

**UNITED STATES TAX COURT**

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

Petitioners, )

v. )

COMMISSIONER OF INTERNAL )  
REVENUE, )

Respondent. )

Docket No.: 17390-09

FILED ELECTRONICALLY

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**MEMORANDUM OF LAW 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**

Like he did in Kaufman and 1982 East, LLC, Respondent denied Petitioners' charitable deduction based, in part, on an alleged failure to satisfy the "protected in perpetuity" requirement of IRC § 170(h)(5)(A). Kaufman v. Commissioner, 136 T.C. No. 13 (2011); 1982 East, LLC v. Commissioner, T.C. Memo. 2011-84. This memorandum of law explains:

1. Why Kaufman v. Commissioner, 136 T.C. No. 13 (2011), does not apply in New York;
2. Why 1982 East, LLC v. Commissioner, T.C. Memo. 2011-84, was wrongly decided; and
3. Why the full Court should review 1982 East, LLC's interpretation of Treas. Reg. § 1.170A-14(g)(6) before the issue is considered by the Second Circuit Court of Appeals.

**ISSUES**

1. Whether Citimortgage's<sup>1</sup> reservation, in the Lender Agreement, of a prior claim to insurance and/or condemnation proceeds violates Treas. Reg. § 1.170A-14(g)(6)?

2. Whether application of the local law exception set forth in Treas. Reg. § 1.170A-14(g)(6) means that Kaufman v. Commissioner, 136 T.C. No. 13 (2011) does not apply to New York donations?

3. Was 1982 East, LLC v. Commissioner, T.C. Memo. 2011-84, was wrongly decided?

4. Whether the issue raised in this motion is a controlling question of law for which there is a substantial ground for difference of opinion?

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<sup>1</sup> At the time of Petitioners' facade easement contribution, the Property also secured a line of credit from Citibank with a borrowing limit of \$200,000. (Motion, Exhibit E). The Citibank mortgage was satisfied on April 16, 2009. (Motion, Exhibit G). Thus, Citibank no longer has a priority claim over the proceeds identified in the Lender Agreement. Nevertheless, to the extent necessary, the discussion regarding Citimortgage contained herein applies to Citibank during the period that its mortgage encumbered the Property.

5. Whether the resolution of this issue may terminate this litigation, as well as, the litigation brought by similarly situated easement donors?

**RELEVANT FACTS**

1. Petitioners<sup>2</sup> donated a conservation easement (sometimes the "Easement") on their home (the "Property") to the National Architectural Trust (the "Trust"), a IRC § 501(c)(3) charity (the "Donation"). (Motion, Exhibit A).

2. The Donation was memorialized by a Conservation Deed of Easement (the "Conservation Deed"). (Motion, Exhibit A).

3. The Donation was completed on November 12, 2004. (Motion, Exhibit A at 5).

4. 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 on 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**

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<sup>2</sup> References to actions by Donor or Petitioners refer to those taken by Gregory T. Mount and Petitioner Allison Cook, together or individually.

**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 consistent with the conservation purposes of the original contribution.

(Motion, Exhibit A at 4, IV.C.) (emphasis added).

5. At all times relevant, Citimortgage held a mortgage on the Property. (Motion, Exhibit F at 4, ¶G).

6. On April 21, 2004, Citimortgage executed a lender agreement ("Lender Agreement") whereby Citimortgage:

joins in the execution of this CONSERVATION DEED OF EASEMENT for the sole and limited purpose of subordinating its rights in the Property to the right of the Grantee, its successors or assigns, to enforce the conservation purposes of this Easement in perpetuity under the following conditions and stipulations:

(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 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).

**ARGUMENT**

**POINT I**

**THE ONLY "PROCEEDS" RELEVANT TO THE ISSUE OF WHETHER  
THE LENDER AGREEMENT VIOLATES TREAS. REG. §  
1.170A-14 (g) (6) ARE THE "PROCEEDS" FROM THE SALE OR  
EXCHANGE OF THE PROPERTY FOLLOWING A JUDICIAL  
PROCEEDING THAT EXTINGUISHES THE EASEMENT.**

Respondent denied Petitioners' charitable deduction based, in part, on a failure to satisfy the "protected in perpetuity" requirement of IRC § 170(h)(5)(A). See, e.g., 1982 East, LLC v. Commissioner, T.C. Memo. 2011-84. Because 1982 East, LLC v. Commissioner, T.C. Memo. 2011-84, ignored the plain language of Treas. Reg. § 1.170A-14(g)(6) and the local law exception incorporated into Treas. Reg. § 1.170A-14(g)(6)(ii) (the "**Local Law Exception**"), it was wrongly decided.

IRC § 170(h)(5)(A) provides, in part:

a contribution shall not be treated as **exclusively for conservation purposes** unless the conservation purpose is **protected in perpetuity**. (emphasis added).

The Secretary published final regulations interpreting IRC § 170(h)(5) on January 14, 1986. See 1982 East, LLC v. Commissioner, T.C. Memo. 2011-84. The regulations recognize that, after the donee organization's receipt of an interest in a

property, an unexpected change in the conditions surrounding the property can make impossible or impractical the continued use of the property for conservation purposes.

To: (a) satisfy the "protected in perpetuity" requirement of IRC § 170(h)(5), and (b) avoid the windfall to the taxpayer that would result from the uncompensated extinguishment of an easement<sup>3</sup>, 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** *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.

