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CONSERVATION EASEMENTS AND THE VALUATION CONUNDRUM

by

Nancy A. McLaughlin[*]

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I. INTRODUCTION

"'Valuation is . . . necessarily an approximation.'
It is an inexact science at best."[1]

The Internal Revenue Service (IRS) first officially sanctioned a charitable income tax deduction for the donation of a conservation easement in 1964.[2] In 1980, Congress enacted § 170(h), which authorizes a deduction for the donation of a conservation easement or a façade easement that is "granted in perpetuity" to a government entity or charitable organization "exclusively for conservation purposes."[3] The deduction has encouraged thousands of property owners to donate easements that protect land and historic structures with important conservation and historic values. The deduction has also, however, been subject to abuse, including valuation abuse.[4]

That the deduction has been subject to valuation abuse is unsurprising. Valuing conservation and façade easements presents difficult challenges. Because such easements are partial interests in property that are not bought and sold in open markets, they generally must be valued indirectly using the before and after method, pursuant to which the value of an easement is equal to the difference between the fair market value of the subject property immediately before and immediately after the donation of the easement.[5]

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1. Stanley Works v. Commissioner, 87 T.C. 389, 408 (1986) (citing Silverman v. Commissioner, 538 F.2d 927, 933 (2d Cir. 1976)).

2. *See* Rev. Rul. 64–205, 1964-2 C.B. 62.

3. I.R.C. § 170(h) (1980). As a general rule, this Article refers to easements encumbering land as conservation easements and easements encumbering historic structures as façade easements.

4. For reports of abuse, see, *e.g.,* DEPT. OF TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2016 REVENUE PROPOSALS, 188–92 (Feb. 2015), https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf [hereinafter 2016 REVENUE PROPOSALS]; Jennie Lay, *Conservation Easement Conundrums*, HIGH COUNTRY NEWS, Mar. 31, 2008; Joe Stephens, *IRS Starts Team on Easement Abuses*, WASH. POST, June 9, 2005, at A06; Joe Stephens & David B. Ottaway, *Developers Find Payoff in Preservation*, WASH. POST, Dec. 21, 2003, at A01; Joe Stephens, *Loophole Pays Off On Upscale Buildings*, WASH. POST, Dec. 12, 2004, at A01; *Conservation Easements: Abusive Transactions Involving Charitable Contributions of Easements*, IRS, http://www.irs.gov/Charities-&-Non-Profits/Conservation-Easements.

5. *See* Reg. § 1.170A–14(h)(3)(i); *see also, e.g.*, Hughes v. Commissioner, 97 T.C.M. (CCH) 1488, 2009 T.C.M. (RIA) ¶ 2009-094, at 703 ("because conservation easements are typically granted by deed or gift rather than sold, comparable sales [of easements] are rarely available. As an alternative, the so-called before-and-after approach is often used" (citation omitted)).

Easements are also subject to a range of arguable values under the before and after method, and the boundary between reasonably supportable and abusive values is blurred.[6] These factors, coupled with the lack of negotiation with respect to valuation in the context of a charitable contribution, present a problem for the IRS. Unless and until an audit is conducted, the IRS must rely on a one-sided assertion of value by taxpayers who have a financial incentive to assert the highest value they think they can get away with.[7]

In 2006, in part in response to a series of *Washington Post* articles alleging a variety of abuses in the easement donation context, the IRS began aggressively auditing and litigating deductions claimed for conservation and façade easement donations. Over the past ten years, the courts have issued more than seventy-five opinions in this context, which is an astonishing amount of case law for such a specific charitable deduction provision. This case law reveals a variety of abuses, including persistent overvaluation of easements, failures to properly substantiate the claimed deductions, and failures to comply with the requirements of § 170(h) and the Regulations, which are designed to ensure that tax-deductible easements protect properties with unique or otherwise significant conservation or historic values[8] and that the protections will be durable.[9]

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6. *See, e.g.*, Scheidelman v. Commissioner, 755 F.3d 148, 151 (2d Cir. 2014) ("'[I]t is not necessary that the value arrived at by the trial court be a figure as to which there is specific testimony, if it is within the range of figures that may properly be deduced from the evidence.'") (quoting *Silverman*, 538 F.2d at 933).

7. *See* Kingsbury Browne, Jr., *Taxes as a Form of Public Financing: Treasury's Open Space Protection Program*, *in* LAND-SAVING ACTION: A WRITTEN SYMPOSIUM BY 29 EXPERTS ON PRIVATE LAND CONVERSATION IN THE 1980S at 147, 149 (Russell L. Brenneman & Sarah M. Bates eds. 1984) (providing that hard bargaining and use of independent appraisers by both sides are not elements of the Treasury's deductibility program unless and until the landowner's tax return is audited).

8. *See* I.R.C. § 170(h)(4) (providing the four conservation purposes for which tax-deductible easements may be donated); *see also* S. Rep. No. 96-1007, 1980-2 C.B. 599, at 603 (stating that the § 170(h) deduction "should be directed at the preservation of unique or otherwise significant land areas or structures").

9. *See* I.R.C. § 170(h)(2)(C), (h)(5)(A) ("granted in perpetuity" and "protected in perpetuity" requirements); Reg. §§ 1.170A–14(c) (eligible donee and restriction on transfer requirements), 1.170A-14(e) (no inconsistent use requirement), 1.170A-14(g) (enforceable in perpetuity requirements). *See also* S. Rep. No. 96-1007, 1980-2 C.B. 599, at 605 ("The bill retains the present law requirement that contributions be made "exclusively for conservation purposes." Moreover, the bill explicitly provides that this requirement is not satisfied unless the conservation purpose is protected in perpetuity.").

Although Congress enacted some modest reforms in 2006,[10] it also temporarily enhanced the tax benefits offered to easement donors by making the percentage limitations on the § 170(h) deduction significantly more favorable.[11] Congress then repeatedly extended those enhanced incentives,[12] and in 2015 made the enhanced incentives a permanent part of the Code.[13] In making the enhanced incentives permanent, Congress turned a blind eye to the abuses revealed by the case law, as well as to Treasury Department proposals to implement further reforms to curb abuses.[14] However, given the significant cost of the incentives,[15] the continued expenditure of administrative and

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10. *See* Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780, §§ 1213, 1219 (2006) (revising § 170(h) to impose additional requirements with regard to façade easement donations, expanding the circumstances under which penalties can be imposed for overvaluing charitable contributions generally, and adding requirements regarding the "qualified appraisals" that must be used to substantiate values claimed with regard to charitable contributions).

11. Pension Protection Act of 2006 § 1206. As a general rule, a landowner can claim the deduction generated by an easement donation to the extent of 30 percent of the landowner's adjusted gross income (AGI) in each of the year of the donation and the following five years. Based on the changes made in 2006, which were temporary, easement donors were permitted to claim the resulting deduction to the extent of 50 percent of the donor's AGI in each of the year of the donation and the following 15 years, or, for qualifying farmer and rancher donations, 100 percent of the donor's AGI for the 16-year period. *See* J. COMM. TAX'N, JCX-38-06, TECHNICAL EXPLANATION OF H.R. 4, THE "PENSION PROTECTION ACT OF 2006," at 275–77 (Aug. 3, 2006) [hereinafter TECHNICAL EXPLANATION OF PPA].

12. *See, e.g.*, Tax Increase Prevention Act of 2014, Pub. L. No. 113-295, § 106, 128 Stat. 4011, (Dec. 19, 2014).

13. RULES COMM., 114TH CONG. TEXT OF H. AMEND. #2 TO THE S. AMEND. TO H.R. 2029, MILITARY CONSTRUCTION AND VETERANS AFFAIRS AND RELATED AGENCIES APPROPRIATIONS ACT, 2016 §111 (Comm. Print 2015) (also allowing Alaska Native Corporations donating conservation easements to claim the resulting deduction to the extent of 100 percent of taxable income in each of the year of the donation and the following 15 years, beginning in 2016).

14. *See, e.g.*, 2016 REVENUE PROPOSALS*, supra* note 4, at 189 ("Court cases over the last decade have highlighted donors who have taken large deductions for overvalued easements and for easements that allow donors to retain significant rights or that do not further important conservation purposes.").

15. *See* J. COMM. TAX'N, JCX-143-15, ESTIMATED REVENUE BUDGET EFFECTS OF DIVISION Q OF AMENDMENT #2 TO THE SENATE AMENDMENT TO H.R. 2029 (RULES COMMITTEE PRINT 114-40), "THE "PROTECTING AMERICANS FROM TAX HIKES ACT OF 2015" (Dec. 16, 2015) (estimating that the enhanced incentives will cost taxpayers, on average, an additional $118 million annually over the next ten years); Roger Colinvaux, *Conservation Easements: Design Flaws, Enforcement Challenges, and Reform*, 3 Utah L. Rev. 755, 756 (2013) (estimating that individual federal taxpayers invested $4.2 billion in conservation easements over the eight-year period from 2003 to 2010 through the federal charitable income tax deduction program); *Conservation Easements*, EO TAX J. 2014-205, Oct. 16, 2014 (ed. Paul Streckfus) (in

judicial resources on enforcement, and the likelihood that the enhanced incentives will exacerbate abuses, calls for reform can be expected to continue and to become more acute.[16]

To date, there has been no comprehensive analysis of the case law involving alleged overvaluation of conservation and façade easements for § 170(h) deduction purposes. This Article fills that void. It examines the easement valuation case law over the past five decades (through 2015) and discusses the most common methods by which taxpayers or, more precisely, their appraisers overvalue easements. It also proposes reforms informed by the lessons learned from the case law.

This Article does not address the equally, if not more important body of case law in which taxpayers have been denied deductions because the easements they donated failed to satisfy one or more of the requirements of § 170(h) and the Regulations.[17] That body of case law will be the subject of a separate article. For purposes of this Article, it is important to note that ensuring that conservation and façade easements are accurately valued at the time of their donation would not guarantee that the public's money is being well spent. Additional reforms are needed to ensure that the easements protect properties that have important conservation or historic values, and that those protections will not be lost through, for example, lack of enforcement or the

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comments delivered to members of the American Bar Association Section of Taxation's Exempt Organizations Committee, Ruth Madrigal, Attorney-Advisor, Office of Tax Policy, Department of Treasury, noted that the program is costing federal taxpayers an estimated $600 million annually).

16. *See* Diane Freda, *Good and Bad of Permanent Exempt Extenders: More Scrutiny*, DAILY TAX REP. (BNA), Jan. 20, 2016, at G-3 ("Now that certain tax-exempt extenders have been made permanent, they may actually face more scrutiny that could lead to either expansion or curtailment.").

17. *See, e.g.*, Belk v. Commissioner, 774 F.3d 221 (4th Cir. 2014) (failure to satisfy granted in perpetuity requirement); Mitchell v. Commissioner, 775 F.3d 1243 (10th Cir. 2015) (failure to satisfy mortgage subordination requirement); Graev v. Commissioner, 140 T.C. 377 (2013) (conditional gift of easement not deductible); Turner v. Commissioner, 126 T.C. 299 (2006) (failure to satisfy open space or historic preservation conservation purposes tests); Atkinson v. Commissioner, 110 T.C.M. (CCH) 550, 2015 T.C.M. (RIA) ¶ 2015-236, at 1695 (failure to satisfy habitat or open space conservation purposes tests); Bosque Canyon Ranch, L.P. v. Commissioner, 110 T.C.M. (CCH) 48, 2015 T.C.M. (RIA) ¶ 2015-130, at 993 (failure to satisfy granted in perpetuity and baseline documentation requirements); Carpenter v. Commissioner, 106 T.C.M. (CCH) 62, 2013 T.C.M. (RIA) ¶ 2013-172, at 1393 (failure to satisfy judicial extinguishment requirement); RP Golf, LLC v. Commissioner, 104 T.C.M. (CCH) 413, 2012 T.C.M. (RIA) ¶ 2012-282, at 1977 (failure to satisfy open space conservation purpose test); Herman v. Commissioner, 98 T.C.M. (CCH) 197, 2009 T.C.M. (RIA) ¶ 2009-205, at 1539 (failure to satisfy historic preservation conservation purpose test).

substantial modification, release, or termination of the easements. In other words, any reforms in the easement deduction context should also include measures designed to ensure both the quality and the durability of the easements.

To set the stage for discussion of the valuation case law, Part II describes the rules governing the valuation of easements for purposes of the § 170(h) deduction. Part III describes the penalties that may be imposed on taxpayers who overstate the value of easements on their tax returns, as well as the penalties that may be imposed on the appraisers who assist them in doing so. Parts IV and V then analyze the forty-five cases through 2015 that involved challenges to the valuation of façade easements and conservation easements, respectively. The façade easement and conservation easement cases are analyzed separately because the two types of easements involve different valuation issues. Informed by the insights from the case law, Part VI offers suggestions for reform. Appendices A and B set forth relevant information regarding the façade easement valuation cases, and Appendices C and D contain similar information with respect to the conservation easement valuation cases.

II. VALUATION RULES

Taxpayers interested in claiming deductions for the donation of façade easements or conservation easements must comply with easement-specific valuation rules set forth in the Regulations as well as generally accepted appraisal standards.[18] Compliance with generally accepted appraisal standards is mandated by the substantiation and reporting requirements for charitable contribution deductions generally.[19]

A. *Sales of Comparable Easements*

The Regulations interpreting § 170(h) provide that the value of the charitable contribution of an easement is the fair market value of the easement at the time of the contribution.[20] "Fair market value" is defined for these purposes as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy

18. See Reg. § 1.170A–14(h)(3) for the easement-specific valuation rules.

19. A conservation easement donor claiming a deduction for an easement with a value of more than $5,000 (which almost always will be the case) must substantiate the deduction with a "qualified appraisal" prepared by a "qualified appraiser." *See* I.R.C. § 170(f)(11)(C); Reg. § 1.170A–13(c). A qualified appraisal must, among other things, be prepared in accordance with "generally accepted appraisal standards." I.R.C. § 170(f)(11)(E)(i)(II).

20. *See* Reg. § 1.170A–14(h)(3)(i).

or sell and both having reasonable knowledge of relevant facts."[21] The Regulations also provide that, if "a substantial record of sales of easements comparable to the donated easement (such as purchases pursuant to a governmental program)" is "available to use as a meaningful or valid comparison," then the fair market value of the donated easement must be based on the sales prices of such comparable easements.[22] Accordingly, this "sales of comparable easements" method is the preferred method of valuation. However, because conservation and façade easements are not bought and sold in true market transactions,[23] and an easement's restrictions and the underlying property generally will be unique in some if not many respects, [24] the sales of comparable easements method is rarely (if ever) used.[25]

B. Before and After Method

Because the Treasury recognized the difficulties associated with attempting to value easements by reference to sales of comparable easements, the Regulations provide an alternative method of valuation. If "no substantial record of market-place sales is available to use as a meaningful or valid comparison, as a general rule (but not necessarily in all cases)," donors should determine the value of their easements using the before and after method.[26] A before and after easement appraisal involves two estimates of value: (i) one of the fair market value of the subject property immediately before the donation,

21. *See id.*; Reg. § 1.170A–1(c)(2).

22. *See* Reg. § 1.170A–14(h)(3)(i).

23. *See* Browning v. Commissioner, 109 T.C. 303, 312 (1997) (the record of sales from a county's easement purchase program was not "available to use as a meaningful or valid comparison" because the sales were bargain-sales, not true market transactions).

24. *See* Trout Ranch, LLC v. Commissioner (*Trout Ranch I*), 100 T.C.M. (CCH) 581, 2010 T.C.M. (RIA) ¶ 2010-283, at 1717, *aff'd* Trout Ranch, LLC v. Commissioner (*Trout Ranch II*), 493 Fed. Appx. 944 (10th Cir. 2012) (rejecting "sales of comparable easements" method because the purportedly comparable easements and the lands they encumbered were different from the easement at issue and the property it encumbered).

25. In none of the cases analyzed for this Article did the courts rely on the sales of comparable easements method in determining the value of the donated easement. *See*, *e.g.*, James Boyd et al., *The Law and Economics of Habitat Conservation: Lessons from an Analysis of Easement Acquisitions*, 19 STAN. ENVTL. L.J. 209, 234 ("Because there is no conventional market for easements, the usual procedure for valuing an asset—simple observation of an equilibrium market price resulting from a large volume of transactions— cannot be followed.").

26. *See* Reg. § 1.170A–14(h)(3)(i); *see also* S. Rep. No. 96-1007, 1980-2 C.B. 599, at 606.

or what a willing buyer would pay a willing seller for the property before it is encumbered by the easement's perpetual restrictions (the "before-value"), and (ii) one of fair market value of the subject property immediately after the donation, or what a willing buyer would pay a willing seller for the property after it is encumbered by the easement's perpetual restrictions (the "after-value").[27] In each case, the fair market value of the subject property must be evaluated considering the property's highest and best use.[28]

1. Before-Value

The first step in estimating the before-value of the subject property is determining the highest and best use of the property unrestricted by the easement.[29] A property's "highest and best use" is "the highest and most profitable use for which [the property] is adaptable and needed or likely to be needed in the reasonably near future."[30] Highest and best use has also been defined as "[t]he reasonably probable and legal use of vacant land or an improved property that is physically possible, appropriately supported, and financially feasible and that results in the highest value,"[31] or the use that is physically possible, legally permissible, financially feasible, and maximally productive.[32]

Valuation does not depend on "whether the owner actually has put the property to its highest and best use."[33] As one court explained: "The landowner 'may have used a valuable corner [of property] for a stable or for a pigsty . . . [but] he is not obliged to have it priced on that basis.'"[34] However, a property's

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27. *See, e.g.*, Thayer v. Commissioner, 36 T.C.M. (CCH) 1504, T.C.M. (P-H) ¶ 77,370 (1977) ("This valuation procedure involves traditional real estate valuation principles, except it is necessary to derive two valuations rather than one.").

28. *See* Hilborn v. Commissioner, 85 T.C. 677, 689–90 (1985); Reg. § 1.170A–14(h)(3)(i), (ii).

29. *Hilborn*, 85 T.C. at 689.

30. *Hughes*, 97 T.C.M. (CCH) at 1490, 2009 T.C.M. (RIA) ¶ 2009-094 at 702–03 (2009).

31. Whitehouse Hotel L.P. v. Commissioner (*Whitehouse III*), 139 T.C. 304, 331 (2012), *aff'd in part, vacated in part, remanded by* 615 F.3d 321 (5th Cir. 2014).

32. Esgar Corp. v. Commissioner (*Esgar II*), 744 F.3d 648, 659 n.10 (10th Cir. 2014).

33. *Id.* at 657 (citing Symington v. Commissioner, 87 T.C. 892, 896 (1986)).

34. *Stanley Works*, 87 T.C. at 400 (citing Central Georgia Power Co. v. Stone, 77 S.E. 565, 567 (1913)).

highest and best use is presumed to be the use to which the property is currently being put absent proof to the contrary.[35]

When a proposed highest and best use differs from the property's current use, the taxpayer must demonstrate both "'closeness in time' and 'reasonable probability'" of the proposed use.[36] Physical suitability of the property for the proposed use is not sufficient; the taxpayer must establish that there existed a reasonable probability the property would be so used in the reasonably near future.[37] In other words, there must be some objective support of future demand for the proposed use.[38]

Proposed uses that "depend upon events or combinations of occurrences which, while within the realm of possibility, are not fairly shown to be reasonably probable" must be excluded from consideration.[39] The question to be asked is whether it would be reasonable to conclude that a hypothetical willing buyer would have considered the property as the site for the proposed use at the time of the easement's donation. If a hypothetical buyer would not reasonably have taken into account the proposed use in agreeing to purchase the property, such proposed use should not be considered in valuing the property.[40]

The Regulations incorporate and supplement these general appraisal principles. The Regulations provide that "the fair market value of the property before contribution of the [easement] must take into account not only the current use of the property but also an objective assessment of how immediate or remote the likelihood is that the property, absent the restriction, would in fact be developed."[41] The 10th Circuit noted that "[t]his is the same as asking a court to determine the reasonable probability that development is 'likely to be needed in the reasonably near future.'"[42] The Regulations also provide that fair market value of the property before contribution of the easement must take into account "any effect from zoning, conservation, or historic preservation

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35. Mountanos v. Commissioner, 105 T.C.M. (CCH) 1818, 2013 T.C.M. (RIA) ¶ 2013-138, at 1185, *motion for reconsideration denied*, 107 T.C.M. (CCH) 1211, 2014 T.C.M. (RIA) ¶ 2014-038, at 305.

36. *Esgar II*, 744 F.3d. at 658.

37. *Stanley Works*, 87 T.C. at 401.

38. Esgar Corp. v. Commissioner (*Esgar I*), 103 T.C.M. (CCH) 1185, 1190, 2012 T.C.M. (RIA) ¶ 2012-035, at 274 (2012), *aff'd Esgar II*, 744 F.3d 648.

39. *Id.*

40. *Stanley Works*, 87 T.C. at 402; *see also Whitehouse III*, 139 T.C. at 332 ("Even if . . . a potential use is profitable and . . . the property is adaptable for that use, that use is not necessarily the measure of the value of the property. Instead, it is to be considered to the extent the prospect of demand for the use affects market value.").

41. Reg. § 1.170A–14(h)(3)(ii).

42. *Esgar II*, 744 F.3d. at 658 (citing *Symington*, 87 T.C.at 897).

laws that already restrict the property's potential highest and best use."[43] In other words, in determining the before-easement highest and best use, all existing federal, state, and local restrictions on development and use must be considered.

2. *After-Value*

The first step in estimating the after-value of the subject property is determining the highest and best use of the property as encumbered by the easement.[44] At this stage, the easement's terms are examined, individually and collectively, as well as existing zoning regulations and other controls (such as local historic preservation ordinances) to determine the highest and most profitable use for which the property would be adaptable and needed or likely to be needed in the reasonably near future once it is restricted by the easement.[45]

The Regulations again incorporate and supplement these general appraisal principles. The Regulations provide that, if the easement permits any development, however limited, on the subject property, "the fair market value of the property after contribution of the [easement] must take into account the effect of the development."[46] In other words, the appraiser must consider the reserved development rights in determining the after-easement highest and best use.

Regulations also provide that an appraisal of the subject property after contribution of the easement

> must take into account the effect of restrictions that will result in a reduction of the potential fair market value represented by [the property's before-easement] highest and best use but will, nevertheless, permit uses of the property that will increase its fair market value above that represented by the property's current use.[47]

For example, if the subject property is being used for agricultural purposes, has a before-easement highest and best use of residential development, and the easement permits but limits residential development, the appraiser must consider the limited retained development rights in determining the after-easement highest and best use.

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43. Reg. § 1.170A–14(h)(3)(ii).
44. *See Hilborn*, 85 T.C. at 690.
45. *See id.*; *see also supra* text accompanying note 30 discussing *Hughes*.
46. Reg. § 1.170A–14(h)(3)(ii).
47. *Id.*

The Regulations further provide that the fair market value of the subject property after contribution of the easement must take into account the amount of public access (if any) permitted by the terms of the easement.[48] An easement that permits public access might reduce the after-value of the property and, thus, increase the value of the easement, but it would depend on the amount of access permitted.[49]

C. Approaches to Estimating Fair Market Value

Once a property's before-easement highest and best use is determined, one or more of three commonly recognized methods of valuing property is generally used to determine the before-value of the property—the sales comparison approach, the income capitalization approach, and the reproduction cost approach.[50] Similarly, once a property's after-easement highest and best use is determined, one or more of those three methods is generally used to determine the after-value of the property.[51] As discussed below, however, the sales comparison approach is generally considered to provide the most reliable estimate of value, the income capitalization approach generally should not be used as the sole or primary method of valuation because it is particularly susceptible to manipulation and abuse, and the appropriateness of using the reproduction cost approach to value easements is questionable.

1. Sales Comparison Approach

Pursuant to the sales comparison approach, the value of the property being appraised is estimated by comparing that property to similar properties that were recently sold in the open market.[52] It "is based upon the

48. *Id.*
49. The rules regarding public access vary depending on the conservation purpose of the donation. *See* Reg. §§ 1.170A–14(d)(2)(ii), –14(d)(3)(iii), –14(d)(4)(ii)(B), –14(d)(4)(iii)(C), –14(d)(5)(iv).
50. *See Hilborn*, 85 T.C. at 689.
51. *Id.* at 690.
52. *See, e.g.*, APPRAISAL INST., THE APPRAISAL OF REAL ESTATE 50 (12th ed. 2001) [hereinafter AI, APPRAISAL OF REAL ESTATE]; J.D. EATON, REAL ESTATE VALUATION IN LITIGATION 197 (1995) [hereinafter EATON, REAL ESTATE VALUATION]; INTERAGENCY LAND ACQUISITION CONFERENCE, UNIFORM APPRAISAL STANDARDS FOR FEDERAL LAND ACQUISITIONS 37–38 (2000) [hereinafter ILAC, YELLOW BOOK].

commonsense approach of taking the actual sales prices of properties similar to the subject property and then relating these prices to the subject property."[53]

An appraiser using the sales comparison approach to estimate the fair market value of a subject property (whether before or after the easement donation) must identify property sales that meet three criteria: (1) the properties must be similar to the subject property (including have the same highest and best use); (2) the sales must have been arm's-length transactions; and (3) the sales must have occurred within a reasonable time of the valuation date.[54] Because no two sales and no two properties are ever identical, the appraiser must then consider aspects of the comparable transactions, such as the size of the property, its location, its topography, and other significant features, and make appropriate adjustments for each aspect to approximate the qualities of the subject property.[55] The appraiser then uses the sale prices of the comparable properties, appropriately adjusted, to estimate the value of the subject property.[56]

When there is sufficient information about sales of properties similar to the property being valued, the sales comparison approach is generally considered to be the most reliable indicator of fair market value.[57] Accordingly, in many (if not most) cases, an appraiser estimating the value of a conservation easement should (a) estimate the before-value of the subject property by looking to comparable sales of similar *unencumbered* properties and (b) estimate the after-value of the subject property by looking to comparable sales of similar *encumbered* properties. In estimating the after-value of the subject property, appraisers can look to sales of properties

53. Wolfsen Land & Cattle Co. v. Commissioner, 72 T.C. 1, 19 (1979).

54. *See, e.g.*, Butler v. Commissioner, 103 T.C.M. (CCH) 1359, 1368, 2012 T.C.M. (RIA) ¶ 2012-072, at 527.

