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Mortgage Kills Façade Easement Tax Deduction

I commented [recently](#) on the considerable interest in conservation easements, a whopping tax benefit expiring Dec. 31, 2011. But if you grab this rich tax benefit before it's too late, do it right! For one, remember that a mortgage on the property can spell trouble.

In [1982 East, LLC v. Commissioner](#), the Tax Court denied a charitable contribution deduction for a façade easement. Why? A bank held a mortgage on the property and had dibs on insurance proceeds if there was a casualty. That mere possibility—which didn't come to fruition—meant the façade easement was not protected in perpetuity.

A façade easement must be protected in perpetuity to qualify for a deduction. No deduction is allowed for property subject to a mortgage *unless* the mortgagee subordinates its rights to that of the qualified organization to enforce the conservation purposes in perpetuity. The lender didn't subordinate here, so that put the lender higher up the totem pole than the charity.

This case involved a 5-story townhouse in New York City's Metropolitan Museum Historic District. The owner entered into a preservation restriction agreement granting the National Architectural Trust (NAT) a façade easement restricting the use of the property. The bank that held a mortgage on the townhouse agreed to subordinate its rights to NAT's rights to enforce the conservation purpose of the donated property in

perpetuity.

Critically, though, there was an exception to this subordination: the bank had a prior claim to all insurance proceeds on any casualty, hazard or accident until the mortgage was paid off. When the owner donated the easement and claimed the deduction, it wound up in Tax Court. The IRS claimed the exception from subordination spoiled the deduction.

No Deduction! The Tax Court sided with IRS. The façade easement was not protected in perpetuity, the court said, because the charity was not guaranteed a proportionate share of proceeds in the event of casualty or condemnation. The lender retained a prior claim to all condemnation and insurance proceeds in preference to the charity until its mortgage was satisfied and discharged.

The lender could deprive the charity of value that should have been dedicated to the conservation purpose. That could happen if the townhouse was substantially or completely destroyed and no significant value remained in the property after the mortgage was satisfied.

Get conservation easements while you can, but be careful!

For more, see:

[Conservation Easements, Valuation, and Substantiation](#)

[Conservation Easements: Quid Pro Quo Revisited](#)

[Conservation Easements, the IRS & Charity](#)

[Courts to IRS: Ease up on Conservation Easement Valuations](#)

[Conservation Easements Conserve Taxes and More](#)

[An Updated Look At Conservation Easements](#)

[ABCs of Charitable Conservation Easements](#)

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