"Rebuilding the Façade's Appeal"– Conservation Easement Valuation

By Frank Agostino and Eduardo S. Chung

Frank Agostino and Eduardo S. Chung examine Tax Court and Appellate Court decisions dealing with the donation of a conservation easement to a not-for-profit organization.

On July 19, 2012, the U.S. Court of Appeals for the First Circuit reversed the Tax Court decision in the matter of *Kaufman*.[1] The First Circuit's *Kaufman* opinion is now the third appeals court opinion involving a façade easement donation in the last two years. Consistent with the Second and D.C. Circuits, the First Circuit rejected the IRS's scorched-earth litigation strategy and affirmed what the majority of courts had held for the prior two decades: the only issue genuinely in dispute in a conservation easement donation case is the value of the contributed easement.[2]

Although the IRS had examined numerous façade easement contributions during the late 1980s and early 1990s, historically the government's attack and the resulting adjustments related to the valuation of the easements.[3] In the late 2000s, however, the government adopted a scorched-earth strategy seemingly designed to dissuade taxpayers from making easement donations and not-for-profit organizations from accepting them. Thus, the IRS routinely disallows qualified conservation contribution deductions based on any and all alleged defects in the donation process, no matter how technical. Also, unlike the earlier government attacks, the IRS has generally refused to discuss settlements that give the easement any value at all.

With the exception of Judge Goeke's opinion in *Simmons,*[4] the Tax Court judges deciding preservation easement cases have supported the government's decision to deny taxpayers all of their charitable contribution deductions.[5] By contrast, all of the Appellate Courts that have decided appeals from the Tax Court have rejected the IRS's litigation strategy and the Tax Court's apparent unwillingness to tackle the real issue—the value of the façade easement donated by the taxpayer to the charity.[6] This article discusses in chronological order three appellate decisions and the Tax Court opinions preceding the appeals.

Common Fact Patterns

The general facts for these donations are remarkably similar.[7] Although each of the cases tried has its idiosyncrasies and the order of the events may be different, the relevant facts are as follows:

A taxpayer is approached regarding the possibility of donating a restrictive easement to a not-for-profit organization. The not-for-profit specifically mentions the potential tax benefits of making such a donation. The taxpayer decides to restrict their property and take advantage of the deduction, and then approach-

Frank Agostino is the Principal at Agostino and Associates, PC in Hackensack, New Jersey.

Eduardo S. Chung is an associate at Agostino and Associates, PC in Hackensack, New Jersey.

es the organization about making the donation. The organization guides the taxpayer through the whole donation process beginning with the application. The organization advises the taxpayer that they will need to obtain an appraisal to determine the value of the easement and sometimes provides a list of appraisers to the taxpayer.

The taxpayer typically contacts one of the appraisers on the list provided and requests an appraisal of the easement. The appraiser determines the value of the easement by applying a percentage to the fair-market value of the property before the easement is donated. Generally, the percentage used is between 10 and 15 percent based on the appraiser's reliance on court cases and an IRS publication that stated, "Internal Revenue Service engineers have concluded that the proper valuation of a façade easement should range from approximately 10 to 15 percent of the value of the property."[8]

The taxpayer executes the easement, sometimes called a "Conservation Deed" or "Preservation Restriction Agreement," thereby restricting his ability to change the exterior façade(s) of the property without the permission of the easement holding organization. To the extent that there are any mortgages encumbering the property at the time of donation, the not-for-profit organization requests that a representative of the financial institution execute an attachment to the easement, usually called a "Lender Agreement." The Lender Agreement contains a provision stating the following:

> 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 is paid off and discharged, notwithstanding that the Mortgage is subordinate in priority to the [Preservation Restriction] Agreement.[9]

The Lender Agreement is attached to the easement and the entire document is submitted for recording in the appropriate land records office.

At the time the taxpayer submits an application to donate the easement, the taxpayer also agrees to make a cash donation to the not-for-profit organization, which is often equal to a certain percentage of the easement value. The organization explains that the cash payment is necessary to fund current charitable operations and the perpetual enforcement of the easement (typically accomplished through annual monitoring and consideration of donor requests to make changes or repairs to the façade). Concurrent with returning the executed easement to the not-for-profit organization, the taxpayer submits the cash donation per the organization's instructions. The charity receives the cash payment and sends the taxpayer an acknowledgment letter. The letter also encloses an appraisal summary (Form 8283) executed by a representative of the not-for-profit and the appraiser, which serves to substantiate the value of the easement donation.

