

2010

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Repository Citation

Small, Stephen J., "Conservation Easements, Appraisals Thereof, and Form 8283 - The Good, The Bad, and the Ugly" (2010). *William & Mary Annual Tax Conference*. 11.
<https://scholarship.law.wm.edu/tax/11>

**CONSERVATION EASEMENTS, APPRAISALS
THEREOF, AND FORM 8283 - -
THE GOOD, THE BAD, AND THE UGLY**

by

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**William & Mary
56th Annual Tax Conference
Kingsmill Resort
Williamsburg, Virginia
November 12, 2010**

**CONSERVATION EASEMENTS, APPRAISALS
THEREOF, AND FORM 8283 - -
THE GOOD, THE BAD, AND THE UGLY**

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Stephen J. Small, Esq.

- I. **Cutting to the Chase: Filing the 1040, and.....**
- A. Form 8283 – Noncash Charitable Contributions
 - B. Supplemental Statement attached thereto
 - C. Qualified Appraisal report, whether or not required
 - D. Baseline Documentation Report
 - E. Gift letter

*See, generally, Small, The Federal Tax Law of Conservation Easements (Land Trust Alliance, 1986), for annotated commentary on the Income Tax Regulations on easement donations and for a discussion of some of the tax considerations associated with easement donations. See also Preserving Family Lands (Book I), FOURTH edition, Landowner Planning Center, 2009; Preserving Family Lands: Book II – More Planning Strategies for the Future, Landowner Planning Center, 1997; Preserving Family Lands: Book III – New Tax Rules and Strategies and a Checklist, Landowner Planning Center, 2002. See www.lawofficeofstephenssmall.com for the long version of this outline.

II. **FEDERAL TAX CODE RULES: AN OVERVIEW**

A. Cutting to the chase: perpetuity

B. First rule of regulation-writing at IRS: read the statute; read the statute;
read the statute

C. So, the statute follows.....

I.R.C. §170(h) Qualified conservation contribution

(h) Qualified conservation contribution

(1) **In general**

For purposes of subsection (f)(3)(B)(iii), the term “qualified conservation contribution” means a contribution—

- (A) of a qualified real property interest,
- (B) to a qualified organization,
- (C) exclusively for conservation purposes.

(2) **Qualified real property interest**

For purposes of this subsection, the term "qualified real property interest" means any of the following interests in real property:

- (A) the entire interest of the donor other than a qualified mineral interest,
- (B) a remainder interest, and
- (C) a restriction (granted in perpetuity) on the use which may be made of the real property.

(3) **Qualified organization**

For purposes of paragraph (1), the term “qualified organization” means an organization which—

- (A) is described in clause (v) or (vi) of subsection (b)(1)(A), or
- (B) is described in section 501(c)(3) and—
 - (i) meets the requirements of section 509(a)(2), or
 - (ii) meets the requirements of section 509(a)(3) and is controlled by an organization described in subparagraph (A) or in clause (i) of this subparagraph.

(4) **Conservation purpose defined**

(A) In general

For purposes of this subsection, the term “conservation purpose” means—

- (i) the preservation of land areas for outdoor recreation by, or the education of, the general public,
- (ii) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem,
- (iii) the preservation of open space (including farmland and forest land) where such preservation is—
 - (I) for the scenic enjoyment of the general public, or
 - (II) pursuant to a clearly delineated Federal, State, or local governmental conservation policy,and will yield a significant public benefit, or
- (iv) the preservation of an historically important land area or a certified historic structure.

[Note: Section 170(h)(4)(B), as set forth below and before amendment by P.L. 109-280, applies to contributions made before July 26, 2006:]

(B) Certified historic structure

For purposes of subparagraph (A)(iv), the term “certified historic structure” means any building, structure, or land area which—

- (i) is listed in the National Register, or
- (ii) is located in a registered historic district (as defined in section 47(c)(3)(B)) and is certified by the Secretary of the Interior to the Secretary as being of historic significance to the district.

A building, structure, or land area satisfies the preceding sentence if it satisfies such sentence either at the time of the transfer or on the due date (including extensions) for filing the transferor's return under this chapter for the taxable year in which the transfer is made.

