

Conservation Easement Audit Techniques Guide

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Chapter 1: Introduction to Conservation Easements

Statement of Purpose

The purpose of this audit techniques guide (ATG) is to provide guidance for the examination of charitable contributions of conservation easements. Users of this guide will learn about the general requirements for charitable contributions and additional requirements for contributions of conservation easements.

This ATG includes examination techniques and an overview of the valuation of conservation easements. It also includes a discussion of penalties, which may be applicable to taxpayers and others involved in the conservation easement transaction.

This guide is not designed to be all-inclusive. It is not a comprehensive training manual on the valuation of conservation easements.

Overview

To be deductible, donated conservation easements must be legally binding, permanent restrictions on the use, modification and development of property such as parks, wetlands, farmland, forest land, scenic areas, historic land or historic structures. The restrictions on the property must be in perpetuity. Current and future owners of the easement and the underlying property must all be bound by the terms of the conservation easement deed.

The general rule is that no charitable contribution deduction is allowed for a transfer of property of less than the taxpayer's entire interest in the property. I.R.C. § 170(f)(3). Section 170(f)(3)(B)(iii) provides an exception to the partial interest rule for contributions of qualified conservation easements.

Internal Revenue Code (IRC) § 170(h) states that a qualified conservation contribution is a contribution of a qualified real property interest (i.e., a restriction granted in perpetuity on the use which may be made of the real property) to a qualified organization exclusively for conservation purposes. The IRC and accompanying Treasury regulations outline the requirements that must be met before a contribution is deductible.

Qualified organizations that accept conservation easements must have a commitment to protect the conservation purposes of the donation in perpetuity and must have sufficient resources to enforce compliance with the terms of the easement deed.

IRC § 170(h)(4)(A) specifies the four deductible types of conservation contributions:

- Preservation of land areas for outdoor recreation by, or the education of, the general public.
- Protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem.
- Preservation of open space (including farmland and forest land).
- Preservation of a historically important land area or a certified historic structure.

The donation of a conservation easement that meets all statutory and regulatory requirements, including specific substantiation requirements, can be claimed as a charitable contribution deduction.

The value of a conservation easement must be determined in a qualified appraisal prepared and signed by a qualified appraiser. The value of the contribution is the fair market value (FMV) of the conservation easement at the time of the contribution. To the extent there is a substantial record of sales of conservation easements comparable to the donated easement, the FMV is based on the sales price of such comparables. If there is no substantial record of market-place sales, the value is generally the difference between the FMV of the underlying property before and after the easement is granted to the donee. Because there is usually no substantial record of comparable sales, a before and after valuation is used in most cases.

To conduct a quality examination, in-depth development of facts is necessary. Examiners have primary responsibility for addressing the taxpayer's compliance with all statutory and regulatory requirements.

Valuation is also an important component of this tax issue. A multi-divisional approach, working with LB&I Engineering, Counsel, and Tax Exempt and Government Entities (TEGE), may be needed to properly develop tax issues in a conservation easement examination.

Taxpayers, return preparers, appraisers, and others involved with an improper or overvalued conservation easement may be subject to various penalties.

While the charitable contribution of a conservation easement may be the most significant issue on the tax return, Examiners should be alert to other related tax issues such as a sale of state tax credits, basis adjustments, or a recapture of rehabilitation tax credits.

Getting Started

Information about conservation easements including contacts, job aids, and other reference materials are on the IRS Intranet at My SB/SE under Examination, Issues and Procedures.

Definition of Conservation Easement

“Conservation easement” is the generic term for easements granted for preservation of land areas for outdoor recreation, protection of a relatively natural habitat for fish, wildlife, or plants, or a similar ecosystem, preservation of open space for the scenic enjoyment of the public or pursuant to a Federal, State, or local governmental conservation policy, and preservation of a historically important land area or historic building.

Conservation easements permanently restrict how land or buildings are used. The “deed of conservation easement” describes the conservation purpose, the restrictions and the permissible uses of the property. The deed must be recorded in the public record and must contain legally binding restrictions enforceable by the donee organization.

The donor gives up certain rights specified in the Deed of Conservation Easement, but retains

ownership of the underlying property. The extent and nature of the donee organization's control depends on the terms of the conservation easement deed. The organization has an interest in the encumbered property that runs with the land, which means that its restrictions are binding not only on the landowner who grants the easement but also on all future owners of the property.

Tax Issues

Taxpayers must satisfy numerous statutory provisions in order to claim a noncash charitable contribution deduction for the donation of a conservation easement. Some deficiencies revealed in examinations of conservation easements include:

- Failure to meet charitable contributions rules, for example the easement was granted in exchange for a change in zoning by the county (a quid pro quo).
- Noncompliance with substantiation requirements.
- Inadequate documentation of or lack of conservation purpose.
- Lack of perpetuity evidenced by terms in the deeds.
- Reserved property rights inconsistent with conservation purpose.
- Failure to comply with subordination rules.
- Failure to provide the donee organization with the specified proportionate share of the proceeds in the event of extinguishment.
- Use of improper appraisal methodologies.
- Failure to report income from the sale of state tax credits.
- Overvalued conservation easements.

The IRS has identified some promoters and appraisers involved in conservation easement tax schemes.

Chapter 2: Statutory Requirements for All Charitable Contributions

Overview

IRC § 170 contains the rules that govern income tax deductions for charitable contributions, including donations of conservation easements.

In order to claim a charitable contribution deduction for a conservation easement, taxpayers must meet the statutory requirements applicable to all charitable contributions, as well as the specific requirements for conservation easement donations.

See [Publication 526, Charitable Contributions](#) (PDF), [Publication 561, Determining the Value of Donated Property](#) (PDF), and [Publication 1771, Charitable Contributions - Substantiation and Disclosure Requirements](#) (PDF).

Charitable Contribution Definition

A charitable contribution is a voluntary gift to or for the use of a qualifying organization. It is a transfer of money or property made with charitable intent and without receipt of adequate consideration. IRC § 170(c); Treas. Reg. § 1.170A-1(h).

Qualified Organization

A taxpayer can only deduct contributions made to organizations eligible to accept tax-deductible contributions, which are organizations described in IRC § 170(c).

An organization accepting tax-deductible contributions of conservation easements must meet additional requirements to be a qualified organization. See Chapter 4 for additional guidance on qualified organizations.

Charitable Intent

A charitable contribution is a donation or gift to, or for the use of, a qualified organization. It is voluntary and made without receipt, or the expectation of receipt, of anything of economic value.

A transfer of money or property is not voluntary if it is required or is made with the expectation of a direct or indirect benefit. A benefit received or expected to be received in connection with a payment or transfer by the taxpayer is called a quid pro quo.

See [Chapter 8](#) for additional discussion of charitable intent and quid pro quo.

Real Estate Contributions

For a contribution of real estate, including a contribution of a conservation easement, there is no “transfer,” and therefore no deductible charitable contribution, **unless** there is:

- A deed signed by the donor transferring the property and
- Acceptance by the qualified organization.

Conservation easement deeds must be recorded in the public record.

Partial Interest Rule

Generally, in order to have a deductible contribution, a taxpayer must contribute the entire interest in the property. A partial interest is generally not deductible. This is known as the “partial interest” rule. IRC § 170(f)(3)(A).

A qualified conservation contribution is deductible even though it is a partial interest. It is an exception to the partial interest rule. IRC § 170(f)(3)(B)(iii) and (h).

Conditional Gifts

If the contribution is a conditional gift, the donor cannot take a deduction.

Example: If Justin transfers land in Maine to a city on the condition that the land is used by the city for an unlikely use (e.g., alligator habitat), there is no deductible charitable contribution before the time that the specified use actually occurs.

However, if there is only a negligible chance that the gift will be defeated, the deduction is allowed. Treas. Reg. §§ 1.170A-1(e) and 1.170A-7(a)(3).

Example: Susan transfers land to a city on the condition that the land is used by the city for a public park. If, on the date of the gift, the city plans to use the property as a park, and the possibility that it will not be used as a park is so remote as to be negligible, the deduction is allowable at the time of the transfer to the city.

Earmarking

A taxpayer may not deduct earmarked contributions (e.g., for the benefit of a particular individual or family). Earmarked amounts are treated as transfers to the earmarked beneficiary and not as transfers to the section 170(c) organization.

Example: Steven made payments to his church. He earmarked the payments for John, a needy individual. Steven cannot deduct the amount of the payments since he earmarked the funds for John. The church was merely a conduit for Steven's gift to John.

Year of Donation

A taxpayer may deduct contributions paid within the taxable year. IRC § 170(a)(1) and Treas. Reg. § 1.170A-1(b).

A promise to pay cash or transfer property in the future is not deductible. The taxpayer may deduct payments made by check when the check is mailed or delivered to the section 170(c) organization. Treas. Reg. § 1.170A-1(b).

For contributions of real estate, the year of the deduction is the year in which the real estate is transferred under the law of the state where the real estate is located. However, for conservation easements, the year of the deduction is the year of recordation.

Example: A conservation easement was granted to a qualified organization on December 20, 2007, as evidenced by the dated signatures on the conservation easement deed. However, the easement was not recorded in the public records until March 12, 2008. The year of donation is 2008.

Substantiation of Noncash Contributions

A charitable contribution is not deductible unless it is properly substantiated in accordance with the Internal Revenue Code and the regulations. The documentation requirements vary depending on the date of contribution, nature of the contribution (noncash in the case of a conservation easement), type of property contributed, and dollar amount claimed.

For a conservation easement, the following documents are required:

1. Contemporaneous written acknowledgment from the charity. I.R.C. § 170(f)(8). This acknowledgment must:
 - a. Describe the property received by the donee;
 - b. Contain a statement of whether the donee provided any goods or services in consideration in whole or in part, for the gift; and
 - c. Provide a description of and a good faith estimate of the goods or services, other than intangible religious benefits, provided to the taxpayer.
2. Form 8283, Section B, with supplemental statement
3. Deed (should be stamped with the recording date)
4. Qualified Appraisal (for contributions of more than \$5,000)
5. Baseline study

See [Publication 526, Charitable Contributions](#) (PDF), and [Publication 1771, Charitable Contributions - Substantiation and Disclosure Requirements](#) (PDF) and [Chapter 6](#) for additional guidance on substantiation requirements.

Amount of Deduction

Factors that may affect the amount a taxpayer may claim as a charitable contribution deduction for a conservation easement include:

- Fair market value
- Quid pro quo and charitable intent
- Bargain sale
- Type of property (ordinary income, short-term capital gain, long-term capital gain)
- Basis
- Percentage limitations
- Type of donee organization

See [Chapter 8](#) and [Publication 526, Charitable Contributions](#) (PDF) for additional guidance on specific limitations on charitable contributions.

Chapter 3: Qualified Conservation Contribution

Overview

IRC § 170(h)(1) defines a qualified conservation contribution as a contribution of a qualified real property interest to a qualified organization to be used exclusively for conservation purposes.

Qualified Real Property Interest

A qualified real property interest is any of the following interests in real property:

- The entire interest of the donor other than a qualified mineral interest.

- A remainder interest.
- A restriction on the use of the real property granted in perpetuity (often referred to as a conservation easement).

See IRC § 170(h)(2).

Qualified Organization

The recipient of a deductible conservation easement donation must be a qualified organization and also an eligible donee. IRC §§ 170(h)(1)(B), 170(h)(3), Treas. Reg. § 1.170A-14(c)(1).

Qualified organizations include:

- The Federal government, a United States possession, the District of Columbia, a state government, or any political subdivision of a state or United States possession.
- An organization described in § 170(b)(1)(A)(vi).
- A charity described in § 501(c)(3) of the Internal Revenue Code that meets the public support test of § 509(a)(2).
- A § 501(c)(3) organization that meets the requirements of § 509(a)(3) and is controlled by one of the organizations described above.

Note: See § 1.170A-14(c)(1) for the requirements to qualify as an eligible donee.

See IRC § 170(h)(3) and [Chapter 4](#) for additional information on qualified organizations.

Conservation Purpose

IRC § 170(h)(4)(A) defines “conservation purpose” as one of the following:

- Preservation of land for outdoor recreation by, or the education of, the general public.
- Protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem.
- Preservation of open space (including farmland and forest land) either for the scenic enjoyment of the general public or pursuant to a clearly delineated governmental conservation policy (both purposes must yield a significant public benefit).
- Preservation of a historically important land area or a certified historic structure.

The easement must be created by deed and be exclusively for conservation purposes. Donations of conservation easements may meet more than one conservation purpose.

See [Chapter 5](#) for additional information on conservation purpose.

Perpetuity

A deductible conservation easement must be made in perpetuity, permanently restricting the use of the property. Section 170(h)(2)(C) requires that the interest in real property be subject to a use

restriction granted in perpetuity, and § 170(h)(5)(A) requires that the conservation purpose be protected in perpetuity. See also Treas. Reg. § 1.170A-14(b)(2), (g).

This means that the deed of conservation easement must indicate that the restriction remains on the property forever and is binding on current and future owners of the property.

If a deed of conservation easement does not meet the perpetuity requirements, the easement is not deductible.

If the conservation easement deed imposes restrictions for a specific period such as ten years, it is not in perpetuity and is not deductible. An easement is not enforceable in perpetuity if it ends after a period of years or if it can revert to the donor or to another private party. However, if a remote future event, like an earthquake, can extinguish the easement, the donation would nevertheless be treated as enforceable in perpetuity. Treas. Reg. § 1.170A-14(g)(3).

In *Carpenter v. Commissioner*, T.C. Memo. 2012-1, motion for reconsideration denied 2013-172, a conservation easement was not enforceable in perpetuity because it allowed for the extinguishment of the easement by mutual consent of the parties if circumstances arose in the future that would render the purpose of the conservation easement impossible to accomplish.

In *Belk v. Commissioner*, 140 T.C. 1 (2013), motion for reconsideration denied, T.C. Memo. 2013-154, aff'd 774 F.3d 1243 (4th Cir. 2014), the deed of easement allowed the taxpayers and donee to change the property subject to the easement by substituting other property owned by the taxpayers for the property originally subject to the easement. The Tax Court ruled that the provision caused the easement to fail the requirements of § 170(h)(2)(C), as the donated property interest was not subject to a use restriction granted in perpetuity.

Recording of Easements

The deed of conservation easement must be recorded in the appropriate recordation office where the property is located. See generally Treas. Reg. § 1.170A-14(g)(1).

In 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. *United States v. Nat'l Bank of Commerce*, 472 U.S. 713, 722 (1985); *Woods v. Commissioner*, 137 T.C. 159, 162 (2011). An easement is not enforceable in perpetuity before it is recorded.

In addition to the deed, all exhibits or attachments to the deed, such as a description of the easement restrictions, maps, and lender agreements, may need to be recorded. In *Herman v. Commissioner*, T.C. Memo. 2009-205, the taxpayer recorded a "Declaration of Restrictive Covenant" for a donation of unused development rights above a building in New York City. The covenant referred to an attached architectural drawing, which described the easement restrictions, but the drawing was not recorded. The court ruled that because the attached drawing was not recorded, it could not bind subsequent purchasers, did not protect the conservation purpose of preserving the building "in perpetuity," and failed to meet the requirements of § 170(h)(5)(A). But see *Butler v. Commissioner*, T.C. Memo. 2012-72, holding that

documents incorporated into the deed by reference do not have to be recorded with the deed under Georgia law.

Amendment Clauses in Easement Deeds

The restriction on the use of the real property must be enforceable in perpetuity, meaning that it lasts forever and binds all future owners. An easement deed will fail the perpetuity requirements of § 170(h)(2)(C) and (h)(5)(A) if it allows any amendment or modification that could adversely affect the perpetual duration of the deed restriction.

The issue of Amendment Clauses is different than the issue of Reserved Rights. See Chapter 11 for information on Reserved Rights in an easement deed.

Subordination of Mortgages in Lender Agreements

If the property has a mortgage or lien in effect at the time the easement is recorded, the easement contribution is not deductible unless the mortgagee or lien holder subordinates its rights in the property to the rights of the donee organization to enforce the conservation purposes of the easement. in perpetuity. Treas. Reg. § 1.170A-14(g)(2).

The subordination agreement must be recorded at the same time that the Deed of Easement is recorded.

Extinguishment

Treas. Reg. § 1.170A-14(g)(6)(i) generally provides that if a subsequent unexpected change in the conditions surrounding the property that is the subject of a donation 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 Treas.

Reg. § 1.170A-14(g)(6)(ii)) 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.

Allocation of Proceeds in Deed and Lender Agreements

In order to claim a charitable contribution deduction for the donation of a conservation easement, the donor, at the time of the gift, 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. The proportionate value of the donee's property rights is a percentage of the value of the entire property that never changes. Treas. Reg. § 1.170A-14(g)(6)(ii). The requirements of § 1.170A-14(g)(6)(i) and (ii) are strictly construed. If a grantee is not absolutely entitled to the proportionate share of extinguishment proceeds, then the conservation purpose of the contribution is not protected in perpetuity.

Treas. Reg. § 1.170A-14(g)(6)(ii) requires the donee's proportionate interest upon extinguishment of a conservation easement to be a percentage determined by (1) the fair market value of the conservation easement on the date of the gift (numerator), over (2) the fair market value of the property as a whole on the date of the gift (denominator). In *Carroll v. Commissioner*, 146 T.C. No. 13 (2016), appeal pending, petitioners' deed of conservation easement instead used a ratio of the charitable contribution deduction allowable over the value of the property as a whole on the date of the gift. Thus, the deed failed to satisfy § 1.170A-14(g)(6)(ii) because it did not guarantee the donees a proportionate share of the extinguishment proceeds based on the fair market value of the conservation easement at the time of the gift. The Tax Court ruled that the petitioners' conservation easement violated Treas. Reg. § 1.170A-14(g)(6)(ii) because the conservation purpose was not protected in perpetuity, and consequently the contribution was not deductible.

Examiners should contact Counsel for assistance in review of deeds and lender agreements to determine if the documents satisfy the allocation of proceeds requirements of Treas. Reg. § 1.170A-14(g)(6)(ii).

Chapter 4: Qualified Organization

Overview

A taxpayer must transfer the conservation easement to an eligible donee to qualify for a contribution deduction. An eligible donee:

- Is a qualified organization,
- Must have the commitment to protect the conservation purpose of the donation, and
- Must have the resources to enforce the conservation restrictions.

See IRC § 170(h)(3) and Treas. Reg. § 1.170A-14(c).

Qualified Organization

A qualified organization is one of the following:

- A governmental unit, including the Federal government, a United States possession, the District of Columbia, a state government, or any political subdivision of a state or United States possession.
- A public charity described in IRC § 501(c)(3) of the Internal Revenue Code that meets the public support test of IRC § 170(b)(1)(A)(vi) or section 509(a)(2).
- An IRC § 501(c)(3) organization that meets the requirements of IRC § 509(a)(3) and that is operated, supervised, or controlled by one of the organizations described above.

Commitment & Resources

The organization must have the commitment to protect the conservation purposes of the donation and resources to enforce the restrictions of the conservation easement. Treas. Reg. § 1.170A-14(c)(1).

An entity organized or operated for one of the conservation purposes in IRC § 170(h)(4)(A) is considered to have the commitment required to protect the conservation purposes of the donation. Treas. Reg. § 1.170A-14(c)(1).

Organizations that accept easement contributions and are committed to conservation will generally have an established monitoring program such as annual property inspections to ensure compliance with the conservation easement terms and to protect the easement in perpetuity.

The organization must also have the resources to enforce the restrictions of the conservation easement. Resources do not necessarily mean cash. Resources may be in the form of the volunteer services of lawyers who provide legal services or conservationists who inspect the property and prepare monitoring reports.

If the organization at the time of contribution does not have the commitment to protect the conservation purposes of the donation or resources to enforce the easement restrictions, no deduction is allowed.

See [Chapter 11](#) for suggestions on how to evaluate the organization's commitment and resources.

Special Rules for Buildings in a registered historic district

For a contribution made after July 25, 2006 of a qualified real property interest with respect to a building in a registered historic district, an additional requirement must be met to satisfy the commitment and resources test.

IRC § 170(h)(4)(B)(ii) requires the taxpayer and the donee to certify, under penalty of perjury, in a written agreement, that the donee is a qualified organization with a purpose of environmental protection, land conservation, open space preservation, or historic preservation, and that the donee has the resources to manage and enforce the restriction and a commitment to do so. **Note:** This special rule does not apply to properties listed on the National Register.

See [Chapter 5](#) for a complete discussion of the special rules for buildings in registered historic districts.

Cash Contributions

A common practice for conservation organizations is to request a cash contribution (sometimes referred to as a "stewardship fee") from donors of conservation easements. To be deductible as a charitable contribution, the cash payment must be a voluntary transfer made with charitable intent to a qualified organization. IRC § 170 (a) and (c).