Perpetuity Requirements

Code Sec. 170(h)(2) and (h)(5)(A) require that a conservation easement donation be made in perpetuity. Reg. §1.170A-14(g) defines in more detail how a donation is made "enforceable in perpetuity." The regulation requires that the donation be subject to legally enforceable restrictions that will protect the conservation purpose of the easement and suggests recording of the easement as an example. In addition, the regulation provides further guidance for mortgaged properties. Of particular note to easement cases, subsections (g)(2) and (g)(6) provide that:

> (2) Protection of a conservation purpose in case of donation of property subject to a mortgage. * * * no deduction will be permitted under this section for an interest in property which is subject to a mortgage unless the mortgagee subordinates its rights in the property to the right of the qualified organization to enforce the conservation purposes of the gift in perpetuity...
>
> * * * *
>
> (6) Extinguishment. (i) In general. 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. (ii) Proceeds. * * * at the time of the gift the donor must agree that the donation of the perpetual conservation restriction gives rise to a property right, immediately vested in the donee organization, with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction at the time of the gift, bears to the value of the property as a whole at that time. * * * Accordingly, when a change in conditions give rise to the extinguishment of a perpetual conservation restriction under paragraph (g) (6)(i) of this section, the donee organization, on a subsequent sale, exchange, or involuntary conversion of the subject property, must be entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction, 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.

Qualified Appraisal Requirements

Reg. §1.170A-13(c)(2) requires any deductions in excess of $5,000 to be supported by a qualified appraisal. A qualified appraisal, in turn, is supposed to include the following information:

(A) A description of the property in sufficient detail for a person who is not generally familiar with the type of property to ascertain that the property that was appraised is the property that was (or will be) contributed;
(B) In the case of tangible property, the physical condition of the property;
(C) The date (or expected date) of contribution to the donee;
(D) The terms of any agreement or understanding entered into (or expected to be entered into) by or on behalf of the donor or donee that relates to the use, sale, or other disposition of the property contributed, including, for example, the terms of any agreement or understanding that—
  (1) Restricts temporarily or permanently a donee's right to use or dispose of the donated property,
  (2) Reserves to, or confers upon, anyone (other than a donee organization or an organization participating with a donee organization in cooperative fundraising) any right to the income from the contributed property or to the possession of the property, including the right to vote donated securities, to acquire the property by purchase or otherwise, or to designate the person having such income, possession, or right to acquire, or
  (3) Earmarks donated property for a particular use;
(E) The name, address, and (if a taxpayer identification number is otherwise required by section 6109 and the regulations thereunder) the identifying number of the qualified appraiser; and, if the qualified appraiser is acting in his or her capacity as a partner in a partnership, an employee of any person (whether an individual, corporation, or partnerships), or an independent contractor engaged by a person other than the donor, the name, address, and taxpayer identification number (if a number is otherwise required by section 6109 and the regulations thereunder) of the partnership or the person who employs or engages the qualified appraiser;
(F) The qualifications of the qualified appraiser who signs the appraisal, including the appraiser's background, experience, education, and membership, if any, in professional appraisal associations;
(G) A statement that the appraisal was prepared for income tax purposes;
(H) The date (or dates) on which the property was appraised;
(I) The appraised fair market value (within the meaning of §1.170A–1 (c)(2)) of the property on the date (or expected date) of contribution;
(J) The method of valuation used to determine the fair market value, such as the income approach, the market-data approach, and the replacement cost-less-depreciation approach; and
(K) The specific basis for the valuation, such as specific comparable sales transactions or statistical sampling, including a justification for using sampling and an explanation of the sampling procedure employed.[10]

Simmons

The first case in this round of cases to reach trial was that of Dorothy Jean Simmons. In *Simmons*,[11] Judge Goeke addressed and rejected many of the government's technical (*i.e.,* non-valuation) attacks on façade easement donations.

In *Simmons*, the IRS argued that Ms. Simmons' easements did not meet the "conservation purpose"

and perpetuity requirements of Code Sec. 170 and Reg. §1.170A-14(g). Additionally, the government claimed the taxpayer did not substantiate her donations with qualified appraisals, as required under Reg. §1.170A-13(c)(2). Finally, the government argued, even if it was determined that the taxpayer's appraisals were qualified appraisals, their determinations of value were not credible.

Conservation Deed

In *Simmons*, the government gave two reasons for its contention that Ms. Simmons did not make her donations in "perpetuity." First, the government argued that the Conservation Deeds did not contain enough language prescribing the organization's enforcement of the easements. Accordingly, the IRS contended that the easement holding organization was free to consent to inappropriate changes to the protected façades despite the stated conservation purpose of the easements, positing that the organization might neglect or abandon its obligations (*i.e.,* not protect the properties in perpetuity). Second, the government also argued that the lender agreements did not expressly identify the easements and, therefore, did not meet the subordination requirements of Reg. §1.170A-14(g)(2).[12]

