

REPAIRING FAÇADE EASEMENTS: IS THIS THE GIFT THAT LAUNCHED A THOUSAND DEDUCTIONS?

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“When we build, let us think that we build for ever.”¹

I. INTRODUCTION

Preservation of America’s built environment is an important, and costly, endeavor. Federal law provides various incentives to encourage preservation and to help defray the cost. The Internal Revenue Code (the “Tax Code”) offers preservation incentives, including *inter alia* a charitable contribution deduction for the gift of a qualified conservation contribution.²

The National Register of Historic Places (the “National Register”) encourages the identification of buildings worthy of preservation.³ Many building owners protect their historic buildings by donating façade easements to charities dedicated to the preservation of our architectural heritage. A façade easement gives the charity a property interest and allows it to control changes made to the façade.⁴

Properly structured, the gift of a façade easement entitles the building owner to claim an income tax deduction for a qualified

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1. JOHN RUSKIN, THE SEVEN LAMPS OF ARCHITECTURE 176-77 (Farrar, Straus, and Giroux, 1981) (1849).

2. *See, e.g.*, I.R.C. §170(a)(1), (f)(3)(B)(iii) (2006).

3. National Historic Preservation Act 101, 16 U.S.C. § 470a (1980). For purposes of this article the phrase “historic building” shall refer to a building listed on the National Register.

4. I.R.C. § 170(h)(1), (4)(A)(iv). The extent of the charity’s control depends on the terms of the façade easement. Some easements grant the right to control not only changes to the façade, but also changes to the building’s structure or to the site. *See, e.g.*, Rome I. Ltd., E.C. Sys., Inc. v. Comm’r, 96 T.C. 697, 700 (1991); THOMAS S. BARRETT & STEFAN NAGEL, MODEL CONSERVATION EASEMENT AND HISTORIC PRESERVATION EASEMENT 96-98 (1996).

conservation contribution.⁵ Unlike the Tax Code's other major preservation incentive, the Rehabilitation Credit,⁶ the qualified conservation contribution deduction is not limited to property held for productive use in a trade or business or investment activity.⁷ Consequently, façade easements may be used to protect a diverse array of historic buildings, commercial buildings, personal residences, even barns, and still qualify for the charitable contribution deduction.

Some façade easements include a covenant in which the grantor assumes sole responsibility for maintaining the façade.⁸ The covenant may require the donor to keep the building in the state of repair existing at the time of the grant or in some other specified condition.⁹ The covenant may also specify the standard to which repairs must conform.¹⁰ For example, the grantor's covenant to maintain the façade contained in one model easement reads as follows:

Grantor agrees at all times to maintain the Buildings in the same structural condition and state of repair as that existing on the effective date of this Easement. Grantor's obligation to maintain shall require replacement, repair, and reconstruction by Grantor whenever necessary to preserve the Buildings in substantially the same structural condition and state of repair as that existing on the date of this Easement. Grantor's obligation to maintain shall also require that the Property's landscaping be maintained in good appearance with substantially similar plantings, vegetation, and natural screening to that existing on the effective date of this Easement. The existing lawn areas shall be maintained as lawns, regularly mown. The existing meadows and open fields shall be maintained as meadows and open fields, regularly bushhogged to prevent the growth of woody vegetation where none currently grows. Subject to the casualty provisions of paragraphs 7 and 8, this obligation to maintain shall require replacement, rebuilding, repair and reconstruction of the Buildings whenever necessary in accordance with *The Secretary of the Interior's Standards for Rehabilitation and Guidelines for Rehabilitating Historic Buildings* (36 C.F.R. §67), as these may be amended from time to time.¹¹

5. I.R.C. §170(a)(1), (f)(3)(B)(iii).

6. *Id.* §47(c)(1)(A)(iv) (2006).

7. I.R.C. §170(h).

8. *See, e.g., Hilborn v. Comm'r*, 85 T.C. 677, 681-82 (1985); BARRETT & NAGEL, *supra* note 4, at 96.

9. *See, e.g., Bailey v. Comm'r*, 88 T.C. 1293, 1296 (1987), *acq.*, 1989-2 C.B.1; *Hilborn*, 85 T.C. at 681-82; BARRETT & NAGEL, *supra* note 4, at 96-97.

10. *See, e.g., Bailey*, 88 T.C. at 1296; BARRETT & NAGEL, *supra* note 4, at 96-97.

11. BARRETT & NAGEL, *supra* note 4, at 96-97. Whether such agreement runs to future owners is questionable unless the state enabling act so provides. Ronald H. Rosenberg & Pamela G.

This article explores the impact of such a covenant on the characterization for tax purposes of expenditures to maintain the façade. In particular this article explores the following question: Given that the charitable easement holder owns a nonpossessory interest in the façade, which imposes on the charity an obligation to repair and maintain the facade and entitles it to benefit from increases in the value of the facade, is a donor's assumption of the charity's obligation to repair the facade an additional charitable contribution to the charity? If a donor gratuitously makes improvements to property owned outright by a charity, such improvements are deductible charitable contributions.¹² Similarly, if a donor gives money to a charitable easement holder to enable it to maintain the property subject to the easement, such donations are deductible charitable contributions.¹³ This article goes one step further and asks whether a donor who assumes the cost of maintaining the charity's nonpossessory interest in the facade makes an indirect deductible charitable contribution to the charity when such repairs are made. Having done so, this article concludes that if the general rule imposes the obligation to repair the facade on the charitable easement on the easement holder,¹⁴ the covenant in which the donor assumes liability to repair the servient estate represents the donor's promise to make gifts in the future and that payments pursuant to such a promise constitute, to the extent of the charity's obligation to repair, additional indirect charitable contributions. This article also concludes that current law supports the allowance of a deduction for indirect, as well as direct, charitable contributions.

Treating a portion of the donor's maintenance expenditures as an additional charitable contribution is particularly advantageous to building owners who donate façade easements on their residences because it converts what would otherwise be a non-deductible personal expense, the cost to repair a personal use building,¹⁵ into a deductible charitable contribution.¹⁶ A charitable deduction for such costs helps defray some of the increased maintenance costs associated with

Jacobstein, *Historic Preservation Easements: A Proposal for Ohio*, 7 U. DAYTON L. REV. 313, 334 (1981). See, e.g., UNIF. CONSERVATION EASEMENT ACT § 4, 12 U.L.A. 179 (1981).

12. Rev. Rul. 76-185, 1976-1 C.B. 60.

13. I.R.S. Priv. Ltr. Rul. 99-33-029 (May 24, 1999).

14. See *infra* notes 75-79 and accompanying text.

15. I.R.C. § 262 (2006).

16. *Id.* § 170. In most situations, treating a portion of the maintenance costs as a charitable contribution will, at most, affect the timing of the deduction for building owners who donate façade easements with respect to buildings held for income producing purposes. See discussion *infra* notes 155-173 and accompanying text.

maintaining the integrity of a historic building and encourages the preservation of the many historic residences that give character to our nation's neighborhoods.¹⁷

Part II of this article discusses the rules for determining if a building is historic and worthy of listing on the National Register. Part II also discusses the relevant rules regarding easements and charitable contributions. Part III explores the question of whether a charitable easement holder should be obligated to repair the façade and, assuming the answer is yes, why repairs made by the donor are additional charitable contributions. Part IV contains a suggested reform, which, if adopted, would provide an administratively convenient method to determine the amount of the charitable contribution, a method that would treat all donors and the government consistently and fairly. Part IV also explains the impact of adopting such reform.

II. BACKGROUND

A. Identifying Historic Buildings

The National Register, which was created as part of the National Historic Preservation Act of 1966,¹⁸ encourages the preservation of America's built environment by identifying and listing buildings determined to have historic significance.¹⁹ The National Register lists buildings of local, state or national significance,²⁰ including all National Historic Landmarks.²¹ A building may be listed due to its association

17. Preservationists have long advocated increased tax incentives for historic homes. For example, the Historic Homeownership Assistance Act of 2001 proposed extending the Rehabilitation Credit to substantial rehabilitations of principal residences. H.R. 1172, 107th Cong. (1st Sess. 2001); S. 920, 107th Cong. (1st Sess. 2001).

18. 16 U.S.C. § 470a (2000) *et seq.*

19. *Id.* § 470a(a)(1)(A). Although this article is only concerned with listed buildings, the actual scope of the National Register is much greater. The National Register is a list of "district, sites, buildings, structures, and objects significant in American history, architecture, archaeology, engineering and culture." *Id.* See also 36 C.F.R. § 60.1(a) (2006).

