TRYING TIMES

IMPORTANT LESSONS TO BE LEARNED FROM RECENT FEDERAL TAX CASES

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I. Developments

A. IRC § 170(h)

1. IRC § 170(h), which authorizes a federal charitable income tax deduction for the donation of a conservation easement meeting specific requirements, was enacted in 1980.

2. Treasury Regulations interpreting § 170(h) were issued in 1986.[1]

3. The Treasury Regulations are based, in large part, on the Senate Report describing § 170(h) (referred to as legislative history).[2]

B. Washington Post Articles

In May 2003, the Washington Post published a series of articles questioning some of the practices of The Nature Conservancy.[3] In December of that same year, the Washington Post published a follow-up article describing allegedly abusive conservation easement donation transactions involving "wildly exaggerated" easement appraisals and developers who received "shocking" tax deductions for donating conservation easements encumbering golf course fairways or otherwise undevelopable land.[4]

In December 2004, the Washington Post published a second series of articles alleging abuses in the facade easement donation context.[5] The articles described a surge in facade easement donations that coincided with the emergence of for-profit facilitators and nonprofit organizations that have "taken in millions of dollars for processing paperwork and monitoring the easements." The articles also noted that facade easements often merely duplicate restrictions already imposed by local law and fail to decrease the value of the buildings they encumber, making the tax deductions based on a 10% to 15% reduction in the value of the properties unwarranted. One promoter reportedly told property owners they would receive tax breaks for a drop in their

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[1] Treas. Reg. § 1.170A-14.

[2] S. Rep. No. 96-1007 (1980).

[3] *See* David B. Ottaway & Joe Stephens, *Nonprofit Land Bank Amasses Billions*, WASH. POST, May 4, 2003, at A1; Joe Stephens & David B. Ottaway, *How a Bid to Save a Species Came to Grief*, WASH. POST, May 5, 2003, at A1; Joe Stephens & David B. Ottaway, *Nonprofit Sells Scenic Acreage to Allies at a Loss; Buyers Gain Tax Breaks with Few Curbs on Land Use*, WASH. POST, May 6, 2003, at A1.

[4] Joe Stephens & David B. Ottaway, *Developers Find Payoff in Preservation*, WASH. POST, Dec. 21, 2003, at A1.

[5] *See* Joe Stephens, *For Owners of Upscale Homes, Loophole Pays; Pledging to Retain the Facade Affords a Charitable Deduction*, Wash. Post, Dec. 12, 2004, at A1 [*Loophole Pays*]; Joe Stephens, *Local Laws Already Bar Alterations; Intervention by Trusts Is Rare for Preservation,* Wash. Post, Dec. 12, 2004, at A15; Joe Stephens, *Tax Break Turns Into Big Business,* Wash. Post, Dec. 13, 2004, at A1.

property values, but stressed that there would be no actual decline; that "[i]t's a paper concept."[6]

C. IRS Notice 2004-41

In June 2004, the IRS issued Notice 2004-41 stating that the IRS is aware that taxpayers who transfer conservation easements to charitable organizations or make payments to charitable organizations in connection with a purchase of real property from the organization may be improperly claiming charitable deductions under IRC § 170.[7] The Notice warned that the IRS intends to disallow improper deductions and impose penalties and excise taxes on taxpayers, promoters, and appraisers involved in such transactions.

D. 2005 Joint Committee on Taxation Report

In January 2005, the Joint Committee on Taxation issued a report to Congress recommending, among other things, that

1. the federal charitable income tax deduction offered to conservation easement donors be eliminated with respect to easements encumbering property on which the donor maintains a personal residence,
2. the deduction be substantially reduced in all other cases, and
3. new standards be imposed on appraisers and appraisals with regard to the valuation of easements.[8]

E. Proposal to Penalize Charities that Remove or Fail to Enforce Easements

In March 2005, the Joint Committee on Taxation published a Description of Revenue Provisions Contained in the President's Fiscal Year 2006 Budget Proposal, one of which was to impose significant penalties on any charity that removes or fails to enforce a conservation easement, or transfers such an easement without ensuring that the conservation purposes will be protected in perpetuity.[9] The proposal was intended to address the concern that charitable contributions of conservation easements, which are required to be in perpetuity, are being removed, or are being transferred without securing the conservation purpose.

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[6] *See Loophole Pays, supra* note 5.
[7] IRS Notice 2004-41 is available at http://www.irs.gov/irb/2004-28_IRB/ar09.html.
[8] *See Options to Improve Tax Compliance and Reform Tax Expenditures*, prepared by the Joint Committee on Taxation, JCS-2-05, 281 (Jan. 27, 2005), available at http://www.jct.gov/publications.html?func=showdown&id=1524.
[9] Staff of Joint Comm. Taxation, 109th Cong., 1st Sess., *Description of Revenue Provisions Contained in the President's Fiscal Year 2006 Budget Proposal*, 239–41 (Comm. Print 2005), available at https://www.jct.gov/publications.html?func=startdown&id=1523.

F. 2005 Senate Finance Committee Report

In June 2005, the Senate Finance Committee held a hearing on the federal tax incentives available with respect to conservation easement donations. In connection with that hearing, the Senate Finance Committee issued a report in which it recommended numerous reforms, including:

> 1. revocation of the tax-exempt status of conservation organizations that regularly and continuously fail to monitor the conservation easements they hold (or the suspension of the ability of such organizations to accept tax-deductible contributions),
> 2. implementation of an accreditation program for conservation organizations acquiring easements,
> 3. limiting charitable contribution deductions for certain small easement donations and providing the IRS with the authority to pre-approve deductions for such donations, and
> 4. IRS issuance of guidance regarding how a conservation organization can establish that it is appropriately monitoring the easements it holds.[10]

The Senate Finance Committee report also expresses concern regarding amendments to conservation easements. The report explains that "[m]odifications to an easement held by a conservation organization may diminish or negate the intended conservation benefits, and violate the present law requirements that a conservation restriction remain in perpetuity."[11] The report notes that modifications made to correct ministerial or administrative errors are permitted under present federal tax law.[12] But the report expresses concern with regard to "trade-off" amendments, which both negatively impact and further the conservation purpose of an easement, but on balance are arguably either neutral with respect to or enhance such purpose.[13] The report provides, as an example, an amendment to an easement that would permit the owner of the encumbered land to construct a larger home in exchange for restrictions further limiting the use of the land for agricultural purposes.[14] The report explains that trade-off amendments "may be difficult to measure from a conservation perspective," and that the "weighing of increases and decreases [in conservation benefits] is difficult to perform by [the holder] and to assess by the IRS."[15]

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[10] *See* Report of Staff Investigation of The Nature Conservancy (Volume I), United States Senate Committee on Finance, Executive Summary 10-11 (June 2005), available at http://finance.senate.gov/.
[11] *Id.,* Executive Summary 9.
[12] *Id.*, Executive Summary 9, n. 20.
[13] *See id*. at Pt. II 5.
[14] *See id.*
[15] *Id*.

G. 2005 IRS Testimony Before Senate Finance Committee

In his testimony before the Senate Finance Committee in June 2005,[16] then IRS Commissioner, Tax-Exempt and Government Entities Division, Steven T. Miller discussed the steps the IRS was taking to enforce the law in this area. Such steps included

1. modifications to IRS Forms 1023, 990, and 8283,
2. the formation of a special cross-functional team to "attack all aspects of the problem of conservation easements," and
3. increased audits of easement donors.

H. Pension Protection Act of 2006

To combat abuses, the Pension Protection Act of 2006,[17] among other things,

1. revised the rules in § 170(h) with respect to contributions of façade easements,
2. provided statutory definitions of the terms "qualified appraiser" and "qualified appraisal" in IRC § 170(f)(11), and
3. lowered the thresholds for accuracy-related penalties and made the gross valuation misstatement penalty with regard to charitable contributions a strict liability penalty (see Part III.A below).

At the same time, the Pension Protection Act increased the tax benefits offered to conservation easement donors for donations made in 2006 and 2007 by making the percentage limitations on the resulting charitable deductions more favorable.[18] These enhanced incentives, which, among other things, allow farmers and ranchers to potentially eliminate their income tax liability for a period of up to sixteen years, have been repeatedly temporarily extended, most recently as part of the American Taxpayer Relief Act of 2012.[19]

I. DOJ Suit Against Trust For Architectural Easements

In June 2011, the Department of Justice filed a lawsuit against the Trust for Architectural Easements ("TAE").[20] The lawsuit alleged, among other things, that TAE made false and fraudulent statements to prospective donors about the tax benefits available for donating façade easements, steered donors to appraisers who had been coached by it to go along with its questionable practices, helped donors to claim deductions before donations were final, and allowed donors to terminate easements they had already

[16] The testimony is available at http://www.irs.gov/Charities-&-Non-Profits/Conservation-Easements.
[17] Pub. L. No. 109–280, 120 Stat. 780.
[18] For an explanation of these changes, see Joint Committee on Taxation, JCX-38-06 (August 3, 2006), available at https://www.jct.gov/publications.html?func=select&id=20.
[19] American Taxpayer Relief Act of 2012, Pub. L. No. 112–240, §206, 126 Stat. 2313 (2013).
[20] Complaint for Permanent Injunction and Other Relief, U.S. v. McClain, Civ. No. 11-1087 (U.S. Dist. Ct. D.C. June 14, 2011). TAE was formerly known as the National Architectural Trust, or "NAT."

granted.[21] In July 2011, a U.S. District Court Judge issued a permanent injunction against TAE settling the case.[22] The injunction permanently prohibits TAE from engaging in what the federal government said were abusive and illegal practices. The injunction bars TAE from, among other things:

> 1. representing to prospective donors and others that the IRS has established a "safe harbor" for the value of a donated façade easement equal to 10 to 15% of the subject building's value,
> 2. participating in the appraisal process for a conservation easement in any regard, including recommending or referring donors to an appraiser or TAE's preferred list of appraisers,
> 3. accepting easements that lack a conservation purpose or do not satisfy the "protected in perpetuity" requirement of § 170(h), and
> 4. requesting fees or cash donations tied to a percentage of the estimated value of the easement or the deduction to be claimed with regard to the easement's donation.

TAE was also ordered to pay an independent monitor for two years to ensure that it complied with the injunction. The injunction did not preclude the IRS from assessing penalties against TAE for violations of the Internal Revenue Code, and did not address whether TAE was entitled to retain its tax-exempt status.[23]

J. <u>IRS Conservation Easement Audit Techniques Guide</u>

The IRS has issued a Conservation Easement Audit Techniques Guide.[24] The Guide provides that it is not an official pronouncement of the law or the position of the IRS, and it cannot be used, cited, or relied upon as such. The Guide nonetheless provides a summary of many of the requirements that must be met to be eligible for a federal charitable income tax deduction for the donation of a conservation easement under § 170(h). The Guide also alerts readers to issues that may be considered and raised on audit. The IRS has informally indicated that the Guide will be periodically updated to reflect case law and other developments.

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[21] *Id. See also* Janet Novack, *Feds Sue Trust Over Historic Easement Tax Breaks*, Taxing Matters, FORBES, June 16, 2011.

[22] Stipulated Order of Permanent Injunction, U.S. v. McClain, Civ. No. 11-1087 (U.S. Dist. Ct. D.C. July, 15, 2011) (TAE agreed to the settlement without admitting any wrongdoing).

[23] *Id. See also D.C. Federal Court Bars Company from Promoting Alleged Tax Scheme Involving Improper Easements on Historic Buildings*, Department of Justice Press Release (July 18, 2011), available at http://www.justice.gov/opa/pr/2011/July/11-tax-933.html; Joe Stephens, *Judge bars D.C. charity from promoting 'façade easement' tax deductions*, WASH. POST, July 19, 2011.

[24] The guide is available at http://www.irs.gov/businesses/small/article/0,,id=249135,00.html.

K. Schedule D, IRS Form 990

IRC § 501(c)(3) organizations—as most land trusts are—must file an IRS Form 990 (Return of Organization Exempt From Income Tax) each year.[25] Schedule D to IRS Form 990 requires a charitable organization holding a conservation easement to provide detailed information, including:

1. the total number of conservation easements held at the end of the year;
2. the total acreage restricted by such easements;
3. the number of easements modified, transferred, released, or extinguished, by the organization during the taxable year;
4. whether the organization has a written policy regarding the monitoring and enforcement of easements;
5. the total number of hours devoted to monitoring, enforcing, and inspecting conservation easements during the tax year; and
6. the expenses incurred during the tax year to monitor, inspect, and enforce easements.

For each easement modified, transferred, released, or extinguished, in whole or in part, the organization must explain the changes in a Supplemental Statement to Schedule D. The Instructions for Schedule D explain:

1. an easement is released, extinguished, or terminated when all or part of the property subject to the easement is removed from the protection of the easement in exchange for cash or the protection of some other property,
2. the use of synonyms does not avoid the application of the reporting requirement (e.g., calling an action a "swap" or a "boundary line adjustment" does not mean the action is not also a modification, transfer, or extinguishment), and
3. "[t]ax exemption may be undermined by the modification, transfer, release, extinguishment, or termination of an easement."[26]

L. 2013 Proposal to Eliminate Deduction for Golf Course Easements

The Administration's fiscal 2013 revenue proposals included a proposal to eliminate the charitable deduction for contributions of conservation easements on golf courses.[27]

M. IRS General Information Letter on Swaps

In a March 2012 Information Letter, the IRS advised that conservation easements that are subject to swaps other than in the very limited situations of a swap that meets the

[25] IRS Form 990 is available at http://www.irs.gov/pub/irs-pdf/f990.pdf.
[26] Instructions for Schedule D (Form 990) are available at http://www.irs.gov/pub/irs-pdf/i990sd.pdf.
[27] *See General Explanations of the Administration's Fiscal Year 2013 Revenue Proposals, Department of the Treasury* 140 (February 2012), available at http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2013.pdf.

extinguishment and proceeds requirements of Treasury Regulation § 1.170A-14(g)(6) are not deductible.[28] A "swap" is defined as the removal of some or all of the originally protected property from the terms of the original deed of conservation easement in exchange for either the protection of some other property or the payment of cash.

N. IRS General Information Letter on Extinguishment

In a September 2012 Information Letter, the IRS advised that, while state law may provide a means for extinguishing a conservation easement for state law purposes, the requirements of § 170(h) and the Treasury Regulations, including Treasury Regulation § 1.170A-14(g)(6) (the extinguishment and division of proceeds regulation), must nevertheless be satisfied for a contribution to be deductible for federal income tax purposes.[29]

O. DOJ Suit Against Façade Easement Appraiser

In January 2013, the United States filed a complaint in District Court against an appraiser and the company he owned with his wife.[30] The complaint alleged, among other things, that the appraiser had appraised more than ninety conservation easements for purposes of the deduction under § 170(h) and had repeatedly and continually made material and substantive errors, distorted data, and provided misinformation and unsupported personal opinions in the appraisals to significantly inflate the value of the easements for federal deduction purposes. The complaint also alleged that the appraiser attempted to obstruct IRS enforcement efforts by claiming not to have any work files for his appraisal reports, which professional standards require that an appraiser maintain. "This sort of abuse of a high-dollar charitable contribution deduction," stated the complaint, "inspires contempt for the system of honest, voluntary income tax reporting."

In February 2013, the District Court issued an Agreed Order of Permanent Injunction that, among other things, (i) barred the appraiser (who was 70 years old and had retired) and the company from preparing any kind of appraisal report or otherwise participating in the appraisal process for any property relating to federal taxes and (ii) ordered the appraiser and the company to provide to counsel for the United States a list of clients for whom they prepared appraisal reports for tax purposes on or since November 1, 2009.[31]

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[28] Information Letter from Karin Goldsmith Gross, Senior Technician Reviewer, IRS (March 5, 2012), *available at* http://www.irs.gov/pub/irs-wd/12-0017.pdf.

[29] Information Letter from Karin Goldsmith Gross, Senior Technician Reviewer, IRS (Sept. 18, 2012), *available at* http://f.datasrvr.com/fr1/513/49712/2013-0014_Qualified_Conservation_Contribution_.pdf.

[30] Complaint for Permanent Injunction and Other Relief, U.S. v. Ehrmann et al., Civ. No. 1:13-cv-214 (N.D. Ohio, Jan. 30, 2013).

[31] Agreed Order of Permanent Injunction, U.S. v. Ehrmann, Civ. No. 1:13-cv-00214-DAP (N.D. Ohio Feb. 12, 2013) (the appraiser and company agreed to the settlement without admitting any wrongdoing). *See also*

P. 2014 Reform Proposals Relating to Easements

In April 2013, the Treasury Department published General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals, one of which was the same proposal to eliminate the deduction for conservation easements on golf courses that was included in the Administration's 2013 proposals.[32] A second proposal would (i) disallow the deduction for the value of a façade easement associated with forgone upward development above a historic building and (ii) require that contributions of façade easements on buildings listed in the National Register comply with the rules imposed on façade easements on buildings located in a registered historic district. The Treasury Department explained, in part:

> The value of [a façade] easement may be zero if it does not restrict future development more than the restrictions already imposed on the building, for example, by local zoning or historic preservation authorities. Some taxpayers, however, have taken large deductions for contributions of easements restricting the upward development of historic urban buildings even though such development was already restricted by local authorities. Because of the difficulty of determining the value of the contributed easement, it is difficult and costly for the Internal Revenue Service to challenge deductions for historic preservation easements. To prevent abuses, no deduction should be allowed for the value associated with forgone upward development above an historic building.

Q. IRS Chief Counsel Memorandum on Conservation Easement Valuation

The IRS Office of Chief Counsel has published a memorandum that provides helpful guidance on valuing conservation easements in accordance with some of the more technical requirements of Treasury Regulation § 1.170A-14(h)(3)(i). The memorandum specifically addresses the "contiguous parcel" and "enhancement" rules, and provides twelve examples illustrating the application of those rules.[33]

Ohio Federal Court Bars Appraiser of Historic-Preservation Easements, Department of Justice Press Release (Feb. 13, 2013), available at http://www.justice.gov/opa/pr/2013/February/13-tax-192.html.

[32] *See General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals, Department of the Treasury* 161-162 (April 2013), available at http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2014.pdf.

[33] IRS Chief Counsel Memorandum 201334039 (released Aug. 23, 2012), available at http://www.irs.gov/pub/irs-wd/1334039.pdf.

R. <u>2015 Reform Proposals Relating to Easements</u>

In March 2014, the Treasury Department published General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals.[34] In addition to eliminating the deduction for contributions of conservation easements on golf courses and restricting the deductions and harmonizing the rules for contributions of façade easements (both of which were part of the Administration's 2014 proposals), the Administration's 2015 proposals include making permanent the enhanced incentives for donations that expired on December 31, 2013.

S. <u>IRS Bars Appraisers from Valuing Easements for Five Years</u>

In March 2014, the IRS issued a press release announcing that its Office of Professional Responsibility (OPR) had entered into a settlement agreement with a group of appraisers from the same firm accused of aiding in the understatement of federal tax liabilities by overvaluing facade easements for charitable donation purposes.[35] To value the facade easements, the appraisers had simply multiplied the "before" value of the property by a fixed percentage, generally 15%.

Under the settlement agreement, the appraisers admitted to violating relevant sections of Circular 230 related to due diligence and submitting accurate documents to the government. According to Karen L. Hawkins, Director of OPR:

> Appraisers need to understand that they are subject to Circular 230, and must exercise due diligence in the preparation of documents relating to federal tax matters. Taxpayers expect advice rendered with competence and diligence that goes beyond the mere mechanical application of a rule of thumb based on conjecture and unsupported conclusions.

The appraisers agreed to a five-year suspension of valuing facade easements and undertaking any appraisal services that could subject them to penalties under the Internal Revenue Code. The appraisers also agreed to abide by all applicable provisions of Circular 230.

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[34] *See General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals, Department of the Treasury* 193-196 (March 2014), available at http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2015.pdf.

[35] IRS Bars Appraisers from Valuing Facade Easements for Federal Tax Purposes for Five Years, IR-2014-31, March 19, 2014. available at http://www.irs.gov/uac/Newsroom/IRS-Bars-Appraisers-from-Valuing-Facade-Easements-for-Federal-Tax-Purposes-for-Five-Years.

T. Cost of the Deduction

The charitable income tax deduction under § 170(h) has been criticized as wasteful, inefficient, and subject to abuse.[36] The potential that conservation easements will not be enforced over the long term, the inadequacy of public benefit, the prospect of overvaluation, and the lack of budget control have all been cited as concerns.[37] The deduction is also very costly. One commentator has estimated a total revenue loss of $3.6 billion resulting from easement deductions claimed by individuals for tax years 2003 through 2008, and that figure would be larger if it included easement deductions claimed by corporate donors.[38] Unlike most charitable contributions, the donation of a conservation easement typically generates at least a six-figure deduction for the donor. The following chart indicates the number of conservation easement donations reported on individual returns in the year designated and the average donation per return.[39]

[36] *See, e.g.,* Daniel Halperin, *A Better Way to Encourage Gifts of Conservation Easements*, 136 Tax Notes 307 (2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2115640.

[37] *See id.* at 308-311. *See also, e.g.,* Roger Colinvaux, *Conservation Easements: Design Flaws, Enforcement Challenges, and Reform*, 2012 UTAH L. REV. 755, available at http://epubs.utah.edu/index.php/ulr/article/view/1134/828; Theodore Sims, *Qualified Conservation Restrictions: Recollections of and Reflections on the Origins of Section 170(h)*, 2013 UTAH L. REV. 727, available at http://epubs.utah.edu/index.php/ulr/article/view/1133/829; Roger Colinvaux, *The Conservation Easement Tax Expenditure: In Search of Conservation Value*, 37 COLUMBIA J. ENVTL. L. 1 (2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2003964 [hereinafter *In Search of Conservation Value*]; Daniel Halperin, *Incentives for Conservation Easements: The Charitable Deduction or a Better Way*, 74 DUKE J. L. & CONTEMP. PROBS. 29 (2011), available at http://scholarship.law.duke.edu/lcp/vol74/iss4/3/; Nancy A. McLaughlin, *Extinguishing and Amending Tax-Deductible Perpetual Conservation Easements: Protecting the Federal Investment after* Carpenter, Simmons*, and* Kaufman, 13 FLA. TAX REV. 217 (2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2194014 [hereinafter *Protecting the Federal Investment*]; Jeff Pidot, *Conservation Easement Reform: As Maine Goes Should the Nation Follow?*, 74 DUKE J. L. & CONTEMP. PROBS. 1 (2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1926389.

[38] *See In Search of Conservation Value*, *supra* note 37, at 9-10.

[39] *See* Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2011*, STAT. OF INCOME BULL. Spring 2014, at 111; Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2010*, STAT. OF INCOME BULL. Winter 2013, at 64; Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2009*, STAT. OF INCOME BULL. Spring 2012, at 63; Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2008*, STAT. OF INCOME BULL. Winter 2011, at 77; Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2007*, STAT. OF INCOME BULL. Spring 2010, at 53; Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2006*, STAT. OF INCOME BULL. Summer 2009, at 68; Janette Wilson, *Individual Noncash Contributions, 2005*, STAT. OF INCOME BULL. Spring 2008, at 69.

Year[40]	Number of Donations	Avg. Donation Per Return
2005	2,307	$787,062
2006	3,529	$422,092
2007	2,405	$812,369
2008	3,158	$372,925
2009	2,102	$463,073
2010	3,241	$261,027
2011	2,202	$383,179

The difficulties associated with the IRS's policing of conservation easement donation transactions as well as the policing of the administration of the easements consistent with their terms and purposes over the long term may continue to stimulate calls for reform or repeal.

U. Case Law

Appendix A lists the seventy-two cases involving challenges to deductions claimed with respect to easement donations as of August 18, 2014. Eleven involved donations made before § 170(h) was enacted. Of the sixty-two cases involving § 170(h) donations, forty-seven (77%) were decided after 2005. Also, because a number of the cases involved motions for reconsideration, remands, or appeals, the number of opinions is even greater.

All cases involving challenges to deductions claimed with respect to easement donations are referred to in the text of this outline by case name and numerical designation only (e.g., *Carpenter I, Kaufman III*). Appendix A includes the case citations and a discussion of the precedential value of Tax Court cases. Appendix F includes blog posts discussing the cases decided in 2013 and 2014 (and other select developments). The blog posts include live links to the cases and other source materials.

[40] The 2010 and 2011 figures include both conservation easements encumbering land and façade easements. In previous years, separate statistics for each type of easement were provided and the figures for 2005-09 relate only to conservation easements encumbering land.

II. Filing a Tax Return Package to Minimize Risk of Audit

- **Correctly Drafted Conservation Easement**
- **IRS Form 8283 & Supplemental Statement**
- **Qualified Appraisal**
- **Contemporaneous Written Acknowledgment**
- **Compelling and Timely Baseline Documentation**
- **Correct and Timely Lender Agreement (if applicable)**

A. Correctly Drafted Conservation Easement

1. **Copy of Conservation Easement.** A copy of the correctly drafted and, if possible, recorded conservation easement deed should be either

a. filed with IRS Form 8283 (the appraisal summary) or

b. if the easement is valued at more than $500,000, included in the qualified appraisal filed with IRS Form 8283. *See* discussion of IRS Form 8283 in Part II.B below.

Best practice is to either (i) file the date stamped copy of the recorded easement deed with the Form 8283 or (ii) have the appraiser include the date stamped copy of the recorded easement deed in the appraisal. It also is imperative that the appraiser values the restrictions as they appear in the recorded easement deed rather than in an earlier draft that was revised prior to recordation.

Façade easements on buildings in registered historic districts are subject to special rules. For donations of such easements made in a taxable year beginning after August 17, 2006, the taxpayer must include with the taxpayer's return for the year of the contribution, in addition to the Form 8283: (a) a qualified appraisal, (b) photos of the entire exterior of the building, and (c) a description of all restrictions on the development of the building.[41] A date stamped copy of the recorded easement deed should be included with these items. If the deduction claimed is more than $10,000, it will be allowed only if the taxpayer also includes a $500 filing fee.[42]

2. **Extensive Recitals**. The conservation easement should include extensive recitals clearly indicating the conservation or historic values of the property worthy of protection.

[41] *See* IRC § 170(h)(4)(B)(iii).

[42] *See* IRC § 170(f)(13); IRS Form 8283-V, available at http://www.irs.gov/pub/irs-pdf/f8283v.pdf.

3. **Clearly Delineated Governmental Conservation Policy**. If attempting to satisfy the open space conservation purpose test by reference to a clearly delineated federal, state, or local governmental conservation policy, the conservation easement deed should refer only to those policies that apply to the subject property. In *RP Golf*, *LLC* the IRS asserted that the conservation easement donation at issue was not made exclusively for conservation purposes, in part because the Missouri "conservation policy" the taxpayer referenced in the easement deed was limited to certain areas of the state and there was no evidence that the property subject to the easement was located in such an area on the date of the donation. The taxpayer was forced to concede that the easement was not made pursuant to a clearly delineated governmental conservation policy and the Tax Court granted the IRS's motion for summary judgment on this issue.[43] **Referring to governmental conservation policies that do not apply to the subject property undermines a taxpayer's credibility with both the IRS and the court.**

4. **Retained Development and Use Rights**. In *Butler*, the IRS asserted that the development and use rights retained by the landowners in conservation easement deeds were inconsistent with the conservation purposes of the easements. One of the protected properties, a 393.3-acre tract, can be subdivided into as many as eleven approximately 36-acre lots, each of which can be used for both residential and agricultural purposes.[44] Although the court determined that the properties would still serve habitat protection conservation purposes even if developed to the fullest extent permitted by the easement deeds, the holding should not be viewed as a green light for conservation easements that reserve extensive development and use rights for a number of reasons.

a. Typically the taxpayer bears the burden of proof on the issue of whether a conservation easement would continue to accomplish its conservation purpose if all retained rights are fully exercised. In *Butler*, that burden had shifted to the IRS.