Based on its plain language interpretation of the documents, the Tax Court rejected both of the government's arguments. As to the first contention, Judge Goeke explained that the plain language of the Conservation Deed required that any rehabilitative work or new construction on the protected façades comply with the requirements of all applicable federal, state, and local government laws and regulations.[13] With respect to subordination, the Court stated that the Lender Agreements specifically included language subordinating the rights of the mortgage holders to the conservation purposes of the easements in perpetuity and attached descriptions of the parcels as exhibits.[14]

Qualified Appraisal

In *Simmons*, the IRS argued that requirements (A), (C), (G), (J) and (K) of Reg. §1.170A-13(c)(3)(ii) were not met. The court disagreed. The Tax Court summarily rejected the government's argument concerning requirements (A), (J) and (K) stating, the "appraisals[15] adequately describe the parcels of land owned by petitioner and the structures built thereon. The appraisals also contain lengthy discussions of historic preservation easements in general. In addition, the appraisals contain statistics gathered by [the easement holder] and the [easement processor] that [the appraiser] took into account in preparing the appraisals."[16]

The Court also found that Ms. Simmons satisfied subsections (C) and (G) of Reg. §1.170A-13(c)(3)(ii). The court found that the Forms 8283 contained the date the easements were donated and when it was received. Finally, the court explained that "[a]lthough the appraisals did not contain an explicit statement that they were prepared for income tax purposes, the appraisals did contain statements that the owner of the parcels (petitioner) was contemplating donating conservation easements to L'Enfant. The appraisals also include discussions of IRS practice and cases of this Court concerning façade easements."[17]

Valuation

Judge Goeke explained that there are certain principles that are universally applicable to the valuation of façade easements. Foremost, there is no established market for determining the fair market value of an easement.[18] Therefore, the generally accepted method for valuing easements is the before and after approach (*i.e.,* the difference in the price of the property before and after the encumbrance).[19] Both of the experts in *Simmons* alleged to have applied the before and after method.[20]

With regard to the before values, aside from the impact on value of the parcels' views, the appraisers did not have any major disagreements and the Tax Court, therefore, found the taxpayer's before valuations to be reasonable. The properties' values after being encumbered with easements were the major point of contention.

The Commissioner's appraiser reasoned that the properties were already subject to the local preservation laws of Washington, DC. Further, the IRS' appraiser determined that the easements did not modify the highest and best use of the properties and that the restrictions of the easements were superfluous. The Tax Court disagreed with the Commissioner. The Tax Court found a higher level of enforcement of the restrictions by the easement holder. In addition, the court reasoned that, even if the easements' restrictions were duplicative of local preservation laws, at a minimum the easements require the donor to obtain an additional set of approvals for any exterior work. The Tax Court, however, did not agree with the taxpayer's easement values and reduced the deductions[21] to five percent of the unencumbered value of the properties.

After *Simmons*

Remarkably, *Simmons* did not result in settlements or in any way affect the Commissioner's litigation strategy. On the contrary, the IRS redoubled its efforts and advanced modified or additional grounds for disallowing taxpayers' façade easement donations. Taking the kitchen sink approach, the Commissioner attacked every step in the donation process. In addition, the Commissioner began attacking the validity of the cash donations to easement holding organizations and asserted the application of penalties wherever possible. The government's scorched-earth tactics resulted in two major Tax Court decisions, *Kaufman*[22] and *Scheidelman*.[23]

Kaufman I

On April 26, 2010, Judge Halpern unexpectedly granted a motion for partial summary judgment for the government in *Kaufman*.[24] In *Kaufman I*, the IRS modified its perpetuity argument and concentrated on the Lender Agreement and Reg. §1.170A-14(g)(6)(ii) instead of Reg. §1.170A-14(g)(2). The Tax Court accepted the government's argument that the Lender Agreement created a priority in extinguishment proceeds for the lender over the easement holder in violation of Reg. §1.170A-(g)(6). Therefore, the Tax Court held that the donation did not meet the perpetuity requirements of the regulations.

Scheidelman

Shortly after the government's motion for partial summary judgment was granted in *Kaufman I*, the Tax Court decided *Scheidelman*.[25] Oddly, instead of relying on *Kaufman I*, Judge Cohen decided to revisit many of the issues decided by Judge Goeke in *Simmons* and, in contradiction with *Simmons,* denied Ms. Scheidelman's charitable donation deductions.