20. 36 C.F.R. § 60.1(b). A building is never listed on the National Register over the objection of its owner. 16 U.S.C. § 470a(a)(6). If an owner objects, the building is denominated as eligible for listing. *Id.* Although entitled to some benefits associated with listing, *see, e.g.*, 16 U.S.C. § 470a(a)(8), eligible buildings do not qualify their owners for tax benefits such as the deduction for giving a façade easement to charity. I.R.C. § 170(b)(4)(B).

21. 36 C.F.R. §§ 60.1(b)(2), 65.2(b) (2006). A building is a National Historic Landmark if it "possess[es] exceptional value or quality in illustrating or interpreting the heritage of the United States" and is "of exceptional value to the nation as a whole rather than to a particular state or locality." *Id.* § 65.2, 4(a).

with a significant historic event²² or person,²³ or due to its architectural importance.²⁴ An architecturally significant building embodies the distinctive characteristics of a particular style of architecture or method of construction, was designed or constructed by a master, or possesses high artistic value.²⁵ Listed buildings must “possess integrity of location, design, setting, materials, workmanship, feeling and association.”²⁶ Buildings may be listed individually or as part of a historic district.²⁷

A building may be removed from the National Register if alteration or decay destroys the qualities on which the decision to list relied.²⁸ Procedural and substantive errors during the listing process or failure to continue to satisfy the listing criteria may cause removal.²⁹ Boundary changes and relocation of the building can also result in de-listing.³⁰

The National Register is merely a planning tool.³¹ Listing indicates a building’s historic significance and the desirability of protecting it from “destruction or impairment.”³² Listing does not, however, prevent either. The owner of a listed building has complete freedom to alter or destroy the building.³³

22. *Id.* § 65.4(a)(1).

23. *Id.* § 65.4(a)(2).

24. *Id.* § 60.4(c).

25. *Id.*

26. *Id.* § 60.4.

27. *Id.* A district is a collection of buildings, which are either associated with a historic event or representative of a particular style of architecture, that forms a geographically definable area. *Id.* § 60.3(d).

28. *Id.* § 60.15(a)(1).

29. *Id.* § 60.15.

30. *Id.* § 60.4.

31. *Id.* § 60.2(a).

32. *Id.* § 60.2

33. *Id.* Listing does afford the protection of Section 106 Review. Section 106 Review is a procedural requirement that must be completed before a federal agency engages in an “undertaking” that may have an effect on a listed building or a building eligible for listing. *Id.* Section 106 Review gives the Advisory Council on Historic Preservation an opportunity to review the undertaking and to suggest ways to minimize any adverse impact on the building. *Id.* § 60.2(a). The federal agency, however, is not required to implement the suggestion. *Id.* Although listing does not protect the building, it does provide certain advantages, such as tax incentives. *Id.* § 60.2(c). Also, certain federal statutes may provide additional protection to listed buildings. For example, the Surface Mining Control and Reclamation Act substantially restricts surface mining on property listed on the National Register. 30 U.S.C. § 1272(e)(3) (2006).

B. Deduction for Charitable Contributions

1. Generally

Section 170 allows an income tax deduction for any “contribution or gift to or for the use of” a charity made during the taxable year.³⁴ The maximum charitable contribution deduction allowable in any given year is limited based on the taxpayer’s income, the identification of the charitable donee, and the type of property donated.³⁵ An individual taxpayer is limited to a maximum aggregate charitable contribution deduction of fifty percent of adjusted gross income.³⁶ A corporate taxpayer is limited to ten percent of taxable income.³⁷ If a taxpayer’s aggregate charitable contributions for a given year exceed the maximum, the excess may be carried forward for five years.³⁸

2. Deduction for Gifts of Façade Easements

A qualified conservation contribution is one type of deductible charitable contribution.³⁹ A gift of a façade easement is a qualified conservation contribution if the easement creates a perpetual restriction on the use of the servient estate and is given to a qualified charity exclusively for conservation purposes.⁴⁰ The definition of conservation

34. I.R.C. § 170(c) (2006).

35. *Id.* § 170(b).

36. *Id.* § 170(b)(1)(A)-(F). The limit is lower, however, if the charitable recipient is not listed in section 170(b)(1)(A) or if the donated property is an appreciated capital asset held for more than one year. *Id.* § 170(b)(1)(B).

37. *Id.* § 170(b)(2). For purposes of this limit, the corporation’s taxable income is calculated before certain deductions, such as net operating loss carrybacks. *Id.*

38. *Id.* § 170(d).

39. *Id.* § 170(f)(3)(B)(iii), (h). This deduction is an exception to the general rule denying a charitable deduction for a gift of less than the donor’s entire interest in the donated property. *Id.* § 170(f)(3)(A), (B)(iii). See generally C. Timothy Lindstrom, *Income Tax Aspects of Conservation Easements*, 5 WYO. L. REV. 1 (2005).

40. § 170(h)(1), (2)(C), (3). Only a charity that meets the definition of a qualified organization is entitled to receive a tax deductible gift of a façade easement or other qualified conservation contribution. *Id.* § 170(h). A qualified organization is a charity that falls within one of the following four categories: a governmental organization described in section 170(b)(1)(A)(v); a publicly supported charity described in section 170(b)(1)(A)(vi); a tax exempt organization described in section 501(c)(3) that meets the requirements of section 509(a)(2); or a tax exempt organization described in section 501(c)(3) that meets the requirements of section 509(a)(3) and is controlled by a qualified organization. *Id.* § 170(h)(3)(A),(B). Furthermore, a charity that otherwise meets the requirements of a qualified organization is disqualified unless it has both the commitment and the necessary resources to protect the conservation purposes of the façade easement. Treas. Reg. § 1.170A-14(c)(1) (as amended in 1999). A qualified organization dedicated to the conservation of historic buildings satisfies the commitment requirement. *Id.*

purposes includes the preservation of a historic building listed on the National Register.⁴¹

The donor of a façade easement may claim a charitable contribution equal to the fair market value of the easement.⁴² The fair market value of property is the price at which it would sell in an arm's-length transaction.⁴³ Because of the dearth of sales of easements, the Regulations provide an alternative method to establish fair market value.⁴⁴ Absent an established market, easements are valued using the before-and-after method.⁴⁵ Under the before-and-after method, the fair market value of the easement equals the decline in value of the servient estate as a result of encumbering it with the easement.⁴⁶

C. Easements

1. Generally

An easement is a nonpossessory interest in another person's land.⁴⁷ Affirmative easements entitle the holder to enter the servient estate, the

41. I.R.C. § 170(h)(1)(C), (4)(A)(iv), (4)(B). The building may be listed individually or as part of a historic district. *Id.* § 170(h)(4)(B); Treas. Reg. § 1.170A-14(d)(5)(iii). A building listed as part of a district qualifies only if the Secretary of the Interior certifies it is of historic significance to the district. I.R.C. § 170(h)(4)(B), Treas. Reg. § 1.170A-14(d)(5)(iii). *See* 36 C.F.R. § 67.4 (2006) (stating the requirements of buildings certified as historically significance to the district).

42. Treas. Reg. § 1.170A-1(c)(1) (as amended in 2005). The amount of the deduction must be reduced by the amount of gain, if any, that would not be taxed as long-term capital gain if the easement were sold at fair market value. I.R.C. § 170(e)(1)(A). For donations made after July 25, 2006, the Pension Protection Act of 2006 reduces the amount of the donation if the taxpayer has claimed the rehabilitation credit with respect to the building during the preceding five years. Pension Protection Act of 2006, Pub. L. No. 109-289, § 1213(d), (e) 120 Stat. 780 (2006). The amount of the reduction must correspond to the ratio of the amount claimed as a rehabilitation credit during the preceding five years to the fair market value of the building. *Id.* § 1213(d).

43. Treas. Reg. § 1.170A-1(c)(2). Fair market value is the price that a willing buyer would pay and a willing seller would accept if both have reasonable knowledge of all relevant facts and neither is under the compulsion to buy or sell. *Id.*

44. Treas. Reg. § 1.170A-14(h)(3)(i).

45. *Id.*

46. *Id.* The value of the servient property before and after the grant of the easement is determined by appraisals. *Id.* The unencumbered value equals the property's value at its highest and best use. *Id.* The encumbered value must take into account any future development permitted to the owner. *Id.* The easement's fair market value must be reduced by any resulting increase in the value of other property owned by the grantor or the grantor's family. *Id.* § 1.170A-14(h)(3)(ii). If the grant increases the value of the servient estate, no charitable contribution deduction is allowed. *Id.*

47. RESTATEMENT OF PROPERTY §450(a) (1944). *See also* Dorsey v. Comm'r, 59 T.C.M. (CCH) 592 (1990).

land subject to the easement, and to make use of it.⁴⁸ Negative easements permit the holder to prevent the owner of the servient estate from engaging in certain actions but do not afford entry onto the servient estate.⁴⁹

2. Façade Easements

Façade easements help redress the inadequate protection afforded by the National Register. A façade easement protects the architectural features of a building by prohibiting alteration of the building's shell.⁵⁰ A façade easement grants the easement holder, typically a charity dedicated to the preservation of historic buildings, the right to control what alterations the current or future owners may make to the building's façade.⁵¹ A façade easement also gives the charity the right to inspect the building periodically and to require the owner to correct any violations of the easement.⁵² Some façade easements include a covenant committing the donor to undertake all repairs to the façade.⁵³ The covenant specifies the standard to which the repairs must conform⁵⁴ and may include an agreement to maintain the façade in its current, or other

48. 3 RICHARD R. POWELL, *POWELL ON REAL PROPERTY* §34.02[2][c] (2000). See e.g. *Bailey v. Comm'r*, 88 T.C. 1293, 1295 (1987), *acq.*, 1989-2 C.B.