55. *Id.*

56. *Id.*

57. *See id.* ("We have found the comparable sales approach to be the most reliable indicator of value when there is sufficient data about sales of properties similar to the subject property."); United States v. 320.0 Acres of Land, 605 F.2d 762, 798 (5th Cir. 1979) ("Courts have consistently recognized that, in general, comparable sales constitute the best evidence of market value"); *Esgar I*, 103 T.C.M. (CCH) at 1198, 2012 T.C.M. (RIA) ¶ 2012-035 at 284 , *aff'd* 744 F.3d 648; SWF Real Estate v. Commissioner, 109 T.C.M. (CCH) 1327, 2015 T.C.M. (RIA) ¶ 2015-063, at 469 ("Although the comparable sales method, like all valuation techniques, is far from an exact science . . . we have found the comparable sales approach to be the most reliable indicator of value when there is sufficient data about sales of properties similar to the subject property" (citation omitted)); *see also* EATON, REAL ESTATE VALUATION, *supra* note 52, at 198 ("The courts appear to prefer the sales comparison approach to value overwhelmingly"); ILAC, YELLOW BOOK, *supra* note 52, at 37 ("federal courts recognize that the sales comparison approach is normally the best evidence [of value]").

encumbered by similar conservation easements or, if no such sales exist, sales of properties subject to development and use restrictions or limitations analogous to those in the conservation easement, such as zoning restrictions or restricted access.[58] Given that the sales comparison approach is generally the most reliable indicator of value, and the income capitalization and reproduction cost approaches are subject to manipulation and abuse (as described below), claims that there are no comparable sales with which to estimate either the before- or after-value of a property should be carefully scrutinized.

The sales comparison approach that is applied in determining the before- and after-values of the subject property in a conservation easement appraisal should not be confused with the Treasury's preferred method of valuing easements discussed above (the "sales of comparable easements" method). Pursuant to the sales of comparable easements method, the appraiser would look to sales of easements comparable to the easement being donated, rather than sales of properties comparable to the subject property before and after the easement's donation.

2. *Income Capitalization Approach*

The income capitalization approach is sometimes used to estimate the before- or after-value of property subject to a conservation or façade easement. In the easement context, this approach generally involves a discounted cash flow analysis, which is based on the premise that the subject property's market value, either before or after the donation, is equal to the present value of the future income its owners could expect to realize.[59] Stated simply, the property's future cash flows are estimated and those cash flows are then discounted to present value.[60]

A discounted cash flow analysis is complex, however, and generally requires the appraiser to assume a myriad of factors and variables, the accuracy

58. Comparable sales of easement-encumbered properties are available in some jurisdictions. *See, e.g.*, *SWF Real Estate*, 109 T.C.M. (CCH) 1327, 2015 T.C.M. (RIA) ¶ 2015-063, at 469 (each parties' expert used some sales of properties subject to conservation easements in estimating the after-easement value of the subject property); *see also* S. Rep. No. 96-1007, 1980-2 C.B. 599, at 606 ("[A]s the use of conservation easement increases, valuation [will] increasingly take into account the selling price value, in arm's-length transactions, of other properties burdened with comparable restrictions.").

59. *Whitehouse III*, 139 T.C. at 321–22.

60. *See id.* at 322; EATON, REAL ESTATE VALUATION, *supra* note 52, at 194.

of which cannot clearly and easily be demonstrated by direct market data.[61] Even relatively minor changes in only a few of the assumptions can have large bottom-line effects on the value estimate produced.[62] In addition, "the seeming precision of computer-generated projections may give the appearance of certainty to projections that are actually variable within a wide range."[63] Accordingly, a discounted cash flow analysis is particularly susceptible to manipulation and abuse and is not favored if comparable-sales data are available.[64]

In a case involving valuation for condemnation purposes of a portion of property used for soil, sand, and gravel extraction, the 8th Circuit explained:

> [W]here [the income capitalization method] is used all of the factors that must necessarily be taken into account should be established by proper evidence. Where several of the elements or factors relied on . . . are without objective evidential support, that method is faulty and can obviously lead to unfounded and enhanced valuations. . . . Great care must be taken, or such valuations can reach wonderland proportions.[65]

The "subdivision development analysis" is a variant of the income capitalization approach.[66] It is a method of appraising undeveloped acreage, the highest and best use of which is assumed to be subdivision into residential lots, using a discounted cash flow analysis.[67] The approach involves

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61. *See* ILAC, YELLOW BOOK, *supra* note 52, at 42.

62. *See, e.g.*, APPRAISAL STANDARDS BD., UNIFORM STANDARDS OF PROFESSIONAL APPRAISAL PRACTICE, STATEMENT ON APPRAISAL STANDARDS NO. 2 (SMT-2) at U-71, U-72 (2014–2015 ed.) ("Because of the compounding effects in the projection of income and expenses, even slight input errors can be magnified and can produce unreasonable results.") [hereinafter USPAP SMT-2].

63. *Id.* at U-71 (discounted cash flow analysis "did not enjoy widespread use until modern computer technology enabled appraisers to automate the process").

64. *Whitehouse III*, 139 T.C. at 324 (stating that "we are not hostile to the income approach to determining value" but "it is not favored if comparable-sales data are available"); ILAC, YELLOW BOOK, *supra* note 52, at 42 (noting "the courts' obvious preference for the sales comparison approach and that '[h]istorically, the capitalization of income approach to value has been suspect'"); USPAP SMT-2, *supra* note 62, at U-71 (providing that discounted cash flow analysis is vulnerable to misuse because it is dependent on the analysis of uncertain future events).

65. United States v. 47.14 Acres of Land, 674 F.2d 722, 726 (8th Cir. 1982) ("Many of [the] factors are impossible to predict with reasonable accuracy.").

66. *See* EATON, REAL ESTATE VALUATION, *supra* note 52, at 245; ILAC, YELLOW BOOK, *supra* note 52, at 44; AI, APPRAISAL OF REAL ESTATE, *supra* note 52, at 342–43.

67. ILAC, YELLOW BOOK, *supra* note 52, at 44.

estimating a final sale price for the total number of lots into which the property could be divided and then deducting all costs of development, including the developer's anticipated profit.[68]

The subdivision development analysis is a "highly sensitive and complex method of valuation" that involves numerous steps, namely: (i) the creation of a detailed development plan for the property, including streets, utilities, lot sizes and locations; (ii) a market study to locate comparable finished lots and selling prices; (iii) an estimate of the time lag between the effective date of the appraisal and the date when the subdivision would be approved and construction of the infrastructure completed, making the lots marketable; (iv) an absorption analysis to estimate how quickly the lots could be sold; (v) an analysis of the direct costs of development, including the costs of surveying, design, engineering, permitting, grading, clearing, sewers, street paving, curbs and gutters, water lines and other utilities; (vi) an analysis of indirect costs, including financing, insurance, real property taxes, sales, advertising, accounting, legal and closing costs, and project overhead and supervision; (vii) an estimate of developer's expected profit; and (viii) the determination of an appropriate discount rate.[69] In addition, all of the income and expenses have to be scheduled over an assumed period of permitting, development, and sellout so that the income stream can be discounted back to present value.[70]

The subdivision development analysis, like discounted cash flow analyses generally, is particularly susceptible to manipulation and abuse and is not favored if comparable-sales data are available. The Uniform Appraisal Standards for Federal Land Acquisitions states that, "[w]hen comparable sales are available with which to accurately estimate the property's market value, the [subdivision development analysis] should not be relied upon as the primary indicator of value, as it is considerably more prone to error."[71] The Appraisal of Real Estate similarly cautions "[w]hen used on its own without an abundance of reliable market data, [the subdivision development analysis] can be the least accurate raw land valuation technique."[72] And the author of a treatise on valuation in the eminent domain context cautions:

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68. *Id.* at 44.
69. *Id.* at 45.
70. *Id.*
71. *Id.*
72. AI, APPRAISAL OF REAL ESTATE , *supra* note 52, at 342–43; *see also* EATON, REAL ESTATE VALUATION, *supra* note 52, at 247 ("If comparable sales are available, they should be used in evaluation the property . . . Bona fide sales data provide a better indication of value than a subdivision development prospectus.").

> [I]n many cases the [subdivision development analysis] has been applied under the wrong circumstances or in the wrong way. If all of the land that has been appraised by the development approach were actually subdivided, there would be enough subdivision lots on the market to last hundreds of years and little, if any, farmland left in the United States.[73]

Because of the highly speculative nature of the subdivision development analysis, established appraisal rules dictate that the analysis should be used as the sole or primary appraisal method only in relatively rare circumstances. In general, three conditions should be present before the subdivision development analysis is used to establish the value of land: (1) the highest and best use of the land must be for subdivision purposes, (2) the sales comparison approach must not be available because comparable sales either do not exist or are so few and dissimilar to the subject property that a sales comparison approach would involve unacceptably speculative adjustments and assumptions, and (3) sufficient market and technical data are available to estimate the value of the property reliably using the subdivision development analysis.[74] If comparable sales are available, the subdivision development analysis should be used only to support the value indicated by the sales comparison approach, and only then if additional support is needed.[75]

3. Reproduction Cost Approach

Pursuant to the reproduction (or replacement) cost approach, a property is valued by estimating the current costs to reproduce or replace it, less applicable depreciation or amortization.[76] In the easement context, this approach generally would be relevant only with regard to the valuation of

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73. EATON, REAL ESTATE VALUATION, *supra* note 52, at 246.

74. EATON, REAL ESTATE VALUATION, *supra* note 52, at 246; ILAC, YELLOW BOOK, *supra* note 52, at 19 ("When the highest and best use of a property is for subdivision purposes and comparable sales do not exist, the appraiser may resort to the [subdivision development analysis] . . . but only if adequate market and/or technical data are available with which to reliably estimate the property value by this approach.").

75. EATON, REAL ESTATE VALUATION, *supra* note 52, at 247; ILAC, YELLOW BOOK, *supra* note 52, at 45 ("when adequate comparable sales are available, the [subdivision development analysis] can be utilized to *test* . . . the highest and best use conclusion and to support the indicated value of the property by the sales comparison approach to value.") (emphasis in original); USPAP SMT-2, *supra* note 62, at U-71 (the discounted cash flow analysis "is best applied in developing value opinions in the context of one or more other approaches").

76. *See* EATON, REAL ESTATE VALUATION, *supra* note 52, at 157–61; ILAC, YELLOW BOOK, *supra* note 52, at 40–42.

historic structures. However, its appropriateness even in that context is questionable. *Powell on Real Property* explains:

> The [reproduction] cost approach to valuation encounters substantial difficulties when applied to historic structures (virtually its only application in the conservation easement context). The reproduction cost of an historic building usually bears little relationship to its present economic value. Such cost is usually far in excess of the cost of construction of a similarly sized modern structure, and may reflect the price of materials and workmanship that are no longer readily available.[77]

The reproduction cost approach appears in the valuation case law only twice, and in both instances the courts rejected its use. In *Losch*, the IRS's valuation expert at trial used the reproduction cost approach (as well as the sales comparison and income capitalization approaches) to value a façade easement donated with respect to an office building in a historic district in Washington, D.C. In rejecting the use of the reproduction cost approach, the Tax Court explained:

> [I]n dealing with an older, historic structure, it is highly questionable whether the replacement cost method can be used to provide meaningful results. It is extremely doubtful that a building such as 1716 New Hampshire Avenue could be constructed today. Even if it could, the construction methods and materials used would likely differ substantially from those utilized in 1910.[78]

In *Whitehouse v. Commissioner*, the taxpayer's valuation expert used the reproduction cost approach (as well as the sales comparison and income capitalization approaches) to value a façade easement donated with respect to a historic building in New Orleans. The Tax Court, affirmed by the 5th Circuit,

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77. RICHARD R. POWELL, POWELL ON REAL PROPERTY, VALUATION AND APPRAISAL METHODS VARY FOR CONSERVATION EASEMENTS § 34A.06, at 34A–54 (Michael Allen Wolf ed. 2015) ("[T]his method of valuation has substantial disadvantages in the best of circumstances. Its utility has been questioned and it should be used with care, if it is used at all, in connection with the appraisal of structures subject to conservation easements.").

78. Losch v. Commissioner, 55 T.C.M. (CCH) 909, T.C.M. (P-H) ¶ 88,230, at 1150 (1988).

rejected the use of the reproduction cost approach because it was based on unsupported assumptions and the taxpayer was unable to show that it would be a reasonable business venture to reproduce the 100-year-old building if it were destroyed.[79] The Tax Court also noted that the Court of Appeals has observed that the reproduction cost approach "'almost invariably tends to inflate valuation."[80] This latter sentiment is consistent with appraisal resources, which provide, for example:

> A reading of pertinent cases indicates that the courts' lack of confidence in the [reproduction] cost approach is caused not because of some weakness in the approach itself, but by flagrant misuse of the approach by appraisers. Some errors may result from a lack of knowledge, but more often practitioners use the [reproduction] cost approach to intentionally exaggerate the market value of property to benefit their client's interests.[81]

D. When Rezoning Is Assumed

In determining the before-easement highest and best use of the subject property, conservation easement donors (or, more accurately, their appraisers) often assert that the property could be rezoned (or upzoned) to allow for more development than is permitted under existing law. This can dramatically increase the estimated before-value of the property. The author of a treatise on valuation in the eminent domain context cautions that "the probability of rezoning is fertile ground for the unscrupulous, the naïve, and the dreamer . . . [and] . . . few appraisers adequately support their conclusion on this matter in their appraisal reports."[82] Accordingly, assertions of a "reasonable

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79. *Whitehouse III*, 139 T.C. at 321; *see also* ILAC, YELLOW BOOK, *supra* note 52, at 20 ("The cost approach may be excluded . . . when it is clear that the improvements would never be reproduced or replaced and application of the cost approach would contribute nothing to the solution of the appraisal problem.").

80. *Whitehouse III*, 139 T.C. at 317.

81. EATON, REAL ESTATE VALUATION, *supra* note 52, at 159; *see also* ILAC, YELLOW BOOK, *supra* note 52, at 20 ("the cost approach is often the least reliable approach to value and is often maligned by the courts"); United States v. 49,375 Square Feet of Land in Borough of Manhattan, 92 F. Supp. 384, 387–88 (S.D.N.Y. 1950), *aff'd* United States v. Thisman Realty & Const. Co., 193 F.2d 180 (1952) ("This 'method' is perhaps the most excellent example conceivable to demonstrate that none of such abstractions ought to have a place in the search for market value.").

82. EATON, REAL ESTATE VALUATION, *supra* note 52, at 143. As to why eminent domain valuation principles are relevant in the conservation easement valuation context, see *Stanley Works*, 87 T.C. at 401 n.8 ("The principles and legal

probability" of rezoning in the "reasonably near future" call for particularly careful scrutiny.

Moreover, even if it is determined that rezoning of the subject property is reasonably probable, under no circumstances should the property be valued as if it were already rezoned.[83] The risk of being denied rezoning, or that an exaction or other condition may be placed on the rezoning, always exists and must be taken into account.[84] The time delay and costs associated with the rezoning process must also be considered.[85] A willing buyer considering purchase of the property in its current (not yet rezoned) state would take into account each of these factors.[86]

Finding true comparable sales in the reasonable-probability-of-rezoning context is also difficult.[87] Developers interested in purchasing property for development usually condition their purchases on procurement of the necessary rezoning approvals. If the approvals are not obtained, the sale does not take place.[88] Accordingly, sales of properties that have sold for development generally do not represent the price at which the property would

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precedents governing the determination of fair market value of property in tax cases are the same as those that control the valuation of property in condemnation cases."); *Esgar II*, 744 F.3d at 648 (finding "no material difference between conservation easement valuation and just compensation valuation in the context of determining a property's highest and best use"). *Cf.* Drey v. Commissioner, 705 F.2d 965 (8th Cir. 1983) (holding that taxpayers who made a charitable gift of land were not entitled to a deduction for severance damages to adjacent lands, as would be applicable in the eminent domain context, because the measure of compensation for property donated as a charitable contribution is statutory and does not involve the same substantial rights protected by the fifth amendment of the Constitution as in condemnation cases). The concept of severance damages is addressed in the easement donation context in Reg. § 1.170A–14(h)(3)(i). *See supra* note 95 and accompanying text (discussing the contiguous parcel rule and shadow effect).

83. ILAC, YELLOW BOOK, *supra* note 52, at 83.

84. *Id.*

85. *Id.*

86. *See, e.g.*, NICHOLS ON EMINENT DOMAIN § 12C.03[2] nn.27, 33 and accompanying text (even where it is determined there is a reasonable probability of rezoning, there normally should be a discount because of the uncertainty and consideration of the practical costs and other burdens involved in obtaining the rezoning).

87. ILAC, YELLOW BOOK, *supra* note 52, at 88, 93 (discussing comparable sales "requiring extraordinary verification and treatment").

88. *Id.* at 92; *see also* EATON, REAL ESTATE VALUATION, *supra* note 52, at 134 ("Typically, the sale of a developable tract of land is closed only after the purchaser has procured all necessary permits for development. Thus, the purchaser incurs no risk as to whether development permits will be available.").

have sold if the purchaser had to procure rezoning after the date of closing.[89] Instead, such sales represent the price of a property with the rezoning approval already in place.[90] Although appraisers must often resort to using such sales as comparables, it is essential that they make appropriate adjustments to account for the risks, time delays, and costs inherent in the rezoning procurement process.[91]

E. Contiguous Parcel, Enhancement, and Incidental Benefit Rules

The Regulations contain a number of rules that require an easement donor's charitable income tax deduction to be reduced by any benefits that inure directly or indirectly to the donor as a result of the donation. If the donor or a member of the donor's family owns land contiguous to the land encumbered by the easement, the Regulations provide that the value of the easement is equal to the difference between the before- and after-values of the entire contiguous parcel (the "contiguous parcel rule").[92] If the donation has the effect of increasing the value of any other property owned by the donor or a related person, the amount of the deduction must be reduced by the amount of the increase in the value of the other property, whether or not such property is contiguous (the "enhancement rule").[93]

In the typical case, the contiguous parcel rule operates to decrease the value of an easement by requiring the donor to take into account the increase in the value of contiguous property owned by the donor or a member of the donor's family as a result of the easement donation (buyers often will pay more for property that is contiguous to property protected for its conservation or historic values). In *Whitehouse v. Commissioner*, however, the donor argued, and the 5th Circuit agreed, that the rule operated to increase the value of a façade easement by allowing the donor to take into account the extent to which the easement decreased the value of a contiguous building also owned by the

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89. ILAC, YELLOW BOOK, *supra* note 52, at 92.

90. *Id.* at 92–93.

91. *Id.* at 93 (in certain circumstances a purchaser may also require an entrepreneurial profit).

92. Reg. § 1.170A–14(h)(3)(i). "Family" is defined as brothers and sisters by the whole or half blood, spouse, ancestors, and lineal descendants. *See* I.R.C. § 267(c)(4).

93. Reg. § 1.170A–14(h)(3)(i). "Related person" is defined to include various familial, entity, and trust relationships. *See* I.R.C. §§ 267(b), 707(b); *see also* C.C.A.201334039 (Aug. 23, 2012) (addressing the contiguous parcel and enhancement rules).

donor.[94] This can be referred to as a "shadow effect."[95] The enhancement rule, on the other hand, operates as a one-way street. It specifically requires that the donor reduce the amount of the deduction to the extent the easement increases (or enhances) the value of any other property owned by the donor or a related person.

The Regulations also require that a donor's deduction be reduced by an amount equal to the value of any "financial or economic benefits . . . greater than those that will inure to the general public from the transfer" that the donor or a related person receives or can reasonably expect to receive as a result of the donation.[96] As one example, this rule should prevent a developer from claiming a charitable income tax deduction with respect to a conservation easement that is conveyed in exchange for permits or other development approvals or variances (*quid pro quo*).[97]

F. Zero-Value Easements

The Regulations instruct that "there may be instances where the grant of a conservation restriction may have no material effect on the value of the property or may in fact serve to enhance, rather than reduce, the value of property[.]"[98] "In such instances," state the regulations, "no deduction would be allowable."[99] As discussed in Parts IV and V, there have been numerous cases in which the courts have determined that façade easements had no value, and one case in which the court determined that a conservation easement had no value.

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94. *See* Whitehouse Hotel v. Commissioner, 755 F.3d 236, 242–43 (5th Cir. 2014).

95. *See* James H. Boykin & James A. McLaughlin, *Addressing Enhancement in Conservation Easement Appraisals,* 74 APPRAISAL J. 239, 245 (2006); *see also supra* note 82 (discussing severance damage in the eminent domain context).

96. Reg. § 1.170A–14(h)(3)(i). *See also* Reg. § 1.170-1(h)(1); U.S. v. Am. Bar Endowment, 477 U.S. 105 (1986).

97. For cases disallowing § 170(h) deductions because the easements were conveyed in exchange for *quid pro quo*, see Costello v. Commissioner, 109 T.C.M. (CCH) 1441, 2015 T.C.M. (RIA) ¶ 2015-087, at 631; Seventeen Seventy Sherman Street v. Commissioner, 107 T.C.M. (CCH) 1599, 2014 T.C.M. (RIA) ¶ 2014-124, at 863; Pollard v. Commissioner, 105 T.C.M. (CCH) 1249, 2013 T.C.M. (RIA) ¶ 2013-038, at 351; *see also* Stephen J. Small, *Real Estate Developers and Conservation Easements—Not as Simple as it Sounds*, 19 PROB. & PROP. 24 (2005).

98. Reg. § 1.170A–14(h)(3)(ii).

99. *Id.*

III. OVERVALUATION PENALTIES

Taxpayers that overstate the value of their easements and the appraisers who assist them are potentially subject to penalties.

A. Taxpayer Penalties

Taxpayers may be subject to penalties if they substantially or grossly overstate the value of an easement for purposes of the § 170(h) deduction.[100] Before the enactment of the Pension Protection Act of 2006 (PPA), taxpayers were subject to a 20 percent penalty if the value of an easement reported on a tax return was two times (200 percent) or more of the amount determined to be the correct value (a "substantial valuation misstatement").[101] Taxpayers were subject to a 40 percent penalty if the value reported on a tax return was four times (400 percent) or more of the amount determined to be the correct value (a "gross valuation misstatement").[102] The PPA lowered the thresholds to 150 percent for a substantial valuation misstatement and to 200 percent for a gross valuation misstatement.[103] In addition, if the correct value of an easement is determined to be zero, the value claimed by the taxpayer on the return is deemed to be 400 percent or more of the correct value and, thus, a gross valuation misstatement.[104]

For example, as indicated in Appendix A, in *Zarlengo v. Commissioner* the taxpayers reported that the donated façade easement at issue had a value of $660,000, but the Tax Court determined that the correct value was only $157,500. The taxpayers thus reported a value for the easement on their tax returns that was more than four times (or 419 percent) of the amount the court determined to be the correct value.[105] Accordingly, the taxpayers' reported value constituted a gross valuation misstatement under both pre- and post-PPA law. In addition, in *Dunlap v. Commissioner*, *Kaufman v. Commissioner*, *Foster v. Commissioner*, *Evans v. Commissioner*, *Scheidelman v. Commissioner*, *Reisner v. Commissioner*, and *Chandler v. Commissioner*, the courts determined that the façade easements at issue had no value.[106]

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100. *See* I.R.C. § 6662 (also authorizing the imposition of penalties for negligence or disregard of rules or regulations and substantial understatements of income tax).

101. *See* Kaufman v. Commissioner (*Kaufman I*), 107 T.C.M. (CCH) 1262, 2014 T.C.M. (RIA) ¶ 2014-052 at 387, *aff'd* Kaufman v. Commissioner (*Kaufman II*), 784 F.3d 56 (1st Cir. 2015).

102. *Id.*

103. *See* TECHNICAL EXPLANATION OF PPA*, supra* note 11, at 275–77.

104. *See* Reg. § 1.6662–5(g).

105. *See infra* app. A.

106. *See id.*

Accordingly, the values claimed by the taxpayers on their returns were deemed to be 400 percent or more of the correct value and, thus, gross valuation misstatements.

In some circumstances, penalties may not apply if a taxpayer qualifies for the reasonable cause exception.[107] However, the requirements of the reasonable cause exception vary with regard to the individual penalties.[108] In addition, the PPA eliminated the reasonable cause exception for gross valuation misstatements, making that penalty a strict liability penalty with regard to returns filed after certain dates in 2006.[109]

B. Appraiser Penalties

Appraisers preparing conservation or façade easement appraisals are also potentially subject to a number of penalties. An appraiser who knowingly facilitates (aids and abets) an easement donor's understatement of tax liability may be subject to a penalty of $1,000.[110] An appraiser who prepares an appraisal that results in a substantial or gross valuation misstatement may be subject to a penalty equal to, at most, 125 percent of the gross income derived

107. I.R.C. § 6664(c).

108. Penalties for negligence or disregard of rules or regulations or a substantial understatement of income tax will not apply (that is, the reasonable cause exception will apply) if the taxpayer can show there was reasonable cause for the understatement and the taxpayer acted in good faith. I.R.C. § 6664(c)(1). The penalty for a substantial valuation misstatement in the case of charitable deduction property will not apply if the taxpayer can show that (i) the misstatement was made with reasonable cause and in good faith, (ii) the misstatement was based on a qualified appraisal prepared by a qualified appraiser, and (iii) the taxpayer made a good-faith investigation of the value of the easement. I.R.C. § 6664(c)(1), (3), (4). Before the changes made by the PPA, the reasonable cause exception with regard to the gross valuation misstatement penalty required the same showing as in the preceding sentence.

