UNITED STATES TAX COURT

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

PETITIONER'S OBJECTION TO RESPONDENT'S MOTION FOR PARTIAL SUMMARY JUDGMENT

A. Preliminary Statement

Respondent's principal argument in his Motion for Partial Summary Judgment is that, applying the Court's recent opinion in Kaufman v. Commissioner, 134 T.C. No. 9 (April 26, 2010) leads to the conclusion that the conservation easement granted by the Partnership in this case does not satisfy the requirement of the Internal Revenue Code (the "Code") and Treasury Regulations that the purposes of the conservation easement be protected in perpetuity. However, as is more fully discussed below, Judge Halpern, who issued the Court's opinion in Kaufman has stated that he will reconsider his opinion.

In addition to the "Kaufman issue," Respondent's Motion raises two additional grounds for partial summary judgment - that the ability of the Trust to allow changes to the façade or to abandon its rights under the easement somehow violates the "in perpetuity" requirement of the Code and Regulations, and that the façade easement granted by Petitioner is not binding because an exhibit referred to in the grant of the easement was not included in the documents recorded in the county clerk's office. All of Respondent's arguments are dealt with in

this Objection to Respondent's Motion for Partial Summary Judgment. [1]

Petitioner respectfully requests a hearing in Washington, D.C. before the trial on Respondent's Motion for Partial Summary Judgment.

This case is scheduled for trial on the trial calendar commencing October 4, 2010 in New York, New York. Petitioner has previously filed a Motion for Continuance requesting that trial of the case be continued to a later date so that the Court can address the issues raised in Respondent's Motion for Partial Summary Judgment before requiring the parties to prepare to conduct a full trial (which involves preparing witnesses, preparing a stipulation of facts and a Trial Memorandum) and to prepare extensive post-trial briefs. In its consideration of Petitioner's Motion for Continuance, Petitioner respectfully asks the Court to take into account that there are any number of cases pending before several Judges in the Tax Court (including, Petitioner understands, Judge Halpern, Judge Gale, Judge Colvin, and Judge Goeke) which involve the "Kaufman issue" as well as a number of docketed cases that have not yet been assigned for trial or to a Judge that involve the "Kaufman issue." Petitioner understands that the issue addressed in Kaufman arises in nearly every grant of a preservation easement on real property for which a charitable contribution deduction was claimed, where there is an existing mortgage on the property at the time of the grant of the easement to the charity. Petitioner also understands that Respondent has joined petitioners in a motion to continue the trial of other cases involving the "Kaufman issue" until after the opinion is Kaufman has been reconsidered.

[1] Petitioner intends to file its own Motion for Partial Summary Judgment within a day or two so that all other technical issues that Respondent has typically raised in other façade easement cases under Code section 170(h) can be resolved before the trial.

B. The Conservation Easement Deed granted by the Partnership to the Trust complies with the requirements of Treas. Reg. §1.170A-14(g)(6) regarding "extinguished" easements.

Respondent's argument that the requirements of Treasury Regulation section 1.170A-14(g)(6) have not been met reflects a gross misunderstanding of when and how this provision applies. This provision of the Regulations addresses a narrow circumstance involving the disposition of property that was subject to an easement, which disposition occurs after the extinguishment of the easement in a judicial proceeding. This provision of the Regulations does not, as Respondent appears to argue, dictate to whom routine casualty insurance proceeds should be paid.

Respondent relies on this Court's opinion in Kaufman v. Commissioner, 134 T.C. No. 9 (April 26, 2010). In his memorandum in support of his motion, Respondent fails to inform the Court that Judge Halpern, who issued the Court's opinion in Kaufman, held a hearing on a motion filed by petitioner Kaufman for reconsideration of the Court's opinion. In support of that motion for reconsideration, the Trust for Architectural Easements (formerly known as the National Architectural Trust), the recognized qualified charitable organization to which the Partnership granted the façade easement at issue in this case, and the National Trust for Historic Preservation in the United States, another recognized charitable organization which accepts preservation easements on real property, each submitted motions for permission to file an *amicus* brief along with a copy of their respective *amicus* brief. Both these *amicus* briefs set forth in detail the errors in the Court's opinion in Kaufman. The briefs also point out that the Court's interpretation of the Regulation would put a halt to the grant of all façade easements where there is a pre-existing mortgage on the property, a result that Congress could not have intended when it enacted Section 170(h) of the Code and the provisions regarding conservation of certified

historic structures. At that hearing Judge Halpern indicated that he would reconsider his opinion, and he requested that petitioner incorporate in his post trial brief the arguments made by the two *amici*. Copies of the motions to file *amicus* briefs that were submitted by the two trusts and of the briefs they offered to the Court are attached as exhibits to the Declaration of Richard A. Levine filed in support of Petitioner's Objection to Respondent's Motion. The arguments presented by the two trusts are incorporated into Petitioner's Objection. The transcript of the hearing held by Judge Halpern is also attached as an exhibit to Levine's Declaration.

Section 1.170A-14(g)(6)(i) provides,

> 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.)

Treasury Regulation section 1.170A-14(g)(6)(ii) provides,

> In the case of a donation made after February 13, 1986, 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. . . . For purposes of this paragraph (g)(6)(ii), that proportionate value of the donee's property rights shall remain constant.

Furthermore, in the event of a judicial extinguishment of the easement on account of a "subsequent unexpected change" in conditions making "impossible or impractical" continued use of the property for conservation purposes, section 1.170A-14(g)(6)(ii) provides

that the qualified organization must be entitled to a portion of the proceeds from a subsequent sale, exchange, or involuntary conversion of the property at least equal to the proportionate value of the conservation restriction as determined thereunder, unless state law provides otherwise. The Regulation continues from above, as follows:

> Accordingly, when a change in conditions gives 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, 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.)