49. POWELL, *supra* note 48, §34.02[2][d]. The common law also categorized easements as appurtenant or in gross. An easement appurtenant attaches to a particular piece of land, the dominant estate, and benefits its owner in the physical use of the dominant estate. *Id.* An easement in gross does not attach to a dominant estate; it benefits the holder without regard to the ownership or possession of another piece of land. JON W. BRUCE & JAMES W. ELY, JR., *THE LAW OF EASEMENTS AND LICENSES IN LAND* § 2.01[2] (1995). The common law considered easements appurtenant to be assignable and to run with the dominant estate. POWELL, *supra* note 48, §34.02[2][d]. Easements in gross, on the other hand, were traditionally viewed as nonassignable. *Id.*

50. Façade easements may be granted on either the interior or exterior of a building, but most commonly are limited to the exterior. See e.g. *Rome I. Ltd., E.C. Sys., Inc., v. Comm'r*, 96 T.C. 697 (1991). The other conservation easement commonly used to protect historic buildings is the development rights easement, which restricts further development on the building's site or into the appurtenant air space. For a discussion of development rights, see Daniel Markey, Note, *Money from Heaven: Should Qualified Air Rights Donations be Characterized as Interests in Land or Buildings? Why does it Matter?*, 50 CLEV. ST. L. REV. 283, 287 (2002). Applicable for donations made after July 25, 2006, the Pension Protection Act of 2006 requires façade easements encumbering buildings located in registered historic districts to protect the entire exterior of the building. Pension Protection Act of 2006, Pub.L.No. 109-289, § 1213(d),(e) 120 Stat. 780 (2006).

51. See e.g. BARRETT & NAGEL, *supra* note 4, at 95-107; *Dorsey*, 59 T.C.M. 592.

52. Treas. Reg. § 1.170A-14(g)(5)(D)(ii) (as amended in 1999).

53. BARRETT & NAGEL, *supra* note 4, at 96-97. See, e.g., *Hilborn v. Comm'r*, 85 T.C. 677, 682-83 (1985).

54. *Id.* See also *supra* note 69 and accompanying text.

specified, condition.⁵⁵

The Tax Code and the Regulations specify certain criteria that a façade easement must satisfy if the donor wants to claim a charitable contribution deduction.⁵⁶ These requirements, aimed mostly at ensuring that the conservation purpose is protected in perpetuity⁵⁷ and the donation is made exclusively for conservation purposes,⁵⁸ distinguish façade easements from other easements in certain key respects.

First, the conservation purpose of the façade easement must be protected in perpetuity.⁵⁹ Recognizing, perhaps, that events beyond the control of both the donor and the charity may extinguish an easement,⁶⁰ the Regulations consider this requirement satisfied if the donor takes reasonable precautions to prevent the easement from being extinguished.⁶¹ These precautions include incorporating in the grant legally enforceable restrictions preventing alteration of the façade.⁶² Provided reasonable precautions are taken, the conservation purpose is deemed protected in perpetuity notwithstanding the remote possibility the easement may be extinguished.⁶³

Second, a façade easement must protect the charity in the event the easement is extinguished by allocating a portion of any post-extinguishment sales proceeds to the charity.⁶⁴ The charity's share of the sales proceeds is determined by reference to the decline in value of the servient property caused by the grant of the easement.⁶⁵ The

55. BARRETT & NAGEL, *supra* note 4, at 96-97. See, e.g., *Bailey v. Comm'r*, 88 T.C. 1293, 1296 (1987) *acq.*, 1989-2 C.B.

56. See Treas. Reg. § 1.170A-14(g).

57. I.R.C. § 170(h)(2)(C) (2006).

58. *Id.* § 170(h)(1)(C).

59. *Id.* § 170(h)(1)(A), (2)(C).

60. See Jeffrey Tapick, Note, *Threats to the Continued Existence of Conservation Easements*, 27 COLUM. J. ENVTL. L. 257 (2002).

61. Treas. Reg. § 1.170A-14(g)(3) (as amended in 1999).

62. *Id.* § 1.170A-14(g)(1). To be legally enforceable, the easement must be recorded. *Satullo v. Comm'r*, 66 T.C.M. 1697, *aff'd*, 67 F.3d 314 (11th Cir. 1995). Other precautions include subordinating any existing mortgages to the easement and including language in the grant prohibiting the charity from transferring the easement to anyone other than another qualified charity. Treas. Reg. § 1.170A-14(c)(2), (g)(2).

63. Treas. Reg. § 1.170A-14(g)(3).

64. *Id.* § 1.170A-14(g)(6). If the façade easement is extinguished as a result of condemnation, the charitable easement holder will share in the proceeds unless prohibited by state law. *Id.* § 1.170A-14(g)(6)(ii). The charity must use its share of the sales proceeds to further the conservation purposes of the easement. *Id.* § 1.170A-14(g)(6)(i). Restrictions on the charity's ability to transfer the façade easement prevent circumvention of this rule. The charitable easement holder may transfer the easement only to another qualified organization and only if the transferee agrees to carry out the conservation purposes of the façade easement. *Id.* § 1.170A-14(c)(2).

65. *Id.* § 1.170-14(g)(6).

charity's percentage of the sales proceeds must, at a minimum, equal the percentage by which the value of the servient property declined as a result of the grant of the easement.⁶⁶ In essence, the minimum percentage provision treats the creation of the façade easement as giving the charity a percentage of the servient estate equal to the percentage of the value of the servient estate that the donor deducts as a charitable contribution.⁶⁷

Subject to certain restrictions, the owner of the servient estate may use the property in any manner, so long as such use does not conflict with the easement's conservation purpose or any other significant conservation purpose.⁶⁸ If the building is within a historic district, any permissible future development or rehabilitation must conform to the standard applicable within the district.⁶⁹

A gift of a façade easement must provide a public benefit, a requirement that is satisfied only if the public has access to the protected features.⁷⁰ Visual access is sufficient, however.⁷¹ If the façade cannot be seen from a public way, physical access must be provided on a regular basis to the extent consistent with the preservation of the protected features.⁷²

III. CHARITABLE CONTRIBUTION DEDUCTION FOR PAYMENTS PURSUANT TO AFFIRMATIVE AGREEMENTS IN EASEMENTS

Amounts expended to repair a façade are deductible as a charitable contribution if the donor's payment is a "contribution or gift to or for the use of" the charitable easement holder.⁷³ In the situation considered by this article, where the donor's promise to maintain the façade is given as part of the gift of the façade easement, the donative intent applicable to the gift of the façade easement should also be applicable to the promise to maintain. Consequently, the requisite donative intent for the transfer

66. *Id.* § 1.170A-14(g)(6). The percentage by which the servient estate's value declines equals the ratio, at the time of the grant of the easement, of the value of the easement to the unencumbered value of the servient estate. *Id.*

67. See discussion *supra* notes 42-46 and accompanying text.

68. Treas. Reg. § 1.170A-14(e)(2). Both new and existing uses are permitted. *Id.* The use cannot unduly interfere with any other significant conservation interest. *Id.* Surface mining is generally prohibited. I.R.C. § 170(h)(5)(B) (2006).

69. Treas. Reg. § 1.170A-14(d)(5).

70. *Id.*

71. *Id.*

72. *Id.*

73. I.R.C. § 170(c). See discussion *infra* Part III.B.

to be a “contribution or gift” should be satisfied,⁷⁴ and deductibility should depend on whether there is a transfer “to or for the use of” the charitable easement holder. This article argues that at least two persuasive arguments in favor of deductibility exist. To the extent the charity possesses, and is relieved of, the obligation to maintain the façade, the donor’s payment should be treated either as an indirect transfer to the charity or a gift of services entitling the donor to deduct any incidental expenses.

