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A Charitable Easement in Cleveland, Ohio: The IRS Is Denied Its Usual Quick Path to Victory

By Nancy O. Kuhn, Esq.[*]
Jackson & Campbell, P.C.
Washington D.C.

On February 28, 2022, the U.S. Tax Court denied the IRS's Motion for Partial Summary Judgment in a case from Cleveland, holding that the charitable easement deed satisfied the Treasury regulation at issue.[1] This Treasury regulation has been used by the IRS as a short cut for a multitude of taxpayers to quickly disallow their charitable deductions in full for gifts of facade or conservation easements to qualified charities. The shortcut that was taken by the IRS, i.e., that Reg. §1.170A-14(g)(6)(ii)[2] must be complied with literally through language in the easement deed, may be slowly closing. The IRS will now have to work harder to get a final outcome, whether favorable or not, in charitable facade and conservation easement cases, at least in the Eleventh Circuit Court of Appeals and perhaps the Tax Court.[3] Perhaps they will now rely upon valuation principles, and review whether the valuation of the easement, and thus the amount of the charitable deduction, is adequately supported and substantiated by the taxpayer. The tides are turning in favor of taxpayers, although the road is long and filled with potholes.

In *Corning Place*,[4] Judge Lauber, who is frequently assigned to charitable conservation easement cases, opined that the easement deed in question met the requirements of Reg. §1.170A-14(g)(6)(ii) (Regulation) despite the IRS's arguments to the contrary. Judge Lauber compared the language in the Corning Place easement deed with the language in the Regulation and stated: "Upon initial inspection the easement deed at issue seems to track the regulation precisely."[5] Pursuant to the Regulation, simply stated, the fraction created at the time of the donation (value of easement over value of property as a whole) is the same fraction that must determine the split of proceeds if the easement is judicially extinguished and the property sold, no matter how many years have passed since the donation. As stated in the Regulation: ". . . proportionate value of the donee's property rights shall remain constant."[6]

However, the *Corning Place* easement deed included another sentence which the IRS highlighted as the basis for its disallowance of 100% of Corning Place's charitable deduction. The easement deed stated: "The values upon the Recording Date of this Deed shall be those values used to calculate the deduction for federal income tax purposes allowable by reason of this grant. . . ."[7] The IRS argued in its motion for partial summary judgment that this sentence allowed *Corning Place* to zero out the charitable easement's ownership interest should its charitable deduction be denied. The IRS reasoned that the numerator

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[*] Nancy Kuhn is a Director and the head of the Tax Group at Jackson & Campbell, P.C. in Washington, D.C. Nancy was a law clerk at the U.S. Tax Court for two years and then worked as a litigator for the IRS for approximately 10 years, handling litigation for exempt organizations the final five years. She is now in private practice and represents taxpayers before the IRS, Tax Court, and district courts. She has served as an expert witness on several matters, including charitable conservation easements.

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[1] *Corning Place Ohio, LLC v. Commissioner*, T.C. Memo 2022-12.

[2] All section references herein are to the Internal Revenue Code of 1986, as amended (the Code), or the Treasury regulations promulgated thereunder, unless otherwise indicated.

[3] Nancy O. Kuhn, *Charitable Conservation Easements — IRS and Tax Court Act to Shut Them Down*, Daily Tax Rep. (July 22, 2020).

[4] T.C. Memo 2022-12.

[5] *Corning Place,* T.C. Memo 2022-12.

[6] Reg. §1.170A-14(g)(6)(ii).

[7] *Corning Place*, T.C. Memo 2022-12.

of the fraction retroactively becomes zero in the event of the disallowance of the charitable deduction. Thus, the IRS theorized that the charitable easement holder would receive nothing because the easement value would be nullified. The IRS relied upon the Tax Court's earlier opinion in *Carroll v. Commissioner*[8] in making this argument.

In *Carroll*, the charitable donee's share of the proceeds upon extinguishment, as set forth in the easement deed, was based upon the amount of the charitable deduction, rather than a proportionate share of valuation at the time of the donation, as required by the Regulation. The IRS argued in *Carroll* that if the charitable deduction is retroactively denied in full to the donor for reasons other than valuation, i.e., failure to comply with the Regulation, the donee charity's property received through the easement deed would become worthless in a monetary sense. The Tax Court agreed with the IRS in *Carroll* and disallowed the charitable deduction. However, the *Corning Place* easement deed used different language than the deed in *Carroll*. The *Corning Place* easement deed also contained several references to the proportionate share of values determined at the time of the donation, and therefore the outcome upon extinguishment would be different. Judge Lauber easily distinguished the *Carroll* easement deed from the *Corning Place* deed and faulted the IRS for equating them.[9] The Regulation envisions a situation in which even if the easement ultimately fails and is extinguished, the charity will still receive the value of the easement determined at the time of the contribution, which corresponds to the amount of the charitable deduction originally claimed by the donor. Practically speaking, even if the donor's §170 charitable contribution deduction is denied in part or in full, under the authority that emerges from the analysis in *Corning Place* and *Carroll*, the charitable easement owner remains entitled to receive payment for the full valuation amount claimed for the easement determined at the time of the donation of the easement to the charity.