(emphasis added). Thus, the plain language of Treas. Reg. § 1.170A-14(g)(6)(i) conditions its applicability on:

(a) a judicial proceeding that extinguishes an easement (i.e., a cy pres proceeding); and

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<sup>3</sup> The effect of the regulation is to protect the public's investment (in the form of deferred tax revenue) in easements eligible for the federal tax incentive program.

(b) a sale or exchange of the property subsequent to the cy pres proceeding that extinguishes the easement.

Recognizing that the judicial extinguishment of an easement does not, generally, generate any proceeds, the drafters of the regulation deferred the obligation to pay the easement holder for the value of the extinguished easement until a subsequent sale or exchange that generates proceeds. Accordingly, 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<sup>4</sup> 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).

Finally, Treas. Reg. § 1.170A-14(g)(6)(ii) provides that the obligation to pay the easement holder for the extinguished easement does not apply if state law provides an alternative mechanism for the payment to the easement holder and the donor is

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<sup>4</sup> The only condemnation proceeds relevant to Treas. Reg. § 1.170A-14(g)(6)(ii) are those following a cy pres proceeding that extinguishes an easement.

entitled to full proceeds from the subsequent sale or exchange (i.e., the **Local Law Exception**).

**A. CY PRES IS A JUDICIAL PROCEEDING THAT EXTINGUISHES AN EASEMENT; REGULATORY CY PRES EXTINGUISHES AN EASEMENT AND, GENERALLY, CREATES POST-EXTINGUISHMENT PROCEEDS**

Treas. Reg. § 1.170A-14(g) (6) creates 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. See Kaufman, 136 T.C. No. 13 at 20; see also Stephen J. Small, The Federal Tax Law of Conservation Easements 16-4, 16-5 (4th ed. 1997).

*Cy pres* refers to the common law doctrine that deals with unexpected changes that make the continued use of the property for conservation purposes impossible or impractical. See Kaufman, 136 T.C. No. 13 at 21; see also Application of Abrams, 151 Misc.2d 1056, 1060, 574 N.Y.S.2d 651, 655 (1991).

To: (a) satisfy the "protected in perpetuity" requirement of IRC § 170(h) (5) (A), and, (b) avoid the windfall to a property owner that could result from the uncompensated extinguishment of an easement, Treas. Reg. § 1.170A-14(g) (6) (i) creates a regulatory version of *cy pres*. The regulatory version of *cy pres* created by Treas. Reg. § 1.170A-14(g) (6) (i) requires the

donor and holder of a conservation easement to agree, in the conservation deed, that in the event a state court extinguishes the easement, the value attributable to the easement will continue to be used by the donee for charitable conservation purposes and, by implication, the value of the easement will not revert to the donor or the donor's successors. (Motion, Exhibit A at 4, IV.C.).

Thus, the difference between a traditional *cy pres* proceeding and Treas. Reg. § 1.170A-14(g)(6)(i)'s version of *cy pres* is the requirement that the property owner provide the easement holding organization with a right to a pro rata share of any proceeds from the "sale or exchange of the property" following a judicial proceeding that extinguishes an easement (sometimes "**POST-EXTINGUISHMENT PROCEEDS**").

The purpose and effect of the **POST-EXTINGUISHMENT PROCEEDS** requirement was to provide for the transfer of the value of easement extinguished to the charity. Recognizing that some states had statutory regimes for compensating the holders of extinguished easements that did not generate **POST-EXTINGUISHMENT**

**PROCEEDS**, the regulations exempted those states from Treas. Reg. § 1.170A-14(g)(6)(i) (i.e., the **Local Law Exception**).

Of relevance, here, is that New York was one of the states whose laws already provided for the payment of compensation to the holder of an easement in the event of extinguishment. Specifically, New York Real Property Actions and Proceedings Law Section 1951 provides a *cy pres*-based procedure for the extinguishment of a conservation easement (sometimes a "NY Cy Pres Proceeding"). Like both the regulatory and common law versions of *cy pres*, a New York Cy Pres Proceeding provides for the judicial extinguishment of a conservation easement as a result of unforeseen circumstances that make the continued enforcement of the easement impossible or impractical. See N.Y. Real Prop. Act. L. § 1951(2). Unlike the regulatory *cy pres* proceedings governed by Treas. Reg. § 1.170A-14(g)(6), a New York Cy Pres Proceeding does not, however, result in

**POST-EXTINGUISHMENT PROCEEDS.**

Instead, the New York legislature has chosen to protect the interests of their easement holders by requiring the property owner to pay the holder of the easement "damages" as a condition

precedent to extinguishment. See N.Y. Real Prop. Act. L. § 1951(2).

Because, in New York, the easement is completely extinguished prior to the conclusion of a NY Cy Pres Proceeding, the Trust does not have a right to any **POST-EXTINGUISHMENT PROCEEDS** nor do they have standing in any condemnation proceeding brought after the conclusion of the NY Cy Pres Proceeding.

For the reasons set forth below, the Local Law Exception is applicable in New York. Thus, Kaufman v. Commissioner, 136 T.C. No. 13 (2011), does not apply in New York.

**B. CONDEMNATION IS NOT A JUDICIAL PROCEEDING THAT EXTINGUISHES AN EASEMENT**

The flaw in both Kaufman v. Commissioner, 136 T.C. No. 13 (2011) and 1982 East, LLC v. Commissioner, T.C. Memo. 2011-84 is the failure to recognize that Treas. Reg. § 1.170A-14(g)(6) was not designed to capture condemnation proceeds. The only condemnation proceeds relevant to the Treas. Reg. § 1.170A-14(g)(6)(ii) analysis are those generated by a condemnation proceeding commenced after a cy pres proceeding in a state where the Local Law Exception does not apply.