Scheidelman was unprecedented but for the Tax Court's approach in disallowing the penalties.[26] First, the Tax Court held that taxpayer must include the date and manner of acquisition of the property contributed or its adjusted cost basis on a single Form 8283 and not include that information as an attachment to the Form 8283.[27] Second, the Tax Court separated requirements (J) and (K) from the remainder of the qualified appraisal regulations, holding that they are not subject to the doctrine of substantial compliance. Third, the Tax Court held that the qualified appraisal regulations require a "reliable" and "meaningful" methodology. Fourth, the Tax Court disallowed the taxpayer's cash donation, which most interpreted to mean that the easement holding organizations' practice of requiring cash donations was prohibited.[28]

Kaufman II

On April 4, 2011, after the trial of the remaining issues in *Kaufman I*, the Tax Court reconsidered its determination in *Kaufman II*.[29] With respect to the extinguishment proceeds issue, the Judge Halpern clearly stated that the decision was affirmed.

On the other hand, with respect to the taxpayer's cash contribution, Judge Halpern implicitly rejected *Scheidelman*.[30] Specifically, the Tax Court explained that the services the Commissioner alleged were provided by the donee organization in exchange for the cash payment were not for the benefit of taxpayers and, therefore, denied the Commissioner's disallowance of the cash donation. The court claimed that the different results between *Scheidelman* and *Kaufman II* with respect to the cash contribution was due to the burden of proof being on the Commissioner in the latter case. The remaining issues were generally decided in favor of the taxpayers.[31]

The Court of Appeals' Review–It's All About Valuation

The decisions in *Kaufman I, Kaufman II* and *Scheidelman* emboldened the IRS. Although the IRS failed to win penalties, it was clear that the Tax Court had acquiesced to the government's litigation strategy to avoid, at all costs, the valuation of the façade easement donation.[32] Under these circumstances, the decisions in *Simmons, Kaufman II* and *Scheidelman* were appealed to three different Circuit Courts (*i.e.,* the District of Columbia, First and Second Circuits, respectively). The Commissioner appealed *Simmons,* and the taxpayers appealed *Scheidelman* and *Kaufman II.* Regardless of the appealing party, all three Circuits decided in favor of the taxpayers.

Simmons Appeal (*Simmons II*)

The first appellate decision was *Simmons II*. On June 21, 2011, the U.S. Court of Appeals for the District of Columbia Circuit affirmed the Tax Court's decision.[33] The D.C. Circuit's opinion was relatively brief, but clearly supported the taxpayer's litigation of façade easement donations.

With respect to the government's allegation that the easement donations failed to meet Code Sec. 170(h)(5)(A), in addition to affirming the Tax Court's

arguments, the D.C. Circuit noted that the Conservation Deeds protect the conservation purpose in perpetuity through the provision that the easements be transferred to another preservation organization.[34]

With respect to the government's abandonment argument, the D.C. Circuit accepted the easement holder's explanation that "this type of clause is needed to allow a charitable organization that holds a conservation easement to accommodate such change as may become necessary 'to make a building livable or usable for future generations' while still ensuring the change is consistent with the conservation purpose of the easement."[35] In addition, the Court of Appeals found that the government had failed to establish that the likelihood of abandonment was more than negligible.[36]

Finally, with respect to qualified appraisal requirements (J) and (K) relating to methodology and basis, the D.C. Circuit found that, although the appraiser could have been more detailed, the Tax Court did not clearly err in its determination.[37]

Scheidelman Appeal (*Scheidelman II*)

On June 15, 2012, approximately a year after *Simmons II*, the Second Circuit decided *Scheidelman II*.[38] The Second Circuit reversed the Tax Court's findings and remanded the case for further proceedings.

The Second Circuit first addressed whether the petitioner's appraisal met the requirements of subsections (J) and (K) of the regulations. The appellate court explained that, contrary to the Tax Court's finding, the appraiser "did in fact explain at some length how he arrived at his numbers."[39] In reaching this decision, the Court of Appeals resoundingly denied the government's argument that an unreliable method is no method at all.[40] In addition, the Second Circuit determined that the appraisal had identified its specific basis for the valuation, which included IRS publications, prior court decisions, the appraiser's past experience, and the location of the house in the regulatory environment of New York City.[41]

The Second Circuit further held that denying the taxpayer's easement deduction for providing some information on an attachment to the Form 8283, instead of on the face of the original Form 8283, constituted a hyper-technical argument that should be excused based on substantial compliance and/or reasonable cause.[42]

With respect to the other major issue at play, the taxpayer's cash donation, the Second Circuit also reversed the Tax Court's decision and awarded the taxpayer her charitable deduction.[43] The Court of Appeals specifically held that the required cash donation was used to monitor the easement and, hence, the taxpayer obtained no benefit except a charitable deduction.[44]

The Second Circuit's analysis as to the purpose of a qualified appraisal and the deductibility of cash donation gave hope to both easement donors and easement holding organizations. The Tax Court opinions in *Simmons* and *Scheidelman* had been irreconcilable because the appraisal reports in *Simmons* and *Scheidelman* were practically identical.[45] The facts surrounding the donations in *Kaufman II* and *Scheidelman* were, for all intents and purposes, identical.[46] The Second Circuit's resolution of these two issues in the taxpayer's favor in *Scheidelman II* suggested that the opportunity for consensual resolutions was on the horizon.

