

PRELIMINARY STATEMENT

Petitioners Ernest and Barbara Kafka submit this memorandum of law in support of their Motion for Partial Summary Judgment ("Petitioners' Motion").

FACTS

The facts are set forth in Petitioners' Motion.¹

RELEVANT HISTORY & RELATED CASES

1. Petitioners made an easement donation to the Trust pursuant to the Federal Historic Preservation Tax Incentive Program (sometimes the "Program").

2. The Trust is one of the largest preservation easement holding organizations in the nation; it holds more than 825 easements. (<http://www.architecturaltrust.org>).

3. As more fully explained in the Internal Revenue Service Advisory Council 2009 Public Report (sometimes the "IRSAC Report") at 10, released November 17, 2009, Respondent has for the most part disallowed the charitable deductions claimed by most Program donors, including but not limited to the Trust's donors.

¹ Unless otherwise defined, capitalized terms have the meaning given to them in Petitioners' Motion.

4. The Notice, here, disallows the deductions claimed by Petitioners for their Non-cash Contribution to the Trust.

5. The Court has decided the following cases that address facade easement donations:

A. Scheidelman v. Commissioner, T.C. Memo. 2010-151 (J. Cohen) (appeal pending) (Trust case).

B. Simmons v. Commissioner, T.C. Memo. 2009-208 (J. Goeke) (appeal pending) (non-Trust case).

C. Evans v. Commissioner, T.C. Memo. 2010-207 (J. Wherry) (non-Trust case).

D. Kaufman v. Commissioner, 136 T.C. No. 13 (J. Halpern) (Trust case).²

E. 1982 East, LLC v. Commissioner, T.C. Memo. 2011-84 (J. Laro) (Trust case).

6. Dunlap v. Commissioner, Docket No. 28849-08, also currently pending before this Court, involves a donation by several New York City-based taxpayers to the Trust.

² On April 26, 2010, the Court granted Respondent's motion for partial summary judgment on the Treas. Reg. § 1.170A-14(g)(6)(ii) issue. Kaufman v. Commissioner, 134 T.C. No. 9 (2010). Petitioners filed a motion for reconsideration on this issue. On April 4, 2011, the Court issued an opinion that confirmed the Court's April 26th decision and addressed the remaining issues in the case. Kaufman v. Commissioner, 136 T.C. No. 13 (2011).

7. Dunlap was tried before the Honorable Judge Goeke and is fully briefed. The parties are currently awaiting Judge Goeke's opinion.

8. In addition to being one of the largest preservation easement holding organizations in the United States, the Trust is one of the largest preservation easement holding organizations in New York City. It holds more than 500 easements in New York. (<http://www.architecturaltrust.org>).

9. Respondent has for the most part disallowed the charitable deductions claimed by most of the Trust's New York City based-donors. Respondent's disallowance of the Trust's donors' charitable deductions has resulted in the filing of at least 30 petitions in this Court.

10. A search of the Trust's easements on New York City's Automated City Register Information System ("ACRIS") reveals that most, if not all, of the Trust's easements are memorialized by similarly worded Conservation Deeds.

11. Except for the IRC § 170(h)(4)³ preservation issue raised here, the issue of whether the form of Conservation Deed

³ Unless otherwise defined, all references to Sections refer to the Internal Revenue Code of 1986, as amended, and in effect during 2003 and 2004, as the context requires.

used by the Trust in New York satisfies the perpetuity requirements of IRC § 170(h) is at issue in Schultz v. Commissioner, Docket No. 24388-09.

12. Since the parties in Schultz have briefed the issues involving the form of Conservation Deed used by the Trust, Petitioners do not repeat them here.

13. Jerome Haims ("Haims") of JHR prepared the appraisal substantiating the value of Petitioners' facade easement donation (sometimes the "Haims Appraisal").

14. In Gorra v. Commissioner, Docket No. 15336-10, the Court has been asked to determine whether appraisals prepared by Eric Haims of Jerome Haims Realty, Inc. ("JHR") were qualified appraisals.

15. Since the parties in Gorra have briefed the issues involving an appraisal similar to the one substantiating Petitioners' non-cash contribution, Petitioners do not repeat them here.