As an initial matter, neither Kaufman v. Commissioner, 136 T.C. No. 13 (2011) nor and 1982 East, LLC v. Commissioner, T.C. Memo. 2011-84 recognize that condemnation and cy pres are not interchangeable doctrines. Condemnation is a legal process by which a governmental 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). A condemnation proceeding is not a judicial extinguishment proceeding based on changed circumstances. Instead, it is a quasi-judicial proceeding that allows the government to divest both the holder of the

conservation easement and the owner of a property of his or her interest in the property. See Application of Cantro, 198 Misc. 925, 928, 103 N.Y.S.2d 764, 766 (1950).

In condemnation cases, the property owner does not receive a windfall from the condemnation of his property because the value of the easement: (a) reduces the just compensation payment paid to the Property owner, and (b) is paid to the Easement holder. See e.g. In re West Tenth Street, Borough of Brooklyn, City of New York, 267 N.Y. 212, 196 N.E. 30 (1935).

**Because:**

(a) condemnation is a quasi-judicial proceeding, as opposed to a judicial proceeding, that extinguishes an easement, and

(b) most states pay "just compensation" to both the Property owner and the Easement holder before extinguishing their title in condemnation cases, it follows that:

(c) the **POST-EXTINGUISHMENT PROCEEDS** requirement does not logically apply to condemnation proceedings.

**C. THE DRAFTERS OF TREAS. REG. § 1.170A-14(g)(6) WERE CONCERNED WITH CY PRES AND NOT CONDEMNATION.**

Against this background, the language chosen by the drafters of Treas. Reg. § 1.170A-14(g)(6) compels the conclusion that the

drafters were concerned with the consequences of *cy pres* and not with condemnation. Compare Treas. Reg. § 1.170A-14(g) (6) with N.Y. Real Prop. Act. L. § 1951; N.Y. Em. Dom. L. § 402(5); see also Gerald Korngold, Solving the Contentious Issues of Private Conservation Easements: Promoting Flexibility for the Future and Engaging the Public Land Use Process, Utah L. Rev. 1039, 1081, n. 206 (2007).

First, the Court should note that common law-based extinguishment proceedings generally resulted in a windfall to property owners because the common law did not require property owners to compensate the easement holding organizations for its lost property rights. By contrast, in condemnation proceedings the government almost always paid "just compensation" to the easement holder before extinguishing his or her easement. Consequently, there was no policy reason to apply Treas. Reg. § 1.170A-14(g) (6) (i) to condemnation.

Second, in Kaufman, the Honorable Judge S. Halpern observed that Treas. Reg. § 1.170A-14(g) (6) (i):

speaks specifically of "**the donee's proceeds \* \* \* from a subsequent sale or exchange of the property**". (Emphasis added.) While subdivision (ii) specifies that the donee's vested property right must have a value proportional to the value of the encumbered

property, it does not otherwise describe the property in which the donee must have a vested right. Nevertheless, considering the "property right" language in subdivision (ii) together with the term "donee's proceeds" in subdivision (i), **we think it the intent of the drafters of section 1.170A-14(g) (6), Income Tax Regs., that the donee have a right to a share of the proceeds** and not merely a contractual claim against the owner of the previously servient estate.

Kaufman, 136 T.C. No. 13 at p. 25 (emphasis added). Because of the concession described in Point V, *infra.*, the Kaufman Court's analysis fails to account for the difference between *cy pres* and condemnation i.e., (a) in condemnation, there is no "judicial extinguishment of the conservation easement;" and (b) in most states, there are no **"donee's proceeds \* \* \* from a subsequent sale or exchange of the property."**

Finally, a plain language analysis of Treas. Reg. § 1.170A-14(g) (6) compels the conclusion that it does not apply to most states' condemnation proceedings because, in general, condemnations do not produce **POST-EXTINGUISHMENT PROCEEDS.**

Consequently, when conducting a plain language analysis of the regulations here at issue, the Court can and should infer that the drafters of Treas. Reg. § 1.170A-14(g) (6) (i) intentionally limited its application to judicial proceedings

that extinguish easements without payment (i.e., cy pres proceedings).

**D. THE LENDER AGREEMENT DOES NOT VIOLATE TREAS. REG. § 1.170A-14(g)(6) BECAUSE IT DOES NOT GRANT THE LENDER A PRIOR INTEREST IN THE PROCEEDS FROM THE SALE OR EXCHANGE OF THE PROPERTY FOLLOWING A JUDICIAL PROCEEDING THAT EXTINGUISHES AN EASEMENT**

Once the history, purpose and plain language of the regulations are considered, it becomes clear that the only "proceeds" relevant to issue of whether the Lender Agreement violates Treas. Reg. § 1.170A-14(g)(6)(i) are the proceeds from the "sale or exchange of the property" *following* a judicial proceeding that extinguishes an easement (i.e., the **"POST-EXTINGUISHMENT PROCEEDS"**).

To avoid duplication with the Motion, the chart annexed hereto as Exhibit A summarizes the effect on the Easement of:

- (a) casualty, hazard or accident occurring to or about the Property,
- (b) condemnation of the Property,
- (c) a NY Cy Pres proceeding, and
- (d) a NY Cy Pres proceeding followed by a condemnation of the Property.

