigns) to enforce the conservation purposes of the easement in perpetuity. Exhibit 2-R, pg. 10.[3] The Lender Agreement, however, fails to comply with the requirements of Treas. Reg. § 1.170A-14(g)(6)(ii). The Lender Agreement expressly acknowledges the mortgagee's prior claim and priority as to insurance proceeds. According to the terms of the Lender Agreement, Transamerica and its assignees:

> shall have a prior claim to all proceeds of casualty insurance, 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.

Exhibit 2-R, pg. 10.

Thus, if a casualty were to give rise to the extinguishment of the easement, under the Transamerica mortgage and the Lender Agreement, the NAT might not be entitled to any of the insurance proceeds.[4] In addition, under the Transamerica mortgage,

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[3] The Lender Agreement was executed on December 18, 2003. The Conservation Easement Deed was executed by the donor December 16, 2003 and donee on December 29, 2003. The Lender Agreement is attached to and part of the Conservation Easement Deed, which was recorded with the Department of Finance, New York City Office of Register on January 15, 2004.

[4] Additionally, Article III.A.3. of the Conservation Easement Deed provides that any lien placed by the Grantee against the property to secure the payment of any of the Grantor's

Transamerica has a claim as to condemnation proceeds. Therefore, no charitable contribution deduction for the donation of the easement is allowable.

Article IV.C. of the Conservation Easement Deed provides that the NAT is entitled to a proportionate share of the proceeds from the sale, exchange, or conversion of the property in the event the agreement is extinguished through condemnation, judicial decree or otherwise. Nonetheless, the Transamerica mortgage and Lender Agreement override this provision, recognizing the mortgagee's priority to insurance proceeds, and thus ensuring that the donee organization will not receive its proportionate share in all events. Under certain circumstances, until the mortgage was satisfied, the NAT would not be entitled to any proceeds. Therefore, with respect to Transamerica and its assignees, the requirements of Treas. Reg. § 1.170A-14(g)(6) are not met and no charitable contribution deduction for the donation of the easement is allowable. Transamerica's Lender Agreement only joins in the deed for the "sole and limited purpose of subordinating its rights. . . to enforce the conservation purposes." [5] Transamerica's prior claim as to proceeds is

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obligations is subordinate to the lien of any existing or future mortgage on the property.

[5] Compliance with Treas. Reg. § 1.170A-14(g)(2) is a separate, additional requirement that must be met for a conservation purpose to be protected in perpetuity. However, compliance with that provision is outside the scope of this Motion for Partial Summary Judgment.

notwithstanding its subordination of its rights to the rights of the grantee to enforce the conservation purposes of the deed. Exhibit 2-R, pg. 10.

In Kaufman v. Commissioner, 134 T.C. No. 9 (April 26, 2010), the Tax Court recently held for the respondent on the basis of Treas. Reg. 1.170A-14(g)(6) in response to respondent's summary judgment motion. The taxpayer in Kaufman had contributed a conservation easement to the NAT. The underlying property was subject to a mortgage. Based on a similar lender agreement to the Transamerica Lender Agreement[6], the Court recognized that the mortgagee bank retained a "prior claim" to insurance and condemnation proceeds, and that the bank was entitled to those proceeds "in preference" to the NAT until the mortgage was satisfied and discharged. Slip. op. at 7. The Court rejected any argument that the NAT might be entitled to its proportional share of future proceeds, finding:

> Yet that provision [Treas. Reg. 1.170A-14(g)(6)(ii)] states that the donee organization must be so entitled. See id. The requirement is not conditional. Petitioners cannot avoid the strict requirement in section 1.170A-14(g)(6)(ii), Income Tax Regs., simply by showing that they would most likely be able to satisfy both their mortgage and their obligation to NAT.

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[6] The Transamerica Lender Agreement, like the agreement in Kaufman, contains a preference as to proceeds of casualty insurance in favor of the mortgagee, but unlike the agreement in Kaufman is silent as to proceeds of a condemnation. Nonetheless, under the Transamerica mortgage, the mortgagee has a right to condemnation proceeds.

> The façade easement contribution thus fails to satisfy the requirement in section 1.170A-14(g)(6), Income Tax Regs., and so fails to satisfy the enforceability in perpetuity requirement under section 170(h)(2)(C) and (5)(A).

Slip op. at 8.

In Kaufman, as in this case, the lender agreement, attached to the conservation easement, created the distinct possibility that the NAT would not receive its proportionate share of proceeds, or potentially any proceeds. For example, this could happen if a casualty took place: 1) making "impossible or impractical the continued use of the property for conservation purposes"; 2) accompanied by the judicial extinguishment of the easement; and 3) resulting in the payment of proceeds. In such a case, the donee organization, the NAT, would not receive its proportionate share of proceeds, in direct violation of the perpetuity requirements and Treas. Reg. § 1.170A-14(g)(6). Here as in Kaufman, there are no facts in dispute precluding the grant of partial summary judgment as to this issue.