Charitable intent exists if the transfer is made without the receipt of, or the expectation of receiving, a quid pro quo for the transfer. As a general rule, if the benefits the transferor receives or expects to receive are substantial, rather than incidental to the transfer, the transfer does not satisfy the charitable intent requirement under IRC § 170. *Hernandez v. Commissioner*, 490 U.S. 680, 691 (1989); *United States v. American Bar Endowment*, 477 U.S. 105, 117-118 (1986); *Singer Co. v. United States*, 196 Ct. Cl. 90, 106 449 F.2d 413, 422-423 (1971).

If a direct or indirect economic benefit (other than a tax deduction) is received as a result of making a contribution, the deduction may be limited or disallowed.

Quid Pro Quo Contribution

A quid pro quo contribution is a transfer of money or property made to a qualified organization partly in exchange for goods or services in return from the charity or a third party.

A quid pro quo may also be in the form of an indirect benefit from a third party.

Example: A land developer agrees to grant a conservation easement to the county or other qualified organization in exchange for the approval of a proposed subdivision.

If a taxpayer receives a quid pro quo, the cash payment may be deductible as a charitable contribution, but only to the extent the amount transferred exceeds the fair market value (FMV) of the quid pro quo, and only if the excess amount was transferred with charitable intent. *United States v. American Bar Endowment*, 477 U.S. 105, 117 (1986).

The burden is on the taxpayer to show that all or part of a payment is a charitable contribution or gift. Treas. Reg. § 1.170A-1(h)(1) and (2); *United States v. American Bar Endowment*, 477 U.S. 105, 116-118 (1986); and Rev. Rul. 67-246, 1967-2 C.B. 104.

Chapter 5: Conservation Purpose

Overview

A charitable contribution made under IRC § 170(h)(4)(A) (conservation easement) must be made exclusively for one of the following conservation purposes:

- Preservation of land areas for outdoor recreation by, or the education of, the general public.
- Protection of a relatively natural habitat for fish, wildlife, or plants, or a similar ecosystem.
- Preservation of open space for the scenic enjoyment of the general public, or pursuant to a Federal, State, or local governmental conservation policy.
- Preservation of historically important land area or certified historic buildings.

The conservation easement must be transferred by deed (or other legal instrument as appropriate under the law of the relevant state) and recorded where the property is located, be

exclusively for conservation purposes, protected in perpetuity, and meet at least one of the above conservation purposes.

The required access to the land by the general public depends on the conservation purpose of the conservation easement. If the claimed conservation purpose is for the preservation of open space under IRC § 170(h)(4)(A)(iii), the contribution must yield a significant public benefit which is usually by visual access from a public highway.

The deed of conservation easement must prohibit inconsistent use of the property that could permit destruction of a significant conservation interest, even if the easement accomplishes an enumerated conservation purpose.

A baseline study is used to identify the conservation attributes and to establish the condition of the property at the time of the conservation easement donation.

Land for Outdoor Recreation or Education

This category includes the donation of a qualified real property interest to preserve land for outdoor recreation by, or for the education of, the general public. IRC § 170(h)(4)(A)(i).

Substantial and regular physical access by the general public to the preserved land is required. Treas. Reg. § 1.170A-14(d)(2)(ii).

Example: A donation to preserve a lake for use by the general public for boating or fishing, or to preserve land for a hiking trail.

See Treas. Reg. § 1.170A-14(d)(2) for additional guidance.

Relatively Natural Habitat or Ecosystem

This conservation purpose is satisfied if the conservation easement protects a **significant** relatively natural habitat of fish, wildlife or plants, or similar ecosystem. IRC § 170(h)(4)(A)(ii). An ordinary tract of land where a common fish, wildlife or plant community, or similar ecosystem normally lives does not satisfy this conservation purpose. Treas. Reg. § 1.170A-14(d)(3).

Significant habitats and ecosystems include, but are not limited to:

- Habitats for rare, endangered, or threatened species.
- Natural areas that are relatively intact and are considered high quality examples of land or aquatic communities.
- Natural areas that are in or contribute to the ecological viability of a park, preserve, wildlife refuge, wilderness area, or other similar conservation area.

For this conservation purpose, limitations on public access are allowable. For example, a restriction on all public access to the habitat of a threatened native animal species would not defeat the claimed deduction. Treas. Reg. § 1.170A-14(d)(3)(iii).

The determination of what specifically meets this conservation purpose test is based on the facts and circumstances of the specific case. In *Glass v. Commissioner*, 124 T.C. 258 (2005), aff'd, 471 F.3d 698 (6th Cir. 2006), the taxpayer donated two easements that restricted the development of a fraction of a 10-acre parcel of residential property. The Tax Court held that the conservation purpose of natural habitat was satisfied where the conservation easements were placed on property that had possible places to create or promote a relatively natural habitat of plants or wildlife.

In *Atkinson v. Commissioner*, T.C. Memo 2015-236, involving conservation easements encumbering operating golf courses, the Tax Court distinguished the *Glass* case and held that the easements did not protect a relatively natural habitat. In so holding, the Tax Court reasoned, among other things, that the golf courses' use of pesticides could destroy the ecosystem of the easement property. The Tax Court's reliance on the Service's expert reports and testimony in *Atkinson* demonstrates the importance of expert evidence in "protecting natural habitat" cases.

Open Space

The donation of a qualified real property interest to protect open space (including farmland and forest land) must be (1) for the scenic enjoyment of the general public, or (2) pursuant to a clearly delineated federal, state, or local governmental conservation policy. This type of conservation easement must preserve open space **and** must yield a significant public benefit. IRC § 170(h)(4)(A)(iii).

Scenic Enjoyment

Preservation of open space may be for the scenic enjoyment of the general public if development of the property would impair the scenic character of the local rural or urban landscape or interfere with a scenic panorama that can be enjoyed by the public. See Treas. Reg. § 1.170A-14(d)(4)(ii) for additional guidance.

Whether the easement provides scenic enjoyment to the general public is evaluated based on all the facts and circumstances. The burden of proof is on the taxpayer to show the scenic characteristics of the property.

Treas. Reg. § 1.170A-14(d)(4)(ii)(A) lists factors to consider:

- The compatibility of the land use with other land in the vicinity.
- The degree of contrast and variety provided by the visual scene.
- The openness of the land (which would be a more significant factor in an urban or densely populated setting or in a heavily wooded area).

- Relief from urban closeness.
- The harmonious variety of shapes and textures.
- The degree to which the land use maintains the scale and character of the urban landscape to preserve open space, visual enjoyment and sunlight for the surrounding area.
- The consistency of the proposed scenic view with a methodical state scenic identification program, such as a state landscape inventory.
- The consistency of the proposed scenic view with a regional or local landscape inventory made pursuant to a sufficiently rigorous review process, especially if the donation is endorsed by an appropriate state or local governmental agency.

A conservation easement preserving open space for the scenic enjoyment of the general public does not require physical access. Visual access to or across the property by the general public is sufficient. Although the entire property need not be visible to the public in order to qualify for a deduction, the public benefit from the donation may be insufficient to qualify if only a small portion of the property is visible to the public. Treas. Reg. § 1.170A-14(d)(4)(ii)(B).

In *Turner v. Commissioner*, 126 T.C. 299 (2006), the conservation purpose of open space was not met because the easement deed did not restrict development and did not include specific provisions to protect the views of the property. The taxpayer was not entitled to a deduction because the conservation easement did not satisfy one of the required conservation purposes in IRC § 170(h)(4)(A).

See Treas. Reg. § 1.170A-14(d)(4)(ii) for additional guidance.

Governmental Conservation Policy

Conservation purpose includes the preservation of open space where such preservation is pursuant to a clearly delineated federal, state, or local government conservation policy. IRC § 170(h)(4)(A)(iii)(II).

A broad declaration by a single official or legislative body that the land should be conserved is not sufficient. The donation must further a specific, identified conservation project. The fact that the donation was accepted (or purchased) by a government agency is not sufficient to satisfy this requirement. The more rigorous the review process by the governmental agency, the more the acceptance of the easement tends to establish the requisite clearly delineated governmental policy.

The government need not fund the conservation program but it must involve a significant commitment by the government with respect to the conservation project.

Public access is not required if the conservation purpose would be undermined or frustrated by the public access. Treas. Reg. § 1.170A-14(d)(4)(iii)(C).

Example: For a donation pursuant to a local governmental policy protecting a scenic bluff area, visual access would be required, as the conservation purpose is to protect the scenic beauty of the bluff.

See Treas. Reg. § 1.170A-14(d)(4)(iii) for additional guidance.

Significant Public Benefit

A conservation purpose based on the preservation of open space, whether for scenic enjoyment or pursuant to a governmental conservation policy, must yield a significant public benefit. IRC § 170(h)(4)(A)(iii).

A determination of whether a conservation easement provides a significant public benefit must be based on all facts and circumstances. Treas. Reg. § 1.170A-14(d)(4)(iv) lists a number of factors that may be considered:

- Uniqueness of the property to the area.
- Intensity of land development in the area.
- Consistency of the proposed open space use with public and private conservation programs.
- Likelihood the property would be developed in the absence of the easement.
- Opportunity of the public to appreciate the property's scenic values.
- Importance of the property to preservation, tourism, or commerce.
- Likelihood of the donee acquiring substitute property or property rights.
- Cost of enforcing the terms of the conservation restrictions.
- Population density in the area.
- Consistency of open space use with a legislatively mandated program identifying particular parcels of land for future protection.

The preservation of an ordinary tract of land would not, in and of itself, yield a significant public benefit. Treas. Reg. § 1.170A-14(d)(4)(iv)(B). A conservation easement that merely limits the number of lots that the acreage is divided into does not satisfy the open space requirement of IRC § 170(h). *Turner v. Commissioner*, 126 T.C. 299 (2006).

The legislative history underlying IRC §170(h) shows that Congress did not intend for every easement to qualify for a deduction. A deduction is not allowed unless there is an assurance that the public benefit furthered by the contribution would be substantial enough to justify the allowance of a deduction. S. Rep. 96-1007, at 9-10 (1980), reprinted in 1980 U.S.C.C.A.N. 6736, 6744-45.

Example: Significant public benefit includes the preservation of a unique natural land formation for the enjoyment of the general public or the preservation of woodland along a well-traveled public highway to preserve the appearance of the area so as to maintain the scenic view from the highway.

Historically Important Land or Structure

This category includes the donation of a qualified real property interest to preserve a historically important land area or a certified historic structure. IRC § 170(h)(4)(A)(iv).

Historically Important Land

Historically important land includes:

- An independently significant land area that meets the National Register Criteria for Evaluation
- Land where the physical or environmental features contribute to the historic or cultural importance and continuing integrity of certified historic structures.

See Treas. Reg. § 1.170A-14(d)(5)(ii) for additional guidance.

Under the Pension Protection Act (IRC § 170(h)(4)(C)), a “certified historic structure” includes a land area listed in the National Register. The National Register of Historic Places is part of a national program administered by the National Park Service (NPS) to identify, evaluate and protect historic and archeological resources worthy of preservation. A list of properties listed in the National Register can be found on the NPS Web page.

Certified Historic Structure

A certified historic structure is:

- Any building, structure, or land area listed on the National Register, or
- Any building located in a registered historic district and certified by the Secretary of the Interior as being of historic significance to the district.

The National Park Service Technical Preservation Services administers the certification program for the Department of the Interior. This certification must be done at the time the property is donated or by the due date (including extensions) of the return for the year of the donation.

A certified historic structure may be a commercial property or a personal residence. The term “registered historic district” includes a district described in IRC § 47(c)(3)(B).

The term “registered historic district” means:

- Any district listed in the National Register, and
- Any district
 - designated under a statute of the appropriate State or local government, if such statute is certified by the Secretary of the Interior to the Secretary as containing criteria which will substantially achieve the purpose of preserving and rehabilitating buildings of historic significance to the district, and
 - that is certified by the Secretary of the Interior to the Secretary as meeting substantially all of the requirements for the listing of districts in the National Register.

A building in a local historic district will not meet the definition of a certified historic structure unless both the structure and the district have been certified in accordance with IRC § 47.

Some visual access by the public to the building, structure or land area is required.

See Treas. Reg. § 1.170A-14(d)(5)(iv) for additional guidance.

Special Rules for Buildings in Registered Historic Districts

IRC §170(h)(4)(B) imposes additional requirements for contributions of conservation easements on buildings in registered historic districts. **Note:** These special rules do not apply to properties listed in the National Register.

To qualify, all of the following additional requirements must be met:

- the entire exterior of the building, including the front, sides, rear, and height, must be restricted, and no changes can be made to the exterior that are inconsistent with the historical character of the exterior;
- the donor must enter into a written agreement with the donee certifying, under penalty of perjury, that the donee is a qualified organization with a purpose of environmental protection, land conservation, open space preservation, or historic preservation, and that the donee has the resources to manage and enforce the restrictions and the commitment to do so.
- Donors must attach to the return a qualified appraisal as defined in IRC § 170(f)(11)(E), photographs of the entire exterior of the building, and a description of all restrictions on the development of the building.
- Donors must pay a \$500 filing fee to the U.S. Treasury if a deduction of more than \$10,000 is claimed. IRC § 170(f)(13). The fee is to be used to enforce the provisions of IRC § 170(h).

Public Access

Public access (either physical or visual) to the property is generally required for the conservation easement to be deductible except with respect to protection of a relatively natural habitat or ecosystem or pursuant to specified governmental policies. The type of access depends on the claimed conservation purpose.

If physical access is required, access must be substantial and on a regular basis.

If only visual access is required, the entire property need not be visible to the public for a donation to qualify. However, the public benefit from the donation is insufficient to qualify for a deduction if only a small portion of the property is visible to the public.

See Treas. Reg. § 1.170A-14(d) for specific access requirements.

Inconsistent Uses

A donation must be exclusively for conservation purposes, and generally the deed of conservation easement must prohibit inconsistent uses. An inconsistent use allows for the destruction or potential destruction of significant conservation interests in conflict with a conservation purpose.

However, some inconsistent uses are permitted if necessary to protect the conservation interests that are the subject of the easement.

All conservation easement donors reserve some rights. Depending on the nature and extent of these reserved rights, the claimed conservation purpose may be impaired to such a degree that the contribution may not be allowable. A determination of whether the reserved rights defeat the conservation purpose must be determined based on all facts and circumstances.

Example: The conservation purpose of the easement as described in the conservation easement deed was to protect the relatively natural habitat for scrub jay, a threatened bird. The deed of easement allows the taxpayer to use pesticides that would destroy the natural food source for the scrub jay. The taxpayer is not entitled to a deduction because the allowed activity is an inconsistent use.

See Treas. Reg. § 1.170A -14(e)(2) and (e)(3) for additional guidance.

Baseline Study

The donor of a conservation easement must provide baseline documentation (sometimes referred to as the baseline study) to the donee, **prior to the time the donation is made**. Treas. Reg. § 1.170A-14(g)(5)(i). This documentation should provide specific information about the conservation values of the property.

The baseline documentation is generally prepared by a person with specific training in the assessment of conservation values such as a biologist, botanist, or historian. The baseline study may be prepared by a person affiliated with the donee.

This documentation may include:

- Survey maps from the United States Geological Survey, showing the property line and other contiguous or nearby protected areas.
- A map of the area drawn to scale showing all existing man-made improvements or incursions (such as roads, buildings, fences, or gravel pits) and vegetation, and identification of flora and fauna (including, for example, rare species locations, animal breeding and roosting areas, and migration routes), land use history (including present uses and recent past disturbances), and distinct natural features (such as large trees and aquatic areas).
- An aerial photograph of the property.
- On-site photographs taken at appropriate locations on the property.

The documentation must be accompanied by a statement signed by the donor and a representative of the donee organization affirming that the documentation of the natural resources is an accurate representation of the protected property at the time of the transfer.

See Treas. Reg. § 1.170A-14(g)(5)(i) for additional guidance.

Chapter 6: Substantiation

Overview

A charitable contribution is not deductible unless properly substantiated in accordance with the Internal Revenue Code and applicable regulations, including:

- IRC § 170(a)(1)
- IRC § 170(f)(8)
- IRC § 170(f)(11)
- IRC § 170(f)(13)
- IRC § 170(f)(17)
- Treas. Reg. § 1.170A-13
- Treas. Reg. § 1.170A-14

These code sections and corresponding regulations describe the specific recordkeeping and substantiation requirements for donors of noncash contributions.

A donor cannot claim a charitable contribution deduction unless the donor maintains a record of the contribution. The kind of records required to substantiate a charitable contribution vary depending on the amount, date of contribution, type of property contributed and whether the donation was a cash or noncash contribution. There are also special rules with respect to buildings in registered historic districts.

The burden is on the taxpayer to demonstrate that the cash or property transferred to the qualified organization is a deductible contribution. *See* Treas. Reg. § 1.170A-1(h)(1) and (2); *United States v. American Bar Endowment*, 477 U.S. 105, 116-118 (1986); and Revenue Ruling 67-246, 1967-2 C.B. 104.

See [Publication 1771, Charitable Contributions-Substantiation and Disclosure Requirements](#) (PDF), [Publication 526, Noncash Contributions](#) (PDF), and [Publication 561, Determining the Value of Donated Property](#) (PDF), for additional information.

See Exhibit 6-1 for a summary of substantiation requirements.

Contemporaneous Written Acknowledgment

A contemporaneous written acknowledgment (CWA) by the qualified donee organization is required for all contribution deductions of \$250 or more (in cash or property).

“Contemporaneous” means that the taxpayer must obtain the acknowledgment by the earlier of the date on which the taxpayer files his or her tax return claiming the charitable contribution deduction, or the due date (including extensions) for the return. IRC § 170(f)(8), Treas. Reg. § 1.170A-13(f)(3), and [Publication 1771, Charitable Contributions-Substantiation and Disclosure Requirements](#) (PDF).

This acknowledgment by the qualified donee organization must contain:

- Amount of any cash contribution,
- Description (but not the value) of the property contributed,
- Statement that no goods or services were provided by the organization in return for the contribution (if this was the case),
- Description and good faith estimate of the value of goods or services, if any, that an organization provided in return for the contribution, and
- A statement that goods or services (if any) that an organization provided in return for the contribution consisted entirely of intangible religious benefits (if this was the case).

See IRC § 1.170A-13(f)(2). IRC § 170(f)(8) requirements must be complied with for a deduction to be allowed. See *Addis v. Commissioner*, 374 F.3d 881, 887 (9th Cir. 2004), affg. 118 T.C. 528 (2002) (“the deterrence value of section 170(f)(8)’s total denial of a deduction comports with the effective administration of a self-assessment and self-reporting system”), cited in *Viralam v. Commissioner*, 136 T.C. 151; *Schrimsher v. Commissioner*, T.C. Memo. 2011-71.

The following CWA does not meet the statutory requirement of IRC § 170(f)(8) since it does not make an affirmative statement that no goods or services were provided (or describe if goods or services were actually provided) in exchange for the contribution.

Example: “Thank you for your contribution by deed of a conservation easement on XYZ property and \$10,000 cash contribution for maintenance of the easement that ABC Land Trust received on May 5, 2008.”

A CWA is not required to take any particular form, and an easement deed may qualify as a CWA under certain circumstances. Unless the deed expressly states the total value of the goods or services received by the donor in exchange for the contribution, the deed taken as a whole must provide that no goods or services were received in exchange. *Schrimsher v. Commissioner*, T.C. Memo. 2011-71. The Tax Court has held that a deed qualified as a CWA when no valuable consideration was mentioned in the deed and the deed contained a merger clause. *Averyt v. Commissioner*, T.C. Memo. 2012-198; *RP Golf, LLC v. Commissioner*, T.C. Memo. 2012-282. A merger clause provides that the particular deed sets forth the entire agreement of the parties regarding the contribution of the conservation easement and supersedes all prior discussions, negotiations, or agreements relating to the easement. *French v. Commissioner*, T.C. Memo. 2016-53, held that in the case of a deed without an indication that there were no goods or services provided, unless there is a merger clause, the deed cannot be taken as a whole to qualify as a CWA. In such a case, the absence of a merger clause means that a donor could have received consideration in exchange for the contribution even if the deed does not mention that there was any valuable consideration transferred.

Some deeds recite the amount of consideration as "\$1.00 and other good and valuable consideration." Numerous state courts have held that phrase is inherently and intrinsically ambiguous. The phrase may mean that no real consideration was given, that the consideration was nominal, or that the consideration was substantial but was not disclosed. Nevertheless, in the absence of any other evidence concerning the amount of consideration, the Tax Court has held that a deed can satisfy the CWA requirements even if it describes the consideration as \$1.00 and other good and valuable consideration so long as the deed contains a merger clause. *310 Retail, LLC v. Commissioner*, T.C. Memo. 2017-164, and *Big River Dev., L.P. v. Commissioner*, T.C. Memo. 2017-166.

If you have any questions or concerns whether the deed language satisfies the requirements for a CWA under IRC § 170(f)(8), please consult with local counsel.

