Be Careful What You Ask For: Charitable Deductions and Donor Benefits.

Qualified conservation easements have generated a number of cases recently, primarily focused on the technical requirements for the appraisal and related issues. A recent case from the District of Idaho raises a more fundamental question: whether a conservation easement was a charitable gift at all. The government's theory was that the easement was part of a larger *quid pro quo* transaction and therefore did not meet the basic requirement of donative intent. *Pesky v. United States*, 2013 U.S. Dist. LEXIS 96097 (D. Id. July 8, 2013).

The case revolved around a property in Ketchum, Idaho that apparently was next to Ernest Hemingway's Sun Valley home. Mary, Hemingway's widow, had granted an easement to the owners of three parcels of undeveloped land to permit access over the Hemingway property, but there were questions about the validity of that easement. When Mary died, The Nature Conservancy ("TNC") became the owner of the Hemingway property. Litigation over the easement then arose between the owners of the undeveloped property ("M&H") and TNC. TNC made a settlement proposal to M&H which involved a conservation easement and a cash contribution in return for agreements that would benefit the parcel owned by M&H. *Pesky v. United States*, 2013 U.S. Dist. LEXIS 96097, slip op. at *2-*5.

Later the Peskys got involved. TNC obtained an option giving it the right purchase the undeveloped land from M&H for $1.6 million, and it transferred this option to the Peskys for $50,000, along with an agreement guaranteeing access over the disputed Hemingway easement for three home sites on the undeveloped land. TNC also agreed that it would support an application for construction of a driveway over the Hemingway easement, which required local approvals. *Id.* at *6. But there were a couple of complications: *first*, when Mr. Pesky's attorney outlined the transaction in a memorandum to his client, he indicated that it contemplated a subsequent contribution to TNC of two of the lots on the undeveloped property at a later date; *second*, a formal pledge agreement was executed that restricted the Peskys' ability to develop the property to a single family home and provided for a $400,000 donation for purposes of a new office building for TNC. *Id.* at *5, *7-*8.

To round out the transactions, the Peskys purchased the property in 1993 and then began listing it for sale. In 2002, they granted TNC a conservation easement on two of the lots; the documentation for this agreement included an increase on the height limit that encumbered the remaining lot on the undeveloped property. The Peskys then sold the property subject to the conservation easement, claiming a deduction on their returns for 2002-2004. *Id.* at *8-*9. After the IRS assessed them for deficiencies and assessed a civil fraud penalty, the Peskys paid under protest and filed suit for a refund.

There was little doubt that a showing of a *quid pro quo* transaction would invalidate the claimed deduction, as courts have long recognized that a donation made with the expectation that adequate consideration would be received is not a gift. The real question was whether the fact pattern before the district court was sufficient for it to rule as a matter of law that there was a *quid pro quo* arrangement. On that score, the district court concluded that the government's evidence was not strong enough to permit summary judgment, noting specifically that the assignment agreement contained no reference to development restrictions and did not indicate that its benefits were to provide consideration for the pledge agreement. *Id.* at *18. By the same

token, the court was unwilling to categorically accept the Peskys' argument that the conservation easement was wholly separate from the prior transactions. *Id.* at *19-*20.

While the Peskys are presumably pleased that the government's summary judgment motion was denied, it is hard to look at the outcome as a big win from their perspective.

The case serves as a reminder to lawyers who are working on conservation easements that they may need to take a broader look at the surrounding landscape to make sure that the planned transaction will pass muster.

Reading between the lines, the Peskys might also have benefited from an additional layer of legal counsel. The memorandum that their attorney prepared indicated that the contemplated easement was a part of the total transaction. Presumably, this became available because the Peskys invoked reliance upon counsel's opinion as a defense to the civil fraud penalty assessment, thereby waiving attorney-client privilege. If a separate lawyer had been retained to handle the opinion, it is conceivable that the memorandum, which clearly didn't help matters, might have retained privileged status.

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