Points II and IV below explain why neither (a), (b) nor (c) generate **POST-EXTINGUISHMENT-PROCEEDS**. Point (d) below explains why the **Local Law Exception** of Treas. Reg. § 1.170A-14(g)(6)(ii) is applicable to the payment of condemnation proceeds subsequent to a NY Cy Pres proceeding.

Because the events described in (a) through (d), above, do not generate **POST-EXTINGUISHMENT PROCEEDS** or provide Citimortgage to a prohibited interest in such proceeds, the Lender Agreement's reservation of 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" does not grant Citimortgage any interest, much less, a prohibited interest in **POST-EXTINGUISHMENT PROCEEDS**.

Because the Conservation Deed entitles the Trust to its proportionate share of the sales proceeds following any judicial extinguishment,<sup>5</sup> absent the grant of a prohibited interest in **POST-EXTINGUISHMENT PROCEEDS**, the Conservation Deed satisfies Treasury Regulation § 1.170A-14(g)(6).

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<sup>5</sup> See Motion, Exhibit A at 4, IV.C.

Thus, for the reasons set forth below, the Lender Agreement does not violate Treas. Reg. § 1.170A-14(g) (6).

**POINT II**

**BECAUSE A CASUALTY, HAZARD OR ACCIDENT OCCURRING TO OR ABOUT THE PROPERTY DOES NOT GENERATE POST-EXTINGUISHMENT PROCEEDS, CITIMORTGAGE'S RESERVATION OF A PRIOR CLAIM TO INSURANCE PROCEEDS DOES NOT VIOLATE TREAS. REG. § 1.170A-14(g) (6)**

As explained in Point I, the plain language of Treas. Reg. § 1.170A-14(g) (6) confirms that the only "proceeds" relevant to the issue of whether the Lender Agreement violates Treas. Reg. § 1.170A-14(g) (6) (i) are the proceeds from the "sale or exchange of the property" following a judicial proceeding that extinguishes an easement. If the plain language analysis is the correct analysis, then Citimortgage's reservation of a prior claim to insurance proceeds does not violate Treas. Reg. § 1.170A-14(g) (6).

**FACTS & LAW RELEVANT TO POINT II**

1. The Conservation Deed creates a conservation easement. Compare Motion, Exhibit A with N.Y. Env'tl. Conserv. L. § 49-0303(1).

2. N.Y. Evtl. Conserv. L. § 49-0305(2) provides that a conservation easement **can only** be extinguished as provided in N.Y. Evtl. Conserv. L. § 49-0307.

3. N.Y. Evtl. Conserv. L. § 49-0307 provides that the only methods for extinguishment of 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.

4. Under N.Y. Evtl. Conserv. L. § 49-0307, neither casualty, hazard nor accident will result in the judicial extinguishment of the easement. See N.Y. Evtl. Conserv. L. § 49-0307(1).

5. The Lender Agreement grants Citimortgage, and its assignees, a prior claim to all insurance proceeds resulting from any casualty hazard or accident occurring to or about the Property. (Motion, Exhibit A at 6).

6. The Conservation Deed requires Petitioners to rebuild the Property "if totally or substantially destroyed." (Motion, Exhibit A at 2, II.3.).

7. Petitioners' obligation to rebuild applies even if the Property is destroyed by casualty, hazard or accident. (Motion, Exhibit A at 2, II.3; Exhibit F at 23, ¶5).<sup>6</sup>

**THE FLAW IN 1982 EAST LLC IS ITS FAILURE TO RECOGNIZE THAT THE ONLY "PROCEEDS" RELEVANT TO THE ISSUE OF WHETHER THE LENDER AGREEMENT VIOLATES TREAS. REG. § 1.170A-14(g)(6)(i) ARE THE PROCEEDS FROM THE "SALE OR EXCHANGE OF THE PROPERTY" FOLLOWING A JUDICIAL PROCEEDING THAT EXTINGUISHES AN EASEMENT.**

8. In 1982 East, LLC, the Court reviewed a lender agreement that is, for all intents and purposes, identical to the Lender Agreement here at issue. (Compare Motion, Exhibit A at 7 with 1982 East LLC, T.C. Memo. 2011-84).

9. In 1982 East, LLC, the Court concluded that the lender agreement violated IRC § 170(h) because:

As in Kaufman I, the lender agreement here is clear that First Republic Bank retained a "prior claim" to all condemnation and insurance proceeds "in preference" to NAT "until" that mortgage was satisfied and discharged. Thus, at any point before the mortgage was repaid, the possibility existed for First Republic Bank to deprive NAT of value that should have otherwise been dedicated to the conservation purpose. **Such would be the case, for example, if the servient property was substantially or completely destroyed and no**

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<sup>6</sup> The mortgage agreement provides in relevant part: "The amount paid by the insurance company for loss or damage to the Property is called "Insurance Proceeds." Unless Lender and I otherwise agree in writing, any Insurance Proceeds, whether or not the underlying insurance was required by the Lender, will be used to repair or restore the damaged Property . . ."

**significant value remained in that property after the mortgage was satisfied. Under such circumstances, the right of NAT to a proportionate share of the future proceeds of a condemnation or casualty would not be guaranteed.**<sup>7</sup> LLC's contribution of the donated property thus fails to comply with the enforceability in perpetuity requirements of section 1.170A-14(g)(6)(ii), Income Tax Regs.

Id. at 23(emphasis added).

10. To the extent, 1982 East, LLC concludes that Citimortgage's reservation of a prior claim to insurance proceeds violates Treas. Reg. § 1.170A-14(g)(6), it is incorrect.