THE NEED FOR RESOLUTION OF THE IRC § 170(h)(4) ISSUE AND THE IMPACT ON OTHER TRUST CASES PENDING BEFORE THE COURT

16. Petitioners are among several hundred Program donors whose charitable deductions Respondent has disallowed.

17. Pursuant to IRC § 170(f)(3), a charitable contribution deduction is available for donors of qualified conservation contributions.

18. Pursuant to IRC § 170(h)(1), a qualified conservation contribution includes a contribution exclusively for conservation purposes.

19. Conservation purpose is defined by IRC § 170(h)(4) to include a donation for the **preservation** of a certified historic structure.

20. IRC § 170(h)(4) defines certified historic structure as either:

a. Any building, structure, or land area which is listed in the National Register; or

b. Any building which is located in a registered historic district (as defined in section 47(c)(3)(B) and is certified by the Secretary of the Interior to the Secretary as being of historic significance to the district.

21. In New York City, the Landmarks Preservation Commission ("LPC") is charged with the enforcement of New York City laws and LPC rules protecting properties located in designated historic districts ("Historic District").

22. Petitioners, like many other New York City Trust donors, own a property located in a Historic District that was protected by New York City laws and LPC rules at the time of the non-cash contribution.

23. Petitioners, like many other New York City Trust donors, claimed a charitable contribution deduction for their non-cash donation to the Trust.

24. Petitioners' charitable contribution deduction is based on the definition of a certified historic structure contained in IRC § 170(h)(4)(C)(ii), i.e., a building located in a registered historic district and certified by the Secretary of the Interior as being of historic significance to the district.

25. In Simmons v. Commissioner, T.C. Memo. 2009-208, this Court determined that a conservation easement donation on a property protected by local laws and regulations qualified for a charitable contribution deduction. See also Hilborn v. Commissioner, 85 T.C. 677 (1985); Nicoladis v. Commissioner, T.C. Memo. 1988-163 (1988); Losch v. Commissioner, T.C. Memo. 1988-230 (1988); Griffin v. Commissioner, T.C. Memo. 1989-130 (1989);

Dorsey v. Commissioner, T.C. Memo. 1990-242. Compare Evans v. Commissioner, T.C. Memo 2010-207.⁴

26. In Herman v. Commissioner, T.C. Memo. 2009-205, this Court stated that a charitable contribution deduction is not justified when a property owner agrees to refrain from engaging in activities he is already legally forbidden to do.

27. In 1982 East, LLC v. Commissioner, T.C. Memo 2011-84, Judge Laro, relying on Herman held that *because*: (i) New York City laws and LPC rules already preserve historic properties in New York City, *then* (ii) a New York City-based donation to the Trust could never satisfy the "preservation" requirement of IRC § 170(h)(4)(A)(iv).

28. There is a conflict between the Court's opinions in Simmons et al, and 1982 East, LLC as to the relevance of New York City laws and the rules of the LPC on the IRC § 170(h)(4)(A)(iv) preservation issue.

⁴ In Evans, the Court explained: "We note that ordinarily any encumbrance on real property, howsoever slight, would tend to have some negative effect on that property's fair market value. Even a nominal encumbrance that is placed by the current owner of the property would, at the very least, deprive a subsequent owner of the opportunity of placing a similar encumbrance on that property."

29. Before any more cases are tried, Petitioners and other New York City donors to the Trust need guidance on the IRC § 170(h)(4)(A)(iv) preservation issue.

30. If Respondent's interpretation of the holding in 1982 East LLC, as to the IRC § 170(h)(4)(A)(iv) preservation issue, is correct, then all easement donations for properties protected by New York City Laws and LPC rules do not satisfy the requirements of IRC § 170(h)(4)(A)(iv) and no trial is necessary.

31. If the holding in Simmons, as to the IRC § 170(h)(4)(A)(iv) preservation issue, is correct, then Petitioners and all New York City-based donors to the Trust are entitled to: (a) proceed to trial and (b) present expert testimony on the effect of local law on the valuation of their easement donations. See also Hilborn v. Commissioner, 85 T.C. 677 (1985).

32. Resolution of the IRC § 170(h)(4)(A)(iv) preservation issue will affect hundreds of taxpayers and will conserve the Court's time and the parties' resources.