The first point to be noted is that the Regulation addresses a very narrow circumstance -- the sale or exchange of the property after the judicial extinguishment of the conservation easement. The Regulation has no application to how the insurance proceeds paid after a routine casualty should be apportioned among the mortgagee, the owner of the property and the charitable organization that owns the easement.[2]

The provision of the Regulations regarding extinguishment of an easement may have had New York State Environment Conservation Law (and perhaps the laws of other states with similar statutes) in mind. Under New York State law, the owner of an easement-restricted property can maintain an action in a court of law to extinguish the easement on account of a change in conditions surrounding the property making the continued use of the property for conservation purposes impractical or impossible. Provided that a court finds the easement to be of "no actual or substantial benefit" to the persons who might otherwise look to enforce the

[2] The Regulation might apply to casualty insurance proceeds in the implausible situation where an easement has been "judicially extinguished" because of an unexpected change in the conditions surrounding the property that makes the continued use of the property for conservation purposes impossible or impractical, and thereafter there is a casualty loss that gives rise to an insurance recovery. In such case, the Regulations would require that the Trust share in the proceeds of insurance. The remoteness of this fact pattern is discussed below in Section E.

easement, a court may extinguish the easement upon payment to all persons seeking its enforcement. Because the payment requirement is built into New York State law, the payment requirement in Treasury Regulation section 1.170A-14(g)(6)(ii) is unlikely ever to be relevant.

New York State Environmental Conservation Law section 49-0305.2, addressing the modification or extinguishment of conservation easements, provides, "A conservation easement shall be modified or extinguished only pursuant to the provisions of section 49-0307 of this title."[3]

Environmental Conservation Law section 49-0307 provides,

> (1) A conservation easement held by a not-for-profit conservation organization may only be modified or extinguished:
>
> (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.

Of these three provisions, only (a) and (b) are relevant to the analysis of Treasury Regulation sections 1.170A-14(g)(6)(i) and (ii). Whether a conservation easement may be extinguished upon condemnation or exercise of the State's power of eminent domain is beyond the scope of the reasons for extinguishment addressed by Treasury Regulation section 1.170A-14(g)(6)(i) and (ii), which describe a subsequent unexpected change in conditions making the continued use of the property for conservation purposes impossible or impractical. In the case of condemnation or eminent domain, moreover, the owner of the eased property does not remain

[3] A "conservation easement" for purposes of the relevant provisions of the Environmental Conservation Law discussed herein means,

> an easement, covenant, restriction or other interest in real property, created under and subject to the provisions of this title which limits or restricts development, management or use of such real property for the purpose of preserving or maintaining the scenic, open, historic, archaeological, architectural, or natural condition, character, significance, or amenities of the real property.

the owner of the property after the judicial extinguishment of the easement and there would be no "subsequent" sale, exchange, or involuntary conversion addressed by the Regulations.

In contrast, New York State Real Property Actions and Proceedings Law section 1951, referenced in Environmental Conservation Law section 49-0307.1(b), corresponds to the circumstances addressed by Treasury Regulation section 1.170A-14(g)(6)(i). Section 1951 in general addresses the enforcement and extinguishment of restrictions on the use of land created by covenant, promise, or negative easement. Section 1951.2, addressing actions brought by the owner of the restricted property to have the restrictions extinguished or otherwise declared unenforceable, provides,

> When relief against such a restriction is sought in an action to quiet title or to obtain a declaration with respect to enforceability of the restriction or to determine an adverse claim arising from the restriction, or is sought by way of defense or counterclaim in an action to enforce the restriction or to obtain a declaration with respect to its enforceability, if the court shall find that the restriction is of no actual and substantial benefit to the persons seeking its enforcement or seeking a declaration or determination of its enforceability, either because the purpose of the restriction has already been accomplished, or, by reason of changed conditions or other cause, its purpose is not capable of being accomplished, or for any other reason, it may adjudge that the restriction is not enforceable by injunction or as provided in subsection 2 of section 1953 and that it shall be completely extinguished upon payment, to the person or persons who would otherwise be entitled to enforce it in the event of a breach at the time of the action, of such damages, if any, as such person or persons will sustain from the extinguishment of the restriction. (Emphasis added.)

In applying these provisions, New York courts have made payment to persons who would otherwise seek to enforce the restrictions on the property a pre-condition to extinguishment of the restrictions. See, *e.g.*, Wicks v. Pat Pallone Co., Inc., 48 Misc.2d 734, 741-42 (Sup. Ct. 1965), rev'd on other grounds, 29 A.D.2d 626 (App. Dev. 1967). See also Flynn v. N.Y., W. & B. Ry. Co., 218 N.Y. 140 (1916) (payment required to persons who sought

to enforce restrictive easements on land owned by railway.) Moreover, New York courts have held that the amount of damages that must be paid to the persons seeking enforcement of the restrictions under this section includes both current and potential future damages. Orange and Rockland Utilities, Inc. v. Philwold Estates, Inc., 52 N.Y.2d 253, 267 (N.Y. 1981) (citing the 1958 Report of the Law Revision Commission as background to enactment of the statute, the Court of Appeals concluded that section 1951.2 of the Real Property Actions and Proceedings Law contemplates payment of damages up to the time of trial and damages in the future).

Under the Conservation Easement Deed (Ex. 2-R), the Partnership agreed that in the event the easement were extinguished, the Trust (including its successors and assigns) would be entitled to receive a portion of the proceeds from a subsequent sale, exchange, or involuntary conversion of the Property, as required by Treasury Regulation section 1.170A-14(g)(6)(ii). Article IV.C provides,

> In the event this Easement is ever extinguished, whether through condemnation, judicial decree or otherwise, Grantor agrees on behalf of itself, its heirs, successors and assigns, that Grantee, or its successors and assigns, will be entitled to receive upon the subsequent sale, exchange or involuntary conversion of the Property, a portion of the proceeds from such sale, exchange or conversion, or (upon the release of the Property from this Easement as set forth below) a sum, equal to the same proportion that the value of the initial easement donation bore to the entire value of the property at the time of donation as estimated by a state licensed appraiser, unless controlling state law provides that the Grantor is entitled to the full proceeds in such situations, without regard to the Easement. Grantee agrees to use any proceeds so realized in a manner consistent with the conservation purposes of the original contribution.