A. The Charity’s Obligation to Maintain the Façade

As a general rule, the holder of an easement is obligated to repair and maintain the property subject to the easement.⁷⁵ The general rule places the obligation to repair on the easement holder to the exclusion of all others; the owner of the servient estate is relieved of any duty to repair.⁷⁶ When the nature of the easement is such that both parties use it, such as a right of way, some courts continue to find the easement holder exclusively obligated to maintain the property.⁷⁷ Others apportion the obligation based on use.⁷⁸ Regardless of how the law allocates the obligation to repair in the absence of an agreement, the parties may change that allocation by agreement.⁷⁹

74. Courts interpret the “contribution or gift” requirement to speak to the donor’s intent; however, they differ with respect to the exact intent required. *Compare* DeJong v. Comm’r, 309 F.2d 373 (9th Cir. 1962), *and* Oppewal v. United States, 468 F.2d 1000 (1st Cir. 1972), *with* Singer Co. v. United States, 449 F.2d 413 (Ct. Cl. 1971). According to the Supreme Court, “[t]he sine qua non of a charitable contribution is a transfer of money or property without adequate consideration. The taxpayer, therefore, must at a minimum demonstrate that he purposefully contributed money or property in excess of the value of any benefit he received in return.” *United States v. Am. Bar Endowment*, 477 U.S. 105, 118 (1986). Consequently, donors who pay all maintenance expenses even though the façade easement does not obligate them to do so and subsequent purchasers of the servient property may also have an argument that a portion of their maintenance expenses should be considered a charitable contribution. Such arguments differ from the one considered by this article in that the taxpayer must establish the existence of donative intent, and are beyond the scope of this article.

75. *E.g.*, *Cardinal v. Long Island Power Auth.*, 309 F. Supp. 2d 376, 384-85 (E.D.N.Y. 2004); *Greiner v. Columbia Gas Transmission Corp.*, 41 F. Supp. 2d 625, 631 (S.D. W. Va. 1999); *Lynch v. Keck*, 263 N.E.2d 176, 182 (Ind. App. 1970) (quoting 28 C.J.S. *Easements* § 94). *See also* BRUCE & ELY, *supra* note 49, § 8.02[1][a].

76. *E.g.*, *Cardinal*, 309 F. Supp. 2d at 385; *Flower v. Valentine*, 482 N.E.2d 682, 687 (Ill. App. Ct. 1985).

77. *Lynch*, 263 N.E.2d at 182 (quoting 28 C.J.S. *Easements* § 94); *Seller v. Powell*, 815 P.2d 448, 449 (Idaho 1991).

78. *Grace v. Yarnall*, 441 F. Supp. 130, 142-43 (D. Me. 2006); *MacIntyre v. Baltic Realty Corp.*, No. 919-0781A, 2005 Mass. Super. LEXIS 22, at *18 (Mass. Super. Ct. Jan. 20, 2005); *Lakeland Prop. Owners Ass’n v. Larson*, 459 N.E.2d 1164, 1170 (Ill. App. Ct. 1984).

79. *See, e.g.*, *Greiner*, 41 F. Supp. 2d at 631; *Sutera v. Go Jokir, Inc.*, 86 F.3d 298, 302, 308

In jurisdictions that apply the above rules to façade easements, the obligation to repair the façade rests exclusively with the charitable easement holder or is shared by the charity and the donor.⁸⁰ Courts may question whether the general rule should apply to conservation easements, which are generally viewed as negative easements.⁸¹ Although the application of the general rule to all conservation easements is a question beyond the scope of this article, several compelling reasons exist for applying it to façade easements.

First, valid questions can be raised regarding the characterization of a façade easement as a negative easement.⁸² A negative easement does not permit the holder to enter and use the servient estate,⁸³ it has been described as no more than a “veto power.”⁸⁴ The holder of a façade easement, on the other hand, must have access to the façade⁸⁵ and must be able to inspect the façade to ensure compliance with the terms of the easement.⁸⁶ Either or both of these requirements may necessitate entry onto the servient estate. Furthermore, some easements may explicitly grant the easement holder the right to enter and perform any repairs not made by the donor, or to repair to its satisfaction any violations of the easement’s restrictions.⁸⁷ To the extent the charity must enter the servient estate, the façade easement more closely resembles an affirmative easement than a negative one.

Regardless of whether it is considered affirmative or negative, the purpose of a façade easement dictates that the obligation to repair rests with the charity. An easement holder has the “right to do whatever is reasonably convenient or necessary in order to enjoy fully the purposes for which the easement was granted.”⁸⁸ This rule grants an easement holder the right to undertake all repairs and improvements necessary for the enjoyment of the easement.⁸⁹ Because the purpose of a façade

(2nd Cir. 1996); *Nat’l Exch. Bank v. Cunningham*, 22 N.E. 924 (Ohio 1989).

80. *See supra* notes 75-79 and accompanying text.

81. *See discussion supra* notes 47-49 and accompanying text.

82. *See, e.g.*, POWELL, *supra* note 48, §34A.01.

83. *Id.* at §34.02[2][c].

84. *Id.*

85. Treas. Reg. § 1.170A-14(d)(5)(iv)(A) (as amended in 1999). Access must not only be granted to the easement holder but to the public. *Id.*

86. *Id.* § 1.170A-14(g)(5)(ii).

87. Subject to the requirements of the Tax Code and Regulations, the parties may negotiate any terms they desire.

88. BRUCE & ELY, *supra* note 49, §8.02[1][a].

89. *Id.* (citing *Prof’l Executive Ctr. v. LaSalle Nat’l Bank*, 570 N.E.2d 366, 383 (Ill. App. Ct. 1991)). This right is always subject to the general caveat that an easement holder cannot increase the burden on the servient estate. *Id.*

easement is to preserve the architectural features of the building, not simply to prevent changes to the façade, fulfillment of such purpose suggests that the obligation to repair the façade, including any structural problems that may threaten it, should rest exclusively with the easement holder. Preservation demands *inter alia*: control over the quality of materials and craftsmanship used; saving a building's distinctive features, such as finishes, construction techniques, and craftsmanship;⁹⁰ repairing, rather than replacing, deteriorated historic features whenever possible;⁹¹ and avoiding the use of destructive methods or treatments, such as chemical treatments or sandblasting.⁹² Above all, preservation demands control to decide which repairs are economically viable and which are not.⁹³ Imposing the obligation to repair on the charitable easement holder affords it sufficient control to ensure that repairs preserve, rather than destroy, the protected features. If the charitable easement holder has no obligation to maintain the façade, its ability to ensure fulfillment of the purpose of the façade easement is compromised.⁹⁴

Requiring the charity to shoulder at least partial responsibility for repairs is further warranted because the benefits of the repairs inure to the easement holder as well as to the owner of the servient estate. Encumbering property with an easement reduces its value.⁹⁵ If the easement is extinguished, the property value increases.⁹⁶ For most easements, the property owner enjoys the full benefit of that increase in value.⁹⁷ But, the rules governing façade easements give a portion of the post-termination sales proceeds to the easement holder.⁹⁸ The amount payable to the easement holder includes a portion of any increase in the

90. See 36 C.F.R. § 67.7(b)(5) (2006).

91. If historic features must be replaced, the work should be adequately documented. *Id.* § 67.7(b)(6).

92. See *id.* § 67.7(b)(7).

93. See *id.* § 67.7(b).

94. Although strong arguments exist for charging the easement holder with the exclusive obligation to maintain the façade, apportionment is more appropriate. Both the donor and the charity use the façade and benefit from the maintenance. Furthermore, nature, not use, causes much of the wear and tear. The problem with apportionment is determining the extent of the charity's use. The charity uses the property by conserving it and providing access to the public. Gauging the frequency of public access may be impossible in many situations. This article solves that problem by apportioning the obligation based on economic benefit to the charity and the donor. See *infra* notes 160-166 and accompanying discussion in Part IV.

95. Treas. Reg. § 1.170A-14(h)(3)(ii) (as amended in 1999).

96. *Id.*

97. *Id.* § 1.170A-14(h)(3)(iii) (indicating the increase in value through the increase in value of the property generally, or in the value of the induction).

98. *Id.* § 1.170A-14(g)(6).

value of the property resulting from the repairs.⁹⁹

B. Payment of Maintenance Expenses as an Indirect Contribution to Charity

To the extent the obligation to repair rests with the charity, a donor who pays for a repair makes an indirect contribution to the charity. Financially, the donor and charity are in the same position as if each paid their respective share of the cost and, then, the donor reimbursed the charity for its out-of-pocket expense. The donor's agreement in the grant to assume responsibility for all repairs constitutes a promise to make gifts in the future, which should give "rise to a charitable contribution [when] payment is actually made."¹⁰⁰

Both general tax principles and case law interpreting the charitable contribution deduction support the argument that satisfaction of the charity's obligation is a deductible indirect contribution to the charity. In *Old Colony Trust Co. v. Commissioner*, the Supreme Court addressed the question of whether an employer's payment of an employee's federal tax liability was income to the employee.¹⁰¹ Holding in the affirmative, the Supreme Court said "[i]t is therefore immaterial that the taxes were paid directly over to the Government. The discharge by a third person of an obligation to him is equivalent to receipt by the person taxed."¹⁰²

While *Old Colony Trust* addressed whether discharge of a liability by a third party creates gross income, the principle underlying its holding, that discharge of one's obligation is equivalent to receipt of the amount expended for the discharge, is equally applicable in the context of determining whether a donor has made a contribution to the charity.

