KATHRYN KENEALLY
Assistant Attorney General

MICHAEL P. HATZIMICHALIS
RICK WATSON
LANDON YOST
Trial Attorneys, Tax Division, U.S. Department of Justice
P.O. Box 683
Ben Franklin Station
Washington, D.C. 20044
Tel: (202) 353-1854
(202) 307-2144
Fax: (202) 307-0054
Michael.P.Hatzimichalis@usdoj.gov
Landon.M.Yost@usdoj.gov
Rickey.Watson@usdoj.gov
Western.Taxcivil@usdoj.gov

WENDY J. OLSON (Idaho State Bar No. 7634)
United States Attorney, District of Idaho

*Attorneys for the United States of America*

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF IDAHO

| | |
|---|---|
| ALAN PESKY AND WENDY PESKY,<br><br>Plaintiffs,<br><br>v.<br><br>UNITED STATES OF AMERICA,<br><br>Defendant. | Case No. 1:10-CV-186-WBS<br><br>**UNITED STATES' MOTION FOR RECONSIDERATION** |
| UNITED STATES OF AMERICA,<br><br>Counterclaim Plaintiff,<br><br>v.<br><br>ALAN AND WENDY PESKY<br><br>Counterclaim Defendants. | |

## INTRODUCTION

The United States respectfully disagrees with much of the Court's ruling and analysis in its orders in Docket ## 121-123, and moves to reconsider three issues in which legal error is apparent: (1) the Court's denial of the United States' motion for summary judgment as to Plaintiffs' 2003 and 2004 conservation easement deductions on the grounds that the appraisal they submitted to substantiate these deductions does not satisfy Treasury Regulations (Dkt. # 122, pp. 17-24); (2) the Court's denial of the United States' motion for summary judgment as to Plaintiffs' "mortgage interest and other miscellaneous deductions" (Dkt. # 123, pp. 6-7); and (3) the Court's granting of Plaintiffs' motion for summary judgment as to the United States' fraud claims.

"Denial of summary judgment is 'generally interlocutory and [thus] subject to reconsideration by the court at any time.'" *In re Roth*, 431 Fed.Appx. 541, 543 (9th Cir. 2011) (citing *Preaseau v. Prudential Ins. Co. of Am.*, 591 F.2d 74, 79–80 (9th Cir. 1979) (internal quote omitted). Generally speaking, for both denials and grants of summary judgment, "[r]econsideration is appropriate if the district court (1) is presented with newly discovered evidence, (2) committed clear error or the initial decision was manifestly unjust, or (3) if there is an intervening change in controlling law." *School Dist. No. 1J v. ACandS, Inc.*, 5 F.3d 1255, 1263 (9th Cir. 1993).

## ARGUMENT

The Court effectively indicated that the Richey Appraisal was not a qualified appraisal, and that, as a result, Plaintiffs' conservation easement deductions would typically be denied. However, the Court did not deny the deductions, as it held that there was a genuine dispute of material fact as to whether Plaintiffs' failure to submit a qualified appraisal was excused by the defense of reasonable cause, a defense that Plaintiffs had not advanced and which was not briefed by either party. This holding is wrong as a matter of law, however, because the defense of reasonable cause did not exist for the conservation easement deductions at issue. The reasonable cause defense for failure to comply with substantiation requirements was not added to 26 U.S.C. § 170 until 2004, and it was made effective for contributions made after June 3, 2004.

The Court also held that "it cannot speculate as to [the] meaning and importance" of the documents Plaintiffs submitted to substantiate their other miscellaneous deductions, but then it denied the United States' motion for summary judgment seeking to disallow these deductions. Because Plaintiffs have "the burden of establishing the facts from which an exact determination of the proper deduction may be made," however, the proper consequence of Plaintiffs' failure to clearly substantiate the amount of their deductions should be a denial of these deductions. *Tulia Feedlot, Inc. v. United States*, 513 F.2d 800, 805 (5th Cir. 1975).

Finally, the Court did not consider all facts tending to show fraud by Mr. Pesky, and did not take all reasonable inferences from those facts in the United States' favor. Importantly, the Court focused on the actions of Mr. Pesky's advisors without addressing Mr. Pesky's personal involvement with the transaction at issue, as evidenced by the testimony of those same advisers.

**I. No reasonable cause exception for failure to submit a qualified appraisal existed for the conservation easement deductions at issue, and the Court therefore committed clear error by denying the United States' motion for summary judgment on the grounds that there is a genuine dispute of fact as to whether Plaintiffs had reasonable cause for their failure to submit a qualified appraisal**

26 U.S.C. § 170(a)(1), in the form it existed at the time Plaintiffs made the conservation easement contribution, provides that "[a] charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary." 26 U.S.C. § 170(a)(1) (*See* 26 U.S.C. § 170, effective January 1, 2001 to March 8, 2002, attached as Exhibit A to this motion).

The United States argued in its motion for summary judgment that Plaintiffs' conservation easement deductions are not allowable as a matter of law because they failed to substantiate these deductions under the prescribed Treasury Regulations. More pointedly, the Richey Appraisal that Plaintiffs submitted to substantiate these deductions does not even come close to satisfying the applicable Treasury Regulations.