The facade easement in question donated by *Corning Place* is of remarkable historical significance. The easement is on the Garfield Building that was constructed in 1893 for the sons of President James A. Garfield and built on land owned by John D. Rockefeller. The Garfield Building is considered the first steel-frame ''skyscraper'' east of Cleveland's Public Square and has been listed on the National Register of Historic Places since 2002. *Corning Place* purchased the eleven-story building including the land it occupies for $6 million in January 2015. Approximately 16 months later in May 2016, after a ''certified rehabilitation,'' *Corning Place* donated the facade easement to a qualified charitable organization claiming a valuation for its charitable easement donation of $22.6 million. *Corning Place* will now have the opportunity to substantiate its valuation in Tax Court. Presumably the certified rehabilitation of the building, along with the perpetual nature of the easement, will add to the valuation of the building and easement. However, it will be a steep road to get from $6 million for the entire property to $22.6 million for the easement.

As noted in my recent article[10] the Eleventh Circuit has now ruled that the Regulation is invalid.[11] The Eleventh Circuit ruled that promulgation of the Regulation did not comply with the Administrative Procedures Act[12] and thus Treasury's interpretation of the Regulation was arbitrary and capricious. Judge Lauber, in *Corning Place*, noted that it was not clear whether the Eleventh Circuit invalidated the entire Regulation or just the apparent implicit requirement that there be no carveout for donor improvements in the calculations of distributions upon the unlikely event of judicial extinguishment. In my opinion, the Eleventh Circuit invalidated the entire Regulation, given its reliance on Treasury's violation of the Administrative Procedures Act.[13] There was no differentiation of factual scenarios provided by the Eleventh Circuit that could still be governed by the now invalid Regulation (as to those cases that are appealable to the Eleventh Circuit).

The Sixth Circuit, on the other hand, has now ruled that the Regulation is valid. In *Oakbrook Land Holdings, LLC v. Commissioner*[14] the Sixth Circuit carefully analyzed the Regulation, Treasury's compliance with the Administrative Procedures Act, and a Chevron[15] argument advanced by Oakbrook Land Holdings. The Sixth Circuit held: ''...the regulation is a reasonable way to ensure that the perpetuity requirement of I.R.C. §170(h)(5)(A) is protected in the event of a judicial extinguishment of a conservation ease-

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[8] 146 T.C. 196 (2016), appeal docketed No. 16-2417 (4th Cir. Dec. 15, 2016). The case was voluntarily dismissed by the parties pursuant to FRAP 42(b) on October 6, 2017. Information from PACER accessed on March 8, 2022.

[9] *Corning Place*, T.C. Memo 2022-12 (''. . . . . we think respondent errs in equating them.'').

[10] Nancy O. Kuhn, *A Rare Victory for Taxpayers in the Fight for Conservation Easements*, 38 Tax. Mgmt. Real Est. J. No. 1 (Jan. 19, 2022).

[11] *Hewitt v. Commissioner*, 21 F.4th 1336 (11th Cir. 2021), *rev'g and rem'g*, T.C. Memo 2020-89.

[12] Pub. L. No. 79-404, 5 U.S.C. §706.

[13] *Id.*

[14] No. 20-2117, 2022 BL 84909 (6th Cir. Mar. 14, 2022), *aff'g*, 154 T.C. 180 (2020).

[15] *Chevron USA Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984) (Supreme Court gave deference to administrative interpretations and set forth a two-step analysis to determine if the administrative interpretation survived scrutiny).

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ment.''[16] *Corning Place* is appealable to the Sixth Circuit and so *Oakbrook Land Holdings* is controlling. Due to Judge Lauber's factual finding that Corning Place's easement deed satisfied the Regulation, it is consistent with validation of the Regulation by the Sixth Circuit.

The IRS also took issue with other substantiation requirements for the facade easement in *Corning Place* and argued that the taxpayer had not timely complied. The IRS was offering more ammunition to the Tax Court for a quick denial. Notably, they failed. Judge Lauber stated: ''To be entitled to a charitable contribution deduction, a taxpayer need not be in literal compliance with every single reporting requirement.''[17] In other words, IRS, do your work and keep Congress' incentives for charitable easements in place to protect land and property. The valuation and appraisals should be the focus, not the technical language in an obscure Regulation provision for an extinguishment clause that will, in all likelihood, never need to be utilized. The dichotomy of requiring a perpetual easement in which the easement never expires, and yet requiring such precise language for the unlikely situation of a judicial extinguishment of the perpetual easement, is a bit counter intuitive. Also, the interpretation by the IRS and the Sixth Circuit that the property owner could never get his or her investment back for any improvements to the property post-easement, does not make economic sense. The Sixth Circuit and the Eleventh Circuit now have competing views on the topic which sets up an obvious conflict. Perhaps the Supreme Court will take up the issue.

There are still many cases pending in Tax Court regarding charitable easements. There are also multiple cases in the appellate pipeline, primarily the Eleventh Circuit and Sixth Circuit. The goal should be, as Congress intended in §170(h), to protect historic properties and environmental assets. Hopefully the IRS and courts can refocus the issues to ensure that easements satisfy the conservation requirements and are valued reasonably. The goal should not be to put an end to conservation easements with environment and history the ultimate loser. The goal should be to protect land, endangered species, open spaces, and historical buildings, while taking a realistic view of the value of a never-ending easement curtailing the use of said protected property. A middle ground seems to be the answer to resolve all of these many cases clogging the court system.

Corning Place is far from finished with its litigation in the Tax Court. Now that the IRS lost its relatively quick path to victory on the seminal issues before the Tax Court, the case must be factually developed, and the taxpayer given the opportunity for a trial on the merits of the case. *Corning Place* filed its Tax Court Petition on October 20, 2020. A trial date has not been scheduled. Status reports are due to Judge Lauber on March 30, 2022, and the long march to a trial begins anew. The path to justice is a long one.

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[16] *Oakbrook Land Holdings*, No. 20-2117, *slip op*. at 26.

[17] *Corning Place*, T.C. Memo 2022-12.

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