11. A casualty does not extinguish the Easement. The language of Treas. Reg. § 1.170A-14(g)(6)(i) makes crystal clear that the only "proceeds" relevant to issue of whether the Lender Agreement violates Treas. Reg. § 1.170A-14(g)(6)(i) are the proceeds from the "sale or exchange of the property" following a judicial proceeding that extinguishes an easement.

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<sup>7</sup> The 1982 East LLC does not address the fact that in New York a casualty does not result in an extinguishment of a conservation easement and that a condemnation proceeding does not result in the creation of any **POST-EXTINGUISHMENT PROCEEDS**.

**CONCLUSION POINT II**

12. **Because:**

A. Both the Conservation Deed and N.Y. Env'tl. Conserv. L. § 49-0307 provide that neither casualty, hazard nor accident extinguishes the Easement, 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**),

**then**, it follows that:

C. The insurance proceeds resulting from a casualty, hazard or accident are not **POST-EXTINGUISHMENT-PROCEEDS**, and

D. Citimortgage's prior claim to insurance proceeds resulting from a casualty, hazard or accident does not violate Treas. Reg. § 1.170A-14(g)(6).

**POINT III**

**NEW YORK LAW PROVIDES THAT PETITIONERS ARE ENTITLED TO THE PROCEEDS RESULTING FROM A CONDEMNATION OF THE PROPERTY SUBSEQUENT TO A NY CY PRES PROCEEDING WITHOUT REGARD TO THE TERMS OF THE PRIOR PERPETUAL CONSERVATION RESTRICTION; CONSEQUENTLY, THE LENDER AGREEMENT'S GRANT OF A PRIOR CLAIM TO CONDEMNATION PROCEEDS DOES NOT VIOLATE TREAS. REG. § 1.170A-14(g)(6).**

The **POST-EXTINGUISHMENT PROCEEDS** requirement does not apply in New York to condemnation proceeds received subsequent to a NY Cy Pres Proceeding because of the **Local Law Exception**. Specifically, Treas. Reg. § 1.170A-14(g)(6)(ii) provides that the Trust must be entitled to the **POST-EXTINGUISHMENT PROCEEDS**:

**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).

Here, local law (i.e., N.Y. Real Prop. Acts. Law § 1951(2)) conditions the complete extinguishment of a conservation easement on the payment of damages. After the Trust receives the damages pursuant to N.Y. Real Prop. Acts. Law § 1951(2), the donor is entitled to **POST-EXTINGUISHMENT PROCEEDS** without regard to the terms of the extinguished Easement. Thus, Citimortgage's prior

claim to condemnation proceeds does not violate Treas. Reg. §  
1.170A-14(g) (6).

**FACTS & LAW RELEVANT TO POINT III**

1. The Conservation Deed created an easement in gross which is a property right under New York law. See Whitmier & Ferris Co. v. State of New York, 12 A.D.2d 165, 168, 209 N.Y.S.2d 247, 248 (App. Div. 1961).

2. N.Y. Envtl. Conserv. L. § 49-0307(1)(b) provides that an easement can be extinguished pursuant to a judicial proceeding commenced under N.Y. Real Prop. Acts. Proc. Law § 1951, i.e., a NY Cy Pres Proceeding.

3. N.Y. Real Prop. Acts. Law § 1951(2)<sup>8</sup> both (a) provides for, and (b) conditions, the complete extinguishment<sup>9</sup> of a conservation easement on the payment of damages.<sup>10</sup>

4. Damages payable pursuant to N.Y. Real Prop. Acts. Law § 1951(2) compensate the easement holder for the loss incurred as a result of the extinguishment of its property rights. See Orange & Rockland Utils., 52 N.Y.2d at 267, 437 N.Y.S.2d 291.

5. Put into context, upon payment of the amount set by the Court pursuant to N.Y. Real Prop. Acts. L. §§ 1951 and 1955, the Trust's interests in the Property would be "completely extinguished."

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<sup>8</sup> Specifically, a conservation easement "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).

<sup>9</sup> N.Y. Real Prop. Acts. L. § 1951 does not authorize a partial extinguishment of a conservation easement. See e.g. Nature Conservancy v. Congel, 296 A.D.2d 840, 744 N.Y.S.2d 281 (App. Div. 2002)

<sup>10</sup> Damages is defined as "the sum of money, if any, to which they [owners of the benefitted land] are entitled in exchange for a complete extinction of the restrictions (1958 Report of NY Law Rev Comm, at p. 269), inclusive of both damages up to the time of trial and damages in the future.'" See Orange & Rockland Utils. v Philwold Estates, 52 N.Y.2d 253, 267, 437 N.Y.S.2d 291 (1981).

6. The Court determines the damages payable to the Trust.  
N.Y. Real Prop. Acts. Law § 1951(2).

7. The doctrine of res judicata<sup>11</sup> applies to the issues decided in the NY Cy Pres Proceeding, i.e., the amount of damages payable to the Trust. See e.g. Parker v. Blauvelt Volunteer Fire Co., 93 N.Y.2d 343, 690 N.Y.S.2d 478, 712 N.E.2d 647 (1999).

8. N.Y. Real Prop. Acts. Law § 1951(2) provides that after a New York Court judicially extinguishes the Easement, the Trust has no claim to either the Property or the **POST-EXTINGUISHMENT**

**PROCEEDS.**

9. Condemnation proceedings in New York are governed by the N.Y. Eminent Domain Procedure Laws. N.Y. Em. Dom. Proc. L. § 104.