As the Court noted, the United States' first principal argument in this regard is that the Richey Appraisal failed to comply with 26 C.F.R. § 1.170A-14(h)(3)(ii). This Treasury Regulation, in the form it existed at the time Plaintiffs made the conservation easement contribution, provides:

> If before and after valuation is used, the fair market value of the property before contribution of the conservation restriction must take into account not only the current use of the property but also an objective assessment of how immediate or remote the likelihood is that the property, absent the restriction, would in fact be developed, as well as any effect from zoning, conservation, or historic preservation laws that already restrict the property's potential highest and best use.

*See* 26 C.F.R. § 1.170A-14, current through April 1, 2002, attached as Exhibit B to this motion.

The United States gave specific examples of how the Richey Appraisal does not "take into account … how immediate or remote the likelihood is that the property, absent the restriction, would in fact be developed [for two home sites], as well as any effect from zoning … laws that already restrict the property's potential highest and best use," in valuing the "before" value of the Ketchum Property.

First, the Richey Appraisal completely ignores the easement restrictions that limited development and were already in place at the time Plaintiffs made the conservation easement contribution. The Richey Appraisal does not mention the Whitmyre Easement, which already limited development of the Ketchum Property to a single home site at the time the conservation easement contribution was made. SUF to US MSJ, Dkt. # 105-2, ¶ 42. Nor does it mention the

Ebbert Easement, which, prior to the superseding Whitmyre Easement, prevented *all* development of the majority of the buildable area on the Ketchum Property. *Id.* Nor does it mention the Easement Agreement, which already limited development of the Ketchum Property by limiting the height of any structures on the Ketchum Property to 25 feet. Exhibit 23 to the US MSJ, Dkt. # 105.

Second, the Richey Appraisal ignores applicable law that already limited development of the Ketchum Property to a single home site. Ketchum municipal code only allows for a driveway to serve a maximum of four residences. Ketchum Municipal Code § 12.04.030(L)(9)(a). Mr. Pesky's attorney, Thomas Campion, in connection with Plaintiffs' driveway application, submitted proposed findings of fact to the Ketchum P&Z commission which stated that the driveway already served three residences.[1] SUF to US MSJ, Dkt. # 105-2, ¶ 35. Therefore, the Ketchum Property could only be developed for a single residence.

Third, the Richey Appraisal makes no attempt to discuss the likelihood that the City of Ketchum would actually approve a driveway for two home sites, even if the four-residence limitation somehow did not apply. This is highly significant given the evidence that the City's approval for a driveway was conditioned upon the fact that only one home would be built. *See* SUF to US MSJ, Dkt. # 105-2, ¶¶32, 35-38, and exhibits referenced therein.[2]

There is no factual dispute that the Richey Appraisal did not even begin to "take into account" all these factors already limiting development. Thus, as a matter of law, the Richey Appraisal does not satisfy 26 C.F.R. § 1.170A-14(h)(3)(ii).

[1] Despite the explicit admission of their attorney, Plaintiffs may argue that there is an issue of fact as to whether the driveway already served three residences, or only two residences, as one of the three residences which used the driveway also had access via a separate driveway to the city street. Whether there were two residences or three residences, however, is beside the point. The point is that this fact should have at least been discussed in the Richey Appraisal.

[2] Again, the question of whether the City of Ketchum would have actually approved a driveway for two home sites may be in factual dispute. However, that is beside the point. The point is that this issue should have at least been discussed in the Richey Appraisal.

Nor is there a factual dispute that the Richey Appraisal does not include the "terms of any agreement or understanding entered into (or expected to be entered into) by or on behalf of the donor or donee that relates to the use, sale, or other disposition of the property contributed," as required by 26 C.F.R. § 1.170A-13(c)(3)(ii)(D) (*see* 26 C.F.R. § 1.170A-13, current to April 1, 2002, attached as Exhibit C to this motion). For example, in addition to not even mentioning the Pledge Agreement, the Whitmyre Easement, the Ebbert Easement, or the Easement Agreement, the Richey Appraisal does not mention or discuss the Contract for Deeds. The Contract for Deeds specifically states that the contract for the sale of the Ketchum Property from Plaintiffs to John and Elizabeth Bunce "provides for three (3) separate sales of three (3) separate properties," with the sale of each "separate property" to occur in 2002, 2003, and 2004.[3] Exhibit 42 to the US MSJ, Dkt. # 105, p. 1. The division of ownership between Plaintiffs and the Bunces which resulted from the separation of the sale of the Ketchum Property into three separate sales violated the very terms of the Conservation Easement, which provides that "[t]he Grantors promise and agree that there shall be no subdivision of any kind whatsoever of the Grantors' Property; or the breaking up of the Grantors' Property into smaller parcels by any manner, including sale." Thus, the Contract for Deeds, along with the other named agreements, clearly relate to the use or sale of the property contributed, and the Richey Appraisal fails to satisfy 26 C.F.R. § 1.170A-13(c)(3)(ii)(D) by not discussing their terms.