In IRC § 170(f)(8)(D), Congress provided an exception to the CWA requirement. IRC § 170(f)(8)(D) states that a CWA is not required if the donee organization files a return on such form and in accordance with such regulations as the Treasury Department may prescribe (donee reporting). When issuing TD 8690 in 1997, the Treasury Department and the IRS purposely declined to issue regulations to implement that exception. The IRS has consistently maintained that the section 170(f)(8)(D) exception is not available unless and until the Treasury Department and the IRS issue final regulations prescribing the method for donee reporting. Therefore, the donee reporting exception still remains unavailable. *15 West 17th St. v. Commissioner*, 147 T.C. No. 19 (2016).

Note: Taxpayers and return preparers frequently confuse the CWA requirement with the filing of [Form 8283, Noncash Charitable Contributions](#) (PDF). This form is not a substitute for the contemporaneous written acknowledgment; both are required. Failure to meet either requirement may result in disallowance of the charitable contribution deduction.

Form 8283, Noncash Charitable Contributions

Section B of [Form 8283, Noncash Charitable Contributions](#) (PDF), referred to in the Deficit Reduction Act of 1984 and in Treas. Reg. § 1.170A-13(c)(4) as an “appraisal summary,” must be fully completed and attached to the return for noncash donations greater than \$5,000.

Note: If the donation originates from a flow-through entity (such as S corporation or partnership), the partner or shareholder who receives an allocation of the charitable contribution must attach a copy of the flow-through entity’s appraisal summary (Form 8283) to the tax return on which the deduction for the contribution is first claimed. Treas. Reg. § 1.170A-13(c)(4)(iv)(G).

Section B of Form 8283 is often improperly completed. Common errors include:

- Inadequate description of the property
- Missing information
- Missing signatures
- Inconsistent dates

The description of the property must have sufficient detail for a person unfamiliar with the type of property to ascertain that the property being appraised is the property that was contributed. Treas. Reg. § 1.170A-13(c)(4)(ii)(B).

Section B, Part I, requests information regarding:

- Acquisition date of the property

- How the property was acquired by the donor
- Donor's cost or adjusted basis
- Bargain sale amount received
- Appraised fair market value of the easement

The instructions to Form 8283 also require a statement that identifies the conservation purpose, shows fair market value before and after, states whether the donation was made in order to get an approval or was required by contract, and whether the taxpayer or related person has any interest in nearby property. This statement must be attached to the Form 8283.

See [Instructions for Form 8283, Noncash Charitable Contributions](#) (PDF), and Treas. Reg. § 1.170A-13(c)(4) for detailed discussion of the appraisal summary (Form 8283) requirements.

Declaration of Appraiser

Section B, Part III, Declaration of Appraiser, must be completed by the qualified appraiser for donations in excess of \$5,000. Treas. Reg. § 1.170A-13(c)(4)(ii)(K) and (L).

Donee Acknowledgment

Section B, Part IV, Donee Acknowledgment, must be signed by an official authorized to sign the tax or information returns of the donee organization or a person specifically authorized by such official to sign Form 8283. Treas. Reg. § 1.170A-13(c)(4)(iii).

Failure to Attach Form 8283

The failure to file Form 8283 or the filing of an incomplete Form 8283 results in disallowance of the charitable contribution deduction for the conservation easement unless:

- Such failure was due to a “good-faith omission”,
- The donor otherwise complied with Treas. Reg. § 1.170A-13(c)(3) and (c)(4) (including completion of a timely qualified appraisal), and
- The IRS requests that the donor submit a fully completed form within 90 days of the request, and the donor complies. Treas. Reg. § 1.170A-13(c)(4)(iv)(H).

In rare and unusual circumstances in which it is impossible for the taxpayer to obtain the signature of the donee, the taxpayer's deduction will not be disallowed for that reason provided that the taxpayer attaches a statement to the Form 8283 explaining, in detail, why it was not possible to obtain the donee's signature. Treas. Reg. § 1.170A-13(c)(4)(iv)(C)(2).

Qualified Appraisal

Qualified appraisals are required for all contribution deductions for conservation easements valued at more than \$5,000. IRC § 170(f)(11)(C).

To be a qualified appraisal under IRC § 170(f)(11)(E), an appraisal of property (1) must be treated as a qualified appraisal under regulations or other guidance prescribed by the Secretary

and (2) must be conducted by a qualified appraiser in accordance with generally accepted appraisal standards and any regulations or other guidance prescribed by the Secretary. *See also* Notice 2006-96, 2006-2 C.B. 902.

(1) Qualified appraisal under regulations

Treas. Reg. § 1.170A-13(c)(3), defines a qualified appraisal as a document that, among other things: (1) relates to an appraisal that is made not earlier than 60 days before the date of contribution of the appraised property and no later than the due date (including extensions) of the return on which a deduction is first claimed under IRC § 170; (2) is prepared, signed, and dated by a qualified appraiser; (3) includes, among other requirements, (a) a description of the property appraised; (b) the fair market value of such property on the date of contribution and the specific basis for the valuation, (c) a statement that such appraisal was prepared for income tax purposes; (d) the qualifications of the qualified appraiser; and (e) the signature and taxpayer identification number of such appraiser; and (4) does not involve an appraisal fee that violates certain prescribed rules.

(2) Generally accepted appraisal standards

IRC § 170(f)(11)(E) specifies that the qualified appraisal must be conducted by a qualified appraiser in accordance with generally accepted appraisal standards.

Reasonable Cause

If the taxpayer failed to obtain a qualified appraisal, the deduction is not disallowed if the failure was due to reasonable cause and not to willful neglect, *see* IRC § 170(f)(11)(A)(ii)(II). A determination of whether or not the taxpayer acted reasonably and not with willful neglect, requires an analysis of the relevant facts and circumstances. If you have any questions or concerns, please consult local counsel.

If a charitable contribution deduction of more than \$500,000 is claimed for a noncash contribution, the taxpayer must attach a copy of a qualified appraisal of the property to the return for the year of donation. IRC § 170(f)(11)(D).

Special rule: For contributions of façade easements in registered historic districts, a qualified appraisal must be attached to the return regardless of the dollar amount claimed for the conservation easement. IRC § 170(h)(4)(B)(iii)(I). **Note:** This special rule does not apply to properties listed on the National Register.

See [Chapter 7](#) for additional information on qualified appraisals.

Façade Easement Filing Fee (Registered Historic District Only)

For deductions of more than \$10,000, for a donation of an easement on a building in a registered historic district, a donor must pay a \$500 filing fee with its return in the taxable year of the contribution. IRC § 170(f)(13). The fee is to be used to enforce the provisions of IRC § 170(h).

Payment is transmitted to the IRS using [Form 8283V, Payment Voucher for Filing Fee under Section 170\(f\)\(13\)](#) (PDF).

Baseline Study

A donor that retains rights in property subject to a donated conservation easement must give the qualified organization documentation (baseline study) that establishes the condition of the property at the time of the gift. Treas. Reg. § 1.170A-14(g)(5)(i). The baseline study must be signed by the donor and donee. The baseline study generally includes maps, surveys, and photographs of the property and must be given to the qualified organization prior to the time the donation is made.

See [Chapter 5](#) for additional information on baseline documentation.

Exhibit 6-1 - Substantiation Requirements

Required Item	Criteria	Due Date	Attach to Return?
Contemporaneous Written Acknowledgment	All \$250 or more	Earlier of Return filing date or Due Date (with extensions)	No
F8283 (Appraisal Summary)	All > \$500 not to exceed \$5,000 Part A All > \$5,000 Part B	Return filing date	Yes Also attach conservation easement statement per Form 8283 Instructions
Qualified Appraisal	All >\$5,000	Must be made no earlier than 60 days prior to date of contribution but no later than original/amended return filing date	Yes, but only if over \$500,000 or an easement on a building in a registered historic district
Facade Filing Fee of \$500	All easements on buildings in registered historic districts >\$10,000	Return filing date	No Mail in with Form 8283V
Baseline Study	Required to be given to donee and signed by donor and donee to establish	Before time of donation	No

Required Item	Criteria	Due Date	Attach to Return?
	condition of property		

Chapter 7: Qualified Appraisal Requirements

Overview

Generally, noncash charitable contributions for which a deduction of more than \$5,000 is claimed must be substantiated with a qualified appraisal prepared by a qualified appraiser in accordance with generally accepted appraisal standards. IRC § 170(f)(11)(C) and (E)(i)(II).

The Pension Protection Act of 2006 (PPA) amended IRC § 170(f)(11)(E) to provide definitions of qualified appraisal and qualified appraiser. See Notice 2006-96, 2006-2 C.B. 902, for transitional rules.

IRC § 170(f)(11)(E) and Treas. Reg. § 1.170A-13(c)(3), which predates IRC § 170(f)(11)(E), set forth substantiation requirements that must be met for the appraisal to be considered a qualified appraisal. Some of Treas. Reg. § 1.170A-13(c)(3) is superseded by IRC § 170(f)(11)(E).

This chapter discusses the requirements for a qualified appraisal, a qualified appraiser and generally accepted appraisal standards.

See [Publication 561, Determining the Value of Donated Property](#) (PDF) and Treas. Reg. § 1.170A-13 for additional guidance on qualified appraisal requirements.

Qualified Appraisal

IRC § 170(f)(11) requires a qualified appraisal for property donations of more than \$5,000.

IRC § 170(f)(11)(D) requires the attachment of a qualified appraisal to the return if the deduction claimed exceeds \$500,000. For contributions of façade easements in registered historic districts, a qualified appraisal must be attached regardless of the dollar amount claimed as a deduction. IRC § 170(h)(4)(B)(iii)(I). **Note:** This special rule does not apply to properties listed on the National Register.

IRC § 170(f)(11)(E) was amended in 2006 to include definitions of the terms “qualified appraisal” and “qualified appraiser.” Notice 2006-96 provides transitional guidance and safe harbors to be used until proposed regulations are finalized.

An appraisal is treated as a qualified appraisal within the meaning of IRC § 170(f)(11)(E) if the appraisal complies with all of the requirements of Treas. Reg. § 1.170A-13(c) (except to the extent the regulations are inconsistent with IRC § 170(f)(11)(E)). See also Notice 2006-96.

A qualified appraisal must:

- Be prepared no earlier than 60 days before the date of contribution nor later than the due date (including extensions) of the tax return on which the charitable contribution deduction is first claimed. Treas. Reg. § 1.170A-13(c)(3)(i)(A).
- Be prepared, signed and dated by a qualified appraiser. Treas. Reg. § 1.170A-13(c)(3)(i)(B) and IRC § 170(f)(11)(E)(ii).
- Not involve a prohibited appraisal fee, which, in general, means that the appraisal fee may not be based on a percentage of the appraised value of the property. Treas. Reg. § 1.170A-13(c)(6).

Treas. Reg. § 1.170A-13(c)(3)(ii) outlines specific items that must be included in a qualified report:

- A detailed description of the property.
- The property's physical condition (for a contribution of tangible property).
- The date or expected date of the contribution.
- The terms of any agreement relating to the property's use, sale or other disposition.
- The appraiser's name, address, and taxpayer identification number, and that of the appraiser's employer or partnership.
- The qualifications of the appraiser, including the appraiser's background experience, education and membership in professional appraisal associations.
- The appraiser's qualifications.
- A statement that the appraisal was prepared for income tax purposes.
- The date the property was appraised.
- The appraised fair market value of the property on the date or expected date of the contribution.
- The method of valuation used to determine the fair market value.
- 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 used).

See also [Notice 2006-96](#).

Reasonable Cause Exception

The charitable deduction will not be denied for the donor's failure to comply with the requirements of IRC § 170(f)(11) if it was due to reasonable cause and not willful neglect. IRC § 170(f)(11)(A)(ii)(II).

Qualified Appraiser

The term "qualified appraiser" as defined in IRC § 170(f)(11)(E)(ii) means an individual who:

- Has earned an appraisal designation from a recognized professional appraiser organization or met minimum education and experience requirements as set forth in the regulations,
- Regularly performs appraisals for which the individual receives compensation, and
- Meets such other requirements as prescribed by the Secretary in regulations or other guidance.

An individual is not a qualified appraiser unless the individual:

- Demonstrates verifiable education and experience in valuing the type of property subject to the appraisal, and
- Has not been prohibited from practicing before the IRS any time in the 3-year period ending on the date of the appraisal. IRC § 170(f)(11)(E)(iii).

[Notice 2006-96](#) offers guidance on the qualified appraiser requirements and can be relied upon until the final regulations are published. The Notice provides that:

- The appraisal designation from a recognized appraiser organization must be based on the appraiser's education and demonstrated competency in valuing the type of property for which the appraisal is performed.
- The appraiser is treated as having demonstrated verifiable education and experience in valuing the type of property if the appraiser makes a declaration in the appraisal that, because of the appraiser's background, experience, education and membership in professional associations, the appraiser is qualified to make appraisals of the type of property being valued.
- The appraiser will be treated as having met minimum education and experience requirements if, for real property, the appraiser is licensed or certified for the type of property being appraised in the state in which the appraised real property is located.

An individual is not a qualified appraiser with respect to a particular donation if the donor had knowledge of facts that would cause a reasonable person to expect the appraiser to falsely overstate the value of the donated property. Treas. Reg. § 1.170A-13(c)(5)(ii).

The appraiser's resume, which is typically included in the appraisal, provides a good starting point to assess whether the appraiser is a qualified appraiser. The resume provides information on his or her education and experience and professional designations. It will also typically indicate in which jurisdictions the appraiser holds a license or certification.

License information regarding jurisdictions, history, and disciplinary actions can be found on The Appraisal Foundation Web page. You can search for information on a specific appraiser by selecting the "find an appraiser" button or utilize this link: [Find an Appraiser](#). Some states also provide appraisal licensing information online. Examiners or IRS appraisers can contact the various state boards by telephone to determine if there are any past or pending disciplinary actions against the appraiser. The Office of Professional Responsibility (OPR) publishes a list of practitioners, including appraisers, who have been subject to disciplinary actions by the IRS.

Generally Accepted Appraisal Standards

IRC § 170(f)(11)(E)(i)(II) and Notice 2006-96 state that a qualified appraisal is an appraisal conducted by a qualified appraiser in accordance with generally accepted appraisal standards and any regulations or other guidance prescribed by the Secretary.

Section 3.02(2) of Notice 2006-96 states that an appraisal will be treated as having been conducted in accordance with generally accepted appraisal standards if, for example, the appraisal is consistent with the substance and principles of the Uniform Standards of Professional Appraisal Practice (USPAP), as developed by the Appraisal Standards Board of The Appraisal Foundation.

Uniform Standards of Professional Appraisal Practice

In 1989, The Appraisal Foundation, a nonprofit organization, adopted licensing and appraisal standards for the appraisal industry. The Uniform Standards of Professional Appraisal Practice (USPAP) are the minimum acceptable appraisal standards for federally regulated transactions. USPAP is recognized throughout the United States as the generally accepted standards of professional appraisal practice.

Although USPAP was intended for appraisals prepared for federally regulated transactions, all states have adopted USPAP for real estate appraisals completed by licensed or certified appraisers.

In addition, various appraisal organizations such as the Appraisal Institute (AI), National Association of Independent Fee Appraisers (NIAFA), American Society of Appraisers (ASA), and American Society of Farm Managers and Rural Appraisers (ASFMRA) have additional standards and ethics that their membership (both designated and undesignated) is required to follow. For the most part these organizations require adherence to USPAP.

IRC § 170(f)(11)(E)(i)(II) does not specifically mandate compliance with USPAP but does require the appraisal to be prepared in accordance with generally accepted appraisal standards. Qualified real estate appraisers holding themselves out to the public as appraisers generally would be required to comply with USPAP by virtue of their appraisal licenses and professional designations.

In assessing whether an appraisal is a qualified appraisal, Examiners and IRS Appraisers must consider whether the appraisal is consistent with the substance and principles of USPAP and, if not, whether the appraisal satisfies the generally accepted appraisal standard requirement.

Appraisal Fees

Appraisal fees that a taxpayer pays to determine the fair market value (FMV) of donated property are not deductible as charitable contributions. However, taxpayers can claim appraisal

fees, subject to the two percent of adjusted gross income (AGI) limit, as a miscellaneous itemized deduction on [Schedule A, Itemized Deductions](#) (PDF), of [Form 1040, U.S. Individual Income Tax Return](#) (PDF).

Chapter 8: Amount of Deduction

Overview

Several factors may affect the amount a taxpayer may claim as a charitable contribution deduction for a conservation easement:

- Fair market value
- Percentage limitations
- Basis limitations
- Type of property (ordinary income, short-term capital gain, long-term capital gain)
- Bargain sale
- Quid pro quo and charitable intent

Any charitable contribution amount that cannot be utilized by the taxpayer in the year of donation of the conservation easement can be carried over and claimed on subsequent year tax returns, generally for five years but, in the case of a conservation easement, 15 years. See below for the conservation easement percentage limitation and carryover rules.

Percentage Limitations

For charitable contributions by individuals of property other than cash, the amount of the deduction a taxpayer may claim is subject to percentage limitations based on:

- The type of property donated,
- The type of qualified organization, and
- The use of the property by the qualified organization.

See [Publication 526, Charitable Contributions](#) (PDF) for additional guidance on percentage limitations.

Individuals

In general, deductible contributions may not exceed 50% of the individual's contribution base, but lower percentages apply in the case of appreciated property and contributions to certain private foundations.

A 30% limit applies to contributions of long-term capital gain property donated to 50% limit organizations (those described in IRC § 170(b)(1)(A)), and a 20% limit applies for similar gifts to 30% organizations (those described in IRC § 170(b)(1)(B)).

Contribution base for individuals is defined in IRC § 170(b)(1)(G) as adjusted gross income (computed without regard to any net operating loss carryback to the taxable year under IRC § 172).

A conservation easement is considered long-term capital gain property if the underlying property is a capital asset held for more than a year. An individual may deduct a qualified conservation easement contribution up to 50% of the individual's contribution base (after reducing the contribution base by other contributions) but see special rule (100%) for farmers and ranchers below. IRC § 170(b)(1)(E)(i).

The maximum percentage limitation for contributions of cash is 50%.

Corporations

For corporations, in general, the maximum amount allowable as a charitable contribution deduction for any taxable year is 10% of the corporation's taxable income for that year, computed with certain adjustments described in IRC § 170(b)(2)(D).

Special Rules for Individuals and Corporations that are Farmers and Ranchers

Individuals

An individual who is a qualified farmer or rancher may deduct up to 100% of the individual's contribution base (after reduction by other contributions) for the donation of a qualified conservation contribution.

A qualified farmer or rancher is an individual whose gross income from the trade or business of farming within the meaning of IRC § 2032A(e)(5) is greater than 50% of the individual's gross income for the taxable year.

For any contribution of property that is used in agriculture or livestock production, the 100% limitation applies only if the property is subject to a restriction that requires the property to remain available for agriculture or livestock production. IRC § 170(b)(1)(E)(iv)(II). If the contribution is not subject to such a restriction, the 50% limitation applies.

Corporations

A corporation that is a qualified farmer or rancher may make a qualified conservation contribution of property used in agriculture or livestock production (or available for such production) and deduct up to 100% of the corporation's taxable income only if the property is subject to a restriction that requires the property to remain available for such production. IRC § 170(b)(2)(B).

Carryovers

In general, taxpayers (both individuals and corporations) can carry over unused charitable contributions for up to five years. For conservation easement contributions, the carryover period

is 15 years.

Basis Limitations

The deduction for a charitable contribution of property generally is equal to the fair market value (FMV) of the property, but in some cases may be limited to the lesser of FMV or basis.

In the case of tangible property, the deduction is limited to the lesser of FMV or basis if the use of the property transferred is unrelated to the charitable purpose of the qualified organization, for example, donation of a piece of art work to a land trust. IRC § 170(e)(1)(B)(i)(I).

Contributions of Appreciated Property

If a taxpayer contributes property with a FMV that is more than the taxpayer's basis, the taxpayer may have to reduce the FMV by the amount of appreciation when determining the amount of the deduction. IRC § 170(e)(1). To determine whether to reduce the FMV, find out whether the property is:

- Ordinary income property
- Short-term capital gain property
- Long-term capital gain property

See [Publication 544, Sales and Other Dispositions of Assets](#) (PDF) for additional guidance.

Ordinary Income and Short-Term Capital Gain Property

If the property is ordinary income property or short-term capital gain property, the deduction generally is limited to basis. IRC § 170(e)(1)(A).

Property is ordinary income or short-term capital gain property if its sale at FMV on the date of contribution would result in ordinary income or short-term capital gain.

An example of ordinary income property is real property (land and anything built on it) held by a real estate dealer, if the donated real property is primarily held for sale to customers in the ordinary course of trade or business. If the property is ordinary income property in the hands of the donor, then the deduction would be limited to basis.