[Note: Section 170(h)(4)(B), as set forth below, as added by P.L. 109-280, applies to contributions made after July 25, 2006:]

(B) Special rules with respect to buildings in registered historic districts

In the case of any contribution of a qualified real property interest which is a restriction with respect to the exterior of a building described in subparagraph (C)(ii), such contribution shall not be considered to be exclusively for conservation purposes unless—

- (i) such interest—
 - (I) includes a restriction which preserves the entire exterior of the building (including the front, sides, rear, and height of the building), and
 - (II) prohibits any change in the exterior of the building which is inconsistent with the historical character of such exterior,
- (ii) the donor and donee enter into a written agreement certifying, under penalty of perjury, that the donee—

- (I) is a qualified organization (as defined in paragraph (3)) with a purpose of environmental protection, land conservation, open space preservation, or historic preservation, and
 - (II) has the resources to manage and enforce the restriction and a commitment to do so, and
- (iii) in the case of any contribution made in a taxable year beginning after the date of the enactment of this subparagraph, the taxpayer includes with the taxpayer's return for the taxable year of the contribution—
- (I) a qualified appraisal (within the meaning of subsection (f)(11)(E)) of the qualified property interest,
 - (II) photographs of the entire exterior of the building, and
 - (III) a description of all restrictions on the development of the building.

[Note: Section 170(h)(4)(C), as set forth below, as redesignated and amended by P.L. 109-280, applies to contributions made after August 17, 2006:]

(C) Certified historic structure

For purposes of subparagraph (A)(iv), the term “certified historic structure” means—

- (i) any building, structure, or land area which is listed in the National Register, or
- (ii) any building which is located in a registered historic district (as defined in section 47(c)(3)(B)) and is certified by the Secretary of the Interior to the Secretary as being of historic significance to the district.

A building, structure, or land area satisfies the preceding sentence if it satisfies such sentence either at the time of the transfer or on the due date (including extensions) for filing the transferor's return under this chapter for the taxable year in which the transfer is made.

(5) **Exclusively for conservation purposes**

For purposes of this subsection—

- (A) Conservation purpose must be protected

A contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.

- (B) No surface mining permitted

- (i) In general

Except as provided in clause (ii), in the case of a contribution of any interest where there is a retention of a qualified mineral interest, subparagraph (A) shall not be treated as met if at any time there may be extraction or removal of minerals by any surface mining method.

- (ii) Special rule

With respect to any contribution of property in which the ownership of the surface estate and mineral interests were separated, subparagraph (A) shall be treated as met if the probability of surface mining occurring on such property is so remote as to be negligible.

(6) **Qualified mineral interest**

For purposes of this subsection, the term “qualified mineral interest” means—

- (A) subsurface oil, gas, or other minerals, and
(B) the right to access to such minerals.

III. VALUATION OF AN EASEMENT

- A. §170 rule for “fair market value”
1. Willing buyer/willing seller
 2. What fmv is and is not
 - a. “Other” types of values
 - b. Unrealistic marketplace or no marketplace
 - c. Easy if a regular market
 - d. See Wortmann v. Commissioner, T.C. Memo 2005-227; Whitehouse v. Commissioner, 131 T.C. No. 10, vacated and remanded on appeal, August 10, 2010, 5th Circuit, No. 09-60085.
- B. §170(h) does not tell you how to value an easement; the regulations do and the cases do; see the attached “Appraisal Rules and Questions”
- C. For an easement, four rules; **most appraisers do not get this right**
1. **Rule 1:** if a substantial record of comparable marketplace sales of easements exists, value is based on such comparable sales. Reg. §1.170A-14(h)(3).
 2. **Rule 2:** generally (but not always) "before and after," that is, fair market value of the property before the easement (highest and best use) minus fair market value after the easement. Discussion.
 3. **Rule 3:** if the easement covers a portion of the contiguous property owned by the donor and the donor's family, the value of the easement is equal to the value of the entire contiguous portion before the easement minus the value of the entire contiguous portion after the easement. Reg. §170A-14(h)(3). This is not the same as the “enhancement” rule. Discussion.
 4. **Rule 4:** must consider “enhancement” of any (any) property owned by taxpayer, taxpayer’s family, or “related” parties (with expansive definition of related parties under Reg. §1.170A-14(h)(3)).