There is no factual dispute about what the Richey Appraisal includes and does not include. *See* Richey Appraisal, Exhibit 43 to the US MSJ, Dkt. # 105. There is no factual dispute that the Richey Appraisal, in valuing the "before" value of the Ketchum Property, does not take into

[3] As discussed in the United States' spoliation motion, Dkt. # 117, Plaintiffs structured the sale as three separate sales in order to attempt to defer substantial taxes by a device known as a "1031 Exchange."

account numerous factors highly relevant to the development potential of the property, and there is no factual dispute that the Richey Appraisal does not include the terms of numerous agreements relevant to the use or sale of the Ketchum Property. Thus, there is no factual dispute that Plaintiffs did not submit a qualified appraisal that satisfies applicable Treasury Regulations, and that Plaintiffs' deductions are therefore not allowable.

The Court, however, denied summary judgment on the grounds that there is "a genuine issue of material fact" as to "whether the Peskys are excused from the requirements regarding submission of a qualified appraisal due to reasonable cause." Dkt. # 122, p. 24. Plaintiffs did not argue reasonable cause as a defense to their failure to submit a qualified appraisal, and the parties did not brief this issue in their summary judgment briefing, nor did they argue this issue at the summary judgment hearing.

The Court's denial of the United States' summary judgment motion on this basis is clear legal error. There is no reasonable cause exception for failure to submit the required qualified appraisal for charitable contributions made in 2002, the year the conservation easement contribution was made in this case. *Smith v. Comm'r*, T.C. Memo 2007-368, at *16 (for contributions made prior to June 3, 2004, there did not exist any reasonable cause exception for failure to comply with substantiation requirements for noncash charitable contributions (including the requirement of submitting a qualified appraisal)). The statutory provision the Court relies on for finding a reasonable cause exception in this case, 26 U.S.C. § 170(f)(1)(A)(ii)(II*), did not exist until 2004, and is effective only for contributions made after June 3, 2004*. *Id.*; *see* § 883 of the American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 883, 118 Stat. 1418 (2004) (Jobs Act); *see also* 26 U.S.C. § 170, effective January 1, 2001 to March 8, 2002, attached as Exhibit A to this motion (lacking any "reasonable cause" exception for failure to comply with the substantiation requirements outlined in Treasury Regulations).

Finally, to the extent the Court considers whether the Richey Appraisal, despite clearly failing to satisfy Treasury Regulations, nevertheless "substantially complies" with those regulations, there is no question that the Richey Appraisal did not approach substantial compliance.

In the Ninth Circuit, "[s]ubstantial compliance with regulatory requirements may suffice when such requirements are procedural and when the essential statutory purposes have been fulfilled." *Baccei v. United States*, 632 F.3d 1140, 1145 (9th Cir. 2011) (internal citation omitted). "Full compliance is necessary when the requirement relates to the substance of the statute or where the essential purposes have not been fulfilled." *Id.* (internal citation omitted). In other words, "the doctrine [of substantial compliance] can be applied only where invocation thereof would not defeat the policies of the underlying statutory provisions." *Id.* quoting *Sawyer v. Sonoma County*, 719 F.2d 1001, 1008 (9th Cir. 1983); *see also Prussner v. United States*, 896 F.2d 218, 224 (7th Cir.1990) (en banc) ("The common law doctrine of substantial compliance should not be allowed to spread beyond cases in which the taxpayer had a good excuse (though not a legal justification) for failing to comply with either an unimportant requirement or one unclearly or confusingly stated in the regulations or the statute.").

"[I]t is clear that the principal objective of DEFRA section 155 [(which "instructs the Secretary to provide heightened substantiation reporting requirements for certain noncash charitable contributions")] was to provide a mechanism whereby [the IRS] would obtain sufficient return information in support of the claimed valuation of charitable contributions of property to enable [the IRS] to deal more effectively with the prevalent use of overvaluations." *Smith*, T.C.

Memo 2007-368, at *13, 15; *see also Hendrix v. United States*, 2010 WL 2900391, at *6 (S.D. Ohio 2010) ("the purpose of the qualified appraisal is to 'show the work' so as to obviate the injection of unfounded guessing into the tax scheme").

The Richey Appraisal's remarkable failure to even mention the most basic documents affecting the development potential, use, and sale of the Ketchum Property is not a failure to satisfy unimportant or procedural requirements. Rather, this failure defeats the entire purpose of requiring the taxpayer to submit a qualified appraisal: to provide the IRS with "sufficient return information" to determine whether the valuation is accurate. *Smith*, T.C. Memo 2007-368, at *15. The information omitted from the Richey Appraisal was not simply requisite technical jargon or ancillary background information. Rather, the omitted information spoke directly to the "substance" and "essential purpose" of the qualified appraisal requirements, as it directly and profoundly spoke to the accuracy of the valuation of the Ketchum Property. *Baccei*, 632 F.3d at 1145. Indeed, Mr. Richey himself testified that taking into account the Whitmyre Easement in valuing the "before" condition of the Ketchum Property "wipes out half [the Plaintiffs'] developable potential" because "it would destroy one of the building sites." Exhibit 44 to the US MSJ, Dkt. # 105, Deposition of Mark Richey, pp. 171-172. Thus, the requirements that the Richey Appraisal failed to satisfy were clearly not simply unimportant procedural requirements. They were requirements relating to the essential purpose and substance of the requirement that a taxpayer must submit a qualified appraisal, and the doctrine of substantial compliance does not apply. *Baccei*, 632 F.3d at 1145.