[43] The IRS also asserted that the easement failed to satisfy the habitat protection conservation purpose, but the Tax Court found that material facts regarding the easement's preservation of a natural habitat continued to be in dispute. Accordingly, the court denied the IRS's motion for summary judgment on that issue.

[44] The easement grantor retained the right to the following with regard to each of the eleven lots, subject to certain limitations and approvals: (i) a single family residence, garage, and barn or single multipurpose outbuilding within a two-acre building site; (ii) structures ancillary to agricultural and recreational uses, such as a cattle barn, horse barn, and sheds, (iii) commercial timber harvesting, (iv) removal of trees for agricultural or aesthetic purposes and the planting of nonnative species, (v) a wide variety of recreational activities such as noncommercial hunting, fishing, horseback riding, boating, and hiking, (vi) fence construction, (viii) the construction of roads and trails to access permitted building sites and to accommodate timber management, and (ix) the use of agrichemicals.

b. The taxpayers in *Butler* offered some (albeit "sparse") evidence in the form of testimony of environmental consultants to support their contention that the reserved rights were not inconsistent with the habitat protection conservation purpose of the easements, and the IRS failed to introduce any evidence to the contrary.[45] Had the IRS in hired its own environmental consultants or similar experts *Butler*, that case might have been decided differently. **The IRS has informally indicated that it intends to hire environmental experts in appropriate cases.**

c. The parties disagreed about whether the easement deeds restricted the location of the building sites. The donors argued that the easement deeds incorporated the baseline documentation by reference, and the baseline included a map stipulating the placement of the building sites in locations consistent with the preservation of the conservation purposes. The court found that, under Georgia law, reference in the recorded easement deed to the baseline effectively made the baseline (including the map) part of the recorded deed, and the restrictions on the location of the lots in the map were therefore binding.

5. **<u>Swaps Are Prohibited</u>**. **In *Belk I*, the Tax Court held that a conservation easement that permits the parties to agree to "substitutions" (i.e., to remove land from the easement in exchange for the addition of some other land), even if subject to certain limitations, is not eligible for a deduction under § 170(h)**.[46] The taxpayers had donated the easement encumbering a 184-acre golf course in a residential development to a land trust in 2004 and claimed a $10.5 million deduction. The IRS argued that an easement that does not relate to a specific piece of property (a "floating easement") is not eligible for a deduction under § 170(h) because it violates the perpetuity requirements. The Tax Court agreed, holding that the easement failed to satisfy the requirement in § 170(h)(2)(C) that a tax-deductible conservation easement be "a restriction (granted in perpetuity) on the use which may be made of *the real property*" (emphasis added), which is specifically identified in the instrument of conveyance and the conservation values of which are specifically documented in the baseline documentation. "To conclude otherwise," explained the court, "would permit petitioners a deduction

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[45] *See also Glass II* (6th Circuit found reserved rights were not inconsistent with the habitat protection conservation purpose of the two easements at issue, in part because the taxpayers and the holder presented credible testimony to that effect, and the IRS failed to present any evidence to the contrary).

[46] The easement at issue in *Belk* authorizes the landowner to remove land from the protection of the easement in exchange for adding an equal or greater amount of contiguous land to the easement, provided, among other things, that <u>in the opinion of the grantee</u>: (i) the substitute land "is of the same or better ecological stability" as the land removed, (ii) the fair market value of the "easement interest" on the substitute land will be at least equal to or greater than the fair market value of the "easement interest" that will be extinguished as a result of the substitution, and (iii) the substitution will have no adverse effect on the conservation purposes of the easement.

for agreeing not to develop the golf course when the golf course can be developed by substituting [other property for] the property subject to the conservation easement."

a. The court found it **immaterial that the land trust has to approve the substitutions**, explaining:

> There is nothing in the Code, the regulations, or the legislative history to suggest that section 170(h)(2)(C) is to be read to require that the interest in property donated be a restriction on the use of the real property granted in perpetuity unless the parties agree otherwise. The requirements of section 170(h) apply even if taxpayers and qualified organizations wish to agree otherwise.

b. Citing to Treasury Regulation § 1.170A-14(c)(2), the "restriction on transfer" requirement, the court noted that the **regulations permit substitutions, but only under limited circumstances**, including that an unexpected change in conditions has to have made continued use of the property for conservation purposes impossible or impractical. Treasury Regulation § 1.170A-14(c)(2) appears to provide that the restriction on transfer requirement will not be violated if the holder is permitted to extinguish (i.e., transfer) the easement in accordance with Treasury Regulation § 1.170A-14(g)(6), the extinguishment and division proceeds regulations, and those regulations sanction substitutions only in limited circumstances—i.e., in a judicial proceeding, upon a finding that continued use of the property for conservation purposes has become impossible or impractical, and with a payment of at least a minimum proportionate share of proceeds to the holder to be used "in a manner consistent with the conservation purposes of the original contribution."[47] The easement at issue in *Belk* did not limit substitutions to such circumstances.

c. In *Belk II*, the Tax Court denied the taxpayers motion for reconsideration of and supplemented its opinion in *Belk I*.

- The taxpayers in *Belk II* argued that, as long as they agree not to develop 184 acres of land, the court and the IRS should not be concerned with what land actually comprises the 184 acres. The Tax Court noted that it had already rejected the notion of such "floating easements" in *Belk I* and reiterated that **§ 170(h)(2)(C)**

[47] Although Treasury Regulation § 1.170A-14(c)(2) cross-references to Treasury Regulation § 1.170A-14(g)(5)(ii), the proper cross-reference is to -14(g)(6)(ii); the Treasury failed to update the cross-references when it finalized the proposed regulations in 1986.

requires that taxpayers donate an interest in an identifiable, specific piece of real property.

- The taxpayers in *Belk II* also argued that the Tax Court could not disallow the deduction on the ground that the deed included a substitution provision because state law permits the parties to mutually agree to substitutions in any event. The Tax Court disagreed, noting that the taxpayers:

  > "confuse their right under State law to modify the terms of a contract by mutual consent with the effect such a modification would have for tax purposes. **Even if [the parties] had the right to modify the terms of the conservation easement agreement under State law by mutual agreement [an issue the court did not analyze], North Carolina law does not dictate the resulting tax consequences of the modification."**

- The taxpayers in *Belk II* further argued, citing to *Simmons II*, that the Tax Court in *Belk I* failed to consider "that an element of trust and confidence is placed in a qualified organization that it will continue to carry out its mission to protect and conserve property." The Tax Court held that ***Simmons*** **is distinguishable**. The court noted that, while the taxpayers were correct that courts trust qualified organizations to fulfill their responsibilities, that trust is based on the requirements imposed on the qualified organization by the conservation easement and local law. In *Simmons*, although the easement deed contained a clause granting the holder the right to consent to changes or abandon its rights under the easement, the D.C. Circuit found that both the easement deed and local historic preservation laws prevented the donee from consenting to any changes that were inconsistent with the conservation purposes of the easement. Moreover, if the donee dissolved (thereby abandoning the easement), the easement would be transferred to the District of Columbia to be reassigned to a similar organization. Accordingly, in *Simmons*, "the conservation purpose was protected at all times." The same was not true in *Belk*, where the easement granted the parties the right to agree to substitutions and, thus, "there is no restriction on the golf course in perpetuity that we can trust [the holder] to enforce."

- Although not discussed by the Tax Court in *Belk II*, the D.C. Circuit implicitly rejected the argument of the amici curiae in *Simmons II*

that land trusts should be permitted to agree with developers to extinguish perpetual easements on some properties (to allow development) in exchange for easements on other properties.[48] The D.C. Circuit explained, in part, that an "eligible donee" must have a "commitment to protect the conservation purposes of the donation" and "the resources to enforce the restrictions" and that a tax-exempt organization would fail to enforce a conservation easement "at its peril." The D.C. Circuit also concluded that the donated easements at issue in *Simmons II* "will prevent in perpetuity any changes to the properties inconsistent with conservation purposes."

d. **The holdings in *Belk I* and *II* are consistent with**

- Congress's admonition in the **legislative history** "that provisions allowing deductions for conservation easements should be directed at the preservation of unique or otherwise significant land areas or structures,"[49] as well as the detailed **threshold conservation purpose and other qualification and valuation requirements** that must be met to be eligible for a deduction under § 170(h),

- **IRS General Information Letter** dated March 5, 2012 regarding swaps,[50] and

- **Instructions for Schedule D of the Form 990**,[51] which (i) explain that an easement is released, extinguished, or terminated "when all or part of the property subject to the easement is removed from the protection of the easement in exchange for the protection of some other property or cash to be used to protect some other property," and (ii) require nonprofits to annually report their conservation easement transfer, modification, and termination activities.

e. The taxpayers have appealed *Belk* to the 4th Circuit.

[48] *See* Brief for the National Trust for Historic Preservation et al. as Amici Curiae Supporting Appellee at *17, Comm'r v. Simmons, No. 10-1063, 2011 WL 2451012 (D.C. Cir. June 21, 2011) 2010 WL 6511476 (C.A.D.C.).

[49] S. Rep. No. 96-1007, 1980-2 C.B. 599, at 603.

[50] *See supra* note 28 and accompanying text.

[51] Instructions for Schedule D (Form 990), available at http://www.irs.gov/pub/irs-pdf/i990sd.pdf.

6. **<u>Extinguishment and Division of Proceeds</u>. A conservation easement should include provisions limiting extinguishment to the circumstances specified in Treasury Regulation § 1.170A-14(g)(6)(i) and (ii) (the extinguishment and division of proceeds regulations)**.[52] The following is a sample extinguishment clause:

> This Easement can be released, terminated, or otherwise extinguished, whether in whole or in part, only (a) in a judicial proceeding in a court of competent jurisdiction, (b) upon a finding by the court that a subsequent unexpected change in the conditions surrounding the Property has made impossible or impractical the continued use of the Property for conservation purposes, and (c) with a payment of proceeds to Grantee[53] as described in [the easement provision tracking Treasury Regulation § 1.170A-14(g)(6)(ii)[54]], which proceeds must be used by Grantee in a manner consistent with the conservation purposes of this Easement. The provisions of this paragraph shall survive extinguishment of this Easement and apply notwithstanding, and in addition to, any conditions that may be imposed on the release or other extinguishment of this Easement under the law of [the applicable state].

a. In *Carpenter I*, the Tax Court held that conservation easements extinguishable by mutual agreement of the parties, even if subject to a

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[52] Treas. Reg. § 1.170A-14(g)(6), which addresses "Extinguishment" of a tax-deductible conservation easement, provides:

> (i) *In general*. If a subsequent unexpected change in the conditions surrounding the property that is the subject of a donation under this paragraph can make impossible or impractical the continued use of the property for conservation purposes, the conservation purpose can nonetheless be treated as protected in perpetuity if the restrictions are extinguished by judicial proceeding and all of the donee's proceeds (determined under paragraph (g)(6)(ii) of this section) from a subsequent sale or exchange of the property are used by the donee organization in a manner consistent with the conservation purposes of the original contribution.
>
> (ii) *Proceeds*. In case of a donation made after February 13, 1986, for a deduction to be allowed under this section, at the time of the gift the donor must agree that the donation of the perpetual conservation restriction gives rise to a property right, immediately vested in the donee organization, with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction at the time of the gift, bears to the value of the property as a whole at that time. See § 1.170A-14(h)(3)(iii) relating to the allocation of basis. For purposes of this paragraph (g)(6)(ii), that proportionate value of the donee's property rights shall remain constant. Accordingly, when a change in conditions give rise to the extinguishment of a perpetual conservation restriction under paragraph (g)(6)(i) of this section, the donee organization, on a subsequent sale, exchange, or involuntary conversion of the subject property, must be entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction, unless state law provides that the donor is entitled to the full proceeds from the conversion without regard to the terms of the prior perpetual conservation restriction.

[53] Grantee should be defined to include all successors and assigns.

[54] See discussion of "greater of" proceeds formula in Part II.A.9 below.

standard such as "impossibility," fail as a matter of law to satisfy the extinguishment requirements in Treasury Regulation § 1.170A–14(g)(6)(i).

b. With regard **federal and state law interaction**, the court in *Carpenter I* explained:

> To determine whether the conservation easement deeds comply with requirements for the . . . deduction under Federal tax law, we must look to State law to determine the effect of the deeds. **State law determines the nature of the property rights**, and **Federal law determines the appropriate tax treatment of those rights**.[55]

c. The court in *Carpenter I* also held that the "so-remote-as-to-be-negligible" standard of Treasury Regulation § 1.170A-14(g)(3) does not modify Treasury Regulation § 1.170A–14(g)(6)(i). Accordingly, **failure to comply with the extinguishment requirements of Treasury Regulation § 1.170A–14(g)(6)(i) cannot be cured by a showing that the possibility of extinguishment is so remote as to be negligible**.

d. **In *Carpenter II*, the Tax Court confirmed that "extinguishment by judicial proceedings is mandatory." The Tax Court specifically rejected the taxpayers' argument that Treasury Regulation § 1.170A–14(g)(6)(i) contemplates alternatives to judicial extinguishment or is "merely a safe harbor."**

e. In *Carpenter II,* **the Tax Court also rejected the taxpayers' argument that the 1st Circuit's decision in *Kaufman III*, was an intervening change in the law** that required the court to reconsider its holding in *Carpenter I*. The court explained that, not only is *Kaufman III* not binding in the 10th Circuit (to which *Carpenter* would be appealed), *Kaufman III* addressed legal issues different from those present in *Carpenter*.[56] The court also noted that it does not read *Kaufman III* as sanctioning "putting into the hands of the parties to a conservation agreement the authority to determine when to extinguish the conservation easement so long as the donee organization gets its shares of the proceeds of a subsequent sale."

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[55] *See also Patel v. Comm'r*, 138 T.C. 395 (2012) (State law determines only which sticks are in a person's bundle. . . . Once property rights are determined under State law, as announced by the highest court of the State, the tax consequences are decided under Federal law).

[56] *Kaufman III* involved interpretation of Treasury Regulation § 1.170A-14(g)(1) (the "general enforceable in perpetuity" requirement) and Treasury Regulation § 1.170A-14(g)(6)(ii) (the "division of proceeds" requirement). *Carpenter*, on the other hand, involved interpretation of Treasury Regulation § 1.170A-14(g)(6)(i) (the "extinguishment" requirement)).

f. In *Mitchell II*, the Tax Court similarly rejected the argument that *Kaufman III* was an intervening change in the law requiring it to reconsider its holding in *Mitchell I*.[57] The court explained that, not only is *Kaufman III* not binding in the 10th Circuit (to which *Mitchell* would be appealed), *Kaufman III* addressed legal issues different from those present in *Mitchell*.[58] **The court reiterated that Treasury Regulation 1.170A-14(g)(6) is *not* "merely … a safe harbor," and the specific provisions of Treasury Regulation § 1.170A-14(g)(1) through (g)(6) "are mandatory and may not be ignored**." The court further rejected the taxpayer's argument that the court should "draw a general rule" with respect to the in-perpetuity requirement of § 170(h)(5)(A) and Treasury Regulation § 1.170A-14(g) from the analysis in *Kaufman III*. The taxpayer asserted: "The regulation emphasizes perpetuating an easement's purpose as opposed to the conservation easement itself. The proceeds are protected which is the goal of the law." The Tax Court disagreed, stating: "Nowhere in Kaufman III did the Court of Appeals for the 1st Circuit state a general rule that protecting the proceeds from an extinguishment of a conservation easement would satisfy the in-perpetuity requirements of section § 1.170A-14(g) ... generally." In other words, **the Tax Court held that § 170(h) requires perpetuation of the conservation easement itself, not just conservation purposes generally.**

g. **The holdings in *Carpenter I* and *II* and *Mitchell II* are consistent with IRS General Information Letter dated March 5, 2012, on extinguishment.**[59]

h. **The holdings in *Carpenter I* and *II* and *Mitchell II* are also consistent with the Land Trust Alliance's 2007 report on conservation easement amendments**, which instructs:

> If the conservation easement was the subject of a federal income tax deduction, then Internal Revenue Code Section 170(h) and the Treasury Regulations Section 1.170A-14 apply. . . . The easement must be transferable only to another government entity or qualified charitable organization that agrees to continue to enforce the easement. The easement can only be extinguished by the holder through a judicial proceeding, upon a finding that continued use of the encumbered land for conservation purposes has become "impossible or impractical," and with the payment to

[57] In *Mitchell I* the Tax Court sustained the IRS's disallowance of a deduction for an easement donation because the taxpayer failed to obtain a mortgage subordination agreement at the time of the gift.
[58] *Mitchell* involved interpretation of Treasury Regulation § 1.170A-14(g)(2) (the "mortgage subordination" requirement).
[59] *See supra* note 29 and accompanying text.

the holder of a share of proceeds from a subsequent sale or development of the land to be used for similar conservation purposes. To the extent an amendment amounts to an extinguishment, the land trust must satisfy these requirements.[60]

i. The time for appeal of *Carpenter* has run. The taxpayers have appealed *Mitchell* to the 10th Circuit.

7. **State Law Can Render Conservation Easements Nondeductible.** In *Wachter*, the Tax Court held that North Dakota law, which limits the duration of easements created after July 1, 1977, to a maximum of 99 years, precludes conservation easement donors in the state from qualifying for a federal charitable income tax deduction under § 170(h) because **easements in North Dakota cannot be granted "in perpetuity."**

The Tax Court in *Wachter* reiterated the fundamental principle that, while state law determines the nature of property rights, it is federal law that determines the federal tax treatment of those rights.[61] *Wachter* confirmed that state law can render all conservation easement donations in a state ineligible for the federal deduction if state law prevents conservation easements from complying with federal requirements. Some states have considered making changes to their easement enabling statutes that could run afoul of federal requirements. Potential easement donors and their advisors should be aware of this issue.

In *Wachter*, the IRS argued that North Dakota's law limiting the term of all real property easements to 99 years prevents conservation easements in the state from satisfying both:

a. Section 170(h)(2)(C)'s requirement that a tax-deductible easement be "a restriction (granted in perpetuity) on the use which may be made of the real property" and
b. Section 170(h)(5)(A)'s requirement that the conservation purpose of a tax-deductible easement be protected in perpetuity.

The Tax Court noted that these are **separate and distinct perpetuity requirements, and the failure to satisfy either of them will prevent an easement from being deductible under § 170(h)**. The court held that North Dakota law precludes conservation easements in the state from satisfying either requirement.

[60] Land Tr. Alliance, Amending Conservation Easements: Evolving Practices and Legal Principles 24 (2007).
[61] *See also supra* note 55 and accompanying text.

The taxpayers in *Wachter* argued that North Dakota's 99-year limitation should be considered the equivalent of a remote future event that does not prevent an easement from being considered perpetual. They cited Treasury Regulation § 1.170A–14(g)(3), which provides, in part, that:

> A deduction shall not be disallowed … merely because the interest which passes to, or is vested in, the donee organization may be defeated by the performance of some act or the happening of some event, if on the date of the gift it appears that the possibility that such act or event will occur is so remote as to be negligible.

The Tax Court in *Wachter* noted that the courts have construed the so-remote-as-to-be-negligible standard to mean:

> 'a chance which persons generally would disregard as so highly improbable that it might be ignored with reasonable safety in undertaking a serious business transaction' or 'a chance which every dictate of reason would justify an intelligent person in disregarding as so highly improbable and remote as to be lacking in reason and substance.'

The Tax Court explained that the term "remote" refers to the likelihood of the event that could defeat the donee's interest in the gift. It then explained that the likelihood of the event in *Wachter* that could defeat the donee's interest in the charitable gifts of the conservation easements – expiration of the easements after 99 years - was not "remote." **On the date of the donation of the easements,** the court explained, it was not only possible, **it was inevitable that the donee would be divested of its interests in the easements by operation of North Dakota law. Accordingly, the easements were not restrictions granted "in perpetuity" and, thus, were not deductible under § 170(h).**

8. **Reimbursement Provision and Use of Proceeds**. *Irby* analyzed Treasury Regulation § 1.170A-14(g)(6)(ii) (the division of proceeds regulation) as applied to conservation easements conveyed in bargain sale transactions. [62] The conservation easements in *Irby* had been conveyed to a land trust, but three government entities had supplied funding to pay approximately 75% of the value of the easements to the landowners, and the landowners made charitable gifts of the remaining 25%. The easements provide that the grantee is entitled to Treasury Regulation § 1.170A-14(g)(6)(ii)'s mandated minimum proportionate share of proceeds following extinguishment, but must pay 75% of those proceeds to the government entities to reimburse them for their contributions to the purchase price of the easements, which would leave the grantee with only 25% of the proceeds.

[62] The division of proceeds regulation is set forth in *supra* note 52.

The IRS argued that the reimbursement obligation meant that the grantee was not actually entitled to the mandated minimum proportionate share of proceeds following extinguishment—i.e., that its entitlement was merely "superficial." The Tax Court disagreed. The court explained that, unlike the situation where a lender holding an outstanding mortgage on the property is given priority to proceeds upon extinguishment (which furthers the taxpayer's interests because the proceeds will be used to pay down the taxpayer's debt), **there was no risk that the taxpayers in *Irby* could reap a similar windfall upon extinguishment because the proceeds payable by the grantee to the governmental entities, each of which has a conservation mission, would be used by such entities "in a manner consistent with the original conservation purposes of the contribution**" (as explained in the next paragraph). Thus, the court found that the easement deeds met the requirements of division of proceeds regulation.

The Tax Court also noted that the IRS's concerns in *Irby* more properly seemed to address the question of whether all of the extinguishment proceeds would be used by the grantee "in a manner consistent with the conservation purposes of the original contribution" as required by Treasury Regulation § 1.170A-14(g)(6)(i) (the extinguishment regulation). The court determined that they would. It explained that all three government entities "were established to assist the conservation of open land" and are "legally obligated to fulfill their conservation purpose." In addition, the court stated that it appeared that **the reimbursements would enhance the ability of the government entities "to conserve and protect more land, since the reimbursed funds would be used to do just that**." Accordingly, the court found that the reimbursement provision in *Irby* did not violate the requirements of either the extinguishment or division of proceeds regulations.[63]

The Tax Court issued Stipulated Decisions in *Irby* in December 2013 ordering the taxpayers to pay agreed upon deficiencies in income tax for taxable years 2003 and 2004, but no penalties were imposed.

9. "**<u>Greater of" Proceeds Formula</u>**. Some holders favor conservation easements that include a "greater of" proceeds formula, where the holder, following extinguishment, is entitled to *the greater of* (i) the percentage the easement represented of the value of the property at the time of the easement's donation, which is the *minimum* proportionate value required by Treasury Regulation § 1.170A-14(g)(6)(ii) (the "donation percentage") or (ii) the percentage the

[63] Some have argued that the court reached the correct result in *Irby*, but for the wrong reason. Treasury Regulation § 1.170A-14(g)(6)(ii) could be viewed as applying only to the portion of the proceeds attributable to the contribution component of a bargain sale transaction, and not to the portion of the proceeds attributable to the sales component of the transaction. Allowing the funders to be reimbursed for the funds they contributed to the purchase price should thus not run afoul of the proceeds requirement, although the priority of the payments might be an issue.

easement actually represents of the value of the property at the time of the easement's extinguishment (the "extinguishment percentage").[64]

a. The "greater of" formula complies with federal tax law requirements because the holder will always receive *at least* the Treasury Regulation's required minimum proportionate (or floor) share of proceeds.

b. The "greater of" formula ensures the holder will receive the appreciation (if any) in the value of easement over time to be used "in a manner consistent with the conservation purposes of the original contribution" (i.e., to replace lost conservation or historic values).

c. The "greater of" formula eliminates the property owner's perverse incentive to seek extinguishment to benefit from any appreciation in the value of the easement over time (i.e., the "spread" between the donation percentage and the extinguishment percentage).

d. While the "greater of" formula may create an incentive for the easement holder to seek extinguishment, holders have fiduciary obligations to donors and the public to administer and enforce conservation easements consistent with their terms and purposes; "eligible donees" must have a commitment to protect the conservation purposes of the donation and the resources to enforce the restrictions;[65] and extinguishment is permitted only in a judicial proceeding and upon a finding that a subsequent unexpected change in conditions has made impossible or impractical the continued use of the property for conservation purposes.[66]

10. **<u>Restricted Gift Status</u>**. The Tax Court in *Carpenter I*, held that, while the **conservation easements at issue** did not constitute charitable trusts under Colorado law, they **did constitute restricted gifts, or "contributions conditioned on the use of a gift in accordance with the donor's precise directions and limitations**." Charitable gifts made for specific purposes are referred to in some states as charitable trusts and in others as restricted gifts, but the different labeling is a distinction without a difference—the same rules apply.[67] Restricted gift status has a variety of benefits, including:

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[64] For an example of a proceeds clause using the "greater of" formula, see Maryland Environmental Trust Model Conservation Easement at 14, available at http://www.dnr.state.md.us/met/pdfs/MET_Model%20Easement_FINAL_for%20website.pdf.

[65] Treas. Reg. § 1.170A-14(c)(1).

[66] *See* Treas. Reg. § 1.170A-14(g)(6); *Carpenter II*.

[67] *See Protecting the Federal Investment, supra* note 37 (discussing the history of restricted gifts in the U.S.).

a. **restricted charitable gifts are highly favored by the courts, and courts are likely to interpret charitable gifts of conservation easements in favor of accomplishing their charitable conservation purposes, rather than in favor of the "free use of land,"**[68]

b. **restricted gifts may be excluded from the bankruptcy estates of donee charitable corporations** and transferred intact to new charitable holders,[69]

c. **actions to recover conservation easements** that have been improperly transferred, released, modified, or terminated **may not be barred by laches or the statute of limitations**,[70]

d. **conservation easements should not be extinguished pursuant to the doctrine of merger** if the government or nonprofit holder acquires title to the subject land because the required "unity of ownership" generally will not be present (i.e., the two estates would be "in the same person at the same time," but they generally would *not* be held "in the same right"),[71]

e. **attempts by state legislatures to terminate or otherwise weaken or undermine existing conservation easements may be found**

[68] *See, e.g.*, *Jackson v. Phillips*, 96 Mass. 539, 550, 556 (1867) ("gifts to charitable uses are highly favored, and will be most liberally construed in order to accomplish the intent and purpose of the donor"…. "If the words of a charitable bequest are ambiguous or contradictory, they are to be so construed as to support the charity, if possible."); *Board of Trustees of Univ. of N. C. v. Unknown Heirs*, 319 S.E.2d 239, 242 (N.C. 1984) ("It is a well recognized principle that gifts and trusts for charities are highly favored by the courts. Thus, the donor's intentions are effectuated by the most liberal rules of construction permitted.").

[69] *See* Evelyn Brody, *The Charity in Bankruptcy and Ghosts of Donors Past, Present, and Future*, 29 SETON HALL LEG. J. 471 (2005) ("the courts will try to identify those charitable assets that are restricted in such a manner that they survive the bankruptcy proceeding").