This type of event is specifically recognized in Article IV.D of the Conservation Easement Deed. Under this Article, if all or substantially all of the property has been damaged or destroyed by casualty, and the restoration is "economically imprudent" (i.e., the cost to repair is materially in excess of insurance proceeds available; the mortgagee elects to apply insurance proceeds to satisfy its debt; or once restored, the

Property is not economically viable in the current market), the Grantor has the right to extinguish and remove the easement, and the Grantee agrees to join and assist the Grantor in any proceedings necessary to effectuate such extinguishment. Exhibit 2-R, Article IV.D.

Because the NAT's entitlement to its proportionate share of proceeds is subject to the priority claim of the mortgagee, the requirements that the conservation easement be granted and protected in perpetuity are not met. On this basis, the Court should grant partial summary judgment in respondent's favor, and disallow petitioner's charitable contribution deduction.

3. Treas. Reg. § 1.170A-14(g)(3) is not applicable.

Petitioner might argue, as have other taxpayers, that the rule for extinguishments under Treas. Reg. § 1.170A-14(g)(6) must be read in light of Treas. Reg. § 1.170A-14(g)(3), and thus is only applicable if the Court first determines whether the possibility of such casualty is remote or not. If so, Petitioner would argue that this issue is not susceptible to partial summary judgment due to the factual nature of such a question. Such position is groundless.

Treas. Reg. § 1.170A-14(g)(3) provides that a deduction will not be disallowed merely because the interest transferred to the donee may be defeated by the happening of an event, if on the date of the gift, the possibility of the act or event is so

remote as to be negligible. This provision prevents the Service from disallowing a contribution merely by conjuring up remote future events that might occur to defeat the transfer. This question is entirely distinct from the question raised in Treas. Reg. § 1.170A-14(g)(6), which requires that in the event of an occurrence making the continued use of the easement impossible or impractical, that the donee organization receive its proportionate share of proceeds for use consistent with the conservation purposes of the original contribution.

Treas. Reg. 1.170A-14(g)(6) has no remoteness requirement. As the Court found in Kaufman, the rule of Treas. Reg. § 1.170A-14(g)(6)(ii) is "not conditional." Slip. op. at 8. "Unexpected changes" in conditions, such as casualties and condemnations, which make the continued use of the property for conservation purposes impossible or impractical, are by their very nature remote. The question for the Court to decide is not the likelihood of such an unexpected change occurring, but rather if it occurs, whether the donee organization will receive its proportionate share of the proceeds. By ensuring that the donee organization receives its proportionate share of proceeds to use for conservation purposes, Treas. Reg. § 1.170A-14(g)(6) enables judicially extinguished easements to be treated as protected in perpetuity. The priority of Transamerica, as mortgagee, precludes that from happening.

C. The Conservation Easement Deed allows changes in the façade inconsistent with a conservation purpose and allows the NAT to abandon the deed altogether.

The conservation purpose that the Conservation Easement Deed purports to fulfill is the preservation of a certified historic structure under I.R.C. § 170(h)(4)(A)(iv). However, the deed fails to fulfill this purported purpose, since it gives broad discretion to the NAT and its successors to consent to changes in the façade.

Article II.A. of the Conservation Easement Deed provides that the Partnership may not materially alter the façade of the underlying property "without the express written consent" of the NAT. More importantly, the deed states that "nothing herein contained shall be construed to limit the Grantee's right to give its consent (e.g., to changes in the principal exterior of the Façade) or to abandon some or all of its rights hereunder." Exhibit 2-R, Article IV.B. Thus, by the very terms of the deed, (1) there is no limitation on the rights of the NAT to consent to changes in the façade, even if the changes are contrary to the conservation purpose of the deed, and (2) the NAT has the right not to exercise--that is to "abandon"--any or all of its rights under the deed.

Moreover, even the written consent language in Article II.A. of the deed is undercut by language in Article II.B. of the deed. Notably, the grantee can give "consent" without taking any action

at all. A 20-business day lapse of time without response is deemed consent to the grantor's request. Exhibit 2-R, Article II.B.

In short, the Conservation Easement Deed does not "preserve" a certified historic structure; the NAT has the unlimited ability to approve any changes to the façade, including changes that are inconsistent with the agreement's stated conservation purpose, and even to abandon its rights altogether. Therefore, no conservation purpose described in I.R.C. § 170(h)(4)(A)(iv) has been met.

