

UNITED STATES TAX COURT

1982 EAST, LLC., SOLOMON D. ASSER,)
TAX MATTERS PARTNER,)
)
Petitioner,)
)
v.) Docket No. 30052-08
) Judge Laro
COMMISSIONER OF INTERNAL REVENUE,)
)
Respondent.)

**RESPONDENT'S RESPONSE TO THE SUBORDINATION PORTION OF THE BRIEF
OF AMICUS CURIAE TRUST FOR ARCHITECTURAL EASEMENTS
IN SUPPORT OF PETITIONER**

On December 6, 2010, the Court issued an Order granting the Trust for Architectural Easements'¹ Motion for Leave to File an Amicus Brief in Support of Petitioner. The Court ordered that respondent may file by December 20, 2010 a response to the portion of the Brief of Amicus Curiae Trust for Architectural Easements in Support of Petitioner ("Amicus Brief") discussing subordination in Argument, Section II.A., pages 51 through 57. Respondent hereby provides a response to the subordination portion of the Amicus Brief. Respondent addresses the corresponding sections of the Amicus Brief as follows:

**II. The Lender Agreement, Made Part of the Conservation Deed,
Does Not Comply with the Code and Regulations**

I.R.C. § 170(a)(1) generally allows a deduction for a charitable contribution made during the taxable year, subject to

¹ The Trust for Architectural Easements was formerly known as the National Architectural Trust.

certain limitations. I.R.C. § 170(f)(3) generally denies a deduction for contributions of partial interests in property. One exception to the partial interest rule under I.R.C. § 170(f)(3)(B)(iii) allows a charitable contribution deduction, under certain circumstances, for a "qualified conservation contribution". Under I.R.C. § 170(h)(1), 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)(2)(C), a qualified real property interest includes "a restriction (granted in perpetuity) on the use which may be made of the real property". An easement is a qualified real property interest. Treas. Reg. § 1.170A-14(b)(2). 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".

Treas. Reg. § 1.170A-14(g)(6)(i) provides, with respect to whether an easement is treated as protected in perpetuity, that

[i]f 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 and all of the donee's proceeds (determined under paragraph (g)(6)(ii) of this section) 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.

Treas. Reg. § 1.170A-14(g)(6)(ii) states with respect to "proceeds" that

for a deduction to be allowed under this section, 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, 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. . . . Accordingly, 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 . . .

Because the easement in this case is not enforceable in perpetuity, petitioner is not entitled to any charitable contribution deduction for the contribution of this easement. Petitioner fails to meet the requirements of Treas. Reg. § 1.170A-14(g)(6) because the donee organization is not guaranteed a portion of the proceeds from any subsequent sale, exchange, or involuntary conversion of the property, as will be discussed below.

**A. The Lender Agreement Fails to Meet the Requirements of
Treas. Reg. § 1.170A-14(g)(6)²**

- 1. Treas. Reg. § 1.170A-14(g)(6) Requires That the
Easement Holder Must Be Entitled to a Portion of
the Proceeds on a Sale, Exchange, or Involuntary
Conversion of the Property After a Judicial
Extinguishment of the Easement**

As stated above and acknowledged in the Amicus Brief, page 52, the easement holder must be entitled to a portion of the proceeds from a sale, exchange, or involuntary conversion after extinguishment of the easement in order to meet the requirement that the easement be protected in perpetuity.

- 2. The Lender Agreement is Inconsistent with the
Language of Treas. Reg. § 1.170A-14(g)(6).**

As the Amicus Brief states, the Lender Agreement by First Republic Bank was made part of and was recorded with the Conservation Deed. See Amicus Brief, page 53, and Exhibit 74-J. The Lender Agreement must be read together with the rest of the Conservation Deed in determining whether the requirements of Treas. Reg. § 1.170A-14(g)(6) have been met. The Lender Agreement states that "(a) 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

² Respondent is not asserting that petitioner failed to meet the subordination requirements of Treas. Reg. § 1.170A-14(g)(2). See Opening Brief for Respondent, page 85, footnote 6.

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." Because it gives the lender 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, . . . in preference to Grantee until the Mortgage/the Deed of Trust is paid off and discharged," the Lender Agreement does not meet the requirements of Treas. Reg. § 1.170A-14(g)(6). As a result of the lender's prior claim, the easement holder, the Trust for Architectural Easements ("Trust"), is not guaranteed any proceeds from a sale, exchange, or involuntary conversion of the property after extinguishment of the Conservation Deed as required by Treas. Reg. § 1.170A-14(g)(6). Therefore, the Conservation Deed cannot be treated as protecting the conservation purpose in perpetuity and was not a qualified conservation contribution under I.R.C. § 170(h)(1). See Kaufman v. Commissioner, 134 T.C. ____ (2010).

3. Petitioner Clearly Fails to Meet the Requirements of Treas. Reg. § 1.170A-14(g)(6) in This Case

The Trust is not guaranteed proceeds from a sale, exchange, or involuntary conversion of the property after extinguishment of the Conservation Deed as required by Treas. Reg. § 1.170A-14(g)(6). The Trust must be guaranteed proceeds from a sale, exchange, or involuntary conversion of the property after judicial extinguishment of the easement in order to be able to use those proceeds in a manner consistent with the conservation purposes of the original donation. The Trust must be entitled to these proceeds under Treas. Reg. § 1.170A-14(g)(6) if there is a subsequent unexpected change that makes impossible or impractical the continued use of the property for conservation purposes. When the conservation purpose can no longer be continued with respect to the Property, Treas. Reg. § 1.170A-14(g)(6) applies to allow the conservation purpose to nonetheless be treated as protected in perpetuity if the Trust is guaranteed a proportionate amount of the proceeds from a sale, exchange, or involuntary conversion of the Property after judicial extinguishment of the easement. Treas. Reg. § 1.170A-14(g)(6) only applies in cases of judicial extinguishment.