[70] *See, e.g.*, *Tauber v. Commonwealth*, 499 S.E.2d. 839, 845 (Va. 1998) (laches may not be pled successfully as a defense in an equitable proceeding to bar the state attorney general from asserting a claim on behalf of the public to insure that charitable assets are distributed in accord with the charitable purposes to which they should have been devoted); *Trustees of Andover Theological Seminary v. Visitors of Theological Inst. in Phillips Acad. in Andover*, 148 N.E. 900, 918 (Mass. 1925) ("Generally it is true that no length of time of diversion from the plain provisions of a charitable foundation will prevent its restoration to its true purpose").

[71] *See* Nancy A. McLaughlin, *Conservation Easements and The Doctrine of Merger*, 74 DUKE J. L. & CONTEMP. PROBS 279 (2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1923390. *See also* Virginia Attorney General advisory opinion (Aug. 13, 2012) (conservation easements in Virginia are not extinguished by application of the common law doctrine of merger), available at http://www.oag.state.va.us/Opinions%20and%20Legal%20Resources/Opinions/2012opns/11-140%20Rust.pdf.

unconstitutional on a number of grounds, including the prohibition on impairment of private contracts,[72]

f. **provisions included in the deed to comply with federal tax law requirements** (such as the restriction on transfer, extinguishment, and proceeds provisions) **will be enforceable under state law,** thus ensuring compliance with § 170(h), and

g. **the state attorney general may serve as a back-up enforcer** of conservation easements.[73]

B. IRS Form 8283 (Appraisal Summary) & Supplemental Statement

1. **Short History**.

a. In 1984, as part of the Deficit Reduction Act of 1984 (DEFRA),[74] Congress required taxpayers claiming deductions for noncash charitable contributions in excess of $5,000 to obtain a qualified appraisal prepared by a qualified appraiser[75] and attach an appraisal summary to the return on which the deduction is first claimed for the property contributed. DEFRA also directed the Secretary of the Treasury to prescribe regulations implementing the statutory requirements. Pursuant to this legislative mandate, the IRS and the Treasury Department promulgated Treasury Regulation § 1.170A-13(c) (attached as Appendix B), which provides that no deduction shall be allowed for a **noncash contribution in excess of $5,000** unless the taxpayer

(i) obtains a **qualified appraisal prepared by a qualified appraiser** and

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[72] *See* Nancy A. McLaughlin & W. William Weeks*, In Defense of Conservation Easements: A Response to The End of Perpetuity,* 9 Wyo. L. Rev. 1, 88-91 (2009) (gathering the relevant authorities), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1332225.

[73] At least six state enabling statutes expressly grant the attorney general enforcement rights. Conn. Gen. Stat. Ann. § 47-42c (2012); 765 Ill. Comp. Stat. 120/4 (2012); Me. Rev. Stat. Ann. tit. 33, § 478(1)(D) (2012); Miss. Code Ann. § 89-19-7(1) (2012); R.I. Gen. Laws § 34-39-3(f)(4) (2012); Va. Code Ann. § 10.1-1013 (2012). On the attorney general's common law and statutory rights to enforce charitable gifts and trusts on behalf of the public, see CHESTER, BOGERT & BOGERT, THE LAW OF TRUSTS & TRUSTEES § 411 (3RD ED. 2005).

[74] Pub. L. No. 98-369, 98 Stat. 691 (1984).

[75] DEFRA § 155(a). Congress defined the term "qualified appraisal" to mean an appraisal prepared by a qualified appraiser that includes, among other information: (1) a description of the property appraised, (2) the fair market value of the property on the contribution date and the specific basis for valuation, (3) a statement that the appraisal was prepared for income tax purposes, (4) the qualifications of the appraiser, and (5) any additional information the Secretary may prescribe by regulation. *Id.* § 155(a)(4).

(ii) attaches a **fully completed appraisal summary (IRS Form 8283**) to the tax return on which the taxpayer first claims a deduction for the contribution.

b. In 2004, Congress added § 170(f)(11) to the Internal Revenue Code effective for contributions made after June 3, 2004 (§ 170(f)(11), as amended, is attached as Appendix C).[76] Section 170(f)(11) provides, among other things, that

(i) in the case of **contributions** of property for which a deduction **of more than $5,000** is claimed, the taxpayer must obtain a qualified appraisal and **attach** to the return for the taxable year in which such contribution is made such information regarding such property and such appraisal as the Secretary may require (i.e., the **Form 8283, appraisal summary**),[77] and

(ii) in the case of **contributions** of property for which a deduction **of more than $500,000** is claimed, the taxpayer must **attach the full qualified appraisal** to the return (i.e., the entire qualified appraisal must be filed with the Form 8283).[78]

c. In 2006, Congress amended § 170(f)(11) to add statutory definitions of the terms "qualified appraiser" and "qualified appraisal."[79]

d. Later in 2006, the IRS issued Notice 2006-96,[80] which, among other things, provides transitional guidance regarding § 170(f)(11)(E)'s definitions of qualified appraisal and qualified appraiser.

e. In 2008, the IRS and the Treasury Department issued proposed regulations implementing the substantiation and reporting rules.[81] Until these regulations are finalized and effective, the transitional guidance in IRS Notice 2006-96 applies.

f. As the foregoing indicates, the qualified appraisal and appraisal summary requirements are both statutory and regulatory requirements.

[76] *See* § 883 of the American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418.
[77] IRC § 170(f)(11)(C).
[78] *Id*. § 170(f)(11)(D).
[79] IRC § 170(f)(11)(E). *See* § 1219 of the Pension Protection Act of 2006, Pub. L. No. 109–280, 120 Stat. 780. For an explanation of the Pension Protection Act changes, see Joint Committee on Taxation, JCX-38-06 (August 3, 2006), available at https://www.jct.gov/publications.html?func=select&id=20.
[80] IRS Notice 2006-96 is available at http://www.irs.gov/irb/2006-46_IRB/ar13.html.
[81] *See* Substantiation and Reporting Requirements for Cash and Noncash Charitable Contribution Deductions, 73 Federal Register 45908 (proposed August 7, 2008).

2. **<u>Form 8283</u>**. Despite the 1st Circuit's holding in *Kaufman III*, donors should **correctly and completely fill out Form 8283 and attach a Supplemental Statement as described below and *not* rely on substantial compliance**.[82]

a. An example of a correctly filled out Form 8283 is attached as <u>Appendix D</u>.

b. The donee and the individual appraiser or appraisers (if more than one) must all sign the Form 8283.[83]

c. DEFRA specifically requires taxpayers to include on the return on which a deduction is first claimed such information as may be prescribed by Treasury Regulations, including the cost basis and acquisition date of the donated property.[84] The Treasury Regulations follow up on this requirement by providing that the appraisal summary must include, among other things (i) the manner and date of acquisition of the property by the donor, or, if the property was created by the donor, a statement to that effect and the approximate date the property was substantially completed, and (ii) the cost or other basis of the property.[85] The Treasury Regulations also provide that, if a taxpayer has reasonable cause for being unable to provide the foregoing information, an appropriate explanation should be attached to the appraisal summary. The taxpayer's deduction will not be disallowed simply because of the inability (for reasonable cause) to provide these items of information.[86]

d. The Instructions for Form 8283[87] state, with regard to Section B, Part I, Line 5, Columns (d) through (f) (addressing date acquired, how acquired, and basis): "If you have reasonable cause for not providing the information in columns (d), (e), or (f), attach an explanation *so your deduction will not automatically be disallowed*" (emphasis added).

3. **<u>Supplemental Statement</u>**. The Instructions for Form 8283 require the donor to attach a supplemental statement to the form.

a. The supplemental statement must:

(i) identify the conservation purposes furthered by the donation,

[82] In *Kaufman III*, the 1st Circuit held that failure to include the date, manner of acquisition, and cost or other basis of the property contributed on the Form 8283 was not fatal to the deduction.

[83] *See* Treas. Reg. § 1.170A-13(c)(5)(iii).

[84] DEFRA § 155(a)(1)(C).

[85] *See id.* § 1.170A-13(c)(4)(ii)(D) and (E).

[86] *See id.* § 1.170A-13(c)(4)(iv)(C)(1).

[87] Instructions for Form 8283 are available at http://www.irs.gov/pub/irs-pdf/i8283.pdf.

(ii) show, if before and after valuation is used, the fair market value of the underlying property before and after the gift,
(iii) state whether the donation was made in order to get a permit or other approval from a local or other governing authority and whether the donation was required by a contract (i.e., was there a *quid pro quo*), and
(iv) if the donor or a related person has any interest in other property nearby, describe that interest.

b. The Supplemental Statement should be comprehensive and detailed (numerous pages long). An example of a supplemental statement is attached as Appendix E.

4. **Special Rules for Façade Easement Donations**. For the donation of a façade easement on a building in a registered historic district that is made in a taxable year beginning after August 17, 2006, in addition to the Form 8283 and Supplemental Statement, the taxpayer must include with the taxpayer's return for the year of the contribution: (a) a qualified appraisal, (b) photos of the entire exterior of the building, (c) a description of all restrictions on the development of the building, and (d) if the deduction claimed is more than $10,000, a $500 filing fee.[88]

C. Qualified Appraisal

1. **"Qualified Appraisal" Requirements**.[89]

a. **Donors should strictly comply with all statutory and regulatory qualified appraisal requirements** despite (i) the Circuit Court holdings in *Simmons II, Scheidelman II,* and *Friedberg II* that the appraisals obtained to substantiate façade easement donations sufficiently detailed the "method used" and "basis" of valuation within the purview of Treasury Regulation §§ 1.170A-13(c)(3)(ii)(J) and (K),[90] (ii) the Tax Court's holding in *Irby* that an appraisal report's discussion of the purpose of the appraisal (i.e., to value an easement for purposes of § 170(h)) was sufficient to satisfy Treasury Regulation § 1.170A–13(c)(3)(ii)(G)'s requirement that the appraisal contain: "A statement that the appraisal was prepared for income tax purposes." and (iii) the Tax Court's holding in *Zarlengo* that the taxpayer complied or substantially complied with the various qualified appraisal requirements in Treasury Regulation § 1.170A-

[88] *See* IRC §§ 170(h)(4)(B)(iii) and 170(f)(13). *See also* IRS Form 8283-V, available at http://www.irs.gov/pub/irs-pdf/f8283v.pdf.
[89] *See* IRC § 170(f)(11) (attached as Appendix C); Treas. Reg. § 1.170A-13(c) (attached as Appendix B); IRS Notice 2006-96, available at http://www.irs.gov/irb/2006-46_IRB/ar13.html.
[90] Provision of the basis of valuation is also required by DEFRA §155(a)(4)(B).

13(c), even though, among other things, the appraisal was "premature" (i.e., prepared more than 60 days prior to the date of the contribution).

b. After the 2nd Circuit's holding in *Scheidelman II*, the Tax Court In *Rothman II* reconsidered its earlier opinion and concluded that the *Rothman* appraisal met the "method used" and "basis" of valuation requirements of the Treasury Regulations. However, the Tax Court noted that **Treasury Regulation § 1.170A-13, the qualified appraisal regulation** (which is attached as Appendix B), **imposes 15 distinct requirements and the appraisal in *Rothman* still failed to satisfy 8 of the 15 requirements.** Accordingly, **because of the "collective defects," the court reconfirmed its holding that the *Rothman* appraisal was not qualified**.

> (i) The Tax Court in *Rothman II* further noted that, because the qualified appraisal regulation was promulgated under an express delegation of congressional authority and has been found to be valid, the Supreme Court instructs that courts respect the lines the Secretary of the Treasury has drawn therein as a valid exercise of rulemaking authority.
>
> (ii) Whether the donor in *Rothman* qualified for the "reasonable cause" exception for not having a qualified appraisal under § 170(f)(11)(A)(ii)(II) (see Appendix C) was an issue that remained to be tried. The case, however, was settled.

c. In *Scheidelman II*, the 2nd Circuit explained

> [f]or the purpose of gauging compliance with the reporting requirement, it is irrelevant that the IRS believes the method employed [a mechanical application of a percentage diminution] was sloppy or inaccurate, or haphazardly applied—it remains a method, and [the appraiser] described it. The regulation requires only that the appraiser identify the valuation method "used"; it does not require that the method adopted be reliable.

However, the 2nd Circuit went on to explain that its conclusion (that the appraisal met the minimal requirements of a qualified appraisal) mandated neither that the Tax Court find the appraisal persuasive nor that Scheidelman be entitled to any deduction for the donated easement, and it remanded to the Tax Court. **In *Scheidelman III*, the Tax Court held that, although the taxpayers' appraisal was a qualified appraisal: (i) the taxpayers did not provide sufficient credible evidence to meet their burden of establishing entitlement to their claimed charitable contribution deduction and (ii) the preponderance of the evidence**

supported the IRS's position that the easement had no value. **In *Scheidelman IV* the 2nd Circuit affirmed the Tax Court's holding that the easement had no value.** In support of its holding, the 2nd Circuit quoted the IRS's valuation expert, who explained that "in highly desirable, sophisticated home markets like historic brownstone Brooklyn, the imposition of an easement, such as the one granted…does not materially affect the value of the subject property." The 2nd Circuit also found persuasive the fact that the donee had assured one of Scheidelman's mortgagors that

> [a]s a practical matter, the easement does not add any new restrictions on the use of the property because the historic preservation laws of the City of New York already require a specific historic review of any proposed changes to the exterior of this property.

d. In *Kaufman III*, the 1st Circuit vacated the Tax Court's opinions in *Kaufman I* and *Kaufman II* in part and remanded to the Tax Court on the issue of valuation. The 1st Circuit explained that the Kaufmans had expressed concern to the donee—the National Architectural Trust (NAT)—about the high appraised value of the façade easement they were donating because it implied a substantial reduction in the resale value of their home. "In an effort to reassure them, a [NAT] representative told the Kaufmans that experience showed that such easements did not reduce resale value." "This," said the 1st Circuit, "could easily be the IRS's opening argument in a valuation trial."[91] And so it apparently was. **In *Kaufman IV*, on remand from the 1st Circuit, the Tax Court sustained the IRS's complete disallowance of the deductions claimed with regard to the façade easement donation on the ground that the value of the easement was zero, and further sustained the IRS imposition of accuracy-related penalties on the basis of gross valuation misstatement or negligence**. The Tax Court placed particular emphasis on the fact that NAT had represented to Dr. Kaufman (an Emeritus Professor of Statistics at MIT) that façade easements do not reduce the value of the properties they encumber,[92] and the Kaufmans nonetheless claimed deductions for their façade easement donation based on an appraisal obtained from an appraiser NAT recommended indicating that the easement reduced the value of their property by 12% (or by $220,800). The court was critical of

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[91] The 1st Circuit also noted that "**Section 170(h) does not allow taxpayers to obtain six-figure deductions for gifts of lesser or no value**."

[92] The email from the NAT representative to Dr. Kaufman stated, in part:

> One of our directors, Steve McClain, owns fifteen or so historic properties and has taken advantage of this tax deduction himself. He would never have granted any easement if he thought there would be a risk or loss of value in his properties.

Dr. Kaufman's "lack of initiative" in exploring this "discordance," noting, among other things, that "[i]n determining whether a taxpayer has reasonably relied in good faith on advice, we take into account his education, sophistication, and business experience." **Although the court assumed the appraisal obtained by the Kaufmans was a "qualified appraisal," the court gave no weight to the appraisal's estimate of value because it found the appraiser's method to be unreliable and his analysis unpersuasive.**

e. **In *Chandler*, the Tax Court sustained the IRS's complete disallowance of deductions claimed with regard to two façade easement donations.** As in *Kaufman*, the properties were located in Boston's South End Historic District and the easements were donated to the National Architectural Trust. Relying on its analysis in *Kaufman*, the court explained that, although there were minor differences (in scope, monitoring, and enforcement) between the easement restrictions and the restrictions already imposed by local law, those differences do not affect property values because a typical buyer would perceive no difference between the two sets of restrictions.[93] **The court also did not find the taxpayer's appraisal, which asserted a 16% diminution in the value of the properties, to be credible.** The appraiser who prepared the appraisal has been barred from preparing any kind of appraisal report or otherwise participating in the appraisal process for any property relating to federal taxes.[94]

f. **Donors should not rely on appraisals that use questionable valuation methods or bases or do not strictly comply with the qualified appraisal requirements because, even though the appraisal might be found to be a qualified appraisal, (i) it may trigger an audit and (ii) if litigated, the donor may be found to have failed to provide sufficient credible**

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[93] *Cf. Zarlengo*, *Seventeen Seventy Sherman Street,* and *Whitehouse Hotel*. In *Zarlengo*, the Tax Court held that a façade easement reduced the value of a townhouse in a historic district in New York City by 3.5% (or $157,500), as opposed to 11% ($660,000) as asserted by the taxpayers. The court found that the easement placed some burdens on the property owner over and above those imposed by local historic preservation laws. The court also found credible the testimony of a real estate broker that, if two properties are identical in all respects except one is burdened by a façade easement, the property without the easement will have a greater value. In *Seventeen Seventy Sherman Stree*t, the IRS argued that a façade easement had no effect on the value of a historic shrine because of already existing local historic preservation restrictions. The Tax Court disagreed, holding that the easement was more protective of the shrine than local law, in part because the donee more regularly monitored the property than local authorities. In *Whitehouse Hotel*, after two appeals, the 5th Circuit affirmed the Tax Court's holding that a façade easement encumbering the historic Maison Blanche building (which is located in the French Quarter in New Orleans and is now used as a Ritz Carlton) reduced the value of the building by $1.857 million, as opposed to the $7.445 million clamed by the taxpayer.

[94] *See supra* Part I.O.

evidence to meet the donor's burden of proving entitlement to a deduction. In situations where a donation has already been made and satisfaction of the qualified appraisal requirements is an issue on audit or in litigation, however, the decisions in *Simmons II, Scheidelman II, Friedberg II, Irby,* and *Zarlengo* may be helpful.

g. The bulk of the cases that have been decided to date involved donations made before (i) the effective date of § 170(f)(11) (June 4, 2004), (ii) enactment of the Pension Protection Act of 2006, which amended § 170(f)(11) to add statutory definitions of the terms "qualified appraiser" and "qualified appraisal," and (iii) the IRS's issuance of Notice 2006-96, which, among other things, provides transitional guidance regarding § 170(f)(11)(E)'s definitions of qualified appraisal and qualified appraiser. We can expect to see discussion of the new statutory requirements in § 170(f)(11) in future cases.[95]

2. **Conservation Easement-Specific Valuation Rules. Donors should also strictly comply with the conservation easement-specific valuation rules** in Treasury Regulation § 1.170A-14(h)(3). These rules draw a distinction in certain circumstances between the "value" of the easement and the "amount of the deduction."

The IRS Office of Chief Counsel recently published a memorandum providing helpful guidance on the application of two of the easement-specific valuation rules – the "contiguous parcel" and "enhancement" rules.[96]

- Pursuant to the **contiguous parcel rule**,[97] the amount of the deduction in the case of a conservation easement covering a portion of contiguous property owned by the donor and the donor's "family" is the difference between the fair market value of the entire contiguous parcel before and after the granting of the easement.

- Pursuant to the **enhancement rule**,[98] if the granting of a conservation easement has the effect of increasing the value of any other property owned by the donor or a "related person," the amount of the deduction must be reduced by the amount of the increase in the value of the other property, whether or not such property is contiguous.

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[95] *See supra* notes 76—80 and accompanying text (discussing these new requirements).

[96] IRS Chief Counsel Memorandum 201334039 (released Aug. 23, 2012), available at http://www.irs.gov/pub/irs-wd/1334039.pdf.

[97] The contiguous parcel rule is found in the fourth sentence of Treasury Regulation § 1.170A-14(h)(3)(i).

[98] The enhancement rule is found in the fifth sentence of Treasury Regulation § 1.170A-14(h)(3)(i).

The Chief Counsel memorandum discusses (i) the meaning of the term "family" for purposes of the contiguous parcel rule, (ii) the meaning of the term "related person" for purposes of the enhancement rule, and (iii) rules relating to constructive ownership and entity classification and their impact on both the contiguous parcel and enhancement rules. The memorandum provides twelve examples of the application of these rules to various situations involving property owned by individuals and entities (LLCs, partnerships, and corporations).

The Chief Counsel memorandum also explains in a footnote that, for purposes of the contiguous parcel rule, whether the entire contiguous parcel is valued as one large property or as separate properties depends on the highest and best use of the entire contiguous parcel.

3. **File Appraisal With Income Tax Return**. Consistent with the IRS's informal suggestion, **a copy of the qualified appraisal should be included in the package filed with the income tax return** on which a deduction for the easement donation is first claimed **even if the appraised value of the easement is $500,000 or less**. If possible, the qualified appraisal should include a copy of the correctly drafted and recorded (date stamped) conservation easement deed. In all cases, the appraiser should have valued the restrictions as they appear in the recorded easement deed rather than in an earlier draft of the easement that was revised prior to recordation.

D. Contemporaneous Written Acknowledgment

1. **No deduction is allowed for a charitable contribution of $250 or more unless the taxpayer substantiates the contribution with a contemporaneous written acknowledgment (CWA) obtained from the donee.**[99]

2. Pursuant to IRC § 170(f)(8)(B), a CWA must include the following information:

a. the amount of cash and a description (but not value) of any property other than cash contributed,

b. whether the donee provided any goods or services in consideration, in whole or in part, for the contributed property, and

c. if goods and services were provided, a description and good faith estimate of the value of such goods or services.

3. Pursuant to § 170(f)(8)(C), a CWA will be contemporaneous only if the taxpayer obtains it on or before the earlier of

a. the date on which the taxpayer files a return for the taxable year in which the contribution was made, or

[99] IRC § 170(f)(8)(A).

b. the due date (including extensions) for the filing of such return.

4. Failure of a donor to obtain a CWA cannot be cured by having the donee file a Form 990 or any other form containing the required information, despite the Tax Court's reference in *Schrimsher* to § 170(f)(8)(D).[100]

5. In *Schrimsher*, the Tax Court held that the conservation easement deed could not serve as a CWA. *See also Bruzewicz* (letter identifying cash contributions relating to façade easement donation was not a CWA; doctrine of substantial compliance inapplicable); *Didonato* (settlement agreement was not a CWA). In *Simmons I*,[101] *Averyt,* and *RP Golf*, *LLC,* however, the Tax Court held that the conservation easement deed could serve as a CWA. And in *Irby*, the Tax Court held that documents associated with the bargain sale of two easements collectively constituted a CWA.

6. Despite the Tax Court's willingness to find that the conservation easement deed or other documentation can serve as a CWA in some cases, do not rely on that—**the holdings in the cases are unpredictable.**

7. **Some government entities accepting conservation easement donations refuse to provide donors with a CWA**. Donors and their counsel should discuss this issue early on with a prospective government holder. To address the issue, some practitioners include a statement in the easement deed that no goods or services were provided in consideration for the easement and the donee agrees to provide the donor with a letter to that effect.

8. While not a conservation easement donation case, *Van Dusen*, 136 T.C. 515 (2011),[102] contains a detailed discussion of the CWA requirement.

E. Compelling and Timely Baseline Documentation

1. If the donor reserves rights in the conservation easement, the exercise of which may impair the conservation interests associated with the property (which typically will be the case), **the donor must make available to the donee, *prior to the time the donation is made***, documentation sufficient to establish the

[100] *See* IRS Chief Counsel Advice 201120022 (May 20, 2011), http://www.us.kpmg.com/microsite/taxnewsflash/Exempt/2011/CCA201120022.pdf.

[101] In *Simmons I*, Tax Court Judge Goeke stated that the easement deed could serve as a CWA. However, the donee in *Simmons* had provided the donor with a separate letter that complied with the statutory CWA requirements, so it is not clear why the Judge addressed the issue, or why he did so in the manner in which he did. The judge did not fully discuss whether or how the easement deed satisfied the statutory CWA requirements.

[102] *Van Dusen* is available at http://www.ustaxcourt.gov/InOpHistoric/VanDusen.TC.WPD.pdf.

condition of the property at the time of the gift ("**baseline documentation**").[103] Such documentation is designed to protect the conservation interests associated with the property, which although protected in perpetuity by the easement, could be adversely affected by the exercise of the reserved rights.[104]

a. In addition to describing in detail the property and its open space, habitat, scenic, historic, and other conservation values, **if the easement contains restrictions with regard to a particular natural resource to be protected**, such as water quality or air quality, then **the condition of that resource at or near the time of the gift must be established in the baseline documentation**.[105]

b. **The baseline documentation must be accompanied by a statement signed by the donor and a representative of the donee** clearly referencing the documentation and in substance stating: "This natural resources inventory is an accurate representation of [the protected property] at the time of the transfer" (referred to hereinafter as a "certification").[106]

- In some cases, the parties have drafted the certification to provide that the parties agree the inventory (or baseline) may be supplemented in the future (e.g., where the baseline is prepared when the property is covered with snow). This has caused problems on audit. The baseline must be fully completed *prior to the time the donation is made*. Although a fully completed baseline can be supplemented in the future, a statement in the certification regarding supplementation should not imply that the baseline was not fully completed at the time of the donation.

- Assuming the baseline is timely completed, easement drafters may want to include language in the easement deed confirming that the baseline is completed and the parties agree that it is an accurate representation of the protected property at the time of the donation.

c. **The baseline documentation should be detailed and compelling**; it is the donor's best opportunity (as part of the tax filing) to persuade the IRS

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[103] *See* Treas. Reg. § 1.170A-14(g)(5)(i).
[104] *Id.*
[105] *Id*.
[106] *Id*.

that the property has important conservation or historic values worthy of preservation.

2. The IRS routinely asks for the baseline documentation on audit and has informally recommended that easement donors include a copy of the baseline documentation in the package filed with the income tax return on which a deduction for the easement donation is first claimed. **The baseline documentation should be filed along with the tax return if it is a good, thorough, and compelling report**.

- In some instances, easement donors are hiring qualified consultants to put together comprehensive and extensive baseline reports. Note that the Treasury Regulations actually put the burden of delivery of the baseline on the donor (see E.1. above).

F. Correct and Timely Lender Agreement (if applicable)

1. **Full Subordination is Advisable**. In *Kaufman III*, the 1st Circuit vacated the Tax Court's holding in *Kaufman I* and *Kaufman II* that priority language in a lender agreement impermissibly limited the operation of the "proceeds" clause included in a facade easement to satisfy the requirements of Treasury Regulation § 1.170A-14(g)(6)(ii). The lender agreement in *Kaufman* provided that, if the easement were extinguished as a result of a casualty event (such as a fire or flood) or condemnation, the bank holding an outstanding mortgage on the property had first priority to any insurance or condemnation proceeds. The 1st Circuit held that it was sufficient that the donee in *Kaufman* has a right to postextinguishment proceeds that is absolute against the owner of the burdened property. Despite this ruling, **donors should still obtain a lender agreement that subordinates the lender's rights to *all* of the rights of the holder under the conservation easement, including the holder's right to at least a minimum proportionate share of the proceeds received following extinguishment as specified in Treasury Regulation § 1.170A-14(g)(6)(ii)**.[107]

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[107] Treas. Reg. § 1.170A-14(g)(6)(ii) contains a limited exception to the proceeds requirement with respect to involuntary conversions if state law provides that the donor is entitled to all of the proceeds following such a conversion. For an example of a "full" subordination clause, see Virginia Outdoors Foundation's model easement, which can be found at www.virginiaoutdoorsfoundation.org, and provides:

> The Lender hereby consents to the terms and intent of this Easement, and agrees that the lien represented by said Deed of Trust shall be held subject to this Easement and joins in this Deed to reflect its direction to the Trustee to execute this Easement to give effect to the subordination of such Deed of Trust to this Easement.