Treas. Reg. § 1.170A-14(g)(1), entitled "Enforceable in perpetuity," provides that in the case of any contribution under Treas. Reg. § 1.170A-14, "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 purposes of the donation." (emphasis added.) The terms of the deed are expressly contrary to this requirement because, as discussed above, the NAT may approve changes to the façade (or merely fail to respond to a request to make changes) that are inconsistent with the conservation purpose and may even choose to abandon its rights and obligations to enforce the terms of the deed. Because there is no requirement under the deed that the consent given by the NAT comply with the purported conservation purpose and more

importantly, because the deed allows NAT to completely abandon its rights, the deed does not contain a legally sufficient restriction that will prevent uses of the retained interests inconsistent with the conservation purpose of the deed, as required by Treas. Reg. § 1.170A-14(g)(1).

In addition, the deed is silent as to what happens if the NAT abandons its rights and obligations. Although the deed itself would still exist, without the NAT enforcing it, the deed does not protect a conservation purpose in perpetuity.

Because the deed allows the NAT to permit changes that are not in compliance with the conservation purpose or to not enforce the deed, the conservation purpose is not granted in perpetuity as required by I.R.C. § 170(h)(2)(C) or protected in perpetuity under § 170(h)(1)(C) and (5)(A) and Treas. Reg. § 1.170A-14(a), (b)(2), (e)(1) and (g)(1). The charitable contribution deduction that the Partnership claimed in the 2003 tax year should therefore be disallowed.[7]

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[7] In Simmons v. Commissioner, T.C. Memo. 2009-208, notice of appeal filed (D.C. Cir. Mar. 15, 2010), the Court held that because the donee organization, L'Enfant, was subject to local, state and federal restrictions, its right to consent to changes to the property did not negate the conservation purposes requirement of the statute and regulations. Respondent respectfully disagrees, yet notes that the Court did not address the right of the donee organization to abandon the easement or its rights under the agreement. Clearly, an easement that can be

D. The conservation purpose is not granted or protected in perpetuity because terms that are critical to the enforcement of the deed are not attached to the deed or recorded.

Article I.F. of the Conservation Easement Deed provides that:

> It is the intent of the parties that the Façade visible from the outside of the Building as follows . . . remains essentially unchanged and in full public view. Written descriptions and photographs of the Facade are "Exhibit B" hereto and are on file at the offices of the Grantee but are not appended hereto. In case of ambiguity, the photographs and descriptions constituting Exhibit B shall control."

Exhibit 2-R, pg. 2 (emphasis added).

To be considered enforceable in perpetuity, interests retained by the donor and successors must be subject to legally enforceable restrictions, including recordation in the land records of local jurisdictions that will prevent uses of the retained interest inconsistent with the conservation purposes of the donation. Treas. Reg. § 1.170A-14(g)(1). Under N.Y. Real Prop. Law sec. 291-e (McKinney 2006), if an "exception, reservation or recital" refers to an unrecorded document, the reference does not affect the marketability of title or bind subsequent purchasers. See 165 Broadway Bldg., Inc. v. City Investing Co., 120 F.2d 813 (2d Cir. 1941); L.C. Stroh & Sons, Inc. v. Batavia Homes & Dev. Corp., 17 A.D.2d 385, 234 N.Y.S.2d 401, 405 (App.Div. 1962). In L.C. Stroh, the court found that

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abandoned is not protected in perpetuity.

N.Y. Real Prop. Law sec. 291-e:

> expressly relieves a prospective purchaser from the obligation of inquiring or examining into the facts and states that an exception, reservation or recital gives no notice beyond the recital itself. In other words, it rescinds the former rule that, upon notice of a recital such as that in question, one who was interested as a potential purchaser would have been charged with any knowledge that a reasonable inquiry would have produced.

Id.

The grantor and grantee in the present case purposely failed to attach the descriptions and photographs (Exhibit B) that control in case of ambiguity. Since Exhibit B, describing the façade and including photographs, is not attached to the Conservation Easement Deed, it cannot bind subsequent purchasers under New York State law. Therefore, it does not protect the conservation purpose of preserving the façade "in perpetuity," and the deed fails to meet the requirement of I.R.C. § 170(h)(1)(C) and (5)(A).

In Herman v. Commissioner, T.C. Memo. 2009-205, the Court, relying on the same New York real property statute, granted summary judgment in favor of Respondent, holding that the unrecorded drawing in question failed to protect a conservation purpose in perpetuity under I.R.C. § 170(h)(5)(A) because the drawing referred to in the easement was not recorded and did not bind subsequent purchasers.

Since the Exhibit B written descriptions and photographs of

the façade to be preserved are not binding on subsequent purchasers of the Property, they do not protect the conservation purpose in perpetuity as a matter of law.

III. Conclusion.

For the reasons outlined above, the Partnership is not entitled to a charitable contribution deduction for the contribution of a façade easement to the NAT in 2003.

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