33. Given the split between the Tax Court's holdings on this issue, Petitioners respectfully request review by the full Court on this issue.

ISSUES

1. Whether the protections afforded by New York City Law and the rules of the Landmarks Preservation Commission ("LPC") preclude a deduction for Petitioners' 2003 donation of a facade easement to the Trust for Architectural Easements f/k/a the National Architectural Trust (the "Trust") under Section 170(h)(4)(A)(iv) of the Internal Revenue Code?

No. New York City Laws and the rules of the LPC are relevant to the valuation of the easement; however, neither New York City law nor the rules of the LPC that preserve the subject property preclude this Court from finding that the rights that Petitioner granted to the Trust under the Conservation Deed are exclusively for the preservation of a historically important structure.

SUMMARY OF ARGUMENT

First, Petitioners' donation of a conservation easement on their Property to the Trust satisfies the requirements of IRC § 170(h)(4)(A)(iv) because:

1. Petitioners' facade easement donation satisfies the requirements of IRC § 170(h)(4)(C)(ii), i.e., that the easement donation is placed on a certified historic structure; and,

2. Petitioners' facade easement donation is consistent with the requirements of IRC § 170(h)(4)(A)(iv), i.e., that the easement donation is exclusively for the preservation of a certified historic structure.

Second, any critical comparison of: (a) the preservation protections set forth in the Conservation Deed used by the Trust, and (b) the preservation protections for historic properties governed by the Landmarks Preservation Commission ("LPC"), Title 25 of the New York City Administrative Code and Title 63 of the Rules of New York City (collectively the "LPC Rules"), compel the conclusion that the preservation protections differ. To the extent the Court finds that the LPC Rules and the rights donated to the Trust all, in their own fashion, "preserve" New York City-

based properties, Respondent's IRC § 170(h)(4) arguments must be rejected.

Finally, Herman and 1982 East, LLC are inconsistent with Hilborn v. Commissioner, 85 T.C. 677 (1985); Nicoladis v. Commissioner, T.C. Memo. 1988-163 (1988); Losch v. Commissioner, T.C. Memo. 1988-230 (1988); Griffin v. Commissioner, T.C. Memo. 1989-130 (1989); Dorsey v. Commissioner, T.C. Memo. 1990-242; and Simmons v. Commissioner, T.C. Memo. 2009-208.

Stated simply, the only document relevant to the IRC § 170(h)(4) preservation issue is the Conservation Deed. The Conservation Deed imposes burdens that are indistinguishable from those previously approved by the Tax Court. Id. By contrast, if, and to the extent the Conservation Deed's protections overlap with New York City law and the rules of the LPC, Respondent is free to argue that those "overlaps" are relevant to the value of Petitioners' easement contribution. Hilborn v. Commissioner, 85 T.C. 677 (1985); Simmons v. Commissioner, T.C. Memo. 2009-208.

ARGUMENT

THE LPC RULES ARE ONLY RELEVANT TO THE VALUATION OF PETITIONERS' EASEMENT; THE CONSERVATION DEED ESTABLISHES THAT PETITIONERS' DONATION TO THE TRUST WAS EXCLUSIVELY FOR THE PRESERVATION OF A CERTIFIED HISTORIC STRUCTURE

1. The Conservation Deed Satisfies the Literal Requirements of IRC § 170(h)(4)(C)(ii)

As more fully set out in Petitioners' Motion, the Property is a certified historic structure pursuant to IRC § 170(h)(4)(C)(ii) because:

1. The Property is located in the Carnegie Hill Historic District of New York City; and
2. The Property was certified as a historically important structure in that district by the National Park Service ("NPS"). See Petitioners' Motion at ¶¶ 22-28.

2. The Conservation Deed Satisfies the Spirit of the Federal Historic Preservation Tax Incentive Program; IRC § 170(h)(4)(A)(iv) Was Intended to Supplement Existing Local Preservation Efforts.