See also the subordination agreement template of the Compact of Cape Cod Conservation Trusts, which provides:

> [Name and address of financial institution] ("Mortgagee"), present holder of a mortgage from, [donors] ("Mortgagor"), recorded on [date] in the [County] Registry of Deeds in Deed Book [ ] Page [ ] , for consideration paid, hereby recognizes and assents to the terms and provisions of a

a. ***Kaufman III* is good law only in the 1st Circuit**.

b. In **footnote 5 of *Kaufman III***, the 1st Circuit noted that Treasury Regulation § 1.170A-14(g)(2) (the "mortgage subordination regulation") could be read broadly to require that a lender subordinate its rights to the donee organization's right to post-extinguishment proceeds, which, pursuant to Treasury Regulation § 1.170A–14(g)(6)(i), must be used to advance conservation purposes.[108] The 1st Circuit noted that it did not pursue this issue because the IRS had "disclaimed" that broad reading of paragraph (g)(2) in *Kaufman III*.

c. A lender agreement that subordinates the lender's rights to all of the rights of the holder under the conservation easement ensures that the **holder will receive its "slice of the pie**" following extinguishment to be used to replace lost conservation or historic values.

2. **<u>Lender Agreement Should be Recorded *at the Same Time* as the Conservation Easement</u>**.

a. ***<u>Mitchell I</u>***. In *Mitchell I*, the Tax Court held that the conservation purpose of the conservation easement at issue was not "protected in perpetuity" at the time of the gift because the donor did not obtain a lender agreement from the holder of an outstanding mortgage on the subject property until two years following the date of the donation. The court found that **Treasury Regulation § 1.170A-14(g)(2), the "mortgage subordination" regulation, "requires that a subordination agreement be in place at the time of the gift."** The court explained that, had the donor defaulted on the mortgage before the date of the subordination, the lender could have instituted foreclosure proceedings and eliminated the conservation easement. Accordingly, the conservation easement was not protected in perpetuity at the time of the gift as is required by § 170(h).

- The donor in *Mitchell I* argued that the conservation purpose of the easement had been protected in perpetuity at the time of the gift

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Conservation Restriction running to the ___________ Conservation Trust, to be recorded herewith, and agrees to subordinate and hold its mortgage subject to the terms and provisions of said Conservation Restriction to the same extent as if said mortgage had been recorded subsequent to the recording of the Conservation Restriction, and the undersigned shall, in the exercise of its rights pursuant to said instrument, recognize the terms and provisions of the aforesaid Conservation Restriction.

[108] The mortgage subordination regulation provides that no deduction will be permitted "unless the mortgagee subordinates its rights in the property to the right of the qualified organization to enforce the conservation purposes of the gift in perpetuity." Enforcing "the conservation purposes of *the gift* in perpetuity" (rather than just the original easement) arguably requires that the holder receive its share of proceeds upon extinguishment to be used to replace lost conservation or historic values.

even without a lender agreement because the probability that the donor would have defaulted on the mortgage (and the easement would be eliminated) was "so remote as to be negligible."[109] The Tax Court rejected that argument, noting that the requirements of the mortgage subordination regulation are strict requirements that may not be avoided by invoking the so-remote-as-to-be-negligible standard of Treasury Regulation § 1.170A-14(g)(3).

- The Tax Court took the opportunity in *Mitchell I* to review decisions on the so-remote-as-to-be-negligible issue. It explained that **the so-remote-as-to-be-negligible standard cannot be used to avoid any of the following specific requirements: (i) the mortgage subordination requirement of Treasury Regulation § 1.170A-14(g)(2),**[110] **(ii) the judicial proceeding requirement of Treasury Regulation § 1.170A-14(g)(6)(i),**[111] **or (iii) the proceeds requirement of Treasury Regulation § 1.170A-14(g)(6)(ii)**.[112] The court also held that the D.C. Circuit's decision in *Simmons* was distinguishable because the D.C. Circuit had applied the so-remote-as-to-be-negligible standard to defeat a general argument made by the IRS as to the conservation easement's grant in perpetuity, rather than to defeat a specific subparagraph of Treasury Regulation § 1.170A–14(g).

b. ***Minnick*.** Similar to *Mitchell I*, In *Minnick* the Tax Court held that the conservation purpose of the conservation easement at issue was not "protected in perpetuity" at the time of the gift because the donor did not obtain a lender agreement from the holder of an outstanding mortgage on the subject property until five years following the date of the donation. The court rejected the argument that the lack of subordination should be forgiven because there was only a remote possibility that the taxpayer would have defaulted on the mortgage. Citing *Mitchell I*, the court noted "the likelihood of default is irrelevant."

- The taxpayer in *Minnick* argued that *Mitchell I* was distinguishable because (i) he had represented in the easement deed that there

[109] *See* Treas. Reg. § 1.170A-14(g)(3), which provides that "[a] deduction shall not be disallowed…merely because the interest which passes to, or is vested in, the donee organization may be defeated by the performance of some act or the happening of some event, if on the date of the gift it appears that the possibility that such act or event will occur is so remote as to be negligible."
[110] *Mitchell I.*
[111] *Carpenter I*.
[112] *Kaufman II,* vacated on other grounds in *Kaufman III*. In *Kaufman III*, the 1st Circuit explained "[i]n reaching our conclusion, we do not rely on the general provision of [Treas. Reg. § 1.170A–14(g)(3)] that aims to prevent deductions from being lost by improbable events…because, as the Tax Court noted, "[o]ne does not satisfy the extinguishment provision...merely by establishing that the possibility of a change in conditions triggering judicial extinguishment is unexpected."

were no outstanding mortgages on the property and that "warranty provision" demonstrated his intention to obtain a subordination agreement at the time of the donation and (ii) the lender would have been willing to freely subordinate at the time of the donation. The Tax Court was not persuaded:

- The court stated **"Intention and willingness are not what matters.** The regulation required a subordination agreement. Without a subordination agreement, [the lender] would have been able to seize the land in the event of default on the mortgage, thus owning the land free of the conservation easement."

- The warranty provision demonstrated only that the taxpayer falsely—although the court thought unintentionally—represented to the land trust that the mortgage had been subordinated at the time of the donation.

- The lender refused the taxpayer's request before trial to sign a letter stating that it would have been willing to subordinate at the time of the donation and required that the taxpayer pay down a portion of the loan before it agreed to subordinate five years following the donation.

c. ***Mitchell II*.** In *Mitchell II*, the taxpayer argued that the First Circuit's decision in *Kaufman III*, was an intervening change in the law that required the Tax Court to reconsider its opinion in *Mitchell I*. The Tax Court disagreed, explaining that not only is *Kaufman III* not binding in the Tenth Circuit (to which *Mitchell* would be appealed), *Kaufman III* addressed legal issues different from the one present in *Mitchell*. *Kaufman III*, explained the court, "addressed the proper interpretation of the proceeds regulation and, in particular, the breadth of the donee organization's entitlement to proceeds from the sale, exchange, or involuntary conversion of property following the judicial extinguishment of a [conservation easement]." *Mitchell*, on the other hand, addressed interpretation of the mortgage subordination regulation.

The Tax Court also rejected all three of the taxpayer's specific arguments in *Mitchell II*.

- The taxpayer argued that the donor's financial ability to discharge the mortgage at any time before the date on which the lender agreed to the subordination "was the functional equivalent of a

subordination." The Tax Court summarily dismissed that argument, explaining "**There is no functional subordination contemplated in [Treasury Regulation § 1.170A-14(g)(2)]**, nor do we intend to create such a rule."

- The taxpayer argued that Treasury Regulation § 1.170A-14(g)(6) "merely creates a safe harbor," and given the opinions in *Kaufman III* and *Simmons*, "the entire regulation could and should be read as a safe harbor." The Tax Court explained that it had rejected a similar argument in *Carpenter II*, and reiterated that **the specific provisions of Treasury Regulation § 1.170A-14(g), including paragraph (g)(6) and (g)(2) "are mandatory and may not be ignored."**

- The taxpayer further argued that the court should "draw a general rule" with respect to the in-perpetuity requirement of § 170(h)(5)(A) and Treasury Regulation § 1.170A-14(g) from the analysis in *Kaufman III*. In particular, the taxpayer argued: "The regulation emphasizes perpetuating an easement's purpose as opposed to the conservation easement itself," and if the holder is entitled to proceeds upon extinguishment that is all that is required by the law. The Tax Court rejected that argument, stating: "Nowhere in *Kaufman III* did the Court of Appeals for the First Circuit state a general rule that protecting the proceeds from an extinguishment of a conservation easement would satisfy the in-perpetuity requirements of section § 1.170A-14(g)…generally." In other words, **§ 170(h) requires perpetuation of the conservation easement itself, not just conservation purposes generally.**

- The taxpayers have appealed *Minnick* and *Mitchell* to the Circuit Courts.

III. Other Important Issues

A. **IRS's Renewed Focus on Valuation**. Following the lead of the courts (see, e.g., *Scheidelman, Kaufman, Mountanos,* and *Gorra*), the IRS has renewed its focus on easement valuation. In addition, as part of the Pension Protection Act of 2006 (the PPA), Congress expanded the circumstances under which penalties can be imposed for overvaluations.

1. **Penalty Provisions**. Before the enactment of the PPA, a substantial valuation misstatement (subject to a 20% penalty) existed if the value of property reported on a tax return was 200% or more of the amount determined to be the correct value. A gross valuation misstatement (subject to a 40% penalty) existed if the value reported on a tax return was 400% or more of the amount determined to be the correct value. Taxpayers could avoid these penalties if they made the valuation misstatement in good faith and with reasonable cause.

The PPA lowered the threshold from 200% to 150% for a substantial valuation misstatement and from 400% to 200% for a gross valuation misstatement. The PPA also eliminated the reasonable cause exception for gross valuation misstatements of charitable deduction property, making that penalty a strict liability penalty. The PPA further enacted new penalties for preparers of an appraisal to be used to support a tax position if the appraisal results in a substantial or gross valuation misstatement.[113] The PPA changes apply to all returns involving façade easement donations filed after July 25, 2006, and all returns involving donations of easements encumbering land filed after August 17, 2006.[114]

- In *Gorra*, the Tax Court rejected the taxpayers' argument that the gross valuation misstatement penalty was an "excessive fine" under the Eighth Amendment to the United States Constitution, noting that such penalties are remedial in nature, not "punishments," and are an important tool because they enhance voluntary compliance with tax laws.

- In *Mountanos I*, the Tax Court held that the taxpayer failed to show that the conservation easement he donated had any value. In *Mountanos II*, in what the Tax Court noted was "a calculated maneuver to avoid the accuracy-related penalty," the taxpayer asked the court to consider the alternative grounds on which the IRS had argued for disallowance of the deductions—namely that the taxpayer failed to obtain a

[113] IRC § 6695A.

[114] For an explanation of the Pension Protection Act Changes, see Joint Committee on Taxation, JCX-38-06 (August 3, 2006), available at https://www.jct.gov/publications.html?func=select&id=20. *See also Chandler v. Comm'r,* 142 T.C. No. 16 (2014) (discussing the PPA effective dates).

"contemporaneous written acknowledgment" or a "qualified appraisal." The Tax Court refused to consider these alternative grounds, noting, in part, that the continued viability of the line of cases on which the taxpayer relied for the proposition that an overvaluation penalty may not be imposed when there is some other ground for disallowing a deduction is in question after the U.S. Supreme Court's opinion in *United States v. Woods*, 134 S. Ct. 557 (2013).

- In *Kaufman IV*, on remand from the 1st Circuit, the Tax Court sustained the IRS's complete disallowance of the deductions claimed with regard to the Kaufmans' façade easement donation on the ground that the value of the easement, which was largely duplicative of local historic preservation restrictions, was zero. The court further sustained the IRS imposition of accuracy-related penalties on the basis of gross valuation misstatement or negligence. Because the Kaufmans' returns were filed before the effective date of the PPA, the gross valuation misstatement penalty was not a strict liability penalty. However, the Kaufmans were unable to avoid the penalties by showing that they made a good-faith investigation of the value of the easement, or acted with reasonable cause and in good faith, or had a reasonable basis for claiming the deductions. This was due, in large part, to the fact that the donee—the National Architectural Trust (NAT)—had represented to the Kaufmans that façade easements do not reduce the value of the properties they encumber, and the Kaufman's nonetheless claimed deductions based on an appraisal obtained from an appraiser NAT had recommended indicating the easement reduced the value of their property by 12% (or by $220,800).[115]

- In *Chandler*, the Tax Court sustained the IRS's complete disallowance of deductions claimed with regard to two façade easement donations on the same grounds as in *Kaufman*. The taxpayers in *Chandler* claimed deductions with regard to the easement donations on their 2004, 2005, and 2006 returns, and because the Tax Court determined the easements had no value, the valuation misstatement for each year was a gross valuation misstatement. The facts in *Chandler* raised the novel issue of whether the taxpayers could assert the reasonable cause defense for the underpayment on their 2006 return (despite the PPA having made the gross valuation misstatement penalty a strict liability penalty) because the underpayment was the result of a carryover of deductions from their 2004 return. The taxpayers argued that denying their right to raise a reasonable cause defense with regard to their 2006 return would amount to retroactively applying the PPA. The Tax Court disagreed, noting that (i) the penalty statute as revised by the PPA by its plain language applies

[115] *See supra* note 92 and accompanying text.

to returns filed after a certain date and (ii) when the taxpayers filed their 2006 return they "reaffirmed" the easement's grossly misstated value.

The court in *Chandler* did, however, find that the taxpayers were not liable for penalties for their 2004 and 2005 underpayments because they underpaid with reasonable cause and in good faith. The IRS argued that Mr. Chandler should have known the easements were overvalued because he was well educated (he had a JD and an MBA). The Tax Court disagreed, noting that even experienced appraisers find valuing conservation easements difficult and the flaws in the appraisals would not have been evident to the Chandlers. The court also distinguished *Kaufman* because, unlike in *Kaufman*, where the taxpayers had been assured by the donee that their easement did not reduce the value of the property, there was no evidence in *Chandler* that the taxpayers relied on appraisals in bad faith.

- In *Schmidt* and *Zarlengo*, the Tax Court noted that, In *Chandler*, it did not consider whether the pre- or post-PPA percentage thresholds for imposition of penalties applied to the Chandlers' 2006 return because the Chandlers failed to prove the conservation easement they donated had any value and, thus, they made a gross valuation misstatement on their 2006 return regardless of which threshold applied. The Tax Court further noted that it did not need to decide this issue in either *Schmidt* or *Zarlengo* for similar reasons. Accordingly, it remains to be seen whether the pre- or post-PPA percentage thresholds will apply to returns filed after the effective dates of the PPA.

2. **Battle of the Appraisers**. When the value of a conservation easement is challenged, the case often involves a "battle of the appraisers."

a. **Courts no longer** take the two appraisals from the expert witnesses and "**split the baby**." Instead, **courts generally weigh the evidence offered by each expert and come to their own conclusions regarding value.**

b. In a battle of the appraisers, **the credibility of the appraiser and the appraisal report is of paramount importance**, and extensive experience in the relevant local market **("geographic competence") can also be key.**

c. In *U.S. v. Richey*, 632 F.3d 559 (9th Cir. 2011), the Ninth Circuit held that the attorney-client privilege did not extend to documents in a conservation easement **appraiser's work file** that were not made for the purpose of providing legal advice. The work file was also not protected by

the work-product doctrine because it was not "prepared or obtained because of the prospect of litigation."

3. **Case Law**. Recent land conservation (as opposed to façade) easement cases involving valuation include *Kiva Dunes, Trout Ranch, Hughes*, *Boltar*, *Butler*, *Mountanos*, *Esgar, Palmer Ranch, and Schmidt.*[116] The four most recent cases, *Esgar, Mountanos, Palmer Ranch,* and *Schmidt* are summarized below.

a. ***Mountanos***. In *Mountanos*, **the Tax Court sustained the IRS's disallowance of deductions claimed for the donation of a conservation easement encumbering 882 acres of undeveloped land** in California. The land is almost completely surrounded by federal land and, at the time of the donation, it was (i) accessible only through neighboring properties (the Bureau of Land Management had granted the taxpayer limited access to the property for single-family use) and (ii) subject to a Williamson Act contract under California law that limited its use and development. In addition, a permit was required to divert water for private use from the creek flowing through the property.

Among other things, the IRS disputed the claimed $4.6 million value of the conservation easement. **The Tax Court found that the taxpayer failed to show that the easement reduced the value of the land.** The court agreed with the taxpayer's valuation experts that the highest and best use (HBU) of the land *after* the easement donation was for recreation. However, the court found that the taxpayer failed to show that the HBU of the land *before* the donation was, in part, a vineyard and, in part, either a 22-lot residential development or a subdivision for unspecified uses.

With regard to use as a vineyard, the taxpayer failed to show that there was the necessary legal access or water supply or demand for vineyard-suitable property in the county, or that vineyard use was economically feasible.

With regard to use as a residential development or a subdivision (i) the taxpayer's valuation experts failed to take into account the restrictions imposed by the Williamson Act, (ii) neither the taxpayer nor the IRS provided the court with the Williamson Act contract relating to the land or a description of the contract's terms, and (iii) the taxpayer failed to provide any evidence that the Williamson contract was scheduled to terminate for non-renewal or that it could be cancelled. Accordingly, the

[116] Recent façade easement donation cases involving valuation include *Kaufman IV, Chandler, Whitehouse Hotel IV, Scheidelman IV,* and *Zarlengo*.

court looked to the purpose of the Williamson Act, which is to preserve agricultural and open space land and discourage premature urban development, and the general terms of Williamson Act contracts, which limit land to agricultural and compatible uses for ten or more years and automatically renew each year absent notice of non-renewal.

The court found that the taxpayer, who had the burden of proof, failed to establish that vineyard use, residential development, or unspecified subdivision were permitted or probable uses of the land at the time of the easement's donation. Thus, **the taxpayer failed to prove that the HBU of the land before and after the easement donation differed, and it followed that the taxpayer failed to show that the easement reduced the value of the land.**

The court also found that the taxpayer was liable for a gross valuation misstatement penalty.

It is not uncommon for property to be subject to temporary development and use restrictions under state law provisions similar to the Williamson Act at the time of the donation of a conservation easement (numerous states have temporary agricultural land protection programs). In situations where property is subject to such temporary restrictions, the estimate of the *before* value of the property for purposes of valuing the easement should take into account the remaining tenure of the restrictions and any penalties or other conditions imposed on termination of the restrictions. The best evidence of such before value would be the sales price of land subject to similar temporary restrictions. **In many cases, the before value of the property, even considering the temporary restrictions, may exceed the after value, and the donor should be entitled to a deduction for the difference**. In *Mountanos*, the taxpayer failed to provide any evidence of the Williamson contract terms, the remaining tenure of the restrictions, or the conditions or limitations imposed on termination of those restrictions. Moreover, even if such evidence had been provided, the limited access and water supply issues may have prohibited or limited vineyard use, a 22-lot residential development, or subdivision in any event.

b. ***Esgar***. In *Esgar*, a partnership owning land in Prowers County, Colorado, a substantial portion of which was leased to a gravel mining company, conveyed approximately 163 of the non-leased acres to three of its partners. Each of the three partners (who were the taxpayers in *Esgar*) ended up owning approximately 54 acres, and each donated a conservation easement to a charitable organization in 2004. The taxpayers claimed charitable deductions for the donations on their 2004,

2005, and 2006 tax returns. After an audit of the taxpayers' income tax returns, the IRS determined that the conservation easements had no value.

In *Esgar I*, the sole issue before the Tax Court was the value of the conservation easements. **The parties disagreed over the highest and best use of the subject properties before the easements were donated; the taxpayers argued it was gravel mining, whereas the IRS argued it was agriculture**. Both sides introduced reports and testimony from various experts and the Tax Court ultimately sided with the IRS. **The Tax Court's conclusion that agriculture was the properties' highest and best use before the easements were donated was based, in part, on a finding that, although "it would have been physically possible to mine the properties in 2004 (or in the future)," there was no demand for such use "in the reasonably foreseeable future."** The Tax Court determined that each of the three conservation easements was worth approximately $49,000 (the IRS had asserted a $9,000 value for each easement at trial, and the taxpayers had asserted values of $570,500, $867,500, and $836,500, respectively).

The taxpayers appealed the case to the 10th Circuit. In *Esgar II*, the taxpayers first argued that the Tax Court erred in *Esgar I* by placing the burden of proving the "before" value of the subject properties on them. They asserted that because the burden was not properly allocated, the IRS was allowed to prevail without presenting any objective evidence that agriculture was the properties' highest and best use. They also argued that the Tax Court's decision was void of "factual evidence presented by the [IRS]" and instead supported "through negative presumptions of fact improperly inferred" against them.

The 10th Circuit rejected all of those arguments. It found that the rule shifting the burden of proof to the IRS was immaterial to the outcome of the case because there was no evidentiary tie—the Tax Court was justified in finding that the preponderance of the evidence favored the IRS. The 10th Circuit noted that **the IRS's position was supported by the expert testimony of a certified general appraiser who had appraised some 150 conservation easements, and much of the taxpayers' own evidence undermined their position that gravel mining was the properties' highest and best use**. The 10th Circuit also noted that the Tax Court did not rely solely on the missing-evidence inference to find that already existing mines in Prowers County were sufficient to satisfy future increases in demand. Rather, that inference was just one of a number of factors indicating that gravel mining was not the properties' highest and best use.

The taxpayers next argued that that the Tax Court erred in *Esgar I* by adopting the properties' current use as its highest and best use rather than taking a "development-based approach." The 10th Circuit also rejected this argument. It found that **the Tax Court applied the correct highest and best use standard by looking for the use that was "most reasonably probable in the reasonably near future**," and that the Tax Court did not clearly err by concluding that such use was agriculture.

The taxpayers' final argument was that eminent domain principles are wholly inapplicable when valuing conservation easements. The 10th Circuit also rejected this argument, finding that **there is "no material difference between conservation easement valuation and just compensation valuation in the context of determining a property's highest and best use."** The 10th Circuit explained that **Treasury Regulation § 1.170A–14(h)(3)(ii) "does not preclude reference to eminent domain cases where they inform an objective assessment of the likelihood of future development."** The 10th Circuit also noted that, in *Stanley Works*, the Tax Court had gone so far as to state "The principles and legal precedents governing the determination of fair market value of property in tax cases are the same as those that control the valuation of property in condemnation cases."

c. ***Palmer Ranch***. In *Palmer Ranch*, **the Tax Court allowed a $19.9 million deduction for a partnership's donation of a conservation easement, which represented a 95% diminution in the value of the property. The court found the partnership's appraisal, which assumed the subject property could have been rezoned before the easement donation to allow higher density development, to be more persuasive.**

The subject property is an 82.19-acre parcel located in Sarasota County, Florida, that includes upland developable acreage as well as wetlands, a wildlife corridor, and a bald eagle nest. The partnership (which is 100%-owned directly and indirectly by Hugh Culverhouse Jr., former Tampa Bay Buccaneers owner) donated the easement to the county in 2006 for the purpose of preserving the property for public use, conservation, and open space. The partnership claimed a $23.9 million deduction for the donation and the IRS disallowed $16.9 million of that amount.

The IRS conceded that the easement constituted a qualified conservation contribution for purposes of § 170(h), so the only issue before the Tax Court was the value of the easement. The court explained that the fair market value of a conservation easement is generally equal to the difference between the fair market value of the subject property before the granting of the easement (the "before-value") and the fair market

value of the subject property after the granting of the easement (the "after-value") and, in determining the property's before-value, there must be taken into account not only the property's then-current use, but also its highest and best use. Quoting *Olson v. United States*, 292 U.S. 246, 255 (1934), the court noted that a property's highest and best use is "the highest and most profitable use for which it is adaptable and needed or likely to be needed in the reasonably near future." The court explained that "[i]f different from the current use, a proposed highest and best use requires 'closeness in time' and 'reasonable probability.'"

The IRS's appraiser estimated the before-value of the Palmer Ranch property to be $7.7 million based on the property's actual zoning classification on the date of the donation.

The partnership's appraiser, on the other hand, estimated the property's before-value to be $25.2 million based, in part, on the assumption that the property could be successfully rezoned. Although the property's zoning classification in 2006 was for "residential estates," which limited current development to 41 units (1 unit per 2 acres), a land planning and engineering firm hired by the partnership concluded that the property could have been rezoned to permit a 360-unit multifamily development, provided the denser development was concentrated (or clustered) on the developable portions of property and left the environmentally sensitive areas largely as open space.

At trial, the IRS argued that successful rezoning of the property at the time of the donation was not reasonably probable given four factors: (i) a failed rezoning history with respect to the property, (ii) environmental concerns, (iii) limited access to outside roads, and (iv) neighborhood opposition. **The court examined each of those factors in turn and found for the partnership.** The court determined that (i) nothing in the rezoning history foreclosed the possibility of a successful rezoning, (ii) the proposed rezoning would have protected the eagle nest and wetland areas, and given due consideration to the wildlife corridor, within which there were significant developable areas, and (iii) required road access for development on the subject property could have been provided through adjacent land owned by the partnership and through extension of a "stubbed out" residential street in an adjacent development. The court noted that the stubbed out road demonstrated a general expectation that future residents of the subject parcel would use the road to access their homes. The court also gave little credence to the IRS's arguments that neighborhood opposition would have precluded the hypothetical development, despite the IRS's pointing to the neighbors' "fervor and organization" against proposed development of the subject

property in 2004. The court refused to assume that neighbors would object to the rezoning or that the board of county commissioners would find merit to their objections.[117]

The court ultimately determined that the before-value of the property was $21,005,278—it adjusted the partnership's appraised value downward slightly to account for the softening of the real estate market in the area in 2006.

It is not clear from the court's opinion whether the partnership's appraiser or the court took into account the costs, time, and risks associated with obtaining the rezoning approval in estimating the property's before-value. Consideration of those factors appears to be required under the *Olson* formula, which, stated in full, provides: "The highest and most profitable use for which the property is adaptable and needed or likely to be needed in the reasonably near future is to be considered, *not necessarily as the measure of value, but to the full extent that the prospect of demand for such use affects the market value* while the property is privately held" (emphasis added).

The court noted that the process to rezone and develop land would have involved the following steps:

- a preapplication meeting with County staff,
- a neighborhood workshop with adjacent property owners,
- submitting of applications to the County, which would be subject to staff review,
- public hearings by a lay body (the planning commission), and
- a public hearing by the board of county commissioners, wherein the commissioners would take final action.

In addition, even if the commissioners issued a final determination, the determination would still be subject to the circuit court's review. And for the subject property to receive rezoning approval, the applications would have to be consistent with the region's master development order, the comprehensive plan, zoning regulations, and land development regulations.

Although obtaining approval of the rezoning may have been reasonably probable, a hypothetical willing buyer would have factored into the price he or she would be willing to pay the costs, time, and risks associated

[117] *See also* footnote 6 in *Stotler*, in which the Tax Court noted that the record supported the taxpayer's contention that a low-density subdivision "would probably have received approval."

with the process outlined above. Whether this was taken into account in estimating the before-value of the hypothetically rezoned property is not clear.