Gain on the disposition of depreciable real property is treated as ordinary income to the extent of additional depreciation allowed or allowable on the property. Additional depreciation is the amount of the actual depreciation over the depreciation figured using the straight line method.

See [Publication 544, Sales and Other Disposition of Assets](#) (PDF) and [Form 4797](#) (PDF) and the related instructions.

Short-term capital gain property (such as real estate held for investment) held for a year or less is treated the same as ordinary income property.

Example: Jefferson contributes a conservation easement on a parcel that he held for 11 months. The conservation easement is short-term capital gain property, and Jefferson's deduction is limited to the lesser of his basis in the easement or its fair market value.

The amount of basis allocable to the conservation easement bears the same ratio to the total basis of the property as the FMV of the conservation easement bears to the FMV of the entire parcel before the granting of the conservation easement.

Example: Mary paid \$80,000 for a parcel held for investment, which has a FMV of \$100,000. She decides to donate a conservation easement with a FMV of \$5,000.

If Mary's parcel is held for less than one year, her deduction for the easement is \$4,000 ($\$5,000/\$100,000 \times \$80,000 = \$4,000$).

If Mary held the property for more than a year, her deduction is the easement's FMV (\$5,000).

Long-Term Capital Gain Property

If property is long-term capital gain property, the deduction generally is not limited to basis and may be as much as FMV. IRC § 170(e)(1).

Property is long-term capital gain property if its sale at FMV on the date of the contribution would result in long-term capital gain.

Long-term capital gain property is a capital asset held for more than a year.

Examples of long-term capital gain property are (1) real estate held for more than a year for investment, or (2) a personal residence held for more than a year.

Bargain Sale

A bargain sale of property to a qualified organization is a sale or exchange for less than the property's fair market value (FMV). For a bargain sale, the taxpayer must have charitable intent and, therefore, knowingly accepts less than FMV for the property. IRC § 1011(b).

A bargain sale is treated as partly a charitable contribution and partly a sale or exchange. To determine the FMV of the contributed part, subtract the amount paid by the qualified organization from the property's FMV at the time of the gift.

Example: Betty sells a conservation easement (on property held for investment for more than one year) to a conservation organization for \$10,000. The FMV of the easement is \$12,500. Her charitable contribution deduction from the bargain sale is \$2,500 ($\$12,500 - \$10,000$) provided that all requirements to claim a conservation easement deduction have been met and she knew, at the time of the sale, that the easement was worth \$12,500. If a taxpayer contributes property subject to a debt (such as a mortgage), and the debt is assumed by the qualified organization, the taxpayer must reduce the FMV of the property by the amount of the debt.

Taxable Gain

The part of the bargain sale that is a sale or exchange may result in a taxable gain. The amount of taxable gain is determined by allocating basis (under IRC § 1011(b)) between the portion of the property deemed sold and the portion of property deemed contributed.

For more information on determining the amount of any taxable gain, see "Bargain Sales to Charity" in [Publication 544, Sales and Other Dispositions of Assets](#) (PDF), and IRC § 1011(b). There are examples in Pub. 544, page 4, and also Pub. 526, pages 12-13.

See Treas. Reg. § 1.170A-14(h)(3)(iii) for additional guidance on allocating basis.

Federal and State Easement Purchase Programs

Many states and some federal agencies have land or conservation easement purchase programs. The purchase price may be at fair market value (FMV) or at a discounted price, depending on the specific program. If the conservation easement was purchased at FMV, then there would be no charitable contribution for the conservation easement.

The donation must meet all of the statutory and regulatory requirements for a qualified conservation easement contribution in order for the taxpayer to claim a noncash charitable contribution for the donation portion of a bargain sale.

Quid Pro Quo and Charitable Intent

Charitable intent exists if the transfer was made without the receipt of, or the expectation of receiving, a quid pro quo for the transfer. As a general rule, if the benefits received or expected to be received are greater than those that inure to the general public, the transfer does not satisfy the charitable intent requirement under IRC § 170. *Hernandez v. Commissioner*, 490 U.S. 691 (1989); *United States v. American Bar Endowment*, 477 U.S. 105, 118 (1986); *Singer Co. v. U.S.*, 196 Ct. Cl. 90, 449 F.2d 413, 422-423 (1971).

If the donor receives, or can reasonably expect to receive, a substantial financial or economic benefit, but it is clearly shown that the benefit is less than the amount of the donor's transfer, then a deduction is allowable for the excess of the amount the donor transferred over the amount of the financial or economic benefit received or reasonably expected to be received by the donor.

Example 1: Steven is a real estate developer. He contributes a conservation easement with the expectation that it will result in his receiving preferential zoning treatment from the city zoning board. Steven is not allowed a charitable contribution deduction.

Example 2: Jeanie lives along a scenic highway. In order for her to secure a variance on her property, the zoning board requires an easement on 10 percent of her property. Jeanie decides to place an easement on 25 percent of her property. Jeanie may deduct as a charitable contribution the value of the easement she placed on 15 percent of her property.

The burden is on the taxpayer to show that all or part of a payment is a charitable contribution or gift. Treas. Reg. § 1.170A-1(h)(1) and (2); *United States v. American Bar Endowment*, 477 U.S. 105, 116-118 (1986); and Rev. Rul. 67-246, 1967-2 CB 104.

Rehabilitation Tax Credit

IRC § 47 is an investment tax credit intended to encourage rehabilitation of historic buildings for urban and rural revitalization. The rehabilitation tax credit is a two-tier credit with a 20% credit available for a certified historic structure, and a 10% credit for any qualified rehabilitated building first placed in service before 1936 other than a certified historic structure that is a qualified rehabilitated building.

The National Park Service and the IRS in partnership with State Historic Preservation Offices jointly administer the Historic Preservation Tax Incentives Program. See the Rehabilitation Tax Credit Market Segment Specialization Program Guide (PDF) for additional information.

Recapture of Rehabilitation Tax Credit

IRC § 50(a)(1) provides for recapture of the investment tax credit upon disposition.

When a façade easement is contributed during the same year that a qualified rehabilitated building is placed in service, the taxpayer will not be entitled to claim the portion of the rehabilitation tax credit attributable to the façade easement. See *Rome I, Ltd. v. Commissioner*, 96 T.C. 697 (1991); Rev. Rul. 89-90, 1989-2 C.B. 3.

Under IRC § 50, if a taxpayer claims a rehabilitation tax credit with respect to property and subsequently makes a qualified conservation contribution (i.e., contributes a façade easement) with respect to the property, the charitable contribution is a partial disposition of the property. This event will trigger recapture of all or part of the credit if the contribution is made within the recapture period (5 years from the placed in service date). See Rev. Rul. 89-90.

Under § 170(f)(14), if, during the 5 years preceding the date of a façade easement contribution, a rehabilitation tax credit under IRC § 47 was claimed for the building, the amount of the charitable contribution deduction must be reduced by the ratio of the sum of the credits allowed for those 5 years over the fair market value of the building on the date of contribution.

See the Rehabilitation Tax Credit Market Segment Specialization Program Guide (PDF) for additional information.

Chapter 9: Valuation of Conservation Easements

Overview

To determine the fair market value (FMV) of a conservation easement, appraisers must have a clear understanding of IRC § 170 and the accompanying Treasury regulations. The appraiser also must meet the definition in IRC § 170(f)(11)(E) of a “qualified appraiser.”

The value of a conservation easement is the FMV at the time of contribution and depends on the particular facts and circumstances of the property. Treas. Reg. § 1.170A-14(h)(3)(i).

IRC § 170(f)(11)(E) and Treas. Reg. § 1.170A-13(c)(3) impose special substantiation requirements that must be met for the appraisal to be considered a qualified appraisal.

Treas. Reg. § 1.170A-14(h)(3)(i) requires that, if there is a substantial record of sales of comparable easements, those sales are used to value conservation easements. Since easements are not typically sold, there usually are insufficient sales to use a comparable easement sales approach. In most cases, the "before and after" method of valuing a conservation easement is used.

The purpose of this chapter is to provide a general overview on the valuation of conservation easements and generally accepted appraisal standards. A comprehensive discussion of valuation is beyond the scope of this ATG.

See Treas. Reg. §§ 1.170A-13 and 1.170A-14 of the Income Tax Regulations, Notice 2006-96, 2006-2 C.B. 902, Publication 526, Charitable Contributions, [Publication 561, Determining the Value of Donated Property](#) (PDF), [Form 8283, Noncash Charitable Contributions](#) (PDF), and the [Instructions for Form 8283](#) (PDF) for more information about valuation, qualified appraisers, qualified appraisals, and other requirements.

Valuation Process

Valuation, as defined by the *Dictionary of Real Estate Appraisal, Sixth Edition*, The Appraisal Institute, Chicago, Ill., 2015, is the process of estimating the FMV of an identified interest in a specific parcel or parcels of real estate as of a specified date. It is a term used interchangeably with appraisal. The valuation process includes:

- Defining the problem/scope of work,
- Data collection and property description,
- Data analysis,
- Application of the approaches to value,
- Reconciliation of value indications and final opinion of value, and
- Reporting the defined value.

Critical to the completion of any valuation assignment, especially the valuation of a conservation easement, is clearly defining the problem and determining the scope of work. A detailed scope of work should be presented in the appraisal to allow a reader to understand exactly what steps and procedures were utilized by valuation experts in their analyses and FMV determinations.

Appraisers must have a thorough understanding of which rights were “given up” or relinquished and which rights were retained by the donor in order to properly value the conservation easement. They must refer to the deed to determine what rights were relinquished.

Valuation Date

The value of a conservation easement contribution is the fair market value of the easement at the time of the contribution. Treas. Reg. § 1.170A-14(h)(3)(i). For federal income tax purposes, the date of contribution is the date the deed of easement is recorded pursuant to state law. The qualified appraisal must state, among other things, the date or expected date of the contribution. Treas. Reg. § 1.170A-13(c)(3)(ii)(C).

Fair Market Value (FMV)

The value of the donated easement must meet the definition of FMV as defined by Treas. Reg. § 1.170A-1(c)(2):

"The fair market value is 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."

A common error found in appraisals submitted for federal tax purposes is that the FMV definition utilized in the appraisals is not correct. Also, the FMV of the property must decrease as a result of the granting of the conservation easement in order for a taxpayer to claim a charitable contribution deduction. In some instances, the grant of a conservation easement may have no material effect on the value of the property or may in fact serve to enhance the value of property. Treas. Reg. § 1.170A-14(h)(3)(ii).

Before and After Method

In theory the best evidence of FMV of a conservation easement is the sale price of easements comparable to the donated easement. An appraiser should research the market to determine if there is a substantial record of sales of comparable easements; however, in most instances, there are no substantial record of comparable sales.

If there is no substantial record of comparable easement sales, which is usually the case, the "before and after" approach to valuing a conservation easement is used.

FMV of the property before the easement
Less: FMV of the property after the easement
Equals FMV of the easement

In essence, an appraiser must determine the highest and best use (HBU) and the corresponding FMV of the subject property twice: first, without regard to the conservation easement ("before" value), and then again after considering the specific restrictions imposed on the property by the deed ("after" value).

In determining the "before" value of the property, an appraiser must consider the current use of the property but also objectively assess the likelihood that the property would be developed absent the conservation easement restriction. Existing zoning, conservation, historic

preservation, or other laws and restrictions may limit the property's potential HBU. Treas. Reg. § 1.170A-14(h)(3)(ii).

In determining the “after” value of the property, an appraiser must consider both the specific restrictions imposed by the conservation easement being valued and the specific restrictions imposed by easements on any “comparable” properties.

Use of Flat Percentage Cannot Be Applied to Before Value

There is no standard value or percentage impact on the “before” value of the property due to the granting of a conservation easement. Each conservation easement must be valued before and after the granting of the easement, based on the particular facts and circumstances of that property, and the value must be substantiated with a qualified appraisal.

Contiguous Parcels

The amount of the charitable contribution deduction due to the granting of a conservation easement covering a portion of a contiguous property owned by the donor and the “donor's family” (as defined in IRC 267(c)(4)) is the difference between the FMV of the entire contiguous parcel of the property before and after the granting of the easement. Treas. Reg. § 1.170A-14(h)(3)(i).

Section 267(c)(4) defines the term “family” as including only an individual's “brothers and sisters (whether by the whole or half-blood), spouse, ancestors and lineal descendants.” Parents, children, grandparents, grandchildren, half-brothers and half-sisters are included in the definition of family but cousins, nieces, nephews, in-laws, and step relations are not included.

Example: John Smith owns a 1,000-acre farm. Mr. Smith decides to put a conservation easement on the southern 500 acres. The entire 1,000 acres would need to be valued before and after the easement is imposed because the donor owns the entire 1,000 acres, and the unencumbered parcel is contiguous to the encumbered parcel.

In order to properly determine what properties should be valued, an appraiser must identify and determine the ownership of any contiguous parcels at the outset of the appraisal assignment. Next, the appraiser must assess whether the owners of any contiguous parcels are the donor or donor's family as defined in IRC § 267(c)(4).

Application of the contiguous parcel rules can be complex. IRS appraisers should contact a program analyst or Counsel for guidance. See CCA 201334039 (8/23/2013).

Enhancement Rule

A taxpayer must also consider any enhancement to the value of any other property owned by the donor or a “related person” resulting from the conservation easement. The amount of the conservation contribution deduction is reduced by the amount of the increase in the value of the other property, whether or not that other property is contiguous. Treas. Reg. § 1.170A-14(h)(3)(i).

A related person, for purposes of applying the enhancement rule, is defined in IRC §§ 267(b) or 707(b). Application of the related party rules can be complex. IRS appraisers should contact a program analyst or Counsel for guidance.

There are two important distinctions between the contiguous parcel and the enhancement rules. First, the contiguous parcel rule applies only to contiguous property, but the enhancement rule can apply to both contiguous and noncontiguous property. Second, the contiguous parcel rule only applies to contiguous property owned by the donor or the donor's family (as defined in IRC § 267(c)(4)), but the enhancement rule applies to contiguous or noncontiguous property owned by a related party under §§ 267(b) or 707(b). The definition of "related person" includes the donor's family members and also "related" non-family members.

Example: John Smith owns a 1,000-acre farm. Mr. Smith decides to put a conservation easement on the southern 500 acres. The entire 1,000-acre parcel would need to be valued based on the application of the contiguous parcel rule. John Smith also owns a noncontiguous 50-acre parcel located within a quarter mile of the subject property. Because of the conservation easement, the 50-acre parcel will have superior views of the river that lies beyond the 500-acre parcel. As a result, the 50-acre parcel would need to be valued and the conservation easement contribution would be reduced by the amount of the increase in value (if any) to the 50-acre parcel.

Application of the enhancement rules can be complex. IRS appraisers should contact a program analyst or Counsel for guidance. See CCA 201334039 (8/23/2013).

Market Analysis

Market analysis is defined as a process for examining the demand for and supply of a property type and the geographic market area for that property type. This is a critical step in the highest and best use analysis. The six-step market analysis process described below is data required for the four test criteria (physically possible, legally permissible, financially feasible and maximally productive). See *The Appraisal of Real Estate, 14th Edition*, The Appraisal Institute, Chicago, Ill., 2013, page 299.

An appraiser can use current and historical market conditions to infer future supply and demand. In addition, to forecast subject-specific supply, demand, absorption and capture rate (capture rate is the percentage of total market demand a specific property or group of properties is expected to capture) over a property's projected holding period, the appraiser should augment the analysis of current and historical market conditions with fundamental analysis. Given the fact that, in the majority of conservation easement cases, development of the property has not taken place, then there should be more emphasis on a fundamental analysis. A fundamental analysis would require an analysis of historic and projected: population, income, zoning, demand, absorption, supply, ideal improvement, existing space, proposed space, occupied space, market demographics, market income and expense information, capitalization rates, etc. to forecast future market conditions and is a much more detailed analysis than an inferred analysis.

Most market analysis can be performed using a six-step process:

Step 1-Property Productivity Analysis: Physical, Legal and Location Attributes
Step 2-Market Delineation: Competitive Market Area
Step 3-Demand Analysis: Demand Segmentation, Historical Growth & Demand Drivers
Step 4-Supply Analysis: Existing, Under Construction and Proposed Competition
Step 5-Interaction of Supply and Demand: Competitive and Residual Demand
Step 6-Forecast Subject Capture: Reconciliation of Inferred and Fundamental Forecasts

Layman's terms: The appraiser analyzes how competitive the subject property is or will be in its market area. The current and future demand for similar properties is estimated and compared to the estimated current and future supply within the market area.

Appraisers using a residential subdivision method may not always adequately quantify the market demand and supply for the proposed lots and/or houses. *The Appraisal of Real Estate, 14th Edition*, The Appraisal Institute, Chicago, Ill, 2013, pages 299 – 330 (Chapter 15) provides a detailed discussion on completing a market analysis for a variety of property types and serves as a good reference tool.

When appraisers fail to follow the six-step process, and do not support demand, supply and a capture rate for the subject property, it can lead to erroneous conclusions in the highest and best use analysis.

Highest and Best Use (HBU)

The determination of the property's highest and best use (HBU) is vital to the valuation of any real estate, including conservation easements.

All professional appraisal organizations recognize that the HBU of the property is a key element to a proper valuation. To qualify as the HBU, a use must satisfy four criteria:

- **Physically Possible** - The land must be able to accommodate the size and shape of the ideal improvement: What uses of the subject site are physically possible?
- **Legally Permissible** - A property use that is either currently allowed or most probably allowable under applicable laws and regulations. What uses of the subject site are permitted by zoning, deed restrictions, and government restrictions?
- **Financial Feasibility** - The ability of a property to generate sufficient income to support the use for which it was designed. Among those uses that are physically possible and legally permissible, which uses will produce a net return to the owner?
- **Maximally Productive** - The selected use must yield the highest value among the possible uses. Among the feasible uses, which use will produce the highest net return or the highest present worth?

An appraiser's HBU analysis and conclusion should be documented in the appraisal report with a comprehensive discussion supported by relevant market data or other information sources to adequately support the conclusions.

At times, an appraiser may rely in part on the analysis by another professional such as a land planner or geologist. However, an appraiser is required by generally accepted appraisal standards to exercise due diligence with respect to the assumptions put forth by the other professional. An appraiser must have a reasonable basis to believe that the other professional's work product is credible and should disclose such reliance.

Methodology

Treas. Reg. § 1.170A-14(h)(3)(i) and (ii) allows for two different types of valuation: direct comparison or indirect analysis.

Direct comparison is to analyze sales of comparable properties to arrive at a conclusion as to value. A direct comparison is based on direct sales of easements, meaning the price paid by purchases of easements having the same or similar restrictions.

Conservation easements are sold infrequently and even if the appraiser is able to identify sales of easements they might not be appropriate comparables, and the number of sales might not be substantial. Accordingly, most conservation easements are valued by indirect analysis (before and after approach).

There are three recognized valuation methodologies within the appraisal industry:

- Sales Comparison Approach (SCA)
- Cost Approach (CA)
- Income Capitalization Approach (ICA)

All three approaches should be considered in every appraisal assignment. This does not mean that all three approaches need to be applied.

Example: If the appraiser is valuing the impact of granting a conservation façade easement on a single-family home in an area in which single-family homes are typically not rental income properties, then it is not necessary to complete the income capitalization approach. Generally, a statement that due to the lack of market information the income capitalization approach was not completed would be sufficient.,

The following brief descriptions of the three approaches (i.e., Sales, Cost and Income Capitalization Approaches) were taken from *The Dictionary of Real Estate Appraisal, Sixth Edition*, which was published by The Appraisal Institute, Chicago, Ill., 2015.

Sales Comparison Approach

In the Sales Comparison Approach, a value indication is derived by comparing the property being appraised to similar properties that have been sold recently, applying appropriate units of comparison, and making adjustments to the sale prices of the comparables based on the elements of comparison. The sales comparison approach is the most common and preferred method of land valuation when an adequate supply of comparable sales are available.

Elements of comparison are defined by *The Appraisal of Real Estate, 14th Edition*, The Appraisal Institute, Chicago, Ill. 2013, page 404 as “the characteristics or attributes of properties and transactions that help explain the variances in the prices paid for real property.” The elements of comparison are divided into two categories: transactional adjustments and property adjustments.

Transactional adjustments are:

- Real property rights conveyed
- Financing terms
- Conditions of sale
- Expenditures made immediately after purchase
- Market conditions

These adjustments are “generally applied in the order listed” and are successive.

Property adjustments are:

- Location
- Physical characteristics
- Economic characteristics
- Legal characteristics
- Non-realty components of value.

Property adjustments are usually applied after the transactional adjustments, but in no particular order and are not successive.

Layman’s terms: The appraiser compares the subject property to recently sold properties. Adjustments are made to the sales to account for differences between the properties to estimate the FMV of the subject property. If there are sufficient sales, this is the preferred valuation methodology for land.