Accordingly, since Plaintiffs have not submitted a qualified appraisal and verified their conservation easement deductions under the regulations proscribed by the Secretary, these deductions should be denied. 26 U.S.C. § 170(a); *Hendrix v. United States*, 2010 WL 2900391, at *6 (S.D. Ohio, 2010) (granting summary judgment denying deductions for failure to substantially comply with the qualified appraisal requirements); *Smith*, T.C. Memo 2007-368, at *13-20; *Estate of Evenchik v. Comm'r*, T.C. Memo 2013-34, 2013 WL 424791 (2013) (denying deduction where appraisal was not a qualified appraisal ); *Hewitt v. Comm'r*, 109 T.C. 258, 261, 1997 WL 668995 (1997), affd. without published opinion 166 F.3d 332 (4th Cir.1998).

**II. The Court's decision regarding the United States' motion for summary judgment to deny Plaintiffs' mortgage interest and other miscellaneous deductions is clear error**

The Court held that "the dispute is not over [whether] plaintiffs were entitled to deduct their mortgage interest and the other miscellaneous expenses, but rather whether the plaintiffs submitted the right documentation, and in the right form, to substantiate the Peskys' claimed expenses." This is not entirely correct. The dispute is precisely over whether Plaintiffs were entitled to these deductions, and the United States fears that, should the Court not reconsider this decision, this mischaracterization of the dispute might lead a jury to believe that the Court has concluded that there is no dispute that Plaintiffs were actually entitled to these deductions, but that it is simply unclear whether Plaintiffs meet some technical requirement that the substantiating documentation be in a certain form.

The law is clear that "an income tax deduction is a matter of legislative grace and [] the burden of clearly showing the right to the claimed deduction is on the taxpayer." *INDOPCO, Inc. v. Comm'r.*, 503 U.S. 79, 84 (1992) (citations omitted); *see also Sparkman v. Comm'r*, 509 F.3d 1149, 1159 (9th Cir. 2007). "[T]he taxpayer bears the burden of showing that he or she meets every condition of a tax exemption or deduction." *Davis v. Commissioner*, 394 F.3d 1294, 1298 n.2

(9th Cir. 2005). Further, taxpayers are required to keep sufficient records to substantiate deductions. I.R.C. § 6001; Treas. Reg. § 1.6001–1(a); *Sparkman*, 509 F.3d at 1159. Finally, and critically, *taxpayers also have "the burden of establishing the facts from which an exact determination of the proper deduction may be made." Tulia Feedlot, Inc. v. United States*, 513 F.2d 800, 805 (5th Cir. 1975) (emphasis added); *see also Gaitlin v. Comm'r*, 754 F.2d 921, 923 (11th Cir. 1985) ("At all times the taxpayer must come forward with evidence to support his entitlement to the deduction and the amount of that entitlement.")

Plaintiffs did not meet their burden, as illustrated by this Court's finding that it could not speculate as to the meaning and importance of the evidence they submitted. They simply submitted Exhibits 17-26 and conclusorily claimed, without any explanation or analysis to support this claim, that these records substantiate the full amount of their claimed deductions. Plaintiffs, however, bear "the burden of establishing the facts from which an exact determination of the proper deduction may be made." *Tulia Feedlot*, 513 F.2d at 805. Plaintiffs have simply failed to (even attempt to) meet this burden, and the consequence of this failure should not be a denial of the United States' motion for summary judgment on these issues. Rather, "if evidence to establish a deduction is lacking, the taxpayer, not the government, suffers the consequence." *Talley Indus. Inc. v. Commissioner*, 116 F.3d 382, 387–88 (9th Cir. 1997).

Although it does not have the burden to prove that Plaintiffs are not entitled to these deductions, the United States submitted Appendix A with its reply. Dkt. # 113-1. Appendix A examined Exhibits 17-26 to explain that the information in these documents could not possibly substantiate what Plaintiffs claim it substantiates. The burden should be on Plaintiffs to prove that it does.