The obligation on the Partnership created under Article IV.C satisfies the requirement in Treasury Regulation section 1.170A-14(g)(6)(ii) that, upon a change in conditions giving rise to the extinguishment of the easement by judicial proceeding, the Trust must be entitled to a portion of the proceeds from a subsequent sale, exchange, or involuntary conversion

of the Property based on the proportionate value of the easement relative to the value of the property "as a whole" at the time of the original contribution.

In fact, under New York law, the Trust would be paid at the time of and as a pre-condition to the extinguishment of the easement, and would not be required to wait for payment until there was a subsequent sale, exchange, or involuntary conversion of the Property. Since the measure of damages in such a judicial proceeding includes any future damages, Orange and Rockland Utilities, Inc. v. Philwold Estates, Inc., *supra,* a New York court would take the Trust's right to future payment into account under the Conservation Easement Deed and Treasury Regulation sections 1.170A-14(g)(6)(i) and (ii) in determining the amount of damages sustained by the Trust.

Environmental Conservation Law section 49-0307.1(a) also provides that a conservation easement could be modified or extinguished as provided in the instrument creating the easement. The only provision in the Conservation Easement Deed other than Article IV.C addressing extinguishment of the restrictions under the easement is Article IV.D, dealing with extinguishment in the event that all or substantially all of the Property has been damaged or destroyed by any casualty and where the restoration thereof shall be "economically imprudent." Article IV.D provides:

> In the event all or substantially all of the Property shall have been damaged or destroyed by any casualty and the restoration thereof shall be Economically Imprudent (defined below), Grantor shall have the right to extinguish and remove this Easement from the Property in accordance with applicable law, and Grantee (subject to paragraph C above and without any further requirements or agreement between the parties hereto except as provided herein) upon receipt of Grantor's request therefor, does hereby agree to promptly join and assist Grantor as necessary in any proceedings to effectuate such extinguishment, so as to provide Grantee's consent to, and support of, such release and removal of this Easement from the Property. The term "Economically Imprudent" shall mean that:

> (a) the cost to restore the Property to the specifications required by the Trust shall be materially in excess of the insurance proceeds that would be made available for restoration, or (b) the mortgagee shall elect to apply insurance proceeds so as to satisfy the debt; or (c) once reconstructed as per the aforementioned specifications, the Property is not economically viable in the then current market.

Article IV.D addresses a situation clearly within the scope of Real Property Actions and Proceedings Law section 1951.2, and does not provide a separate rationale for extinguishment of the restrictions under the Conservation Easement Deed. The courts in New York contemplate economic imprudence of enforcing the restrictions of an easement as a reason for extinguishment. See, *e.g.*, Orange and Rockland Utilities, Inc. v. Philwold Estates, Inc., *supra*, citing the 1958 Report of the Law Revision Commission, holding that extinguishment was appropriate under Real Property Actions and Proceedings Law section 1951.2 where enforcement would deprive the property owner of any economic benefit from the property).

Respondent argues in its Motion for Partial Summary Judgment that the requirement in Treasury Regulation section 1.170A-14(g)(6)(ii) that the Trust must be entitled to a share of the proceeds from a subsequent sale, exchange, or involuntary conversion of the property has not been satisfied because Transamerica Life Insurance and Annuity Company (including its assignees, "Transamerica") has a "prior claim" to casualty insurance proceeds under the "Lender Agreement." Respondent also notes that although the Lender Agreement is silent regarding condemnation proceeds, nevertheless, "under the Transamerica mortgage, the mortgagee has the right to condemnation proceeds." These observations by Respondent are interesting, but they do not support his assertion that the requirements of subsection (g)(6)(ii) have not been met.

Under the Lender Agreement (the next to last page of Ex. 2-R), Transamerica joined in the execution of the Conservation Easement Deed "for the sole and limited purpose of subordinating its rights in the Property to the right of the [Trust] . . . to enforce the conservation purposes of this easement in perpetuity," subject to certain conditions and stipulations. This subordination provision subordinates all the provisions of the mortgage that affect the Trust's rights under the easement, except the one item specifically reserved - i.e. the right under the terms of the mortgage to apply casualty insurance proceeds to pay the mortgage debt in the event the proceeds have not been used to repair the damage to the property. Specifically, paragraph (a) of the Lender Agreement, provides,

> (a) The Mortgagee/Lender 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.

Respondent's argument that the Trust might not be entitled to a share of condemnation proceeds because of provisions under the mortgage, notwithstanding that Transamerica asserted no prior claim to such proceeds under the Lender Agreement, is strained. First, a straightforward reading of the Lender Agreement indicates that Transamerica's failure to reserve a prior claim to proceeds from condemnation means that it, in fact, subordinated its interest in those proceeds to the rights of the Trust. The Lender Agreement clearly provides that Transamerica subordinated all of its rights in the Property to the Trust to enforce the conservation purposes of the Conservation Easement Deed, subject to the listed conditions and stipulations. By failing to reserve a prior claim to condemnation proceeds that it may have had under the mortgage as one of such listed conditions and stipulations, Transamerica subordinated its interest in those proceeds to the Trust.

Even assuming that the terms of the Lender Agreement and mortgage may mean under certain circumstances that the Trust would not receive any share of casualty insurance or condemnation proceeds, Respondent fails to take into account that under New York law, the Trust would be entitled to payment upon extinguishment of the easement and would not be entitled to be paid again upon a subsequent involuntary conversion. Treasury Regulation section 1.170A-14(g)(6)(ii) clearly contemplates an exception to the requirement that the Trust be entitled to a portion of the proceeds after the easement is extinguished if "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."