As for the after-value of the property, **the conservation easement limits use of the property to a nature park; recreational improvements, such as campgrounds, swimming pools, and athletic fields; and agricultural uses. The property is now used as a public park, a community garden, a conservation area, and preserved open space**. Given the use restrictions in the easement, the court determined that potential purchasers of the property would be limited to either a nonprofit organization or the State of Florida. The court also noted that this already shallow pool of purchasers is further reduced because any purchaser would also have to abide by the easement's restrictions.

While both parties' appraisers agreed that the conservation easement severely limits the marketability of the subject property and, thus, significantly reduced the property's value, the IRS's appraiser estimated a 90% diminution in value, while the partnership's appraiser estimated a 95% diminution in value. After explaining that "reasonable minds may disagree when it comes to providing estimates such as these" and valuation is necessarily an approximation, the court ultimately adopted the partnership's estimate. Accordingly, the court determined that the conservation easement had a value of $19,955,014 (i.e., a $21,005,278 before-value less a $1,050,264 after-value).

The partnership was found not liable for an accuracy-related penalty because it acted with reasonable cause and in good faith with regard to its claimed deduction for the easement donation **(i.e., it relied in good faith on the advice of an experienced tax attorney).**

d. ***<u>Schmidt</u>***. In *Schmidt*, **the Tax Court determined that the value of a conservation easement** donated with respect to a 40-acre parcel located in El Paso County, Colorado, to the county **was $1,152,445, as opposed to the $1.6 million value claimed by the taxpayer**. Mr. Schmidt purchased the subject property in 2000 and, with the help of a consultant, prepared preliminary zoning change and plan applications for the development of the subject property and an adjacent property. In the summer of 2003, however, Mr. Schmidt began constructing a personal residence on the subject property, donated the easement to the county, and terminated an agreement he had to purchase the adjacent property. Before the donation of the easement, the subject property could have been developed as a 13-lot subdivision either separately or in conjunction with the development of the adjacent property. After the

donation of the easement, only one homesite was permitted on the subject property.

The parties agreed that both the subdivision development method and the comparable sales (or "market") method were appropriate methods by which to value a property before the donation of an easement. However, the parties disagreed as to which of those methods was more appropriate in this case. The Schmidts' valuation expert contended that the market method was inappropriate because there were insufficient comparables and the comparables used by the IRS's valuation expert were inappropriate because they lacked the development entitlements that Mr. Schmidt had secured for the subject property. The IRS countered that comparables used by its expert were appropriate because Mr. Schmidt had not actually obtained any development entitlements when he granted the conservation easement. The Tax Court sided with the Schmidts, noting, in part, that

> "[e]ven though the pending applications were nontransferable, the record establishes that the applicants had been able to address all relevant issues that could have prevented or delayed the granting of development entitlements for the subject property and that the proposed development of the subject property was consistent with the … Comprehensive Plan. Moreover, … much of the work [the development consultant] had done was transferable even if the applications themselves were not."

Once the court determined that the subdivision development method was the appropriate method by which to value the subject property before the conveyance of the easement, the Tax Court conducted a detailed review of each expert's application of that method to the property.

The court explained that the subdivision development method consists of six primary steps.

- First, the property's highest and best use is determined.
- Second, the market method is used to identify comparable finished (developed) lots and a per-lot value is derived.
- Third, anticipated gross proceeds from the sale of the developed lots are calculated by multiplying the per-lot value by the total number of estimated finished lots.
- Fourth, expected net proceeds are calculated by reducing the expected gross proceeds by direct and indirect costs and entrepreneurial profit.

- Fifth, net sales proceeds are discounted to present value at a market-derived rate over the development and market absorption period.
- Sixth, appropriate discounts for lack of marketability, partition, and market absorption are applied where appropriate. The resulting figure equals the indicated value of the undeveloped land.
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Because the court did not find either expert's report to be complete and convincing, it drew its own conclusions regarding these steps based on its examination of the evidence. The court ultimately determined that the easement had a value of $1,152,445, or 72% of the $1.6 million value that had been claimed by the Schmidts.

As part of its valuation analysis, the Tax Court confusingly noted that "what the before and after method is trying to measure is the price that a hypothetical purchaser of a conservation easement would have to pay a hypothetical seller <u>for the easement</u>" (emphasis in original). This statement is at odds with the description of the before and after method in Treasury Regulation § 1.170A-14(h)(3)(i). The regulations explain that, if there is no substantial record of market-place sales of comparable easements to use as a meaningful or valid comparison (which generally will be the case because easements are not bought and sold in the open market), then the fair market value of a conservation easement is equal to the difference between the fair market value of the subject property before the grant of the easement and the fair market value of the subject property after the grant of the easement, with fair market value defined as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts." In other words, the before and after method is not trying to measure what a hypothetical purchaser would pay a hypothetical seller for the easement. Rather, it measures what a hypothetical purchaser would pay a hypothetical seller for the subject property immediately before and immediately after the donation of the easement, with the difference between those two amounts being the value of the easement.

The Schmidts were found not liable for penalties because they did not make substantial valuation misstatements and they had reasonable cause and acted in good faith with regard to any understatement. The court noted that the Schmidts reasonably relied in good faith on the appraisal they obtained and the problems the court found with that appraisal did not call into question the reasonableness of their reliance.

B. **IRS Focus on Partnerships/Syndicated Deals**. In Notice 2004-41, the IRS stated that it intended to review promotions of transactions involving improper deductions for conservation easement conveyances, and that promoters, appraisers, and other persons involved in these transactions may be subject to penalties.[118] The IRS has also informally indicated that it intends to focus attention on "syndicated" conservation easement donation transactions. The IRS has at least two weapons in its arsenal that can be used to attack such syndicated transactions.

1. **Partnership Allocation Rules**. For partnership allocations to be respected they must either (i) be made in accordance with the partners' interests in the partnership or (ii) meet the requirements for the "substantial economic effect" safe harbor. If allocations do not have substantial economic effect, they will be reallocated according to the partners' interests in the partnership. These rules are intended to prevent partners from allocating partnership items based on purely tax rather than economic consequences.[119]

Many syndicated conservation easement donation transactions involve "special allocations"—i.e., an investor purchases a small percentage interest in a partnership or limited liability company (LLC), but is then allocated a much larger percentage of the deduction (or, in some cases, tax credits) generated by the partnership's donation of a conservation easement. For example, an investor might purchase a 10% interest in a partnership, but then be allocated 50% of the deduction generated by the partnership's easement donation. This could be referred to as an "explicit" special allocation; it occurs by virtue of specific terms in the partnership or LLC agreement. In some syndicated conservation easement donation transactions it could be argued that there is an "implicit" special allocation. For example, assume the asset in the partnership (or LLC) has a fair market value of $5 million, an investor purchases a 10% interest in the partnership (with a pro rata value of $500,000) for $100,000, and the investor is allocated 10% of the conservation easement deduction. For the $100,000 purchase price, the investor arguably purchased only a 2% interest in the partnership but was nonetheless allocated 10% of the deduction. These types of special allocations may be attacked on the ground that they lack "substantial economic effect."

2. **Disguised Sales Rules**. In *Route 231, LLC*, discussed in the context of state tax credits below, the IRS successfully invoked a different tax avoidance principle—the "disguised sales" rules under IRC § 707—to attack the special allocation of tax benefits resulting from a partnership's donation of conservation easements

[118] IRS Notice 2004-41 is available at http://www.irs.gov/irb/2004-28_IRB/ar09.html.

[119] *See* Partnership Audit Techniques Guide, Chapter 6 – Partnership Allocations, available at http://www.irs.gov/Businesses/Partnerships/Partnership---Audit-Technique-Guide---Chapter-6---Partnership-Allocations-(Revised-12-2007).

and land. In holding that the partnership's transfer to a 1% partner of 97% of the state tax credits generated by the donations was a taxable disguised sale, the Tax Court explained that IRC § 707 "prevents use of the partnership provisions to render nontaxable what would in substance have been a taxable exchange if it had not been 'run through' the partnership."

C. **Date of Donation and Recordation Date**. Treasury Regulation § 1.170A-14(g)(1) provides that

> any interest in the property retained by the donor (and the donor's successors in interest) must be subject to legally enforceable restrictions (for example, by recordation in the land records of the jurisdiction in which the property is located) that will prevent uses of the retained interest inconsistent with the conservation purposes of the donation.

Although recordation is not stated as an absolute requirement, **the donor of a conservation easement should see to it that the easement is recorded in the year in which the donor intends to claim the donation was made.** Absent recordation of an easement, a purchaser of the subject property who records the purchase deed will generally take the property free of the easement. In addition, many state conservation easement enabling statutes specifically require recordation for an easement to be legally enforceable.[120] Accordingly, absent recordation in the year of the purported donation, the IRS can argue that the easement was not "granted in perpetuity" and its conservation purpose was not "protected in perpetuity" in that year.

1. **IRS's Position on Recordation**. The IRS's position on recordation is set forth in the Conservation Easement Audit Techniques Guide.[121] The Guide instructs that the complete deed of conservation easement (including all exhibits or attachments, such as a description of the easement restrictions, diagrams, and lender agreements) must be recorded in the appropriate recordation office in the county where the property is located and, under state law, an easement is not enforceable in perpetuity before it is recorded.[122] The Guide further instructs that the effective date of the gift is the recording date, and provides the following as an example:

> A conservation easement was granted to a qualified organization on December 20, 2007, as evidenced by the dated signatures on the

[120] For example, the Uniform Conservation Easement Act provides that "[n]o right or duty in favor of or against a holder and no right in favor of a person having a third-party right of enforcement arises under a conservation easement before its acceptance by the holder and a recordation of the acceptance." Uniform Conservation Easement Act § 2(b) (Last Revised or Amended in 2007).

[121] Conservation Easement Audit Techniques Guide, available at http://www.irs.gov/pub/irs-utl/conservation_easement.pdf.

[122] *Id.* at 15.

conservation easement deed. However, the easement was not recorded in the public records until March 12, 2008. The year of donation is 2008.[123]

2. ***Gorra***. In *Gorra*, the donee of a façade easement delivered the easement to the recorder's office on December 28, 2006, paid the recording fees and taxes, and obtained a receipt for the delivery. Due to a cover sheet error, however, the easement was not recorded until January 18, 2007. The IRS argued that the deed was not recorded until 2007. The Tax Court disagreed, holding that, under New York law, delivery of the deed to the recorder's office, with receipt acknowledged, constituted recordation, even though there was a delay in the actual recording until the following year because of the cover sheet error. The court cited N.Y. Real Prop. Law § 317, which provides that every instrument entitled to be recorded is considered recorded from the time of delivery to the recording officer.

3. ***Zarlengo***. In *Zarlengo*, **the easement donors and the donee signed the façade easement at issue in 2004,** the donee sent the donors a letter thanking them for the donation in 2004, and the donors claimed deductions for the donation on their 2004 returns. For reasons not explained in the Tax Court's opinion, however, **the easement was not recorded until January 26, 2005.** The IRS argued that the taxpayers were not entitled to deductions in 2004 because the façade easement was neither (i) a "qualified real property interest" as defined in § 170(h)(2)(C) (i.e., "a restriction (granted in perpetuity) on the use which may be made of the real property") nor (ii) donated exclusively for conservation purposes as required under § 170(h)(5) (i.e., the conservation purpose of the easement was not "protected in perpetuity").

In analyzing these issues, **the Tax Court first reiterated the well settled rule that, "[i]n a Federal tax controversy, State law controls the determination of a taxpayer's interest in property while the tax consequences are determined under Federal law."** Accordingly, New York law governed when the taxpayers' donation of the façade easement was regarded as complete, but Federal tax law determined the tax consequences. **Because New York law provides that conservation easements in the state have no legal effect unless they are recorded, the court found that the façade easement was not effective until January 26, 2005.**[124]

The Tax Court further explained that, **even assuming the façade easement had been legally enforceable by the donee against the donors in 2004 because both parties signed the easement that year, the easement still would not have**

[123] *Id.* at 13.
[124] *See also Rothman I.*

satisfied the perpetuity requirements in 2004 "because neither the use restriction nor the conservation purpose of the conservation easement was protected in perpetuity until January 26, 2005." The court explained that, if a buyer had purchased the subject townhouse and recorded the purchase deed before January 26, 2005, the buyer would have taken the townhouse free and clear of the conservation easement. Moreover, the possibility that this could have occurred was not so remote as to be negligible.

The Tax Court concluded that **the donors were not entitled to deductions on their 2004 returns because the perpetuity requirements were not satisfied in 2004, and it followed that the donors were also not entitled to carryover deductions on subsequent years' returns**. However, the IRS had acknowledged that the easement could be considered "made in perpetuity" in 2005 under §§ 170(h)(2)(C) and (5)(A) because the easement was recorded in that year, and the Tax Court determined that **"both the use restriction and the conservation purpose of the conservation easement were protected in perpetuity as of January 26, 2005."** Accordingly, given that the other requirements of § 170(h) (including the conservation purposes test) and the substantiation requirements were satisfied, **the donors' tax liability for 2005, 06, and 07 could be redetermined assuming the donation had been made in 2005**.[125]

D. ***Quid Pro Quo***. **A charitable contribution is not deductible if it is structured as a *quid pro quo* exchange.**[126] Treasury Regulation § 1.170A-14(h)(3)(i) provides:

- If, as a result of the donation of a [conservation easement], the donor or a related person receives, or can reasonably expect to receive, financial or economic benefits that are greater than those that will inure to the general public from the transfer, no deduction is allowable under this section.

- However, if the donor or a related person receives, or can reasonably expect to receive, a financial or economic benefit that is substantial, but it is clearly

[125] For a more detailed description of this case, which involved two donors and IRS challenges to deductions claimed in different years, see *Zarlengo v. Commissioner—Conservation Easement Overvalued and Not Protected In Perpetuity Until Recorded*, at http://lawprofessors.typepad.com/nonprofit/2014/08/zarlengo-v-commissionerconservation-easement-not-protected-in-perpetuity-until-recorded-and-overvalued.html. *See also Satullo v. Commissioner*, T.C. Memo. 1993-614 (although decided on lack of mortgage subordination grounds, the Tax Court stated "Georgia law clearly provides that until an easement is recorded its intended property restrictions are legally unenforceable" and "although the Deed of Gift created an easement that was accepted by [the land trust] during December 1985, its terms were not enforceable as required by [Treas. Reg. § 1.170A-14(g)(1)] until January 19, 1988, when it was recorded").

[126] *Hernandez v. Comm'r*, 490 U.S. 680, 681 (1989) ("The legislative history of the 'contribution or gift' limitation reveals that Congress intended to differentiate between unrequited payments to qualified recipients, which are deductible, and payments made to such recipients with some expectation of a quid pro quo in terms of goods or services, which are not deductible.").

shown that the benefit is less than the amount of the transfer, then a deduction under this section is allowable for the excess of the amount transferred over the amount of the financial or economic benefit received or reasonably expected to be received by the donor or the related person.[127]

1. ***Pollard***. In *Pollard*, **the Tax Court sustained the IRS's disallowance of a deduction claimed with respect to a conservation easement conveyance because the conveyance was part of a *quid pro quo* exchange**. The taxpayer had purchased a 67-acre parcel in Boulder County, Colorado, and had to obtain approval from the county to increase the property's building density. After public hearings, the board of county commissioners agreed to grant the taxpayer's subdivision exemption request, which allowed the property to be split into two residential lots, provided the taxpayer granted a conservation easement encumbering the property to the county.

The taxpayer in *Pollard* maintained that no *quid pro quo* arrangement existed, arguing, among other things, that approval of his subdivision exemption request had been "virtually guaranteed," that the land use code sections governing his exemption request did not require the grant of a conservation easement, and that all documents relating to the grant of the easement referred to it as a "gift." One of the county commissioners even wrote a letter to the taxpayer (apparently at the taxpayer's request in preparation for the Tax Court trial) stating that, to the best of his recollection, he did not require the taxpayer to grant the easement in exchange for the subdivision exemption.

The Tax Court was not persuaded. Based on its examination of the "external features of the transaction," the court found that the subdivision exemption request was far from being virtually guaranteed and, in fact, had little chance of being granted without the taxpayer's promise to grant the easement.[128] The taxpayer also did not establish that the value of the easement he conveyed to

[127] *See* Rev. Rul. 76-185 (from which the Treasury Regulation language appears to be derived, and which provides that "payments made by the taxpayer for the restoration and maintenance of the historic mansion and its grounds are not deductible as charitable contributions…unless the taxpayer can establish that the payments exceed the monetary value of all benefits received or expected to be received"). *See also* Treas. Reg. § 1.170A-1(h)(1) ("No part of a payment that a taxpayer makes to or for the use of an organization described in section 170(c) that is in consideration for…goods or services…is a contribution or gift within the meaning of section 170(c) unless the taxpayer—(i) Intends to make a payment in an amount that exceeds the fair market value of the goods or services; and (ii) Makes a payment in an amount that exceeds the fair market value of the goods or services.").

[128] In ascertaining whether a given payment is a contribution or gift, or is made with the expectation of *quid pro quo*, the IRS and the courts examine "the external features of the transaction," thus avoiding the need to conduct an imprecise inquiry into the motivations of individual taxpayers. *Hernandez v. Commissioner,* 490 U.S. 680, 701–702 (1989).

the county exceeded the value of the subdivision exemption granted to him, or that he intended to make a charitable contribution.[129]

The Tax Court sustained the IRS's imposition of an accuracy-related penalty in *Pollard*, finding that the taxpayer did not act with reasonable cause and in good faith in claiming the deduction. The evidence produced at trial, said the court, demonstrated that **all of the parties involved understood that the easement was contributed for the express purpose of encouraging the county to grant the taxpayer a subdivision exemption, and it would be unreasonable for the court to believe that anyone involved in the transaction (i.e., the taxpayer, his advisers, or the county commissioners) believed there was an unrequited contribution.**[130]

2. ***Seventeen Seventy Sherman Street***. In *Seventeen Seventy Sherman Street*, **the Tax Court sustained the IRS's complete disallowance of an LLC's claimed $7.15 million deduction for the conveyance of interior and exterior easements restricting the use of a shrine because the conveyance was part of a *quid pro quo* exchange.** The shrine is listed on the National Register of Historic Places and as a historic landmark by the City and County of Denver. The LLC owned two properties on Sherman Street—the shrine and a parking lot. Prior to granting the easements, the LLC and the City of Denver entered into a development agreement in which, among other things, the LLC agreed to convey the easements to Historic Denver and rehabilitate the shrine in exchange for certain zoning changes to the shrine and the parking lot.

The Tax Court's opinion details the elements of a *quid pro quo* analysis in the charitable deduction context.

- A taxpayer's contribution is deductible 'only if and to the extent it exceeds the market value of the benefit received.'
- '[t]he sine qua non of a charitable contribution is a transfer of money or property without adequate consideration.'
- 'a charitable gift or contribution must be a payment made for detached and disinterested motives. This formulation is designed to ensure that

[129] *See supra* note 127.

[130] *See also* Boone v. Commissioner, T.C. Memo 2013-101 (conveyance of fill to city not a deductible charitable contribution because taxpayer failed to meet its burden of proving that the fair market value of the fill exceeded the fair market value of the consideration received in exchange); Perlmutter v. Commissioner, 45 T.C. 311 (1965) (transfers of land to school districts and a recreation district in accordance with zoning regulations were not charitable contributions); Ottawa Silica Co. v. U.S., (Ct. Cl. Trial Div.), 49 A.F.T.R.2d 82-1162, 82-1 USTC P 9308 ("It is … quite apparent that plaintiff conveyed the land to the school district fully expecting that as a consequence of the construction of public access roads through its property it would receive substantial benefits in return"); Small, *Real Estate Developers and Conservation Easements—Not as Simple as it Sounds*, 19-JUN Prob. & Prop. 24 (2005).

the payor's primary purpose is to assist the charity and not to secure some benefit personal to the payor.'

- The consideration received by the taxpayer need not be financial. Medical, educational, scientific, religious, or other benefits can be consideration that vitiates charitable intent.
- In ascertaining whether a given payment was made with the expectation of anything in return, courts examine the external features of the transaction. This avoids the need to conduct an imprecise inquiry into the motivations of individual taxpayers.
- The taxpayer claiming a deduction must, at a minimum, demonstrate that "he purposely contributed money or property in excess of the value of any benefit he received in return."
- Thus, a taxpayer who receives goods or services in exchange for a contribution of property may still be entitled to a charitable deduction if the taxpayer (1) makes a contribution that exceeds the fair market value of the benefits received in exchange and (2) makes the excess payment with the intention of making a gift.[131] If the taxpayer satisfies these requirements, the taxpayer is entitled to a deduction not to exceed the fair market value of the property the taxpayer transferred less the fair market value of the goods or services received.[132]

The Tax Court explained that a *quid pro quo* analysis in the conservation easement donation context ordinarily requires two parts—(1) valuation of the contributed conservation easement and then (2) valuation of the consideration received in exchange for the easement. The court explained, however, that **when a taxpayer grants a conservation easement as part of a *quid pro quo* exchange and fails to identify or value *all* of the consideration received, the taxpayer is not entitled to a deduction because he failed to comply with § 170 and the regulations. In such a case, it is unnecessary to determine either the value of the easement or whether the taxpayer made an excess payment with the intention of making a gift**. The taxpayer's failure to identify or value *all* of the consideration received and, thus, to prove that the value of the easement exceeded the value of the consideration is fatal to the deduction.[133]

[131] *See* Treasury Regulation § 1.170A–1(h)(1).
[132] *Id*. § 1 .170A–1(h)(2).
[133] *See also Cohan v. Commissioner*, T.C. Memo. 2012-8, in which the Tax Court upheld the IRS's complete disallowance of a charitable income tax deduction claimed with respect to a bargain sale transaction because the contemporaneous written acknowledgement (CWA) the donee provided to the donor did not include a description or good faith estimate of the total consideration provided to the donor and the donor's reliance on the CWA was unreasonable. The court explained that "the deterrence value of § 170(f)(8)'s total denial of a deduction comports with the effective administration of a self-assessment and self-reporting system."

In this case, the Tax Court found that the LLC had received two types of consideration in exchange for its conveyance of the interior and exterior easements:

- a zoning change that eliminated authorization to develop residential condominium units within the shrine but also permitted development on the parking lot up to 650 feet, subject to a "view plane" restriction of 155 feet (a view plane restriction limits the height of buildings from a specified view point within Denver's city park and is meant to preserve the view of the Rocky Mountain Skyline from that view point), and
- the Denver Community Planning and Development Agency's recommendation to the Denver Planning Board to approve a view plane variance (which variance was ultimately approved).

On its 2003 tax return, however, the LLC claimed a $7.15 million charitable deduction for its conveyance of the easements and made no adjustment for the consideration it received in exchange. At trial, the LLC conceded that it had received the zoning change in exchange for its conveyance of the easements and argued that its deduction should be reduced by just over $2 million as a result. The LLC also asserted that the Planning and Development Agency's recommendation to the Planning Board to approve a view plane variance was either not consideration received in exchange for the grant of the easements, or was consideration but had no real value. The Tax Court disagreed, finding that the Agency's view-plane-variance recommendation was consideration and had substantial value. The court concluded that **the LLC's failure to identify or value all of the consideration received, or to provide any credible evidence to permit the court to accurately value all of the consideration received, was fatal to the deduction.**

The Tax Court agreed with the IRS that the LLC was liable for the accuracy-related penalty because it acted negligently or in disregard of the requirements of § 170 and the regulations. "Negligence," said the court, is strongly indicated where a taxpayer fails to make a reasonable attempt to ascertain the correctness of a deduction that would seem to a reasonable and prudent person to be "too good to be true." And a taxpayer acts with "disregard" when, among other things, he does not exercise reasonable diligence to determine the correctness of a return position. **The LLC conveyed the easements as part of a *quid pro quo e*xchange but reported the conveyance on its 2003 return as a charitable contribution without making any adjustment for the consideration it received in exchange.** The court found that the LLC acted negligently or with disregard because it did not make a reasonable attempt to ascertain the correctness of the deduction.

The LLC argued that it was eligible for the reasonable cause and good faith exception to the penalty because it relied on professional advice. The Tax Court disagreed. Although the LLC had consulted with a tax attorney regarding the conveyance, that attorney testified at trial that he had advised the LLC that it had to reduce the value of its deduction by the consideration received in the *quid pro quo* exchange. **The Tax Court noted that it would be unreasonable for the court to believe that at the time of the contribution or at the time of filing the LLC's return either the LLC or its advisers believed that the contribution of the easements was an unrequited contribution or that the consideration received had no value**. Consequently, the LLC's disregard of the attorney's advice was not reasonable and in good faith, and the LLC could not rely on the professional advice of the attorney to negate the penalty.

3. ***Pesky***. In *Pesky*, the IRS asserted not only that the taxpayer's conveyance of a conservation easement was made in exchange for a *quid pro quo*, but also that the taxpayer was liable for a civil fraud penalty under IRC § 6663. IRC § 6663 imposes a 75% penalty on tax underpayments due to fraud. Fraud is defined as an "intentional wrongdoing on the part of the taxpayer with the specific intent to avoid a tax known to be owing." The government must prove fraud by clear and convincing evidence, but intent can be inferred from strong circumstantial evidence.

After a review of the facts and circumstances surrounding the easement conveyance, the District Court was unable to conclude that a reasonable jury could find it "highly likely" that the taxpayer's deduction was due to fraud. Because the **government did not produce sufficient evidence to meet its burden of showing fraud by clear and convincing evidence**, the court granted the taxpayer's motion for summary judgment on the issue. The court determined, however, that **other issues could not be resolved on summary judgment, including whether the conveyance of the easement was made in exchange for *quid pro quo*** and whether the taxpayer obtained a contemporaneous written acknowledgment accurately reflecting any goods and services provided by the donee in exchange for the contribution. It is understood that the parties in *Pesky* settled the case after the District Court rejected the fraud claim.

E. **Side Agreements**. In *Graev*, the Tax Court sustained the IRS's disallowance of deductions claimed with regard to the donation to the National Architectural Trust (NAT) of both a façade easement valued at $990,000 and an accompanying $99,000 cash endowment. NAT had written a side letter to Mr. Graev, the donor, promising that, if the deduction for the easement were disallowed, NAT would "promptly refund [Mr. Graev's] entire cash endowment contribution and join with [him] to immediately remove the facade conservation easement from the property's title." **The Tax Court disallowed the deductions for both the easement and cash donations because the gifts**

were conditional and, at the time they were made, the possibility they would be defeated was not so remote as to be negligible.

- Section 170 and the corresponding Treasury Regulations provide instructions and limitations that, at least in part, ensure that a donor will be able to deduct only what the donee organization actually receives. Three such limitations effectively provide that no deduction for a charitable contribution will be allowed unless, on the date of the contribution, the possibility that the donee's interest in the contribution would be defeated is "so remote as to be negligible." Those limitations are found in regulation § 1.170A-1(e) (pertaining to conditional gifts), regulation § 1.170A-7 (pertaining to partial interest gifts), and regulation § 1.170A-14(g)(3) (pertaining to gifts of conservation easements).