The following chart summarizes Appendix A to show the amounts that Plaintiffs claimed for each item, the amounts that their submitted exhibits purport to substantiate, and the amounts in which summary judgment should be granted in the United States' favor denying the deductions or credit at issue. Thus, to take the foreign tax credit as an example, this chart shows that Plaintiffs claimed $5,290 for a foreign tax credit, that they submitted Exhibit 21 to substantiate this amount, that Exhibit 21 can only purportedly substantiate this amount in the amount of $353.02, and that the United States is entitled to a judgment denying Plaintiffs a foreign tax credit in the amount of $3,678.[4]

| | 2004 Foreign Tax Credit | 2004 Investment Interest Expense | 2003 Miscellaneous Itemized Deductions | 2004 Miscellaneous Itemized Deductions | 2003 Home Mortgage Interest | 2004 Home Mortgage Interest |
|---|---|---|---|---|---|---|
| Amount Claimed | $5,290 | $82,583 | $47,892 | $112,963 | $41,308 | $41,514 |
| Exhibits | 21 | 22, 26 | 23, 24, 25 | 22, 26 | 17-20 | 17-20 |
| Amount Purportedly Substantiated | $353.02 | $34,731.99 | $19,716.85 | $34,261.86 | $0 | $0 |
| Judgment Amount Denying Item | $3,768 | $44,073 | $22,034 | $75,879 | $27,251 | $27,386 |

[4] Although Plaintiffs only substantiate $353.02 in foreign tax credit in Exhibit 21, other information that Plaintiffs have provided in discovery, which they did not submit as part of their summary judgment briefing, may substantiate the foreign tax credit in the amount of $1,522. Thus, the United States is only moving that judgment be granted denying the foreign tax credit in the amount of $3,768 ($5,290-$1,522), instead of in the amount of $4,936.98 ($5,290-$353.02). Similar situations apply for the 2004 investment interest expense, the 2003 miscellaneous itemized deductions, and the 2004 miscellaneous itemized deductions. Thus, the amount in the row titled "Judgment Amount Denying Item" is less than the amount in the row titled "Amount Claimed" minus the amount in the row "Amount Purportedly Substantiated" for these items.

## III. A reasonable jury could conclude that it is highly probable that Mr. Pesky intentionally took steps designed to avoid taxes that he knew to be owing

"Fraud is defined as an intentional wrongdoing designed to evade tax believed to be owing." *Petzoldt v. Comm'r*, 92 T.C. 661, 699 (internal citations omitted). The government has the burden to prove fraud by "clear and convincing evidence." *Id.* "However, fraud may be proved by circumstantial evidence and reasonable inferences drawn from the facts because direct proof of the taxpayer's intent is rarely available." *Id.* Finally, "[t]he existence of fraud is a question of fact to be resolved upon consideration of the entire record." *Id* ; *see also Owens v. United States*, 197 F.2d 450, 451 (8th Cir. 1952) (The question of whether an "intelligent taxpayer['s] … tax deficiencies were the result of negligence or of fraud on his part is a question of fact to be determined by the trial court. The question of intent, if at all doubtful, is ordinarily one of fact for the trier of the facts.").

Reasonable inferences drawn from the facts below could plausibly lead a jury to conclude that it is highly probable that Mr. Pesky intentionally took actions designed to avoid taxes he knew to be owing.

<u>Undisputed fact # 1</u>

- The initial proposed transaction discussed between Mr. Pesky and his attorney, Mr. Street, was an explicit quid pro quo in which The Nature Conservancy ("TNC") would obtain an option to purchase the Ketchum Property and assign that option to Mr. Pesky, give Mr. Pesky an oral agreement for access to the Ketchum Property, and then, at a later date, Mr. Pesky would give two of the three parcels to TNC so that he could claim a "charitable deduction for more than [the] option based upon access to property." Ex. 67 to US Response, Dkt. # 109. One of the identified risks of this plan, however, was that the "[a]greement with [TNC] to provide access is oral, and under Idaho law, not enforceable." *Id.* Mr. Street and Mr. Pesky had no answer for why it was not feasible to eliminate this risk by simply getting a written agreement from TNC for access to the Ketchum Property. US Response, Dkt. # 109, pp. 12-13. The confidential memorandum outlining this proposed quid pro quo also discussed the IRS's reaction to this transaction as one of the risks.

Reasonable inference

- A reasonable jury could easily conclude that the reason why Mr. Pesky and his attorney were discussing a quid pro quo transaction with the TNC, one component of which was to be an oral agreement, despite the unnecessary risks posed by an oral agreement, was that an oral agreement was difficult for the IRS to discover and point to as evidence of a quid pro quo. This is relevant because it shows that Mr. Pesky was aware of the quid pro quo nature of the exchange and the need to hide that nature from the IRS.

Undisputed fact # 2

- Mr. Pesky's first written offer to TNC also outlined an explicit quid pro quo transaction, and it included terms that were later separated into the Pledge Agreement and the Assignment Agreement. Ex. 68 to US Response. TNC's Guy Bonnivier reacted to this offer by warning Mark Elsbree, who was handling the negotiations of this transaction on behalf of TNC, to "[b]e careful on documenting The Pledge like this. It loses it's [sic] charitable intent in this letter. *From this point on the only place it should be in writing is in The Pledge Letter itself*. They need to talk to Arthur Anderson about all of this. If they should lose the charitable write-off aspects of this, it's an excuse for them to renege. IRS <u>will</u> be scrutinizing this deal." Ex. 69 to US Response ("Bonnivier Handwritten Memo") (underlined emphasis in original). From that point on, the only place the terms of the Pledge Agreement were in writing was in the Pledge Agreement itself.