Petitioner acknowledges that there is a remote theoretical possibility that a New York court of law considering an action maintained by the Partnership under section 1951.2 of the Real Property Actions and Proceedings Law might order the easement to be extinguished without notifying the Trust of the action, and also the remote possibility that the Trust is notified of the action but fails to state a claim for the full amount of proceeds to which it is entitled under Article IV.C of the Conservation Easement Deed and Treasury Regulation section 1.170A-14(g)(6)(ii). In either event, Article IV.C of the Conservation Easement Deed (Ex. 2-R) entitling the Trust to a share of the proceeds from a subsequent sale, exchange, or involuntary conversion of the Property, creates a binding obligation against the Partnership that would entitle the Trust to a portion of the proceeds satisfying the requirement of Treasury Regulation section 1.170A-14(g)(6)(ii).

Respondent looks to the opinion of this Court in Kaufman v. Commissioner, 134 T.C. No. 9 (April 26, 2010) (Halpern, J.) in support of his reading of Treasury Regulation section 1.170A-14(g)(6)(i) and (ii). That case, addressing a façade easement contributed with respect to

a residence in Massachusetts, addressed whether the lender agreement executed by the mortgagee prior to the grant of a façade easement on the property securing the mortgage satisfied the requirement in Treasury Regulation section 1.170A-14(g)(6)(ii). The Court very broadly construed the language of the Regulation and determined that the subordination agreement "fail[ed] to satisfy the enforceability in perpetuity requirement" under Internal Revenue Code sections 170(h)(2)(C) and 170(h)(5)(A).

In Schultz v. Commissioner, Docket No. 24388-09 (Colvin, J.), this Court has been asked to reconsider its opinion in Kaufman and the Court's interpretation of Treasury Regulation sections 1.170A-14(g)(6)(i) and (ii) therein. Petitioner also understands that Respondent has filed a motion for summary judgment raising a "Kaufman" issue in other pending cases before the Court, including Wich v, Commissioner, Docket No. 11656-09 (Gale, J) and Hooper v. Commissioner, Docket No. 7929-09 (Gale, J.).

In Simmons v. Commissioner, T.C. Memo 2009-208, this Court previously held that the fact that a property was encumbered by a mortgage did not cause a conservation easement contributed with respect to such property to fail to preserve the donor's conservation purposes in perpetuity. The Court in Simmons addressed conservation easements contributed on two residential properties in the Washington, D.C. area. Both properties were encumbered by large mortgages at the time of contribution of the easements and both easements included similar lender agreements as addressed in Kaufman. The Court concluded that the conservations purposes were protected in perpetuity. Admittedly, the Court took into consideration only Treasury Regulation section 1.170A-14(g)(2) (requiring a mortgagee to subordinate its rights in the eased property to the right of the qualified organization to enforce the conservation purposes of the easement in perpetuity), and not section 1.170A-14(g)(6).

With all due respect, Petitioner requests that the Court's opinion in Kaufman should be reviewed, reconsidered and revised. First, the Court's opinion appears to suggest that Treasury Regulation section 1.170A-14(g)(6)(ii) entitles a donee organization to a share of casualty insurance or condemnation proceeds from the property even while the easement is still in existence. This is clearly an erroneous reading of Treasury Regulation sections 1.170A-14(g)(6)(i) and (ii). These provisions only address the proceeds from a sale, exchange, or involuntary conversion of property after the easement has already been extinguished by a judicial proceeding due to a subsequent unexpected change in conditions making the continued use of the property for preservation purposes impossible or impractical.

Second, the Court did not address whether the donor's binding obligation created under the conservation easement instrument satisfied the requirement in Treasury Regulation section 1.170A-14(g)(6)(ii) that the donee organization be "entitled to a portion of the proceeds" on a subsequent sale, exchange, or involuntary conversion of the property. The petitioner in Kaufman appears only to have argued that it was a question of fact whether the donee organization would be paid its proportionate share of future proceeds, and did not appear to assert that the donee organization's right to payment was protected in all cases by the donor's binding obligation to pay such proceeds to the qualified organization.

Third, Kaufman is distinguishable from the case at bar to the extent the Court addressed a façade easement granted with respect to a residence in Massachusetts and did not need to consider the interaction of New York State law and Treasury Regulation section 1.170A-14(g)(6).

In sum, the Conservation Easement Deed restricted the Partnership's use of the Façade in perpetuity and preserved the conservation purposes of the Partnership in perpetuity

notwithstanding that mortgagee retained a prior claim to casualty insurance proceeds under the Lender Agreement.

C. The Partnership's contribution of the façade easement to the Trust was a qualified conservation contribution, granted in perpetuity, notwithstanding that the Conservation Easement Deed provided that the Trust had the ability to consent to changes to the Façade or to abandon some or all of its rights thereunder.

Code section 170(h)(1)(A) provides that a "qualified conservation contribution" means a contribution--

(A) of a qualified real property interest,

(B) to a qualified organization,

(C) exclusively for conservation purposes.

Code section 170(h)(2)(C) provides that a qualified real property interest includes "a restriction (granted in perpetuity) on the use which may be made of the real property."

Code section 170(h)(5)(A) provides, "A contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity." (Emphasis added.)

By its terms, the easement granted by the Partnership to the Trust was in perpetuity and exclusively for conservation purposes. The Partnership reserved limited rights to make façade changes (consistent with the existing façade of the Property), and it agreed to an obligation to maintain the façade in accordance with the terms of the conservation easement. The Partnership's contribution was made to the Trust, which was organized for the very purpose of accepting such easements and enforcing them. The Trust was, and it still is, an organization recognized by the Commissioner of Internal Revenue as a qualified organization under Code section 501(c)(3) organized and operating for the purpose of preserving historic structures,

including façades of such structures. In support of Petitioner's objection to Respondent's Motion, Petitioner offers the Affidavit of Victoria McCormick, the Vice President of the Trust for Architectural Easements, confirming that the Trust fulfills its mandate to preserve and protect historic structures, and it does not agree to changes to easements that are inconsistent with that mandate. In view of the foregoing the Court should determine that the "requirements of this section that the contribution must be exclusively for conservation purposes" have been met.