Cost Approach

In the Cost Approach, a value indication is derived for the fee simple interest in a property by estimating the current cost to construct a reproduction of (or replacement for) the existing structure, including entrepreneurial incentive or profit; deducting the depreciation from the total cost; and adding the estimated land value. Improvement cost estimates can be done with national cost manuals (e.g., Marshall Valuation Service Manual), builder cost estimates or market extraction. Because national cost manuals only provide a cost for new improvements, and

in utilizing these manuals, the valuation must include indirect costs and an analysis for all forms of depreciation.

Income Capitalization Approach

In the Income Capitalization Approach, an appraiser derives a value indication for an income-producing property (i.e., rental property) by converting its anticipated benefits (cash flows and reversion) into property value. This conversion can be accomplished in two ways. One year's net income expectancy or an annual average of several years' income expectancies can be capitalized at a market-derived capitalization rate. Alternatively, the annual cash flows for the holding period and the reversion can be discounted at a specified yield rate.

The FMV of the subject property is estimated based on the anticipated net income to the property. The appraiser estimates the potential gross income and subtracts vacancy and collection loss as well as operating expenses to estimate the net income to the property. If one year's net income is estimated then that income is capitalized via a market-derived capitalization rate to provide an indication of the FMV of the subject property. If multiple years' net income is estimated, then the cash flows and reversion are discounted at a specified yield rate to provide a FMV indication.

Subdivision Development Method

In the valuation of land conservation easements, many appraisals include a land residual analysis using a Subdivision Development Method. Although appraisers have referred to this approach as a different valuation methodology, the Subdivision Development Method is an adaptation (or subset) of the income capitalization method. The reason appraisers refer to it as "another" method is because the analysis utilizes a combination of both the sales comparison and cost approaches described above.

This method estimates land value assuming that subdivision and development of the property is the HBU of the parcel of land being appraised. When all direct and indirect costs, and entrepreneurial incentive (expected rate of return on investment) are deducted from the anticipated gross sales price of the finished lots, the resultant net sales proceeds are then discounted to present value at a market-derived rate over the development and absorption period to indicate the value of the raw land (*The Dictionary of Real Estate Appraisal, Sixth Edition*, The Appraisal Institute Chicago, Ill., 2015, page 223).

Layman's terms: The FMV of the subject property is estimated by first estimating what the "finished" lots would sell for in the market place. Costs, including anticipated profit, are then deducted to estimate the net income projected to be generated by the property. The projected net income (i.e.,

cash flow) is discounted (for the time necessary to get approvals, finish the lots and sell the lots) at a specified discount rate (a/k/a yield rate) to provide a FMV indication.

Example: Parcel C is a 100-acre parcel that is zoned residential, and the appraiser has concluded that the HBU of the property is for a 50 lot residential subdivision. An appraiser may use the sales comparison approach to determine the market value of the “finished” lots. The appraisal would provide information on similar projects in order to estimate the absorption period to sell the lots. Next, the appraiser deducts the costs to improve the property (development costs) necessary for the subject property to attain the finished lot status. Finally, the cash flow over the absorption period is discounted back to the valuation date (this accounts for the time get the approvals, take the lots to the finished lot stage, and to sell all of the lots) to provide an estimate of the present value of the subject property as raw land.

The Subdivision Development Method requires a significant amount of data such as development costs, profit margins, sales projections and the pricing of developed lots. It is typically completed using a Discounted Cash Flow (DCF) analysis.

Although the Tax Court has not specifically addressed the merits of utilizing the Subdivision Development Method, there are several decisions in the Federal Courts that provide some insight. The Supreme Court stated in *Olson v. United States*, 292 U.S. 246, 257 (1934) that “Elements affecting value that depend upon events or combinations of occurrences which, while within the realm of possibility, are not fairly shown to be reasonably probable, should be excluded from consideration.”

Since there are many variables involved in the Subdivision Development Method, there is a greater chance of errors, which could result in an incorrect valuation. Some common errors include:

- Failure to account for time to obtain necessary project approval.
- Failure to account for time to put infrastructure in place.
- Failure to include the cost of the infrastructure.
- Failure to account for time necessary to sell the units (absorption) or lack of support for the absorption estimate.
- Failure to include developer’s profit.
- Failure to account for existing competing properties as well as properties that are still in the planning stage.
- Inadequate assessment of the risk associated with the development.

Transferable Development Rights (TDRs)

A transferable development right (TDR) is a development right held by the landowner that can be transferred by the landowner to another party, and may be used in another location. A number of states, counties and cities have established TDR programs. These programs are used to manage land development through the exchange of zoning privileges allowing property owners to separate development rights from the

underlying property and sell them to purchasers who want to increase the density of development in higher density areas.

For example, in New York City, an owner of a building with TDRs may be able to transfer (sell) unused development rights for use in other building sites subject to the program restrictions.

A transfer of development rights by the landowner is not a transfer of the landowner's entire interest in the property and may not qualify for a charitable contribution per IRC § 170(f)(3). Examiners and IRS appraisers should consult with Counsel if the conservation easement case involves TDRs.

Chapter 10: Preplanning the Examination

Overview

IRM 4.10.2, *Pre-contact Responsibilities*, requires Examiners to perform a pre-contact analysis, including a review of the income tax return, any attachments to the return, and internal and external sources of information.

Review of Return

Only itemizers may claim a charitable contribution deduction. A conservation easement deduction is reported on [Schedule A, Itemized Deductions](#) (PDF), Line 17, "Other than by cash or check." Any carryover of charitable contributions originating from earlier tax years appears on the "Carryover from Prior Year," Line 18.

Audit Tip: Examiners should determine, at the beginning of the examination, the tax year of the contribution. If the amount claimed on the return is a carryover from an earlier tax year, the original return, including all attachments, must be secured. This is important 1) to verify compliance with substantiation requirements, and 2) to ensure that all open tax years are included in the examination.

Form 8283 – Appraisal Summary

[Form 8283, Noncash Charitable Contributions](#) (PDF), referred to in the Deficit Reduction Act, Pub. Law 98-369, § 155 "DEFRA", and Treas. Reg. § 1.170A-13(c)(4) as the "appraisal summary," is the starting point to gather information about the conservation easement deduction.

This form must be completed and attached to the return for all noncash charitable contribution deductions greater than \$500. For noncash charitable contribution deductions in excess of \$5,000, the taxpayer must complete Section B of the Form 8283. DEFRA and Treas. Reg. § 1.170A-13(c)(2).

If the donation originates from a flow-through entity (such as S corporation or partnership), the

partner or shareholder must include a copy of the entity's Form 8283 with the return on which the deduction is first claimed. Treas. Reg. § 1.170A-13(c)(4)(iv)(G).

Close inspection of Form 8283 may indicate an improper deduction or overvalued conservation easement. Look for:

- Incomplete or missing information such as an inadequate description of the property or missing acquisition date or basis in the property.
- Missing appraiser or donee signatures.
- Inconsistent dates when compared to the appraisal or other attached documents.
- A short time period between the acquisition of the property and the donation date.
- High valuation of the easement as compared to the basis of the underlying property, in light of holding period and the market conditions for the relevant market.
- High valuation of the easement in light of the total acreage of the underlying land.
- Use of an appraiser who does not generally perform appraisals where the easement is located.

Audit Tip: Completion of the appraisal summary (Form 8283) does not satisfy the contemporaneous written acknowledgment requirement in IRC § 170(f)(8). Failure to comply with the contemporaneous written acknowledgment requirement will result in disallowance of the charitable contribution deduction. See Chapter 2 for a discussion of what information must be included in the contemporaneous written acknowledgment and when it must be obtained by the taxpayer.

Signature Requirements

Part II, of Section B, Taxpayer (Donor) Statement is not relevant unless the appraised value is \$500 or less.

Part III of Section B, Declaration of Appraiser, must be signed and dated by the qualified appraiser for donations in excess of \$5,000.

Part IV of Section B, Donee Acknowledgment, must be signed by an official authorized to sign the tax returns of the donee organization or a person specifically designated to sign Form 8283. Examiners should look for incomplete or improperly completed donee acknowledgments and determine if there are any discrepancies with other available information.

Return Attachments

A qualified appraisal, prepared and signed by a qualified appraiser, is required to be attached to the return if the deduction claimed (1) exceeds \$500,000, or (2) regardless of the dollar amount claimed, if the deduction relates to a contribution of a façade easement on a building or structure in a registered historic district.

Note: The special rule for façade easements does not apply to properties listed on the National Register.

See [Chapter 7](#) for guidance on qualified appraisals.

If a qualified appraisal was required to be attached but was not attached to the original return claiming the conservation easement, the charitable contribution deduction may be disallowed for failing to meet the IRC 170(f)(11) requirements. See IRC § 170(f)(11)(A)(ii)(II) for a limited exception to this rule.

If the Examiner does not have the original return or has been assigned a carryover tax year, the original return must be ordered from the Service Center using SC 45 to verify compliance with the requirement to attach the appraisal.

If a return is filed electronically, any attachments including the appraisal must be filed with the [Form 8453, U.S. Individual Income Tax Transmittal](#) (PDF) for an IRS e-file Return. The Examiner will need to request the original Form 8453 with attachments to determine if the taxpayer has met the substantiation requirements.

IDRS command code TRDBV will show whether the Form 8453 was filed and the related Document Locator Number (DLN). The Form 8283 can be secured using command code ESTAB with the identified DLN. If the TRDBV does not show the filing of a Form 8453, the IDRS print should be included in the examiner's work papers to demonstrate that there is no record of filing the required return attachments.

In some cases, taxpayers attach baseline studies, correspondence or other documents related to the easement donation. This information should be reviewed for unusual items or inconsistencies and ultimately compared to actual source documents.

Other Tax Issues

The Examiner is responsible for determining the scope of the audit and should be alert to other potential tax issues on the tax return, which may or may not be related to the conservation easement deduction.

Some examples of potential issues related to the conservation easement donation are income generated from the sale of state tax credits and recapture of rehabilitation tax credits.

IRM 4.10.4.3, *Minimum Requirements for Examination of Income*, requires Examiners to consider gross income during the examination of all income tax returns regardless of the type of return filed by the taxpayer. All deviations from minimum probes need to be documented and approved by the group manager.

TEFRA Considerations

An individual's income tax return may be selected for examination based on a large noncash contribution or carryover. Examiners must determine as quickly as possible whether the donation originated from a partnership or limited liability company (LLC) treated as a partnership for federal income tax purposes. This information may not be readily available by inspection of the return particularly for carryovers.

The determination of the tax treatment of partnership items is made at the partnership level. If the easement donation was made by a partnership or LLC treated as a partnership, the charitable contribution is a partnership item. An adjustment to the charitable contribution deduction cannot be proposed without conducting an examination of the originating donor entity (i.e., Form 1065 entity). If the entity is a TEFRA entity, the unified audit procedures for partnership proceedings must be followed. These procedures may present additional administrative complexities due to statute concerns, involvement of multiple tiers of ownership, and the location of the key case entity and partnership investors.

It is possible that the minimum assessment period for partnership items per IRC § 6229 may have expired. While the government can best protect its interest by extending the IRC § 6229 period of assessment before it expires and conducting a partnership proceeding that includes all the partners, the government is not precluded from conducting a partnership proceeding if the IRC § 6501 assessment period for any of the partners is still open.

Examiners should consult with their local TEFRA Coordinator for guidance on TEFRA examinations. A list of current coordinators can be found on MySB/SE, Issues and Procedures, TEFRA.

Internal Sources of Information

Information available from internal sources may be useful in preplanning for the examination, including the Conservation Easement issue Web page on MySB/SE, IDRS and contacts with program analysts and the Office of Professional Responsibility.

IRS Intranet

Training materials, job aids, recent court decisions and other reference materials on conservation easements can be found on MySB/SE, Issues and Procedures, under “Conservation Easements.” Examiners should refer to the Web page for updated information.

Program Analysts

Examiners are encouraged to contact program analysts (PAs) assigned to this issue to discuss case development as early as possible in the examination. A list of PAs assigned to conservation easements is available on the conservation easement Web page on MySB/SE under “Contacts.” PAs can explain the statutory requirements, help the examiner analyze the documents, and write reports.

Integrated Data Retrieval System - IDRS

Examiners should review all available IDRS information to identify any additional donations and carryovers. A review of the taxpayer's filing history over several years can provide insight.

Reviewing the taxpayer's Information Returns Processing (IRP) documents and securing a link analysis (Yk1) may reveal related flow-through entities associated with the easement contribution.

Façade Filing Fee Verification

Donors must pay a \$500 filing fee to the U.S. Treasury for donations of easements on buildings in registered historic districts if they claim a deduction of more than \$10,000. IRC § 170(f)(13). The fee is to be used to enforce the provisions of IRC § 170(h).

No deduction is allowed unless the taxpayer includes the fee with the return. IRC § 170(f)(13)(A). Payment is transmitted to the IRS using [Form 8283V, Payment Voucher for Filing Fee under Section 170\(f\)\(13\)](#) (PDF).

IDRS reports IMFOLT (individual returns) and BMFOLT (corporate/partnership returns) will show a TC (Transaction Code) 971 with AC (Action Code) 670 to identify the payment of the filing fee. Examiners can also contact a program analyst for confirmation of fee payment.

Publication 78

Publication 78, Cumulative List of Organizations described in Section 170(c) of the Internal Revenue Code of 1986, should be consulted to verify whether the organization has tax-exempt status. An online searchable version can be found [IRS.gov](https://www.irs.gov). Click on “Charities and Nonprofits,” then “Search for Charities” to search for qualified organizations by name and city.

Examiners should be aware that a listing in Publication 78 is not always necessary in order to qualify to receive tax deductible contributions.

Churches and Federal, State, and local governments generally are eligible to receive tax-deductible contributions even though they are not listed in Publication 78. In addition, a local organization that is exempt under a group ruling may not be listed, as it may be a local arm or subsidiary of a national conservation organization.

Not all organizations eligible to receive deductible contributions are eligible to receive a deductible conservation easement contribution. The donee organization must have the commitment to protect the conservation purpose and have the resources to enforce the conservation restrictions.

See [Chapter 4](#) for detailed discussion on qualified organization requirements.

Office of Professional Responsibility

Examiners can search the Office of Professional Responsibility intranet Web page for any previous disciplinary actions against the appraiser or the return preparer. The presence of prior sanctions suggests a need for extra scrutiny by the examiner.

External Sources of Information

Examination of a charitable contribution deduction for a conservation easement is fact intensive, requiring examiners to gather and analyze information to determine whether the charitable contribution deduction is allowable. Review of documents from external sources such as the Internet, public records, and the National Park Service in advance of taxpayer contact can help streamline the examination process.

Internet Research

The Internet (using Google or other similar search engine) can be an excellent source of background information relevant to the taxpayer, donee organization, and appraiser.

Taxpayer

Examiners should search the Internet for information on the taxpayer's business, personal history, reputation in the community, and involvement with conservation issues and organizations.

A particular easement donation may have received local newspaper coverage at the time of the donation. News articles may provide evidence regarding charitable intent, quid pro quo, transactions between related parties, the donor's basis; or whether the property constitutes inventory in the hands of the taxpayer).

Donee Organization

Guidestar.org provides tax returns of charitable organizations and other important information relating to the organizations. Examiners will need to register online to access the information. Returns provided on Guidestar, however, generally do not include schedules of contributors. The Economic Research Institute also can be used to research charitable organizations.

An Internet search of the donee organization may provide relevant information on the organization. Most organizations have their own websites, which provide a wealth of information, especially regarding their charitable purpose and goals.

This research may reveal relationships between the donor and donee organization. Transactions between related parties by either position or business activity must be scrutinized closely.

Audit Tip: A "self-serving" donee organization organized solely for the purpose of accepting one easement may lack charitable purpose or be engaged in self-dealing. If there is a question or concern as to the operations of the organization, examiners should submit a referral to Tax Exempt and Governmental Entities (TEGE).

Appraiser

Examiners can obtain information about the appraiser and appraisal firm such as their professional credentials, expertise with respect to conservation easements, and past business

dealings with the donor or donee organization. This information is helpful in determining if the appraiser is a "qualified appraiser" and may provide some insight into any business history with the taxpayer or donee organization.

License information regarding jurisdictions, history and disciplinary actions can be found on The Appraisal Foundation Web page. You can search for information on a specific appraiser by selecting the "find an appraiser" button or utilize this link: Find an Appraiser Web page. Some states also provide appraisal licensing information online. Examiners or IRS appraisers can contact the various state boards by telephone to determine if there are any past or pending disciplinary actions against the appraiser.

Audit Tip: The appraiser's professional qualifications should be included as part of the appraisal. Information found on the Internet should be compared to the information provided with the return.

Public Records

Examiners must secure directly from the appropriate recordation office the conservation easement deed, any subordination agreements, and other pertinent documents that are recorded with the deed. If online research is not available, the Examiner or the IRS appraiser will need to travel to the recordation office to obtain this information. Use of research services such as *Accurint* alone is not sufficient.

Audit Tip: Until the easement is recorded, the easement is not enforceable in perpetuity. Treas. Reg. § 1.170A-14(g)(1). In some cases, taxpayers claim the donation in the wrong tax year. See Chapter 2 for a detailed discussion on statutory requirements.

Examiners should determine if there were any preexisting restrictions on the property imposed by local or state ordinances, zoning, or the rules of the historic districts. There may be no loss in value as a result of the granting of the easement if the easement does not impose new restrictions on the property. IRS appraisers have significant experience with this type of research and will generally address this as part of their fieldwork.

In addition to obtaining copies of the recorded instruments, examiners should research the property's ownership, sales, and mortgage history. Be alert to recent sales or mortgages on the property that may provide insight into the easement value. Insurance records may also be informative.

The IRS appraiser will need to identify the property owner of the encumbered property. Identify any contiguous properties, and any other properties owned by the taxpayer or a related party, in order to properly apply the contiguous/enhancement rules in valuing the property and determining the proper amount of the deduction. Examiners should verify ownership on the date of the contribution through interviews and review of public records (in the county where the property is located).

Many conservation easements originate from flow-through entities (i.e., S corporations and partnerships). The allocation of contributions to the shareholders or partners is reported on

Form K-1. Examiners should verify the percentage of ownership and determine if the contribution amount was properly allocated.

National Park Service

For donations of easements on certified historic structures, examiners must verify that the property is a certified historic structure and that the status was obtained by the due date of the return, including extensions. IRC § 170(h)(4)(C) and Treas. Reg. § 1.170A-14(d)(5)(iii). The taxpayer will generally provide this information in response to the initial information document request (IDR).

If a building is individually listed on The National Register of Historic Places, no certification is required from the National Park Service Historic Preservation Division.

Audit Tip: To obtain certification from the National Park Service, the taxpayer would have submitted [Form 10-168](#) (PDF) to the Historic Preservation Division for certification that the building contributes to the district. Examiners should obtain a copy of the certification and any related documents from the taxpayer or the National Park Service.

Interviews

As in all income tax examinations, the interview is an important component of a quality examination. The interview is the first step in securing the necessary background information to evaluate the claimed deduction.

The best time for interviewing the taxpayer is usually after reviewing the easement documents and assignment of an IRS appraiser to the case. If possible, the Examiner and IRS appraiser should jointly interview the taxpayer.

Examiners will usually need to interview the taxpayer. The representative cannot substitute for the taxpayer. Do not provide written questions to the representative to ask the taxpayer. In some instances, it may be necessary to summons the taxpayer.

Information Document Requests

A sample Information Document Request (IDR) can be found on the conservation easement MySB/SE Web page under the “Job Aids” tab and on RGS. The IDR should be modified to meet the specific needs of the examination, requesting only relevant information. Documents from the taxpayer are necessary not only to verify the easement donation, but also to collect initial documentation of the fair market value (FMV) of the easement. See Chapter 2 for a detailed discussion of what documents are required to substantiate a conservation easement contribution.

Securing documents is only the beginning of the examination of a conservation easement deduction. A final determination cannot be made without careful review of the documents and

background information, coordination with LB&I Engineering on the valuation, and in many cases, third party contacts.

Valuation Expert Involvement

Valuation of the conservation easement is an important part of a conservation easement deduction examination. A referral to LB&I Engineering for an IRS appraiser or an outside expert will generally be required. Examiners and the IRS appraiser need to work together to avoid duplication of effort, share information, and rely on each person's specific job skills to fully develop the case.

Note: The Examiner has primary responsibility for the non-valuation aspects of the issue and must not suspend or delay work on the income tax case pending receipt of LB&I Engineering's valuation report.

Referral to LB&I Engineering

A referral is made through the Specialist Referral System (SRS). Referrals to LB&I Engineering should be considered in all conservation easement cases, even if the case falls outside of the mandatory referral specifications. See the SRS Web page for current referral criteria.

The referral must be made early in the examination process to allow sufficient time for LB&I Engineering input. The Examiner should inform the taxpayers and their Representative of an IRS appraiser's participation and expected examination timeframes.