Reasonable inference

- A reasonable jury could easily conclude that the reason why the terms of Mr. Pesky's initial offer letter were separated into the Pledge Agreement and the Assignment Agreement subsequent to the Bonnivier Handwritten Memo, with the terms of the Pledge Agreement not appearing in writing in any place except the Pledge Agreement itself, was that Mr. Pesky and TNC representatives understood that Mr. Pesky too obviously (to a later-scrutinizing IRS) "loses [his] charitable intent" by including all the terms of the parties' overall deal in the same document.

Undisputed fact # 3

- On September 29, 1993, the day he entered into the Pledge Agreement and the Assignment Agreement, Mr. Pesky received the only tax advice about the effect of the Pledge Agreement that has been identified in this case. Ex. 65 to US Response ("Charitable Deduction Memo"). The Charitable Deduction Memo stated, in part:
    - If the conservation easement contribution is part of the consideration to purchase the real property, then *there is a strong possibility that there is no intent to make a gift*. The determination of "intent" is a question of fact. Consequently, *the better facts that can be marshalled before the transaction is consummated, the better case our client will*

> *have to present to the IRS*. With the dollar amount of the contribution and the nature of the contribution, the probability of an IRS exam increases significantly. *The more "time and events" that separate the real property purchase and the gift, the better our client's case.*

Reasonable inference

- A reasonable jury could easily conclude that the reason why Mr. Pesky twice extended the Pledge Agreement and waited nine years before consummating the transaction by making the conservation easement contribution, is that he understood that since the conservation easement contribution required by the Pledge Agreement was consideration for the Assignment Agreement, "there is no intent to make a gift," but that "the more 'time and events' that separate the real property purchase and the gift," "the better case [he] will have to present to the IRS" in attempting to take a charitable deduction for this "gift." In other words, a reasonable jury could easily conclude that the Charitable Deduction Memo effectively advised Mr. Pesky that he was not entitled to a charitable deduction for the conservation easement, but that he could play the IRS audit lottery.

Undisputed fact # 4

- On September 27, 1993, the same day Mr. Pesky's attorney, Mr. Street, received the Charitable Deduction Memo, Mr. Street sent a fax to TNC stating that Mr. Pesky was "very concerned about recording the option or any other agreement," and Mr. Street proposed some alternatives to recording the Pledge Agreement that might still give TNC the power "[t]o enforce the agreement." Ex. 66 to the US Response.

Reasonable inference

- A reasonable jury could easily conclude that the reason why Mr. Pesky was very concerned about recording the Pledge Agreement was because the Charitable Deduction Memo made it clear that the Pledge Agreement's existence revealed that there "is no intent to make a gift," and the public recording of this agreement would make it too easy for the IRS to find.

Undisputed fact # 5

- At a Ketchum City Council hearing held on September 19, 1994, Mr. Pesky's attorney at that hearing, Ed Lawson, in response to a comment from the city attorney that the "scenic easement" between TNC and Mr. Pesky should be recorded, stated that "he was concerned that the Council's suggestion may jeopardize the whole agreement between [TNC] and [Mr. Pesky], since the tax deduction derived from the dedication of the scenic easement as a voluntary charitable gift was the motivating force for the agreement." Ex. 29 to US MSJ, Dkt. # 105.

Reasonable inference

- A reasonable jury could easily conclude that the reason why Mr. Pesky's attorney was concerned that recording the "scenic easement" (or Pledge Agreement) would "jeopardize the whole agreement between TNC and Mr. Pesky, was because Mr. Pesky and his attorneys understood that the existence of the Pledge Agreement revealed that there "is no intent to make a gift," and the public recording of this agreement would make it too easy for the IRS to find.

Undisputed fact # 6

- In a February 9, 1995 letter from Mr. Pesky's real estate agent, Stoney Burke, to Mr. Pesky's brother-in-law/co-investor in the transaction, Peter Stern, Mr. Burke wrote: "As you know, this Pledge Agreement should not see the light of day." Ex. 72 to US Response (emphasis in original). Mr. Pesky and TNC's Guy Bonnivier were copied on this correspondence.

Reasonable inference

- A reasonable jury could easily conclude that the reason why the understanding of the parties was that "the Pledge Agreement should not see the light of day" was because its existence would reveal the nature of the quid pro quo to the IRS.

Undisputed fact # 7

- In response to an IRS Information Document Request ("IDR") that clearly requested its production, Mr. Pesky did not produce a copy of the Pledge Agreement, despite the fact that his real estate agent, TNC, Peter Stern, and three different sets of his attorneys had a copy of the Pledge Agreement in their files. US Response, pp. 14-16. Despite not having produced the Pledge Agreement, Mr. Pesky's attorneys, copying Mr. Pesky on the correspondence, later assured the IRS that "[t]o the best of our knowledge, you have been provided with all information" requested by the IDR. Ex. 78 to US Response.

Reasonable inference

- A reasonable jury could easily conclude that the reason why Mr. Pesky did not produce a copy of the Pledge Agreement to the IRS, despite its availability to him and his agents, was that he knew that it revealed the nature of the quid pro quo between him and TNC.