109. *See* TECHNICAL EXPLANATION OF PPA*, supra* note 11, at 311. The strict liability penalty applies to returns claiming deductions for façade easement donations filed after July 25, 2006, and to returns claiming deductions for conservation easement donations filed after August 17, 2006. *See* Chandler v. Commissioner, 142 T.C. 279, 293, n.5 (2014).

110. I.R.C. § 6701(b)(1). If the easement donor is a corporation, the penalty is $10,000. I.R.C. § 6701(b)(2).

from the appraisal.[111] This latter penalty does not apply if the appraiser can establish that it was "more likely than not" that the appraisal was correct.[112]

In addition, after notice and opportunity for a hearing, the Secretary of the Treasury may "blacklist" an appraiser (that is, provide that the appraiser's appraisals will have no probative effect in any administrative proceeding before the Treasury or the IRS and bar such appraiser from presenting evidence or testimony in any such proceeding).[113] Furthermore, the United States may enjoin any person from engaging in "specified conduct," including knowingly aiding and abetting the understatement of tax liability.[114]

IV. FAÇADE EASEMENT VALUATION CASE LAW

The seventeen cases involving the valuation of façade easements for charitable contribution deduction purposes through 2015 are listed in Appendix A. These cases can be usefully divided into two categories: (i) the six cases involving façade easements donated between 1979 and 1981 (the early cases) and (ii) the eleven cases involving façade easements donated in 1997 and thereafter (the recent cases). An analysis of these cases, particularly the recent cases, reveals some interesting trends.

A. Persistent and Increased Overstatements

As indicated in Appendix A, in the six early cases involving donations of façade easements, the average amount by which the taxpayers overstated the value of the easements was $102,100, and, on average, the taxpayers asserted values for their easements that were slightly more than two times (or 206 percent of) the court-determined values. In the eleven recent cases, the average amount by which the taxpayers overstated the value of the easements increased to more than $1.4 million,[115] and, on average, the taxpayers asserted values for the easements that were more than four times (or 406 percent of)

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111. I.R.C. §6695A(b). The penalty is equal to the greater of $1,000 or 10 percent of the understatement of tax resulting from the substantial or gross valuation misstatement, up to a maximum of 125 percent of the gross income derived from the appraisal.

112. I.R.C. § 6695A(c).

113. *See* 31 U.S.C. § 330(c) (2015); *see also* 31 U.S.C. § 330(b) (2015) (authorizing the Secretary to suspend or disbar from practice before the Treasury a representative who, among other things, is incompetent, disreputable, or violates regulations).

114. *See* I.R.C. § 7408.

115. Some of the increase in the dollar value of the overstatements is attributable to appreciation in the value of real estate since the late 1970s and early 1980s.

the court-determined values. In all but one of the recent cases, the taxpayers' asserted values for the easements constituted gross valuation misstatements.[116]

Some of the individual overstatements in the recent cases in terms of dollar value were substantial: more than $500,000 in two of the cases, more than $5.5 million in one case, and more than $8.1 million in another. Moreover, in seven of the eleven recent cases, the taxpayers claimed sizable deductions (from $98,500 to $8.1 million) for easements that were determined to have no value.

The case law reflected in Appendix A suggests that overvaluation has been a persistent problem in the facade easement donation context. In addition, the fact that the taxpayers in the recent cases asserted values for their easements that were, on average, more than four times the court-determined values, and in seven of the cases claimed sizable deductions for easements that were determined to have no value, suggests that the problem of overstatements has worsened over time. It also is likely that the IRS has become more skilled at ferreting out and litigating abuses.

B. Commercial versus Residential Properties

The existing case law also indicates that façade easements tend to have a more significant negative impact on the value of commercial properties than on residential properties. As indicated in Appendix B, all six of the early cases involved façade easements donated with respect to commercial properties, while ten of the eleven recent cases involved façade easements donated with respect to residential properties. *Dunlap v. Commissioner* involved a residential property—a condominium in New York City—in which the owners of units donated a façade easement with regard to the building and claimed a share of the deduction based on the value of their units. *Whitehouse v. Commissioner* is the only recent case that involved the donation of a façade easement with respect to a commercial property.

As indicated in Appendix B, in *Whitehouse v. Commissioner*, the Tax Court, affirmed by the Fifth Circuit, found that a façade easement reduced the value of a historic building in New Orleans, which is now used as a hotel, by approximately $1.85 million, or by 14.9 percent. This is consistent with the six early cases involving commercial properties in which the courts found that the façade easements reduced the value of the properties, on average, by 18.9 percent. In contrast, in the ten recent cases involving façade easements donated with respect to residential properties, seven of the easements were found to

116. The taxpayer's asserted values for the easements in *Simmons v. Commissioner* constituted substantial valuation misstatements at the time the returns were filed but would have constituted gross valuation misstatements had the returns been filed after the PPA changes were effective.

have no value, and three were found to have reduced the value of the residences by only a modest percentage (2 percent in *Gorra v. Commissioner*, 3.5 percent in *Zarlengo v. Commissioner*, and 5 percent in *Simmons v. Commissioner*).

In *Chandler v. Commissioner*, which involved façade easements donated with respect to two residential properties, the court offered an explanation as to why façade easements tend to have a more significant negative impact on the value of commercial as opposed to residential properties.

> Restrictions on construction impair the value of commercial property more tangibly than they impair the value of residential property. Commercial property derives its value from its ability to generate cashflows. For commercial property, development generally correlates with increased future cashflows. More retail space, more space for tenants, and more room for customers generally increase profitability. Restrictions on the development of commercial property reduce potential for increased future cashflows and thus diminish value.
>
> Construction restrictions affect residential property values more subtly. People do not buy homes primarily to make money, and personal rather than business reasons usually motivate any construction on their homes. The loss of freedom to make changes to the exterior of one's home has a price, but it is difficult to quantify. The task becomes even more difficult when we consider the already existing [local historic preservation] restrictions on the property. Even if [the taxpayers in *Chandler*] had not granted the easements, local law would have prevented them from freely altering their homes. The easements had value only to the extent their unique restrictions diminished [the taxpayers'] property values.[117]

In *Chandler* the Tax Court ultimately concluded that the façade easements donated with respect to the residential properties had no value.[118]

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117. *Chandler*, 142 T.C. at 289.
118. *Id.* at 290.

C. *Residential Properties Subject to Local Historic Preservation Laws*

The recent cases analyzed in Appendix B suggest that façade easements donated with respect to residential properties that are already subject to local historic preservation laws either have no negative impact on the value of such properties or reduce the value of such properties by only a modest percentage. The results in the cases are, however, somewhat unpredictable. In some cases courts have found that the additional restrictions in an easement have no negative impact on value, while in other (very similar) cases the courts find that the additional restrictions have a modest negative impact on value. In addition, facts specific to a particular case, such as the credibility (or lack thereof) of the parties' valuation experts, can influence the holdings.

As indicated in Appendix B, in the ten recent cases involving façade easements donated with respect to residential properties, all of which were subject to local historic preservation laws, seven of the easements were found to have no value, while three were found to have reduced the value of the residences by 5 percent or less. In two of the seven zero-value cases, *Foster v. Commissioner* and *Evans v. Commissioner*, the taxpayers failed to provide sufficient credible evidence that the easements had any value.[119] In one of the seven zero-value cases, *Reisner v. Commissioner*, the parties stipulated at trial that the easement had no value.[120] In the remaining four of the seven zero-value cases, *Dunlap v. Commissioner, Kaufman v. Commissioner, Scheidelman v. Commissioner*, and *Chandler*, the courts compared the restrictions imposed by the easements and the restrictions imposed by local law and determined that, despite some differences, the easements did not negatively impact the fair market value of the residences.[121] In contrast, in *Simmons v. Commissioner, Zarlengo v. Commissioner*, and *Gorra v. Commissioner*, the courts compared the restrictions imposed by the easements

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119. *See* Evans v. Commissioner, 100 T.C.M. (CCH) 275, 279, 2010 T.C.M. (RIA) ¶ 2010-207, at 1276 (2010) (declining to give the reports of the taxpayer's expert any probative weight in part because of "the various conceptual, methodological, and calculation errors that she acknowledged"); Foster v. Commissioner, T.C. Summ. Op. 2012-90, 2012 WL 3964754, at *4–5 (taxpayer's expert improperly relied on what he apparently considered to be a "safe harbor" diminution percentage to determine the value of the easement).

120. Reisner v. Commissioner, 108 T.C.M. (CCH) 518, 2014 T.C.M. (RIA) 2014-230, at 1663.

121. *See Kaufman II*, 784 F.3d 56; *Scheidelman*, 755 F.3d 148; *Chandler*, 142 T.C. at 279; Dunlap v. Commissioner, 103 T.C.M. (CCH) 1689, 2012 T.C.M. (RIA) ¶ 2012-126, at 987.

and the restrictions imposed by local law and determined that the differences, although modest, did negatively impact the value of the residences.[122]

A comparison of the holdings in *Chandler, Scheidelman,* and *Zarlengo* provides some sense of the unpredictability of the decisions in this context. *Chandler* involved the donation of façade easements with respect to two residences located in the South End Historic District of Boston, Massachusetts.[123] Both residences were subject to local historic preservation laws enforced by the South End Landmark District Commission (LDC).[124] The Tax Court determined that there were several differences between the easement restrictions and the local historic preservation laws. In particular, the restrictions in the easements were broader in scope than those under local law and the easement holder, the National Architectural Trust (NAT), more actively enforced its easements than the LDC enforced local law.[125]

Despite these differences, the Tax Court in *Chandler* found that the easements did not negatively impact the value of the residences.[126] In addition to finding the report of the taxpayer's valuation expert not to be credible, the court agreed with the IRS's valuation expert that "a typical buyer would perceive no difference between the two sets of applicable restrictions[.]"[127]

In *Scheidelman*, the Second Circuit similarly held that the donation of a façade easement to NAT with respect to a residence located in Brooklyn's Fort Greene Historic District had no negative impact on the value of the residence.[128] The Second Circuit agreed with the Tax Court that the easement

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122. Simmons v. Commissioner, 646 F.3d 6 (D.C. Cir. 2011); Zarlengo v. Commissioner, 108 T.C.M. (CCH) 155, 2014 T.C.M. (RIA) ¶ 2014-161, at 1135; Gorra v. Commissioner, 106 T.C.M. (CCH) 523, 2013 T.C.M. (RIA) ¶ 2013-254, at 2059.

123. *Chandler*, 142 T.C. at 280.

124. *Id.* at 282.

125. *Id.* at 290.

126. *Id.*

127. *Id.* The Tax Court in *Chandler* relied on its earlier holding in *Kaufman*, in which the court performed the same analysis under identical circumstances and determined that the easement had no value (*Kaufman* also involved a façade easement donated to NAT with respect to a residence in the South End Historic District). *Id.* In *Kaufman*, after engaging in a detailed analysis of the two sets of restrictions, the Tax Court explained that the IRS's expert "convinced us that the restrictive components of the preservation agreement are basically duplicative of, and not materially different from, the South End Standards and Criteria." *Kaufman I*, 107 T.C.M. (CCH) 1262, 2014 T.C.M. (RIA) ¶ 2014-052, at 387.

128. *Scheidelman*, 755 F.3d at 153–54; *see also Dunlap,* 103 T.C.M. (CCH) 1689, 2012 T.C.M. (RIA) ¶ 2012-126, at 987 (façade easement donated with respect to the Cobblestone Loft Condominium in New York City's Tribeca North Historic District had no value; the building was subject to the New York City Landmark Preservation Commission's (LPC's) special "sound, first-class condition" designation

"was not appreciably more restrictive" than local historic preservation laws.[129] While the Second Circuit acknowledged that "[o]rdinarily any encumbrance on real property, howsoever slight, would tend to have some negative effect on that property's fair market value," it explained that neither the Tax Court nor any Circuit Court has held that the grant of an easement effects a per se reduction in the fair market value of the subject property.[130] "To the contrary," said the Second Circuit, "the regulations provide that an easement that has no material effect on the obligations of the property owner or the uses to which the property may be put 'may have no material effect on the value of the property.'"[131]

Quoting the Regulations, the Second Circuit further explained that sometimes an easement "may in fact serve to enhance, rather than reduce, the value of property."[132] The Second Circuit concluded that, based on the evidence in *Scheidelman*, the Tax Court "drew the fair inference" that the preservation of historic façades in the Fort Greene Historic District is a benefit rather than a detriment to the value of the subject properties.[133]

However, the Tax Court came to a different conclusion in *Zarlengo. Zarlengo* also involved the donation of a façade easement to NAT, but this time with respect to a residence in the Riverside Historic District of New York City.[134] The residence was subject to local historic preservation laws enforced

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and the court did not believe the restrictions imposed by or the holder's enforcement of the easement were any more stringent than the restrictions imposed by or the LPC's enforcement of local laws).

129. *Scheidelman*, 755 F.3d at 153.

130. *Id.* at 152.

131. *Id.* The Court also cited to the Vice President & General Counsel of the National Trust for Historic Preservation, who, in a hearing before a Congress, stated, "This is 'especially' true if only a 'simple façade easement' has been granted over a property 'that ha[s] substantial market value because of [its] historic character.'" *Id.*

132. *Id* (quoting Regulation § 1.170A-14(h)(3)(ii)).

133. *Id.* at 152; *see also* Richmond v. Commissioner, 699 F.Supp. 578, 582–83 (E.D. La. 1988) ("It is by no means axiomatic that the value of property encumbered by a facade easement automatically declines as a result of the easement"; the donation of a facade easement "may, in fact, enhance the value of the property."); S. Rep. No. 96-1007, 1980-2 C.B. 599, at 606 (stating that "there may be instances in which the grant of an easement may serve to enhance, rather than reduce, the value of property and in such instances no deduction would be allowable; for example, where there is a premium in value on property of a historic nature").

134. *Zarlengo*, 108 TCM (CCH) 155, 2014 T.C.M. (RIA) ¶ 2014-161, at 1138. As indicated in Appendix B, NAT (now known as the Trust for Architectural Easements) was the donee in seven of the ten cases involving façade easements donations with respect to residences. In June 2011, the Department of Justice filed a lawsuit against NAT alleging that it was engaged in abusive practices. *See* Complaint

by New York City's Landmark Preservation Commission (LPC).[135] As in *Chandler*, the Tax Court determined that there were several differences between the easement restrictions and local law. In particular, the restrictions in the easement were somewhat more restrictive than those under local law and NAT more actively enforced its easements than the LPC enforced local law.[136]

Based on these facts, and in contrast to its conclusions in *Chandler* and *Scheidelman*, the Tax Court found that the easement in *Zarlengo* provided the residence "with an additional layer of protection over and above that provided by the LPC's regulations."[137] The court also found the assertion of the IRS's valuation expert that the easement did not place additional burdens on the owner of the residence to be "conclusory" and based on the expert's "preconceived notion that conservation easements have no value."[138] The court rejected the IRS expert's analysis as unsupported and unreliable, noting that "any encumbrance on real property, however slight, would ordinarily tend to have some negative effect on a property's fair market value."[139]

The Tax Court in *Zarlengo* ultimately concluded that 3.5 percent was a reasonable diminution in the value of the residence as a result of the

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for Permanent Injunction and Other Relief, United States v. McClain, Civ. No. 11-1087 (D.C. June 14, 2011). In July 2011, the court issued a permanent injunction against NAT settling the case. *See* Stipulated Order of Permanent Injunction, United States v. McClain, Civ. No. 11-1087 (D.C. July, 15, 2011). The injunction permanently prohibits NAT from engaging in certain practices, such as representing that the IRS has established a safe harbor for the value of donated façade easements, participating in the appraisal process, and requesting cash donations tied to the estimated value of the easement. *Id.* NAT was ordered to pay an independent monitor for two years to ensure it complied with the injunction. *Id.*

135. *Zarlengo*, 108 T.C.M. (CCH) 155, 2014 T.C.M. (RIA) ¶ 2014-161, at 1138.

136. *Id.* at 1138, 1140, 1146 n.11.

137. *Id.* at 1140, 1146 n.11.

138. *Id.* at 1143–44.

139. *Id*. at 1153 (citation omitted); *see Dunlap*, 103 T.C.M. (CCH) 1689, 2012 T.C.M. (RIA) ¶ 2012-126, at 1007 (accord); *see also* Simmons v. Commissioner, 98 T.C.M. (CCH) 211, 217, 2009 T.C.M. (RIA) ¶ 2009-208, at 1570, *aff'd*, 646 F.3d 6 (D.C. Cir. 2011) ("We do not find [the IRS's] expert reports credible insofar as they maintain that an easement would have absolutely no effect on the fair market value of valuable real estate."); *Gorra*, 106 T.C.M. (CCH) 523, 2013 T.C.M. (RIA) ¶ 2013-254, at 2069 (same). In *Dunlap*, *Kaufman*, *Scheidelman*, and *Chandler*, however, the courts agreed with the IRS that the façade easements had no effect on the fair market value of the residences. *See Dunlap*, 103 T.C.M. (CCH) 1689, 2012 T.C.M. (RIA) ¶ 2012-126; *Kaufman II*, 784 F.3d 56; *Scheidelman*, 755 F.3d 148; *Chandler*, 142 T.C. 279.

additional burdens imposed by the easement.[140] The court explained that "'[v]aluation is . . . necessarily an approximation[,]' and '[i]t is not necessary that the value arrived at by the trial court be a figure as to which there is specific testimony, if it is within the range of figures that may properly be deduced from the evidence.'"[141] In settling on 3.5 percent as a reasonable diminution percentage, the court noted that it had found 2 percent to be reasonable in *Gorra v. Commissioner* and 5 percent to be reasonable in *Simmons v. Commissioner*.[142]

Chandler, Scheidelman, and *Zarlengo* illustrate that, despite similar facts, courts can come to different conclusions regarding whether a façade easement reduces the value of a residence that is already subject to local historic preservation laws. The cases also illustrate the type of analysis of the two sets of restrictions that is required to assess whether a façade easement has an effect on market value, as well as some of the additional factors that a court may find persuasive, such as the credibility of a party's valuation expert.

D. Whitehouse v. Commissioner—Tripartite Abuse

Whitehouse illustrates that all three approaches to valuation can be used to overstate the value of a facade easement. In *Whitehouse*, a partnership claimed a deduction of more than $7.4 million for the donation of a façade easement with respect to the Maison Blanche building in the French Quarter of New Orleans, which the partnership planned to rehabilitate for use as a Ritz-Carlton hotel.[143] The IRS challenged the claimed deduction, and the Tax Court, affirmed by the Fifth Circuit, concluded that the easement had a value of only approximately $1.85 million.[144] The value the partnership reported for the easement on its tax return was thus slightly more than four times (401 percent

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140. *Zarlengo*, 108 T.C.M. (CCH) 155, 2014 T.C.M. (RIA) ¶ 2014-161, at 1138.

141. *Id.*

142. *Id.*; *see Gorra*, 106 T.C.M. (CCH) 523, 2013 T.C.M. (RIA) ¶ 2013-254, at 2059 (holding that a façade easement donated to NAT with respect to a residence subject to New York City's Landmarks Preservation Law was more restrictive than local law and resulted in a 2 percent diminution in the residence's value); *Simmons*, 646 F.3d at 12 (holding that façade easements donated to L'Enfant Trust with respect to residences subject to local historic preservation laws were duplicative of those laws in some respects but nonetheless resulted in a 5 percent diminution in value).

143. *See Whitehouse III*, 139 T.C. at 307–10. The building is now used as a Ritz-Carlton hotel. *Id.* at 308.

144. *Id.* at 348.

of) the amount the court determined to be the correct value, which constituted a gross valuation misstatement.[145]

At trial, the partnership offered the report and testimony of a valuation expert who relied primarily on a reproduction cost approach and an income capitalization approach, but also, in part, used a sales comparison approach. The expert estimated that the easement had a value of $10 million, which was $2.6 million more than partnership had claimed as the value on its tax return, and more than five times the value the court determined to be the correct value.[146] As discussed below, the Tax Court determined that the partnership's expert had inflated the value of the easement by using nonlocal "comparables" in his sales comparison approach, by using unsupported assumptions in his income capitalization approach, and by inappropriately employing the reproduction cost approach.

1. Nonlocal Comparables

The partnership's expert was based in Chicago but had obtained a temporary license from the state of Louisiana for the purpose of preparing the *Whitehouse* appraisal.[147] He used the sales comparison approach to determine that the Maison Blanche building and the adjacent Kress building had a collective before-value of $40 million, or more than three times the $11 million that the partnership had paid for the buildings just two years before the easement donation.[148] The partnership's expert included five sales of buildings in downtown New Orleans (local comparables) in his analysis.[149] He also included seven sales of buildings in various other U.S. cities (nonlocal comparables) because he claimed that none of the buildings in downtown New Orleans were similar to the Maison Blanche-Kress buildings "in size, luxury, or hotel market orientation."[150] He also noted that "'[b]uildings purchased for rehabilitation into first class luxury hotels trade in a national marketplace, so it is appropriate to analyze sales in other cities for purposes of establishing the

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145. *Id.* at 349. The Fifth Circuit found that the partnership was not liable for the gross valuation misstatement penalty because it qualified for the reasonable cause exception. *Whitehouse Hotel*, 755 F.3d at 249–50.

146. *Whitehouse III*, 139 T.C.at 311–12.

147. *Id.* at 310.

148. *Id.* at 308, 311. The partnership owned both buildings and its hotel development plan included combining the buildings. *Id*. at 308.

149. Whitehouse Hotel v. Commissioner, 131 T.C. 112, 142–43 (2008), *vacated and remanded by* 615 F.3d 321 (5th Cir. 2010), *holding on remand*, 139 T.C. 304 (2012), *aff'd in part and vacated in part*, 755 F.3d 236 (5th Cir. 2014).

150. *Id*. at 143, 157 (four of the seven nonlocal comparables were located in Manhattan, one was in Boston, one was in Washington, D.C., and one was in Cleveland).

value of the Maison Blanche Hotel Complex by the Sales Comparison Approach.'"[151]

The IRS's expert at trial was licensed by the state of Louisiana; had been appraising real estate in the state for over twenty-five years; had appraised between fifty and seventy buildings in and around New Orleans that were to be used as or converted into hotels; and had, over the years, appraised the value of every building within the same square as the Maison Blanche building, as well as the value of the Maison Blanche building itself on three prior occasions.[152] The IRS's expert saw no need to use nonlocal comparables.[153] While he agreed that an appraiser occasionally has to look outside the location of a subject property for comparables because there are insufficient local sales, he determined that there were adequate local comparable sales on which to base the before-value of the Maison Blanche and, indeed, he identified nine.[154]

The Tax Court rejected the partnership's expert's use of nonlocal comparables for a number of reasons. First, "location plays a huge role in determining the desirability, and, thus, the value of real estate" and the risk of error is reduced substantially in employing the sales comparison approach "if, on account of proximity, we can eliminate (or reduce the significance of) location as a distinguishing factor."[155] Second, the Fifth Circuit has recognized the link between proximity and probative value: "The more comparable a sale is in characteristics, *proximity,* and time, the more probative it is of value."[156] Third, the risk of relying on the nonlocal comparables in *Whitehouse* was substantial because the values the partnership's expert attributed to the nonlocal properties were significantly higher than those he attributed to the local comparables, and those large variances "underscore[d] the lack of comparability" of the nonlocal properties.[157] Fourth, given that the partnership's expert had identified five, and the IRS's expert had identified nine local comparables, it was unnecessary to rely on the riskier nonlocal comparables.[158] Fifth, the Tax Court was not convinced by the partnership's expert's claim that it was appropriate to take nonlocal sales into account because buildings purchased for rehabilitation into first class luxury hotels

151. *Id.* at 157.
152. *Whitehouse III*, 139 T.C. at 311.
153. *Id.* at 329.
154. *Id.*
155. *Id.*
156. *Id.* (quoting Estate of Jameson v. Commissioner, 267 F.3d 366, 373 (5th Cir.2001)) (emphasis added by Tax Court).
157. *Id.* at 329–30.
158. *Id.* at 330.

traded in a national marketplace.[159] The expert offered no statistics supporting that claim, nor did he have evidence of any competition in the local or national market for the Maison Blanche building, which, just two years before the valuation date, had been purchased for the relatively moderate price of $6.625 million.[160]

Finally, the partnership's expert also justified his use of nonlocal comparables on the ground that buyers in the marketplace for shell buildings suitable for development into luxury hotels "will pay a premium without trying to think about what the local buyers will pay."[161] In other words, he testified that developers of luxury hotels "will leave money on the table by paying more than the local market would demand for the property."[162] The Tax Court found that this assertion "defie[d] common sense" and contradicted a basic tenet of the fair market value paradigm, namely that the hypothetical buyer and the hypothetical seller are rational economic actors and "each seeks to maximize his advantage in the context of the market that exists at the date of valuation."[163]

Whitehouse illustrates how the sales comparison approach can be abused by relying on sales of nonlocal properties. The degree of proximity will vary with the type of property being appraised and sales activity in the area[164] and, in some circumstances, a property may be desirable in the national or regional market for a special use.[165] However, "the best rule of thumb . . . is that, all else being equal, the best comparables are those located closest to the property being appraised."[166] Accordingly, any use of nonlocal comparables should be carefully scrutinized.[167]

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159. *Id.*

160. *Id.*

161. *Id.* at 336.