10. Once a New York court determines that a taking is proper, the property owner's exclusive remedy is to "just

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<sup>11</sup> "Under res judicata, or claim preclusion, a valid final judgment bars future actions between the same parties on the same cause of action. **As a general rule, once a claim is brought to a final conclusion, all other claims arising out of the same transaction or series of transactions are barred, even if based upon different theories or if seeking a different remedy.**" (emphasis added). Parker v. Blauvelt Volunteer Fire Co., 93 N.Y.2d 343, 690 N.Y.S.2d 478, 712 N.E.2d 647 (1999).

compensation." See City of Monterey v. Del Monte Dunes, Ltd., 526 U.S. 687, 710 (1999).

11. Just compensation is paid in order to compensate a property owner for the property rights lost during the taking.

12. N.Y. Em. Dom. Proc. L. § 304(D) provides that when more than one party has an interest in the property subject to condemnation, New York courts determine the appropriate allocation of condemnation proceeds.

13. Under New York law, the holder of an easement that was extinguished in a NY Cy Pres Proceeding has neither a claim nor standing to pursue to any portion of proceeds from a subsequent condemnation of the Property.<sup>12</sup>

**1982 EAST, LLC OVERLOOKED THE LOCAL LAW EXCEPTION**

14. In 1982 East, LLC, like here, the taxpayer relied "on N.Y. Real Prop. Acts. Law sec. 1951(2) (McKinney 2008), which petitioner believes "requires" that NAT be compensated before the easement may be extinguished." Id. at 24.

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<sup>12</sup> The government has an obligation to serve notice on the condemnees. N.Y. Em. Dom. L. § 501. Furthermore, only the condemnees have standing to file a petition for Condemnation Proceeds. N.Y. Em. Dom. L. § 502. In New York, the term "condemnee" means "the holder of any right, title, interest, lien, charge or encumbrance in real property subject to an acquisition or proposed acquisition." N.Y. Em. Dom. L. § 103.

15. The 1982 East, LLC Court rejected the taxpayer's argument because:

as we have discussed above and in Kaufman I and II, section 1.170A-14(g)(6)(ii), Income Tax Regs., requires that NAT "must" be entitled to its proportionate share of proceeds in the event the easement is extinguished. Petitioner cannot avoid the unconditional requirement of section 1.170A-14(g)(6)(ii), Income Tax Regs., by showing that a New York court might adjudge the facade easement unenforceable, especially where, as here, petitioner has not established that NAT would sustain or recover actual damages in the event of extinguishment.

Id.

16. The 1982 East, LLC Court erred because it failed to consider the **Local Law Exception** to the **POST-EXTINGUISHMENT PROCEEDS** requirement appearing in the last sentence of the regulation (i.e., the Trust must be entitled to **POST-EXTINGUISHMENT PROCEEDS "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).

17. 1982 East, LLC v. Commissioner, T.C. Memo. 2011-84, was wrongly decided.

**CONCLUSION POINT III**

**Because :**

1. The only "proceeds" relevant to the proceeds analysis required by Treas. Reg. § 1.170A-14(g)(6) are the "proceeds" from a sale exchange or involuntary conversion following a judicial extinguishment; and

2. pursuant to N.Y. ECL § 49-0307 and N.Y. Real Prop. Acts. Law §§ 1951 through 1955, the Trust must be paid before a New York court can extinguish its easement; and

3. pursuant to N.Y. Real Prop. Acts. Law § 1951(2), after the Trust has been paid for its interest in the Property, the Trust's interest in the Property is completely extinguished; and

4. pursuant to N.Y. Em. Dom. Proc. L. § 304(D), after the Trust's interest is extinguished, the donor of the easement is entitled to the full proceeds from any subsequent sale, exchange, or involuntary conversion of the Property;

**then, it follows that:**

5. The Treas. Reg. § 1.170A-14(g)(6)(ii) requirement that "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" is inapplicable to New York conservation easements.

Stated simply, because the Trust has no interest in the proceeds of sale after judicial extinguishment, the Lender Agreement does not give the Lender any amount otherwise payable to the Trust pursuant to Treas. Reg. § 1.170A-14(g)(6).

**POINT IV**

**BECAUSE, (A) IN NEW YORK, EMINENT DOMAIN (I.E., CONDEMNATION) DOES NOT GENERATE POST-EXTINGUISHMENT-PROCEEDS, THEN (B) THE LENDER AGREEMENT'S GRANT OF A PRIOR CLAIM TO CONDEMNATION PROCEEDS DOES NOT VIOLATE TREAS. REG. § 1.170A-14(g)(6).**

It is axiomatic that neither Petitioners, the Trust nor Citimortgage can bind the governmental body acquiring the Property. If:

(a) the only "proceeds" relevant to issue of whether the Lender Agreement violates Treas. Reg. § 1.170A-14(g)(6)(i) are the proceeds from the "sale or exchange of the property" following a judicial proceeding that extinguishes an easement, and,

(b) condemnation results in a non consensual transfer of the Property to the government, it follows that:

(c) to satisfy the Treas. Reg. § 1.170A-14(g)(6)(i), private parties would be able to enter into an agreement that would bind the governmental body acquiring the Property.

**FACTS & LAW RELEVANT TO POINT IV**

1. At all times relevant, Petitioners and the Trust had an interest in the Property. (Motion, Exhibits A, C).

2. Condemnation is the legal process by which a governmental 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).

3. Under New York law, the Trust's interest in the property may be extinguished in a condemnation proceeding. N.Y. Evtl. Conserv. L. § 49-0307(1)(c).