IV. THE CHANGING LANDSCAPE

- A. Enormous growth in land trust business for years, but still a “sleepy” field
- B. Sharks started to circle by mid-late 1990s: promoters, bad appraisals, greedy deals
- C. Land trusts were not keeping up with the demand for accurate information
- D. 2003-2004: Washington Post series, Exchange articles, Ethics Plenary at Rally (see www.lawofficeofstephensmall.com, Articles, 10/30/2003 Ethics Plenary address), interest by the Senate Finance Committee, interest by IRS, Notice 2004-41, etc.
- E. Where we are today: Congress
- F. Where we are today: IRS’ current areas of concern
 - 1. Audits: new decisions, more coming
 - 2. Required endowment “contributions”
 - 3. “Conservation buyer” transactions
 - 4. Amending easements
 - 5. Form 990 and instructions
 - 6. Form 8283 and instructions
 - 7. Turner v. Commissioner, T.C. No. 5165-04, 126 T.C. 299!! Read this decision.
 - 8. See Glass v. Commissioner, 124 T.C. 258; affirmed, December 21, 2006, 6th Circuit, No. 06-1398. Read this decision.
 - 9. See Kiva Dunes Conservation, LLC, v. Commissioner, T.C. Memo 2009-145 (June 22, 2009); Hughes v. Commissioner, T.C. Memo 2009-94 (May 6, 2009); Scheidelman v. Commissioner, T.C. Memo 2010-151 (July 14, 2010); Lord v. Commissioner, T.C. Memo 2010-196 (Sept. 8, 2010).
 - 10. Proceeds clause; see Kaufman v. Commissioner, 134 T.C. No. 9 (April 26, 2010).

V. **TAX BENEFITS FROM EASEMENT DONATIONS**

- A. Estate tax benefits: lower the value of the property; avoid the forced sale of the property to pay estate taxes.
1. Run the numbers!! Don't assume anything!! See Chapter 7 of early editions of Preserving Family Lands: Book I, "Cash Sale Compared to Good Planning." See §2031(c).
 2. Potentially less of an issue as estate tax rules change, but keep in mind that real estate values change, too.
- B. Income tax deduction
1. Pre-2006 and post-2009 law (NOW!!) for easement donations and for other donations: gift of property generally deductible up to 30% of adjusted gross income ("AGI"). Five-year carryforward. (A gift of cash is deductible up to 50% of AGI.)
 2. Example: John and Mary have adjusted gross income of \$100,000. They give land with a value of \$100,000 to charity. They can deduct \$30,000 of the gift (30% times \$100,000) in the first year, with a five-year carryforward of the \$70,000 that's left. Any undeducted "value" remaining after six years disappears into thin air.
 3. 2006-2009 law for "qualified conservation contributions," now expired!!
 - a. **Deduction up to 50% of AGI, with 15-year carryforward, for individuals**
 - b. **Deduction up to 100% of AGI, with 15-year carryforward, for "qualified farmers or ranchers"**
 - c. "Qualified farmer or rancher": "gross income" from farming must be greater than 50% of total "gross income" for the taxable year
 - d. Expired 12/31/2009!!!
 - e. See new Preserving Family Lands: Book I
 - f. **Likelihood of extension??**

4. May be state income tax credit; state income tax credits raise complex tax questions. See Davenport and Hocker, "Federal Tax Treatment of State Tax Incentives for Real Estate Donations," Tax Notes, December 4, 2006, pp. 919-924.
5. Allocation of basis to easement, with resulting lower basis in retained interest. Reg. §1.170A-14(h)(3)(iii) and Examples (10), (11), and (12) of Reg. §1.170A-14(h)(4).
 - a. Aunt Sally's farm has a basis of \$400,000 and a value of \$1,000,000; easement lowers value to \$600,000
 - b. Easement is "worth" 40% of the value of the farm; 40% of the basis, or \$160,000, is "assigned" to the easement. Almost always not important.
 - c. Farm basis drops to \$240,000; may or may not be important.
6. Holding period issues; see §§170(e)(1)(A) and 1222(3) and (4): if you don't own the asset for more than one year, when you contribute it to charity your deduction is limited to basis. This issue comes up frequently in "conservation buyer" cases.
7. See discussion of "developer" easements, below.
8. Run the numbers!!