- Based on the facts in *Graev*, the court found that, **on the date of the contributions, the possibility the IRS would disallow the easement deductions and NAT would return the cash to Mr. Graev and remove the easement (i.e., the gifts would be defeated) was not so remote as to be negligible.** The facts the court found persuasive included the IRS's announced intention to scrutinize deductions for facade easement donations; Mr. Graev's insistence that NAT issue the side letter; NAT's practice of issuing side letters, the very essence of which "implies a non-negligible risk;" the enforceability of the side letter under state law; and NAT's incentive to honor its promises in the side letter so as not to undermine its reputation and impair its ability to obtain future contributions.

- The standard for finding that the possibility of defeat of a conditional gift is so remote as to be negligible is very high.[134] In *Graev*, the court explained: "the mere fact that he required the side letter is strong evidence that, at the time of Mr. Graev's contribution, the risk that his corresponding deductions might be disallowed could not be (and was not) 'ignored with reasonable safety in undertaking a serious business transaction.'" Obtaining the side letter also indicated that Mr. Graev did not disregard the chance of disallowance "as so highly improbable and remote as to be lacking in reason and substance." Accordingly, **the mere fact of obtaining a side letter such as that at issue in *Graev* may be a tripwire that destroys deductibility.**

[134] *Briggs v. Comm'r*, 72 T.C. 646, 656-57 (1979) (defining so remote as to be negligible as "'[a] chance which persons generally would disregard as so highly improbable that one might ignore it with reasonable safety in undertaking a serious business transaction.' It is likewise a chance which every dictate of reason would justify an intelligent person in disregarding as so highly improbable and remote as to be lacking in reason and substance.").

F. “**<u>Floating” Development Rights</u>**. Several regulatory requirements apply to retained development rights.

- Treasury Regulation § 1.170A-14(d)(4)(v) contains a specific limitation on the reservation of rights in an open space easement—a deduction will not be allowed “if the terms of the easement permit a degree of intrusion or future development that would interfere with the essential scenic quality of the land or the governmental conservation policy being furthered by the donation.”

- Treasury Regulation § 1.170A-14(e)(2) provides that “a deduction will not be allowed if the contribution would accomplish one of the enumerated conservation purposes but would permit destruction of other significant conservation interests” (the “no inconsistent use” requirement),[135] and

- Treasury Regulation § 1.170A-14(g)(1) provides that “any interest in the property retained by the donor … must be subject to legally enforceable restrictions … that will prevent uses of the retained interest inconsistent with the conservation purposes of the donation” (the “general enforceable in perpetuity” requirement).

1. **<u>Examples 3 and 4</u>**. The Treasury Regulations provide two examples addressing “future development” in an open space easement.[136]

<u>Example 3</u> involves Greenacre, a 900-acre parcel of woodland, rolling pasture, and orchards on the crest of a mountain, all of which is clearly visible from a nearby national park.[137] The highest and best use of Greenacre is as a subdivision of 40-acre tracts (potentially twenty-two residential lots). The landowner wishes to donate a scenic easement on Greenacre and would like to reserve the right to subdivide Greenacre into 90-acre parcels with no more than one single-family home allowable on each parcel. Example 3 provides that “[r]andom building on the property, even as little as one home for each 90 acres [a total of only ten homes], would destroy the scenic character of the view. Accordingly, no deduction would be allowable.”

<u>Example 4</u> assumes the same facts, except not all of Greenacre is visible from the park and the deed of easement allows for limited cluster development of no more than five nine-acre clusters with four houses on

[135] For limited exceptions to this rule, see Treas. Reg. § 1.170A-14(e)(3).
[136] Treas. Reg. § 1.170A-14(f), Examples 3 and 4.
[137] *Id.*, Example 3.

each cluster (for a total of twenty homes) located in areas generally not visible from the national park and subject to site and building plan approval by the donee organization to preserve the scenic view from the park.[138] Example 4 further provides that the donor and the donee have "already identified sites where limited cluster development would not be visible from the park or would not impair the view," and owners of homes in the clusters will not have any rights with respect to the surrounding Greenacre property that are not also available to the general public. Example 4 concludes that the donation qualifies for a deduction.

Example 3 evidences the Treasury Department's dislike of "floating development rights," or rights exercisable anywhere on the property. Such rights could interfere with the essential scenic quality of the land or the governmental conservation policy being furthered by the donation,[139] permit destruction of other significant conservation interests,[140] and permit uses of the retained interest inconsistent with the conservation purposes of the donation.[141] Example 4 suggests that, even if the number of permitted homes is increased (from ten to twenty), if the homesites are clustered, located in areas generally not visible from the nearby park, and subject to site and building plan approval by the donee to preserve the scenic view, the donation will be deductible. Based on the wording of Example 4, the donor and the donee had, at the time of the donation, "already identified sites where limited cluster development would not be visible from the park or would not impair the view." It is not clear from Example 4 if having rights with respect to the surrounding Greenacre property available to the general public was necessary to the outcome.

G. **Private Letter Rulings[142] Recommending Revocation of Tax-Exempt Status**. The IRS has issued a number of Private Letter Rulings (PLRs) recommending revocation of the tax-exempt status of organizations holding conservation easements based on fairly egregious facts.[143] These PLRs illustrate some of the issues the IRS has focused on when examining organizations that accept and hold conservation easements.

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[138] *Id.*, Example 4.

[139] *See* Treas. Reg. § 1.170A-14(d)(4)(v) (the limitation on reserved rights in open space easements).

[140] *See* Treas. Reg. § 1.170A-14(e)(2) (the no inconsistent use requirement).

[141] *See* Treas. Reg. § 1.170A-14(g)(1) (the general enforceable in perpetuity requirement).

[142] A Private Letter Ruling (PLR) is a written statement issued to a taxpayer that interprets and applies tax laws to the taxpayer's specific set of facts. A PLR may not be relied on as precedent by other taxpayers or IRS personnel. PLRs are generally made public after all information has been removed that could identify the taxpayer to whom it was issued. *See* Understanding IRS Guidance – A Brief Primer, available at http://www.irs.gov/uac/Understanding-IRS-Guidance-A-Brief-Primer.

[143] *See, e.g.,* PLR 201044026; PLR 201048045; PLR 201109030; PLR 201110020; PLR 201405018. *See also* PLR 201234029 (organization created for the purpose of carrying on a for-profit hay farm on property that is not ecologically significant or open to the public is not operated for an exempt purpose).

1. Although the PLRs are impossible to accurately summarize in an outline because of their highly fact specific nature, some of the problems noted in the PLRs include:

- the organization served as a vehicle for its founder, the founder's family, or other related parties to donate conservation easements and claim deductions;
- the easements donated to the organization did not satisfy the conservation purpose test under § 170(h)(4) (e.g., the preservation was not pursuant to a clearly delineated government conservation policy; the easement encumbered ordinary farmland with no unique features like native plants, trees, or animals; or the easement encumbered land in a gated condominium tennis resort and contained a private miniature golf course used for the pleasure of the residents only);
- the organization did not take steps to ensure that the easements it accepts serve a conservation purpose (e.g., the organization's officers, trustees, and employees did not have backgrounds or expertise in botany, biology, ecological sciences, or other fields that would enable them to credibly process or evaluate the property, or no baselines were obtained or consisted of one page or one paragraph reports; or the organization was unaware of the extensive retained rights in the easements it accepted);
- the organization did not monitor the easements it accepted on a regular basis (or at all), did not have the commitment to protect the conservation purposes (if any) of the donations, and did not have the resources to enforce the easements should enforcement become necessary;
- there was no one associated with the organization that had any formal education, training, or expertise in conservation matters;
- the organization allowed one of its easement-encumbered properties to be damaged by illegal dumping and vehicles, and another, located in an exclusive small waterfront residential development, to be encroached upon by the residents who constructed, among other things, large ponds and a boat and recreational vehicle storage facility for the exclusive use of the residents;
- the organization amended a conservation easement to allow additional development for a fee;
- the easements the organization acquired violated the perpetuity requirement under § 170(h) because the organization had the right to terminate the easements;
- the organization did not develop or sponsor any educational events, solicit the general public for support, or appear to hold itself out to the public as a charitable conservation organization; and
- the organization was not operated in accordance with it bylaws (e.g., there were no meetings of officers or board members, no elections, and

no internal controls, and there was only the bare minimum with regard to records and recordkeeping).

2. PLR 201048045 explains:

> **To establish that it operates exclusively for charitable conservation purposes under section 501(c)(3), an organization must do more than merely accept and hold easements for which donors are claiming charitable contribution deductions under section 170(h). The organization must establish that any accepted easements actually serve a conservation purpose. The organization must also operate as an effective steward to ensure that the easement continues to further a conservation purpose. The easement is a set of legal rights. It can serve conservation purposes only if enforced where necessary. The need for enforcement can be determined only through monitoring. The extent of an organization's due diligence and monitoring activities, combined with its capacity for and commitment to enforcement when necessary, becomes highly significant in determining whether accepting and holding easements actually furthers a charitable conservation purpose and thus whether an organization with the primary purpose of accepting and holding easements qualifies for exemption under section 501(c)(3).**

H. **State Tax Credits.** A number of states offer state income tax credits to donors of conservation easements.

1. **Tax Treatment of Sale of State Tax Credits**. *Esgar* (discussed in Part III.A. above) involved three taxpayers, each of whom donated a conservation easement on land located in Colorado, received transferable income tax credits from Colorado as a result of the donation, and sold a portion of the credits to third parties within two weeks. The taxpayers reported the proceeds from the credit sales as long-term capital gain, short-term capital gain, and ordinary income, respectively. After an audit of the taxpayers' income tax returns, the IRS determined that the proceeds from the sales of the credits should have been reported as ordinary income.

In *Tempel v. Commissioner*, 136 T.C. 341 (2011), the Tax Court held that the **taxpayers' state tax credits were zero-basis capital assets** and, given the short holding periods, income from the sale of such credits was short-term capital gain. Several months later, the IRS released **Chief Counsel Memorandum 201147024, which addresses the tax consequences of the sale of state tax credits to both the seller and the buyer**.[144]

[144] Chief Counsel Memorandum 201147024 is available at http://www.irs.gov/pub/irs-wd/1147024.pdf.

The taxpayers appealed both *Esgar I* (in which the Tax Court held that the taxpayers had substantially overvalued the conservation easements) and *Tempel* to the 10th Circuit. In *Esgar II*, the taxpayers argued that their state tax credits, which they held for only about two weeks, were nonetheless long-term capital assets because they held the underlying real properties for longer than one year, they relinquished development rights in those properties through the donation of the easements, and they received the tax credits because of the donations.

The 10th Circuit disagreed, noting that the Tax Court correctly concluded in *Tempel* that the taxpayers had no property rights in the tax credits until the easement donations were complete and the credits were granted, and the credits never were, nor did they become, part of the taxpayers' real property rights. The 10th Circuit also agreed with the Tax Court that the taxpayers' holding period in the credits began at the time the credits were granted and ended when taxpayers sold them, and since the taxpayers sold the credits in the same month in which they received them, the gains from the sale of the credits were short term capital gains.

The 10th Circuit also summarily rejected the argument that the transactions amounted to some sort of like-kind exchange of conservation easements for tax credits that might result in the "tacking" of holding periods. The court further noted that if these were like-kind exchanges it would negate the charitable nature of the taxpayers' contributions of the easements.

2. **<u>Nonpro rata Allocation of State Tax Credits was Disguised Sale</u>**. In *Route 231, LLC*, the Tax Court held that **a partnership's transfer to a 1% partner** (who had contributed $3.8 million to the partnership) **of 97% of the state tax credits the partnership received for making charitable contributions of conservation easements and land was a taxable disguised sale under IRC § 707**. The partnership (Route 231) treated the transaction as a $3.8 million capital contribution by the partner followed by an "allocation" of the tax credits to that partner. In holding that the transaction was, in substance, a disguised sale, the Tax Court relied on *Virginia Historic Tax Credit Fund 2001 LP v. Commissioner*, 639 F.3d 129 (4th Cir. 2011), which the court found to be "squarely on point." The Tax Court also explained that **IRC § 707 "prevents use of the partnership provisions to render nontaxable what would in substance have been a taxable exchange if it had not been 'run through' the partnership."**

In *Virginia Historic*, three individuals set up a web of partnerships for the purpose of passing Virginia historic rehabilitation tax credits to investors. The partnerships solicited investors who contributed money to the partnerships' capital accounts in return for (i) small (generally 0.01%) partnership interests and (ii) the partnerships' promise to provide them with a fixed amount of Virginia

historic rehabilitation tax credits. The IRS determined that these transactions were disguised sales under IRC § 707 and the 4th Circuit agreed.

The Tax Court found "compelling similarities" between the transactions at issue in *Virginia Historic* and the transaction at issue Route 231. Just as in *Virginia Historic*, *Route 231, LLC* involved a contribution of money to a partnership in return for (i) a small (1%) partnership interest and (ii) the partnership's promise to provide the contributor with a fixed amount of tax credits.

There were some factual differences between the transactions at issue in the two cases. *Virginia Historic* involved a complex web of partnerships with hundreds of investors, most of whom received a 0.01% interest in the partnerships, while *Route 231, LLC* is a stand-alone partnership with only three partners, including the 1% partner. Unlike the investors in *Virginia Historic*, who were partners in the partnerships for only approximately five or six months (characterized by Route 231 as "grab the tax credits and run" cases), the 1% partner in *Route 231, LLC* was still a partner in that partnership. In addition, in *Virginia Historic* the IRS argued that the investors were not valid partners, whereas in *Route 231, LLC* the IRS did not question whether the 1% partner was a valid partner. The Tax Court was unmoved by these factual differences, finding that they did not detract from the compelling similarities between the two cases.

I. **Private Letter Ruling on Sale of Mitigation Bank Credits**. In Private Letter Ruling 201408031, the IRS ruled that:

- **a § 501(c)(3) organization's stream mitigation activities were substantially related to its exempt purpose and did not constitute an unrelated trade or business and**
- **the income the organization would receive from the sale of mitigation credits would not be unrelated business taxable income**.[145]

The exempt purposes of the organization at issue in the ruling, as set forth in its articles of incorporation, included "protecting the natural and scenic spaces of real property, protecting natural resources, and maintaining or enhancing water and air quality." The organization partnered with a political subdivision of a state (the Commission) regarding the protection of certain land the Commission owned within a watershed and had covenanted to protect as stream buffers. The Commission conveyed a perpetual conservation easement with respect to the land to the organization, and the organization represented to the IRS that the perpetual easement would ensure that the land is kept undeveloped and its conservation values are preserved.

[145] Private Letter Ruling 201408031 is available at http://www.irs.gov/pub/irs-wd/1408031.pdf.

To raise the funds necessary to conduct stream remediation activities and address nonpoint sources of water pollution, the organization planned to form a stream mitigation bank with the support of the Commission. By conducting stream mitigation activities the organization would generate mitigation credits that could be sold to private developers or governmental entities that have projects that may cause stream disturbances somewhere else in the watershed. Once all the mitigation credits are sold, there will be no additional proceeds from the bank, but the owner/sponsor of the bank will be responsible for the monitoring and maintenance of the restored streams for seven years after the completion of the final phase and, in the case of the organization, it is charged with management of the water resources in perpetuity.

In ruling that the organization’s stream mitigation activities were substantially related to its exempt purpose, and that the income the organization would receive from the sale of mitigation credits would not be unrelated business taxable income, the IRS noted, in part, that:

- The Commission covenanted to maintain a significant part of the land as stream buffers.
- The Commission assigned its conservation obligations contained in the conservation easement to the organization, requiring the organization to maintain the land in essentially pristine condition and seek Commission's approval before making any capital improvements.
- The Commission authorized the organization to negotiate the mitigation banking instrument and remediate the waterways, and delegated to the organization all responsibilities for the planning, funding, developing, and monitoring of the bank, as well as the authority to sell the credits generated by the bank.
- By carrying out these activities, the organization will be fulfilling the Commission's conservation and legal obligations and lessening the government’s (the Commission's) burden.

Appendix A

Table of § 170(h) Deduction Cases as of August 18, 2014

Table Structure

The Table below lists the cases involving challenges to charitable income tax deductions claimed with respect to conservation easement donations. Given that § 170(h) and the Treasury Regulations are effective only for transfers made on or after December 18, 1980,[146] the cases are separated into two groups:

> (i) those involving donations made before the effective date of § 170(h) (pre-§ 170(h) cases) and
>
> (ii) those involving donations made on or after the effective date of § 170(h) (post-§ 170(h) cases).

Substantial changes were made to the deduction provision with the enactment of § 170(h) in 1980. Accordingly, the law in effect on the date of the donation may be an important factor in analyzing the relevance of an older case to a current controversy.[147]

Precedential Value of Tax Court Cases

The Tax Court issues several different types of opinions, the precedential value of which differs.

> (1) **Summary Opinions**. Certain disputes (for example, disputes involving deficiencies of $50,000 or less for each year at issue) qualify for simplified or "S case" procedures. The Tax Court generally issues Summary Opinions in these cases, and Summary Opinions cannot be relied on as precedent or appealed.
>
> (2) **Regular Opinions and Memorandum Opinions**. The Tax Court generally issues two types of opinions in cases that are not "S" cases.

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[146] Pub. L. 96-541, 94 Stat. 3206, §6(d). Treas. Reg. § 1.170A-14(j). The mortgage subordination, division of proceeds, baseline documentation, and donee notification, access, and enforcement rights requirements apply only to donations made after February 13, 1986. *See* Treas. Reg. §§ 1.170A-14(g)(2), -14(g)(6)(ii), -14(g)(5)(i), -14(g)(5)(ii). The provision requiring a reduction in amount of the donor's deduction for any increase in the value of certain property owned by the donor or a related person as a result of the donation applies only to donations made after January 14, 1986. *See id.* § 1.170A-14(h)(3)(i).

[147] For example, cases involving interpretation of the deduction provision in effect before § 170(h) was enacted should not be relied upon in interpreting new requirements added to the deduction provision in 1980 to curb abuses and ensure protection of the federal investment, such as § 170(h)(5)(A)'s new "protected-in-perpetuity" requirement. On the other, hand, some of the general rules governing valuation discussed in the older cases are still relevant to current controversies.

(i) Opinions, sometimes referred to as "Regular Opinions," (cited as "T.C.") are generally issued in cases that the Tax Court believes involve sufficiently important legal issues or principles. Regular Opinions can be cited as legal authority and appealed, and the Tax Court treats them as binding precedent.

(ii) Memorandum Opinions (cited at "T.C. Memo.") are generally issued in cases that do not involve novel legal issues and, instead, address situations where the law is settled or factually driven. Memorandum Opinions can be cited as legal authority and appealed, but the Tax Court does not treat them as binding precedent.

The Chief Judge of the Tax Court decides whether an opinion will be issued as a Regular Opinion or a Memorandum Opinion.

(3) **Bench Opinions**. A Tax Court judge is authorized to issue a Bench Opinion in an S case or a regular case when the judge is "satisfied as to the factual conclusions to be reached in the case and that the law to be applied thereto is clear." To issue a Bench Opinion, the judge orally states the findings of fact and the opinion in court during the trial session and a transcript reflecting the findings of fact and opinion is sent to the parties. Bench Opinions cannot be relied upon as precedent.

T.C. and T.C. Memo. Opinions starting 09/25/95 and Summary Opinions starting 01/01/01 are available at
https://www.ustaxcourt.gov/UstcInOp/asp/HistoricOptions.asp.

<u>**Pre-§ 170(h) Cases (Listed in Order of Final Opinion Date)**</u>	<u>**Date of Donation**</u>
Thayer v. Comm'r, T.C. Memo. 1977-370	1969
Todd v. U.S., 617 F. Supp. 253 (W.D. Pa. 1985)	1979
Hilborn v. Comm'r, 85 T.C. 677 (1985)	1979
Stanley Works v. Comm'r, 87 T.C. 389 (1986)	1977
Akers v. Comm'r, 799 F.2d 243 (6th Cir. 1986), aff'g ***Akers v. Comm'r***, T.C. Memo. 1984-490	1977
Symington v. Comm'r, 87 T.C. 892 (1986)	1979
Stotler v. Comm'r, T.C. Memo. 1987-275	1979
Fannon v. Comm'r, 842 F.2d 1290 (4th Cir. 1988) (unpublished), modifying ***Fannon v. Comm'r***, T.C. Memo. 1986-572	1979
Fannon v. Comm'r, T.C. Memo. 1989-136	1978
Dennis v. U.S., 70 A.F.T.R. 2d 92-5946 (E.D. Va. 1992)	Nov. 8, 1980
McLennan v. U.S., 994 F.2d 839 (Fed. Cir. 1993), aff'g ***McLennan v. U.S.***, 24 Cl. Ct. 102 (1991) and ***McLennan v. U.S.***, 23 Cl. Ct. 99 (1991)	Nov. 10, 1980
<u>**Post-§ 170(h) Cases (Listed in Order of Final Opinion Date)**</u> **§ 170(h) and the Treasury Regulations are effective only for transfers made on or after Dec. 18, 1980.**[148]	
<u>**1988 through 2000**</u>	
Nicoladis v. Comm'r, T.C. Memo. 1988-163	1981
Losch v. Comm'r, T.C. Memo. 1988-230	Dec. 24, 1980
Richmond v. U.S., 699 F. Supp. 578 (E.D. La. 1988)	Dec. 29, 1980
Higgins v. Comm'r, T.C. Memo. 1990-103	1981
Dorsey v. Comm'r, T.C. Memo. 1990-242	1981
Griffin v. Comm'r, 911 F.2d 1124 (5th Cir. 1990), aff'g ***Griffin v. Comm'r***, T.C. Memo. 1989-130	1981
Schapiro v. Comm'r, T.C. Memo. 1991-128	1981, 1984
Clemens v. Comm'r, T.C. Memo. 1992-436	1982
Schwab v. Comm'r, T.C. Memo. 1994-232	1983
Satullo v. Comm'r, 67 F.3d 314, 76 A.F.T.R.2d 6536 (11th Cir. 1995), aff'g ***Satullo v. Comm'r***, T.C. Memo. 1993-614	1985
Great Northern Nekoosa v. U.S., 38 Fed. Cl. 645 (1997)	1981
Johnston v. Comm'r, T.C. Memo. 1997-475	1989
Browning v. Comm'r, 109 T.C. 303 (1997)	1990

[148] *See supra* note 146 for exceptions to the effective date for some of the Treasury Regulation provisions.

Strasburg v. Comm'r, T.C. Memo. 2000-94	1993, 1994
<u>2006</u>	
Turner v. Comm'r, 126 T.C. No. 16 (2006)	1999
Ney v. Comm'r, T.C. Summ. Op. 2006-154 (2006)	2001
Glass v. Comm'r, 471 F.3d 698 (6th Cir. 2006) (*Glass II*), aff'g ***Glass v. Comm'r***, 124 T.C. 258 (2005) (*Glass I*)	1992, 1993
Goldsby v. Comm'r, T.C. Memo. 2006-274	2000
<u>2009</u>	
Bruzewicz v. U.S., 604 F. Supp. 2d 1197 (N.D. Ill. 2009)	2002
Hughes v. Comm'r, T.C. Memo. 2009-94	2000
Kiva Dunes v. Comm'r, T.C. Memo. 2009-145	2002
Herman v. Comm'r, T.C. Memo. 2009-205	2003
<u>2010</u>	
Lord v. Comm'r, T.C. Memo. 2010-196	1999
Evans v. Comm'r, T.C. Memo. 2010-207	2004
<u>2011</u>	
Schrimsher v. Comm'r, T.C. Memo. 2011-71	2004
Boltar v. Comm'r, 136 T.C. No. 14 (2011)	2003
1982 East LLC v. Comm'r, T.C. Memo. 2011-84	2004
Comm'r v. Simmons, 646 F.3d 6 (D.C. Cir. 2011) (*Simmons II*), aff'g ***Simmons v. Comm'r***, T.C. Memo. 2009-208 (*Simmons I*)	2003, 2004
Didonato v. Comm'r, T.C. Memo. 2011-153	2004
Herman v. Comm'r, T.C. Bench Op. (Sept. 22, 2011)	2003
<u>2012</u>	
Butler v. Comm'r, T.C. Memo. 2012-72	2003, 2004
Dunlap v. Comm'r, T.C. Memo. 2012-126	2003
Wall v. Comm'r, T.C. Memo. 2012-169	2003
Averyt v. Comm'r, T.C. Memo. 2012-198	2004
Rothman v. Comm'r, T.C. Memo. 2012-218 (*Rothman II*), vacating in part ***Rothman v. Comm'r***, T.C. Memo. 2012-163 (*Rothman I*)	2004
Trout Ranch v. Comm'r, 493 Fed. Appx. 944 (10th Cir. 2012) (unpublished) (*Trout Ranch II*), aff'g ***Trout Ranch v. Comm'r***, T.C. Memo. 2010-283 (*Trout Ranch I*)	2003

Foster v. Comm'r, T.C. Summ. Op. 2012-90	2003
RP Golf, LLC v. Comm'r, T.C. Memo. 2012-282	2003
Irby v. Comm'r, 139 T.C. No. 14 (2012)	2003, 2004
Minnick v. Comm'r, T.C. Memo. 2012-345	2006
2013	
Pesky v. U.S., 2013 WL 97752 (D. Idaho, Jan. 7, 2013)	2002
Pollard v. Comm'r, T.C.Memo. 2013-38	2003
Belk v. Comm'r, T.C. Memo 2013-154 (*Belk II*), denying reconsideration of and supplementing ***Belk v. Comm'r***, 140 T.C. No. 1 (2013) (*Belk I*)	2004
Graev v. Comm'r, 140 T.C. No. 17 (2013)	2004
Pesky v. U.S., 2013 WL 3457691 (D. Idaho, July 8, 2013)	2002
Carpenter v. Comm'r, T.C. Memo. 2013-172 (*Carpenter II*), denying reconsideration of and supplementing ***Carpenter v. Comm'r***, T.C. Memo. 2012-1 (*Carpenter I*)	2003
Mitchell v. Comm'r, T.C. Memo. 2013-204 (*Mitchell II*), denying reconsideration and supplementing ***Mitchell v. Comm'r,*** 138 T.C. No. 16 (2012) (*Mitchell I*)	2003
Friedberg v. Comm'r, T.C. Memo. 2013-224 (*Friedberg II*), reversing in part and supplementing ***Friedberg v. Comm'r***, T.C. Memo. 2011-238 (*Friedberg I*)	2003
Gorra v. Comm'r, T.C. Memo. 2013-254	2006
61 York Acquisition, LLC v. Comm'r, T.C. Memo. 2013-266	2006
2014	
Mountanos v. Comm'r, T.C. Memo. 2014-38 (*Mountanos II*), denying reconsideration of and supplementing ***Mountanos v. Comm'r***, T.C. Memo. 2013-138 (*Mountanos I*)	2005
Esgar Corp. v. Comm'r, 744 F.3d 648 (10th Cir. 2014) (*Esgar II*), aff'g ***Esgar Corp. v. Comm'r***, T.C. Memo. 2012-35 (*Esgar I*) and ***Tempel v. Comm'r***, 136 T.C. 341 (2011)	2004
Wachter v. Comm'r, 142 T.C. No. 7 (2014)	2004, 2005, 2006
Kaufman v. Comm'r, T.C. Memo. 2014-52 (*Kaufman IV*), on remand from, ***Kaufman v. Shulman***, 687 F.3d. 21 (1st Cir. 2012) (*Kaufman III*), vacating and remanding in part ***Kaufman v. Comm'r***, 136 T.C. No. 13 (2011) (*Kaufman II*) and ***Kaufman v. Comm'r***, 134 T.C. No. 9 (2010) (*Kaufman I*)	2003
Palmer Ranch Holdings, Ltd. v. Comm'r, T.C. Memo 2014-79	2006
Chandler v. Comm'r, 142 T.C. No. 16 (2014)	2004, 2005
Whitehouse Hotel, LP v. Comm'r, 755 F.3d 236 (5th Cir. 2014)	

(*Whitehouse IV*), aff'g in part and vacating in part ***Whitehouse Hotel, LP v. Comm'r***, 139 T.C. No. 13 (2012) (*Whitehouse III*), on remand from ***Whitehouse Hotel, LP v. Comm'r***, 615 F.3d 321 (5th Cir. 2010) (*Whitehouse II*), vacating and remanding ***Whitehouse Hotel, LP v. Comm'r***, 131 T.C. 112 (2008) (*Whitehouse I*)	1997
Scheidelman v. Comm'r, 755 F.3d 148 (2d Cir. 2014) (*Scheidelman IV*), aff'g ***Scheidelman v. Comm'r,*** T.C. Memo. 2013-18 (*Scheidelman III*), on remand from ***Scheidelman v. Comm'r,*** 682 F.3d 189 (2d Cir. 2012) (*Scheidelman II*), vacating and remanding ***Scheidelman v. Comm'r,*** T.C. Memo. 2010-151 (*Scheidelman I*)	2004
Seventeen Seventy Sherman Street v. Comm'r, T.C. Memo. 2014-124	2003
Schmidt v. Comm'r, T.C. Memo. 2014-159	2003
Zarlengo v. Comm'r, T.C. Memo. 2014-161	2005

Appendix B

Treasury Regulation § 1.170A-13(c)

Treas. Reg. § 1.170A-13(c). Deductions in excess of $5,000 for certain charitable contributions of property made after December 31, 1984.