4. The N.Y. Eminent Domain Procedure Laws set forth the rules governing the calculation and payment of just compensation (sometimes "**CONDEMNATION PROCEEDS**") in condemnation proceedings. N.Y. Em. Dom. Proc. L. § 104 *et seq.*

5. Under New York law, **CONDEMNATION PROCEEDS** are determined before a property owner's<sup>13</sup> rights in the property are extinguished. See 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, 287 (App. Div. 1976) (It is well settled that just compensation must be secured and certain *before* the taking of the property).

6. Upon condemnation of the Property, Petitioners' and the Trust's interests in the Property are extinguished. See e.g. Application of Cantro, 198 Misc. at 928, 103 N.Y.S.2d at 766.

7. Under New York law, the government (i.e., the condemnor) thereafter takes title to the condemned property free and clear of all prior encumbrances. Id.

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<sup>13</sup> N.Y. Em. Dom. Proc. L. § 304(D) provides that when more than one party has an interest in the property subject to condemnation, New York courts determine the appropriate allocation of **CONDEMNATION PROCEEDS**. Where, like here, there are two or more interests or estates in a condemned parcel, the proper mode of assessing damages is to ascertain first the damage to the fee as if it were unencumbered, and then to apportion that amount among all of the estates and interest which are held in the property. See e.g. Matter of City of New York [Mott Haven Houses], 33 Misc.2d 808, 227 N.Y.S.2d 858 (1960) aff'd. 16 A.D.2d 637, 227 N.Y.S.2d 891 aff'd. 13 N.Y.2d 959, 244 N.Y.S.2d 458 (1963); Matter of City of New York [Allen St.], 256 N.Y. 236, 242-243, 176 N.E. 377, \_\_\_ (1931).

8. Neither Petitioners nor the Trust would have a right to the proceeds resulting from the government's sale or exchange of the Property following a condemnation proceeding. See Id.

9. As a matter of New York law, there can never be **POST-EXTINGUISHMENT-PROCEEDS** following a proceeding that condemns a property encumbered by a conservation easement. Compare Application of Cantro, 198 Misc. at 928, 103 N.Y.S.2d at 766 with Treas. Reg. § 1.170A-14(g) (6).

#### CONCLUSION POINT IV

10. **Because, in condemnation cases:**

A. New York law controls the payment of just compensation (See N.Y. Em. Dom. L. § 104 et seq.);

B. Under New York law, **CONDEMNATION PROCEEDS** for Petitioners and the Trust's interest in the Property would be determined before the government extinguishes the Trust's conservation easement (In re (College Point. Indus. Park Urban Renewal Project II, Borough of Queens) City of New York, 51 A.D.2d at 798, 380 N.Y.S.2d at 287); and

C. There are no and can never be any **POST-EXTINGUISHMENT-PROCEEDS** after a New York condemnation;

then, it follows that:

D. By definition, **CONDEMNATION PROCEEDS**<sup>14</sup> are not **POST-EXTINGUISHMENT-PROCEEDS**; Compare Application of Cantro, 198 Misc. at 928, 103 N.Y.S.2d at 766 with Treas. Reg. § 1.170A-14(g) (6) (i); and

E. Citimortgage's reservation of a prior claim to condemnation proceeds does not violate Treas. Reg. § 1.170A-14(g) (6).

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<sup>14</sup> The proceeds of a condemnation following a NY Cy Pres proceeding are not **POST-EXTINGUISHMENT PROCEEDS** for purposes of Treas. Reg. § 1.170A-14(g) (6).

**POINT V**

**THE KAUFMAN COURT'S CONCLUSION WAS BASED ON A MAJOR  
CONCESSION THAT IS NOT MADE HERE AND CAN NEVER BE MADE  
IN NEW YORK**

In Kaufman v. Commissioner, 136 T.C. No. 13 (2011), the Court concluded that in Massachusetts, a lender's reservation of a "prior claim to the proceeds of condemnation" violates Treas. Reg. § 1.170A-14(g) (6). The conclusion in Kaufman was based on the following:

**We based our grant solely on the fact, CONCEDED BY PETITIONERS, that, because, following a judicial extinguishment of the facade easement, NAT *might not* receive its proportional share of any FUTURE PROCEEDS, the agreement failed to satisfy the requirements of section 1.170A-14(g) (6), Income Tax Regs., and so failed to satisfy the enforceability-in-perpetuity requirements under section 1.170A-14(g), Income Tax Regs., and section 170(h) (2) (C) and (5) (A).**

Id. at 27-28 (emphasis added).

For the reasons set forth in Points II, III and IV above, Petitioners here do not and cannot concede that the Trust might not receive its proportional share of any "future proceeds" (i.e., **POST-EXTINGUISHMENT PROCEEDS**). See Id. at 27-28.

First, the Conservation Deed explicitly "entitles" the Trust to its proportionate share of the sales proceeds, if any,

following a judicial extinguishment of the Easement. (Motion, Exhibit A at 4, IV.C.). Treas. Reg. § 1.170A-14(g)(6) requires no more than this.

Second, and more important, under New York law, there are never any "future proceeds" in a condemnation proceedings. The Trust is paid for its easement before the easement is extinguished.

**Because**, in New York:

(a) neither the Trust nor Petitioners have a right to any "future proceeds" following a condemnation proceeding,<sup>15</sup> **then**:

(b) the Trust's right to any "future proceeds" of a condemnation proceeding always equals "zero".