In the charitable contribution context, *Douglas v. Commissioner* stands for the proposition that payment of a charity's liability is a contribution to the charity.¹⁰³ Mr. Douglas, a Greek immigrant and self-made man, was approached by a cash-strapped Greek Orthodox church trying to purchase a church building.¹⁰⁴ Mr. Douglas agreed to purchase the property and to pay the mortgage until the church was in a position to buy the property from him.¹⁰⁵ Shortly after he purchased the property, Mr. Douglas deeded 20 percent to the church, free and clear of any

99. *Id.*

100. *Douglas v. Comm'r*, 58 T.C.M. (CCH) 563, *25 (1989).

101. 279 U.S. 716, 720 (1929).

102. *Id.* at 729.

103. 58 T.C.M. (CCH) 563 (1989).

104. *Id.* at 7.

105. *Id.* at 10.

liability for the mortgage.¹⁰⁶ After the gift, Mr. Douglas continued to pay one hundred percent of the mortgage payments.¹⁰⁷ The court held that Mr. Douglas had made charitable contributions equal to twenty percent of the mortgage payments because, although the church was not personally liable for the mortgage, its interest in the property was subject to the mortgage.¹⁰⁸ The church was obligated to pay its pro rata share of the mortgage or risk losing its property interest.¹⁰⁹

The holding in *Douglas* is consistent with the principle enunciated by the Supreme Court in *Old Colony Trust*. A third party's payment of an amount that the charity would otherwise have to bear is indistinguishable from the situation in which the third party pays the charity and the charity satisfies the obligation.

C. Payment of Maintenance Expenses Treated as Gift of Services

The second argument supporting a charitable contribution deduction for the donor is that, if the charity is obligated to repair the property subject to the easement, the donor who maintains the property effectively makes a gift of the maintenance services that the charity would otherwise be required to undertake. Treasury Regulation 1.170A-1(g) states that a gift of services is not deductible, but unreimbursed expenses incurred in connection with such a gift are.¹¹⁰ Such unreimbursed expenses must be "directly connected with and solely attributable to the rendition of such volunteer services."¹¹¹ Furthermore, the impetus for the services must be the charitable work.¹¹² If the unreimbursed expenses are not directly connected with the gift of services, no charitable deduction is allowed even though the charity may derive a benefit.¹¹³

A donor who gratuitously agrees as part of the gift of a façade easement to assume the charity's share of the maintenance does so for the same reasons prompting the gift of the façade easement. If the donor pays a third party to perform the maintenance, the cost is directly attributable to the donor's gift of the maintenance services; the

106. *Id.* at 11.

107. *Id.* at 11-13.

108. *Id.* at 27, 30-33.

109. *Id.* at 31.

110. Treas. Reg. § 1.170A-1(g) (as amended in 2005).

111. Rev. Rul. 56-509, 1956-2 C.B. 129.

112. *Orr v. United States*, 343 F.2d 553, 556 (5th Cir. 1965); *Smith v. Comm'r*, 60 T.C. 988, 992-93 (1973).

113. *Saltzman v. Comm'r*, 54 T.C. 722, 724 (1970).

contractor is the instrument by which the donor performs the services.

Rockefeller v. Commissioner stands *inter alia* for the proposition that unreimbursed expenses incident to the rendition of services within the meaning of Treasury Regulation 1.170A-1(g) include amounts paid to compensate a third party hired to perform the donated services.¹¹⁴ John D. Rockefeller, III and David Rockefeller (collectively the “Rockefellers”) and other family members shared the expenses of operating the Rockefeller Family Joint Office, which rendered various services to the Rockefellers.¹¹⁵ The Rockefellers used the staff *inter alia* to conduct their philanthropic activities and to render services to various charities.¹¹⁶ The court held the Rockefellers were entitled to deduct the unreimbursed expenses incident to rendering services to charity, including the portion of their staff’s salary attributable to the staff’s rendition of services to the various charities at their behest, as a contribution “to” charity.¹¹⁷

Archbold v. United States lends further support to the argument that Treas. Reg. §1.170A-1(g) allows the donor to claim a charitable contribution deduction for the charity’s share of maintenance expenses.¹¹⁸ In 1924 Anne Archbold gave the United States government some land located in the District of Columbia to be used as a park.¹¹⁹ In the 1950s the District of Columbia proposed construction of a highway through the park.¹²⁰ Mrs. Archbold filed suit to enjoin the project and claimed a charitable contribution for her attorneys’ fees.¹²¹ Referring to the predecessor to Treas. Reg. §1.170A-1(g), the court stated “if a deduction is allowable for expenses incident to the performance of nondeductible services, it would seem to follow, a fortiori, that incidental expenditures in the making of a deductible gift would be deductible.”¹²² Because the legal fees were “caused by, and directly attributable to . . . attempts to destroy . . . the park . . . [they were]

114. 676 F.2d 35 (2d Cir. 1982).

115. *Id.* at 37.

116. *Id.*

117. *Id.* The question in *Rockefeller* turned on whether such unreimbursed expenses were deductible as a contribution “to” or “for the use of.” *Id.* The Internal Revenue Service never questioned whether payments to a third party to induce such party to render services to a charity were unreimbursed expenses as contemplated by the Regulation. *Id.* Rather, the dispute arose because during the years in issue, contributions “to” a charity could be deducted without limit, but contributions “for the use of” were subject to a limit. *Id.* at 39.

118. 444 F.2d 1120 (Ct. Cl. 1971).

119. *Id.* at 1120.

120. *Id.* at 1121.

121. *Id.*

122. *Id.* at 1123.

incidental to the original gift and . . . deductible.”¹²³ That the expenditures for legal fees occurred after the gift, a considerable time after the gift, was irrelevant.¹²⁴ The *Archbold* court essentially interpreted the predecessor to Treas. Reg. §1.170A-1(g) as allowing a charitable contribution deduction for expenses incurred incidental to any gift to charity, regardless of the nature of the charitable gift; the important question is whether the expenses are incidental to the gift.

The donor’s assumption of a charity’s share of maintenance expenses is incidental to the gift of the façade easement. Just like the legal expenses incurred by Mrs. Archbold, such assumption, and the resulting maintenance expenses, are “caused by, and directly attributable to” the donor’s efforts to preserve the property interest given to the charity. Safeguarding a historic façade with an easement is pointless unless the façade is adequately maintained. The donor’s agreement to maintain the façade prevents time and the elements from destroying the gift and is an important element of the gift. So important, in fact, that one commentator has suggested that such an agreement should be implied in every gift.¹²⁵ Therefore, under the rationale of *Archbold*, such expenses should be deductible under Treas. Reg. §1.170A-1(g).

Douglas, Rockefeller, and Archbold all support the allowance of a charitable contribution deduction for at least a portion of the cost of maintaining a building encumbered by a façade easement. *Davis v. United States*,¹²⁶ which was subsequently decided, holds that a contribution “for the use of” a charity is one made in a “legally enforceable trust . . . or similar legal arrangement.”¹²⁷ While *Davis* does not directly address the issue raised in this article or any of the issues addressed by the *Douglas, Rockefeller, or Archbold* courts, it does raise the question of whether its holding should be read broadly to preclude a charitable deduction for any contribution not made directly to the charity, unless such contribution is made in trust. Because the scope of *Davis* is unclear, consideration of its impact, including whether it implicitly overrules *Douglas, Rockefeller, and Archbold* or otherwise undermines the support they provide for the arguments advanced by this article, is necessary.

Davis raises two pertinent questions. One, are indirect contributions made “for the use of” a charity? If so, the donor’s

123. *Id.* at 1124.

124. *Id.*

125. POWELL, *supra* note 48, at §34A.04[3][a].

126. 495 U.S. 472 (1990).