(1) General rule.

(i) In general. This paragraph applies to any charitable contribution made after December 31, 1984, by an individual, closely held corporation, personal service corporation, partnership, or S corporation of an item of property (other than money and publicly traded securities to which § 1.170A-13(c)(7)(xi)(B) does not apply) if the amount claimed or reported as a deduction under section 170 with respect to such item exceeds $5,000. This paragraph also applies to charitable contributions by C corporations (as defined in section 1361(a)(2) of the Code) to the extent described in paragraph (c)(2)(ii) of this section. No deduction under section 170 shall be allowed with respect to a charitable contribution to which this paragraph applies unless the substantiation requirements described in paragraph (c)(2) of this section are met. For purposes of this paragraph (c), the amount claimed or reported as a deduction for an item of property is the aggregate amount claimed or reported as a deduction for a charitable contribution under section 170 for such items of property and all similar items of property (as defined in paragraph (c)(7)(iii) of this section) by the same donor for the same taxable year (whether or not donated to the same donee).

* * *

(2) Substantiation requirements.

(i) In general. Except as provided in paragraph (c)(2)(ii) of this section, a donor who claims or reports a deduction with respect to a charitable contribution to which this paragraph (c) applies must comply with the following three requirements:

(A) Obtain a qualified appraisal (as defined in paragraph (c)(3) of this section) for such property contributed. If the contributed property is a partial interest, the appraisal shall be of the partial interest.

(B) Attach a fully completed appraisal summary (as defined in paragraph (c)(4) of this section) to the tax return (or, in the case of a donor that is a partnership or S corporation, the information return) on which the deduction for the contribution is first claimed (or reported) by the donor.

(C) Maintain records containing the information required by paragraph (b)(2)(ii) of this section.

* * *

(3) Qualified appraisal.

(i) In general. For purposes of this paragraph (c), the term “qualified appraisal” means an appraisal document that—

(A) Relates to an appraisal that is made not earlier than 60 days prior to the date of contribution of the appraised property nor later than the date specified in paragraph (c)(3)(iv)(B) of this section;

(B) Is prepared, signed, and dated by a qualified appraiser (within the meaning of paragraph (c)(5) of this section);

(C) Includes the information required by paragraph (c)(3)(ii) of this section; and

(D) Does not involve an appraisal fee prohibited by paragraph (c)(6) of this section.

(ii) Information included in qualified appraisal. A qualified appraisal shall include the following information:

(A) A description of the property in sufficient detail for a person who is not generally familiar with the type of property to ascertain that the property that was appraised is the property that was (or will be) contributed;

(B) In the case of tangible property, the physical condition of the property;

(C) The date (or expected date) of contribution to the donee;

(D) 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, including, for example, the terms of any agreement or understanding that—

(1) Restricts temporarily or permanently a donee's right to use or dispose of the donated property,

(2) Reserves to, or confers upon, anyone (other than a donee organization or an organization participating with a donee organization in cooperative fundraising) any right to the income from the contributed property or to the possession of the property, including the right to vote donated securities, to acquire the property by purchase or otherwise, or to designate the person having such income, possession, or right to acquire, or

(3) Earmarks donated property for a particular use;

(E) The name, address, and (if a taxpayer identification number is otherwise required by section 6109 and the regulations thereunder) the identifying number of the qualified appraiser; and, if the qualified appraiser is acting in his or her capacity as a partner in a partnership, an employee of any person (whether an individual, corporation, or partnerships), or an independent contractor engaged by a person other than the donor, the name, address, and taxpayer identification number (if a number is otherwise required by section 6109 and the regulations thereunder) of the partnership or the person who employs or engages the qualified appraiser;

(F) The qualifications of the qualified appraiser who signs the appraisal, including the appraiser's background, experience, education, and membership, if any, in professional appraisal associations;

(G) A statement that the appraisal was prepared for income tax purposes;

(H) The date (or dates) on which the property was appraised;

(I) The appraised fair market value (within the meaning of §1.170A-1(c)(2)) of the property on the date (or expected date) of contribution;

(J) The method of valuation used to determine the fair market value, such as the income approach, the market-data approach, and the replacement-cost-less-depreciation approach; and

(K) The specific basis for the valuation, such as specific comparable sales transactions or statistical sampling, including a justification for using sampling and an explanation of the sampling procedure employed.

(iii) Effect of signature of the qualified appraiser. Any appraiser who falsely or fraudulently overstates the value of the contributed property referred to in a qualified appraisal or appraisal summary (as defined in paragraphs (c)(3) and (4), respectively, of this section) that the appraiser has signed may be subject to a

civil penalty under section 6701 for aiding and abetting an understatement of tax liability and, moreover, may have appraisals disregarded pursuant to 31 U.S.C. 330(c).

(iv) Special rules.

(A) Number of qualified appraisals. For purposes of paragraph (c)(2)(i)(A) of this section, a separate qualified appraisal is required for each item of property that is not included in a group of similar items of property. See paragraph (c)(7)(iii) of this section for the definition of similar items of property. Only one qualified appraisal is required for a group of similar items of property contributed in the same taxable year of the donor, although a donor may obtain separate qualified appraisals for each item of property. A qualified appraisal prepared with respect to a group of similar items of property shall provide all the information required by paragraph (c)(3)(ii) of this section for each item of similar property, except that the appraiser may select any items whose aggregate value is appraised at $100 or less and provide a group description of such items.

(B) Time of receipt of qualified appraisal. The qualified appraisal must be received by the donor before the due date (including extensions) of the return on which a deduction is first claimed (or reported in the case of a donor that is a partnership or S corporation) under section 170 with respect to the donated property, or, in the case of a deduction first claimed (or reported) on an amended return, the date on which the return is filed.

(C) Retention of qualified appraisal. The donor must retain the qualified appraisal in the donor's records for so long as it may be relevant in the administration of any internal revenue law.

(D) Appraisal disregarded pursuant to 31 U.S.C. 330(c). If an appraisal is disregarded pursuant to 31 U.S.C. 330(c) it shall have no probative effect as to the value of the appraised property. Such appraisal will, however, otherwise constitute a “qualified appraisal” for purposes of this paragraph (c) if the appraisal summary includes the declaration described in paragraph (c)(4)(ii)(L)(2) and the taxpayer had no knowledge that such declaration was false as of the time described in paragraph (c)(4)(i)(B) of this section.

(4) Appraisal summary.

(i) In general. For purposes of this paragraph (c), except as provided in paragraph (c)(4)(iv)(A) of this section, the term "appraisal summary" means a summary of a qualified appraisal that—

(A) Is made on the form prescribed by the Internal Revenue Service;

(B) Is signed and dated (as described in paragraph (c)(4)(iii) of this section) by the donee (or presented to the donee for signature in cases described in paragraph (c)(4)(iv)(C)(2) of this section);

(C) Is signed and dated by the qualified appraiser (within the meaning of paragraph (c)(5) of this section) who prepared the qualified appraisal (within the meaning of paragraph (c)(3) of this section); and

(D) Includes the information required by paragraph (c)(4)(ii) of this section.

(ii) Information included in an appraisal summary. An appraisal summary shall include the following information:

(A) The name and taxpayer identification number of the donor (social security number if the donor is an individual or, employer identification number if the donor is a partnership or corporation);

(B) A description of the property in sufficient detail for a person who is not generally familiar with the type of property to ascertain that the property that was appraised is the property that was contributed;

(C) In the case of tangible property, a brief summary of the overall physical condition of the property at the time of the contribution;

(D) The manner of acquisition (e.g., purchase, exchange, gift, or bequest) and the date of acquisition of the property by the donor, or, if the property was created, produced, or manufactured by or for the donor, a statement to that effect and the approximate date the property was substantially completed;

(E) The cost or other basis of the property adjusted as provided by section 1016;

(F) The name, address, and taxpayer identification number of the donee;

(G) The date the donee received the property;

(H) For charitable contributions made after June 6 1988, a statement explaining whether or not the charitable contribution was made by means of a bargain sale and the amount of any consideration received from the donee for the contribution;

(I) The name, address, and (if a taxpayer identification number is otherwise required by section 6109 and the regulations thereunder) the identifying number of the qualified appraiser who signs the appraisal summary and of other persons as required by paragraph (c)(3)(ii)(E) of this section;

(J) The appraised fair market value of the property on the date of contribution;

(K) The declaration by the appraiser described in paragraph (c)(5)(i) of this section;

(L) A declaration by the appraiser stating that—

(1) The fee charged for the appraisal is not of a type prohibited by paragraph (e)(6) of this section; and

(2) Appraisals prepared by the appraiser are not being disregarded pursuant to 31 U.S.C. 330(c) on the date the appraisal summary is signed by the appraiser; and

(M) Such other information as may be specified by the form.

(iii) Signature of the original donee. The person who signs the appraisal summary for the donee shall be an official authorized to sign the tax or information returns of the donee, or a person specifically authorized to sign appraisal summaries by an official authorized to sign the tax or information returns of such done. In the case of a donee that is a governmental unit, the person who signs the appraisal summary for such donee shall be the official authorized by such donee to sign appraisal summaries. The signature of the donee on the appraisal summary does not represent concurrence in the appraised value of the contributed property. Rather, it represents acknowledgment of receipt of the property described in the appraisal summary on the date specified in the appraisal summary and that the donee understands the information reporting requirements imposed by section 6050L and §1.6050L-1. In general, §1.6050L-1 requires the donee to file an information return with the Internal Revenue Service in the event the donee sells, exchanges, consumes, or otherwise disposes

of the property (or any portion thereof) described in the appraisal summary within 2 years after the date of the donor's contribution of such property.

(iv) Special rules.

* * *

(B) Number of appraisal summaries. A separate appraisal summary for each item of property described in paragraph (c)(1) of this section must be attached to the donor's return. If, during the donor's taxable year, the donor contributes similar items of property described in paragraph (c)(1) of this section to more than one donee, the donor shall attach to the donor's return a separate appraisal summary for each donee. See paragraph (c)(7)(iii) of this section for the definition of similar items of property. If, however, during the donor's taxable year, a donor contributes similar items of property described in paragraph (c)(1) of this section to the same donee, the donor may attach to the donor's return a single appraisal summary with respect to all similar items of property contributed to the same donee. Such an appraisal summary shall provide all the information required by paragraph (c)(4)(ii) of this section for each item of property, except that the appraiser may select any items whose aggregate value is appraised at $100 or less and provide a group description for such items.

(C) Manner of acquisition, cost basis and donee's signature.

(1) If a taxpayer has reasonable cause for being unable to provide the information required by paragraph (c)(4)(ii)(D) and (E) of this section (relating to the manner of acquisition and basis of the contributed property), an appropriate explanation should be attached to the appraisal summary. The taxpayer's deduction will not be disallowed simply because of the inability (for reasonable cause) to provide these items of information.

(2) In rare and unusual circumstances in which it is impossible for the taxpayer to obtain the signature of the donee on the appraisal summary as required by paragraph (c)(4)(i)(B) of this section, the taxpayer's deduction will not be disallowed for that reason provided that the taxpayer attaches a statement to the appraisal summary explaining, in detail, why it was not possible to obtain the donee's signature. For example, if the donee ceases to exist as an entity subsequent to the date of the contribution and prior to the date when the appraisal summary must be signed, and the donor acted reasonably in not obtaining the donee's signature at

the time of the contribution, relief under this paragraph (c)(4)(iv)(C)(2) would generally be appropriate.

(D) Information excluded from certain appraisal summaries. The information required by paragraph (c)(4)(i)(C), paragraph (c)(4)(ii)(D), (E), (H) through (M), and paragraph (c)(4)(iv)(A)(3), and the average trading price referred to in paragraph (c)(4)(iv)(A)(4) of this section do not have to be included on the appraisal summary at the time it is signed by the donee or a copy is provided to the donee pursuant to paragraph (c)(4)(iv)(E) of this section.

(E) Statement to be furnished by donors to donees. Every donor who presents an appraisal summary to a donee for signature after June 6, 1988, in order to comply with paragraph (c)(4)(i)(B) of this section shall furnish a copy of the appraisal summary to such donee.

(F) Appraisal summary required to be provided to partners and S corporation shareholders. If the donor is a partnership or S corporation, the donor shall provide a copy of the appraisal summary to every partner or shareholder, respectively, who receives an allocation of a charitable contribution deduction under section 170 with respect to the property described in the appraisal summary.

(G) Partners and S corporation shareholders. A partner of a partnership or shareholder of an S corporation who receives an allocation of a deduction under section 170 for a charitable contribution of property to which this paragraph (c) applies must attach a copy of the partnership's or S corporation's appraisal summary to the tax return on which the deduction for the contribution is first claimed. If such appraisal summary is not attached, the partner's or shareholder's deduction shall not be allowed except as provided for in paragraph (c)(4)(iv)(H) of this section.

(H) Failure to attach appraisal summary. In the event that a donor fails to attach to the donor's return an appraisal summary as required by paragraph (c)(2)(i)(B) of this section, the Internal Revenue Service may request that the donor submit the appraisal summary within 90 days of the request. If such a request is made and the donor complies with the request within the 90-day period, the deduction under section 170 shall not be disallowed for failure to attach the appraisal summary, provided that the donor's failure to attach the appraisal summary was a good faith omission and the requirements of paragraph (c)(3) and (4) of this section are met (including the completion of the qualified appraisal prior to the date specified in paragraph (c)(3)(iv)(B) of this section).

(5) Qualified appraiser.

(i) In general. The term "qualified appraiser" means an individual (other than a person described in paragraph (c)(5)(iv) of this section) who includes on the appraisal summary (described in paragraph (c)(4) of this section), a declaration that—

(A) The individual either holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis;

(B) Because of the appraiser's qualifications as described in the appraisal (pursuant to paragraph (c)(3)(ii)(F) of this section), the appraiser is qualified to make appraisals of the type of property being valued;

(C) The appraiser is not one of the persons described in paragraph (c)(5)(iv) of this section; and

(D) The appraiser understands that an intentionally false or fraudulent overstatement of the value of the property described in the qualified appraisal or appraisal summary may subject the appraiser to a civil penalty under section 6701 for aiding and abetting an understatement of tax liability, and, moreover, the appraiser may have appraisals disregarded pursuant to 31 U.S.C. 330(c) (see paragraph (c)(3)(iii) of this section).

(ii) Exception. An individual is not a qualified appraiser with respect to a particular donation, even if the declaration specified in paragraph (c)(5)(i) of this section is provided in the appraisal summary, if the donor had knowledge of facts that would cause a reasonable person to expect the appraiser falsely to overstate the value of the donated property (e.g., the donor and the appraiser make an agreement concerning the amount at which the property will be valued and the donor knows that such amount exceeds the fair market value of the property).

(iii) Numbers of appraisers. More than one appraiser may appraise the donated property. If more than one appraiser appraises the property, the donor does not have to use each appraiser's appraisal for purposes of substantiating the charitable contribution deduction pursuant to this paragraph (c). If the donor uses the appraisal of more than one appraiser, or if two or more appraisers contribute to a single appraisal, each appraiser shall comply with the requirements of this paragraph (c), including signing the qualified appraisal and appraisal summary as required by paragraphs (c)(3)(i)(B) and (c)(4)(i)(C) of this section, respectively.

(iv) Qualified appraiser exclusions. The following persons cannot be qualified appraisers with respect to particular property:

(A) The donor or the taxpayer who claims or reports a deductions under section 170 for the contribution of the property that is being appraised.

(B) A party to the transaction in which the donor acquired the property being appraised (i.e., the person who sold, exchanged, or gave the property to the donor, or any person who acted as an agent for the transferor or for the donor with respect to such sale, exchange, or gift), unless the property is donated within 2 months of the date of acquisition and its appraised value does not exceed its acquisition price.

(C) The donee of the property.

(D) Any person employed by any of the foregoing persons (e.g., if the donor acquired a painting from an art dealer, neither the art dealer nor persons employed by the dealer can be qualified appraisers with respect to that painting).

(E) Any person related to any of the foregoing persons under section 267(b), or, with respect to appraisals made after June 6, 1988, married to a person who is in a relationship described in section 267(b) with any of the foregoing persons.

(F) An appraiser who is regularly used by any person described in paragraph (c)(5)(iv)(A), (B), or (C) of this section and who does not perform a majority of his or her appraisals made during his or her taxable year for other persons.

(6) Appraisal fees.

(i) In general. Except as otherwise provided in paragraph (c)(6)(ii) of this section, no part of the fee arrangement for a qualified appraisal can be based, in effect, on a percentage (or set of percentages) of the appraised value of the property. If a fee arrangement for an appraisal is based in whole or in part on the amount of the appraised value of the property, if any, that is allowed as a deduction under section 170, after Internal Revenue Service examination or otherwise, it shall be treated as a fee based on a percentage of the appraised value of the property. For example, an appraiser's fee that is subject to reduction by the same percentage as the appraised value may be reduced by the Internal Revenue Service would be treated as a fee that violates this paragraph (c)(6).

(ii) Exception. Paragraph (c)(6)(i) of this section does not apply to a fee paid to a generally recognized association that regulates appraisers provided all of the following requirements are met:

(A) The association is not organized for profit and no part of the net earnings of the association inures to the benefit of any private shareholder or individual (these terms have the same meaning as in section 501(c)),

(B) The appraiser does not receive any compensation from the association or any other persons for making the appraisal, and

(C) The fee arrangement is not based in whole or in part on the amount of the appraised value of the donated property, if any, that is allowed as a deduction under section 170 after Internal Revenue Service examination or otherwise.

(7) Meaning of terms. For purposes of this paragraph(c)—

* * *

Appendix C

Internal Revenue Code § 170(f)(11)

IRC § 170 Charitable, etc., contributions and gifts.

. . .

(f) Disallowance of deduction in certain cases and special rules.

. . .

(11) Qualified appraisal and other documentation for certain contributions.

(A) In general.

(i) Denial of deduction. In the case of an individual, partnership, or corporation, no deduction shall be allowed under subsection (a) for any contribution of property for which a deduction of more than $500 is claimed unless such person meets the requirements of subparagraphs (B), (C), and (D), as the case may be, with respect to such contribution.

(ii) Exceptions.

(I) Readily valued property. Subparagraphs (C) and (D) shall not apply to cash, property described in subsection (e)(1)(B)(iii) or section 1221(a)(1), publicly traded securities (as defined in section 6050L(a)(2)(B)), and any qualified vehicle described in paragraph (12)(A)(ii) for which an acknowledgement under paragraph (12)(B)(iii) is provided.

(II) Reasonable cause. Clause (i) shall not apply if it is shown that the failure to meet such requirements is due to reasonable cause and not to willful neglect.

(B) Property description for contributions of more than $500. In the case of contributions of property for which a deduction of more than $500 is claimed, the requirements of this subparagraph are met if the individual, partnership or corporation includes with the return for the taxable year in which the contribution is made a description of such property and such other information as the Secretary may require. The requirements of this subparagraph shall not apply to a C corporation which is not a personal service corporation or a closely held C corporation.

(C) Qualified appraisal for contributions of more than $5,000. In the case of contributions of property for which a deduction of more than $5,000 is claimed,

the requirements of this subparagraph are met if the individual, partnership, or corporation obtains a qualified appraisal of such property and attaches to the return for the taxable year in which such contribution is made such information regarding such property and such appraisal as the Secretary may require.

(D) Substantiation for contributions of more than $500,000. In the case of contributions of property for which a deduction of more than $500,000 is claimed, the requirements of this subparagraph are met if the individual, partnership, or corporation attaches to the return for the taxable year a qualified appraisal of such property.

(E) Qualified appraisal and appraiser. For purposes of this paragraph-

(i) Qualified appraisal. The term 'qualified appraisal' means, with respect to any property, an appraisal of such property which-

(I) is treated for purposes of this paragraph as a qualified appraisal under regulations or other guidance prescribed by the Secretary, and

(II) is conducted by a qualified appraiser in accordance with generally accepted appraisal standards and any regulations or other guidance prescribed under subclause (I).

(ii) Qualified appraiser. Except as provided in clause (iii), the term 'qualified appraiser' means an individual who-

(I) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations prescribed by the Secretary,

(II) regularly performs appraisals for which the individual receives compensation, and

(III) meets such other requirements as may be prescribed by the Secretary in regulations or other guidance.

(iii) Specific appraisals. An individual shall not be treated as a qualified appraiser with respect to any specific appraisal unless-

(I) the individual demonstrates verifiable education and experience in valuing the type of property subject to the appraisal, and

(II) the individual has not been prohibited from practicing before the Internal Revenue Service by the Secretary under section 330(c) of title 31, United States Code, at any time during the 3-year period ending on the date of the appraisal.

(F) Aggregation of similar items of property. For purposes of determining

thresholds under this paragraph, property and all similar items of property donated to 1 or more donees shall be treated as 1 property.

(G) Special rule for pass-thru entities. In the case of a partnership or S corporation, this paragraph shall be applied at the entity level, except that the deduction shall be denied at the partner or shareholder level.

(H) Regulations. The Secretary may prescribe such regulations as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations that may provide that some or all of the requirements of this paragraph do not apply in appropriate cases.

Appendix D

Read the instructions before filling out Form 8283,

available at: http://www.irs.gov/pub/irs-pdf/i8283.pdf

Form **8283** (Rev. December 2013) Department of the Treasury Internal Revenue Service

Noncash Charitable Contributions

▶ Attach to your tax return if you claimed a total deduction of over $500 for all contributed property.

▶ Information about Form 8283 and its separate instructions is at *www.irs.gov/form8283*.

OMB No. 1545-0908

Attachment Sequence No. **155**

Name(s) shown on your income tax return: Jane S. Landowner and John P. Landowner

Identifying number: 123-45-6789

Note. Figure the amount of your contribution deduction before completing this form. See your tax return instructions.

Section A. Donated Property of $5,000 or Less and Publicly Traded Securities—List in this section **only** items (or groups of similar items) for which you claimed a deduction of $5,000 or less. Also, list publicly traded securities even if the deduction is more than $5,000 (see instructions).

Part I — Information on Donated Property—If you need more space, attach a statement.

1	(a) Name and address of the donee organization	(b) If donated property is a vehicle (see instructions), check the box. Also enter the vehicle identification number (unless Form 1098-C is attached).	(c) Description of donated property (For a vehicle, enter the year, make, model, and mileage. For securities, enter the company name and the number of shares.)
A		☐	
B		☐	
C		☐	
D		☐	
E		☐	

Note. If the amount you claimed as a deduction for an item is $500 or less, you do not have to complete columns (e), (f), and (g).

	(d) Date of the contribution	(e) Date acquired by donor (mo., yr.)	(f) How acquired by donor	(g) Donor's cost or adjusted basis	(h) Fair market value (see instructions)	(i) Method used to determine the fair market value
A						
B						
C						
D						
E						

Part II — Partial Interests and Restricted Use Property—Complete lines 2a through 2e if you gave less than an entire interest in a property listed in Part I. Complete lines 3a through 3c if conditions were placed on a contribution listed in Part I; also attach the required statement (see instructions).

2a Enter the letter from Part I that identifies the property for which you gave less than an entire interest ▶ ______
If Part II applies to more than one property, attach a separate statement.

b Total amount claimed as a deduction for the property listed in Part I: **(1)** For this tax year ▶ ______
(2) For any prior tax years ▶ ______

c Name and address of each organization to which any such contribution was made in a prior year (complete only if different from the donee organization above):

Name of charitable organization (donee)

Address (number, street, and room or suite no.)

City or town, state, and ZIP code

d For tangible property, enter the place where the property is located or kept ▶ ______

e Name of any person, other than the donee organization, having actual possession of the property ▶ ______

		Yes	No
3a	Is there a restriction, either temporary or permanent, on the donee's right to use or dispose of the donated property?		
b	Did you give to anyone (other than the donee organization or another organization participating with the donee organization in cooperative fundraising) the right to the income from the donated property or to the possession of the property, including the right to vote donated securities, to acquire the property by purchase or otherwise, or to designate the person having such income, possession, or right to acquire?		
c	Is there a restriction limiting the donated property for a particular use?		

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 62299J Form **8283** (Rev. 12-2013)

Name(s) shown on your income tax return	Identifying number
Jane S. Landowner and John P. Landowner	123-45-6789

Section B. Donated Property Over $5,000 (Except Publicly Traded Securities)—List in this section only items (or groups of similar items) for which you claimed a deduction of more than $5,000 per item or group (except contributions of publicly traded securities reported in Section A). An appraisal is generally required for property listed in Section B (see instructions).

Part I Information on Donated Property—To be completed by the taxpayer and/or the appraiser.

4 Check the box that describes the type of property donated:

- a ☐ Art* (contribution of $20,000 or more)
- b ☑ Qualified Conservation Contribution
- c ☐ Equipment
- d ☐ Art* (contribution of less than $20,000)
- e ☐ Other Real Estate
- f ☐ Securities
- g ☐ Collectibles**
- h ☐ Intellectual Property
- i ☐ Vehicles
- j ☐ Other

*Art includes paintings, sculptures, watercolors, prints, drawings, ceramics, antiques, decorative arts, textiles, carpets, silver, rare manuscripts, historical memorabilia, and other similar objects.

**Collectibles include coins, stamps, books, gems, jewelry, sports memorabilia, dolls, etc., but not art as defined above.

Note. In certain cases, you must attach a qualified appraisal of the property. See instructions.