Kaufman Appeal (*Kaufman III*)

Kaufman III was perhaps the most anticipated of the façade easement donation appeals.[47] Despite the critical reaction of easement donors and historic preservation organizations to the opinion in *Kaufman I,* by the time the appeal of *Kaufman II* was decided, the IRS' arguments were gaining traction amongst some scholars.[48] The First Circuit, however, did not side with the latter and reversed the Tax Court's determination.

The First Circuit decided the appeal on July 19, 2012. After discussing the facts of the case, the First Circuit immediately rejected Judge Halpern's interpretation, in connection with the lender's entitlement to extinguishment proceeds, of the term "entitled" under Reg. §1.170A-14(g)(6) to mean "guaranteed" in favor of the plain language interpretation.[49] The First Circuit reviewed legal dictionaries to demonstrate that "entitled" did not relate to priority.[50] The Court of Appeals, then, explained that to adopt the Tax Court's definition of entitled—especially in light of the super priority of tax liens—"would appear to doom practically all donations of easements, which is surely contrary to the purpose of Congress."[51]

The Court also made clear that it relied neither on arguments regarding section (g)(2) nor (g)(3).[52] In this way, the First Circuit denied the Commissioner's argument that the regulations require a super priority in proceeds.

After addressing the main issue, the appellate court addressed the Commissioner's alternate grounds for denying the taxpayers' deduction. For the most part, the First Circuit rejected the government's contentions based on the *Simmons II* and *Scheidelman II* appeals.

The First Circuit adopted *Simmons* and denied the government's abandonment argument.[53] Continuing with its rejection of the government's hyper-technical

arguments, the Court explained that the Commissioner's view was simply unreasonable.[54] Furthermore, the First Circuit asserted that whether a 501(c)(3) organization acted exclusively for charitable purposes was within the government's power to control and not the taxpayers.[55]

By contrast, the First Circuit did not reach a decision on whether the Kaufmans met the qualified appraisal regulations. The Court of Appeals found that the appraiser's potential bad faith could disqualify him as a qualified appraiser, but this was a question of fact that warranted remand.[56] However, the First Circuit did follow the logic of the Second Circuit in *Scheidelman II* and explained that qualified appraisal regulations were reporting requirements and not factual determinations of value.[57] Accordingly, the First Circuit also remanded questions regarding the value of the easement to the Tax Court.

Finally, in connection with Form 8283, the appellate court added that there is no manner or date of acquisition, or cost basis, for a property right such as an easement and that to deny a taxpayer's deduction on the basis of a failure to write "none" or "not applicable" would be a draconian measure.[58]

The Tax Court's Response: *Rothman*

To those of us trying easement cases, the First Circuit appeared to have dismissed the last of the non-valuation impediments to trial. In that sense, we believed that *Kaufman III* brought us back to where we began. We believed that future trials would focus on whether the experts could establish a loss of value due to the easement contribution.

Unfortunately our joy was short lived. In *Rothman*,[59] Judge Laro made clear that, at least for now, the Tax Court would continue to consider the government's technical challenges to easement donations.

Rothman is the Tax Court's most disheartening opinion for easement donors. In *Rothman*, the Tax Court paid lip service to the *Scheidelman II* appeal, but still found that the taxpayers' did not submit a qualified appraisal. *Rothman* reasoned that *Scheidelman II* exclusively dealt with subsections (J) and (K) of Reg. §1.170A-13(c)(3)(ii) and that the Tax Court remained free to consider other alleged technical violations in the document to deem the appraisal unqualified.[60]

By re-examining the qualified appraisal as a whole, the Tax Court concluded that the Rothmans' "appraisal still failed to satisfy 8 of 15 requirements."[61] At first glance, Judge Laro's conclusions appear reasonable. On further examination, *Rothman* neglects to mention that the majority of the alleged defects in the appraisal were addressed in previous cases (in particular *Simmons*) with opposite results.[62]

The Tax Court provided some consolation to the Rothmans because it explicitly reserved the issue of whether reasonable cause excused their failure to submit a qualified appraisal for trial.[63] Regardless of the taxpayers' victory on the reasonable cause issue, the reality is that, in spite of the appellate court's attempts to rein in the IRS strategy, *Rothman* continues to enable the Commissioner to pursue a "scorched-earth" approach as opposed to focusing on valuation.

In summary, the Courts of Appeal have sent a clear message to the Tax Court—it is time to tackle the issue of conservation easement valuation. Based on Rothman, the Tax Court does not appear ready to do so. Easement donors and easement holding organizations need to prepare for another year of Tax Court trials and appeals.