First, as more fully set out in Petitioners' Motion, the Conservation Deed preserves the Property. See Petitioners' Motion at ¶¶ 29-34, 37, 39, 44, 46-47, 49, 51, 53-56, 58, 61-67, 69, 71, 73, 75. The language of the Conservation Deed provides terms that are indistinguishable from preservation provisions that have been approved by the Tax Court. Compare Petitioners' Motion, Exhibit D with Simmons v. Commissioner, T.C. Memo. 2009-208; see also Petitioners' Motion at ¶¶ 77-86. Stated another way, the plain language of the Conservation Deed satisfies IRC § 170(h)(4)(A)(iv)'s "preservation" requirement.

Second, Congress defined the term "certified historic structure" to include properties located in a registered historic district as defined in IRC § 47(c)(3)(B). See IRC § 170(h)(4)(C)(ii). A district satisfies the requirements of IRC § 47(c)(3)(B) **only** if it is:

1. designated by a local statute certified by the Secretary of the Department of the Interior as **containing criteria which will substantially achieve the purpose of preservation**, and

2. is certified by the Secretary of the Interior as meeting substantially all of the requirements for listing of districts in the National Register.

IRC § 47(c)(3)(B) (emphasis added).

By definition, participation in the Federal Historic Preservation Tax Incentive Program requires that the easement donated preserve a "certified historic structure" in a registered historic district (i.e., containing criteria which will substantially achieve the purpose of preservation). However, in 1982 East⁵, Judge Laro, relying on Herman, opined:

Thus it is local law and the rules of the LPC that preserve the subject property and not the rights which NAT possessed under the deed of easement.

A literal reading of 1982 East, LLC would exclude all qualifying New York City properties from the Program. Stated another way, the existence of local preservation laws cannot, at the same time, both condition entry into the Program and exclude entry into the Program.

Third, when Congress created the tax incentive here at issue, it explained "that the term 'conservation purposes' be *liberally construed* with regard to the types of property with

⁵ The 1982 East LLC case is discussed below at Point I.4.

respect to which deductible conservation easements or remainder interests may be granted." H.R. Rep. No. 95-263, at 30-31 (1977) (Conf. Rep.). Although Congress did not provide guidance on the term "exclusively for conservation purposes⁶," the rules of statutory construction require that the term "conservation purpose" be read in concert with the term "certified historic structure." See e.g. Gustafson v. Alloyd Co., Inc., 513 U.S. 561, 570 (1995) (Acts of Congress should not be read as a series of unrelated and isolated provisions.)

Finally, the LPC was established by New York City Mayor Robert Wagner in 1965. Petitioners' Motion, Exhibit E. On July 23, 1974, pursuant to New York City's preservation laws, the LPC designated the Carnegie Hill Historic District. Petitioners' Motion, Exhibit F. The Carnegie Hill Historic District included the Property at the time of its initial designation. Petitioners' Motion, Exhibit F at 10.

By contrast, Congress created the deduction for donations for conservation purposes in 1976 (i.e., the Property was already subject to local preservation laws). See General Explanation of the Tax Reform Act of 1976 (H.R. 10612, 94th Congress, Public Law

⁶Glass v. Commissioner, 124 T.C. 258, 278 n.16 (2005).

94-455), p. 643, prepared by the Joint Committee on Taxation, JCS-33-76, 94th Cong. (1976). The purpose of the Program was to provide additional protections to properties in registered historic districts (i.e., the existing historic districts was established under laws that substantially achieves the purpose of preservation). See S. Rep. 96-1007, at 11 (1980) (The deduction would be available for existing historic districts such as Waterford, Virginia and Harper's Ferry, West Virginia). A literal reading of 1982 East, LLC would exclude all qualifying properties in the Carnegie Hill Historic District from the Program. Excluding from the Program, the properties that Congress intended the Program to "preserve" is an absurd interpretation of the word "preserve" in Section 170(h)(4). Furthermore, such a holding would be tantamount to saying that there is no property in New York City that would qualify for the tax incentive promised to those that participated in the Program, which in turn would render Section 170(h) surplusage for all New York City donors. See Calafati v. Commissioner, 127 T.C. 219, 229 (2006) ("all parts of a statute, if at all possible, are to be given effect," quoting Weinberger v. Hynson, Westcott & Dunning, Inc., 412 U.S. 609, 633 (1973)).