The Amicus Brief asserts on page 55 that several provisions in the Conservation Deed regarding the rebuilding or repair of the façade of the Property ensure that the requirements of Treas. Reg. § 1.170A-14(g)(6) involving an extinguished easement are met. The Amicus Brief states that the conservation purpose is protected in perpetuity because of these provisions in the Conservation Deed regardless of whether a lender receives insurance proceeds. The provisions the Amicus Brief cites, Sections II A.3. and 4. of the Conservation Deed, provide, in part, that the Grantor will not undertake certain actions without the consent of the Trust including:

3. the rebuilding of the Protected Façade(s) if totally or substantially destroyed, (e.g., by fire) . . .
and 4. the painting or cleaning of the Protected Façade(s) in a manner incompatible with the protection and preservation of the Protected Facades(s); provided, however, that the maintenance, reconstruction, repair and refinishing of presently existing elements of the Protected Façade(s), damage to which has resulted from casualty loss, destruction or deterioration, is permitted so long as it is conducted in a manner which will maintain or recreate the essential appearance of the Protected Façade(s) as it exists at this date or as it existed at the time the improvements were first constructed;

The Amicus Brief fails to recognize that the general requirements in Treas. Reg. § 1.170A-14(g)(6)(i) are addressing a situation in which the easement is extinguished because "a subsequent unexpected change in the conditions surrounding the property . . . make impossible or impractical the continued use

of the property for conservation purposes". Therefore, the Conservation Deed provisions for rebuilding or repairing the Protected Façade, which contemplate the easement not being extinguished, are irrelevant to compliance with Treas. Reg. § 1.170A-14(g)(6), which is intended to ensure that proceeds will be available to the Trust to use in a manner consistent with the conservation purpose after the easement is extinguished. The fact that the lender is ensured a priority interest in insurance proceeds after extinguishment of the easement causes petitioner to fail to comply with Treas. Reg. § 1.170A-14(g)(6) by preventing the Trust from being guaranteed to be entitled to those proceeds to use for a conservation purpose.

The Amicus Brief points out on page 56 that Treas. Reg. § 1.170A-14(g)(2) and Treas. Reg. § 1.170A-14(g)(6) are separate subsections. Respondent agrees. The Treas. Reg. § 1.170A-14(g)(6) requirement applies regardless of whether the requirements of Treas. Reg. § 1.170A-14(g)(2) are met.

With respect to condemnation proceeds, the Amicus Brief concedes that "condemnation might result in the easement's judicial extinguishment". See Amicus Brief, pages 56-57. Treas. Reg. § 1.170A-14(g)(6) requires that the Trust be guaranteed to receive its share of proceeds from a sale, exchange, or involuntary conversion of the property after

judicial extinguishment of the easement. The Lender Agreement prevents the Trust from being guaranteed any proceeds because the Lender Agreement establishes the lender's "prior claim" to those proceeds in preference to the Trust.

The Amicus Brief contends that "[u]nder the terms of the Conservation Deed . . . the Trust retains a right against the Property owner for its proportionate share of the proceeds." See Amicus Brief, page 57. The Lender Agreement provides that the lender has 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, . . . in preference to Grantee until the Mortgage/the Deed of Trust is paid off and discharged". Therefore, even though the Trust could attempt to recover the proceeds, the Lender Agreement makes clear that the Trust might not be entitled to them. Treas. Reg. § 1.170A-14(g)(6)(ii) requires that the Trust "must be entitled to a portion of the proceeds at least equal to that proportional value of the perpetual conservation restriction". As stated in Kaufman v. Commissioner, 134 T.C. ____ (2010), the requirement is not conditional. Therefore, petitioner fails to meet the requirements of Treas. Reg. § 1.170A-14(g)(6).

The Amicus Brief, page 57, citing N.Y. RPAPL § 1951(2), also argues that "under New York law, the Trust retains a right against the Property owner for its proportionate share of the proceeds." N.Y. RPAPL § 1951(2) states in relevant part with respect to extinguishment of restrictions on the use of land that

if the court shall find that the restriction is of no actual and substantial benefit to the persons seeking its enforcement . . . because . . . by reason of changed conditions . . . its purpose is not capable of accomplishment . . . 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.

This provision of New York law does not give the Trust a right to a proportionate share of proceeds from any subsequent sale, exchange, or involuntary conversion of the property after extinguishment of the easement as required by Treas. Reg. § 1.170A-14(g)(6). Instead, this provision of New York law merely states that "damages, if any" must be paid before extinguishing the easement. The distribution of any proceeds is controlled by the Lender Agreement, which gives priority to the lender, not

the Trust. Thus, the requirements of Treas. Reg. § 1.170A-14(g)(6) are not met.

DEC 16 2010

Date: _____

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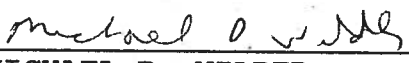
Docket No. 30052-08

CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing
RESPONDENT'S RESPONSE TO THE SUBORDINATION PORTION OF THE BRIEF
OF AMICUS CURIAE TRUST FOR ARCHITECTURAL EASEMENTS IN SUPPORT OF
PETITIONER was served on counsel for petitioner by mailing the
same on DEC 16 2010 in a postage paid wrapper addressed
as follows:

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PETITIONER was served on counsel for Trust for Architectural
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