Endnotes

1 *G. Kaufman,* 136 TC 294, Dec. 58,588 (2011) (*Kaufman II*).

2 *G.P. Dorsey*, 59 TCM 592, Dec. 46,585(M), TC Memo. 1990-242; *J.E. Griffin*, 56 TCM 1560, Dec. 45,568(M), TC Memo. 1989-130; *R.E. Losch*, 55 TCM 909, Dec. 44,801(M), TC Memo. 1988-230; *F. Nicoladis*, 55 TCM 624, Dec. 44,709(M), TC Memo. 1988-163; *M.G. Hilborn*, 85 TC 677, Dec. 42,464 (1985).

3 *Id.*

4 *D.J. Simmons,* 98 TCM 211, Dec. 57,934(M), TC Memo. 2009-208, *aff'd*, CA-DC, 2011-2 USTC ¶50,469, 650 F3d 691.

5 *See, e.g., S. Rothman*, 104 TCM 126, Dec. 59,142(M), TC Memo. 2012-218; *F.M. Wall*, 103 TCM 1906, Dec. 59,091(M), TC Memo. 2012-169; *R.L. Mitchell*, 138 TC No. 16, Dec. 59,013 (2012); *L. Dunlap*, 103 TCM 1689, Dec. 59,043(M), TC Memo. 2012-126; *K.M. Carpenter*, 103 TCM 1001, Dec. 58,902(M), TC Memo. 2012-1; *1982 East, LLC*, 101 TCM 1380, Dec. 58,599(M), TC Memo. 2011-84; *H.T. Scheidelman*, 100 TCM 24, Dec. 58,269(M), TC Memo. 2010-151, *rev'd*, CA-2, 2012-1 USTC ¶50,402, 682 F3d 189; *G. Kaufman*, 134 TC 182, Dec. 58,197 (2010) (*Kaufman I*); *B.L. Evans*, 100 TCM 275, Dec. 58,340(M), TC Memo. 2010-207; *H.R. Lord*, 100 TCM 201, Dec. 58,324(M), TC Memo. 2010-196; *H.B. Bruzewicz*, DC-IL, 2009-1 USTC ¶50,317, 604 FSupp2d 1197. The taxpayers, however, have unanimously defended the application of penalties for the easement donation. *Id.*

6 *D.J. Simmons*, CA-DC, 2011-2 USTC ¶50,469, 650 F3d 691; *H.T. Scheidelman*, CA-2, 2012-1 USTC ¶50,402, 682 F3d 189; *Kaufman*, CA-1, 2012-2 USTC ¶50,472, 687 F3d 21 (*Kaufman III*)

7 *See, e.g., S. Rothman*, 104 TCM 126, Dec. 59,142(M), TC Memo. 2012-218; *F.M. Wall*, 103 TCM 1906, Dec. 59,091(M), TC Memo. 2012-169; *R.L. Mitchell*, 138 TC No. 16, Dec. 59,013 (2012); *L. Dunlap*, 103 TCM 1689, Dec. 59,043(M), TC Memo. 2012-126; *K.M. Carpenter*, 103 TCM 1001, Dec. 58,902(M), TC Memo. 2012-1; *1982 East, LLC*, 101 TCM 1380, Dec. 58,599(M), TC Memo. 2011-84; *H.T. Scheidelman*, 100 TCM 24, Dec. 58,269(M), TC Memo. 2010-151, *rev'd*, CA-2, 2012-1 USTC ¶50,402, 682 F3d 189; *Kaufman I*, 134 TC 182, Dec. 58,197 (2010); *B.L. Evans*, 100 TCM 275, Dec. 58,340(M), TC Memo. 2010-207; *H.R. Lord*, 100 TCM 201, Dec. 58,324(M), TC Memo. 2010-196; *H.B. Bruzewicz*, DC-IL, 2009-1 USTC ¶50,317, 604 FSupp2d 1197.

ENDNOTES

[8] The article *Facade Easement Contributions* by Mark Primoli, was written as part of an IRS program focusing on specialized areas of tax law. The Primoli article, in turn, had relied upon a 1994 IRS 'Audit Technique Guide,' used to train tax examiners but not intended to set IRS policy. In 2003 both the Audit Technique Guide and a revised version of Primoli's article omitted any reference to the 10 to 15 percent range for fear the numbers were being misconstrued." *H.T. Scheidelman*, CA-2, 2012-1 USTC ¶50,402, 682 F3d 189.

[9] *Kaufman III*, 687 F3d 21, at 24.

[10] Reg. §1.170A-13(c)(2)(ii).

[11] *D.J. Simmons,* 98 TCM 211, Dec. 57,934(M), TC Memo. 2009-208.