162. *Id.*

163. *Id.*

164. *See* EATON, REAL ESTATE VALUATION, *supra* note 52, at 208–09.

165. *See Stanley Works*, 87 T.C. at 411–12 (before-easement highest and best use of the subject property, which was located on the Housatonic River in Connecticut, was as a hydroelectric power pumped storage plant, and the per-acre price paid for pumped storage land in the New England region produced a "reasonably reliable guide to the value of the . . . property").

166. *See* EATON, REAL ESTATE VALUATION, *supra* note 52, at 208–09.

167. *Id.* at 209 (stating that appraisers should be cautious, and noting that one condemnor's attorney has been known to display an eight-foot by ten-foot map of the United States in closing arguments to point out the location of the opposing party's appraiser's comparables).

2. *Manipulation of Income Capitalization Approach*

The partnership's valuation expert in *Whitehouse* also employed the income capitalization approach to estimate the value of the easement.[168] The Tax Court rejected his use of this approach, finding it to be unreliable.[169]

In rejecting the expert's income capitalization approach, the Tax Court explained that, on the date of the easement's donation, the partnership and Ritz-Carlton had entered into agreements pursuant to which the partnership agreed to renovate the Maison Blanche and Kress buildings and Ritz-Carlton agreed to operate a hotel therein.[170] However, on the date of the donation there had been no renovation and there was no hotel.[171] Rather, all that was valuable with respect to the Maison Blanche building on the date of donation was its shell, since the rehabilitation plan called for removing all interior partitions as well as mechanical and electrical systems.[172]

The partnership's expert nonetheless assumed an operating Ritz-Carlton hotel in his income capitalization analysis.[173] He estimated the rehabilitation costs, operating revenues, operating costs and expenses, and profits associated with the proposed hotel; he inserted those estimates into a complex computerized discounted cash flow model; and he came up with before-value for the Maison Blanche and Kress buildings of $41 million (which was close to the $40 million before-value he estimated using his flawed sales comparison approach).[174] In rejecting the expert's income capitalization analysis, the Tax Court noted that "[t]he seemingly mechanical nature of the process" should not obscure the fact that the resulting estimate was based on an analysis of a considerable number of underlying data, many of which were as yet unknown.[175] Some of the risks were obvious, said the court: for example, the hotel might not be finished on schedule (it was not) and occupancy might be less than expected.[176] Moreover, in estimating construction costs and hotel receipts and expenses alone, the partnership's expert made hundreds of assumptions involving amounts both large (for example, assumed construction-period interest of $9.9 million) and small (for example, assumed telephone revenue from each hypothetically occupied hotel

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168. *Whitehouse III*, 139 T.C. at 311.
169. *Id.* at 321.
170. *Id.*
171. *Id.*
172. *Id.*
173. *Id.* at 322.
174. *Id.* at 311, 322.
175. *Id.* at 322–23.
176. *Id.* at 323.

room of $4.50 a night), each carrying with it some risk of error.[177] The court also pointed out that its own calculations demonstrated that even relatively minor changes in only a few of the assumptions had large bottom-line effects.[178]

The Tax Court acknowledged that it had used the income capitalization approach, in the form of the subdivision development analysis, to value conservation easements in other cases (for example, *Trout Ranch*).[179] The Tax Court explained, however, that in those instances, it "had sufficient information from the experts that [it was] comfortable in evaluating and adjusting their analyses to produce valuations in which [it] had confidence."[180] The Tax Court also emphasized that the income capitalization approach "is not favored if comparable-sales data are available."[181]

The partnership's expert in *Whitehouse* also did not capitalize the income of an ongoing business.[182] Rather, he identified the property that he was to value as the shell of the Maison Blanche building and, for that property, comparable-sales data were readily available.[183] The Tax Court explained that there was simply too much uncertainty and unquantified risk associated with the application of the income capitalization approach in *Whitehouse* for the court to accept at face value the conclusions resulting from that approach.[184] In other words, the readily-available comparable sales of similar properties were much more reliable indicators of the value of the Maison Blanche shell than the complex income capitalization approach, which relied on hundreds of insufficiently supported assumptions to value a completely hypothetical luxury hotel.

Whitehouse illustrates the complex and manipulable nature of the income capitalization approach. The sophistication and seeming precision of such a computer-generated analysis can obscure the fact that it relies on multiple assumptions, many of which are impossible to predict with reasonable accuracy.[185] If comparable sales are available, as they were in *Whitehouse*, the sales comparison approach should be used to estimate value,

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177. *Id.*
178. *Id.*
179. *Id.* at 324.
180. *Id.*
181. *Id.*
182. *Id.* at 325.
183. *Id.* at 325–26.
184. *Id.* at 326.
185. *See 47.14 Acres of Land*, 674 F.2d 722; *see also supra* note 65 and accompanying text.

with the income capitalization approach being used, if at all, only to check the value indicated by the sales comparison approach.[186]

3. Inappropriate Use of Reproduction Cost Approach

The partnership's expert in *Whitehouse* also used the "often maligned" reproduction cost approach to estimate that the Maison Blanche and Kress buildings had a before-value of $43 million (which was close to the $41 and $40 million estimates he obtained using his flawed income capitalization and sales comparison approaches).[187] As noted in Part II, the Tax Court rejected the expert's use of this approach because it was based on unsupported assumptions and it was unlikely that the 100-year-old Maison Blanche building would be reproduced were it destroyed. The court also explained that a before-value of $43 million "defied reason" given that the partnership had purchased the properties just two years earlier for only $11 million and the New Orleans real estate market had enjoyed, at best, stable growth during the two-year period.[188] It appears that the partnership's expert used this approach to "intentionally exaggerate the market value of the property to benefit [his] client's interests."[189]

4. Lessons from Whitehouse

The Tax Court in *Whitehouse* ultimately relied on the sales comparison approach and local comparable sales to conclude that (i) the before-value of the Maison Blanche and Kress buildings at the time of the easement donation was only approximately $12.4 million (rather than $40, $41, or $43 million), (ii) the after-value was approximately $10.6 million, and, thus, (iii) the easement had a value of approximately $1.85 million.[190] *Whitehouse* illustrates a basic appraisal principle: when there is sufficient information about sales of properties similar to the property being valued, the sales comparison approach is the most reliable indicator of fair market value. *Whitehouse* also illustrates that experts may employ sophisticated and seemingly precise models to inflate values and obscure the question to be answered—namely, at what price would the subject property change hands between a willing buyer and willing seller, neither being under any compulsion

186. *See supra* notes 64 and 75 and accompanying text.
187. *See Whitehouse III*, 139 T.C. at 311; *supra* note 81 and accompanying text.
188. *Whitehouse III*, 139 T.C. at 318–19.
189. *See supra* note 81 and accompanying text.
190. *Whitehouse III*, 139 T.C. at 348.

to buy or sell and both having reasonable knowledge of any relevant facts? As noted in the Uniform Appraisal Standards for Federal Land Acquisitions, "Too often it has been found in appraisal reports that . . . the most reliable approach to value [the sales comparison approach] has been overshadowed by the time, attention, and detail given to other less reliable approaches to value."[191]

E. Penalties

As indicated in Appendix A, in ten of the eleven recent cases involving the valuation of façade easements, the taxpayers overstated the value of the easements by 400 percent or more—that is, they made gross valuation misstatements under both pre- or post-PPA law. In the remaining case, *Simmons v. Commissioner*, the taxpayer asserted values for the donated easements that constituted substantial valuation misstatements under pre-PPA law (which was in effect when the returns were filed), but would constitute gross valuation misstatements under post-PPA law (which lowered the threshold for such misstatements to 200 percent).[192]

In two of the eleven recent cases, and *Simmons* and *Foster v. Commissioner*, valuation overstatement penalties were not addressed in the opinion, presumably because the IRS did not assert such penalties. In seven of the remaining nine recent cases, the taxpayers were able to avoid gross valuation misstatement penalties by qualifying for the reasonable cause exception (in three of the cases, *Reisner v. Commissioner*, *Chandler v. Commissioner*, and *Zarlengo v. Commissioner*, the taxpayers qualified for the exception with regard to returns they filed before the penalty became a strict liability penalty). The taxpayers failed to qualify for the reasonable cause exception in only one case in which the exception was available—*Kaufman v. Commissioner*—and *Kaufman* involved patently abusive behavior (that is, the Kaufmans had been informed that the façade easement they donated had no value and they nonetheless claimed a sizable deduction for its donation).[193]

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191. ILAC, YELLOW BOOK, *supra* note 52, at 37.

192. *See supra* note 103 and accompanying text.

193. Before donating a façade easement with respect to their residence, the Kaufmans expressed concern to the donee regarding an appraisal (prepared by an appraiser the donee recommended) indicating that the easement would reduce the value of their residence by $220,800. *Kaufman II*, 784 F.3d at 61. In response, a donee representative assured the Kaufmans that the easement would not reduce the value of their residence. *Id.* at 61–62. The Kaufmans also sent a form letter to their mortgage lender noting that '"[t]he easement restrictions are essentially the same restrictions as those imposed by current local ordinances."' *Id.* at 60. Despite these "warning signals" the Kaufmans proceeded to claim a $220,800 deduction for the donation of the easement. *Id.* at 62. In upholding the Tax Court's imposition of gross valuation misstatement penalties, the First Circuit explained that the Kaufmans were required to "do some basic inquiry into the validity of an appraisal whose result was squarely

The strict liability penalty for gross valuation misstatements was imposed in four of the eleven recent cases, and in three of the cases, *Reisner*, *Chandler*, and *Zarlengo*, the penalty was imposed only with regard to returns filed after the penalty became a strict liability penalty. That penalties were imposed in *Reisner*, *Chandler*, and *Zarlengo* only for the years in which the penalty was a strict liability penalty illustrates that, absent patently abusive behavior (as in *Kaufman*), taxpayers generally will avoid penalties in the valuation context if the reasonable cause exception is available. This appears to be due to the fact that valuation of easements is complex, "[a]verage taxpayers would not know where to start to value a conservation easement," and, thus, reliance on professionals generally will be sufficient to qualify for the exception.[194]

In addition, the author is aware of only two instances in which appraisers have been sanctioned for overvaluing easements. In January 2013, the Department of Justice filed a complaint in District Court against an appraiser and the company he owned with his wife.[195] The complaint alleged, among other things, that the appraiser had repeatedly made errors, distorted data, and provided misinformation and unsupported personal opinions in façade easement appraisals to inflate the value of the easements for federal deduction purposes. In February 2013, the District Court issued an Agreed Order of Permanent Injunction that, among other things, barred the appraiser (who reportedly had retired) and the company from preparing appraisal reports

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contradicted by other available evidence glaringly in front of them." *Id.* at 67. The First Circuit noted that "[t]he Kaufmans were highly intelligent, very well-educated people, and the Tax Court reasonably found that developments casting doubt on the . . . appraisal should have alerted them that they needed to take further steps to assess their 'proper tax liability.'" *Id.* at 68-69. The First Circuit also noted that cases in which the courts have declined to impose penalties were not inconsistent with its conclusion to impose penalties in *Kaufman* because there were no "red flags" suggesting the easements had no value in those other cases. *Id.* at 68.

194. *See, e.g.*, *Chandler*, 142 T.C. at 295 (because of the complexity of easement valuations "even well-educated taxpayers . . . must rely heavily on the opinions of professionals"); *Whitehouse Hotel*, 755 F.3d at 250 (valuation is a difficult task and it is even more complicated when, as here, the valuation is divorced from a negotiated transaction between a buyer and seller; "[o]btaining a qualified appraisal, analyzing that appraisal, commissioning another appraisal, and submitting a professionally-prepared tax return is sufficient to show a good faith investigation as required by law").

195. *See* Complaint for Permanent Injunction and Other Relief, United States v. Ehrmann, Civ. No. 1:13-cv-214 (N.D. Ohio Jan. 30, 2013) (filed pursuant to IRC § 7408); *supra* note 114 and accompanying text.

or otherwise participating in the appraisal process for any property relating to federal taxes.[196]

In March 2014, the IRS issued a press release announcing it had entered into a settlement agreement with a group of appraisers from the same firm who were accused of aiding in the understatement of federal tax liabilities by overvaluing facade easements for charitable donation purposes.[197] To value the facade easements, the appraisers had applied a flat percentage diminution, generally 15 percent, to the before-values of the subject properties, rather than considering the particular facts and circumstances of each property and the particular easement restrictions imposed.[198] The appraisers agreed to a five-year suspension from preparing any appraisals that could subject them to penalties under the Code.[199]

F. Summary

The existing case law involving challenges to the valuation of façade easements suggests that overvaluation has been a persistent problem in this context and that it has worsened in recent years. The case law also indicates that façade easements on residential properties generally have less effect on value than façade easements on commercial properties, and a façade easement on a residential property that is already subject to local historic preservation laws is likely either to have no impact on the fair market value of the property,

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196. *See* Agreed Order of Permanent Injunction, *United States v. Ehrmann*, Civ. No. 1:13-cv-00214-DAP (N.D. Ohio Feb. 12, 2013) (the appraiser and company agreed to the settlement without admitting any wrongdoing); *see also* Press Release, Dep't of Justice, Ohio Federal Court Bars Appraiser of Historic-Preservation Easements, (Feb. 13, 2013), http://www.justice.gov/opa/pr/2013/February/13-tax-192.html.

197. IR-News Rel. 2014-31, http://www.irs.gov/uac/Newsroom/IRS-Bars-Appraisers-from-Valuing-Facade-Easements-for-Federal-Tax-Purposes-for-Five-Years [hereinafter *IRS Bars Appraisers*]. The appraisers admitted to violating Treasury Department Circular No. 230, which provides regulations governing practice before the IRS issued pursuant to 31 U.S.C. § 330. *See id.*; *supra* note 113 and accompanying text.

198. *See IRS Bars Appraisers, supra* note 197.

199. *Id.* The practice of using a flat diminution percentage to estimate the value of a façade easement was apparently attributable, in part, to documents posted on the IRS website suggesting a range within which a façade easement might be expected to reduce the value of property. A 2007 Chief Counsel Advice explained that such language was removed from those documents and those documents always "made it clear that a full analysis of the value of the property both before and after the donation was necessary. *See* C.C.A. 200738013, 2007 WL 2746198 (Aug. 9, 2007). The Chief Counsel Advice also clarified that taxpayers may not use a diminution percentage to value a façade easement. *See id.*; *see also Scheidelman*, 755 F.3d at 152 (taxpayer's expert's reliance on an IRS "accepted range" of values to determine the value of a façade easement "was legally unfounded").

or to reduce the value of the property by only a modest percentage. The cases further reveal that appraisers can inflate the value of a façade easement by ignoring or understating the impact of existing historic preservation laws, by using nonlocal comparables in a sales comparison approach, by manipulating the income capitalization approach, and by inappropriately employing the reproduction cost approach. Finally, the cases indicate that, unless a valuation misstatement penalty is a strict liability penalty, it rarely will be imposed on taxpayers because of their lack of expertise in evaluating easement appraisals. In addition, appraisers appear to be subject to penalties only in rare cases of patently abusive repeat behavior.

V. CONSERVATION EASEMENT VALUATION CASE LAW

The twenty-eight cases involving the valuation of conservation easements for charitable contribution deduction purposes are listed in Appendix C. These cases can be usefully divided into two categories: (i) the seventeen cases involving conservation easements donated between 1969 and 1994 (the early cases) and (ii) the eleven cases involving conservation easements donated in 2000 and thereafter (the recent cases). As in the façade easement context, an analysis of these cases, particularly the recent cases, reveals some interesting trends.

A. Persistent and Increased Overstatements

As indicated in Appendix C, in the seventeen early cases involving donations of conservation easements, the taxpayers collectively overstated the value of the easements by slightly more than $9.2 million or, on average, by $511,744. In contrast, in the eleven recent cases, the taxpayers collectively overstated the value of the easements by more than $24 million, or, on average, by more than $1.5 million. Eight of the recent cases involved overstatements of $1.1 million to $4.6 million, and two cases involved collective overstatements (from more than one easement donation) of more than $2.1 and $3.8 million, respectively.[200]

In the seventeen early cases, the taxpayers, on average, asserted values for their easements that were close to two times (or 196 percent of) the values the court determined to be correct. In contrast, in the ten recent cases, the taxpayers, on average, asserted values for their easements that were ten times (or 1,002 percent of) the court-determined correct values. In addition, in the seventeen early cases, which involved nineteen conservation easement donations, the taxpayers overstated the value of fourteen (or 74 percent) of the

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200. *See Esgar II*, 744 F.3d 648; *Butler*, 103 T.C.M. (CCH) 1359, 2012 T.C.M. (RIA) ¶ 2012-072.

nineteen easements. With regard to the remaining five donations, the taxpayers were determined either not to have overstated or to have understated the value of the easements. In contrast, in all eleven (100 percent) of the recent cases, which involved sixteen donations, the taxpayers were determined to have overstated the value of the easements.

The case law reflected in Appendix C suggests that overvaluation has been a persistent problem in the conservation easement donation context. In addition, the prevalence of overstatements in the recent cases, and the fact that the taxpayers asserted values for their easements that were, on average, ten times the court-determined correct values, suggest that the problem of overstatements has worsened over time. It also is likely that the IRS has become more skilled at ferreting out and litigating abuses.

B. Common Methods of Abuse

The recent cases illustrate two of the more common ways that taxpayers (or, more accurately, their appraisers) overstate the value of conservation easements. The first is by asserting an unrealistic before-easement highest and best use for the subject property. The second is by manipulating the subdivision development analysis. Both methods can be used to exaggerate the before-value of the property, thereby inflating the value of the easement.

1. Unrealistic Before-Easement Highest and Best Use

As explained in Part II, a property's highest and best use (HBU) is the highest and most profitable use for which the property is adaptable and needed or likely to be needed in the reasonably near future.[201] In four of the ten recent cases, *Hughes v. Commissioner, Boltar v. Commissioner, Esgar v. Commissioner*, and *Mountanos v. Commissioner*, the taxpayers' valuation experts asserted unrealistic before-easement HBUs for the subject properties. The same was arguably true in *Kiva Dunes*, even though the Tax Court accepted the before-easement HBU asserted by the taxpayer's valuation expert.

i. Hughes v. Commissioner

Hughes involved the donation of a conservation easement encumbering two parcels located in a rural part of Gunnison County,

201. *See supra* note 30 and accompanying text.

Colorado.[202] The valuation overstatement in *Hughes* related to only one of those parcels: the 1,950-acre "Bull Mountain" parcel.[203] Both the appraiser who prepared the appraisal used to substantiate the taxpayer's claimed deduction and the appraiser who served as the taxpayer's valuation expert at trial asserted that the Bull Mountain parcel's before-easement HBU was residential development.[204] The taxpayer's expert at trial asserted that "demand was so high that if the Bull Mountain parcel were subdivided into 39 parcels of 35 acres or more, the subdivided parcels could have sold within 5 years."[205] The expert also asserted that the Bull Mountain parcel had appreciated in value by 128 percent in the fourteen months between the date the taxpayer purchased parcel and the date he granted the easement (that is, from approximately $1.54 million to approximately $3.5 million).[206]

The Tax Court disagreed, finding that, at the time of the easement's donation, there was "little to no demand" for residential property of the type suggested by the taxpayer's expert and no evidence that there would be such demand in the near to intermediate future.[207] Among other things, the court pointed out that Gunnison County is about twice the size of Rhode Island, at the time of the donation the county had an overall population density of only 4.3 people per square mile, and the area in which the Bull Mountain parcel was located had a population density of less than one person per square mile.[208]

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202. *Hughes*, 97 T.C.M. (CCH) at 1488, 2009 T.C.M. (RIA) ¶ 2009-094, at 700.

203. *Hughes*, 97 T.C.M. (CCH) at 1492–93, 2009 T.C.M. (RIA) ¶ 2009-094, at 708. The taxpayer's deduction with regard to the second parcel was limited by the price he paid when he purchased the property (i.e., his basis in the property) because he donated the easement less than a year after its purchase. *See* I.R.C. § 170(e)(1)(A) (when a taxpayer grants a conservation easement over appreciated property held for less than one year, the amount of the contribution is limited to the basis in the land allocated to the easement).

204. *Hughes*, 97 T.C.M. (CCH) at 1494, 2009 T.C.M. (RIA) ¶ 2009-094, at 707–08 n.18.

205. *Hughes*, 97 T.C.M. (CCH) at 1494, 2009 T.C.M. (RIA) ¶ 2009-094, at 707.

206. *Hughes*, 97 T.C.M. (CCH) at 1493, 2009 T.C.M. (RIA) ¶ 2009-094, at 706.

207. *Hughes*, 97 T.C.M. (CCH) at 1494, 2009 T.C.M. (RIA) ¶ 2009-094, at 708.

208. *Hughes*, 97 T.C.M. (CCH) at 1489, 2009 T.C.M. (RIA) ¶ 2009-094, at 700. The taxpayer's expert made additional assumptions that the court determined to be inappropriate. The expert asserted that the $3.5 million before-value he ascribed to the Bull Mountain parcel was justified because the owner of that parcel could use the unrestricted access easement appurtenant to the other parcel encumbered by the easement (that is, there was an "assemblage premium"). The Tax Court found this was

The Tax Court concluded that the Bull Mountain parcel's before-easement HBU was not residential development, but, rather, "continued agricultural and recreational use."[209] In other words, the type of residential development the taxpayer's expert asserted was not "reasonably probable" in the "reasonably near future."[210] The Tax Court also determined that the parcel had appreciated in value by the time of the donation to only $1.71 million (or by only 11 percent).[211] Given the Bull Mountain parcel's actual before-easement HBU, the Tax Court concluded that the restrictions in the easement, which permitted only one single-family residential dwelling on the parcel, "had much less effect" on the parcel's value than the taxpayer's expert suggested (the taxpayer's expert had asserted that the easement reduced the value of the parcel by 70 percent).[212]

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not the case, explaining that state law prohibited the taxpayer from using the other parcel's access easement to benefit the Bull Mountain parcel. *Hughes*, 97 T.C.M. (CCH) at 1494, 2009 T.C.M. (RIA) ¶ 2009-094, at 708. The taxpayer's expert also asserted that the $1.54 million the taxpayer had paid for the Bull Mountain parcel fourteen months before the easement donation had been a "discounted" price because the seller had been in financial distress. However, the gentleman who sold the Bull Mountain parcel to the taxpayer testified at trial that he had not been in financial distress. *Hughes*, 97 T.C.M. (CCH) at 1495, 2009 T.C.M. (RIA) ¶ 2009-094, at 710. The Tax Court also noted that the taxpayer's expert's work file contained the handwritten notation "Nick wants it Bigger!!" next to a preliminary estimate of the before-value the Bull Mountain parcel of only $2.4 to $2.7 million, with Nick being Nick Hughes, the taxpayer. *Hughes*, 97 T.C.M. (CCH) at 1491, 2009 T.C.M. (RIA) ¶ 2009-094, at 705 n.12.

209. *Hughes*, 97 T.C.M. (CCH) at 1492–93, 2009 T.C.M. (RIA) ¶ 2009-094, at 707.

210. *See supra* note 37 and accompanying text.

211. *Hughes*, 97 T.C.M. (CCH) at 1495, T.C.M. 2009 (RIA) ¶ 2009-094, at 699.