C. Lower property tax

1. Up to local assessors (or state statute), not federal tax law
2. State and local considerations; state statutory issues.
3. Watch out for "revenue base" mentality.
4. Special use assessment considerations and misconceptions

D. Pay attention to who the donor is

1. Corporation, LLC, etc.; **authority to make donation?**
2. S corporation; old rules, newer rules; current rules
3. Trust?
 - a. Whole other seminar
 - b. See Rev. Rul. 2003-123, 2003-2 C.B. 1200, on §642(c) and other matters.
 - c. See Goldsby v. Commissioner, T.C. Memo 2006-274; No. 8232-05.

E. Relevant federal estate and gift tax rules

1. Extraordinarily difficult situation for planners, let alone clients
 - a. Since January 1, 2010, there has been NO ESTATE TAX... for about seven more weeks.
 - b. If Congress takes no further action, on January 1, 2011, the estate tax comes back and the “exclusion” goes back to \$1,000,000!! Ridiculous? Impossible? True!!!
 - c. If the exclusion goes to \$1,000,000, the estate tax will be a significant issue for landowners all across the country.
2. See §2031(c); two benefits
 - a. Exclusion
 - i. \$2,000,000 (the farm)
- 1,000,000 (the easement)
1,000,000 (“after” value)
- 400,000 (the 40% exclusion)
\$ 600,000 (subject to tax)
 - ii. Exclusion is capped at \$500,000

b. **Post-mortem easements (NOT post-mortem fee gifts)**

- i. Situation 1 (see above)
- ii. Situation 2 (see above)
- iii. Situation 3 (see above); Letter Ruling 200418005

F. Market-value sales and bargain sales

G. Partial interest rules; at least three important things to remember:

1. The partial interest rules
2. Treas. Reg. section 1.170A-7(a)(2)(ii) provides that a deduction is allowed without regard to the partial interest rules for a contribution of a partial interest in property if such contribution constitutes “part of a charitable contribution not in trust in which all interests of the taxpayer in the property are given to a charitable organization described in section 170(c)” (emphasis added).
3. Rev. Rul. 75-66, 1975-1 C.B. 85, ruling that, in the instant case, the retained right during the taxpayer's lifetime to train his personal hunting dog on the entire tract, in accordance with the regulations of the Department of the Interior on such use, is not substantial enough to affect the deductibility of the property contributed.

H. Tax-free swaps of real estate and interests in real estate (§1031)

1. Must be exchange of “property held for productive use in a trade or business or for investment” for “property of a like kind which is to be held either for productive use in a trade or business or for investment.”
2. Much litigation, many rulings. Follow the rules carefully!! See Letter Ruling 9431025; Letter Ruling 9829025 (taxpayer's death before completion of deferred exchange ignored). But see Letter Ruling 20004017 (definition of U.S. is “enlarged” to include the U.S. Virgin Islands); Letter Ruling 200118023 (acquisition of the sole interest in a limited liability company, which owns real property, will be treated as acquisition of like-kind replacement property).

3. See especially Letter Rulings 8334026, 9215049, and 9232030, treating as a tax-free like-kind exchange the swap of a conservation easement for farmland. The state law characterization of an easement (for example, property interest or contract right) will potentially be important for §1031 purposes. See also Letter Rulings 9601046, 9621012, and 200203033, with similar holdings on the like-kind issue. But see Rev. Rul. 72-601, 1972-2 C.B. 467 (life estate not like kind with remainder interest).
4. See Letter Ruling 9612009, holding that ecological impact “mitigation credits” qualify as like-kind property; Letter Ruling 200532008, holding as “like-kind” FCC spectrum rights licenses.
5. Watch for post-exchange holding period requirements; see Click v. Commissioner, 78 T.C. 225 (1982).