Undisputed fact # 8

- In response to an IDR that clearly requested their production, Mr. Pesky did not produce to the IRS a copy of the Whitmyre Easement and the Contract for Deeds. US Response, p. 15. Despite not having produced these documents, Mr. Pesky's attorneys, copying Mr. Pesky on the correspondence, later assured the IRS that "[t]o the best of our knowledge, you have been provided with all information" requested by the IDR. Ex. 78 to US Response.

Reasonable inference

- A reasonable jury could easily conclude that the reason why Mr. Pesky did not produce the Whitmyre Easement was that it already limited development of the Ketchum Property to one home site and thus rendered the conservation easement worthless. A reasonable jury could also easily conclude that the reason why Mr. Pesky did not produce the Contract for Deeds was because it referenced the Pledge Agreement and even attached the Pledge Agreement as an exhibit.

Undisputed fact # 9

- In response to an IDR that clearly requested its production, Mr. Pesky did not produce to the IRS a copy of the Corlett Appraisal. US Response, p. 15. The Corlett Appraisal concluded that the Ketchum Property's "highest and best use … is for development as a single estate site," and that the Ketchum Property "would not suffer a significant diminution in value as a result of a placement of a conservation easement." Ex. 75 to the US Response. Furthermore, on Mr. Pesky's explicit instruction, Mr. Pesky's attorneys subsequently retained Mr. Corlett "on a consulting basis to disqualify him from serving as an appraiser for the IRS in the event of a future audit." US Counterclaim, Dkt. # 85, ¶¶101-103. Despite not having produced these documents, Mr. Pesky's attorneys, copying Mr. Pesky on the correspondence, later assured the IRS that "[t]o the best of our knowledge, you have been provided with all information" requested by the IDR. Ex. 78 to US Response.

Reasonable inference

- A reasonable jury could easily conclude that the reason why Mr. Pesky did not produce the Corlett Appraisal was because it undermined the conclusions reached by his appraiser, Mark Richey. Similarly, a reasonable jury could easily conclude that the reason why Mr. Pesky instructed his attorneys to retain Mr. Corlett "on a consulting basis to disqualify him from serving as an appraiser for the IRS in the event of a future audit" was because Mr. Corlett's conclusions were damaging to Mr. Pesky's claim that the conservation easement was worth $3 million.

Undisputed fact # 10

- In response to a question about whether the terms of the Pledge Agreement were being negotiated, Mr. Pesky's, attorney Paul Street testified that he did not "recall really being involved directly in the negotiations or discussions of the Pledge Agreement [and that he thought] that was all between The Nature Conservancy and Alan [Pesky]." Ex. 62 to US Response, pp. 70:25-71:19. Mr. Street further testified that "Alan [Pesky] is a sophisticated person and … would have direct contact with [TNC representatives] on whatever basis appropriate." *Id.*, p. 75:16-19.

Reasonable inference

- A reasonable jury could easily conclude that any purported reliance by Mr. Pesky on Mr. Street to "identify any major challenges [to a charitable deduction]" (Court's Order, Dkt. # 122, p. 26) was undermined by Mr. Street's testimony that he did not have any direct involvement in the negotiations or discussions of the Pledge Agreement, and that Mr. Pesky, a "sophisticated" person, conducted these negotiations himself. In other words, a reasonable jury could easily conclude that Mr. Pesky, not Mr. Street, was the only one with knowledge of whether his promises in the Pledge Agreement were being negotiated and bargained for in a quid pro quo exchange with TNC's promises in the Assignment Agreement.

Undisputed fact # 11

- Mr. Pesky's attorney, John Thornton, testified in his deposition that Mr. Pesky never told him about any of the negotiations with The Nature Conservancy regarding the Pledge Agreement, that Mr. Pesky never told him what his intent was in entering into the Pledge Agreement, and that Thornton Byron never gave any legal advice to Mr. Pesky about the enforceability of the Pledge Agreement. Exhibit A, Dkt. # 120-1, pp. 19-21. Further, Mr. Thornton testified that he *did not even know about* the Pledge Agreement until approximately 2011. Exhibit 46 to Plaintiffs' MSJ, Dkt. # 106-8, p. 39. Rather, in Mr. Thornton's words, "all that [Mr. Pesky] ever said was [that] he made a pledge to The Nature Conservancy." Exhibit A, Dkt. # 120-1, p. 21.

Reasonable inference

- A reasonable jury could easily conclude that any purported reliance by Mr. Pesky on John Thornton and Thornton Byron to give him any (as-yet-unidentified) tax advice was undermined by Mr. Thornton's testimony that he knew nothing about the transaction between Mr. Pesky and TNC, knew nothing about Mr. Pesky's intent in pledging a conservation easement, and knew nothing the Pledge Agreement itself. In other words, a reasonable jury could easily conclude that, once again, Mr. Pesky, not his attorneys, was the only one with knowledge of whether his promises in the Pledge Agreement were being negotiated and bargained for in a quid pro quo exchange with TNC.