The reservation by the Trust in its easement of the right to consent to changes to the Façade requested by the Partnership or to abandon some or all of the rights granted to it by the Conservation Easement, merely states explicitly a right that the Trust has even in the absence of such a provision in the easement. The Trust would only abandon an easement if its failure to do so would endanger its ability to continue to preserve historic structures. This might happen, for example, where due to dramatically changed circumstances its mere ownership of an easement might saddle the Trust with substantial financial burdens that threaten its very continued existence. The logical extension of Respondent's argument that the very existence of the right to abandon an easement or to consent to a change in an easement, rights that are inherent in the right of every organization to preserve its existence, is that no organization would satisfy the requirement of a qualified charitable organization and no easement affecting real property could ever qualify for a charitable deduction, a result that is clearly contrary to Congressional intent and to the intent expressed in the Treasury Regulations.

Further, Respondent's argument regarding changes to easements or abandoning them ignores the various provisions of the Regulations which recognize that the mere possibility of changes to the restricted property does not, in itself, violate the "in perpetuity" requirement. Under Treasury Regulation sections 1.170A-14(d) and (g), as discussed below, a conservation

easement is a "qualified real property interest" and will be treated as protecting a conservation purpose in perpetuity even if the donor were to reserve rights with respect to the property the exercise of which might impair the conservation interests associated with the property. The relevant Regulations require only that (1) in general, the grantor is subject to legally enforceable restrictions that will prevent uses of the property inconsistent with the conservation purposes of the donation; (2) the terms of the easement provide a right to the donee to enter the property for the purpose of inspecting the property to determine if there is compliance with the terms of the easement and the right to institute legal proceedings to enforce the terms of the easement agreement; and (3) for properties situated within a registered historic district, any future development of the property conforms with appropriate local, state, or Federal standards for construction or rehabilitation within such district.

Treasury Regulation 1.170A-14(g)(1) provides,

> *In general.*--In the case of any donation under this section, any interest in the property retained by the donor (and the donor's successors in interest) must be subject to legally enforceable restrictions (for example, by recordation in the land records of the jurisdiction in which the property is located) that will prevent uses of the retained interest inconsistent with the conservation purposes of the donation.

Treasury Regulation section 1.170A-14(g)(5)(i) provides,

> In the cases of a donation made after February 13, 1986, of any qualified real property interest when the donor reserves rights the exercise of which may impair the conservation interests associated with the property, for a deduction to be allowable under this section the donor must make available to the donee, prior to the time the donation is made, documentation sufficient to establish the condition of the property at the time of the gift. Such documentation is designed to protect the conservation interests associated with the property, which although protected in perpetuity by the easement, could be adversely affected by the exercise of the reserved rights. Such documentation may include . . .
>
> (D) On-site photographs taken at appropriate locations on the property.

In such cases where section 1.170A-14(g)(5)(i) applies, Treasury Regulation section 1.170A-14(g)(5)(ii) provides,

> In the case of any donation referred to in paragraph (g)(5)(i) of this section, the donor must agree to notify the donee, in writing, before exercising any reserved right, *e.g.*, the right to extract certain minerals which may have an adverse impact on the conservation interests associated with the qualified real property interest. The terms of the donation must provide a right of the donee to enter the property at reasonable times for the purpose of inspecting the property to determine if there is compliance with the terms of the donation. Additionally, the terms of the donation must provide a right of the donee to enforce the conservation restrictions by appropriate legal proceedings including, but not limited to, the right to require the restoration of the property to its condition at the time of the donation.

Under these Regulations, a conservation easement may still be treated as having been made exclusively for conservation purposes notwithstanding that the grantor continues to have development rights with respect to the restricted property, provided restrictions are in place to preserve the conservation purposes of the easement. *A fortiori*, where the grantor as in the Partnership's case retained no development rights, the mere fact that the Trust may consent to changes to the Façade should not mean that the easement was not contributed exclusively for conservation purposes.

Furthermore, in such cases where the donor retains the right to develop the property after contribution of a qualified real property interest, and the property is situated within a registered historic district, Treasury Regulation section 1.170A-14(d)(5)(i) provides that the contribution may, nevertheless, meet the conservation purposes test provided that any future development permissible under the easement is in conformity with Federal and local law standards. That section provides,

> The donation of a qualified real property interest to preserve an historically important land area or a certified historic structure will meet the conservation purposes test of this section. When restrictions to preserve a building or land area within a registered historic district permit future development on the site, a deduction will be allowed under this section only if the terms of the restrictions require that such development conform with appropriate local, state, or Federal standards for construction or rehabilitation within the district.

In Simmons v. Commissioner, T.C. Memo 2009-208, notice of appeal filed (D.C. Cir. Mar. 15, 2010), the Tax Court rejected respondent's argument that the conservation easements granted by the taxpayer in that case were not granted in perpetuity and exclusively for conservation purposes on account of the donee, L'Enfant Trust, Inc. having the right to consent to changes to the properties. The Court rejected respondent's argument, relying on Treasury Regulation section 1.170A-14(d)(5)(i):

> We agree with petitioner that the easements granted to L'Enfant are valid conservation easements. Although the grants do allow L'Enfant to consent to changes to the properties, the grants require any rehabilitative work or new construction on the facades to comply with the requirements of all applicable Federal, State, and local government laws and regulations. Section 1.170A-14(d)(5), Income Tax Regs., specifically allows a donation to satisfy the conservation purposes test even if future development is allowed, as long as that future development is subject to local, State, and Federal laws and regulations.