Examiners should promptly provide the IRS appraiser with:

- A copy of the return or pertinent part of the return
- Form 8283, including attachments
- A copy of the appraisal (if attached or once received)
- Other pertinent information attached to the return
- A recorded copy of easement deed including any attachments and correspondence
- Baseline study of the property (if attached or once received)
- Contemporaneous Written Acknowledgement (IRC § 170(f)(8))

Referral Outcomes

LB&I Engineering may accept or decline the referral, depending on the deduction amount, available staffing resources, and other factors. In lieu of an "appraisal review", the IRS appraiser may provide informal feedback to the Examiner as to the reasonableness and adequacy of the taxpayer's appraisal.

If the formal referral is accepted, a meeting should be scheduled with the assigned IRS appraiser to discuss duties and timeframes for completion. This meeting should be documented in memo form. An action plan template is available on the conservation easement Web page on MySB/SE under "Job Aids, Engineering Coordination" to help with allocation of responsibilities. The IRS

appraiser and Examiner should coordinate their actions throughout the examination.

Generally, the scope of the IRS appraiser's work is limited to valuation and qualified appraisal issues, and the Examiner will handle the legal issues under IRC § 170. However, there is some overlap of responsibilities. For example, the inspection of the property and interview of the taxpayer are important for both the IRS appraiser and the Examiner and should (to the extent possible) be conducted jointly.

If funds are available, LB & I Engineering may hire an outside fee appraiser.

Examiners can seek assistance from program analysts to discuss alternatives and assistance in resolution of any issues with LB & I Engineering.

LB&I Engineering Products

The IRS appraiser will generally prepare an "appraisal review with an opinion of value", which is a detailed review of the taxpayer's appraisal and includes an estimate of the fair market value of the conservation easement. In other cases, the IRS appraiser will prepare an appraisal.

In some cases, the IRS appraiser may provide an "appraisal review," which is simply a critique of completeness and reliability of the taxpayer's appraisal without determining the fair market value of the conservation easement. Another option is an informal consultation, where the IRS appraiser gives informal feedback on the taxpayer's appraisal.

Outside Experts

The IRS hires outside valuation experts ("outside fee appraisers") if funds are available. Requests for use of an outside fee appraiser are made using the SRS referral process.

An outside fee appraiser must be approved through the IRS procurement process. LB & I Engineering is responsible for working with the Contracting Officer Technical Representative (COTR) to identify experts, solicit bids, arrange for background investigations, and execute the contract.

The outside fee appraiser reports are only address valuation of the conservation easement. Examiners will need to address the legal issues under IRC § 170.

Consultation with Counsel

Because examination of a conservation easement deduction involves review of a number of legal documents, Examiners will need to consult with Counsel. A list of SBSE Counsel attorneys on the conservation easement cadre is available on MySB/SE under "Contacts."

Counsel should be engaged early in the examination to assist with review of the legal documents for areas of noncompliance, particularly for issues such as conservation purpose, inconsistent use of the property, perpetuity, subordination and allocation of proceeds.

Examiners will need to be alert to court decisions that could affect their examination. Recently decided cases relevant to the conservation easement issue can be found on MySB/SE.

Coordination with TEGE

The Examiner should determine whether the donee organization is or has been under examination by TEGE. If so, the Examiner should contact the Exempt Organization (EO) Examiner assigned to the case to obtain pertinent information and to coordinate examination activities, as appropriate.

The EO Examiner can assist in securing records from the donee organization and provide detailed information on the organization. Coordination with TEGE avoids duplication of effort and unnecessary contacts with the donee organization.

During the examination, the Examiner may need to consider a referral to TEGE for examination of the donee organization. Some factors that may warrant a referral include:

- False or misleading statements by the donee organization regarding the tax requirements or valuation of contributions of conservation easements.
- Evidence of undue influence on the taxpayer's appraiser by the donee organization.
- Presence of related party transactions between donor and the donee organization.
- Lack of any charitable activity by the donee organization, or activities contrary to its stated charitable purpose.
- Use of a related "for-profit" business to process easement donations.
- Information indicating that the donor's conservation contribution lacked a "conservation purpose" for purposes of section 170(h) could also have a bearing on the donee organization's exempt status, particularly if it has accepted other conservation contributions that lack a conservation purpose.

Examiners can make referrals to TEGE using the SRS referral process.

Chapter 11: Conducting the Examination

Overview

Conservation easement examinations are very challenging cases requiring substantial factual development and review of legal documents. A team approach (working with LB&I Engineering, Counsel, and program analysts) is the most effective way to conduct these examinations.

Examiners will need to look beyond information provided on the tax return and analyze the substance of the transaction rather than the mere form. Examiners must employ investigative skills to identify any omissions or discrepancies of material facts.

During an examination, the examiner will obtain documentation, conduct interviews of the taxpayer and third parties, and perhaps visit the property encumbered by the easement. The examiner must evaluate all of this information to determine if the taxpayer meets the:

- General statutory requirements for all charitable contributions per IRC § 170.
- Specific statutory requirements for qualified conservation contributions per IRC § 170(h) and Treas. Reg. § 1.170A-14, including compliance with one or more of the conservation purposes listed in IRC § 170(h)(4)(A).
- Contemporaneous written acknowledgment requirement under IRC § 170(f)(8).
- Substantiation requirements and, specifically, the qualified appraisal and appraiser requirements in IRC § 170(f)(11), Notice 2006-96, and Treas. Reg. § 1.170A-13.
- Statutory (DEFRA) and regulatory requirements for Form 8283. Treas. Reg. § 1.170A-13(c)(4).
- Baseline requirements. Treas. Reg. § 1.170A-14(g)(5).

Interviews

As with all examinations, interviewing the taxpayer who donated the conservation easement is an important first step in the development of facts. The interview provides important information regarding the taxpayer's:

- Intent in making the easement donation
- Understanding of the transaction
- Efforts to comply with the statutory requirements
- Due diligence in obtaining a correct appraisal

If possible, the examiner and IRS appraiser should conduct a joint interview. Review of the conservation easement deed, baseline study and the taxpayer's appraisal, prior to the interview, will help the Examiner and IRS appraiser carry out a focused interview. In some cases, more than one interview may be required to gather all relevant facts.

Sample interview questions are found on the "Job Aids" tab on the conservation easement MySB/SE Web page. The list of questions is not all-inclusive and should be modified to address the specific facts of the case. These questions are not intended to be utilized as a checksheet but rather as a basis to assemble a case-specific interview.

Audit Tip: Some representatives may request that questions be submitted in writing prior to the interview or in lieu of an interview. Written questions and answers are not an appropriate substitute for an in-person interview of the taxpayer. If the taxpayer or representative will not consent to an interview, then the examiner should either issue a summons for interview or develop the case based on third party contacts.

Depending on the case, interviews of third parties such as representatives of the donee organization, the appraiser, the baseline study author, or other conservation experts may be needed. See discussion below on third party contacts.

Property Inspection

The examiner's inspection of the property provides valuable information to assist in determining whether the conservation easement meets one of the IRC § 170(h)(4) conservation purposes.

If possible, the examiner should inspect the entire property. Site visitation should be coordinated with the IRS appraiser, whenever possible. If the examiner does not inspect the property, the examiner should contact the IRS appraiser to discuss the appraiser's observations and review pictures obtained during site inspection. Examiners can also research property on Google Maps or Zillow.

If it is not practical to inspect the entire property, the examiner should view areas that are relevant to the taxpayer's claimed conservation purpose and document the observations.

Both the interior and exterior of historic properties should be inspected. The IRS appraiser generally will need to inspect the interior for purposes of valuing the property.

Audit Tip: Depending on the location of the property and time of year, casual attire and boots may be necessary.

During the inspection, the examiner should note:

- The location of the significant or protected habitat or species
- Physical and visual access by the public to the easement property
- The nature of the surrounding properties and intensity of development in the area
- The location of buildings and other structures
- Any post-easement building or land improvements impacting the stated conservation purposes
- Any inconsistent use of the property

The IRS appraiser will be interested in factors affecting the highest and best use of the property before and after the granting of the conservation easement, such as zoning or other restrictions on the property, topography or floodplains.

Ask the taxpayer or representative to point out the outdoor recreation areas, animals, plants, scenic views, or historic land and structures that contribute to the conservation purpose. If the examiner observes an absence of conservation attributes, lack of access, de minimis public benefit, or use inconsistent with a conservation purpose, the examiner should discuss with the taxpayer or representative to clarify and solicit additional documentation as warranted.

Example: A Wisconsin taxpayer donates a conservation easement with a claimed conservation purpose of protecting habitat for pheasants, a federally protected species. Pheasants thrive in a habitat of hay fields, cropland, and grassland. The examiner observes none of this habitat on the property during the site inspection.

Audit Tip: “A picture speaks a thousand words.” Consider taking photographs and video of the property, the surrounding areas, and the protected habitat or species, from various public access points. The IRS appraiser will generally take pictures of the property.

Review of Documents

The examiner and IRS appraiser will be required to review documents such as the deed of conservation easement, subordination agreements, baseline study, appraisals, contemporaneous written acknowledgement, and information provided by the qualified organization and, in appropriate cases, documents submitted to the National Park Service. The documents lay the foundation for determining deductibility.

Deed of Conservation Easement

Conservation easement deeds vary considerably in complexity and length. It is imperative that the examiner and appraiser read the deed carefully and have a clear understanding of each of the deed’s provisions in order to properly assess the taxpayer’s compliance with the statute and regulations. Program analysts and Counsel should be consulted for help.

Be sure to review a complete and executed copy of the recorded deed including attachments. Taxpayers and representatives sometimes provide drafts or unexecuted copies. If there are multiple versions, ask for them. Inquire as to the changes made and reasons for the revisions.

Audit Tip: A copy of an easement deed should be included as part of the appraisal report. Compare it to the recorded deed to see if they are the same. If not, discuss with the IRS appraiser; the valuation of the conservation easement could be impacted.

In reading the conservation easement deed, the examiner should determine:

- What property is being encumbered?
- What is the stated conservation purpose?
- Does the deed protect the property in perpetuity?
- What type of public access is allowed to the property?
- What are reserved by the taxpayer?
- What are the provisions for mortgage subordination and allocation of proceeds upon extinguishment?

Perpetuity

Most conservation easement deeds will state that the easement is granted and enforceable in perpetuity, but be alert to any provisions contradicting that statement.

See [Chapter 3](#) for guidance on the perpetuity requirements.

Conservation Purpose

The conservation easement deed should include a specific description of the conservation purpose of the particular easement, including, for example, the species, scenic views, or building being protected. The deed alone is not evidence of conservation purpose and must be substantiated by other available information.

Audit Tip: In some cases, the conservation purpose as described in the deed merely repeats the conservation purpose definition in IRC § 170(h)(4)(A). The taxpayer must clearly describe and provide documentation to show how the easement meets the conservation purpose.

Except for protection of a relatively natural habitat or ecosystem, conservation easements generally must offer either physical access or visual access by the public from a public space such as a highway. Physical access is only required if the conservation purpose is for recreation by or education of the general public under IRC § 170(h)(4)(A)(i). When evaluating access, the examiner needs to determine:

- What access is allowed, by whom, and with what frequency?
- What portion of the conservation easement can be seen from the highway or other public space (if an open space easement for scenic enjoyment)?
- What impact do reserved rights have on public access?

For donations of conservation easements on buildings in registered historic districts, the entire exterior (including the front, sides, rear, and height of the building) must be preserved. If the conservation easement deed does not clearly protect the entire exterior, the charitable contribution is not deductible.

Audit Tip: The term “height” was specifically used in the statute to encompass the donation of space above the historic building. A deed that describes the restriction as the “roof,” would not satisfy the statute absent any additional narrative limiting the “height” of the building. A roof can be raised and additional floors can be added if the easement merely uses the term “roof.”

See [Chapter 5](#) for guidance on conservation purpose requirements.

Reserved Rights

Taxpayers sometimes reserve rights that can destroy a conservation purpose.

Example: The easement calls for the protection of the Virginia running buffalo clover, an endangered plant. However, the deed allows use of all-terrain vehicles over the protected land in the area of the clover, which would destroy the clover. This is an inconsistent use, which would result in disallowance of the deduction.

Taxpayers are permitted to reserve some development rights on a portion of the property, such as construction of additional homes or structures, installation of utilities, and building of fences or roads, provided that conservation purposes are protected. Depending on the facts and circumstances, retention of these reserved rights may result in disallowance and need to be reflected in the appraisal report and valuation conclusions.

Example: A taxpayer claims a charitable contribution deduction for an open space easement but reserves the right to build three residences on the property. The deed does not state the specific location or limit the size of the residences. The deed allows the taxpayer to construct residences that could block the public's scenic view, thus permitting destruction of a conservation interest.

See [Chapter 3](#) and [Chapter 5](#) for guidance on perpetuity and conservation purpose requirements.

Lender Agreements

If the property was encumbered by a mortgage or other lien at the time of the easement recordation, the taxpayer must obtain a subordination agreement from the lender prior to the donation of the conservation easement.

See [Chapter 3](#) for additional guidance on lender agreements.

Subordination Agreements

A subordination agreement is an agreement by the lender to subordinate its rights to the rights of the easement holder to enforce the conservation purposes of the donation in perpetuity. Subordination agreements must be recorded in the public record.

The best way to determine if there are existing mortgages, including home equity loans or lines of credit, is by researching public records and interviewing the taxpayer. The subordination agreement is generally part of the lender agreement attached to the conservation easement deed.

Audit Tip: Examiners must confirm that timely subordination agreements for all liens were recorded in the public record no later than the time the easement is recorded. If the taxpayer did not obtain a subordination agreement before the time of the contribution, the charitable contribution should be disallowed for lack of perpetuity.

Substantial compliance does not apply to failure to properly subordinate.

Allocation of Proceeds

In order for a charitable contribution deduction to be allowed, at the time of the gift, the donation of the perpetual conservation restriction must give rise to a property right vested in the donee organization. This means that the donee organization must share in the proceeds in the event of extinguishment (e.g., condemnation, casualty, hazard, or accident) of the easement.

Audit Tip: Counsel should always be consulted to determine whether the deed meets the allocation of proceeds requirement; improper language in the deed could result in disallowance. See *Carroll v. Commissioner*, 146 T.C. No. 13 (2016) (appeal pending).

Baseline Study

A baseline study is required if the taxpayer has reserved any right which may impair the conservation purpose. Taxpayers almost always reserve these kind of rights.

The baseline study is a record of a property's condition at the time of the donation and is required to substantiate the conservation purpose. It serves two significant purposes: 1) to satisfy the Treasury Regulations and 2) to assist the donee organization and others in monitoring and enforcing the easement in perpetuity.

The baseline study does not have to be attached to the return or the deed of conservation easement but the donor must provide the study to the donee prior to the time the donation is made. A statement saying that the natural resource inventory is an accurate representation of the protected property at the time of the transfer must be signed by the donor and donee. Examiners should obtain a copy of the baseline study (natural resource inventory and signed statement) from the taxpayer or donee organization.

The statement required by the Form 8283 is not the baseline study.

The quality of a baseline study can vary a great deal. Some are detailed, expert reports, describing the property's condition, conservation value, impact of reserved rights, and environmental hazards. Some are the taxpayer's self-assessment of the property or the work of a volunteer with little or no professional credentials.

A properly documented baseline study is invaluable in helping the examiner determine if the donation satisfies one of the conservation purposes. A comprehensive baseline study would generally include:

- A description of the encumbrance
- A description and map of the conservation characteristics and areas (i.e., listing of identified plants or wildlife)
- A map or series of maps depicting roads, fences, existing structures, trails, water bodies, wetlands, and any other property features
- Identification of any reserved building sites
- Surveys or plat maps
- Description of any management plans, such as a timber plan
- On-site photographs possibly including aerial photographs
- The study author's name and professional credentials

The first step in reviewing the baseline study is determining whether the taxpayer was required to secure one. Nearly all easement deeds reserve significant rights, so nearly all must have a baseline study.

If the taxpayer is required to have a baseline study, the next step is to ascertain whether the baseline study is sufficient to satisfy the baseline requirements as outlined in Treas. Reg. § 1.170A-14(g)(5), including the signed statement by the donor and representative of the donee organization. This statement is an affirmation that the baseline study is an accurate representation

of the protected property at the time of transfer. The statement may be incorporated in the baseline study or be a separate document.

The examiner will also need to assess the credibility of the baseline study. A baseline study prepared by an independent qualified expert such as a conservationist, biologist, forester or botanist would generally be given greater evidentiary weight than one prepared by a less qualified person or the taxpayer's self-assessment. Also, a baseline with a lot of documentary support is more credible than one with little support.

Examiners will need to confirm that the baseline study is based on accurate information. In some cases, the IRS will hire outside experts to evaluate the baseline study. Generally, examiners will need to conduct their own research contacting federal, state or local conservation agencies or historic preservation groups as appropriate. Internet research will reveal many useful Internet websites such as natureserve.org that can help the examiner in evaluating the baseline study.

Audit Tip: Sometimes taxpayers only have a narrative about the general area or State without any specific reference to the donated property. These generic narratives do not meet the requirements of Treas. Reg. § 1.170A-14(g)(5).

See [Chapter 5](#) for guidance on the baseline study requirements.

Taxpayer's Appraisal

The IRS appraiser has primary responsibility for review of the taxpayer's appraisal to determine if it is a qualified appraisal prepared by a qualified appraiser and that the conservation easement claimed is correct.

The examiner should read the appraisal to obtain background information on the property and have a general understanding of the appraisal content and methodology. In consultation with the IRS appraiser, the examiner should determine if the appraisal was timely and if it meets the requirements of IRC § 170(f)(11), Notice 2006-96, and Treas. Reg. § 1.170A-13(c).

See [Chapter 7](#) for guidance on qualified appraisal requirements.

Donee Organization

During the preplanning of the examination, the examiner will generally be able to determine whether the donee is an organization eligible to receive tax-deductible contributions. The examiner must also consider whether the donor made any cash payments to the donee, and review the contemporaneous written acknowledgment.

The examiner may need assistance from TEGE to determine whether the donee has the commitment to protect the conservation purposes of the donation and has resources to enforce the restrictions of the conservation easement.

Indication of failure by the donee organization in these areas may suggest the need for a referral to TEGE.

See [Chapter 4](#) for guidance on qualified organizations.

Commitment and Resources

The taxpayer must transfer the conservation easement to an eligible donee to qualify for a contribution deduction. In order to be an eligible donee, the organization must be a qualified organization, must have a commitment to protect the conservation purpose of the donation and must have the resources to enforce the restrictions in the conservation easements.

Some of the information used to evaluate commitment and resources include:

- The donee organization's website
- The donee organization's tax returns (Forms 990), obtained from Guidestar.org or the Economic Research Institute
- Interviews of the taxpayer and representatives of the donee organization
- Observations during the property inspection
- Property monitoring reports
- Written agreements between the organization and the taxpayer certifying that the donee is qualified and has commitment and resources (required for contributions of easements in registered historic districts)

If the organization did not meet the commitment and resources tests at the time of contribution, no deduction is allowed. A conservation group organized or operated primarily or substantially for one of the conservation purposes specified in IRC § 170(h)(4)(A) is considered to have the requisite commitment. Treas. Reg. § 1.170A-14(c)(1).

Audit Tip: Ask for the organization's monitoring reports to verify whether the taxpayer is in compliance with, and the donee organization is enforcing, the terms of the easement. In some cases, donee organizations have allowed changes that were in violation of the terms of the easement.

Examiners should consult Counsel for assistance if the easement was terminated or not being enforced. In addition, a referral to TEGE should be considered.

Cash Payments

A voluntary transfer of money to a qualified organization is generally deductible as a charitable contribution.

If a taxpayer received goods or services from the organization in exchange for making the cash contribution, the deduction is limited to the excess of the cash over the FMV of the goods and services. Goods and services include cash, property, services, benefits, or privileges.

Any cash payment made in conjunction with the conservation easement must be addressed as part of the examination. Examination steps should include an interview of the taxpayer and a

review of documents provided by the taxpayer and the donee organization. A properly substantiated stewardship fee may be deductible if it meets the requirements of IRC § 170.

Each case must be decided on the facts and circumstances.

Audit Tip: The Examiner may need to issue a summons to the donee organization for relevant documents (including the application, correspondence, donation agreements, processing documents, and other documents relevant to the cash and easement donations).

Contemporaneous Written Acknowledgment

IRC § 170(f)(8) states that all cash and noncash contributions of \$250 or more must be substantiated with a contemporaneous written acknowledgment (CWA) and lists the requirements for a CWA. It must be obtained by the taxpayer by the earlier of the date the taxpayer filed the return or the due date (including extensions) for the return. The [Form 8283, Noncash Charitable Contributions](#) (PDF), is not a substitute for a CWA.