[12] Reg. §1.170A-14(g)(2) provides that: "…no deduction will be permitted under this section for an interest in property which is subject to a mortgage unless the mortgagee subordinates its rights in the property to the right of the qualified organization to enforce the conservation purposes of the gift in perpetuity."

[13] *Supra* note 11 citing Reg. §1.170A-14(d)(5).

[14] *Supra* note 11.

[15] There were two donations in controversy in *Simmons*. Therefore, two appraisals were prepared by the same appraiser. The analysis in both appraisals for purposes of Reg. §1.170A-13(c)(ii) were identical. *Supra* note 11.

[16] *Supra* note 11.

[17] *Id.*

[18] *Supra* note 11, citing *M.G. Hilborn*, 85 TC 677, Dec. 42,464 (1985).

[19] Reg. §1.170A-14(h).

[20] *Supra* note 11.

[21] The taxpayer's appraiser determined a reduction of 11 percent and 13 percent was applicable to her two easement encumbered properties. *Supra* note 11.

[22] *Kaufman I*, 134 TC 182, Dec. 58,197 (2010).

[23] *H.T. Scheidelman*, 100 TCM 24, Dec. 58,269(M), TC Memo. 2010-151.

[24] *Kaufman I*, 134 TC 182, Dec. 58,197 (2010).

[25] *H.T. Scheidelman*, 100 TCM 24, Dec. 58,269(M), TC Memo. 2010-151.

[26] The court found that the petitioners had reasonable cause and acted in good faith thereby excusing the application of any penalties. *Supra* note 25.

[27] In *Scheidelman*, the taxpayer's accountant submitted two Forms 8283. One contained the signatures of the charity and the appraiser. The second form was a computer generated form prepared by taxpayer's accountant containing the date, manner and cost of the purchased property. The Tax Court did not discuss the information included on the computer generated Form 8283. *Supra* note 25. In the absence of such discussion, the taxpayer in her appellate brief explained that the second page of the form apparently was simply overlooked by the court. The Commissioner, however, adopted the stance that the format in which the information had been presented was invalid. The Second Circuit adopted the Commissioner's argument as the lower court's position in their opinion. *H.T. Scheidelman*, CA-2, 2012-1 USTC ¶50,402, 682 F3d 189 (*Scheidelman II*).

[28] *See, e.g.*, Gerzog, *Mortgages and Conservation Easement: Not a Good Mix,* TAX NOTES, July 25, 2011, at 437-442; R. Lee Stephens and Robert J. Allen, *Lessons on Charitable Conservation Contributions from Scheidelman v. Commissioner*, available at http://www.privatelandownernetwork.org/library/article.aspx?id=95.

[29] *Kaufman II*, 136 TC 294, Dec. 58,588 (2011).

[30] In both cases, the IRS alleged that the cash donations were: (1) a requirement by the easement holding organizations in order to accept the conservation donation and (2) the entity provided services in exchange for donation, such as the processing of the application and obtaining bank approvals. *Kaufman II*, *supra* note 29; *Scheidelman*, supra note 25.

[31] The court found that a negligence penalty was not warranted since there was no overstatement of the charitable contribution. *Kaufman II, supra* note 29, 136 TC, at 324. In addition, the court found that reasonable cause excused the application of the substantial overstatement penalty. The court, however, did find that the taxpayers conceded they incorrectly claimed their cash donation in the 2003 year without providing a basis to exclude the application of a negligence penalty.

[32] *S. Rothman*, 104 TCM 126, Dec. 59,142(M), TC Memo. 2012-218; *F.M. Wall*, 103 TCM 1906, Dec. 59,091(M), TC Memo. 2012-169; *R.L. Mitchell*, 138 TC No. 16, Dec. 59,013 (2012); *L. Dunlap*, 103 TCM 1689, Dec. 59,043(M), TC Memo. 2012-126; *K.M. Carpenter*, 103 TCM 1001, Dec. 58,902(M), TC Memo. 2012-1; *1982 East, LLC*, 101 TCM 1380, Dec. 58,599(M), TC Memo. 2011-84; *H.T. Scheidelman*, 100 TCM 24, Dec. 58,269(M), TC Memo. 2010-151, *rev'd*, CA-2, 2012-1 USTC ¶50,402, 682 F3d 189; *Kaufman I*, 134 TC 182, Dec. 58,197 (2010); *B.L. Evans*, 100 TCM 275, Dec. 58,340(M), TC Memo. 2010-207; *H.R. Lord*, 100 TCM 201, Dec. 58,324(M), TC Memo. 2010-196; *H.B. Bruzewicz*, DC-IL, 2009-1 USTC ¶50,317, 604 FSupp2d 1197.

[33] *D.J. Simmons,* CA-DC, 2011-2 USTC ¶50,469, 650 F3d 691 (*Simmons II*).