I. Practice tips

1. Run the title early (“I really mean it”)
 - a. Mortgage rule
 - b. Mineral interest rule
 - c. Other issues
2. Run the numbers
3. See Preserving Family Lands: Book III

VI. OIL AND GAS AND MINERAL ISSUES

A. Statute and regulations

1. What is the deduction about?
2. Minerals: NO surface mineral extraction permitted
3. Oil and gas: LIMITED oil and gas exploration and extraction is permitted, subject to certain conditions. See Treas. Reg. Section 1.170A-14(g)(4).

B. Who owns the resource, landowner or a third party?

C. Landowner owns the resource; landowner wants a deduction

1. Minerals: NO surface mineral extraction permitted
2. Oil and gas: LIMITED oil and gas exploration and extraction is permitted, subject to certain conditions.
3. How limited? Useful analogy: limited residential development (discuss)
4. See Section 170(h)(5) and regulations on inconsistent use: you cannot protect conservation values on one hand and at the same time allow an activity that can destroy those conservation values
5. Bottom line: must agree to limitations on exploration and extraction, **designed to protect conservation values**

D. Third party owns the resource; landowner wants a deduction

1. Minerals: NO surface mineral extraction permitted, so need to satisfy "so remote as to be negligible" test
 - a. Geologist's report
 - b. Likelihood of favorable report?

2. Oil and gas: third party must be subject to, or must agree to, same kind of limitations that landowner would have to agree to (if landowner owned the resource)
 - a. May be difficult (or not) under existing leases or Surface Use Agreements
 - b. May be negotiable (or not) under new leases or SUAs
- E. Compatibility of oil and gas operations with protection of conservation values
 1. Existing operations
 2. Future operations
- F. Impact on valuation

VII. “DEVELOPER” EASEMENTS

- A. See Stephen J. Small, “Proper – and Improper – Deductions for Conservation Easement Donations, Including Developer Donations,” Tax Notes, October 11, 2004, pp. 217-224. **Five problems** for a developer.
- B. **First:** “conservation purposes” test under §170(h).
- C. **Second:** Harry Investor proposes donating to the town a conservation easement if the town approves his application for a new subdivision. **Quid pro quo** trap: Harry’s “deal” is not a gift, and no deduction is allowable. This not just “conservation” law, it is part of the underlying law of charitable contributions. See Ottawa Silica Company, Ct. Cl. No. 27-278, 49 AFTR 2d 1160 (1982); Jordan Perlmutter, 45 T.C. 311 (1965); and Reg. §1.170A-14(h)(3)(i). For a rather confusing discussion of a **quid pro quo** situation, see Letter Ruling 9239002. For another approach to this issue, read Perlmutter carefully and see Letter Ruling 9352006.
- D. **Third:** appraisal rules, notably “Rule 3”
- E. **Fourth:** basis allocation rules

F. **Fifth:** if Harry can get by the quid pro quo hurdle, will his deduction be limited to his “basis” (or cost) of the donated property? See §170(e)(1)(A) and Pasqualini v. Commissioner, 103 T.C. 1 (1994):

1. On the matter of “dealer” status, for cases favoring the taxpayer, see, Charles E. Meig, 32 T.C. 1314 (1959), acq. 1960-2 C.B. 6; Eline Realty Co., 35 T.C. 1 (1960), acq. 1961-1 C.B. 4; Frank H. Taylor & Son, Inc., T.C. Memo 1973-362; DuVal v. Commissioner, T.C. Memo 1994-603; Paullus v. Commissioner, T.C. Memo 1996-419. For cases in which the results have generally been unfavorable to the taxpayer, see, for example, Biedenharn Realty Co., Inc. v. United States [76-1 USTC Par. 9194], 526 F.2d 409 (5th Cir. 1976) (en banc), cert. denied, 429 U.S. 819, 97 S. Ct. 64, 60 L. Ed. 2d 79 (1976); Houston Endowment, Inc. v. United States [79-2 USTC Par. 9690], 606 F.2d 77 (5th Cir. 1979); United States v. Winthrop [69-2 USTC Par. 9686], 417 F.2d 905 (5th Cir. 1969); Suburban Realty Co. v. U.S., [80-1 USTC Par. 9351], 615 F.2d 171 (5th Cir. 1980). The Internal Revenue Service has an “ordinarily will not rule” policy on the question of whether property is held for sale to customers in the ordinary course of a trade or business. Sections 3 and 4 of Rev. Proc. 2002-3, IRB 2002-1, 117; see Letter Ruling 9537018.
2. Very tricky issue: when does a landowner become a “dealer”? Watch out for situations in which a “mere” landowner blurs the line and begins to engage in development activity with respect to a particular piece of real estate.
3. See the interesting separate line of cases on “liquidation” of inherited (or gifted) property, including J.C. Simpson Est., T.C. Memo 1962-71; Yunker v. Commissioner, [58-1 USTC Par. 9487], 256 F. 2d 130 (6th Cir. 1958) (“this elderly couple” could not have been “engaged in the ordinary course of business of selling lots”); Reidel v. Commissioner, [58-2 USTC Par. 9966], 261 F. 2d 731 (5th Cir. 1958). Compare United States v. Winthrop, cited above.
4. Common error by developers (and non-developers) in this field: failure to start planning with a review of the “conservation purposes” test. Deduction isn’t simply for foregone building; first you must meet the conservation purposes test, then you get a deduction for foregone value.
5. See Turner v. Commissioner, cited above. Read the case and see how many things Mr. Turner did incorrectly.