A CWA is required for both the cash payment and the conservation easement. Examiners must verify that it was a timely acknowledgment and fully complies with the statutory requirements. Failure to secure a timely or proper CWA results in disallowance of the contribution.

Note: A CWA must include either a statement that no goods or services were provided (if this was the case) or the value of any goods or services provided.

Audit Tip: Some taxpayers may argue all that is required is substantial compliance with the CWA requirement. However, because the CWA is specifically required by statute, substantial compliance does not apply.

See [Chapter 6](#) for guidance on CWA requirements.

National Park Service-Form 10-168

Congress provided two incentives for historic preservation: (1) the charitable contribution deduction for historic preservation of a historically important land area or a certified historic structure under IRC § 170(h) and (2) the rehabilitation credit under § 47.

The Form 10-168 (PDF) must be submitted to the National Park Service (NPS) for certification that a building in a registered historic district contributes to the district for purposes of either tax incentive. Examiners should obtain a copy of the certification and any related documents from the taxpayer or the NPS.

Even if the property is certified by the Secretary of Interior, it does not mean the charitable contribution deduction is allowable. 36 CFR 67.1 provides that the IRS is responsible for all legal determinations concerning the tax consequences.

Part I of the Form 10-168, used for certification of the building for historic status, details the condition of the building at the time of the application. Part II is a notice of proposed work and generally includes information such as:

- Date of application
- Description of the condition of the building and any proposed work
- The expected start and completion dates
- Estimated costs
- Architectural drawings

Part II is required for any rehabilitation project whether the property is individually listed on the National Register of Historic Places or in a registered historic district.

In some cases, taxpayers have improperly claimed a charitable contribution deduction for the contribution of development rights that they retained.

Section 47 permits the rehabilitation tax credit to be claimed only by owners and, in some instances, lessees if certain statutory requirements are met. If the taxpayer does not own all of the interests in real property to which the rehabilitation relates (and is not a lessee), the taxpayer is not entitled to the entire rehabilitation tax credit. Generally, no tax credit is permitted for property that the taxpayer does not own. See *Villa v. Commissioner*, T.C.M. 1980-305; *Davenport v. Commissioner*, T.C.M. 1977-34; *Schaevitz v. Commissioner*, T.C.M. 1971-197 and *Bailey v. Commissioner*, 88 T.C. 1293 (1987).

Audit Tip: Contact Counsel in rehabilitation project cases.

Being listed on the National Register of Historic Places or located in a registered district imposes no restrictions on the property. Only local law can impose restrictions. A local historic district may not have the same boundaries as the National Register District by the same name. Thus, a building may be certified for purposes of a charitable contribution deduction by the NPS but the only restrictions prior to the easement might be local zoning.

Audit Tip: Be sure to determine whether there are restrictions under local preservation law. A building added to the National Register of Historic Places may or may not be subject to local restrictions.

Partnership Documents

A partnership arrangement was used to transfer state rehabilitation tax credits in *Virginia Historic Tax Credit Fund 2001LP v. Commissioner*, 693 F.3d 129 (4th Cir. 2011). The Fourth Circuit Court of Appeals held that the transfer of the state tax credit was a disguised sale.

Examiners should carefully review partnership agreements and other documents.

Third-Party Contacts

Development of a conservation easement case frequently requires third-party contacts for additional facts or confirmation of information obtained during the course of the examination. Examples of possible third-party contacts include:

- Donee organization
- Mortgage lenders
- Appraisers
- Local government officials
- Real estate agents
- State and Federal conservation agencies
- Prior and subsequent owners of the encumbered property

Examiners must adhere to procedures for making third-party contacts as outlined in IRM, Section 4.11.57, *Third Party Contacts*. Advance notification of potential third party contacts during an examination is accomplished by the providing the taxpayer with a [Publication 1, Your Rights as a Taxpayer](#) (PDF), at the onset of the examination, generally with the initial appointment letter.

Not all contacts are third-party contacts. See IRM Section 4.11.57.3 for additional guidance.

Form 12180, Third-Party Contact Authorization Form, or Letter 1995, Third Party Contact Letter to Request Information, is used to solicit records. Some cases may require use of an administrative summons (Form 2039).

Audit Tip: While advance notification (using [Publication 1, Your Rights as a Taxpayer](#) (PDF)) and reporting of any third party contacts to the third-party coordinator is required, there is no requirement to obtain the taxpayer's permission prior to making a third party contact.

Donee Organizations

Third-party contacts may be warranted with key representatives of the donee organization. Individuals involved in drafting the easement deed or who were points of contact may have

important information on the transactions. Consider separate interviews of all third parties. Typically, these interviews can be done by telephone.

Audit Tip: Examiners should request the organization's entire file for this donation and any other donation by the taxpayer.

Donee organizations may want a summons before consenting to release of records. A standard document request, approved by Counsel, which can be attached to the summons, is found on the conservation easement Web page on MySB/SE under “Job Aids.”

Mortgage Lenders

Mortgage lender files are a valuable source of information about the subordination, allocation of proceeds, and valuation of the conservation easement.

If the bank agreed to the subordination, the lender's file may include correspondence or other information from the taxpayer or the donee organization describing the impact of the conservation easement on the value or use of the property. Examiners should obtain explanations for any inconsistent statements made to third parties.

Example: Correspondence from the donee organization to the lender soliciting a subordination agreement includes statements that the conservation easement has no impact on the value of the property.

If the taxpayer secured a mortgage or refinancing around the time of the easement donation, an appraisal may have been obtained by the lender. The appraisal coupled, with information on the loan application, may be helpful in evaluating the reasonableness of the claimed value of the easement.

Example: The taxpayer granted a conservation easement on December 29, 2010, claiming a loss in value on the property of \$23 million. The taxpayer's appraised before value of the property was determined to be \$25 million with an after value of \$2 million. The taxpayer obtained a mortgage loan on January 27, 2011. The bank's appraisal reports a value of \$20 million after considering the impact of the conservation easement on the property. This suggests that the taxpayer overvalued the easement.

The taxpayer's loan application and related appraisals can also be useful in determining whether the taxpayer made a good faith investigation of the value of the easement. This is relevant to imposition of penalties.

Example: Using the example above, suppose the taxpayer showed the value of the property on his loan application as \$24 million. If the taxpayer believed his property lost \$23 million in value due to the donation of the easement, why was the “alleged” \$2 million after value not reported on the loan application?

A summons will generally be required to obtain the loan file information. A standard document request, approved by Counsel, which can be attached to the summons, is found on the conservation easement Web page on MySB/SE under “Job Aids.”

Appraiser

In some instances, it may be necessary to interview the taxpayer’s appraiser. The IRS appraiser would generally conduct this interview; however, the examiner may also participate.

It may also be necessary to obtain the taxpayer’s appraiser’s work file. Most licensed appraisers are required to maintain a work file in accordance with State licensing requirements. The appraiser’s work file may include communications between the taxpayer and donee organization or may reveal the existence of multiple versions of the appraisal.

The examiner or the IRS appraiser should determine if there were multiple versions of the appraisal and if so, the reasons for them.

A standard document request, approved by Counsel, which can be attached to the summons, is found on the conservation easement Web page on MySB/SE under “Job Aids.”

Federal and State Conservation Agencies

To find out about the physical characteristics of the subject property and the easement’s conservation purposes, examiners may want to contact various federal and state conservation agencies, including but not limited to:

- National Park Service
- U.S. Fish and Wildlife Service
- U.S. Environmental Protection Agency
- U.S. Department of Agriculture
- U.S. Army Corps of Engineers
- State Departments of Natural Resources

These agencies may have information on the specific property or on the area in general.

Local Government Officials

Local preservation boards and officials responsible for zoning and building permits are good sources of information. If possible, secure copies of pertinent records and speak directly to the officials. Evidence of quids pro quo may be found by talking to local officials and reviewing records including minutes of meetings.

Audit Tip: If the conservation easement is part of subdivision development, request assistance from the IRS appraiser in reviewing documents such as plats, maps, etc.

Real Estate Agents

Local real estate agents can be valuable third-party contacts, having knowledge of property values, sales, and local market conditions, including sales of properties encumbered by easements.

Audit Tip: If the property was purchased or sold shortly before or after the date of the contribution, the real estate agent may be able to provide useful information as to the value of the property or impact of the conservation easement.

Property Owners

Prior or subsequent owners of the subject property can provide information useful in determining the value of the property such as physical condition, preexisting restrictions or encumbrances and other specific attributes.

Audit Tip: If the property was sold subsequent to the granting of the easement, consider contacting the buyer to determine the impact (if any) on the purchase price paid. Buyers are sometimes unaware of the easement or may indicate the easement had no impact on the purchase price.

Chapter 12: Concluding the Examination

Overview

The examiner must determine whether the taxpayer meets all of the requirements to claim a charitable contribution deduction for the conservation easement. While the process of issue identification begins in the preplanning stages of the examination, a conclusion as to the deductibility of the conservation easement can only be made after considering all of the information obtained during the examination.

In addition to identifying legal issues, examiners, generally with the assistance of a valuation expert, will determine if the conservation easement has been properly valued.

Preparation of a quality examination report is a critical component of the examination process. The examiner will need to include a comprehensive explanation of the facts, law, and conclusions, incorporating the IRS appraiser's work product and attaching relevant exhibits. If the examination results in a proposed adjustment, the examiner must consider whether penalties are applicable and who is liable for the penalties.

During the closing conference, the examiner should explain the bases for any proposed adjustments to the charitable contribution deduction and proposed penalties. In unagreed cases, the examiner will need to verify that the taxpayer's protest complies with the requirements as outlined in [Publication 5, Your Appeal Rights and How to Prepare a Protest If You Don't Agree](#) (PDF) and to prepare a rebuttal to the protest as warranted.

Issue Identification

The examiner and IRS appraiser must have a comprehensive understanding of all of the legal requirements and the value of the conservation easement in order to make a decision on deductibility.

The Internal Revenue Code, Treasury Regulations, publications, and this ATG are tools to help in the identification of potential issues. Program analysts and Counsel can also be consulted for assistance.

An Issue Identification Worksheet has been developed as a job aid to help examiners with issue analysis. The worksheet is not all-inclusive but is a summary of key issues. See Exhibit 12-1.

Besides examining all aspects of the conservation easement deduction issue, examiners must also examine whether other costs associated with the conservation easement contribution were properly reported.

Audit Tip: Appraisal fees are deductible only as miscellaneous deductions subject to adjusted gross income limitations. Taxpayers will sometimes improperly claim the appraisal fees and other costs as cash contributions.

Substantial Compliance

The burden is on taxpayers to establish they have complied with all statutory requirements to substantiate the charitable contribution claimed under IRC § 170. Moreover, a charitable contribution is allowed as a deduction only if verified under the Treasury Regulations. IRC § 170(a)(1).

In cases where the disallowance is based in whole or in part on noncompliance with the substantiation rules, taxpayers and their representatives may argue that they have substantially complied, based on a judicial doctrine called “substantial compliance.”

Under prior law, some courts have allowed a deduction for a taxpayer who has substantially, but not strictly, complied with “directory” regulations governing tax elections and deductions. See *Bond v. Commissioner*, 100 T.C. 32, 41 (1993).

It is important to note that *Bond* and *Simmons v. Commissioner*, T.C. Memo. 2009-208, were based on law in effect prior to the enactment of the American Jobs Creation Act (2004) and the Pension Protection Act (2006), both of which imposed new mandatory statutory requirements for qualified appraisals.

In *Costello v. Commissioner*, T.C. Memo. 2015-87, the Tax Court declined to apply the substantial compliance doctrine where the taxpayer’s appraisal valued a fee simple interest “before and after a hypothetical sale of development rights” instead of a conservation easement. The Tax Court stated that an appraisal of the wrong asset cannot substantially comply with the regulations because the appraisal in that case prevents the Commissioner from properly understanding and calculating the claimed deduction. Citing a number of Tax Court cases, a

district court case, and a court of appeals case, the Tax Court stated that the substantial compliance doctrine should not be liberally applied. Compare *Cave Buttes, LLC v. Commissioner*, 147 T.C. 10 (2016). A failure to comply with the contemporaneous written acknowledgment requirement of §170(f)(8) cannot be excused by the substantial compliance doctrine. *Boone Operations Co. LLC v. Commissioner*, T.C. Memo. 2013-101.

Report Writing

The examiner's report is the principal means of informing to the taxpayer, Appeals, and Counsel of the reasons for proposed adjustments to the conservation easement deduction. Typically, conservation easement issue reports take a significant amount of time to prepare. Unagreed reports should be prepared in accordance with IRM section 4.10.8.12, *Unagreed Case Procedures (SB/SE Field and Office Examiners Only)*.

The explanation of items, whether presented in a lead sheet format or on Form 886A, *Explanation of Items*, will be fact intensive, describing all details of the transaction, the tax law, and the bases for any proposed adjustment. There may be a number of exhibits including the appraisal, an appraisal review, the conservation easement deed (with recording date), lender agreement, the contemporaneous written acknowledgment, baseline, and other pertinent documents.

If the lead sheet work papers are used for the unagreed report, extraneous information (e.g., work paper cross-referencing, audit steps, etc.) that would be of no use to the taxpayer or representative should be removed prior to the issuance of the report.

In many cases in which an adjustment is proposed, there will be more than one legal theory for the proposed adjustment (in addition to valuation). The legal issues are generally the primary position, and valuation serves as an alternative position.

Audit Tip: It is very important that the report clearly articulate and address all issues and include relevant exhibits. Appeals will generally not consider bases for the adjustment if not addressed in the unagreed report.

Job Aids

Report writing job aids are available on the conservation easement Web page on MySB/SE under "Job Aids." These aids, while intended to help streamline the report writing process, must be customized to address the facts and circumstances of each case.

The job aids provide a sample presentation format including facts, applicable tax law, analysis, and conclusions. The content in the analysis and conclusions section is organized to match the content of the Issue Identification Worksheet discussed above. The examiner will need to check the most current edition of the IRC to be sure that there have not been any statutory changes since the date of the job aid.

The Facts section of the job aid serves as an example of the extent and type of information that should be included in the report.

The Law section contains a summary of conservation easement tax law. It was prepared in consultation with Counsel and generally is used verbatim in all reports but examiners should update for any new case law decisions and statutory changes.

The Analysis and Conclusion section will also be case specific, but this material may be used to assist with drafting of the examiner's conclusions. A discussion of substantial compliance included in this section should be incorporated into all unagreed reports.

Valuation Expert Reports

The IRS appraiser's or outside fee appraiser's report or review must be attached as an addendum to the examiner's unagreed report.

In some cases, the IRS appraiser will also provide a Form 886A, Explanation of Items, in addition to an appraisal or appraisal review. While this information will be very useful in drafting the unagreed report, these documents generally should not be used as a substitute for the examiner's report narrative.

IRS appraisers sometimes include legal positions in their Form 886A write-ups. The Examiner must review this information for factual and technical accuracy particularly for tax law interpretations to 1) identify any inconsistent facts or conclusions, 2) verify correct application of tax law, and 3) ensure that correct positions are incorporated into the examiner's report as a basis for any proposed adjustment.

Audit Tip: Notate on the Examiner Case Activity Record (Form 9984) and in the Report Transmittal (Form 4665) that a complete copy of IRS appraiser report was provided to the taxpayer so there will be no question that the taxpayer received a copy. It is also a good idea to mention this in the report narrative.

Penalties

The application of penalties is based on the facts and circumstances of each case. There is no statutory authority to waive applicable penalties unless the taxpayer can establish that the reasonable cause exception applies. The reasonable cause exception is not available for gross valuation misstatements. IRC § 6664(c)(3).

A separate lead sheet or Form 886A will be needed if there are any proposed penalties. Throughout the examination, the examiner should be developing relevant facts to determine which penalties may apply and whether waiver of any of the penalties may be appropriate based on reasonable cause. Examiners are required to consider penalties, document their determination, and obtain written approval by their immediate supervisor of any determination to seek a penalty in all taxpayer examinations. See IRC § 6751(b).

Audit Tip: Do not wait until the end of the audit to think about penalties. Consideration of penalties and gathering of information should be done throughout the examination, beginning with the preplan. Interviews of the taxpayer and third parties may be required to obtain all necessary facts.

The penalty report for a conservation easement case will generally include a tiering of proposed penalties with multiple alternative positions, starting with valuation misstatements, then substantial understatement, and finally negligence.

A discussion of reasonable cause must be incorporated into the penalty write-up.

Audit Tip: Examiners should be alert to any indication of fraud and should consult the Fraud Technical Advisor program analyst if badges of fraud are identified during the examination.

See [Chapter 13](#) for detailed discussion of penalties and reasonable cause.

Technical Assistance

Program analysts and Counsel attorneys assigned to this issue are available to provide assistance and feedback with respect to unagreed reports. A list of contacts is found on the conservation easement Web page on MySB/SE under “Contacts.”

Closing Conference

A closing conference is normally held with the taxpayer or representative. The purpose of the conference is to explain the bases for any proposed adjustments to the charitable contribution deduction and proposed penalties, confirm the accuracy of the facts, gather new information, and obtain a preliminary response from (or on behalf of) the taxpayer.

The examiner may want to provide a draft report to the taxpayer or representative in advance of the meeting or at the conference. Since valuation is a significant issue in most conservation easement cases, it is recommended that the IRS appraiser participate in the conference.

Taxpayer Protests

Taxpayers will generally need to file a formal written protest in order to exercise appeal rights. If the total amount of tax for any tax period is less than \$25,000, a small case request can be submitted instead of a formal written protest.

[Publication 5, Your Appeal Rights and How to Prepare a Protest If You Don't Agree](#) (PDF), outlines the specific information that must be included in a formal protest. The taxpayer or representative must provide a list of changes they do not agree with, the facts supporting their position, and the authority they are relying upon.

A protest is not adequate if it does not comply with the requirements as described in Publication 5. A taxpayer's general statements without a clear explanation and without citing any legal basis for disagreement is generally not sufficient.

Letter 3615, Letter Advising of Incomplete Protest, is mailed to the taxpayer if the protest is determined to be inadequate. Unless the group manager agrees to an extension, if the taxpayer fails to provide a complete protest within 10 days, the case should be closed for Statutory Notice of Deficiency.

Rebuttals to Taxpayer Protest

If there is new or contradictory information in the protest, the examiner may need to request additional information from the taxpayer or prepare a rebuttal to supplement the unagreed report.

The examiner should provide a copy of the protest to the IRS appraiser so the appraiser can provide a written rebuttal for issues within the scope of his or her responsibilities (such as qualified appraisal, qualified appraiser, or valuation). The IRS appraiser's rebuttal may be incorporated into a single rebuttal or as an addendum to the examiner's rebuttal.

A copy of the rebuttal, including the IRS appraiser's rebuttal, should be provided to the taxpayer,

Exhibit 12-1 Conservation Easement Issue Identification Worksheet

NOTE: This worksheet is not an all-inclusive list of potential issues for donations of conservation easements. Users should review IRC section 170, DEFRA section 155, the corresponding Treasury Regulations, Notice 2006-96 and case law.