**Because**, in New York, (a) and (b) are always true, **then** the Trust will always receive its proportional share of any "future proceeds" (i.e., "zero"). Consequently, Petitioners cannot make the concession made in Kaufman. Stated simply, absent the concession made in Kaufman, Kaufman is distinguishable and has no applicability here.

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<sup>15</sup> See Application of Cantro, 198 Misc. at 928, 103 N.Y.S.2d at 766.

**CONCLUSION POINT V**

**Because:**

(a) nothing in the Lender Agreement affects the Trust's entitlement to its proportionate share of the sales proceeds following any judicial extinguishment, and

(b) **CONDEMNATION PROCEEDS** are not **POST-EXTINGUISHMENT-PROCEEDS,**

then,

(c) Citimortgage's reservation of a prior claim to **CONDEMNATION PROCEEDS** has no impact the Trust's entitlement, if any, to **POST-EXTINGUISHMENT-PROCEEDS.**

Absent the concession made in Kaufman, the Court must find that the Lender Agreement does not violate Treas. Reg. § 1.170A-14(g)(6).

**POINT VI**

**THIS ISSUE WARRANTS REVIEW BY THE FULL COURT AND A STATEMENT  
PURSUANT TO T.C. RULE 193**

Petitioners made an easement donation to the Trust pursuant to the Federal Historic Preservation Tax Incentive Program (sometimes the "Program"). The Trust is one of the largest preservation easement holding organizations in the nation; it holds more than 825 easements<sup>16</sup> nationwide. It holds more than 500 easements in New York.

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 and Lender Agreements.

In Kaufman v. Commissioner, 136 T.C. No. 13 (2011), the Court concluded that, in Massachusetts, a lender's reservation of a priority claim to the proceeds of condemnation violates Treas. Reg. § 1.170A-14(g)(6). As explained above, Kaufman was based, in part, on a concession that was not made here. Kaufman is appealable to the First Circuit Court of Appeals; Kaufman is being appealed. Because of the differences between New York and

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<sup>16</sup> This fact is reported at <http://www.architecturaltrust.org>.

Massachusetts law, the First Circuit's resolution of the Treas. Reg. § 1.170A-14(g) (6) issue may not be relevant to the New York donors.

In 1982 East, LLC, T.C. Memo. 2011-84, the Court, relying on Kaufman, concluded that a New York lender's reservation of a prior claim to insurance and/or **CONDEMNATION PROCEEDS** violates Treas. Reg. § 1.170A-14(g) (6). Unfortunately, 1982 East, LLC was not appealed.

Respondent has disallowed the charitable deductions claimed by most of the Trust's New York City based-donors. See, e.g., Scheidelman v. Commissioner, T.C. Memo. 2010-151. For most New York donors (residential and commercial) the Treas. Reg. § 1.170A-14(g) (6) issue is a threshold issue (i.e., no deduction is allowable absent compliance with IRC § 170(h) (5) (A)). Stated another way, in light of 1982 East, LLC, no New York-based donor can survive summary judgment.

Against this background, and because of the tax dollars involved in the aggregate, Petitioners anticipate that the Treas. Reg. § 1.170A-14(g) (6) issue will go to the Second Circuit. Because 1982 East, LLC is only a memorandum opinion, review by

the full Court, before the issue is submitted to the Second Circuit is requested.

In addition, perhaps, equally important, the issue to be decided is very important to the cause of historic preservation. Thousands of preservation easements are now held by qualified organizations throughout the country. A significant number of those easements include lender agreements containing subordination provisions closely resembling the one at issue in this case. Indeed, the National Trust for Historic Preservation in the United States has affirmatively supported the use of these provisions by including similar subordination language in model preservation easements since its first publication of a Model Historic Preservation Easement in 1986.<sup>17</sup> Kaufman is based on a concession that will not be made in future cases. 1982 East LLC is a memorandum opinion. In light of the importance of the issue

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<sup>17</sup> The applicable Treasury Regulations were promulgated in 1986. The common acceptance and widespread use of subordination language similar to that involved here has thus been well-publicized and well-known to the Internal Revenue Service for decades. During that period, the Service has reviewed hundreds, if not thousands, of easements containing similar lender agreements. Only recently has Respondent taken the position that those lender agreements render an otherwise perpetual easement non-perpetual.

to the easement community, review by the full Court is appropriate.

Finally, Petitioners ask the Court to note that the Treas. Reg. § 1.170A-14(g)(6) problem cannot easily be solved by revising the language of subordination agreements to satisfy the standard stated in the Court's opinions. Most mortgage liens grant the mortgagee priority to insurance proceeds and the proceeds of condemnation. Banks and mortgage companies are unlikely to enter into subordination agreements if they cannot retain such priority. The consequence would be that few preservation easements on mortgage-encumbered properties would qualify for a charitable deduction under IRC § 170(h)(1), thereby frustrating the congressional policies that the statute was intended to promote.

In light of the above, Petitioners respectfully request review by the full Court.

Additionally, to the extent that this Court finds Kaufman v. Commissioner or 1982 East, LLC compel the conclusion that a lender's reservation of a prior claim to insurance and/or condemnation Proceeds violates Treas. Reg. § 1.170A-14(g)(6), Petitioners respectfully request that the Court include in its

Order denying Petitioners' Motion 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 of this issue may terminate the litigation.

**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  
August \_\_\_\_, 2011

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Tax Court No.: AF0015

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