[34] *Id.,* citing D.C. Code §§29–301.48, 29–301.56 ("More specifically, the State Historic Preservation Officer testified the easement initially reverts to the District of Columbia, which then seeks to assign it to a conservation organization.")

[35] *Simmons II*, supra note 33.

[36] *Id.* citing Reg. §1.170A-14(c)(1).

[37] The court refused to address the Commissioner's other administrative arguments on the basis that they were raised for the first time on reply. *Id.*

[38] *Scheidelman II*, CA-2, 2012-1 USTC ¶50,402, 682 F3d 189.

[39] *Scheidelman*, 682 F3d, at 196.

[40] *Scheidelman*, 682 F3d, at 196-197, FN6.

[41] *Scheidelman*, 682 F3d, at 197.

[42] *Scheidelman*, 682 F3d, at 198-199.

[43] *Scheidelman*, 682 F3d, at 200.

[44] *Id.*

[45] *Id.,* at 197.

[46] *Id.,* at 200.

[47] *Kaufman I*'s significant deviation from customary easement practices drew the concern of easement holding organizations. The Trust for Architectural Easements (formerly National Architectural Trust), Foundation for the Preservation of Historic Georgetown, National Trust for Historic Preservation, and Capitol Historic Trust requested to submit briefs on behalf of the taxpayers. In their *Amicus Curae*, the National Trust for Historic Preservation expressed their concern that the *Kaufman I*'s analysis created requirements that would never be accepted by a lending institution. *Brief Amicus Curiae of the National Trust for Historic Preservation in the United States in Support of Petitioners' Motion for Reconsideration* at 4, *Kaufman II*, 136 TC 294, Dec. 58,588 (2011)(No. 15997-09).

[48] In their *Amicus Curae*, the easement holding organizations explained that they have followed model preservation practices that have been published in various publications for over twenty-five years. *Id.* at 3, n. 1. *Kaufman I* and *II*'s results were supported by some parties, however. *See, e.g.,* Gerzog, *Mortgages and Conservation Easement: Not a Good Mix,* TAX NOTES, July 25, 2011, at 437-442; Nancy A. McLaughlin, *McLaughlin on Kaufman: Protecting Public Investment in Conservation Easements*, 2011 EMERGING ISSUES 6074.

[49] *Kaufman III*, CA-1, 2012-2 USTC ¶50,472, 687 F3d 21, at 27.

[50] *Id.*

[51] *Id.*

[52] "In reaching our conclusion, we do not rely on the general provision of paragraph (g)(3) that aims to prevent deductions from being lost by improbable events, because, as the Tax Court noted, '[o]ne does not satisfy the extinguishment provision ... merely by establishing that the possibility of a change in conditions triggering judicial extinguishment is unexpected.' Nor do we rest our conclusion on the Kaufmans' *expressio unius* reading of paragraph (g)(2), for '*expressio unius* is an aid to construction and not an inflexible rule.'" *Id.* (internal citations omitted).

[53] The First Circuit quoted the D.C. Circuit's rejection of the Commissioner's argument. *Id.* quoting *D.J. Simmons,* CA-DC, 2011-2 USTC ¶50,469, 650 F3d 691.

[54] "Yet the question here is not whether paragraph (g)(1) is reasonable, but whether the IRS's interpretation of that regulation is reasonable. The language of paragraph (g)(1) nowhere suggests the

Endnotes

stringent outcome that the IRS seeks to ascribe to it and the consequences of the reading would be to deprive the donee organization of flexibility to deal with remote contingencies." *Id.*

[55] *Id.*

[56] *Id.*

[57] *Id.*

[58] *Id.*, citing *Scheidelman II*, CA-2, 2012-1 USTC ¶50,402, 682 F3d 189.

[59] *S. Rothman*, 104 TCM 126, Dec. 59,142(M), TC Memo. 2012-218.

[60] Contrary to the court's assertion the Second Circuit's decision was not exclusive to requirements (J) and (K), the Commissioner asserted that Ms. Scheidelman's appraisal failed to meet requirements (A), (C), (D) and (G), in addition to (J) and (K), of Reg. §1.170A-13(c)(ii) both in the lower court and in their appellate brief. Respondent's Opening Brief, at 54-60, *H.T. Scheidelman*, 100 TCM 24, Dec. 58,269(M), TC Memo. 2010-151 (No. 15171-08); Brief and Supplemental Special Appendix for the Appellee-Cross-Appellant, at 42-44, *Scheidelman II*, CA-2, 2012-1 USTC ¶50,402, 682 F3d 189 (Nos. 10-3587; 10-5316).

[61] *Rothman, supra* note 59.

[62] *See Simmons, supra* note 11; *see also* n. 62.

[63] *Rothman, supra* note 59.