In the present case the Partnership made a contribution of a qualified real property interest when it contributed the façade easement with respect to the Property in perpetuity to the Trust, a qualified organization. (Ex. 2-R, Art. II.) The Partnership had photographs taken of the Façade's appearance as of the time of contribution for purposes of documenting the condition of the Façade at that time. These photographs, referred to in the Conservation Easement Deed as Exhibit B, were on file at the office of the Trust at the time of contribution. (Ex. 2-R, Art. I.F.) The Conservation Easement Deed indicates that the Partnership agreed to be subject to the Part

67 Rules of the Secretary of the Interior, i.e., the standards enforced by the Trust, with respect to any rehabilitation work or new construction work on the Façade. (Ex. 2-R, Arts. II.A, II.E.)

Notwithstanding that the Partnership retained the right to request to make changes to the Façade, and even to make limited changes without the Trust's consent, the Conservation Easement Deed imposed legally enforceable restrictions to prevent the use of the Property inconsistent with the Partnership's conservation purposes. The Conservation Easement Deed gave the Trust the right to periodically enter upon the Property to inspect the Façade for the purpose of determining compliance with the terms of the Conservation Easement Deed, and, in the event of a violation thereof, to institute legal proceedings to enjoin such violation by temporary or permanent injunction and to have the Façade restored to its prior condition. The Conservation Easement Deed also provided that in the event of a violation of the terms of the easement, the Trust itself was permitted to enter upon the Property and correct the violation, and to hold the Partnership responsible for the reasonable and necessary cost thereof. (Ex. 2-R, Art. III.A.) Article III.A of the Conservation Easement Deed provides:

> The Grantee, in order to ensure the effective enforcement of this Easement shall have, and the Grantor hereby grants it, the following rights:
>
> 1. at reasonable times and upon reasonable notice, the right to enter upon the Property and inspect the Façade and any improvement thereon;
>
> 2. in the event of a violation of this Easement and upon twenty (20) business days notice to the Grantor and upon an additional thirty (30) business days time to propose a plan to cure agreement to Grantee (subject to *force majeure):*

a. the right to institute legal proceedings to enjoin such violation by temporary, and/or permanent injunction, to require the restoration of the Façade, and open space, to its prior condition, to be reimbursed by Grantor for all reasonable costs and attorneys fees, and to avail itself of all other legal and equitable remedies;

b. the right (i) to enter upon the Property and the improvements thereon upon ten (10) days' notice in order to correct such violation and (ii) to hold Grantor responsible for the reasonable and necessary cost thereof; and

c. the right to place a lien against the Property to secure the payment of any of Grantor's obligations arising under this instrument.

The Property was not located within a registered historic district. Nevertheless, the Property had landmark status within New York City as designated by the New York City Landmarks Preservation Commission. In compliance with Treasury Regulation section 1.170A-14(d)(5)(i), the Partnership agreed that any changes it made, with or without the Trust's consent, would be made only to the extent consistent with the Secretary of the Interior's Part 67 Rules and Federal, state, and local law. (Ex. 2-R, Art. II.E.) Article II.E of the Conservation Easement Deed provides:

> Grantor agrees that any rehabilitation work or new construction work on the Façade, whether or not Grantee has given consent to undertake the same, will comply with the requirements of all applicable federal, state and local governmental laws and regulations. Without limiting the foregoing, Grantor's attention is directed to the Secretary of the Interior's Standards for Rehabilitating Historic Buildings, presently codified at 36 Code of Federal Regulations Part 67 (the "Part 67 Rules").

Notwithstanding that the Conservation Easement Deed is in compliance with all of the Treasury Regulations addressing permissible changes to the Property, including Treasury Regulation sections 1.170A-14(g)(1), 1.170A-14(g)(5), and 1.170A-14(d)(5)(i), Respondent

asserts in his Motion for Partial Summary Judgment that the restrictions imposed by the Conservation Easement Deed were not granted in perpetuity and that the Partnership's conservation purposes were not protected in perpetuity insofar as the Trust might choose not to enforce the terms of the Conservation Easement Deed. Respondent's argument is not relevant to the allowance of a deduction to the Partnership for a qualified conservation contribution. The relevant requirements under the Code and Treasury Regulations that the conservation purposes be protected in perpetuity were satisfied at the time of the contribution by the fact that the Partnership's use of the Property was subject to legally enforceable restrictions preventing uses of the Property inconsistent with the Trust's conservation purposes: namely, the Partnership provided the Trust under the Conservation Easement Deed with the right to periodically inspect the property for the purpose of determining compliance with the terms of the Conservation Easement Deed and with the right to institute legal proceedings to enjoin violations of the terms of the easement by temporary or permanent injunction and to have the Façade restored to its prior condition, or otherwise to cure such violations itself with the reasonable and necessary cost thereof to be borne by the Partnership. Moreover, the Partnership agreed at the time of contribution of the façade easement that any changes it made, with or without the Trust's consent, would be made in conformity with appropriate local, state, or Federal standards for construction or rehabilitation, including the Part 67 Rules of the Secretary of the Interior.

Respondent makes much of the provision in Article IV.B that the Trust had the ability to "abandon some or all of its rights hereunder." The reference comes at the end of Article IV.B (Ex. 2-R) addressing the transfer or assignment of the easement:

> Grantee covenants and agrees that it will not transfer, assign or otherwise convey its rights under this Easement except to another "qualified organization" described in Section 170(h)(3) of the Internal Revenue Code

> of 1986 and controlling Treasury Regulations, that agrees, as part of such transfer, to continue to implement the Grantor's intended conservation purposes, provided, however, that nothing herein contained shall be construed to limit the Grantee's right to give its consent (e.g., to changes in a principal exterior of the Façade) or to abandon some or all of its rights hereunder.

Respondent would read this provision as allowing the Trust to forego its rights and obligations under the Conservation Easement Deed (Ex. 2-R) for any reason or no reason. A more appropriate reading is to read the provision narrowly as a reference to Article IV.D of the Conservation Easement Deed wherein the Trust agrees to assist the Partnership in having the easement extinguished if the Property has been destroyed and restoring the Property would be "economically imprudent."