5	(a) Description of donated property (if you need more space, attach a separate statement)	(b) If tangible property was donated, give a brief summary of the overall physical condition of the property at the time of the gift	(c) Appraised fair market value
A	Conservation easement under IRC 170(h) on land in		$600.000
B	Shoreland, Maryland, to protect open space and		
C	wildlife habitat. See attached Deed of Easement and		
D	Supplemental Statement.		

	(d) Date acquired by donor (mo., yr.)	(e) How acquired by donor	(f) Donor's cost or adjusted basis	(g) For bargain sales, enter amount received	See instructions: (h) Amount claimed as a deduction	(i) Date of contribution
A	May 2008	Purchase	$1,800,000			
B			(basis of fee)			
C						
D						

Part II Taxpayer (Donor) Statement—List each item included in Part I above that the appraisal identifies as having a value of $500 or less. See instructions.

I declare that the following item(s) included in Part I above has to the best of my knowledge and belief an appraised value of not more than $500 (per item). Enter identifying letter from Part I and describe the specific item. See instructions. ▶

Signature of taxpayer (donor) ▶ Date ▶

Part III Declaration of Appraiser

I declare that I am not the donor, the donee, a party to the transaction in which the donor acquired the property, employed by, or related to any of the foregoing persons, or married to any person who is related to any of the foregoing persons. And, if regularly used by the donor, donee, or party to the transaction, I performed the majority of my appraisals during my tax year for other persons.

Also, I declare that I perform appraisals on a regular basis; and that because of my qualifications as described in the appraisal, I am qualified to make appraisals of the type of property being valued. I certify that the appraisal fees were not based on a percentage of the appraised property value. Furthermore, I understand that a false or fraudulent overstatement of the property value as described in the qualified appraisal or this Form 8283 may subject me to the penalty under section 6701(a) (aiding and abetting the understatement of tax liability). In addition, I understand that I may be subject to a penalty under section 6695A if I know, or reasonably should know, that my appraisal is to be used in connection with a return or claim for refund and a substantial or gross valuation misstatement results from my appraisal. I affirm that I have not been barred from presenting evidence or testimony by the Office of Professional Responsibility.

Sign Here

Samuel Brown [signature] Associate Vice President

Signature ▶ Mason Brown [signature] Title ▶ President Date ▶ 1/10/14

Business address (including room or suite no.)	Identifying number
Mason H. Brown Appraisals, Inc., 1313 West Grove Ave., Suite 410	98-7654321

City or town, state, and ZIP code
Bakersville, Maryland 45908

Part IV Donee Acknowledgment—To be completed by the charitable organization.

This charitable organization acknowledges that it is a qualified organization under section 170(c) and that it received the donated property as described in Section B, Part I, above on the following date ▶ December 20, 2013 (date of recording)

Furthermore, this organization affirms that in the event it sells, exchanges, or otherwise disposes of the property described in Section B, Part I (or any portion thereof) within 3 years after the date of receipt, it will file **Form 8282,** Donee Information Return, with the IRS and give the donor a copy of that form. This acknowledgment does not represent agreement with the claimed fair market value.

Does the organization intend to use the property for an unrelated use? ▶ ☐ Yes ☑ No

Name of charitable organization (donee)	Employer identification number	
Shore Preservation Land Trust	45-9200126	
Address (number, street, and room or suite no.)	**City or town, state, and ZIP code**	
197 Crab Drive	Baypearl, Maryland 03569	
Authorized signature	**Title**	**Date**
Lulu Smith [signature]	Executive Director	1/13/14

Form 8283 (Rev. 12-2013)

Appendix E

Name(s) shown on income tax return	Identifying Number
Robert T. Landowner	021-34-1234
Susan B. Landowner	083-23-5555

IRS FORM 8283
SUPPLEMENTAL STATEMENT
DONATION OF CONSERVATION EASEMENT

On November 12, 2010, the taxpayers/donors completed the donation of a conservation easement (in Massachusetts, a "conservation restriction") under the provisions of Section 170(h) of the Internal Revenue Code of 1986, as amended, and the regulations thereunder (the "Code"). The conservation restriction encumbers 55 acres, more or less (the "Property"), of a larger parcel of 65 acres, more or less, owned by the taxpayers in the Town of Barnstable, Barnstable County, Massachusetts.

Pursuant to the Treasury Regulations, the value of the conservation restriction was determined by appraising all of the contiguous property owned by the donors before and after the conservation restriction.

There are currently no residences or other habitable dwellings on the encumbered Property. The conservation restriction prohibits any commercial or industrial activities, or the construction of any new residence or habitable dwelling, on the Property. The donation was made to the Barnstable Land Trust (the "donee"), a "qualified organization" as defined at Section 170(h) of the Code.

The Property is within (i) the Barnstable Harbor/Sandy Neck Area of Critical Environmental Concern; (ii) a Massachusetts Natural Heritage and Endangered Species Program Priority Habitat for rare and endangered species; and (iii) a Massachusetts Department of Fisheries, Wildlife and Environmental Law Enforcement BioMap Core Habitat area and a BioMap Supporting Natural Landscape area, all as further described below. Further, the Property is within areas declared by the Town of Barnstable and the Cape Cod Regional Policy Plan as important and deserving of protection and preservation, as further described below.

The donation will protect a number of important conservation values, including the following:

according to the Baseline Documentation Report, certified by the donors and the donee as accurate as of the effective date of the conservation restriction, the Property encompasses salt marsh, tidal creek, coastal bank, cultural field, pine-oak woodland and maple/blueberry swamp habitats; and

the Commonwealth of Massachusetts, through the authority of the Secretary of Energy and Environmental Affairs under General Law Chapter 21A, Section 2(7) may designate Areas of Critical Environmental Concern ("ACEC"), which are places in Massachusetts that receive special recognition because of the quality, uniqueness and significance of their natural and cultural resources; and,

the 1997 Massachusetts Coastal Zone Management Plan promotes a Protected Areas Policy #1 to preserve, restore, and enhance complexes of coastal resources of regional or statewide significance through the Areas of Critical Environmental Concern program; and,

in 1978, the Barnstable Harbor/Sandy Neck ecosystem in the Towns of Barnstable and Sandwich was designated as an Area of Critical Environmental Concern (ACEC); and,

the Property is located within the Barnstable Harbor/Sandy Neck ACEC, and a copy of the Massachusetts Geographic Information System (MassGIS) map of such ACEC, showing the location of the Property, is included in the Baseline Documentation; and,

the Massachusetts Endangered Species Act, M.G.L. c. 131A, protects rare species and their habitats, and the Massachusetts Natural Heritage and Endangered Species Program ("MNHESP") has designated as Priority Habitats the known geographical extent of habitat for state-listed rare plant and animal species; and,

the Property is located within an MNHESP Priority Habitat for rare and endangered species, and a copy of the MassGIS map of such Priority Habitats, showing the location of the Property, is included in the Baseline Documentation; and,

in 2001 the Massachusetts Department of Fisheries, Wildlife and Environmental Law Enforcement published a report entitled *BioMap: Guiding Land Conservation for Biodiversity in Massachusetts,* which identified critical habitat "areas, that if protected, would provide suitable habitat over the long term for the maximum number of Massachusetts' terrestrial and wetland plant, animal species, and natural communities;" and developed a BioMap to identify the areas most in need of protection in order to protect the native biodiversity of the Commonwealth; and,

the BioMap contains Core Habitat areas, which depict the most viable habitats for rare species and natural communities in Massachusetts, and Supporting Natural Landscape areas, which buffer and connect Core Habitat areas and which identify large, naturally vegetated blocks that are relatively free from the impact of roads and other development; and,

the Property is located within a BioMap Core Habitat area and a BioMap Supporting Natural Landscape area, and a copy of the MassGIS map of such BioMap areas, showing the location of the Property, is included in the Baseline Documentation; and,

in 1998, MNHESP published a report entitled *Our Irreplaceable Heritage: Protecting Biodiversity in Massachusetts,* which stated, "We believe that [there are] eight ecosystem types or natural community assemblages [that are] the most important targets for biodiversity conservation. They represent the most threatened or ecologically essential areas for rare plants and animals in Massachusetts," (p. 29) and specifically identified coastal natural communities as standing out "as some of the most biologically diverse lands in the Commonwealth" and singled out salt marsh in particular as important to conserve and restore (p. 30), and the Property contains approximately 4.49 acres of salt marsh habitat; and,

in 2003, a Statewide Land Conservation Plan was drafted, which identifies the most significant available, undeveloped and unprotected open space lands needed to protect, among other things, biodiversity habitats; and,

the Property is included in the Statewide Land Conservation Plan, and a copy of the MassGIS map of such Statewide Land Conservation Plan, showing the location of the Property, is included in the Baseline Documentation; and,

the 1997 Massachusetts Coastal Zone Management Plan promotes a Coastal Hazards Policy#1 to preserve, protect, restore, and enhance the beneficial functions of storm damage prevention and flood control provided by natural coastal landforms, such as dunes, beaches, barrier beaches, coastal banks, land subject to coastal storm flowage, salt marshes, and land under the ocean; and,

the Property consists of coastal banks, land subject to coastal storm flowage, salt marshes and land under the ocean and lies partially within FEMA Zone A and Zone V coastal floodplain, a high hazard area, and a copy of the official FEMA flood insurance rate map, showing the location of the Property, is included in the Baseline Documentation; and,

in August 2001, the Association for the Preservation of Cape Cod (APCC) produced a map depicting, among other things, residential land of 2.5 acres or more on which a potential conservation restriction could be placed, and the Property is identified on APCC's map as falling within this category; and,

in 2003, The Compact of Cape Cod Conservation Trusts, Inc. completed its *Cape Cod Wildlife Conservation Project* ("Wildlife Project"), a wildlife habitat analysis and parcel ranking for all vacant or underdeveloped parcels on Cape Cod, Massachusetts; and,

the Property was included in the Wildlife Project, and was ranked "High" in terms of its habitat protection priority, and "Maximum," the highest possible ranking, in terms of its wildlife habitat value; and,

the Town of Barnstable developed a *Local Comprehensive Plan*, approved by the Cape Cod Commission in 1998, which plan's stated objectives included, among other things:

- To "preserve and improve the ecological integrity of fresh surface water bodies and marine waters" (Goal 2.1.1; p.2-13);
- To "minimize contamination of water resources with nitrogen, in order to maintain…the ecological integrity of streams, ponds and coastal embayments" (Goal 2.1.3; p. 2-23);
- To "preserve and restore the area, quality and functions of Barnstable's coastal and inland wetlands" (Goal 2.3.1; p.2-86);
- To "prevent loss or degradation of critical wildlife and plant habitat, to minimize the impact of new development on wildlife and plant habitat, to maintain existing populations and species diversity, and to maintain areas which will support wildlife's natural breeding, feeding and migration patterns" (Goal 2.4.1; p.2-93);
- To "protect and increase the wildlife population and habitats of Barnstable" (Goal 6.5; p.6-22) and "preserve those wildlife corridors that foster diversity of habitat and link known wildlife resource areas"(Policy 6.5.1; p. 6-22);
- To "encourage the preservation of open space…through creative means of conservation restrictions"(Goal 6.1.2; p. 6-13); and
- To "identify, protect and preserve Barnstable's historic…landscapes and archaeological resources" (Goal 7.5; page 7-24); and,

the Local Comprehensive Plan included a Greenbelt and Fingerlinks Corridors Map identifying potential parcels of vacant and underdeveloped land for its creation, and a map identifying Archaeological Sensitivity Areas; and,

the Property is identified on the Greenbelt and Fingerlinks Corridors Map as one of the potential parcels for the creation of such corridor within the Town of Barnstable; and,

the Property is located within a Town of Barnstable primary area of archaeological sensitivity, defined as an area within 1000 feet of a marine or marine related ecosystem and which has a high probability of containing prehistoric archaeological sites; and,

the Town of Barnstable developed an *Open Space Plan* (1984, amended 1987, 1998, and 2005) with a goal of preserving "quality open spaces throughout the Town which protect and enhance its visual heritage..." and which identified, among other things, the following community objectives:

- To acquire, retain, preserve and protect a maximum amount of open space for

the community and its natural and wildlife habitats (Goal 1, 2005), with priorities focused on, among things, lands adjacent to designated protected or potential open space, lands adjacent to wetlands, and lands providing wildlife corridors, including areas within and abutting Core Habitats identified by the Massachusetts Natural Heritage and Endangered Species Program, and encourage the use of creative regulatory and non-regulatory land protection tools such as conservation restrictions;

- To protect the environmental health of Barnstable's surface water resources (Goal 2, 2005);
- To protect and enhance Barnstable's unique and fragile natural and cultural resources including scenic beauty, historic areas and unique habitats (Goal 6, 2005);
- To protect and increase wildlife population and habitats (Goal 10, 2005); and,

in 1981 the Town of Barnstable adopted a Conservation Restriction Program consisting of policies and guidelines, in particular an *Open Space Policy*, approved by the Board of Selectmen, Assessors and Conservation Commission, which encourages the use of conservation restrictions in perpetuity to protect natural resources in accordance with the purposes of the Open Space Plan, and which further specified that purposes of a conservation restriction could include the following:

- prevent disturbance of wetlands,
- preserve open space,
- preserve important natural habitats of fish, wildlife or plants,
- protect marine water quality,
- limit or prevent construction on land of natural resource value; and,

in July, 1991, the Barnstable Assembly of Delegates, pursuant to the Cape Cod Commission Act (Chapter 716 of the Acts of 1989), adopted a *Regional Policy Plan*, amended in 1996 and further amended in 2002 and 2009 , which provided, *inter alia* (references are to the 2009 Plan):

- a Wetlands Goal to "preserve and restore the quality and quantity of inland and coastal wetlands and their buffers on Cape Cod" (p.52);
- a Wildlife and Plant Habitat Goal to "prevent loss or degradation of critical wildlife and plant habitat, to minimize the adverse impact of new development on wildlife and plant habitat and to maintain existing populations and species diversity" (p. 55), stating that "renewed commitment to protect the most ecologically sensitive undeveloped lands through land acquisition and other permanent conservation measures is also warranted";

- an Open Space and Recreation Goal to “preserve and enhance the availability of open space that provides wildlife habitat…and protects the region’s natural resources and character” (p.57), with a recommended Town Action of working with “local land conservation organizations to identify, acquire by fee simple or conservation restriction, and manage open space to meet projected community needs. Priority should be given “to the protection of significant natural and fragile areas as identified on the Cape Cod Significant Natural Resources Areas map.” (p.58); and,
- a Heritage Preservation/Community Character Goal to “protect and preserve the important historic and cultural features of Cape Cod’s landscape…that are critical components of the region’s heritage and economy” (p. 80); and,

the Regional Policy Plan includes a Significant Natural Resources Areas Map, which shows, among other things, rare species habitat, priority natural communities, wetlands, and critical upland areas; and,

the Property is located within a Regional Policy Plan Significant Natural Resource Area, and a copy of the map, showing the location of the Property, is included in the Baseline Documentation; and,

the Great and General Court of Massachusetts established the Old Kings Highway Regional Historic District on the northern shore of Barnstable County through Chapter 740 of the Acts of 1973; and,

the Property is located on the north side of Route 6A within the Old Kings Highway Regional Historic District; and,

the Property is visible from Barnstable Harbor, the Great Marsh and Sandy Neck, and therefore is seen by Barnstable residents and tourists on a regular basis; and,

the Property is a substantial contributing element to the overall scenic and cultural character of the area by maintaining the land predominantly in its natural condition.

Therefore, the conservation purposes under Section 170(h) of the Code furthered by the donation of the conservation restriction include the following: (i) the preservation of significant relatively natural habitat of plants and similar ecosystems, under Section 170(h)(4)(A)(ii); (ii) the preservation of open space for the scenic enjoyment of the general public, which yields a significant public benefit, under Section 170(h)(4))(A)(iii)(I); and (iii) the preservation of open space pursuant to clearly delineated local governmental policy, which yields a significant public benefit, under Section 170(h)(4)(A)(iii)(II).

The taxpayers acquired a portion of the property by purchase in 1996, and other portions of the property by gift, beginning in the 1970s. Therefore, the taxpayers are unable at this time to determine with accuracy the basis of the Property.

Applying the Direct Sales Comparison Approach combined with the Cost of Development or "Subdivision" Approach, the appraisers concluded that the market value of the conservation restriction was derived as follows:

a. Market value of the entire contiguous 65 acres before donation of the conservation restriction: $____________
b. Market value of the entire contiguous 65 acres after donation of the conservation restriction: $____________
c. Market value of the conservation restriction: $____________

A copy of the qualified appraisal that substantiates these values and verifies the appraisal methodology is filed with this Form 8283 and the donor's tax return. A copy of the recorded conservation restriction is included in the appraisal report.

Neither the donors, related family members, nor related entities (as defined by the Treasury Regulations) own any other contiguous property or nearby property the value of which is enhanced by the donation of this conservation restriction, so no further adjustment was required to the conclusion of value. The donation of the conservation restriction was not made to obtain a permit or other approval from a local or other governing authority, nor was the donation required by any contractual obligation. The Property was not encumbered by a mortgage at the time of the donation of the conservation restriction.

The condition of the Property was documented and established through extensive baseline documentation acknowledged by the donors and the donee as an accurate representation of the condition of the Property on the effective date of the donation. The Baseline Documentation Report is filed with this Form 8283 and the donor's tax return, as is a copy of the letter from the donee to the taxpayers sent pursuant to the provisions of Section 170(f)(8) of the Code.

The conservation restriction was recorded on November 12, 2010, at the Barnstable County Registry of Deeds, Barnstable County, Massachusetts.

Appendix F

Conservation Easement Blog Posts
(with live links to sources)

2014

Maryland Land Trust and Attorney General Enforce a Conservation Easement
http://lawprofessors.typepad.com/nonprofit/2014/08/maryland-land-trust-and-attorney-general-enforce-a-conservation-easement-.html

Federally-Funded Conservation Easement Thwarts Marijuana Production
http://lawprofessors.typepad.com/nonprofit/2014/08/federally-funded-conservation-easement-thwarts-marijuana-production.html

Maine Supreme Judicial Court Holds that Conservation Lands Open to the Public are Exempt from Property Tax
http://lawprofessors.typepad.com/nonprofit/2014/08/maine-supreme-judicial-court-holds-that-conservation-lands-open-to-the-public-are-exempt-from-proper.html

Zarlengo v. Commissioner—Conservation Easement Overvalued and Not Protected In Perpetuity Until Recorded
http://lawprofessors.typepad.com/nonprofit/2014/08/zarlengo-v-commissionerconservation-easement-not-protected-in-perpetuity-until-recorded-and-overvalued.html

Schmidt v. Commissioner—Conservation Easement Overvalued But No Penalties Imposed
http://lawprofessors.typepad.com/nonprofit/2014/08/schmidt-v-commissionerconservation-easement-overvalued-but-no-penalties-imposed.html

Seventeen Seventy Sherman Street, LLC v. Commissioner—Conservation Easement Conveyed for Quid Pro Quo Not Deductible and Negligence Penalty Applied
http://lawprofessors.typepad.com/nonprofit/2014/06/seventeen-seventy-sherman-street-llc-v-commissionerconservation-easement-conveyed-for-quid-pro-quo-not-deductible-and-ne.html

Scheidelman v. Commissioner (Again)—Second Circuit Affirms Tax Court's Holding that Façade Easement Had No Value
http://lawprofessors.typepad.com/nonprofit/2014/06/scheidelman-v-commissioner-againsecond-circuit-affirms-tax-courts-holding-that-façade-easement-had-n.html

Whitehouse Hotel v. Commissioner (Again)—5th Circuit Affirms Tax Court's Façade Easement Valuation But Vacates on Penalties
http://lawprofessors.typepad.com/nonprofit/2014/06/whitehouse-hotel-v-commissioner-again5th-circuit-affirms-tax-courts-façade-easement-valuation-but-va.html

Chandler v. Commissioner—Façade Easements Had No Value and Strict Liability Penalty Applied for 2006
http://lawprofessors.typepad.com/nonprofit/2014/06/chandler-v-commissionerfaçade-easements-had-no-value-and-strict-liability-penalty-applied-for-2006.html

Massachusetts Supreme Judicial Court Holds that Conservation Land Open to the Public is Exempt from Property Tax
http://lawprofessors.typepad.com/nonprofit/2014/05/massachusetts-supreme-judicial-court-rules-on-property-tax-exemption-for-conservation-lands.html

Palmer Ranch v. Commissioner—$19.9 million Conservation Easement Deduction Allowed Based on "Reasonably Probable" Rezoning
http://lawprofessors.typepad.com/nonprofit/2014/05/palmer-ranch-v-commissioner199-million-conservation-easement-deduction-allowed-based-on-reasonably-p.html

Kaufman v. Commissioner (Again)—Façade Easement Had No Value and Penalties Imposed
http://lawprofessors.typepad.com/nonprofit/2014/04/kaufman-v-commissioner-againfaçade-easement-had-no-value-and-penalties-imposed.html

Glass v. Van Lokeren—Conservation Easement Donors Sue Land Trust
http://lawprofessors.typepad.com/nonprofit/2014/03/glass-v-van-lokerendisgruntled-conservation-easement-donors-sue-land-trust.html

IRS Bars Appraisers from Valuing Facade Easements for Five Years
http://lawprofessors.typepad.com/nonprofit/2014/03/irs-bars-appraisers-from-valuing-facade-easements-for-five-years.html

Perpetual Conservation Easements: What Have We Learned and Where Should We Go From Here?
http://lawprofessors.typepad.com/nonprofit/2014/03/symposium-articles-on-perpetual-conservation-easements.html

Wachter v. Commissioner—North Dakota Conservation Easements are Not Deductible
http://lawprofessors.typepad.com/nonprofit/2014/03/wachter-v-commissionernorth-dakota-law-precludes-federal-deductions-for-conservation-easement-donations.html

Esgar v. Commissioner—10th Circuit Affirms Tax Court: Conservation Easements Were Overvalued, Income From State Tax Credit Sales Was Short Term Capital Gain
http://lawprofessors.typepad.com/nonprofit/2014/03/esgar-v-commissioner10th-circuit-affirms-tax-court-conservation-easements-were-overvalued-income-fro.html

Mountanos v. Commissioner Revisited – Conservation Easement Donor Not Permitted to Avoid Gross Valuation Misstatement
http://lawprofessors.typepad.com/nonprofit/2014/03/mountanos-v-commissioner-revisited-conservation-easement-donor-not-permitted-to-avoid-gross-valuation-misstatement.html

Income From Charitable Organization's Sale of Mitigation Bank Credits is not Unrelated Business Taxable Income
http://lawprofessors.typepad.com/nonprofit/2014/03/income-from-charitable-organizations-sale-of-mitigation-bank-credits-is-not-unrelated-business-taxable-income.html

Route 231 v. Commissioner - Allocation to 1% Partner of 97% of Tax Credits Generated by Conservation Easement Donations Treated as Disguised Sale
http://lawprofessors.typepad.com/nonprofit/2014/03/allocation-to-1-partner-of-97-of-tax-credits-generated-by-conservation-easement-donations-treated-as.html

IRS Rules Tax-Exempt Status of Organization Accepting Conservation Easements Should be Revoked
http://lawprofessors.typepad.com/nonprofit/2014/02/irs-rules-tax-exempt-status-of-organization-accepting-conservation-easements-should-be-revoked.html

Property Tax Exemption of Charitable Organizations' Conservation Lands in Question
http://lawprofessors.typepad.com/nonprofit/2014/01/property-tax-exemption-of-charitable-organizations-conservation-lands-.html

2013

61 York Acquisition, LLC v. Commissioner – $10.7m Facade Easement Deduction Denied For Failure to Restrict Entire Exterior
http://lawprofessors.typepad.com/nonprofit/2013/11/61-york-acquisition-llc-v-commissioner-107m-deduction-for-façade-easement-donation-denied-because-ta.html

Gorra v. Commissioner - Facade Easement Deductible but Gross Valuation Misstatement Penalty Applied
http://lawprofessors.typepad.com/nonprofit/2013/11/gorra-v-commissioner-facade-easement-deductible-but-gross-valuation-misstatement-penalty-applied.html

Friedberg v. Commissioner Revisited—Questionable Appraisal Can Be a "Qualified Appraisal"
http://lawprofessors.typepad.com/nonprofit/2013/09/friedberg-v-commissioner-revisitedquestionable-appraisal-can-be-a-qualified-appraisal.html

Mitchell v. Commissioner Revisited – 170(h) Requires Perpetuation of Conservation Easement Itself, Not Just Conservation Purposes
http://lawprofessors.typepad.com/nonprofit/2013/08/mitchell-v-commissioner-revisited-170h-requires-perpetuation-of-conservation-easement-itself-not-jus.html

IRS Chief Counsel Memorandum Addresses Conservation Easement Valuation
http://lawprofessors.typepad.com/nonprofit/2013/08/irs-chief-counsel-memorandum-addresses-conservation-easement-valuation.html

Carpenter v. Commissioner Revisited - Federally-Deductible Conservation Easements Must be Extinguishable Only in a Judicial Proceeding
http://lawprofessors.typepad.com/nonprofit/2013/07/carpenter-v-commissioner-revisited-federally-deductible-conservation-easements-must-be-extinguishabl.html

Pesky v. U.S. – Deduction for Conservation Easement Donation Not Fraudulent
http://lawprofessors.typepad.com/nonprofit/2013/07/pesky-v-us-deduction-for-conservation-easement-donation-not-fraudulent.html

Graev v. Commissioner - Side Letter Kills Deductions for a Façade Easement Donation
http://lawprofessors.typepad.com/nonprofit/2013/06/graev-v-commissioner-side-letter-kills-deductions-for-a-façade-easement-donation.html

Belk v. Commissioner - Tax Court Reaffirms its Holding that "Floating" Conservation Easements Are Not Deductible
http://lawprofessors.typepad.com/nonprofit/2013/06/belk-v-commissioner-tax-court-reaffirms-its-holding-that-floating-conservation-easements-are-not-ded.html

Belk v. Commissioner - "Floating" Conservation Easements Are Not Deductible
http://lawprofessors.typepad.com/nonprofit/2013/01/more-on-conservation-easements-and-perpetuity.html

Mountanos v. Commissioner - Deduction Denied for Failure to Prove Conservation Easement Had Value
http://lawprofessors.typepad.com/nonprofit/2013/06/mountanos-v-commissioner-conservation-easement-deduction-denied-in-full.html

Façade Easement Appraiser Barred From Preparing Appraisal Reports and Ordered to Turn Over List of Clients
http://lawprofessors.typepad.com/nonprofit/2013/02/façade-easement-appraiser-barred-from-preparing-appraisal-reports-and-ordered-to-turn-over-list-of-clients.html

Pollard v. Commissioner – Conservation Easement Conveyed For Quid Pro Quo Not Deductible
http://lawprofessors.typepad.com/nonprofit/2013/02/pollard-v-commr-conservation-easement-conveyed-for-quid-pro-quo-not-deductible.html

Scheidelman v. Commissioner – A Long Journey to the Denial of a Deduction for a Facade Easement Donation
http://lawprofessors.typepad.com/nonprofit/2013/01/scheidelman-v-commissioner-a-long-journey-to-the-denial-of-a-deduction-for-a-facade-easement-donatio.html

Pesky v. United States – Government Asserts Civil Fraud Penalty in Conservation Easement Donation Case
http://lawprofessors.typepad.com/nonprofit/2013/01/pesky-v-united-states-more-conservation-easement-deduction-cases-.html