212. *Hughes*, 97 T.C.M. (CCH) at 1497, 2009 T.C.M. (RIA) ¶ 2009-094, at 712. Although the reasoning in *Hughes* is sensible, the ultimate result was not. The IRS had asserted that the easement had a value of just over $1.99 million in its notice of deficiency and it did not assert an increased deficiency at trial. *Hughes*, 97 T.C.M. (CCH) at 1491, 2009 T.C.M. (RIA) ¶ 2009-094, at 704 n.10. Rather than determining the extent to which the easement reduced the value of the two parcels, the court merely sustained the IRS's deficiency and allowed a deduction of just over $1.99 million. *Hughes*, 97 T.C.M. (CCH) at 1497, 2009 T.C.M. (RIA) ¶ 2009-094, at 712.That deduction represented an 84 percent diminution in the court-determined $2.38 million before-value of the two parcels, even though the Tax Court determined that a 70 percent diminution was "too high." *Hughes*, 97 T.C.M. (CCH) at 1498, 2009 T.C.M. (RIA) ¶ 2009-094, at 713.

ii. Esgar v. Commissioner

Esgar involved the donation of conservation easements with respect to three fifty-four-acre parcels in Prowers County, Colorado.[213] The owners of the parcels reported values for the easements of $570,500, $836,500, and $867,500, respectively.[214] Those values were based on an appraisal that asserted that the before-easement HBU of the parcels was gravel mining.[215] To support those values, the taxpayers offered experts at trial who used the income capitalization approach to determine the parcels' before-values (that is, the appraisers estimated the future cash flows from hypothetical gravel mining operations and then discounted those cash flows to present value).[216] The Tax Court determined that the actual before-easement HBU of the parcels was agriculture and the easements were worth only approximately $50,000 each.[217] The taxpayers had thus claimed values for the easements that, respectively, were more than eleven, sixteen, and seventeen times the values the court determined to be correct.[218]

The Tax Court explained that the main question in *Esgar* was whether it was reasonable to conclude that a hypothetical willing buyer would have considered the parcels as a site for the construction of a gravel mine at the time of the easement donations.[219] The Tax Court found that this was not the case.[220] The Tax Court determined and, on appeal, the 10th Circuit agreed that (i) there was no unfulfilled demand for gravel in Prowers County at the time of the donations, (ii) demand from the Front Range for Prowers County gravel was not poised to increase in the reasonably foreseeable future, (iii) supply produced by the four existing Prowers County gravel pits was sufficient to satisfy any increases in demand, and (iv) transporting gravel via rail from Prowers County to the Front Range was not a reasonably foreseeable possibility.[221] The 10th Circuit concluded that the Tax Court had applied the

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213. *Esgar II*, 744 F.3d at 650–51.
214. *Id.* at 651.
215. *Id.*
216. *Esgar I*, 103 T.C.M. (CCH) at 1191, 2012 T.C.M. (RIA) ¶ 2012-035, at 274–75.
217. *Esgar I*, 103 T.C.M. (CCH) 1195, 2012 T.C.M. (RIA) ¶ 2012-035, at 281.
218. *See infra* app. C.
219. *Esgar I*, 103 T.C.M. (CCH) at 1195, 2012 T.C.M. (RIA) ¶ 2012-035, at 281.
220. *Id.*
221. See *Esgar II,* 744 F.3d at 658.

correct HBU standard by looking for the use that was "most reasonably probable in the reasonably near future," and that use was agriculture.[222]

The Tax Court also found, and the 10th Circuit affirmed, that the before-value of the parcels should have been based on comparable sales of agricultural lots.[223] The Tax Court explained that the sales comparison approach "is generally the most reliable indicator of value when there is sufficient information about sales of properties similar to the subject property."[224] On the basis of comparable sales, the Tax Court concluded that a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of any relevant facts, would have placed before-easement values on the three properties of approximately $74,000, $74,000, and $76,000, respectively.[225] Those values contrasted starkly with the before-easement values asserted by the taxpayer's valuation expert at trial of more than $625,000, $812,000, and $848,000, respectively, based on an income capitalization approach that estimated the anticipated royalty stream from hypothetical gravel mining operations and then discounted that royalty stream to present value.[226]

iii. Mountanos v. Commissioner

Mountanos involved the donation of a conservation easement encumbering 882 acres of rugged undeveloped property in Lake County, California.[227] At the time of the donation, the property was (i) almost completely surrounded by federal land, (ii) accessible only through neighboring properties (the Bureau of Land Management had granted the taxpayer limited access to the property for "single-family use"), and (iii) subject to a Williamson Act contract under California law that strictly limited its development and use.[228] In addition, a permit was required to divert water for private use from the creek flowing through the property.[229]

The taxpayer, who had purchased the property for recreational use, such as deer hunting, claimed a $4.69 million deduction for the easement

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222. *Id.*
223. *Id.* at 652.
224. *Esgar I*, 103 T.C.M. (CCH) at 1198, 2012 T.C.M. (RIA) ¶ 2012-035, at 284.
225. *Esgar I*, 103 T.C.M. (CCH) at 1200, 2012 T.C.M. (RIA) ¶ 2012-035, at 287–88.
226. *Esgar I*, 103 T.C.M. (CCH) at 1192, 2012 T.C.M. (RIA) ¶ 2012-035, at 276.
227. *Mountanos*, 105 T.C.M. (CCH) at 1818, 2013 T.C.M. (RIA) ¶ 2013-138, at 1185.
228. *Id.*
229. *Id.*

donation.[230] The IRS objected, arguing, among other things, that the easement was overvalued.[231]

At trial, the taxpayer's three valuation experts asserted that the property's before-easement HBU was a combination of vineyard use and residential development.[232] The Tax Court disagreed, finding that the HBU of the property both before and after the easement donation was for recreation.[233]

The Tax Court explained that the taxpayer failed to show that vineyard use was legally permissible, physically possible, or economically feasible.[234] Specifically, the taxpayer failed to demonstrate that the property had the necessary legal access or water supply for vineyard use.[235] The taxpayer also failed to show that there was demand for vineyard-suitable property in the county or to provide any data or analysis indicating that vineyard use was economically feasible.[236] The Tax Court further found that the taxpayer's experts failed to take into account the various legal restrictions that prohibited use of the ranch for residential development—namely, the Williamson Act, the Williamson Act contract, and a California code provision governing the procedures for subdividing land.[237] In other words, neither vineyard use nor residential development was "reasonably probable" in the "reasonably near future."[238]

The Tax Court sustained the IRS's complete disallowance of the claimed deductions, explaining that, because the taxpayer failed to prove that the HBU of the land before and after the easement donation differed, it followed that the taxpayer failed to show that the easement reduced the value of the land.[239] *Mountanos* is on appeal in the 9th Circuit.

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230. *Id.*

231. *Mountanos*, 105 T.C.M. (CCH) 1818, 2013 T.C.M. (RIA) ¶ 2013-138, at 1191.

232. *Id.*

233. *Mountanos*, 105 T.C.M. (CCH) 1818, 2013 T.C.M. (RIA) ¶ 2013-138, at 1191–92.

234. *Mountanos*, 105 T.C.M. (CCH) 1818, 2013 T.C.M. (RIA) ¶ 2013-138, at 1191–92.

235. *Mountanos*, 105 T.C.M. (CCH) 1818, 2013 T.C.M. (RIA) ¶ 2013-138, at 1191–92.

236. *Id.*

237. *Id.*

238. *See supra* note 37 and accompanying text.

239. *Mountanos*, 105 T.C.M. (CCH) 1818, 2013 T.C.M. (RIA) ¶ 2013-138, at 1192.

iv. *Boltar v. Commissioner*

Boltar involved a particularly egregious example of valuation abuse.[240] At issue in *Boltar* was a conservation easement donated with respect to eight acres in Lake County, Indiana.[241] The taxpayer claimed a $3.2 million deduction for the donation based on an appraisal that asserted that the before-easement HBU of the eight acres was residential development—specifically a 174-unit condominium project consisting of twenty-nine buildings, each with six units.[242] The valuation experts who prepared the appraisal represented that the hypothetical condominium project was legally permissible, physically possible, financially feasible, and would be the maximally productive use of the property.[243] They also employed a subdivision development analysis to estimate a before-value for the eight acres of more than $3.3 million (or more than $400,000 per acre), despite acknowledging that comparable land nearby was selling for only approximately $12,000 per acre.[244]

In rejecting the taxpayer's appraisal, the Tax Court noted, among other things, that the hypothetical 174-unit condominium project could not be physically placed on the subject property (the site plan for the project assumed ten acres whereas the subject property was only eight acres), the project was not legally permissible (the taxpayer's experts had erroneously assumed the eight acres were zoned to allow the project when they were not), and experience in the area and decreasing population negated the feasibility of and demand for the type of dense development asserted by the taxpayer.[245] In other words, the 174-unit condominium project was not "reasonably probable" in the "reasonably near future."[246] Rather, the court determined that the HBU of the eight acres both before and after the easement's donation was for single-family residential development.[247]

The Tax Court also explained that, while concept of "highest and best use" is an element in the determination of fair market value, it does not eliminate the requirement of showing that a hypothetical willing buyer would actually purchase the subject property for the indicated value.[248] "'If a hypothetical buyer would not reasonably have taken into account . . . [a]

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240. Boltar v. Commissioner, 136 T.C. 326 (2011).
241. *Id.* at 328.
242. *Id.* at 327, 330.
243. *Id.* at 330.
244. *Id.* at 338–39.
245. *Id.* at 338, 340.
246. *See supra* note 37 and accompanying text.
247. *Boltar*, 136 T.C. at 340.
248. *Id.* at 336.

potential use in agreeing to purchase the property,'" explained the court, "'such potential use should not be considered in valuing the property.'"[249]

Finally, stressing the gatekeeping function of a trial court, the Tax Court granted the IRS's motion in limine to exclude the taxpayer's experts' appraisal report from evidence because it was "too speculative and unreliable to be useful."[250] The court had harsh words for the taxpayer's experts, noting that the factual errors they made in the report demonstrated the "lack of sanity" in their results, that their assertion of a $3.3 million before-value for the eight acres "defie[d] reason and common sense," and that their report was "so far beyond the realm of usefulness" that excluding it served salutary purposes.[251] The Tax Court further noted that, while "Justice is frequently portrayed as blindfolded to symbolize impartiality," a court "need not blindly admit absurd expert opinions."[252] The Tax Court ultimately allowed only a $42,400 deduction for the donation, which was the amount the IRS had allowed in its notice of deficiency.[253]

v. Kiva Dunes v. Commissioner

Kiva Dunes involved a taxpayer's asserted before-easement HBU that, even though accepted by the Tax Court, does not appear to have been "reasonably probable" in the "reasonably near future."[254] In 1994, a partnership began developing a residential resort community on the Fort Morgan Peninsula in Baldwin County, Alabama, which "is consistently ranked as one of the most beautiful beach destinations in the United States."[255] The planned resort community consisted of a gated residential subdivision with 163 lots (thirty on the beach) and a Jerry Pate-designed 141-acre golf course known as the Kiva Dunes golf course.[256] The planned resort community also

249. *Id.*
250. *Id.* at 326, 339–40.
251. *Id.* at 336, 339.
252. *Id.* at 336.
253. *Id.* at 327, 340–41. Although the IRS's experts at trial determined that the easement had a value of less than $42,400, as in *Hughes*, the IRS did not ask for an increased deficiency.
254. *See supra* note 37 and accompanying text.
255. Kiva Dunes Conservation, LLC v. Commissioner, 97 T.C.M. (CCH) 1818, 2009 T.C.M. (RIA) ¶ 2009-145, at 1178 n.2 (2009).
256. *Kiva Dunes*, 97 T.C.M. (CCH) at 1818, 2009 T.C.M. (RIA) ¶ 2009-145, at 1178 n.3; *see also* JERRY PATE COMPANY, https://www.jerrypate.com.

featured swimming pools, tennis courts, beach walkovers, and a private beach.[257]

The Kiva Dunes golf course was completed during 1995 and soon thereafter the partnership began selling individual residential lots.[258] In 1996, the golf course was rated the "No. 2 public golf course in the United States."[259] Six years later, a limited liability company (Kiva Dunes), which had been formed by the partnership and to which the golf course had been transferred, donated a conservation easement on the course to the North American Land Trust.[260] The easement permits the property to be used as a golf course, a park, or an agricultural enterprise.[261] Kiva Dunes claimed a deduction of more than $30.5 million for the donation and the IRS challenged the deduction.[262]

The sole issue addressed by the Tax Court in *Kiva Dunes* was the value of the easement.[263] Each party's valuation expert at trial concluded that the before-easement HBU of the Kiva Dunes golf course was residential subdivision (the taxpayer's expert posited a 370-lot development while the IRS's expert posited a 300-lot development).[264] Each expert also employed the subdivision development analysis to estimate the before-value of the property. The Tax Court noted that "[t]he differences in their assumptions led to a dramatic difference in their respective before value estimates[,]" with the taxpayer's expert asserting a before-value of more than $31.9 million, and the IRS's expert asserting a before-value of only approximately $10 million.[265]

The Tax Court reviewed the various assumptions made by the two experts in their subdivision development analyses.[266] The Tax Court found the taxpayer's expert to be credible, his assumptions reasonable and amply supported by the evidence, and his analysis persuasive.[267] In contrast, the

257. *Kiva Dunes*, 97 T.C.M. (CCH) at 1818, 2009 T.C.M. (RIA) ¶ 2009-145, at 1178 n.3; *see also infra* note 276 and accompanying text.

258. *Kiva Dunes*, 97 T.C.M. (CCH) at 1819, 2009 T.C.M. (RIA) ¶ 2009-145, at 1178.

259. *Kiva Dunes*, 97 T.C.M. (CCH) at 1819, 2009 T.C.M. (RIA) ¶ 2009-145, at 1178 n.2.

260. *Kiva Dunes*, 97 T.C.M. (CCH) at 1818, 2009 T.C.M. (RIA) ¶ 2009-145, at 1178.

261. *Kiva Dunes*, 97 T.C.M. (CCH) at 1818, 2009 T.C.M. (RIA) ¶ 2009-145, at 1179 n.5.

262. *Kiva Dunes*, 97 T.C.M. (CCH) at 1818, 2009 T.C.M. (RIA) ¶ 2009-145, at 1179.

263. *Id.*

264. *Kiva Dunes*, 97 T.C.M. (CCH) at 1818, 2009 T.C.M. (RIA) ¶ 2009-145, at 1181.

265. *Id.*

266. *Id.*

267. *Kiva Dunes*, 97 T.C.M. (CCH) at 1822–23, 2009 T.C.M. (RIA) ¶ 2009-145, at 1184.

IRS's expert made a number of errors, his testimony at trial was inconsistent with his report in several respects, and the court concluded that his assumptions were not realistic.[268] Ultimately, the court sided with the taxpayer's expert with regard to the before-value, adjusted his after-value (which was based on comparable sales of unimproved real estate) upward to reflect the cost of turning unimproved real estate into a comparable golf course, and accepted his determination that the easement enhanced the value of other property owned by the taxpayer by $300,000.[269] Based on those estimates, the court determined that the fair market value of the easement was slightly more than $28.6 million.[270]

The Tax Court's conclusion that Kiva Dunes was entitled to a $28.6 million deduction for placing a conservation easement on a golf course prompted the Treasury to propose eliminating the deduction for contributions of easements on golf courses.[271] In support of this proposal the Treasury argued that "[t]he benefit of an easement on a private golf course, especially one that is part of a luxury housing development, may accrue to a limited number of users such as members of the course club or the owners of the surrounding homes, not the general public"; construction and operation of a golf course may result in environmental degradation; "[e]asements on golf courses are particularly susceptible to overvaluation"; and there may be indirect benefits to the donor, "such as the increase in the value of home sites surrounding the golf course."[272]

Whether the Treasury's criticisms justify eliminating the deduction for all conservation easements donated with respect to golf courses is beyond the scope of this Article.[273] There is, however, a troubling aspect to *Kiva Dunes*

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268. *Kiva Dunes*, 97 T.C.M. (CCH) at 1822, 2009 T.C.M. (RIA) ¶ 2009-145, at 1183.

269. *Kiva Dunes*, 97 T.C.M. (CCH) at 1825, 2009 T.C.M. (RIA) ¶ 2009-145, at 1187.

270. *Id.*

271. *See* 2016 REVENUE PROPOSALS*, supra* note 4, at 189; DEP'T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2015 REVENUE PROPOSALS 195 (Mar. 2014), https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2015.pdf; DEP'T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2014 REVENUE PROPOSALS 161 (Apr. 2013), https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2014.pdf; DEP'T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2013 REVENUE PROPOSALS 140 (Feb. 2012), https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2013.pdf.

272. *See, e.g.*, 2016 REVENUE PROPOSALS, *supra* note 4, at 189.

273. It appears that in some circumstances golf courses can provide important environmental and open space benefits. *See, e.g.*, *Health of Ecosystems on*

that relates directly to valuation abuse. As noted above, as part of his before-easement subdivision development analysis (which the Tax Court accepted), the taxpayer's expert determined that the before-easement HBU of the golf course was a 370-lot residential subdivision. The Tax Court noted that the planning and zoning director of the local zoning board agreed with that assumption, but it is not clear from the opinion if the development would have required rezoning or other approvals.[274] The taxpayer's expert also assumed that the owners of the 370 lots would have access to the amenities of the adjacent 163-lot Kiva Dunes resort community, including use of its tennis courts, swimming pools, beach walkovers, and private beach.[275]

Although apparently not posited by the IRS and thus not discussed by the Tax Court, it is reasonable to assume that the well-heeled individuals who purchased lots in the gated Kiva Dunes resort community would have been upset by the prospect of conversion of the golf course into a 370-lot residential development. Not only would those individuals, just a short time after purchasing their lots, have faced losing the "award winning" golf course that was the centerpiece of their resort community, they also would have faced having the course replaced by a residential development with more than two

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U.S. Golf Courses Better than Predicted, Researchers Find, SCIENCE DAILY, Apr. 10, 2014, http://www.sciencedaily.com/releases/2014/04/140410122201.htm (in a study of ten golf courses, researchers at the University of Missouri determined that golf courses can offer a viable habitat for stream salamanders and enhanced management practices may be beneficial to ecosystems); Laura McCrystal, *In the Rough: Golf Courses Now Developers' Targets*, PHILADELPHIA INQUIRER, July 19, 2015 ("'Golf courses are starting to be called the last frontier of open-space preservation in suburban communities.'"); *but see Atkinson*, 110 T.C.M. (CCH) at 550, 2015 T.C.M. (RIA) ¶ 2015-236, at 1701 (denying $7.88 million of deductions claimed with regard to conservation easements on pesticide-ridden golf course fairways, greens, teeing grounds, ponds, and other areas in a gated community; the court determined that the easements did not satisfy either the habitat or open space conservation purposes tests). To guard against abuse and ensure public benefit, a deduction could be made available for an easement on a golf course in only limited circumstances—e.g., where the easement mandates perpetual use of practices that ensure protection of significant habitat and provides open space accessible by the general public.

274. *See Kiva Dunes*, 97 T.C.M. (CCH) at 1821, 2009 T.C.M. (RIA) ¶ 2009-145, at 1181; *cf.*, Dawn M. Meyers, *Fore! How to Convert Golf Courses, Construction Today*, http://www.construction-today.com/index.php/sections/columns/1124-fore-how-to-convert-golf-courses [hereinafter Meyers, *Fore!*] ("In most communities, golf courses are zoned as commercial, recreational or green, open or park space. The development of these spaces into a residential use requires a rezoning of the land. This carries with it the typical land use change obstacles of neighborhood opposition, reassessment of impacts and compatibility analysis.").

275. *Kiva Dunes*, 97 T.C.M. (CCH) at 1819 n.3, 2009 T.C.M. (RIA) ¶ 2009-145, at 1178 n.3.

times the number of lots in their gated community. And, to add insult to injury, it was posited that they would have to share their other amenities (their tennis courts, swimming pools, beach walkovers, and private beach) with the owners of the new lots. Rather than 163 households sharing those amenities, 533 households would do so.[276]

Bitter neighborhood opposition to the proposed conversion of golf courses to residential development is not unusual, and has played out across the country as countless golf courses have closed due to economic hardship.[277] Community members have leaned on public officials to maintain golf courses as open spaces because they count on the courses for their views, their recreation, and their property values.[278] They have argued that the new

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276. The Kiva Dunes website describes the gated resort community as follows:

> Kiva Dunes is an elite, one-of-a-kind coastal community, and life here includes access to unmatched golfing and amenities. Only at Kiva Dunes can you experience the #1 rated course in Alabama and one of the country's top golf courses. Mere yards away from our championship course we have crystal-clear pools, a tiki bar, and a restaurant with an extensive menu. Just outside your door you can enjoy our gorgeous—and secluded—sugary-white sand beach and the amazing Gulf Coast sunsets. So why wait? Choose your new home now.

See Real Estate, KIVA DUNES, http://www.kivadunes.com/real-estate-sales/houses-for-sale/ (last visited Aug. 11, 2015); *see also Private Paradise,* KIVA DUNES, http://www.kivadunes.com/explore-kiva/kiva-beaches/ ("[W]e at Kiva Dunes are fortunate to be blessed with more than half a mile of our own private beach—over 3,000 feet of stunningly beautiful sun-kissed sand outlined by rolling dunes and turquoise blue waters. Our secluded beach offers complete privacy in an awe-inspiring atmosphere . . .").

277. On golf course closures, see Michael Buteau, *U.S. Golf Course Closures Exceed Openings for Eighth Year*, BLOOMBERG BUSINESS, Jan. 16, 2014, http://www.bloomberg.com/news/articles/2014-01-16/golf-course-closings-outpace-openings-for-eighth-straight-year; Brad Tuttle, *Fore! No Make that Five!, 5 Reasons Golf is in a Hole*, MONEY, June 13, 2014, http://time.com/money/2871511/golf-dying-tiger-woods-elitist/ (golf is declining in popularity because people do not have sufficient leisure time to play eighteen holes; golf is expensive and elitist; golf is an "old man's sport;" golf is difficult and not immediately rewarding; and the Tiger Woods "golf bubble" has popped).

278. *See* Maya Rodriguez, *It's Been a Golf Course for Decades, but the Applewood Golf Course near Golden Could become the site of a 450 New Homes*, KUSA, March 4, 2015, http://www.9news.com/story/news/2015/03/04/neighbors-object-to-golf-course-rezoning/24399415/ ("On Tuesday night, so many people came to a zoning meeting about Applewood Golf Course, that they couldn't all fit inside the

development would exacerbate existing traffic problems, further crowd schools, and be contrary to a jurisdiction's long-term planning.[279] In some locations, they have been successful in forcing developers to scale back on the number of lots and increase protected open space, or drop development plans altogether.[280]

Accordingly, while the Kiva Dunes golf course may have been physically suitable for a 370-lot development, it is not at all clear that there "existed a reasonable probability the property would be so used in the reasonably near future," or that a hypothetical willing buyer would have considered the property as the site for such use at the time of the easement's donation.[281] A willing buyer considering purchasing the course to convert it into a 370-lot subdivision would have considered the prospect of neighborhood opposition and, at a minimum, factored in the cost, time, and risks associated with that opposition (including the risk of having to scale back the development significantly) in settling on a purchase price.[282] Even if neighborhood opposition would not have precluded conversion of the course into a 370-lot residential subdivision, it likely would have had a significant impact on the purchase price a willing buyer would have paid for the land.[283]

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venue at Manning Middle School. The meeting had to be postponed."); Jenna Ross, *Golf Courses Make Good Neighbors, Until Owners Want to Sell*, STAR TRIBUNE, Feb. 4, 2008, http://www.startribune.com/golf-courses-make-good-neighbors-until-owners-want-to-sell/15265596/ ("'Let's face it: City councils are very sensitive to the mass of residents rather than the single interest of the golf course owner . . . You've got one voter versus 100[,]"' quoting Executive Director of the Midwest Golf Course Owners Association).

279. *See, e.g.*, Earl Rinehart, *Neighbors in Dublin Oppose Homes on Site of Riviera Golf Club*, COLUMBUS DISPATCH, Mar. 14, 2014 ("Dublin residents from several neighborhoods told the city's planning and zoning commission last night that they don't want a golf course in their midst transformed into a 284-home development.").

280. *See, e.g.*, Jeff Ferrell, *Developer Cancels Plans for Former Benton Golf Course*, KSLA NEWS 12 SHREVEPORT, May 21, 2015; Rich Van Wyk, *Carmel Gramercy Project Rescaled*, 13 WTHR EYEWITNESS NEWS, http://www.wthr.com/story/5380767/carmel-gramercy-project-rescaled (neighbors signed petitions against development of a golf course and the developer substantially changed the original plan; the revised project calls for 50 individual homes instead of 150 townhomes as well as two more acres of parkland).

281. *See supra* notes 37 and 40 and accompanying text.

282. A blog for developers cautions: "[a] conversion of a golf course . . . carries with it an extra layer of angst. Many developments were created with a golf course centerpiece, and many lots were sold with boasts of golf-course views. Neighbors will feel a sense of possessiveness toward the golf course as if its continued existence is a matter of right." Meyers, *Fore!* (also discussing environmental contamination issues and other non-traditional costs).

283. *See* EATON, REAL ESTATE VALUATION, *supra* note 52, at 105; Dep't of Transp. v. Great Southern Enterprises, 225 S.E. 2d 80, 83 (Ga. 1976) ("[T]he fact that

The parties' valuation experts should have considered these factors in determining the before-easement HBU of the golf course as well as its before-value.

Hughes, Esgar, Mountanos, *Boltar*, and *Kiva Dunes* illustrate that appraisers may assert unrealistic before-easement HBUs to exaggerate the before-easement value of the subject properties and, thus, inflate the value of the easements. Specifically, asserting an unrealistic before-easement HBU for a subject property enables the appraiser to use inappropriate comparables in a sales comparison approach and inappropriate assumptions in an income capitalization or subdivision development analysis. An appraiser who asserts an unrealistic HBU sets a course for an appraisal that will depart materially from the task at hand: to estimate the price at which the property, before the easement donation, would have changed hands between the hypothetical willing buyer and willing seller. The appraiser should be estimating the price at which the donor realistically could sell the subject property before the easement donation in the open market. In each of *Hughes, Esgar, Mountanos*, *Boltar*, and *Kiva Dunes,* the taxpayer's valuation expert seemed to have lost sight of this most basic of valuation principles.

2. *Manipulation of Subdivision Development Analysis*

Trout Ranch, LLC v. Commissioner illustrates the complex and manipulable nature of the subdivision development analysis.[284] *Trout Ranch* involved the conveyance of a conservation easement encumbering 85 percent of a 453-acre parcel in Gunnison County, Colorado, known as Gunnison River Ranch (the Ranch).[285] The taxpayer, a partnership, purchased the Ranch in 2003 with plans to develop a residential subdivision using Gunnison County's "Large Parcel Initiative Process."[286] Pursuant to that process, the partnership was granted the right to subdivide the property into twenty-one three-acre residential lots and an additional lot for a clubhouse in exchange for conveying a conservation easement to a local land trust that would permanently preserve

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the property is merely adaptable to a different use is not in itself a sufficient showing in law to consider such different use as a basis for compensation. It must be shown that such use of the property is so reasonably probable as to have an effect on the present value of the land.").

284. *Trout Ranch 1*, 100 T.C.M. (CCH) 581, 2010 T.C.M. (RIA) ¶ 2010-283, *aff'd* 493 Fed. Appx. 944.

285. *Trout Ranch 1*, 100 T.C.M. (CCH) at 582, 2010 T.C.M. (RIA) ¶ 2010-283, at 1719.

286. *Trout Ranch 1*, 100 T.C.M. (CCH) at 582, 2010 T.C.M. (RIA) ¶ 2010-283, at 1718.