General Contribution Deduction Issues	Code/Regs
Lack of charitable intent (including receipt of quid pro quo)	170(a); 1.170A-1(h)
Conditional gift	1.170A-1(e); 1.170A-7(a)(3)
Contemporaneous written acknowledgment (CWA)	170(f)(8); 1.170A-13(f)
Qualified Appraisal Issues	Code/Regs
(Note: The Deficit Reduction Act of 1984 (DEFRA) and section 170(f)(11) outline the statutory appraisal requirements.)	170(f)(11) DEFRA 155(a)(1)(A),(a)(4) 1.170A-13(c)(3) Notice 2006-96 §3
Appraisal not attached to return (FMV >\$500K)	170(f)(11)(D)
Qualified Appraisal Issues	Code/Regs

Appraisal not prepared in accordance with generally accepted appraisal standards	170(f)(11)(E)(i)(II); Notice 2006-96 §3.02(2)
Appraisal not timely	1.170A-13(c)(3)(i)(A)
Not a qualified appraiser	170(f)(11)(E)(ii) 1.170A-13(c)(3)(i)(B); Notice 2006-96, §3.03
Doesn't meet IRC, DEFRA, or Treas. Reg. requirements	DEFRA 155; 170(f)(11)(E)(i)(I) 1.170A-13(c)(3) Notice 2006-96
Appraisal fee based on percentage of value	1.170A-13(c)(3)(i)(D); 1.170A-13(c)(6)
Form 8283 (appraisal summary) missing or incomplete	1.170A-13(c)(4); 1.170A-13(c)(4)(iv)(H) DEFRA 155(a)(1)(B); DEFRA 155(a)(3)
Qualified Real Property Interest Issues	Code/Regs
Qualified real property interest	170(h)(2); 1.170A-14(a), (b)
Lack of perpetuity	170(h)(2)(C); 170(h)(5)
Lack of perpetuity - Failure to properly subordinate	1.170A-14(g)(2)
Lack of perpetuity - Extinguishment-allocation of proceeds	1.170A-14(g)(6)(ii)
Not a qualified organization or eligible done	170(h)(3); 1.170A-14(c)(1)
Conservation Purpose Issues	Code/Regs
Conservation purpose	170(h)(4); 1.170A-14(d)
Outdoor recreation or education of public	170(h)(4)(A)(i); 1.170A-14(d)(2)
Outdoor recreation or education of public - Lack of access	1.170A-14(d)(2)(ii)
Protection of environmental system (natural habitat)	170(h)(4)(A)(ii); 1.170A-14(d)(3)
Protection of environmental system - Significant habitat or ecosystem	1.170A-14(d)(3)(ii)
Preservation of open space	170(h)(4)(A)(iii); 1.170A-14(d)(4)
Preservation of open space -Scenic enjoyment	170(h)(4)(A)(iii)(I); 1.170A-14(d)(4)(ii)
Preservation of open space -Scenic enjoyment-	1.170A-14(d)(4)(ii)(B)
Conservation Purpose Issues	Code/Regs
Lack of visual access	
Preservation of open space - Governmental conservation policy	170(h)(4)(A)(iii)(II); 1.170A-14(d)(4)(iii)

Preservation of open space -Governmental conservation policy - Physical or visual access required if conservation purpose is frustrated without access	1.170A-14(d)(4)(iii)(C)
Preservation of historic land or certified historic structure	170(h)(4)(A)(iv); 1.170A-14(d)(5)
Preservation of historic land or certified historic structure - Historic land	1.170A-14(d)(5)(ii)
Preservation of historic land or certified historic structure - Certified historic structure	1.170A-14(d)(5)(iii)
Preservation of historic land or certified historic structure - Certified historic structure (1) Individually listed or (2) in historic district and NPS certifies	170(h)(4)(C) (donations made after 8/17/06); 1.170A-14(d)(5)(iii)
Preservation of historic land or certified historic structure - Lack of visual access	1.170A-14(d)(5)(iv)(A)
Failure to comply w/ PPA for buildings not individually listed. (façade only)	170(h)(4)(B)
Failure to comply w/ PPA for buildings not individually listed - No restriction for entire exterior.	170(h)(4)(B)(i)
Failure to comply w/ PPA for buildings not individually listed - Lack of donor/donee written agreement: re donee's qualifications.	170(h)(4)(B)(ii)
Failure to comply w/ PPA for buildings not individually listed - Failure to attach appraisal, with photos and description of restrictions.	170(h)(4)(B)(iii)
Failure to comply w/ PPA for buildings not individually listed - Failure to pay \$500 filing fee (façade only)	170(f)(13)
Not exclusively for conservation purpose	170(h)(5); 1.170A-14(e)
Not exclusively for conservation purpose	1.170A-14(e)(2) and (3)
Conservation Purpose Issues	Code/Regs
Inconsistent Use	
Insufficient or lack of documentation for conservation purpose (baseline study)	1.170A-14(g)(5)(i); 1.170A-13(c)(4)(ii)(M)

Valuation Issues	Code/Regs
Overvaluation	170(a); 1.170A-14(h)(3)
Deduction not based on FMV	170(a); 1.170A-1(c); 1.170A-14(h)(3)
Deduction limited to basis	170(e)(1)(A) Contiguous
Parcel/noncontiguous parcel	1.170A-14(h)(3)(i)
Miscellaneous Issues	Code/Regs
Percentage limitations not computed properly	170(b)
Rehabilitation credit-reduction of deduction (façade only)	170(f)(14)
Rehabilitation credit-recapture (façade only)	50(a); Rev. Rul. 89-90
Penalty Issues	Code/Regs
Taxpayer penalties	6662(a), (e), (h); 6664(c)(1) - (3)
Appraiser penalty	6695A

Chapter 13: Penalties

Overview

Penalties exist to encourage voluntary compliance by supporting the standards of behavior required by the IRC. Examiners are required to consider penalties and document their determination (and obtain written approval by their immediate supervisor) of any determination to seek a penalty in all taxpayer examinations. See IRC § 6751(b).

All facts and circumstances must be developed during the examination to determine what penalties (if any) are appropriate. Penalties may be imposed on the taxpayer, return preparer, appraisers and other tax advisors.

See the IRM 20.1, *Penalty Handbook*, for additional guidance on penalties.

Accuracy-Related Penalties

IRC § 6662 imposes accuracy-related penalties on underpayments. The maximum accuracy-related penalty imposed on any portion of an underpayment is 20% (40% in the case of a gross valuation misstatement), even if that portion of the underpayment is attributable to more than one type of misconduct.

IRC § 6662(c) Negligence or Disregard of Rules or Regulations

A 20% accuracy-related penalty can be asserted pursuant to IRC § 6662(c) if the underpayment of tax is attributable to negligence or to a careless, reckless, or intentional disregard of rules or regulations.

Negligence includes any failure to make a reasonable attempt to comply with the provisions of the Internal Revenue Code or to exercise ordinary and reasonable care in the preparation of a tax return. IRC § 6662(c) and Treas. Reg. § 1.6662-3(b).

In *Turner v. Commissioner* (126 T.C. 299 (2006)), the Tax Court held that the taxpayer was liable for a 20% negligence penalty under IRC § 6662(c). In that case, the appraiser's report was not considered sufficient for the reasonable cause exception (IRC § 6664(c)) to apply because the report was based on erroneous assumptions.

The term “disregard” includes any careless, reckless, or intentional disregard of rules or regulations. A disregard is careless if the taxpayer does not exercise reasonable diligence to determine the correctness of a return position that is contrary to a rule or regulation. A disregard is reckless where the taxpayer makes little or no effort to determine whether a rule or regulation exists, under circumstances which demonstrate a substantial deviation from the standard of conduct that a reasonable person would observe. Additionally, a disregard is intentional where the taxpayer has knowledge of the rule or regulation that the taxpayer disregards. Treas. Reg. § 1.6662-3(b)(2).

“Rules or regulations” under this section includes the provisions of the Internal Revenue Code, temporary or final Treasury regulations, and revenue rulings or notices (other than notices of proposed rulemaking) issued by the Internal Revenue Service and published in the Internal Revenue Bulletin. IRC § 1.6662-3(b)(2). Therefore, if the facts indicate that a taxpayer took a return position contrary to any published notice or revenue ruling, the taxpayer may be subject to the accuracy-related penalty for an underpayment attributable to disregard of rules or regulations.

See IRM 20.1.5.7, *Negligence or Disregard of Rules or Regulations* for additional guidance.

IRC § 6662(d) Substantial Understatement of Income Tax

A 20% accuracy-related penalty can be asserted pursuant to IRC § 6662(d) if the underpayment of tax is attributable to a substantial understatement of income tax.

A substantial understatement of income tax exists for a taxable year of an individual if the amount of understatement exceeds the greater of 10% of the tax required to be shown on the return or \$5,000. IRC § 6662(d)(1).

An understatement of income tax of a corporation (other than an S Corporation or a personal holding company) is substantial if it exceeds the lesser of (i) 10% of the tax required to be shown on the return (or, if greater, \$10,000), or (ii) \$10,000,000.

The amount of the understatement generally is reduced by the portion of the understatement attributable to any item if:

- The treatment is, or was, supported by substantial authority, or
- Facts relevant to the tax treatment were adequately disclosed on the return or on a statement attached to the return and there is a reasonable basis for the tax treatment.

There is no reduction, however, for any item attributable to a tax shelter, which means either: (1) a partnership or other entity, (2) any investment plan or arrangement, or (3) any other plan or arrangement, if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax. IRC § 6662(d)(2)(C).

See IRM 20.1.5.8, *Substantial Understatement*, for additional guidance.

IRC § 6662(e) Valuation Misstatements

A 20% accuracy-related penalty can be asserted pursuant to IRC § 6662(e) if the underpayment of tax is attributable to a substantial valuation misstatement. IRC § 6662(e)(1).

A 40% accuracy-related penalty can be asserted pursuant to IRC § 6662(h) if the underpayment of income tax is attributable to a gross valuation misstatement.

A substantial valuation misstatement exists when the claimed value of any property is 150% or more of the amount determined to be the correct value. A gross valuation misstatement occurs when the claimed value of any property is 200% or more of the amount determined to be the correct value.

Note: The Pension Protection Act of 2006 (PPA), Pub. L. No. 109–280, sec. 1219(a)(2)(B), 120 Stat. at 1083, amended the rules for the 40% gross valuation misstatement penalty. Before the PPA, the penalty applied when taxpayers misstated the value of their property by 400% or more, and taxpayers could avoid the penalty under certain circumstances if they made the misstatement in good faith and with reasonable cause. The reasonable cause exception (IRC § 6664(c)) applied to both substantial and gross valuation misstatements. The PPA lowered the threshold for gross valuation misstatements to 200% and eliminated the reasonable cause exception for gross valuation misstatements of charitable contribution property. See secs. 6662(h), 6664(c).

No penalty is imposed unless the portion of the underpayment attributable to the valuation misstatement exceeds \$5,000 (\$10,000 in the case of a corporation other than an S corporation or a personal holding company).

See IRM 20.1.5.9, *Substantial Valuation Misstatement*, for additional guidance.

IRC § 6663 Civil Fraud Penalties

IRC § 6663 states that if any portion of the underpayment of tax is due to fraud, a penalty of 75% of that portion may be asserted.

Examiners should be alert to any indications of fraud, such as altered or backdated documents, false testimony, or evidence of collusion between the taxpayer, the donee organization, return preparer, and the appraiser.

If badges of fraud are noted, the examiner is required to discuss this with the group manager and involve the local fraud technical advisors as early as possible.

See IRM 20.1.5.12, *Civil Fraud Penalty*, for additional guidance.

IRC § 6664 Reasonable Cause Exception

In general, no penalty will be asserted under IRC §§ 6662 or 6663 if the taxpayer establishes there was reasonable cause for the underpayment and the taxpayer acted in good faith. IRC § 6664(c)(1). See IRM 20.1.5.6, *Reasonable Cause*, for additional guidance.

Reasonable cause must be determined on a case-by-case basis, taking into account all the pertinent facts and circumstances. To determine whether reasonable cause exists, examiners must ascertain the taxpayer's experience, knowledge, education, the extent of the taxpayer's review or inquiry in assessing the correctness of the conservation easement donation, and whether the taxpayer relied on any appraisers, return preparers, or other professionals.

Special Rule for Overvaluation of Charitable Contributions

For substantial valuation misstatements of charitable contribution property, reasonable cause may apply only if:

- The claimed value of the property was based on a qualified appraisal made by a qualified appraiser, and
- The taxpayer made a good faith investigation of the value of the contributed property.

Improper valuation of conservation easements and a lack of qualified appraisal are common bases for full or partial disallowance of the charitable contribution deduction. Accordingly, if the easement is substantially overvalued (150% or more), the reasonable cause exception cannot apply unless the appraisal was a qualified appraisal by a qualified appraiser and the taxpayer made a good faith investigation of the value.

The reasonable cause exception is not available for gross valuation misstatements. IRC § 6664(c)(3).

Reliance on Professionals

Reliance on a return preparer or other professional such as an attorney or appraiser does not automatically constitute reasonable cause and good faith under Treas. Reg. § 1.6664-4(b).

Reliance constitutes reasonable cause and good faith if, under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith.

Reasonable cause and good faith may exist if the taxpayers can demonstrate that:

- They did not know, nor should have known, that the advisor suffered from a conflict of interest or a lack of expertise,
- Complete, accurate and all necessary information was provided to the advisor by the taxpayers, and
- The taxpayers actually relied in good faith on the advisor's judgment.

If the taxpayer claims reliance on professionals, the examiner must identify specifically who advised the taxpayer, when and what services or advice was provided and determine whether the taxpayer fully disclosed the necessary information for the advisor to make a proper determination.

This will generally require an interview of the taxpayer and of the professional to confirm the taxpayer's information and evaluate whether non-assertion of the penalty is appropriate due to reasonable cause. Copies of any professional opinion letters, correspondence, analysis, billing records or other documentation should be solicited from the taxpayer or professional to substantiate reliance on professionals.

Examiners should review IRM 20.1.5.6.4, *Reliance on Advice*, for additional guidance.

Return Preparers-IRC § 6694

Examiners are responsible for determining whether IRC § 6694, Understatement of Taxpayer's Liability by Tax Return Preparer, penalties should be asserted on the return preparer. Preparer penalties should be asserted only after consideration of all facts and circumstances and not based solely on the determination of deficiencies in related tax return examinations.

Examiners may consider asserting penalties under IRC § 6694 on appraisers for inflated or incorrect appraisals in lieu of IRC § 6695A if the appraiser meets the definition of a nonsigning return preparer (Treas. Reg. § 301.7701-15(b)(2)).

IRM 20.1.6.3, *Preparer Conduct Penalties*, provides additional guidance on the return preparer penalties. Examiners also may contact their local Return Preparer Coordinator for help with preparer penalty cases.

Promoters-IRC §§ 6700 and 6701

Appraisers may be subject to IRC § 6700 for direct or indirect participation in the sale of a tax plan or arrangement that results in a material gross overvaluation misstatement. IRC § 6701 may also be applicable for the preparation of the appraisal if the appraiser knows or had reason to believe that the appraisal was to be used in connection with a material tax matter and knows that use of the document would result in an understatement of tax.

The examiner should consider a referral to the SB/SE Lead Development Center (LDC) for return preparers, appraisers, promoters, authors of legal opinions, donee organizations, or anyone else who was directly or indirectly involved with a scheme or promotion advocating improper or overvalued conservation easement donations.

While examiners may secure information on the role and level of involvement of each person in conjunction with the determination of the appropriateness of taxpayer penalties, examiners cannot commence an IRC § 6700, Promoting Abusive Tax Shelters, Etc., or IRC § 6701, Aiding and Abetting Understatement of Tax Liability, penalty investigation without specific authorization from the SB/SE LDC. A referral form can be found on the LDC Web page.

Contact a SB/SE LDC program analyst for assistance on the application of IRC § 6700 or 6701 penalties, determination of whether a referral is warranted, or coordination of participant examinations.

See IRM 20.1.6.1, *Overview of the Return Preparer, Promoter, and Material Advisor Penalties*, and IRM 4.32 for additional guidance.

Appraisers-IRC § 6695A Substantial and Gross Valuation Misstatements Attributable to Incorrect Appraisals

IRC § 6695A was added by the Pension Protection Act of 2006. It provides a civil penalty on any person who prepares an appraisal of the value of property that the appraiser knows (or reasonably should have known) is to be used in connection with a return or a claim for refund, and such appraisal results in a substantial or gross valuation misstatement (as defined in IRC § 6662(e) and (h) respectively).

The amount of the IRC § 6695A penalty is the lesser of:

- The greater of 10% of the amount of the underpayment attributable to the misstatement or \$1,000, or
- 125% of the gross income received from the preparation of the appraisal

Under IRC § 6695A(c), the penalty does not apply if the appraiser establishes that it was "more likely than not" that the value established in the appraisal was correct.

This penalty applies to returns with respect to easements based on one of the first three conservation purposes outlined in IRC § 170(h)(4)(A).

There are no preassessment appeal rights extended to the appraiser at the time of the penalty case closure by the examiner. The appraiser may request an appeals conference upon notice of the Service's intent to assess the penalty.

CAUTION: The statute of limitations for the appraiser penalty case is three years from the later of the due date of the related return or the date the return was filed. Securing an extension on the return being examined does not extend the appraiser penalty statute. Form 872-AP, Consent to Extend the Time on Assessment of IRC Section 6695A Penalty, is used to extend the appraiser penalty case statute.

See IRM 20.1.12, *Penalties Applicable to Incorrect Appraisals*, and the Servicewide Penalty Web page for additional guidance on the assessment of this penalty.

Office of Professional Responsibility Sanctions

Prior to the changes instituted by the Pension Protection Act of 2006 (PPA), an IRC § 6701 penalty for aiding and abetting was required to be assessed before the Office of Professional Responsibility (OPR) could seek disciplinary action against an appraiser.

The PPA eliminated the penalty assessment requirement. Disciplinary action may include, but is not limited to, suspending or barring an appraiser from:

- Preparing or presenting appraisals on the value of property or other assets to the Treasury Department or the IRS.
- Appearing before the Treasury Department or the IRS for the purpose of offering opinion evidence on the value of property or assets.

Chapter 14: State Tax Credits

Overview

An increasing number of states offer incentives in the form of income tax credits for the donation of conservation easements. Some programs allow for the transfer and sale of the tax credits. A taxpayer may qualify for a state tax credit, but still not qualify for a federal tax deduction.

State Tax Credit Programs

1. Arkansas [A “wetland and riparian zone conservation tax credit.”]
2. California
3. Colorado
4. Connecticut
5. Delaware
6. Georgia
7. Iowa
8. Maryland

9. Massachusetts
10. Mississippi
11. New Mexico
12. New York
13. North Carolina
14. South Carolina
15. Virginia
16. Wisconsin [Limited to farmland preservation agreements, and the farmland must be in a “farmland preservation area identified in a certified farmland preservation plan.”].
17. Puerto Rico

The requirements for most state tax credit programs are similar to the requirements under § 170(h) for deducting the contribution of a conservation easement. There is no uniform model, but most state programs determine the amount of the credit based on a percentage of the fair market value of the donated easement. Generally, the programs provide for carryforward of unused tax credits over a number of years. Some states, including Colorado, South Carolina, Virginia, New Mexico, and Georgia have transferable tax credits. Puerto Rico also has transferable tax credits available only to the original donor of the easement.

Transferability allows taxpayers to sell tax credits to third parties. Credit brokers or facilitators assist taxpayers in negotiating the sales price and are generally reimbursed for their services from the proceeds of the sale. The third-party purchasers then use the credits to pay their own state tax liabilities.

In 2007, The Conservation Resource Center, a nonprofit conservation organization, published a report analyzing the impact of state conservation tax credits. According to the report, taxpayers receive as much as 70 to 82 percent of the face value of their state tax credits, depending on market rates at the time of the sale.

Receipt of State Tax Credits

Generally, a state tax credit, to the extent that it can only be applied against the original recipient's current or future state tax liability, is treated for federal income tax purposes as a reduction or potential reduction in that taxpayer's state tax liability, not as a payment of cash or property to the taxpayer that is includible in gross income under § 61. *See generally Maines v. Commissioner*, 144 T.C. 123 (2015). Similarly, for purposes of § 170, the receipt of a state conservation easement tax credit is not a return benefit and, therefore, does not reduce the amount of the taxpayer's federal charitable contribution deduction under § 170. *See Tempel v. Commissioner*, 136 T.C. 341, 351 n.17 (2011), *aff'd sub nom, Esgar Corp. v. Commissioner*, 744 F.3d 648 (10th Cir. 2014). The federal tax effect to the original recipient of a state credit is normally a reduction in the amount of state tax imposed and paid for purposes of § 164. The mere fact that a state tax credit is transferable does not cause it to lose its character as a reduction or potential reduction in liability in the hands of the taxpayer who originally qualified for the credit. If the state tax credit is refundable, please contact Counsel for advice on the federal tax treatment of the credit.

Sale of State Tax Credits

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis of the property.

The amount realized from the sale of the credit is the sum of any money received plus the fair market value of any property received (§ 1001(b)). The taxpayer to whom the state issued tax credits (original recipient) does not have any basis in the credits because nothing was paid to receive the credits and the issuance of the tax credits does not require inclusion in gross income.

The original recipient must recognize gain if and when he or she transfers a state tax credit to another person for value. The gain from the sale of tax credits by the original recipient would usually be equal to the entire amount realized.

The sale of a state tax credit will result in capital gain unless one of the statutory exclusions in § 1221(a) applies. Under § 1222, capital gain results from the sale or exchange of a capital asset. The sale of a capital asset held for more than 1 year will result in long-term capital gain.

The term "capital asset" is statutorily defined in § 1221 as property held by the taxpayer, whether or not connected with the taxpayer's trade or business, unless the property meets one of eight exceptions listed in § 1221(a). Additionally, the Supreme Court has stated "it is evident that not everything which can be called property in the ordinary sense and which is outside the statutory exclusions qualifies as a capital asset"; rather, "the term 'capital asset' is to be construed narrowly in accordance with the purpose of Congress to afford capital-gains treatment only in situations typically involving the realization of appreciation in value accrued over a substantial period of time, and thus to ameliorate the hardship of taxation of the entire gain in one year."

Commissioner v. Gillette Motor Transport, Inc., 364 U.S. 130, 134 (1960). However, in Tempel, the Tax Court held that a state tax credit is a capital asset if it does not fall within the statutory exclusions in § 1221(a) because the amount realized from the sale of a credit is not a substitute for ordinary income. The Tax Court also held that the holding period for tax credits begins when the credits are granted and ends when the credits are sold.