In summary, the plain language of IRC § 170(h)(4)(C)(ii) demonstrates that Congress did not, as Respondent argues, deny the charitable contribution deduction for conservation easements with preservation protections that overlap with local preservation laws. See Simmons, T.C. Memo. 2009-208, Nicoladis v. Commissioner, T.C. Memo. 1988-163. Moreover, because the Federal Historic Preservation Tax Incentive Program was meant to supplement the existing preservation protections, the rules of statutory construction compel the conclusion that existing local law protecting historic properties (i.e., the LPC Rules) are irrelevant as to whether the Conservation Deed satisfies IRC § 170(h)(4)(A)(iv).

3. There Are Material Differences Between the Trust's Easement and the LPC Rules; the Rights Which the Trust Possesses under the Conservation Deed Exceed Those Possessed by the Landmarks Preservation Commission.

In Herman,⁷ supra, Judge Gustafson opined:

Any right that the donee [i.e., the Trust] possesses under the Covenant to sue the donor to enforce the terms of the Covenant is, by definition, redundant of the Landmarks Preservation Commission's role of enforcing its regulations and preventing inappropriate alterations to the building.

In 1982 East, Judge Laro, relying on Herman, opined:

Thus it is local law and the rules of the LPC that preserve the subject property and not the rights which NAT possessed under the deed of easement.

As fully set out in the chart annexed hereto as **Exhibit A** and in Petitioners' Motion at ¶¶ 31, 34-35, 37-76 of Petitioners' Motion, 1982 East, LLC's conclusion that there is no material difference between the LPC and the preservation protection afforded by the Conservation Deed is, incorrect, as a matter of law.

For example, *unlike* the LPC Rules, the Conservation Deed

⁷ It should be noted that the Herman Court also observed: The protections afforded to the building by Federal, State, or local law, whatever they may be, are not part of the conservation easement that Mr. Herman contributed to NAT, and he is not entitled to a deduction under section 170(a)(1) **for or because of them**. *Id.* (emphasis added). Petitioners' deduction is not based on local law; indeed, it is based on the additional restrictions on the Property imposed by the Conservation Deed.

expressly prohibits any expansion or modification of an existing structure. See Petitioners' Motion, Exhibit D, at II.A.2. Indeed, in Penn Cent. Transp. Co. v. City of New York, the Supreme Court was asked to review whether the LPC's denial of a plan to construct an office building on top of a historic structure constituted a taking. 438 U.S. 104 (1978). In concluding that LPC's denial of the construction permit did not constitute a taking, the Supreme Court observed:

While the Commission's actions in denying applications to construct an office building in excess of 50 stories above the Terminal may indicate that it will refuse to issue a certificate of appropriateness for any comparably sized structure, **nothing the Commission has said or done suggest an intention to prohibit any construction above the Terminal. The Commission's report emphasized that whether any construction would be allowed depended upon whether the proposed addition 'would harmonize in scale, material and character with [the Terminal].'**"

Penn Cent. Transp., 438 U.S. at 137-138(emphasis added). The Robbins Report annexed to the Motion identifies several instances where the Commissioner of the LPC has exercised his discretion to permit modifications to existing structures that have materially altered the historic structure. See Petitioners' Motion, Exhibit H at 27-36. Had an easement on these properties been donated to the Trust, the Conservation Deed would have prohibited the

subject modifications. See Petitioners' Motion, Exhibit H at 27-29.

By contrast, the Trust has exercised its authority, pursuant to the Conservation Deed, to deny proposed modifications in cases where the LPC has granted approval. See Petitioners' Motion, Exhibit H at 27-29. These examples show that the Trust's rights to preserve a property under their Conversation Deed exceed those provided by New York City laws and LPC rules.

4. 1982 East, LLC is inconsistent with Hilborn v. Commissioner, 85 T.C. 677 (1985); Nicoladis v. Commissioner, T.C. Memo. 1988-163 (1988); Losch v. Commissioner, T.C. Memo. 1988-230 (1988); Griffin v. Commissioner, T.C. Memo. 1989-130 (1989); Dorsey v. Commissioner, T.C. Memo. 1990-242; Simmons v. Commissioner, T.C. Memo. 2009-208.