85 percent of the Ranch for conservation purposes.[287] The twenty-one lots were situated along the Gunnison River and the lot owners were granted access to a host of shared amenities, including the clubhouse, a boat house, riding stables, duck blinds, an archery range, and three ponds.[288] The lot owners also had access to the conserved land and the river.[289] The partnership claimed a deduction for the easement conveyance of $2,179,849 and the IRS challenged the claimed deduction.[290]

At trial, the partnership relied on the report of one valuation expert and the IRS relied on the reports of two experts.[291] All three experts agreed, and the Tax Court accepted, that the HBU of the Ranch both before and after the easement's conveyance was residential subdivision.[292] All three experts also employed the subdivision development analysis to calculate the before and after values of the property.[293] Finding a lack of comparable market sales

287. *Id.*

288. *Trout Ranch 1*, 100 T.C.M. (CCH) at 582, 2010 T.C.M. (RIA) ¶ 2010-283, at 1719.

289. *Trout Ranch II*, 493 Fed. Appx. 944, 946.

290. *Trout Ranch I*, 100 T.C.M. (CCH) 581, 2010 T.C.M. (RIA) ¶ 2010-283, at 1717. At the time of the donation of the easement, the partnership could have subdivided the Ranch into twelve thirty-five-acre lots as a matter of right. *Trout Ranch I*, 100 T.C.M. (CCH) at 587, 2010 T.C.M. (RIA) ¶ 2010-283, at 1725. However, the Large Parcel Initiative Process permitted twenty-two three-acre lots, provided the partnership permanently protected 85 percent of the Ranch. *Id.* Accordingly, in exchange for its conveyance of the conservation easement, the partnership received the right to subdivide the property into ten additional lots (twenty-two instead of twelve). The partnership's receipt of this *quid pro quo* was taken into account in the valuation process, in which the experts and the court determined that the value of the easement was the difference between the before- and after-values of the entire contiguous parcel (even though the contiguous parcel rule was not mentioned in the opinion). *Trout Ranch I*, 100 T.C.M. (CCH) at 585–92, 2010 T.C.M. (RIA) ¶ 2010-283, at 1723–34. The after-value of the entire contiguous parcel reflected the added value of the extra lots, thus reducing the value of the easement.

291. *Trout Ranch I*, 100 T.C.M. (CCH) at 583, 2010 T.C.M. (RIA) ¶ 2010-283, at 1720.

292. *Trout Ranch I*, 100 T.C.M. (CCH) at 585, 2010 T.C.M. (RIA) ¶ 2010-283, at 1723. Unlike the two parcels in *Hughes*, the Ranch was situated between the towns of Gunnison and Crested Butte, which contained approximately half of the county's total population. *See Hughes*, 97 T.C.M. (CCH) at 1488, 2009 T.C.M. (RIA) ¶ 2009-094, at 699. In addition, the "crown jewel" of the property was two miles of frontage on the Gunnison River, "a stream beloved by fisherman for its world-class Rainbow and German Brown Trout." *Trout Ranch II*, 493 Fed. Appx. at 946.

293. *Trout Ranch I*, 100 T.C.M. (CCH) at 585, 2010 T.C.M. (RIA) ¶ 2010-283, at 1723. The taxpayer's expert also relied on the sales prices of purportedly comparable easements. The Tax Court found use of that valuation method inappropriate because there was "no substantial record of sales of easements

of similar properties, the Tax Court agreed that the subdivision development analysis was the most appropriate way to value the Ranch both before and after the donation.[294] However, because the Tax Court found "none of the experts completely convincing," it constructed its own subdivision development analyses to calculate the before and after values of the Ranch.[295]

The Tax Court first focused on the subdivision development analyses that the experts constructed to estimate the after-value of the Ranch.[296] The Tax Court agreed with the experts that the HBU of the Ranch after the imposition of the easement was a twenty-one-lot shared amenities ranch.[297] The Tax Court then engaged in a detailed review of each component of the experts' subdivision development analyses and came to its own conclusion regarding each component.[298]

With regard to the assumed price of the lots to be sold, the court rejected the taxpayer's expert's asserted per-lot price of $300,000 as too low and the IRS's experts' asserted per-lot prices of $550,000 and $630,000 as too high, and settled on an assumed per-lot lot price of $490,000.[299] With regard to absorption rate, the court rejected the taxpayer's expert's assumed rate as "slightly aggressive" and one of the IRS's expert's assumed rates as "sluggish," and adopted the other IRS expert's assumed rate of four to five lots sale a year.[300] With regard to appreciation in the selling prices of the lots, the court rejected the taxpayer's expert's assumption that the lots would appreciate at a rate of 15 percent a year for the first four years and then stop appreciating as "unwarranted."[301] The Tax Court also rejected the assumed appreciation rates of the two IRS experts of 4 percent and 8 percent as too low, and settled on an appreciation rate of 10 percent a year.[302]

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comparable to the donated easement." *Trout Ranch I*, 100 T.C.M. (CCH) at 584, 2010 T.C.M. (RIA) ¶ 2010-283, at 1721.

294. *Trout Ranch I*, 100 T.C.M. (CCH) at 585, 2010 T.C.M. (RIA) ¶ 2010-283, at 1723.

295. *Id.*

296. *Id.*

297. *Trout Ranch I*, 100 T.C.M. (CCH) at 586, 2010 T.C.M. (RIA) ¶ 2010-283, at 1724–25.

298. *Id.*

299. *Trout Ranch I*, 100 T.C.M. (CCH) at 586–89, 2010 T.C.M. (RIA) ¶ 2010-283, at 1725–27.

300. *Id.*

301. *Trout Ranch I*, 100 T.C.M. (CCH) at 589, 2010 T.C.M. (RIA) ¶ 2010-283, at 1727.

302. *Id.*

With regard to capital expenses, the court accepted the taxpayer's expert's estimate of $2.18 million.[303] With regard to project management expenses (for marketing and advertising), the court adopted one of the IRS's expert's estimates of 10 percent of gross revenues.[304] With regard to sales expenses, the court rejected the experts' assumptions of 6 percent, 7 percent, and 10 percent, and assumed sales expenses of 8 percent of gross sales revenues.[305] With regard to the developer's anticipated profit, the court adopted one of the IRS expert's assumption of a 15 percent profit, rejecting the other IRS's expert's assumption of a 25 percent profit (which appeared to include project management expenses) and the taxpayer's assumption of a 12 percent profit (which the court noted was not even within the range that the expert had asserted in his report).[306] With regard to discount rate, the court rejected one of the IRS's expert's assumed rate of 10 percent and adopted the 15 percent rate assumed by the two other experts.[307] The court then constructed its own subdivision development analysis from this data and concluded that the twenty-one-lot shared amenities ranch had an after-value of approximately $3.89 million.[308]

The Tax Court engaged in a similar process to estimate the before-value of the Ranch.[309] The Tax Court assumed, without explanation, that the before-easement HBU of the Ranch was a forty-lot residential subdivision.[310] After marching through each of the components of the analysis a manner similar to that described above, the Tax Court constructed its own subdivision development analysis from the data and concluded that the before-value of the Ranch at the time of the easement's donation was $4.45 million.[311] The Tax Court thus concluded that the value of the easement was $560,000, or

303. *Id.*

304. *Trout Ranch I*, 100 T.C.M. (CCH) at 589, 2010 T.C.M. (RIA) ¶ 2010-283, at 1728.

305. *Trout Ranch I*, 100 T.C.M. (CCH) at 589–90, 2010 T.C.M. (RIA) ¶ 2010-283, at 1727–30.

306. *Id.*

307. *Id.*

308. *Trout Ranch I*, 100 T.C.M. (CCH) at 589–90, 2010 T.C.M. (RIA) ¶ 2010-283, at 1730. The court's subdivision development analyses are included in an appendix to its opinion.

309. *Trout Ranch I*, 100 T.C.M. (CCH) at 590–92, 2010 T.C.M. (RIA) ¶ 2010-283, at 1730–32.

310. *Id.* It is not clear why the court assumed that the before-easement HBU of the Ranch was a forty-lot subdivision rather than the twenty-two-lot shared amenities ranch that the partnership actually developed.

311. *Id.*

approximately one fourth of the $2,179,849 value that the partnership had reported on its tax return.[312]

Trout Ranch, like *Kiva Dunes*, illustrates that even minor alterations in the assumptions used in a subdivision development analysis can create large variances in the ultimate values determined.[313]For example, the taxpayer's expert's subdivision development analysis resulted in a before-value for the Ranch of $5.6 million, while the Tax Court's analysis resulted in a before-value of only $4.45 million.[314] In addition, the taxpayer's expert's analysis resulted in an after-value for the Ranch of only $2.6 million, while the Tax Court's analysis resulted in an after-value of $3.89 million.[315] Given the one-sided nature of the valuation process and the manipulability of the subdivision development analysis, it is not surprising that a taxpayer's appraiser will often use assumptions that favor the taxpayer and result in a significant overstatement of the value of the easement. *Trout Ranch* is a good example; the partnership reported a value for its easement that was close to four times the value the court determined to be the correct value.

Moreover, the complexity and seeming precision of a subdivision development analysis can obscure the fact that the analysis relies on multiple assumptions, many of which are impossible to predict with reasonable accuracy. It also obscures the basic question to be answered—at what price would the subject property change hands between the hypothetical willing buyer and willing seller? As noted in a treatise on valuation for eminent domain purposes: "The court's resistance to admitting the [subdivision] development approach stems from a fear that testimony in regard to the approach may mislead the trier of fact into determining just compensation based on a fully developed subdivision, rather than the land as it existed on the date of the taking."[316] This same danger exists in the charitable donation context.

C. Palmer Ranch v. Commissioner—Eyebrow Raiser

In 2006, Hugh Culverhouse Jr., son of the longtime owner of the Tampa Bay Buccaneers, through a partnership, donated a conservation easement on eighty-two acres in Sarasota County, Florida (known as the B-10

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312. *Trout Ranch I*, 100 T.C.M. (CCH) at 592, 2010 T.C.M. (RIA) ¶ 2010-283, at 1732

313. *See supra* note 265 and accompanying text.

314. *Trout Ranch I*, 100 T.C.M. (CCH) at 590–92, 2010 T.C.M. (RIA) ¶ 2010-283, at 1730, 1732.

315. *Id.*

316. EATON, REAL ESTATE VALUATION, *supra* note 52, at 257.

parcel) to the county.[317] The partnership claimed a deduction of over $23.9 million for the donation and the IRS challenged the claimed deduction.[318] In *Palmer Ranch*, the partnership's valuation expert argued, and the Tax Court agreed, that there was a reasonable probability at the time of the donation that the B-10 parcel could be rezoned to permit the development of 360 multifamily dwelling units and, thus, that the before-easement HBU of the parcel was such development.[319] The Tax Court also accepted the partnership's valuation expert's estimate of the before-value of the parcel, with a slight downward adjustment to just over $21 million.[320] The court further agreed with the partnership's expert that the easement reduced the value of the parcel by 95 percent.[321] Accordingly, the Tax Court found that the easement had a value of approximately $19.9 million.[322]

Palmer Ranch raises eyebrows for a number of reasons. First, the deduction allowed—$19.9 million, which represented a 95 percent reduction in the value of the eighty-two-acre parcel—seems outsized. Second, it is not clear from the opinion that the partnership's valuation expert took into account the costs, time, and risks associated with obtaining rezoning approval in estimating the before-value of the parcel. And third, the parties appear to have failed to consider whether the donation of the easement increased the value of other property owned by the partnership in the area (that is, there is no mention in the opinion of the entire contiguous parcel and enhancement rules).

While, at first blush, a 95 percent reduction in the value of the B-10 parcel seems high, as indicated in Appendix D, that reduction is consistent with other cases involving easements that severely limit or prohibit the development of the property.[323] Once encumbered by the easement, the B-10

317. Palmer Ranch v. Commissioner, 107 T.C.M. (CCH) 1408, 2014 T.C.M. (RIA) ¶ 2014-79, at 587.

318. *Id.*

319. *Palmer Ranch*, 107 T.C.M. (CCH) 1408, 2014 T.C.M. (RIA) ¶ 2014-79, at 593.

320. *Palmer Ranch*, 107 T.C.M. (CCH) 1408, 2014 T.C.M. (RIA) ¶ 2014-79, at 594.

321. *Id*.

322. *Id.* Unsatisfied with this deduction, Mr. Culverhouse appealed the Tax Court's decision to the Eleventh Circuit. On February 5, 2016, the Eleventh Circuit issued its opinion affirming the Tax Court's decision in part and reversing and remanding in part. *See* Palmer Ranch v. Commissioner, 812 F.3d 982 (11th Cir. 2016). For a critique of the Eleventh Circuit's opinion, which, similar to the Tax Court's opinion, did not address certain key appraisal principles and rules, see Palmer Ranch v. Comm'r—11th Circuit Remands Conservation Easement Valuation to Tax Court, Nonprofit Law Prof Blog, http://bit.ly/1U4cJOQ. At the time of publication of this article, the Tax Court had not issued its opinion on remand.

323. The Kiva Dunes easement resulted in a 90 percent reduction in value and the Stotler easement resulted in a 91 percent reduction in value. *See infra* app. D.

parcel could be used only for public recreational or agricultural purposes and, given that the parcel is surrounded by an urban community, the court noted that the parcel "did not lend itself" to agricultural use.[324] The court also noted that the easement restrictions limit a potential purchaser of the parcel to either a nonprofit organization or the state of Florida.[325]

A $19.9 million deduction with regard to an easement on an eight-two-acre parcel also seems high. As indicated in Appendix D, the *Palmer Ranch* easement had the highest per-acre easement value of all of the easements involved in the valuation cases thus far ($243,354 per acre), beating out even the *Kiva Dunes* golf course easement (which had a $203,234 per-acre value). However, according to the Tax Court's opinion, the B-10 parcel was located in a developed area, it was itself developable, and comparable lands in the area were selling for substantial per-acre prices.[326] Accordingly, assuming those factors, prohibiting development of the eighty-two-acre parcel and effectively committing it to public park and conservation uses could be expected to have substantial price tag.

The more troubling aspects of *Palmer Ranch*, discussed below, relate directly to aspects of the valuation methodology employed.

1. Not Accounting for Costs, Time, and Risks Associated With Rezoning

At the time of the donation of the conservation easement in *Palmer Ranch*, zoning laws limited development of the B-10 parcel to forty-one single-family residential lots, or one lot per two acres.[327] As noted above, the partnership's valuation expert argued, and the Tax Court agreed, that rezoning of the parcel to permit 360 multifamily dwelling units was reasonably probable and, thus, that such development was the B-10 parcel's before-easement HBU. Setting aside the question of whether such rezoning was reasonably probable—a determination that should entail particularly "careful scrutiny" given that it is "fertile ground for the unscrupulous, the naïve, and the dreamer"[328]—it is not clear from the Tax Court's opinion if the comparable

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324. *Palmer Ranch*, 107 T.C.M. (CCH) 1408, 2014 T.C.M. (RIA) 2014-79, at 589.

325. *Id.* As of the date of the Tax Court's opinion, the parcel was being used as a public park, a community garden, a conservation area, and preserved open space.

326. *Id.* at 591–595.

327. *Id.* at 595.

328. *See supra* note 82 and accompanying text. Rezoning seemed more probable in *Palmer Ranch* than in *Kiva Dunes*, given that in *Kiva Dunes* bitter neighborhood opposition to development of the golf course was a virtual certainty.

sales used to determine the before-value of the B-10 parcel were of parcels that similarly had not been rezoned, or if the costs, time delays, and risks associated with obtaining rezoning approval were otherwise taken into account.[329]

The Tax Court noted that obtaining approval to rezone the B-10 parcel would have involved a five-step process: (i) a preapplication meeting with County staff, (ii) a neighborhood workshop with adjacent property owners, (iii) submitting of applications to the county, which would be subject to staff review, (iv) public hearings by a lay body (the planning commission), and (v) a public hearing by the board of county commissioners, wherein the commissioners would take final action.[330] Even if the commissioners approved the rezoning, the determination would still have been subject to circuit court review.[331] In addition, to receive rezoning approval, the applications would have to be consistent with a master development order as well as the local comprehensive plan, zoning regulations, and land development regulations.[332]

As discussed in Part II.D above, under no circumstances should property that is determined to have a reasonable probability of rezoning be valued as if it were already rezoned.[333] The risk of being denied rezoning, or that an exaction or other condition could be placed on the rezoning, always exists and must be taken into account.[334] The time delay and costs associated

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However, rezoning seemed less probable in *Palmer Ranch* than in *Schmidt v Commissioner*, given that the taxpayer in *Schmidt* had submitted rezoning and preliminary plan applications to the relevant authorities and had been able to address all relevant issues that could have prevented or delayed the granting of the requested development entitlements. *See* Schmidt v. Commissioner, 108 T.C.M. (CCH) 135, 2014 T.C.M. (RIA) 2014-159, at 1112; *see also* Akers v. Commissioner, 799 F.2d 243, 245–46 (6th Cir. 1986) (record did not support taxpayer's contention that property could easily have been subdivided and sold as smaller parcels); *Turner*, 126 T.C. 303–05 (rezoning was not assumed because it would have been time-consuming and costly and likely required the taxpayer to agree to a proffer and possible additional conditions); Stotler v. Commissioner, 53 T.C.M. (CCH) 973, T.C.M. (P-H) ¶ 87, 275 at n.6 (1987) (record supported taxpayer's contention that a low-density subdivision "would probably have received approval").

329. *Palmer Ranch*, 107 T.C.M. (CCH) 1408, 2014 T.C.M. (RIA) ¶ 2014-79, at 591–593; *see also supra* note 87 and accompanying text (explaining that finding true comparable sales in this context is difficult because properties are typically sold to developers only after rezoning approvals have been obtained).

330. *Palmer Ranch*, 107 T.C.M. (CCH) 1408, 2014 T.C.M. (RIA) ¶ 2014-79, at 590.

331. *Id.*

332. *Id.*

333. *See supra* notes 83–86 and accompanying text.

334. *Palmer Ranch*, 107 T.C.M. (CCH) at 1408, 2014 T.C.M. (RIA) ¶ 2014-79, at 590.

with the rezoning process must also be considered.[335] A willing buyer, under no compulsion to buy and with reasonable knowledge of all relevant facts, would have considered these factors in settling on a purchase price for the B-10 parcel. The buyer would not have agreed to take on the risks, time delays, and costs associated with the rezoning process without appropriate compensation (that is, a discount in the purchase price of the parcel).[336] That the Tax Court did not discuss this in its opinion gives the reader less confidence in the court's conclusion that a willing buyer would have paid over $21 million for the not-yet-rezoned B-10 parcel.

2. *Not Considering Taxpayer's Other Properties*

A second troubling aspect of *Palmer Ranch* was the apparent failure to consider whether the easement donation increased the value of other property owned by the partnership. At the time of the donation of the easement, the partnership owned a thirty-nine-acre parcel "immediately to the north of" the B-10 parcel (the B-9 parcel).[337] If the B-9 parcel was contiguous to the B-10 parcel, the deduction should have been equal to the difference between the fair market value of the entire contiguous parcel (B-9 and B-10) before and after the donation of the easement.[338] If the B-9 parcel was not contiguous to the B-10 parcel, the deduction should have been reduced by the amount (if any) by which the donation of the easement increased the value of the B-9 parcel.[339] It is impossible to tell from the Tax Court's opinion whether donating the easement on the B-10 parcel increased the value of the B-9 parcel. It might have, however, and if it did the partnership's deduction should have been reduced accordingly. It was contrary to the conservation easement-specific valuation rules in the Regulations not to address this issue.

The uncertainty regarding whether the parties took into account the costs, time, and risks associated with the rezoning process or the effect of the easement on the partnership's other properties is particularly troubling in *Palmer Ranch* given the stakes—a $19.9 million deduction and the highest per-acre easement value ($243,354) of all the conservation easement valuation cases.

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335. *Id.*
336. *Id.*
337. *Palmer Ranch*, 107 T.C.M. (CCH) at 1408, 2014 T.C.M. (RIA) ¶ 2014-79, at 588–89.
338. *See supra* note 92 and accompanying text.
339. *See supra* note 93 and accompanying text.

D. Zero-Value Conservation Easements

In only one of the twenty-eight cases involving the valuation of conservation easements analyzed in this Article—*Mountanos*—did the court conclude that the easement had no value. Similar to the historic residences subject to the zero-value façade easements discussed in Part IV, at the time of the donation in *Mountanos*, the 882-acre parcel was already subject to restrictions and other conditions that prevented its development (in the form of a Williamson Act contract as well as limited access and water supply). Accordingly, the court found that the easement did not further reduce the parcel's value.[340]

In another conservation easement case—*Strasburg v. Commissioner*—the Tax Court discussed a different scenario in which a conservation easement might be found not to reduce the value of the subject property.[341] *Strasburg* involved the donation of a conservation easement encumbering 320-acres in Sweet Grass, Montana, which the court described as "a spectacular piece of property surrounded by the Gallatin National Forest on three sides."[342]

In determining the after-value of the property in *Strasburg*, the court looked to five comparable sales analyzed by the parties' experts.[343] One such sale indicated no loss in the value of the subject property as a result of being encumbered by a conservation easement.[344] The IRS's valuation expert explained this as follows:

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340. *Compare, e.g.*, *Symington*, 87 T.C. at 892 (rejecting IRS's valuation expert's conclusion that the conveyance of the open-space easement had no adverse affect on the fair market value of the subject property); *Hughes*, 97 T.C.M. (CCH) 1488, 2009 T.C.M. (RIA) ¶ 2009-094, at 699 (disagreeing with the IRS's valuation expert's conclusion that the conservation easement had no, or only a nominal, impact on the fair market values of the subject parcels); Schwab v. Commissioner, 67 T.C.M. (CCH) 3004, T.C.M. (RIA) ¶ 94,232 (1994) (finding the IRS's valuation expert's determination that the easement had no value to be "untenable").

341. Strasburg v. Commissioner, 79 T.C.M. (CCH) 1697, 2000 T.C.M. (RIA) ¶ 2000-094, at 506.

342. *Strasburg*, 79 T.C.M. (CCH) at 1698–99, 2000 T.C.M. (RIA) ¶ 2000-094, at 508–09.

343. *Strasburg*, 79 T.C.M. (CCH) at 1704, 2000 T.C.M. (RIA) ¶ 2000-094, at 513–14. The comparable sales analyzed by the parties' experts consisted of (i) conservation easement sales, (ii) easement-encumbered property sales, and (iii) "paired sales" of easement-encumbered properties. *Id.*

344. It is not clear from the court's opinion if this comparable sale constituted an easement-encumbered property sale or a paired sale. *See supra* note 343 and accompanying text.

> The Forest Service's aggressive program to buy in fee or encumber all river front lands with conservation easements, has severely restricted the supply of such lands. Thus the remaining owners can ask almost whatever they want, with a likelihood of getting their asking price. Even though a property cannot be subdivided, it can serve as a country estate for the well-to-do. . . . There is a portion of the buying public who will acquire easement encumbered property without a price discount even with restricted subdivision and development opportunity. This is especially so if the property supply is greatly restricted.[345]

In addition, the taxpayer's valuation expert in *Strasburg* disclosed in his report that he '"has analyzed and is aware of several sales in Montana, Idaho and Wyoming which involved the sale of conservation easement encumbered properties which have not reflected discounts at the time of sale."'[346] He stated further that '"[t]hese easement properties are located in high end development markets with very limited deeded land bases, and in these areas large parcels are rarely exposed to the market."'[347] Accordingly, while the easement at issue in *Strasburg* was determined to have reduced the value of the 320 acres by 43 percent,[348] in the right circumstances—a severely limited supply of properties desirable for use as residential and recreational estates—a conservation easement may not reduce the value of the property. In such cases, the HBU of the property both before and after the easement donation would be a residential and recreational estate, and a conservation easement that prohibits subdivision and development while allowing such an estate could have little or no effect on value.

E. Penalties

As indicated in Appendix C, in the eleven recent conservation easement valuation cases, which involved sixteen easement donations, the taxpayers generally overstated the value of the easements by substantial amounts in terms of dollar value (by more than $24 million collectively, and on average, by more than $1.5 million per donation). However, valuation

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345. *Strasburg*, 79 T.C.M. (CCH) at 1703, 2000 T.C.M. (RIA) ¶ 2000-094, at 513.

346. *Strasburg*, 79 T.C.M. (CCH) at 1703, 2000 T.C.M. (RIA) ¶ 2000-094, at 511.

347. *Id.*

348. *See infra* app. D.

misstatement penalties were imposed in only two of the recent cases, *Mountanous* and *Legg v. Commissioner*, each of which involved gross valuation misstatements subject to the strict liability penalty.[349] In three of the remaining nine cases, *Hughes, Trout Ranch,* and *SWF Real Estate v. Commissioner*, penalties were not addressed in the opinion, presumably because the IRS did not assert penalties. In *Boltar,* the IRS did not assert penalties in a timely manner. In the remaining five cases, penalties were not imposed because the taxpayer qualified for the reasonable cause exception (*Esgar*), the value the taxpayer reported was below the penalty threshold (*Kiva Dunes*), or some combination of those factors (*Palmer Ranch*, *Schmidt v. Commissioner*, *Butler v. Commissioner*).