VIII. **SUBSTANTIATION (REG. §1.170A-13T(C)(1))**

- A. A taxpayer who claims a value in excess of \$5,000 for a charitable gift must have a “qualified appraisal” supporting the claimed value.
- B. If the value of the deduction is more than \$500,000, the “qualified appraisal” must also be attached to the return.
- C. The taxpayer must file with his or her tax return **IRS Form 8283**, “Noncash Charitable Contributions.” See Form 8283 and the instructions!! Generalization: many easement donors do not have a properly filled out 8283 or Supplemental Statement to the Form 8283.
- D. Form 8283 requires an acknowledgment by the donee organization. If the donee organization disposes of the property within two years, the organization must file with the **IRS Form 8282**, “Donee Information Return,” and must provide the taxpayer with a copy.
- E. A “qualified appraisal” must include, among other things, a description of the property, the method of valuation used to determine the fair market value of the property, certain information about the appraiser, and a description of the fee arrangement between the donor and the appraiser.
- F. The “qualified appraisal” must be done by a “qualified appraiser.” See the new rules on who can be a “qualified appraiser”; See Notice 2006-96. Under some circumstances, however, reliance on the appraiser is not sufficient.
- G. The appraisal cannot be completed more than sixty days prior to the date of the gift. The appraisal must be received by the donor before the due date (including extensions) for the federal tax return for the year in which the gift was made. In the case of a deduction first claimed on an amended return, the appraisal must be received by the donor no later than the date on which the amended return is filed. Reg. §1.170A-13(c)(3)(i)(A).
- H. Failure to comply with the appraisal requirements can mean that the deduction will not be allowed. In more than one case, the IRS has moved to disallow an easement deduction because the appraisal was totally inadequate. See, Bond v. Commissioner, 100 T.C. 32 (1993); Hewitt v. Commissioner, 109 T.C. 258 (1997), Ney v. Commissioner, T.C. Summ. Op. 2006-154; No. 10257-05S; September 19, 2006.
- I. See also the substantiation requirements under §170(f)(8) and Weiner v. Commissioner, T.C. Memo 2002-153, aff’d., No. 02-73609 (9th Cir. July 8, 2004); Addis v. Commissioner, 118 T.C. 32 (2002), aff’d., No. 02-

73628 (9th Cir. July 8, 2004); **DEDUCTION DENIED FOR FAILURE TO SUBSTANTIATE**: Gomez v. Commissioner, T.C. Summ. Op. 2008-93; Bruzewicz v. USA, U.S.D.C. N.D. Ill., No. 07-C-4074, March 25, 2009; but see Simmons v. Commissioner, T.C. Memo 2009-208; **DEDUCTION DENIED, NOT A QUALIFIED APPRAISAL**, see Scheidelman v. Commissioner, cited above; **DEDUCTION DENIED, NOT A QUALIFIED APPRAISAL**, see Lord v. Commissioner, cited above. The IRS is winning these cases on administrative requirements!!