127. *Id.* at 485.

deduction cannot be predicated on the theory of an indirect contribution unless the façade easement satisfies the requirements of a “legally enforceable trust . . . or similar legal arrangement.”¹²⁸ Two, does *Davis* preclude treating amounts paid to a third party to perform one’s donated services as unreimbursed expenses as contemplated by Treasury Regulation 1.170A-1(g)?¹²⁹

Davis addressed *inter alia* the question of whether amounts paid by Mr. and Mrs. Davis to their missionary sons to cover the sons’ living expenses were contributions “for the use of” their church.¹³⁰ The Davises and their sons belong to the Church of Jesus Christ of Latter-day Saints (the “Mormon Church”), which operates a voluntary missionary program for young men, mostly aged 19 to 22.¹³¹ Both of the sons volunteered to spend two years as missionaries.¹³²

In accordance with the procedures it followed at the time, the Mormon Church calculated the amount needed for living expenses based on a missionary’s assignment and then looked to his parents for the money.¹³³ If the parents were unable to provide the funds, the Mormon Church tried to find another member to cover the missionary’s costs.¹³⁴ Failing that, the Mormon Church paid the expenses from its funds.¹³⁵ Church policy was to have the support money sent directly to the missionary in order to “foster[] the church doctrine of sacrifice and consecration in the lives of its people” and to simplify bookkeeping.¹³⁶

128. Structuring façade easements to meet the requirements of a “trust or similar legal arrangement” should not be too difficult. In fact, for many existing façade easements, a strong argument can probably be made that the easement is sufficiently similar to a trust to satisfy the requirements of the *Davis* Court. *Davis* states that “[a] defining characteristic of a trust arrangement is that the beneficiary has the legal power to enforce the trustee’s duty to comply with the terms of the trust.” *Id.* at 483 (citing 3 W. FRATCHER, SCOTT ON TRUSTS § 200 (4th ed. 1988)). Most façade easements give the charity the right to compel the donor to comply with the restrictions of the easement. See, e.g., NAGEL & BARRETT, *supra* note 4, at 102. A complete discussion of the similarities between a façade easement and a trust is beyond the scope of this article. See Alexander R. Arpad, *Private Transactions, Public Benefits, and Perpetual Control Over the Use of Real Property: Interpreting Conservation Easements as Charitable Trusts*, 37 REAL PROP. PROB. & TR. J. 91 (2002).

129. Treas. Reg. §1.170A-1(g) (as amended in 2005). *Davis* does not invalidate Regulation 1.170A-1(g) because unreimbursed expenses are considered to be contributions “to,” not “for the use of,” a charity. *Rockefeller v. Comm’r*, 676 F.2d 35, 42 (2d Cir. 1982); Rev. Rul. 84-61, 1984-1 C.B. 39.

130. *Davis*, 495 U.S. at 478.

131. *Id.* at 473-74.

132. *Id.* at 475.

133. *Id.* at 474.

134. *Id.*

135. *Id.*

136. *Id.*

The Church provided guidance to the missionaries with respect to how the funds should be spent, instructing them not to squander the funds on frivolities.¹³⁷ Although the Church did not require advance approval of expenditures, the missionaries were required to report their expenditures to the church.¹³⁸

After their sons promised to abide by the Church's restrictions on spending, Mr. and Mrs. Davis deposited the necessary funds into each son's personal checking account.¹³⁹ The sons used the money for "rent, food, transportation and personal needs" while serving as missionaries.¹⁴⁰

The Davises advanced two arguments to support a charitable contribution deduction.¹⁴¹ Their primary argument was based on statutory construction. They argued that the amounts were contributions "for the use of" the Mormon Church.¹⁴² Alternatively, they argued the amounts were deductible as unreimbursed expenses incurred incident to the rendition of services to the Mormon Church.¹⁴³

In support of their first argument, the Davises argued that "for the use of" should be construed broadly to mean "the entire array of fiduciary relationships in which one person conveys money or property to someone else to hold or employ in some manner for the benefit of a third person."¹⁴⁴ While recognizing that section 170(c) could be read to support that interpretation, the Court found the legislative history indicated Congress added "for the use of" as a response to the Internal Revenue Service's contention that the language "contributions or gifts to" charity did not encompass donations in trust for the benefit of a charity.¹⁴⁵ Consequently, the Court held that a gift "for the use of" a charity is one made in trust or in some similar legal arrangement.¹⁴⁶ The

137. *Id.* at 475. The Church also exercised far greater control over the missionaries than an employer or another charitable recipient of volunteer services would. The Church not only established the number of hours to be devoted to missionary activities, but it also controlled a missionary's free time, forbidding many activities, such as dating. *Id.*

138. *Id.*

139. *Id.* at 476.

140. *Id.*

141. *Id.* at 477.

142. *Id.*

143. *Id.*

144. *Id.* at 479 (citing Brief for Petitioner 17).

145. *Id.* at 479-81.

146. *Id.* at 485. While the interpretation of "for the use of" adopted by the Supreme Court in *Davis* appears to accord with the legislative history, the outcome appears contrary to common sense and exalts form over substance. One cannot help but wonder whether the *Davis* court gave undue weight to the missionaries' status as the sons and natural object of the Davises' bounty. Would a different result have been reached if the money had come from some third-party church member

amounts paid by the Davises to support their sons did not qualify because they were not made pursuant to a legal arrangement that satisfied the definition of a trust.¹⁴⁷ Although this definition of a charitable contribution “for the use of” a charity does “not require that the [charity] take actual possession of the contribution, it nevertheless reflects that the beneficiary must have significant legal rights with respect to the disposition of donated funds.”¹⁴⁸

The Davises never argued that they had made an indirect contribution to the Mormon Church that was deductible as a contribution “to” charity. Consequently, the *Davis* court neither considered whether the definition of a contribution “to” charity includes or excludes indirect contributions nor said that indirect contributions to a charity must satisfy the requirements of a contribution “for the use of” a charity. The *Davis* court simply concluded that “for the use of” was added to allow deductions for charitable contributions made in trust and, therefore, any deduction predicated on that language must satisfy the requirement of being in a trust.¹⁴⁹ There is nothing in *Davis* that indicates that indirect contributions to a charity must be treated differently from direct contribution to a charity.

In addition, *Davis* is factually distinguishable from the situation addressed in this article. The Davises were not satisfying a legal obligation of the Mormon Church.¹⁵⁰ Their sons were volunteers, not employees,¹⁵¹ the Church had no legal obligation to pay the expenses associated with the son’s gift of services.¹⁵² The Church voluntarily paid the living expenses if no sponsor could be found because it benefited from the missionaries’ services, not because it had a legal obligation to do so.¹⁵³

Contrast *Davis* with a donor’s payment of a charity’s share of maintenance expenses. Not only does the obligation to repair the façade

who did not know the sons? If the Church determines that \$500 will support a missionary for a year and solicits donations in that amount, it seems to be nitpicking in the extreme to deny a charitable contribution deduction to a church member who donates \$500 for the support of some unknown missionary merely because the Church asks the member to mail the \$500 directly to the missionary. The primary consequence of *Davis* from a pragmatic standpoint is to require the Mormon Church to change its procedures so that it requires parents to send the money directly to the church, which then sends a check to the missionaries.

147. *Id.* at 485-86.

148. *Id.* at 483.

149. *Id.* at 485-86.

150. *Id.* at 474.

151. *Id.*

152. *Id.* at 474.

153. *Id.* at 474.

rest with the charity absent an assumption by the donor, but the charity cannot choose to ignore its obligation if the purpose of the easement is to be fulfilled. Furthermore, failure to maintain the façade is not only inconsistent with preservation, it also renders superfluous the requirement that a charity have the financial resources to preserve the easement's conservation purposes.¹⁵⁴ If not properly maintained, the façade may deteriorate to the point where the building is removed from the National Register or is demolished.¹⁵⁵ *Davis* teaches us nothing regarding the proper tax treatment of a donor's satisfaction of the charity's obligation to repair the façade.

The Davises' second argument, that the funds were unreimbursed expenses incurred incident to the rendition of services by their sons, was also rejected, but not because the nature of the expenses disqualified them from being incidental to a charitable gift of services. The rejection was based on the identity of the taxpayer claiming the charitable deduction.¹⁵⁶ Regulation §1.170A-1(g) applies only to expenses incurred by the taxpayer giving the services to charity.¹⁵⁷ The sons, not Mr. and Mrs. Davis, donated their services to the Church.¹⁵⁸

Unlike the Davises, the donor of a façade easement is the one contributing the services. The donor is motivated by the desire to benefit the charitable easement holder and to serve the conservation purpose of the easement, not by a desire to benefit the contractors who will be hired to make the repairs. On the contrary, the donor expects to receive services of equivalent value to the consideration paid. And, unlike the Davises' sons, the contractors have no desire to make a gift to the charitable easement holder; the only reason they are performing services is because they are being paid full value for their efforts. The contractors assist the donor in rendering the maintenance services. As the *Davis* Court recognized, a situation in which a donor pays a third party to assist in the gift of services is inapposite to the situation presented in *Davis*.¹⁵⁹

As the analysis above shows, *Davis* does not address the question of indirect contributions "to" a charity, nor does it prohibit the deduction of payments to independent third parties who perform services at the behest of the donor. Therefore, *Davis* does not implicitly overrule

154. Treas. Reg. §1.170A-14(c)(1) (as amended in 1999).

155. See discussion *supra* notes 28-30 and accompanying text.

156. *Davis*, 495 U.S. at 487.