For example, in *Palmer Ranch*, the taxpayer overstated the value of the easement by more than $3.9 million but was able to avoid the negligence, substantial understatement, and substantial valuation misstatement penalties by qualifying for the reasonable cause exception. The taxpayer also was not liable for the strict liability gross valuation misstatement penalty because the amount claimed on its return with regard to the easement did not meet the penalty threshold (it was not 200 percent or more of the value the court determined to be the correct value). In fact, despite the substantial dollar value of the overstatements in the recent cases, the values reported with respect to only seven of the sixteen donations would constitute gross valuation misstatements under the more stringent post-PPA penalty thresholds. Moreover, in every recent case in which the reasonable cause exception was available, the courts found that the taxpayers qualified for the exception. As in the façade easement context, this appears to be due to the fact that valuation of easements is complex, the average taxpayer has no expertise in valuing conservation easements, and, thus, reliance on professionals is sufficient to qualify for the exception.[350]

F. Summary

The existing case law involving challenges to the valuation of conservation easements suggests that, as in the façade easement context, overvaluation has been a persistent problem and it has worsened in recent years. The case law also indicates that appraisers can inflate the estimated value of a conservation easement by asserting an unrealistic before-easement

349. *See supra* note 109 and accompanying text.

350. *See, e.g.*, *Esgar I*, 103 T.C.M. (CCH) at 1200, 2012 T.C.M. (RIA) ¶ 2012-035, at 288–89 (taxpayers qualified for the reasonable cause exception because they relied in good faith on the advice of their accountant of twenty-five years and the in-house lawyers in his firm); *Butler*, 103 T.C.M. (CCH) at 1393, 2012 T.C.M. (RIA) ¶ 2012-072, at 563 (taxpayers qualified for the reasonable cause exception because they relied on their longtime attorney and accountant, as well as appraisers who were qualified and had experience appraising conservation easements).

HBU for the subject property; by manipulating an income capitalization or subdivision development analysis; by assuming rezoning when it is not reasonably probable; by not accounting for the costs, times, and risks associated with rezoning even when it is reasonably probable; and by not considering whether the easement increases the value of the taxpayer's other properties. The case law further indicates that a conservation easement may not always reduce the value of the subject property and, unless a valuation misstatement penalty is a strict liability penalty, it rarely will be imposed because taxpayers generally qualify for the reasonable cause exception.

VI. REFORMS

As noted in the introduction, despite overvaluation and other abuses in the § 170(h) deduction context, in 2015 Congress made the enhanced incentives for conservation and façade easement donations a permanent part of the Code. In so doing, Congress ignored the abuses revealed by the case law and the Treasury's calls for reforms. For the reasons noted in the introduction, however, calls for reform can be expected to continue and to become more acute. Accordingly, an analysis of proposed reforms is warranted.

Section A below discusses the Treasury's proposed reforms to address valuation abuse and why those reforms would likely be ineffective. Section B then outlines alternative proposed reforms that are informed by the analysis of the case law in this Article.

A. Difficulties with Treasury's Proposed Reforms

To address valuation abuse, the Treasury has proposed, among other things, that the organizations accepting easement donations play a role in policing the valuation of the easements. Specifically, the Treasury has proposed that such organizations be subject to penalties and to the risk of losing their status as donees eligible to accept tax-deductible easements if they accept easements that they "know (or should know)" are "substantially" overvalued.[351] These proposed reforms are unlikely to significantly reduce overvaluations for a number of reasons.

First, both donors and donees have an incentive to assert high values for easements. Donors want the largest deduction possible to maximize their tax benefits, and donees know that property owners are more likely to donate if their easements are determined to have high values. Second, valuation is more of an art than a science and there will always be a range of acceptable values for an easement. Accordingly, it is likely to be difficult to determine

351. *See* 2016 REVENUE PROPOSALS*, supra* note 4, at 191.

when a donee "knew" or "should have known" that an easement was "substantially" overvalued in all but the most egregious of cases, making the threats of penalties and loss of qualified organization status potentially empty threats.

Third, the Treasury's proposed reforms might compel donee organizations to acquire their own appraisals of easements. Some donees may not have sufficient funds to pay for appraisals and, even with respect to those that do, the funds arguably would be better spent on additional conservation and historic preservation efforts and on the monitoring and enforcement of existing easements.[352] Moreover, given that donee organizations have an incentive to support high values for easements, the end result of compelling donees to obtain appraisals may be that the IRS would find itself faced with two opponents and two appraisals when challenging an easement's overvaluation.

The Treasury has also proposed that donees be required to electronically report and publicly disclose information about easement contributions, and that the deduction be eliminated with regard to easements conveyed with respect to golf courses. Transparency through electronic reporting and public disclosures would be an appropriate reform given that the public investment in tax-deductible easements is considerable and the details of that investment should be publicly available. Given that easement valuation is a complex process with which most people have no familiarity or expertise, however, such disclosures seem unlikely to curb valuation abuse except perhaps at the outer margin, where the prospect of public shaming might chill some of the most outrageous valuations. And while golf course easements have been much maligned, the case law indicates that golf course easements are not the only easements that are overvalued. Moreover, golf courses can provide important habitat if they are properly managed and, in some locations, constitute the only remaining open space.[353] Accordingly, a more nuanced approach to reforming the deduction in the case of golf course easements should be considered.

Finally, the Treasury's proposal to create a tax credit program as an alternative to and eventual replacement of the § 170(h) deduction is troubling, at least as it has been described.[354] The voluminous case law in this context evidences not only valuation abuse, but also persistent failures to satisfy the requirements of § 170(h), which are designed to ensure that federally-subsidized easements will actually provide significant benefits to the public

352. The expenses associated with monitoring and enforcement can be expected to increase over time as easements age and the encumbered lands change hands.

353. *See supra* 273 and accompanying text.

354. *See* 2016 REVENUE PROPOSALS*, supra* note 4, at 190, 191–92.

over the long term.[355] There is a great deal of money to be made by overvaluing easements, obtaining outsized deductions, and later releasing or modifying the easement restrictions to permit previously prohibited development.[356] "[A]llowing larger tax benefits to be claimed with fewer restrictions" and "the value of easements [to] be determined between the donor and the qualified conservation organizations," as the Treasury has proposed,[357] would be a recipe for increased abuse. For example, one need only look to the various audits of the Natural Resource Conservation Service's easement purchase programs to see that, without appropriate oversight and controls, those programs have been subject to significant abuses, including by the nonprofit organizations that participate in the programs. One of the audits concluded that "relying on NGOs without maintaining oversight is not an effective approach to ensuring program compliance."[358]

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355. *See supra* notes 8, 9, and 17 and accompanying text.

356. It was reported to the author that a well-known land trust advised a landowner to donate a very restrictive conservation easement to maximize the amount of landowner's deduction, and the land trust would amend the easement once the statute of limitations had run on the landowner's deduction to permit the building of ten house lots on the subject property. The extent to which this type of abuse is occurring is difficult to determine given the current lack of transparency associated with easement amendments.

357. *See* 2016 REVENUE PROPOSALS*, supra* note 4, at 190.

358. *See* U.S. DEP'T OF AGRICULTURE, REP. NO. 10099-6-SF, AUDIT REPORT, NATURAL RESOURCE CONSERVATION SERVICE FARM AND RANCH LANDS PROTECTION PROGRAM REVIEW OF NON-GOVERNMENTAL ORGANIZATIONS 5, (July 2009) (finding, among other things, that nonprofit "cooperating entities" did not comply with program rules and made misrepresentations in their certifications to the Natural Resource Conservation Service). *See also, e.g.*, U.S. DEP'T OF AGRICULTURE, REP. NO. 10601-0001-23, NRCS CONTROLS OVER LAND VALUATIONS FOR CONSERVATION EASEMENTS, (September 2015) (finding NRCS's valuation and payment processes did not meet appropriate standards and resulted in the payment of more than $43 million for insufficiently supported easements); U.S. DEP'T OF AGRICULTURE, REP. NO. 10601-0002-31, NRCS CONSERVATION EASEMENT COMPLIANCE, (July 2014) (finding that NRCS was not consistently detecting and reporting violations on easement-encumbered lands and recommending that NRCS improve its stewardship practices to maintain the integrity of and safeguard the easements); U.S. DEP'T OF AGRICULTURE, REP. NO. 10099-0001-31, NATURAL RESOURCES CONSERVATION SERVICE'S ADMINISTRATION OF EASEMENT PROGRAMS IN WYOMING, (September 2013) (finding that program employees lacked critical knowledge and the Wyoming office approved at least $14.1 million in easements that were not correctly processed and did not ensure that the Government's interest in the easements would be served and secured); U.S. DEP'T OF AGRICULTURE, REP. NO. 10099-03-CH, CONTROLS OVER THE FARM AND RANCH LANDS PROTECTION PROGRAM IN MICHIGAN, (September 2011) (finding serious problems with the

To avoid exacerbating current abuses, any tax credit program would have to include safeguards designed to ensure that (i) the easements are accurately valued, (ii) the subject properties have unique or otherwise significant conservation or historic values and the easements are drafted to protect those values, and (iii) the protections will be durable (e.g., mortgages are subordinated, comprehensive baseline documentation is obtained, holders have sufficient resources and expertise to monitor and enforce, and there are appropriate restrictions on and independent oversight of the transfer, modification, and termination of the easements).[359]

B. *Alternative Proposed Reforms*

Given the potential problems with the Treasury's proposed reforms to address valuation abuse, alternative reforms informed by the analysis of the valuation case law should be considered. The following suggested reforms are not listed in order of priority.

1. *Six-Year Statute of Limitations*

The enhanced incentives, which are now permanent, are exceedingly generous to a narrow class of charitable donors—those who donate conservation or façade easements. Instead of being able to claim the deduction generated by an easement donation only to the extent of 30 percent of the donor's adjusted gross income (AGI) in each of the year of the donation and the following five years, easement donors are permitted to claim the deduction to the extent of 50 percent of the donor's AGI in each of the year of the donation and the following fifteen years, or, for qualifying farmer and rancher donations, 100 percent of the donor's AGI in each of the year of the donation

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appraisal processes and recommending the State office implement a number of reforms); U.S. DEP'T OF AGRICULTURE, REP. NO. 10099-3-SF, AUDIT REPORT, NATURAL RESOURCE CONSERVATION SERVICE WETLANDS RESERVE PROGRAM, COMPENSATION FOR EASEMENTS, (August 2005), http://www.usda.gov/oig/webdocs/10099-3-SF.pdf (finding that easements were being significantly overvalued and that, if the National Resources Conservation Service had changed one of its policies, it could have potentially saved the program more than $159 million over a five year period).

359. If the § 170(h) qualification requirements were repealed or significantly reduced, there would be little assurance that the easements acquired would provide benefits to the public over the long term. Given that state laws and donee organization policies, resources, and commitment to conservation vary widely and are subject to change at any time, there would be significant inequities, with landowners in some jurisdictions receiving credits for easements that provide far fewer protections and public benefit over the long term than landowners in other jurisdictions.

and the following fifteen years.[360] Farmers and ranchers can potentially avoid paying income tax for up to sixteen years. No other form of charitable gift is treated as favorably under the Code.

Given the extent of the abuses in the easement donation context and the generosity of the enhanced incentives, it seems a fair trade to extend the period within which the IRS could challenge the claimed deductions from the current three years to six years.[361] Doubling the window of vulnerability would make playing the audit lottery a less attractive option for those engaged in abusive transactions.[362] Doubling the window of vulnerability would also encourage well-intentioned donors to obtain well-supported appraisals and to strictly comply with the requirements of § 170(h) and the Regulations. In addition, while some might argue that doubling the window of vulnerability would discourage donations, given the generosity of the enhanced incentives, the chilling effect is likely to be minimal—property owners would still have a uniquely compelling financial incentive to donate.

2. Improved Reporting on Form 8283

A conservation easement donor claiming a deduction for an easement with a value of more than $5,000 (which almost always will be the case) must substantiate the deduction with a "qualified appraisal" prepared by a "qualified appraiser," and must attach a fully completed appraisal summary (the IRS Form 8283) to the return on which the deduction is first claimed.[363] If the claimed deduction is more than $500,000, the taxpayer must attach the full qualified appraisal to the return.[364] The donor must also attach a "supplemental statement" to the Form 8283 that (i) identifies the conservation purposes furthered by the donation, (ii) shows, if the before-and-after valuation method is used, the fair market value of the subject property before and after the gift, (iii) states whether the donation was made in order to get a permit or other approval from a local or other governing authority and whether the donation

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360. *See* TECHNICAL EXPLANATION OF PPA*, supra* note 11.

361. Congress recently revised I.R.C. § 6501(e)(1) to provide for a special six-year statute of limitations with regard to a common component of tax shelter transactions. *See* Erin McManus, *IRS Gets Six-Year Statute of Limitations for Tax Shelter Ploy*, DAILY TAX REP. (BNA), Aug. 5, 2015, at G-2.

362. *See, e.g.*, *Important Advisory: Syndication*, LAND TRUST ALLIANCE, http://www.landtrustalliance.org/important-advisory-syndication (describing abusive syndicated easement donation transactions).

363. *See* I.R.C. § 170(f)(11)(C); Reg. § 1.170A–13(c); *see also* IRS Form 8283, https://www.irs.gov/pub/irs-pdf/f8283.pdf.

364. *See* I.R.C. § 170(f)(11)(D).

was required by a contract (i.e., was there a *quid pro quo*), and (iv) states whether the donor or a related person has any interest in other property nearby and, if so, describes that interest.[365]

In its current iteration, the Form 8283 is not a particularly effective reporting tool for conservation or façade easement donations. Some of the questions on the form are difficult to understand as applied to easement donations, making the form difficult for donors to complete and the information provided on the form difficult for the IRS to understand. For example, in Section B, Part I of the form, subparts 5(c), (d), (e), (f) ask for the "[a]ppraised fair market value," "[d]ate acquired by donor," "[h]ow acquired by donor," and "[d]onor's cost or adjusted basis," respectively. Most donors understand that the appraised fair market value should be that of the easement, but it is not clear if the "date acquired," "how acquired," and "basis" questions relate to the easement or the subject property. It also is not clear whether or how to address the entire contiguous parcel and enhancement rules.[366]

The Form 8283 could be revised to instruct the donor, in a straightforward and easy to understand manner, to provide specific information relating to the subject property and the easement donation. For example, it should be clear from the face of the form that the donor of a conservation or façade easement (i) purchased the underlying property for $1 million in early November 2014, (ii) donated the easement with respect to that property fourteen months later, in late December 2015, and (iii) is claiming that the easement (a partial interest in the property) had an appraised fair market value on the date of the donation of $10 million (that is, that the subject property appreciated in value by more than 900 percent in just fourteen months). It also should be clear from the face of the form or the instructions how the donor should report values determined using the contiguous parcel or enhancement rules.

In addition, even though overvaluation appears to be a persistent problem in the easement donation context, the existing Form 8283 does little to highlight valuation issues. The IRS's enforcement efforts could be facilitated by requiring that the donor or the donor's appraiser provide additional valuation information in the supplemental statement, such as the per-acre or per-square-foot value of the conservation or façade easement; whether a façade easement encumbers a residential or commercial property;

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365. *See* Instructions for IRS Form 8283, https://www.irs.gov/pub/irs-pdf/i8283.pdf. For the donation of a façade easement on a building in a registered historic district, in addition to the Form 8283 and supplemental statement, the taxpayer must include with the taxpayer's return for the year of the contribution (a) a qualified appraisal, (b) photos of the entire exterior of the building, (c) a description of all restrictions on the development of the building, and (d) if the deduction claimed is more than $10,000, a $500 filing fee. *See* I.R.C. §§ 170(h)(4)(B)(iii), 170(f)(13); *see also* IRS Form 8283-V, http://www.irs.gov/pub/irs-pdf/f8283v.pdf.

366. *See supra* Part II.E.

whether the subject property is subject to existing restrictions or limitations on its development and use; whether the appraiser assumed a before-easement HBU for the subject property that differs from its current use; whether rezoning was assumed in estimating the before-value of the subject property; and whether the income capitalization approach, the subdivision development analysis, the reproduction cost approach, or nonlocal comparables were used to value the subject property.

Requiring that all easement donors attach the full qualified appraisal to the return on which the deduction is first claimed would also facilitate IRS enforcement efforts. Putting appraisers of easements valued at $500,000 or less on notice that their appraisals will be submitted to the IRS is likely to make at least some more careful in their analyses.

Lastly, the donee acknowledgment on the current Form 8283 requires the donee to affirm that "in the event it sells, exchanges, or otherwise disposes of the property . . . or any portion thereof" within three years of the donation it will file Form 8282. This acknowledgment suggests that holders are free to sell, exchange, or otherwise dispose of perpetual conservation easements, in whole or in part, when they are not. The Regulations specify the limited circumstances in which a tax-deductible easement may be transferred intact to another eligible donee or extinguished by a court, and the form should be revised to make this clear.[367]

Improving reporting on the Form 8283 with respect to easement donations should be easy to accomplish and cost little to implement. A separate Form 8283E could be created to report such contributions, or a new section relating specifically to easements could be added to the existing form. The instructions could also be revised to require that additional information be included in the supplemental statement. Such revisions would help donors comply with the reporting requirements, facilitate IRS review and enforcement of the § 170(h) deduction, and signal to donors and their appraisers that valuation will be carefully scrutinized. Such revisions would also enable the collection of additional data regarding conservation and façade easement contributions.

3. *Limited-Role Easement Advisory Panel*

The creation of an Easement Advisory Panel, somewhat like the Art Advisory Panel that was created in the late 1960s to assist the IRS in curbing

367. *See* Reg. § 1.170A–14(c)(2) (restriction on transfer provision); Reg. § 1.170A–14(g)(6) (extinguishment provision); *see also Belk*, 774 F.3d 221 (tax-deductible easements must be extinguishable only in a judicial proceeding upon a finding of impossibility or impracticality as provided in the Regulations).

valuation abuses in the artwork context, should be considered. This is not a new recommendation, having been made by the author in an article published eleven years ago.[368] For the reasons discussed in that earlier article, however, it may be preferable for the Easement Advisory Panel to be temporary in nature, and for its role to be limited to developing a conservation easement qualified appraisal form and instructions that would guide appraisers through the easement appraisal process (as described below). Members of the panel could include IRS appraisers with appropriate expertise; appraisal managers from Federal agencies, such as the U.S. Forest Service and the Natural Resource Conservation Service, who have significant experience valuing conservation easements for federal easement purchase programs; appraisal managers from state agencies who similarly have significant experience valuing conservation easements for state easement purchase programs; Tax Court judges with a particular interest in easement valuation; and others with relevant expertise and independence from taxpayer clients.

4. Conservation Easement Qualified Appraisal Form and Instructions ("Green Book")

At present, appraisers of conservation and façade easements are required to comply with numerous requirements contained in various sections of the Code, the Regulations, and other IRS guidance documents, as well as generally accepted appraisal standards.[369] They also must be familiar with the growing body of easement valuation case law.[370] To help educate appraisers regarding the requirements in this highly specialized context, the Treasury, with the help of the Easement Advisory Panel or other individuals with appropriate expertise, could develop a conservation easement qualified appraisal form and accompanying instructions for a § 170(h) deduction appraisal. The form and instructions could consolidate the requirements and other guidance in one publication, specify the various issues that should be addressed in the appraisal and the order in which they should be addressed,

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368. *See* Nancy A. McLaughlin, *Increasing the Tax Incentives for Conservation Easement Donations–A Responsible Approach*, 31 ECOL. L. Q. 1, 87–91 (2004).

369. *See, e.g.*, I.R.C. §§ 170(f)(11), 170(h); Reg. §§ 1.170A–13(c), 1.170A–14(h)(3); Notice 2006-96, 2006 I.R.B. 46 (transitional guidance relating to the definitions of "qualified appraisal" and "qualified appraiser" in IRC § 170(f)(11)); C.C.A. 200738013 (Aug. 9, 2007) (addressing valuation of façade easements); C.C.A. 201334039 (July 25, 2013) (addressing contiguous parcel and enhancement rules); IRS Form 8283 & Instructions; IRS Publication 561, Determining the Value of Donated Property; IRS Publication 526, Charitable Contributions.

370. *See infra* app. A and C (listing the forty-five valuation cases through 2015).

and provide warnings about common methods of abuse.[371] The Uniform Appraisal Standards for Federal Land Acquisitions (generally referred to as the "Yellow Book") could serve as a model for the creation of the form and instructions.[372]

A conservation easement qualified appraisal form with instructions (perhaps referred to as the "Green Book") would have a variety of important benefits. It would guide appraisers through the appraisal process in this highly specialized context, thereby reducing errors and ensuring a level of consistency that is unseen today. It would perform an important signaling function for taxpayers and appraisers inclined to overvalue easements. And it would assist the IRS and the courts in reviewing easement appraisals and assessing the credibility of the appraisers and the assumptions and methodologies they employ.

5. *Automatic Review of Certain Appraisals*

Automatic (rather than audit lottery) IRS review of certain appraisals could be required. Automatic review could be mandated with respect to, for example (i) appraisals that use nonlocal comparables, assume rezoning, or use the income capitalization, subdivision development, or reproduction cost approach as the primary method of valuation, (ii) appraisals asserting values for easements over a threshold dollar amount or a threshold per-acre or per-square foot amount, or (iii) appraisals asserting a value for an easement that is more than 50 percent of the before-value of the subject property. The triggers for automatic review could be included as reportable items in the revisions to the Form 8283 suggested above. To help defray the cost of the reviews, a filing fee similar to that currently charged with regard to certain façade easement donations could be required.[373]

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371. The form and instructions could also mandate that the appraiser sign a declaration at the end of the appraisal stating that the before and after value estimates reflect the price at which the donor realistically could sell the property in its current before- and after-easement condition in the open market. This most basic of principles is often lost in a flood of data, statistics, and assumptions, particularly when an appraiser relies on the income capitalization, subdivision development, or reproduction cost approach. Requiring appraisers to sign this declaration may help to remind them of the basic goal of the appraisal and discourage abusive overvaluations.

372. *See* ILAC, YELLOW BOOK, *supra* note 52, Parts I through VII; *see also USDA, Natural Resource Conservation Service*, *Implementation of Agricultural Conservation Easement Program*, Attachment 9: ACEP-ALE Appraisal and Appraisal Review Specifications, http://directives.sc.egov.usda.gov/ViewerFS.aspx?hid=35548. The form and instructions could be produced in electronic form so they can be easily updated to reflect new case law and other developments.

373. *See supra* note 365.

Awareness of the automatic review triggers may make taxpayers and their appraisers more cautious about aggressive valuations and the use of valuation methodologies that are particularly susceptible to manipulation and abuse. If this reform were implemented, however, some easement donors and appraisers might seek to avoid the automatic review by avoiding the triggers, while nonetheless overvaluing the easements, by, for example, asserting unrealistic before-easement HBUs for the subject properties, using local but noncomparable "comparable" sales, making improper adjustments to comparable sales, or estimating values that fall just below the trigger amounts. Accordingly, if this reform were adopted, the existing process of reviewing returns involving easement donations and selecting some for audit should continue with regard to those returns that do not trigger automatic review.

6. *More Effective Pre-Trial Process for Resolving Valuation Disputes*

The courts, particularly the Tax Court, have had to devote considerable judicial resources to resolving easement valuation disputes. In several of the early easement valuation cases the Tax Court expressed its view that such cases should be disposed of by way of settlement or other procedures short of court proceedings. For example, in *Losch v Commissioner*, the court stated:

> At this point we feel constrained to reiterate once again our doubts as to the efficacy of using the judicial process to resolve valuation issues. . . . Litigation is an inefficient, wasteful, and inherently imprecise method of resolving these disputes. . . . Additionally, we believe that resolution of these issues by settlement or other procedures short of court proceedings will more often result in a value which is fairer to both parties. The parties and their experts will generally have a fuller knowledge of the pertinent facts and greater expertise than does this Court which must rely only on 'a cold record and dry briefs' to form the basis of its conclusion.[374]

374. *Losch*, 55 T.C.M. (CCH) 909, T.C.M. (P-H) ¶ 88,230; s*ee also Symington*, 87 T.C. at 904 ("Too often in valuation disputes the parties have convinced themselves of the unalterable correctness of their positions and have consequently failed successfully to conclude settlement negotiations—a process clearly more conducive to the proper disposition of disputes such as this."); Fannon v. Commissioner, 52 T.C.M. (CCH) 1113, 1118 T.C.M. (P-H) ¶ 86,572 at n.18 (1986) (voicing concern over the time and resources spent by the court in resolving valuation disputes and repeating its admonition that such cases should be disposed of short of court proceedings; when valuation experts are too 'result oriented' it "places the Court

Although the Tax Court judges seem now to be somewhat resigned to having to resolve valuation disputes, problems associated with using litigation to resolve these disputes persist.[375] Modification of the current appeals process or mandating or offering the option of nonbinding pre-trial mediation involving the IRS, the donor, and an independent mediator with easement appraisal expertise (or assisted by an independent appraiser with easement appraisal expertise) should be considered.[376] A pre-trial process in which a significant percentage of valuation disputes are resolved could both relieve the burden on the courts and result in values that are closer to the actual value of the easements.

7. *Increased Appraiser Penalties*

It is not clear that the penalty provisions that apply to taxpayers deter overvaluations in the easement donation context. Many easement donors are one-time participants in such transactions and may be unaware of the penalty provisions. In addition, if they are aware of the penalty provisions, they also may be aware that the substantial valuation misstatement penalty is subject to the reasonable cause exception and, in virtually all cases, taxpayers qualify for that exception.[377] Moreover, even though the gross valuation misstatement penalty is now a strict liability penalty, the valuation of easements is complex and a range of values generally will be defendable. Accordingly, many

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in the unenviable position of applying its judgment in an area where it has no particular expertise").

375. *See, e.g.*, *Zarlengo*, 108 T.C.M. (CCH) 155, 2014 T.C.M. (RIA) ¶ 2014-161, at 1152 (each of the parties' experts made adjustments designed to support his side's litigating position; "[e]xperts lose their usefulness and credibility when they merely become advocates for the position argued by a party"); Crimi v. Commissioner, 105 T.C.M. (CCH) 1330, 2015 T.C.M. (RIA) ¶ 2015-051, at 333 (providing that the court's concerns about the helpfulness of expert testimony led it to have the experts testify concurrently, which enabled the court "to more easily separate the reliable portions of the expert reports from the unreliable").