Article IV.D of the Conservation Easement Deed (Ex. 2-R) provides:

> In the event all or substantially all of the Property shall have been damaged or destroyed by any casualty and the restoration thereof shall be Economically Imprudent (defined below), Grantor shall have the right to extinguish and remove this Easement from the Property in accordance with applicable law, and Grantee (subject to paragraph C above and without any further requirements or agreement between the parties hereto except as provided herein) upon receipt of Grantor's request therefor, does hereby agree to promptly join and assist Grantor as necessary in any proceedings to effectuate such extinguishment, so as to provide Grantee's consent to, and support of, such release and removal of this Easement from the Property. The term "Economically Imprudent" shall mean that: (a) the cost to restore the Property to the specifications required by the Trust shall be materially in excess of the insurance proceeds that would be made available for restoration, or (b) the mortgagee shall elect to apply insurance proceeds so as to satisfy the debt; or (c) once reconstructed as per the aforementioned specifications, the Property is not economically viable in the then current market.

The provision in Article IV.B of the Conservation Easement Deed (Ex. 2-R) appears to be a narrow exception to the general covenant and agreement by the Trust that it would not transfer, assign, or convey its rights under the easement except to another qualified

organization. The fact that the Trust also agreed to join and assist the Partnership in extinguishing the easement on account of a "subsequent unexpected change in the conditions of the" Property is a situation clearly contemplated by Treasury Regulation section 1.170A-14(g)(6). See Part B, above.

In sum, the Partnership's contribution of the façade easement to the Trust was a qualified conservation contribution, granted in perpetuity, notwithstanding that the Trust had the ability to consent to changes to the Façade requested by the Partnership or to abandon some or all of its rights under the Conservation Easement Deed.

D. The Conservation Easement granted to the Trust by the Partnership was properly recorded in the New York County Clerk's Office and is binding on the Partnership and on all subsequent purchasers or owners of the Property.

Section 49-0305.4 of the New York State Environmental Conservation Law provides in relevant part,

> A conservation easement shall be duly recorded and indexed as such in the office of the recording officer for the county or counties where the land is situate in the manner prescribed by article nine of the real property law. The easement shall describe the property encumbered by the easement by adequate legal description or by reference to a recoded map showing its boundaries and bearing the seal and signature of a licensed land surveyor.

Section 291 of Article 9 of New York Real Property Law provides that a conveyance of real property be recorded in the office of the clerk of the county where such real property is situated and that it be "duly acknowledged by the person executing the same, or proved as required by this chapter."

These requirements were satisfied by the recording of a duly acknowledged Conservation Easement Deed with the Office of the City Register of the City of New York, a copy of which is Exhibit 2-R to the Declaration of Curt M. Rubin. Schedule A (Legal

Description)[4] of the Conservation Easement Deed is a legal description of the Property by metes and bounds, in satisfaction of section 49-0305.4 of the New York State Environmental Conservation Law which requires only that the easement describe the "property encumbered by the easement," as opposed to the easement itself. Furthermore, Article I.F of the Conservation Easement Deed (Ex. 2-R) defined the Façade in considerable detail, as follows:

> The term "Façade" as used herein consists of all exterior surfaces of the improvements on the Property, including all walls, roofs, and chimneys (the existing improvements at the Property hereinafter sometimes referred to as the "Building"), except for apart of the southern façade of the Building up to and including 24th Floor of the Building, to the extent such southern façade is attached to and obstructed from the public view by the northern wall of the adjacent building located on the southern side of the Building, which part of the southern façade is expressly excluded from the grant of this Easement. It is the intent of the parties that the Façade visible from the outside of the Building as follows: (i) all of the exterior surfaces of the tower of the Building (25th Floor of the Building and above) (the "Tower"), and (ii) the northern, eastern and western parts of the Façade of the base of the Building up and including the 24th Floor of the Building below the Tower, remains essentially unchanged and in full public view. Written descriptions and photographs of the Façade 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.

Respondent argues that the restrictions imposed by the Conservation Easement Deed are not binding upon subsequent purchasers of the Property for value because "the grantor and grantee in the present case purposely failed to attach the description and photographs (Exhibit B) that control in case of ambiguity" and therefore the Conservation Easement Deed "does not protect the conservation purpose of preserving the façade 'in perpetuity.'" Respondent relies on New York Real Property Law section 291-e and the case of L. C. Stroh & Sons, Inc. v. Batvia Homes & Development Corp., 17 A.D.2d 385 (App. Div. 1962), for support. Neither authority, however, supports Respondent's argument.

[4] Schedule A (Legal Description) of the Conservation Easement Deed follows page 9 of Exhibit 2-R.

New York Real Property Law section 291-e is relevant where a recorded conveyance includes a reference to an unrecorded conveyance or contract involving all or any part of the same property, and where the recorded conveyance "fails to identify the premises previously conveyed or contracted to be sold or exchanged in any other manner than by indicating that a conveyance or contract has previously been made or indicating the fact or possibility that one or more conveyances or contracts have been or may have been previously made." Thus, for instance, in L. C. Stroh & Sons, Inc. v. Batvia Homes & Development Corp., 17 A.D.2d 385 (App. Div. 1962), the Appellate Division of the Supreme Court of New York held that the reference to an unrecorded contract contained in a prior conveyance in the chain of title did not render title unmarketable, where the prior conveyance included only the following recital: "Subject to the terms of an unrecorded contract made by and between Jessie W. Allen and Walter and Albert Stroh."

The note of the Law Revision Commission involved in the enactment of section 291-e provides that the purpose of the section---

> is to remove clouds on title arising from certain indefinite references, contained in conveyances of land and indicating that a previous conveyance or contract for sale has been made or may have been made, where the conveyance or contract so referred to is unrecorded. It makes any exception or reservation with respect to premises that are identified solely by reference to a previous conveyance or contract void as against a subsequent purchaser for value in good faith and without other notice of the identity of the premises referred to.