This Court had consistently rejected 1982 East, LLC's construction of the preservation requirement of IRC § 170(h)(4)(C)(iv). See e.g. Hilborn v. Commissioner, 85 T.C. 677 (1985) (Court allowed a 10% value and resulting charitable deduction with respect to a historic property located in the French Quarter of New Orleans); Nicoladis v. Commissioner, T.C. Memo. 1988-163 (1988) (Court confirmed that the taxpayers were allowed at least a 10% charitable deduction for an easement on a property protected by the New Orleans' Historic District Landmarks Commission); Losch v. Commissioner, T.C. Memo. 1988-230

(1988) (Court held that a 15% charitable deduction was proper regarding property located within the Washington D.C. Dupont Circle Historic District); Griffin v. Commissioner, T.C. Memo.

1989-130 (1989) (Court upheld a 20% charitable deduction concerning a charitable easement donation for a property regulated by the New Orleans Historic District Landmarks Commission); Dorsey v. Commissioner, T.C. Memo. 1990-242

(1990) (Court recognized a 35% charitable deduction with respect to an easement located in the Picayune Place Historic District of New Orleans.); Simmons v. Commissioner, T.C. Memo. 2009-208.

In The Federal Tax Law of Conservation Easements, Stephen Small observed that the degree to which a conservation easement provides protections beyond those provided by local preservation laws is a central issue to valuation. See Small, Stephen J., The Federal Tax Law of Conservation Easements, 11-4 (4th ed. 1997).

Consequently, in Hilborn v. Commissioner, 85 T.C. at 689-690, the Court explained the relevance of local laws protecting historic properties as follows:

"Before" value (before value) is arrived at by first determining the highest and best use of the property in its current condition unrestricted by the easement. **At this stage, the suitability of the property's current use under existing zoning and market conditions and realistic alternative uses are examined.** Any suggested use higher

than current use requires both "closeness in time" and "reasonable probability." Next, to the extent possible, the three commonly recognized methods of valuing property (capitalized net operating income, replacement cost, and comparable sales) are used, but are modified to take into account any peculiarities of the property which impact on the relative weight to be afforded each respective method.

"After" value (after value) is arrived at by first determining the highest and best use of the property as encumbered by the easement. **At this stage the easement's terms and covenants are examined, individually and collectively, and compared to existing zoning regulations and other controls (such as local historic preservation ordinances) to estimate whether, and the extent to which, the easement will affect current and alternate future uses of the property.** Next, the above-mentioned three approaches to valuing property are again utilized to estimate the value of the property as encumbered by the easements.

(Emphasis added). Implicit in Hilborn was that local preservation laws are relevant to the process whereby the additional protections provided by the facade easement are valued. See Small, Stephen J., The Federal Tax Law of Conservation Easements, 11-5.

It was against this background, that in Simmons v. Commissioner, T.C. Memo. 2009-208, the Court clearly and unequivocally rejected Respondent's IRC § 170(h)(4) based argument as follows:

Although respondent argues that the properties were already subject to District of Columbia preservation

laws, this does not prevent any charitable contribution deductions. **We have previously allowed charitable contribution deductions even if the property was subject to local preservation laws before the granting of an easement.** See, e.g., Griffin v. Commissioner, T.C. Memo. 1989-130; Nicoladis v. Commissioner, T.C. Memo. 1988-163.

* * *

Even if we were to accept respondent's contention that the easements did not impose any restrictions on petitioner over and above those imposed by the District of Columbia, **the easements still added an additional level of approval before any changes could be made to the properties.** See Nicoladis v. Commissioner, *supra*. Petitioner is required to obtain L'Enfant's consent to make any changes to the facades, even if those changes are allowable under District of Columbia preservation laws. (emphasis added).

Stated another way, the Court has consistently held that *because* some level of local historic protection is a condition precedent of a "qualified conservation contribution," it follows that the relevance of local preservation laws is limited to the process by which the easement is valued.

CONCLUSION

For the foregoing reasons, Petitioners' respectfully request a finding that the facade easement donation memorialized by the Conservation Deed preserved the Property for purposes of IRC § 170(h)(4) and that neither New York City law nor the LPC rules preclude Petitioners' charitable deduction.

Respectfully Submitted,

Dated: Hackensack, NJ
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Tax Court No.: AF0015

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