157. *Id.*

158. *Id.* at 476.

159. *Id.* at 488.

Douglas, Rockefeller, or Archbold, nor does it undermine the theories advanced by this article regarding the existence of a charitable contribution deduction for a donor of a façade easement who agrees to assume liability for the charity's share of maintenance expenses.

IV. SUGGESTIONS TO ENSURE UNIFORM TREATMENT FOR ALL TAXPAYERS

Current law provides strong support for the argument that a donor who assumes the cost of maintaining property subject to a façade easement makes additional charitable contributions every time the donor expends money for repairs, but only to the extent that state law imposes the obligation to repair on the charity.¹⁶⁰ Because state law may vary with respect to the existence and extent of a charity's obligation, relying on it to determine when a donor is entitled to claim a charitable contribution is not the best approach and may lead to disparate treatment.

Façade easements are as much creatures of federal tax law as of state law. The primary, if not sole, reason many provisions are included in façade easements is to qualify for the federal charitable contribution deduction.¹⁶¹ Donors seeking federal tax benefits should be able to rely on readily ascertainable and consistent federal rules regarding the tax consequences of their actions. The government deserves equal consideration, as well as assurance, that aggressive donors do not claim a charitable contribution deduction that is disproportionate to the benefit derived by the charity. The best way to accomplish these goals is to promulgate a federal rule, one that is easily administered, regarding how much of the donor's maintenance expenditures constitute charitable contributions.

The existing rules regarding façade easements provide a blueprint for devising a fair and easily administered rule to determine a donor's charitable contribution. Currently, the Treasury Regulations require donors to compute what percentage of the value of their servient estate is

160. See, e.g., *Bailey v. Comm'r*, 88 T.C. 1293, 1296 (1987), *acq.*, 1989-2 C.B.; *Hilborn v. Comm'r*, 85 T.C. 677, 681-82 (1985); BARRETT & NAGEL, *supra* note 4, at 96-97.

161. See I.R.C. §170(a)(1), (f)(3)(B)(iii) (2006). See STAFF OF JOINT COMM. ON TAX'N, 94TH CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976, 643 (Comm. Print 1976); See also, e.g., Jennifer Anne Rikoski, Comment, *Reform but Preserve the Federal Tax Deduction for Charitable Contributions of Historic Façade Easements*, 59 TAX LAW. 563 (2006); Neighbors of Watertown Inc., <http://www.neighborsofwatertown.com> (last visited Mar. 10, 2006); Kansas Preservation Alliance, http://www.kpalliance.org/Pages/01_programs_easement.html (last visited Mar. 20, 2006).

attributable to the façade easement.¹⁶² That percentage, which I will call the Charitable Percentage, is established at the time of the gift and remains constant. The Charitable Percentage equals the ratio of the value of the façade easement at the date of the gift to the unencumbered value of the servient estate at the time of the gift.¹⁶³ The Charitable Percentage establishes the percentage of the value of the servient estate that the donor claims as a charitable contribution for the grant of the easement.¹⁶⁴ And, because the fair market value of a façade easement is, generally, determined by the decrease in value of the servient estate as a result of the easement grant,¹⁶⁵ the Charitable Percentage represents the loss of value to the donor from the grant. The Charitable Percentage also represents the percentage of the value of the servient estate that the Treasury Regulations treat as belonging to the charity if the façade easement is ever extinguished. In a post-termination sale, the charity must receive a portion of the sales proceeds.¹⁶⁶ And, the Charitable Percentage establishes the minimum percentage payable to the charity.¹⁶⁷

The Charitable Percentage can be used to fashion an easily administered rule to determine what portion of a donor's maintenance expenses should be treated as a charitable contribution. Such a rule would provide that a donor who assumes responsibility for paying all maintenance expenses makes a charitable contribution each time the donor incurs an expense for maintenance, with the amount of the contribution equaling the amount of the expense multiplied by the Charitable Percentage.

Example: Donor owns Blackacre, which has a fair market value of \$100. Donor grants a façade easement to Charity. The fair market value of the façade easement is \$20. The Charitable Percentage is twenty percent, the percent of the value of Blackacre that Donor gave to Charity. In the easement grant Donor agrees to pay all maintenance expenses. Several years after the gift of the façade easement, Donor spends \$10 maintaining the façade. Donor's charitable contribution deduction equals twenty percent of the \$10, or \$2.

Determining the amount of the donor's charitable contribution by

162. Treas. Reg. § 1.170A-14(g)(6)(ii) (as amended in 1999). The Charitable Percentage also determines the amount by which a donor must reduce his basis in the servient estate as a result of the gift of the façade easement. I.R.C. §170(e)(2), Treas. Reg. §1.170A-14(b)(3)(iii).

163. Treas. Reg. §1.170A-14(g)(6)(ii).

164. *Id.* § 1.170A-14(h)(3)(i). *See supra* notes 39-46 and accompanying discussion in Section II.B.2.

165. Treas. Reg. § 1.170A-14(g)(6)(ii).

166. *Id.*

167. *Id.*

reference to the Charitable Percentage is simple. It is also fair to both the donor and the government, since it reflects the benefit to the charity from the maintenance expenses. The practical impact of this rule on a donor's tax consequences is explained below.

A. Tax Treatment of Maintenance Expenses

The tax treatment of the cost of maintaining a building varies depending on whether the expenditure is considered a repair or a capital improvement.¹⁶⁸ Whether the building is held for income producing purposes or for personal use also affects the tax consequences.

The Tax Code characterizes maintenance costs as repairs or as capital improvements. A repair is an expenditure that keeps the building "in an operating condition over its probable useful life for the uses for which it was acquired."¹⁶⁹ A capital improvement materially adds to the value of the building, adapts it to another use, or substantially prolongs its useful life.¹⁷⁰ Capital improvements include "replacements, alterations, improvements, or additions which prolong the life of the [building], increase its value or make it adaptable to a different use."¹⁷¹ The cost of capital improvements is added to the building's basis.¹⁷² Repairs, if they have any tax consequences at all, are treated as expenses.¹⁷³

Whether a building is held for income producing or for personal use affects the tax treatment of both a repair and a capital improvement.¹⁷⁴ If the building is held for income producing purposes, both repairs and capital expenditures are deductible; the difference is simply one of

168. Treas. Reg. § 1.162-4 (1960).

169. *Midland Empire Packing Co. v. Comm'r*, 14 T.C. 635, 640 (1950) (quoting *In re Illinois Merch. Trust Co.*, 4 B.T.A. 103, 106 (1926)); Treas. Reg. § 1.162-4.

170. Treas. Reg. § 1.162-4.

171. *Midland Empire*, 14 T.C. at 640, (quoting *In re Illinois Merch.*, 4 B.T.A. at 106).

172. I.R.C. § 1016(a)(1) (2006). Regardless of the arguments advanced by this article, a servient owner who makes a capital improvement may be considered to make an additional qualified conservation contribution. The Internal Revenue Service has ruled that the grantor of a charitable remainder trust who makes capital improvements to the property held by the trust makes an additional contribution to the charitable remainderman. I.R.S. Priv. Ltr. Rul. 85-29-014 (Apr. 16, 1985). A capital improvement to a façade may be viewed similarly, as an additional grant of an easement. A discussion of whether capital improvements create additional easement grants is beyond the scope of this article; however, even if they do, it is far more convenient, administratively, to determine the amount of the donor's additional charitable deduction using the method suggested in this article than to try to determine the increase in the value of the easement created by the capital improvement.

173. Treas. Reg. § 1.162-4; I.R.C. §§ 162, 212.

174. Buildings held for income producing purposes include those held for investment purposes as well as those used in the taxpayer's trade or business. I.R.C. §§ 162, 212.

timing. Repairs are currently deductible.¹⁷⁵ Capital expenditures, on the other hand, are deducted over their useful life through depreciation deductions.¹⁷⁶ If the building is sold before the capital improvement is fully depreciated, the balance is deducted against the sales price to determine the taxpayer's gain or loss.¹⁷⁷

Example: Taxpayer holds a building for income producing purposes that has an adjusted basis of \$33,000. In 2006, Taxpayer spends \$2,000 on repairs and \$7,800 for a capital improvement. The \$2,000 repair is deductible in 2006. The \$7,800 capital improvement increases the building's basis to \$40,800 and will be depreciated over its useful life. Several years later, Taxpayer sells the building. Since making the capital improvement, Taxpayer has claimed a total of \$6,000 in depreciation, of which \$1,000 was attributable to the capital improvement. Therefore, Taxpayer's adjusted basis in the building is \$34,800.¹⁷⁸ When Taxpayer sells the building, she calculates her gain or loss by deducting her basis from the sales proceeds.¹⁷⁹ If she sells for \$40,000, her gain is \$5,200.¹⁸⁰ If she sells for \$30,000, she realizes a \$4,800 loss, which is deductible against taxable income.¹⁸¹ In either alternative, Taxpayer deducts the undepreciated cost of the capital improvement at the time the building is sold.