N.Y. Legis. Doc., 1960, No. 65(E), p. 175 (cited in L. C. Stroh & Sons, Inc. v. Batvia Homes & Development Corp., *supra*).

Respondent's reliance on the Tax Court's decision in Herman v. Commissioner, T.C. Memo 2009-205, is inappropriate. The taxpayer in that case contributed a portion of his development air rights above a New York City apartment building. The taxpayer argued that

certain drawings included in the appraisal report and referred to in a recital in a Restrictive Covenant recorded with the Office of the City Register of the City of New York limited a bona fide purchaser's permissible development of the apartment building to three additional, equal-level stories. Respondent argued that other development was permissible, for instance, six additional stories over the front half of the building, and that the drawings did not impose any such limitation as the taxpayer suggested. The appraisal report, of which the drawings were a part, was not recorded with the Restrictive Covenant. The Tax Court noted that even assuming, arguendo, that the drawings were incorporated in the Restrictive Covenant by reference, nevertheless, citing Real Property Law section 291-e, the limitations imposed by the unrecorded drawings would not survive the sale of the remaining development rights to a bona fide purchaser.

In the present case, Exhibit B, which was not recorded in the County Clerk's Office for some unknown reason, is merely an elaboration of the description of the Property in Schedule A (Legal Description) of the recorded easement that is encumbered by the façade easement. Exhibit B does not effectuate an additional conveyance of a real property interest that would need to be recorded in order to be binding upon subsequent purchasers for value. A copy of Exhibit B is attached as Exhibit 6-P to the Declaration of Richard A. Levine filed in support of Petitioner's Objection to Respondent's Motion.

The Conservation Easement Deed is binding upon future bona fide purchasers of the Property for value notwithstanding that Exhibit A thereto was not recorded.

E. In light of the Lender Agreement in this case, and the other facts and circumstances, the possibility of the Trust not receiving the amount required by the Regulations where there has been an extinguishment of the easement is so remote as to be negligible.

Even if the Court adopts Respondent's reading of Treasury Regulation sections 1.170A-14(g)(6)(i) and (ii), the Lender Agreement, and the underlying mortgage to mean that under certain circumstances the Trust might not receive a proportionate part of the proceeds of a subsequent involuntary conversion of the Property under the circumstances to which Treasury Regulations sections 1.170A-14(g)(6)(i) and (ii) apply, Petitioner respectfully submits that the possibility that the Lender Agreement defeats the Trust's interest in the proceeds is so remote as to be negligible.

Treasury Regulation section 1.170A-14(g)(3) provides,

> A deduction shall not be disallowed under section 170(f)(3)(B)(iii) and this section merely because the interest which passes to, or is vested in, the donee organization may be defeated by the performance of some act or the happening of some event, if on the date of the gift it appears that the possibility that such act or event will occur is so remote as to be negligible. See paragraph (e) of § 1.170A-1.[5] For example, a state's statutory requirement that use restrictions must be rerecorded every 30 years to remain enforceable shall not, by itself, render an easement not perpetual.

The following events would all need to occur to defeat the Trust's interest in insurance proceeds under the circumstances to which Treasury Regulations sections 1.170A-14(g)(6)(i) and (ii), apply:

[5] Treasury Regulation section 1.170A-1(e) provides, in relevant part, "If an interest in property passes to, or is vested in, charity on the date of the gift and the interest would be defeated by the subsequent performance of some act or the happening of some event, the possibility or occurrence of which appears on the date of the gift to be so remote as to be negligible, the deduction is allowable."

1. a subsequent, unexpected change in the conditions surrounding the Property makes impossible or impractical the continued use of the Property for conservation purposes; and
2. the owner of the Property successfully petitions a New York court to have the restrictions under the Conservation Easement Deed extinguished in a judicial proceeding; and
3. the Trust is not paid its "proportionate value" in such judicial proceeding extinguishing the restrictions under the Conservation Easement Deed; and
4. after the easement has been extinguished, all or substantially all of the Property is damaged or destroyed in a casualty event; and
5. at the time of the involuntary conversion event in paragraph 3, the Property is still encumbered by its original mortgage; and
6. the amount of the proceeds received from the involuntary conversion event is insufficient to cover both the mortgagee's claim to such proceeds under the Lender Agreement and the Trust's interest in such proceeds under Treasury Regulation section 1.170A-14(g)(6)(i) and (ii).

In Stotler v. Commissioner, T.C. Memo 1987-275, this Court addressed whether a conservation and scenic easement with respect to real property conveyed to the county in which the property was located was granted in perpetuity where the conservation deed provided that the easement would terminate as of the time of the filing of any complaint in condemnation as to the land or any portion thereof. Respondent argued that the possibility of the land being condemned was an issue of fact creating a possibility not so remote as to be negligible that that the county's interest in the land under the easement would be defeated under Treasury Regulation section

1.170A-1(e). The Court rejected Respondent's interpretation of that Regulation and held that the mere possibility of condemnation did not result in a disallowance of the taxpayer's charitable deduction.

Petitioner submits that, *a priori*, the possibility of any and all of these events occurring to defeat the Trust's interest in the casualty insurance proceeds from a subsequent involuntary conversion of the Property is remote within meaning of Treasury Regulation section 1.170A-14(g)(3). If the Court disagrees that this concatenation of events is remote, then Petitioner submits that this raises questions of fact to be decided after a trial.

F. Conclusion

WHEREFORE, Petitioner respectfully requests that the Court enter an order denying Respondent's Motion for Partial Summary Judgment.

Petitioner respectfully requests a hearing in Washington, D.C. before the trial on Respondent's Motion for Partial Summary Judgment.

Respectfully submitted,

Date: August ___, 2010

_____

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