Undisputed fact # 12

- Mr. Pesky was copied on all correspondence between his attorneys and other parties, including the IRS. Thus, Mr. Pesky was copied on all letters from Thornton Byron responding to the IDRs discussed in facts ## 7, 8, and 9, above. Further, Mr. Pesky was often more involved than his attorneys in these matters. For example, Mr. Pesky himself obtained the minutes to the Ketchum City Council meeting referenced in fact # 5, above, and sent them to his attorney Mr. Street, along with his commentary thereon. Ex. 29 to US MSJ. As another example, Mr. Pesky himself obtained the Corlett Appraisal, and sent a copy to his real estate agent, Stoney Burke.

Reasonable inference

- A reasonable jury could easily conclude that Mr. Pesky, a sophisticated person who negotiated the transaction with TNC himself, was actively involved in these matters, including his attorneys' response to the IDRs. Thus, for example, a reasonable jury could easily conclude that, even if Mr. Thornton and Thornton Byron had no knowledge of any copies of the responsive Pledge Agreement or Corlett Appraisal, Mr. Pesky certainly did, and Mr. Pesky's silence regarding Thornton Byron's misleading representation to the IRS that it had "been provided with all the information" it had requested is evidence of an intent to mislead or conceal.

The Court did not consider facts 1, 2, 3, 4, 6, 8, 9, 10, 11, and 12. Thus, for example, the Court did not address the fact that the only specific tax advice Mr. Pesky received about the entire transaction effectively advised him that he lacked donative intent, but that if he waited long enough to give the conservation easement, he would have a better chance of winning the IRS audit lottery. The Court did address facts 5 and 7. For fact 7, the Court found that Mr. Pesky's failure to produce the Pledge Agreement to the IRS was "susceptible to an innocent interpretation," namely, that Mr. Pesky and his agents only had one copy of the Pledge Agreement, and did not turn that copy over because it was in the Richey Appraisal file and it "was the firm's practice not to turn over such information." Dkt. # 122, pp. 26-27. For fact # 5, the Court found that the attempt to conceal the Pledge Agreement from the City of Ketchum was "similarly susceptible to an innocent interpretation." *Id.* The Court did not, however, address the fact that Mr. Pesky's attorney told the city that recording the Pledge Agreement would "jeopardize" the tax deduction.

In reversing a district court's grant of summary judgment, the Ninth Circuit succinctly laid out the summary judgment standard:

> In deciding whether to grant summary judgment, the judge's function is not himself to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial. Credibility determinations, the weighing of the evidence, and the drawing of legitimate inferences from the facts are jury functions, not those of a judge. Further, at the summary judgment stage, we must draw all reasonable inferences in favor of the non-moving party and, where disputed issues of material fact exist, assume the version of the material facts asserted by the non-moving party to be correct. *Aloe Vera of America, Inc. v. United States*, 699 F.3d 1153, 1165 (9th Cir. 2012) (internal citations and quotations omitted); *see also Braxton–Secret v. A.H. Robins Co.*, 769 F.2d 528, 531(9th Cir. 1985) ("Questions involving a person's state of mind …are generally factual issues inappropriate for resolution by summary judgment.").

The Court committed clear legal error by not considering facts 1, 2, 3, 4, 6, 8, 9, 10, 11, and 12, and not drawing all reasonable inferences from those facts in favor of the United States. The Court also committed clear legal error by weighing the evidence and drawing all inferences from facts 5 and 7 in favor of Plaintiffs, by not only finding that these facts were "susceptible to an innocent interpretation," but by implicitly and implausibly holding that no reasonable juror could find that the facts were susceptible to anything but that interpretation. Finally, the Court committed clear legal error by considering only the actions of Mr. Pesky's advisers, without considering Mr. Pesky's intent, Mr. Pesky's own involvement in the transaction, and Mr. Pesky's acquiescence in what he, if no one else, must have known to be a misleading response to the IDRs.

//

//

//

Respectfully submitted this 12th day of July, 2013.

KATHRYN KENEALLY
Assistant Attorney General

By: /s/ Landon Yost
MICHAEL P. HATZIMICHALIS
RICK WATSON
LANDON YOST
Trial Attorneys

Of Counsel:

WENDY J. OLSON
United States Attorney

## CERTIFICATE OF SERVICE

IT IS HEREBY CERTIFIED that on the 12th day of July, 2013, service of the foregoing has been made via the Court's CM/ECF system to:

Justin C. Jones, Esq.
Thornton Byron LLP
Riverfront Plaza
3101 W. Main Street, Suite 200
Boise, Idaho 83702

*Counsel for Plaintiffs*

Benjamin Schwartzman
Brent Bastian
Susan Pierson
ANDERSON BANDUCCI LLP
101 S. Capitol Blvd; Suite 1600
Boise, ID 83702Telephone: (208) 342-4411
Facsimile: (208) 342-4455
bschwartzman@bwslawgroup.com
bbastian@bwslawgroup.com

*Counsel for Plaintiffs*

/s/ Landon Yost
LANDON YOST
Trial Attorney