If the building is used for personal purposes, such as the owner's residence, repairs are nondeductible personal expenses.¹⁸² Capital improvements still increase the building's basis,¹⁸³ however, depreciation deductions are no longer permitted.¹⁸⁴ If the building is subsequently sold for a gain, capital improvements are deducted to determine gain.¹⁸⁵ But, since losses from the sale of personal use property are not deductible,¹⁸⁶ if the taxpayer sells the building at a loss, some or all of the capital improvement becomes a nondeductible personal expense.¹⁸⁷

175. Treas. Reg. §1.162-4; I.R.C. §§ 162, 212.

176. I.R.C. §§ 162, 167, 212. The building's basis is reduced to reflect depreciation. *Id.* §1016(a)(2).

177. *Id.* §§ 1001(a),(b),165(a),(c).

178. Depreciation deductions reduce the building's basis. *Id.* § 1016(a)(2).

179. *Id.* § 1001(a),(b).

180. *Id.* § 1001(a).

181. *Id.* §§ 1001, 165(a)(c).

182. *Id.* § 262.

183. *Id.* § 1016(a)(2).

184. *Id.* § 262.

185. *Id.* § 1001(a).

186. *Id.* § 165(c).

187. *Id.* §§ 162, 262.

Example: Taxpayer holds a building for personal use; the building has an adjusted basis of \$50,000. Taxpayer spends \$1,000 for repairs and \$6,000 for a capital improvement. The repairs are not deductible; the \$6,000 capital improvement increases the building's adjusted basis to \$56,000.¹⁸⁸ If Taxpayer subsequently sells the building for more than \$56,000, the capital improvement is deducted in full. If Taxpayer sells for less than \$56,000, some or all of the capital improvement is not deductible. For example, if Taxpayer sells for \$54,000, Taxpayer realizes a nondeductible loss of \$2,000. In this situation only \$4,000 of the capital improvement is deducted.

B. Tax Treatment if a Portion of Maintenance Expenses is Considered a Charitable Contribution

If a portion of the cost of maintaining a historic building is treated as a charitable contribution, the tax treatment of the balance is determined by the foregoing rules. The portion treated as a charitable contribution will be deductible, subject to the rules applicable to charitable contributions.

Because of the limitations applicable to charitable contributions, recharacterizing a portion of the maintenance expenses as a charitable contribution may or may not be advantageous. Depending on the taxpayer's circumstances, such treatment will have no effect, change the timing of the deduction, disallow a deduction, or permit the deduction of an otherwise nondeductible expense.

If the historic building is held for income producing purposes, and assuming the taxpayer's contribution base is sufficient to permit immediate deduction of the charitable contribution in full, recharacterization of an expenditure that would be treated as a repair has no effect; recharacterization of one that would be treated as a capital improvement accelerates the deduction. If the taxpayer's contribution base is insufficient to allow immediate deduction, recharacterization of a repair defers a deduction that would otherwise be allowed currently; however, recharacterization of a capital improvement still accelerates the deduction, since buildings and their components have a depreciable life greater than six years.¹⁸⁹ Finally, if the contribution base is too small, there is a risk that recharacterization of either a repair or a capital improvement will result in total disallowance of a portion of the deduction.

188. *Id.* § 1016(a)(1).

189. *See id.* § 168.

Example: In 2006, Taxpayer, an individual whose contribution base, adjusted gross income, is \$50,000, donates a façade easement to charity and agrees to assume the charity's liability for a share of future maintenance expenses. The charity qualifies as a section 170(b)(1)(A) charity, which entitles Taxpayer to deduct cash contributions to the charity to the extent of fifty percent of adjusted gross income.¹⁹⁰ Taxpayer's maximum allowable charitable contribution deduction is \$25,000. The building is held for income producing purposes and has an adjusted basis of \$100,000. Assume the Charitable Percentage is twenty percent, i.e., twenty percent of all repairs and capital improvements are recharacterized as charitable contributions. Further assume that Taxpayer makes no other charitable contributions. In 2007, Taxpayer spends \$10,000 on repairs, of which \$2,000 is recharacterized as a charitable contribution. Taxpayer deducts \$8,000 as a repair,¹⁹¹ and provided that Taxpayer's other cash donations do not exceed \$23,000, the other \$2,000 as a charitable contribution.¹⁹² Alternatively, assume Taxpayer spends \$100,000 on a capital improvement of which \$20,000 is recharacterized. Taxpayer must capitalize and depreciate the \$80,000, which, if the building is used for residential rental means the recovery period is twenty-seven and a half years.¹⁹³ The \$20,000 charitable contribution deduction is deductible immediately or over a maximum of six years if Taxpayer's other charitable contributions prevent immediate deduction. In either instance, the deduction for the \$20,000 is greatly accelerated.

If the building is held for personal use, recharacterization should almost always be beneficial. Recharacterization converts a nondeductible repair into a deductible charitable contribution. For capital improvements, recharacterization makes immediately deductible an expenditure that would, at best, be deductible only against gain at the time of sale.

Example: In 2006, Taxpayer, an individual whose contribution base, adjusted gross income, is \$50,000, donates a façade easement to charity and agrees to assume the charity's liability for a share of future maintenance expenses. The charity qualifies as a section 170(b)(1)(A)

190. *Id.* § 170(b)(1)(A).

191. *Id.* § 162.

192. *Id.* § 170(b)(1)(A). If Taxpayer's other cash contributions exceed \$23,000, some or a part of the \$2,000 deduction will be deferred to the next year or beyond. *Id.* §170(d)(1)(A). There is also a risk that the \$2,000 deduction, when coupled with Taxpayer's other cash deductions, results in the deferral of deduction for contributions of property. *Id.* §170(b)(1)(B).

193. *Id.* § 168.

charity, which entitles taxpayer to deduct cash contributions to the charity to the extent of fifty percent of adjusted gross income.¹⁹⁴ Taxpayer's maximum allowable charitable contribution deduction is \$25,000. The building is held for personal use and has an adjusted basis of \$100,000. Assume the Charitable Percentage is twenty percent, i.e., twenty percent of all repairs and capital improvements are recharacterized as charitable contributions. Also assume Taxpayer makes no other charitable contributions. In 2007, Taxpayer spends \$10,000 on repairs, of which \$2,000 is recharacterized as a charitable contribution. Taxpayer may deduct the \$2,000 charitable contribution.¹⁹⁵ No deduction is allowed for the \$8,000 characterized as a repair. Alternatively, assume Taxpayer spends \$100,000 on a capital improvement of which \$20,000 is recharacterized. Taxpayer may deduct the \$20,000 charitable contribution deduction immediately. The remaining \$80,000 is added to Taxpayer's basis in the building and is deducted against the sales proceeds if the building is sold for a gain. To the extent Taxpayer realizes a loss on the sale of the building, the \$80,000 is not deductible.¹⁹⁶

V. CONCLUSION

To the extent a charity is obligated to maintain property subject to a façade easement, a donor's assumption of such obligation benefits the charity and furthers the conservation purposes of the easement. There are several persuasive arguments that current law considers the discharge of the charity's obligation to be an additional charitable contribution by the donor. The difficulty exists in determining the extent of the charity's obligation to maintain the façade and in assuring consistent treatment of all taxpayers. That problem is easily resolved by adopting a federal rule that determines the donor's charitable contribution without regard to the extent to which state law imposes the obligation to maintain on the charitable easement holder. The solution suggested by this article, using the Charitable Percentage to determine the amount of the charitable contribution, is easy and fair to both taxpayers and the government.

194. *Id.* § 170(b)(1)(A).

195. *Id.* § 170(b)(1)(A). If Taxpayer's other cash contributions exceed \$23,000, some or a part of the \$2,000 deduction will be deferred to the next year or beyond. *Id.* § 170(d)(1)(A). There is also a risk that the \$2,000 deduction, when coupled with Taxpayer's other cash deductions, results in the deferral of the deduction for contributions of property. *Id.* § 170(b)(1)(B).

196. *Id.* § 165(c).