376. The proposed nonbinding pre-trial mediation would differ from the current IRS appeals mediation program in that the mediator would be independent, rather than an IRS employee, and would have easement appraisal expertise or be assisted by an independent appraiser with easement appraisal expertise. *See* Rev. Proc. 2014–63, 2014–52 IRB (describing the IRS appeals mediation program and noting that "An Appeals employee trained as a mediator will serve as the mediator").

377. *See supra* Parts IV.E, V.E and app. A and C; *see also* David M. Wooldridge et al., *Navigating the Defenses to Valuation Penalties in Charitable Deduction Cases*, 121 J. TAX. 255 (2014) (advising easement donors regarding how to qualify for the reasonable cause exception).

easement donors may be unable to competently assess whether an appraisal overstates the value of an easement, which calls into question the deterrent effect of even a strict liability penalty.

Given that appraisers are repeat players, are aware of the penalties, and should have the necessary valuation expertise, increasing the penalties that apply to them is likely to be a more effective deterrent to overvaluations.[378] Moreover, the Tax Court has noted with exasperation "the cottage industry of [valuation] experts who function primarily in the market for tax benefits" and that such experts should be "discouraged."[379] The court explained that "[t]he problem is created by [the experts'] willingness to use their resumes and their skills to advocate the position of the party who employs them without regard to objective and relevant facts, contrary to their professional obligations."[380]

The existence of this cottage industry is evidenced by the numerous cases involving appraisers who were willing to assert unreasonable or unsupported values for easements on behalf of their taxpayer clients.[381] It also

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378. Appraisers are required to sign a declaration on the Form 8283 in which they specifically acknowledge that they may be subject to penalties. They also are required to satisfy certain educational requirements and are likely to learn of the penalty provisions as part of that education.

379. *Boltar*, 136 T.C. at 335 (granting the IRS's motion in limine to exclude from evidence the report and testimony of the taxpayer's valuation expert as "so far beyond the realm of usefulness that admission is inappropriate and exclusion serves salutary purposes").

380. *Id.* at 335.

381. *See, e.g.*, *id.*; *Butler*, 103 T.C.M. (CCH) at 1385, 2012 T.C.M. (RIA) ¶ 2012-072, at 552 ("we have frequently concluded that appraisals submitted with taxpayers' returns overstated the values of claimed deductions even when those reports were prepared long before the commencement of litigation"); *Esgar I*, 103 T.C.M. (CCH) 1185, 1189, 2012 T.C.M. (RIA) ¶ 2012-035, at 272 (appraiser who prepared the appraisal report used to substantiate deductions for three conservation easement donations asserted values determined to be more than eleven, sixteen, and seventeen times the correct values; Colorado later suspended his appraisal license "'FOR OVERVALUING conservation easements'") (emphasis in original); Scheidelman v. Commissioner, 105 T.C.M. (CCH) 1117, T.C.M. (RIA) ¶ 2013-018 at 171, *aff'd Scheidelman*, 755 F.3d at 148 (taxpayer's valuation expert ignored studies suggesting a contrary result and adopted those supporting his client's desired value; his testimony had all of the earmarks of overzealous advocacy in support of the donee land trust's marketing program and, indirectly, the taxpayer's tax reporting); *Whitehouse Hotel*, 755 F.3d 236 (finding "rather remarkable" the taxpayer's valuation expert's assertion that the Maison Blanche building had a value of $96 million less than three years after the taxpayer had purchased it for $8.9 million); Dunlap v. Commissioner, 2012 T.C.M. (RIA) ¶ 2012-126 at 1004 (declining to give the reports of the taxpayers' valuation experts any probative weight because their conclusions lacked credibility); *Evans*, 100 T.C.M. (CCH) 275, 279, 2010 T.C.M. (RIA) ¶ 2010-207 at 1276 (same); *Chandler* , 142 T.C. at 289 (same).

is the result of the current incentive structure. Taxpayers want high values for the easements they donate because it increases the tax benefits they receive. Donee organizations benefit from high values because property owners are more likely to donate if their easements are determined to have high values and the donees may receive significant stewardship endowments as a result of the donations.[382] Donees thus have an incentive to recommend to prospective donors appraisers who are willing to assert aggressive values. Appraisers also have an incentive to assert high values to please their taxpayer clients (who pay their fees), to receive referrals from those clients, and to remain on the list of appraisers that donee organizations recommend to prospective donors.[383] Confidential conversations with land trust personnel, attorneys, and appraisers lead this author to believe that appraisers who consider it a point of professional pride to write only fully-supported easement appraisals currently lose business to appraisers willing to assert abusive values and to charge less to do so.

Given that the incentives for taxpayers, donees, and appraisers generally align toward aggressive valuations and the risk of audit is low, the current modest monetary penalties to which appraisers are subject are unlikely to deter overvaluations.[384] In addition, although the government can blacklist appraisers and file suits to enjoin them from aiding and abetting the understatement of tax liability, those sanctions appear to be invoked only in the most egregious cases.[385] Moreover, even if invoked more frequently, those sanctions might not be much of a deterrent given that tax appraisals are generally only one aspect of an appraisal business.

Imposing more significant monetary penalties on appraisers who prepare easement appraisals that result in substantial or gross valuation misstatements could alter the current incentive structure. The threat of such penalties (or having to litigate about the appropriateness of such penalties) might help persuade appraisers to prepare only well-supported easement appraisals. It might also discourage appraisers without significant easement valuation expertise from accepting such assignments. And a decrease in the

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382. *See, e.g.*, *Kiva Dunes*, 97 T.C.M. (CCH) at 1818, 2009 T.C.M. (RIA) ¶ 2009-145, at 1177 (taxpayer donated $35,000 along with a conservation easement the taxpayer valued at $30.5 million to the North American Land Trust).

383. *See, e.g.*, *Kaufman I*, 107 T.C.M. (CCH) 1262, 2014 T.C.M. (RIA) ¶ 2014-052 at 384–85 (stating that '"the appraiser, who admitted receiving fees for a succession of such appraisals for [donee] easements, assuredly had an interest in remaining on the list of those recommended by the [donee] to potential donors"').

384. *See supra* Part III.B. (explaining that an appraiser may be subject to a penalty of $1,000 for knowingly aiding and abetting an understatement of tax liability, and a penalty equal to no more than 125 percent of the fee for the preparation of an appraisal that results in a substantial or gross valuation misstatement).

385. *See supra* Part III.B; *see also supra* Part IV.E.

number of appraisers willing to take on easement appraisal assignments might enable the remaining appraisers, who would have a highly specialized skill set, to charge fees commensurate with the complexity of the assignments.

8. *Standardized Safe Harbor Provisions*

Although federally-deductible conservation and façade easements obviously could not be standardized in full, certain of their terms generally should not vary from easement to easement. For example, the Regulations specify the limited circumstances under which tax-deductible easements can be transferred or extinguished, the minimum proceeds that must be payable to the holder upon extinguishment, and the manner in which the holder must use such proceeds.[386] These requirements are designed to ensure that tax-deductible easements are (i) transferred only to governmental or charitable entities that will continue to enforce the easements on behalf of the public and (ii) extinguished only in a judicial proceeding, upon a finding that continuing to use the subject property for conservation or historic preservation purposes has become impossible or impractical, and with a payment of a share of proceeds to the holder to be used to replace lost conservation or historic values (thereby protecting the federal investment).[387]

Taxpayers currently draft easements that address these "perpetuity" requirements in countless different ways, and sometimes in ways purposefully designed to circumvent the requirements.[388] This variability makes an already complex valuation assignment more complex. Moreover, appraisers generally assume that a conservation or facade easement that states that it is "perpetual" will, in fact, be perpetual. The result is that some (perhaps not insignificant percentage of) easements that do not satisfy the perpetuity requirements slip through the current system and are valued—and subsidized by federal taxpayers—as if they were perpetual when they are not. Use of standardized

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386. *See* Reg. §§ 1.170A–14(c)(2) (restriction on transfer requirement); Reg. 1.170A–14(g)(6) (judicial extinguishment, division of proceeds, and use of proceeds requirements); *see also Belk*, 774 F.3d 221 (tax-deductible easements must be extinguishable only in a judicial proceeding and upon a finding of impossibility or impracticality as provided in the Regulations).

387. *Id.*

388. *See, e.g.*, *Carpenter*, 106 T.C.M. (CCH) at 62, 2013 T.C.M. (RIA) ¶ 2013-172, at 1393 (donated conservation easements provided that they could be extinguished by judicial proceeding or by mutual agreement of the parties); Belk v. Commissioner, 774 F.3d 221 (4th Cir. 2014) (donated conservation easement provided that the landowner and the holder could agree to extinguish the easement with regard to portions of the protected land in exchange for protecting other land). In both cases the deductions were disallowed for failure to satisfy the extinguishment requirements in the Regulations.

safe harbor provisions would help to ensure that easements valued and subsidized as if they satisfy the perpetuity requirements actually satisfy those requirements.[389]

VII. CONCLUSION

Overvaluation has been a persistent problem in the conservation and façade easement donation context. It results, in part, from the lack of a market for such easements, the complexity associated with indirect valuation, and the fact that all parties (the donor, the donee, and the appraiser) have an incentive to assert high values. But this problem is not insurmountable. As the foregoing discussion indicates, a variety of reforms could be implemented to help reduce valuation abuse.

Overvaluation, however, is only part of the problem. Ensuring that conservation and façade easements are accurately valued at the time of their donation would not guarantee that the public's money is being well spent. Additional reforms are needed to ensure that the easements protect properties that have important conservation or historic values, and that those protections will not be lost through, for example, lack of enforcement or the substantial modification, release, or termination of the easements. Accordingly, any reforms in the easement deduction context should also include measures designed to ensure both the quality and the durability of the easements.

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389. As in the charitable lead and charitable remainder trust context, safe harbor or "sample" conservation easement provisions that meet the requirements of § 170(h) and the Regulations and generally should not vary from easement to easement could be developed and published in a Revenue Procedure. *See, e.g.*, Rev. Proc. 2005–52, 2005 I.R.B. 34 (providing sample provisions that meet the requirements for an inter vivos charitable remainder unitrust and annotations explaining the provisions).

Appendix A: Façade Easements

Early Cases[1]	Year Donated	Property	Property Location	Donee	TP's FE Value[2]	Court's FE Value[3]	TP's Over-statement	Penalty %[4]	Penalty[5]
Hilborn, 85 T.C. 677 (1985)	1979	Townhouse (apartments)	Vieux Carre Historic District, New Orleans, LA	Vieux Carre Commission	$ 94,000	$ 55,278	**$ 38,722**	**170%**	No[6]
Losch, T.C. Memo. 1988-230	1980	Office Building	Dupont Circle Historic District, Washington, D.C.	National Trust for Historic Preservation	$ 215,000	$ 130,000	**$ 85,000**	**165%**	Yes[7]
Richmond, 699 F. Supp. 578 (E.D. La. 1988)	1980	Commercial Building	Vieux Carre Historic District, New Orleans, LA	Vieux Carre Commission	$ 150,000	$ 59,000	**$ 91,000**	**254%**	Yes[8]
Nicoladis, T.C. Memo. 1988-163	1981	Office Building & Parking Lot	New Orleans, LA	Preservation Alliance of New Orleans	$ 350,000	$ 168,700	**$ 181,300**	**207%**	No[9]
Dorsey, T.C. Memo. 1990-242	1981	Office Building	Picayune Place Historic District, New Orleans, LA	Historic Faubourg St. Mary Corporation	$ 245,000	$ 153,422	**$ 91,578**	**160%**	No[10]
Griffin, 911 F.2d 1124 (5th Cir. 1990)	1981	Land & 3 Buildings	Lafayette Square Historic District, New Orleans, LA	Historic Faubourg St. Mary Corporation	$ 195,000	$ 70,000	**$ 125,000**	**279%**	Yes[11]
Total: **Average:**							**$ 612,600** **$ 102,100**	**--** **206%**	
Recent Cases	**Year Donated**	**Property**	**Property Location**	**Donee**	**TP's FE Value**	**Court's FE Value**	**TP's Over-statement**	**Penalty %**	**Penalty**
Whitehouse Hotel, 755 F.3d 236 (5th Cir. 2014)	1997	Commercial Building	Vieux Carre and Canal Street Historic Districts, New Orleans, LA	Preservation Resource Center of New Orleans	$ 7,445,000	$ 1,857,716	**$ 5,587,284**	**401%**	No/rc[12]
Dunlap et al., T.C. Memo. 2012-126	2003	Residential Condominium	Tribeca North Historic District, New York, NY	National Architect-ural Trust (NAT)	$ 8,171,000	$ 0	**$ 8,171,000**	**400%**[13]	No/rc[14]
Kaufman, 784 F.3d 56 (1st Cir. 2015)	2003	Residence	South End Historic District, Boston, MA	NAT	$ 220,800	$ 0	**$ 220,800**	**400%**	Yes[15]
Foster, T.C. Sum. Op. 2012-90[16]	2003	Residence	Georgetown Historic District, Washington, D.C.	L'Enfant Trust	$ 98,500	$ 0	**$ 98,500**	**400%**	No[17]
Simmons, 646 F.3d 6 (D.C. Cir. 2011)	2003 2004	Residence Residence	Washington, D.C.	L'Enfant Trust	$ 162,500 $ 93,000	$ 56,250 $ 42,250	**$ 106,250** **$ 50,750**	**289%** **220%**	No[18]
Evans, T.C. Memo. 2010-207	2004 2004	Residence Residence	Capitol Hill Historic District, Washington, D.C.	Capital Historic Trust	$ 154,350[19]	$ 0	**$ 154,350**	**400%**	No/rc[20]
Scheidelman, 755 F.3d 148 (2d Cir. 2014)	2004	Residence	Fort Greene Historic District, Brooklyn, NY	NAT	$ 115,000	$ 0	**$ 115,000**	**400%**	No/rc[21]
Reisner, T.C. Memo. 2014-230	2004	Residence	Brooklyn, NY	NAT	$ 190,000	$ 0[22]	**$ 190,000**	**400%**	No/rc[23] Yes/sl[24]
Chandler, 142 T.C. 279 (2014)	2004 2005	Residence Residence	South End Historic District, Boston, MA	NAT	$ 191,400 $ 371,250	$ 0 $ 0	**$ 191,400** **$ 371,250**	**400%** **400%**	No/rc[25] Yes/sl[26]
Zarlengo, T.C. Memo. 2014-161	2005	Residence	Riverside Historic District, New York, NY	NAT	$ 660,000	$ 157,500	**$ 502,500**	**419%**	No/rc[27] Yes/sl[28]
Gorra, T.C. Memo. 2013-254	2006	Residence	Carnegie Hill Historic District, New York, NY	NAT	$ 605,000	$ 104,000	**$ 501,000**	**582%**	Yes/sl[29]
Total: **Average:**							**$16,260,084** **$ 1,478,189**	**--** **406%**	

1. The cases are listed in order of the date of the first donation (some cases involved more than one donation).

2. This column lists the façade easement (FE) values the taxpayers asserted on their income tax returns.

3. This column lists the court-determined values for the façade easements.

4. These percentages represent the easement value asserted by a taxpayer on a return divided by the value determined by the court to be the correct value, multiplied by 100. For the recent cases, these percentages are used to determine whether a taxpayer made a substantial or gross valuation misstatement for penalty purposes. For example, in *Whitehouse*, the taxpayer asserted that the easement had a value of $7,445,000, the court determined that the correct value was $1,857,716, and the taxpayer thus asserted a value for the easement that was just over 4 times (or 401 percent of) the correct value (i.e., $7,445,000/$1,857,716 x 100 = 400.7). Under both pre- and post-PPA law, this would constitute a gross valuation misstatement.

5. This column indicates whether the taxpayers were found liable for penalties due to overstatement of the value of the easements. The initials "rc" mean "reasonable cause" and "sl" means "strict liability."

6. Penalties were not addressed in the opinion.

7. Taxpayers were found liable for the increased rate of interest imposed on substantial underpayments attributable to tax motivated transactions under I.R.C. § 6621(c).

8. Taxpayers were found liable for the increased rate of interest imposed on substantial underpayments attributable to tax motivated transactions under I.R.C. § 6621(c).

9. Penalties were not addressed in the opinion.

10. Taxpayers, who had no particular expertise in the area of facade easement valuation and relied on their appraiser, were found not to be negligent and therefore not liable for an addition to tax under I.R.C. § 6653(a). Also, the court incorrectly determined that the value the taxpayers claimed for the easement ($245,000) was not 150 percent or more of what the court stated was the easement's correct value ($153,305) and, thus, that there was no valuation overstatement for purposes of the increased rate of interest under I.R.C. § 6621(c) or the addition to tax under I.R.C. § 6659(d). In other sections of the opinion the court stated that the easement's correct value was $153,422. Regardless of the value used, the taxpayers appear to have overstated the value of the easement by approximately160 percent.

11. Taxpayers were found liable for the increased rate of interest imposed on substantial underpayments attributable to tax motivated transactions under I.R.C. § 6621(c).

12. Taxpayer was found not liable for the gross valuation misstatement penalty because it qualified for the reasonable cause exception.

13. If the correct value of the easement is determined to be zero, the value claimed by the taxpayer on the return is considered to be 400 percent or more of the correct value and, thus, there is a gross valuation misstatement. *See* Reg. § 1.6662–5(g).

14. The taxpayers were found not liable for the gross valuation misstatement penalty because they qualified for the reasonable cause exception.

15. The taxpayers were found liable for gross valuation misstatement penalties because they did not qualify for the reasonable cause exception.

16. Tax Court summary opinions may not be treated as precedent for any other case. *See* I.R.C. § 7463(b).

17. Taxpayers conceded liability for an I.R.C. § 6651(a)(1) addition to tax (for failure to file a return or pay tax) as appropriate. That penalty was not based on the taxpayers' valuation overstatement. No other penalties were addressed in the opinion.

18. The parties agreed that additions to tax under I.R.C. §6651(a)(1) and (2) (for failure to file a return or pay tax) and I.R.C. § 6654 (for failure to pay estimated income tax) were applicable to any resulting deficiency because the taxpayer failed to timely file returns for the years at issue. Those penalties were not based on the taxpayers' valuation overstatement. No other penalties were addressed in the opinion.

19. Taxpayers donated two façade easements and claimed this amount on their tax return with regard to the donations.

20. The taxpayers were found not liable for a valuation misstatement penalty because they qualified for the reasonable cause exception.

21. The taxpayers were found not liable for a valuation misstatement penalty because they qualified for the reasonable cause exception.

22. The parties agreed at trial that value of easement was zero.

23. The parties agreed that the taxpayers made gross valuation misstatements on their 2004, 2005, and 2006 returns attributable to the overvaluation of the façade easement. The parties also agreed that the taxpayers were not liable for penalties with regard to the overstatements on their 2004 and 2005 returns because they qualified for the reasonable cause exception.

24. The taxpayers were found liable for the strict liability gross valuation misstatement penalty with regard to their 2006 return.

25. The taxpayers were found not liable for gross valuation misstatement penalties with regard to their 2004 and 2005 returns because they qualified for the reasonable cause exception.

26. The taxpayers were found liable for the strict liability gross valuation misstatement penalty with regard to their 2006 return.

27. The taxpayers were found not liable for valuation misstatement penalties with regard to their 2004 and 2005 returns because they qualified for the reasonable cause exception.

28. One of the taxpayers was found liable for the strict liability gross valuation misstatement penalties with regard to her 2006 and 2007 returns (provided the applicable dollar limitation set forth in I.R.C. § 6662(e)(2) were satisfied).

29. The taxpayers were found liable for the strict liability gross valuation misstatement penalties for their 2006 and 2007 returns.

Appendix B: Façade Easements

Early Cases[1]	Year Donated	Property	Property Location	Donee	Before-Value[2]	After-Value[3]	Easement Value[4]	Reduction In Value[5]
Hilborn, 85 T.C. 677 (1985)	1979	Townhouse (apartments)[6]	Vieux Carre Historic District, New Orleans, LA[7]	Vieux Carre Commission[8]	$ 552,780	$ 497,502	$ 55,278	**10.0%**
Nicoladis, T.C. Memo. 1988-163	1981	Office Building & Parking Lot[9]	New Orleans, LA	Preservation Alliance of New Orleans	$ 1,187,000	$ 1,018,300	$ 168,700	**14.2%**
Losch, T.C. Memo. 1988-230	1980	Office Building[10]	Dupont Circle Historic District, Washington, D.C.	National Trust for Historic Preservation	$ 775,000	$ 645,000	$ 130,000	**16.8%**
Griffin, 911 F.2d 1124 (5th Cir. 1990)	1981	Land & 3 Buildings[11]	Lafayette Square Historic District, New Orleans, LA	Historic Faubourg St. Mary Corporation	$ 350,000	$ 280,000	$ 70,000	**20.0%**
Dorsey, T.C. Memo. 1990-242	1981	Office Building[12]	Picayune Place Historic District, New Orleans, LA	Historic Faubourg St. Mary Corporation	$ 459,205	$ 305,783	$ 153,422	**33.4%**
Richmond, 699 F. Supp. 578 (E.D. La. 1988)	1980	Commercial Building[13]	Vieux Carre Historic District, New Orleans, LA	Vieux Carre Commission	$ ---	$ ---	$ 59,000	**---**
							Average:	**18.9%**
Recent Cases	**Year Donated**	**Property**	**Property Location**	**Donee**	**Before-Value**	**After-Value**	**Easement Value**	**Reduction In Value**
Dunlap et al., T.C. Memo. 2012-126	2003	Residential Condominium[14]	Tribeca North Historic District, New York, NY	National Architectural Trust (NAT)	$ 68,000,000	$ 68,000,000	$ 0	**0.0%**
Kaufman, 784 F.3d 56 (1st Cir. 2015)	2003	Residence	South End Historic District, Boston, MA	NAT	$ 1,840,000	$ 1,840,000	$ 0	**0.0%**
Foster, T.C. Sum. Op. 2012-90[15]	2003	Residence	Georgetown Historic District, Washington, D.C.	L'Enfant Trust	$ ---	$ ---	$ 0	**0.0%**
Evans, T.C. Memo. 2010-207	2004 2004	Residence Residence	Capitol Hill Historic District, Washington, D.C.	Capital Historic Trust	$ ---	$ ---	$ 0	**0.0%**
Scheidelman, 755 F.3d 148 (2d Cir. 2014)	2004	Residence	Fort Greene Historic District, Brooklyn, NY	NAT	$ ---	$ ---	$ 0	**0.0%**
Reisner, T.C. Memo. 2014-230	2004	Residence	Brooklyn, NY	NAT	$ ---	$ ---	$ 0	**0.0%**
Chandler, 142 T.C. 279 (2014)	2004 2005	Residence Residence	South End Historic District, Boston, MA	NAT	$ --- $ ---	$ --- $ ---	$ 0 $ 0	**0.0%**
Gorra, T.C. Memo. 2013-254	2006	Residence	Carnegie Hill Historic District, New York, NY	NAT	$ 5,200,000	$ 5,096,000	$ 104,000	**2.0%**
Zarlengo, T.C. Memo. 2014-161	2005	Residence	Riverside Historic District, New York, NY	NAT	$ 4,500,000	$ 4,342,500	$ 157,500	**3.5%**
Simmons, 646 F.3d 6 (D.C. Cir. 2011)	2003 2004	Residence Residence	Washington, D.C.[16]	L'Enfant Trust	$ 1,250,000 $ 845,000	$ 1,193,750 $ 802,750	$ 56,250 $ 42,250	**5.0%**[17]
Whitehouse Hotel, 755 F.3d 236 (5th Cir. 2014)	1997	Commercial Building[18]	Vieux Carre and Canal Street Historic Districts, New Orleans, LA	Preservation Resource Center of New Orleans	$ 12,473,236	$ 10,615,520	$ 1,857,716	**14.9%**

1. The early and recent cases, respectively, are listed in order of the percentage by which the façade easement decreased the value of the subject property, from the lowest to the highest percentage.

2. This column lists the court-determined value of the subject property before the easement donation.

3. This column lists the court-determined value of the subject property after the easement donation. In some cases (where the court did not do the computation) this value was computed by subtracting the court-determined easement value from the court-determined before-value.

4. This column lists the court-determined value for the façade easement.

5. This column lists the percentage by which the easement reduced the before-value of the subject property, assuming the court-determined values.

6. At the time of the donation there were ten apartment units in the building, which were later converted into nine condominium units and 674 square feet of open space. The donor of the easement was a partnership, the purpose of which was to acquire, rehabilitate, hold for investment, and operate the building as an apartment building.

7. Vieux Carre is the old name for the French Quarter in New Orleans. It means “Old Square” in French.

8. The Vieux Carre Commission is a government agency responsible for the historic preservation of the French Quarter in New Orleans.

9. The property consisted of three lots. At the time of the donation an office building was located on one of the lots, the adjacent lot was used as a parking lot, and the rear lot was vacant.

10. The property consisted of a semi-detached three-story and full basement townhouse that was restored by the taxpayers and used as a law office.

11. At the time of the donation the property was zoned for mixed residential and commercial use.

12. The taxpayers renovated the property (a three-story building) into office-space.

13. At the time of the donation the building was available for “office/commercial use.”

14. The Cobblestone Loft Condominium is a seven-story loft building made up of thirty-one residential units and one unit owned by Cobblestone for use by the superintendent. All taxpayers owned units within Cobblestone.

15. Tax Court Summary Opinions may not be treated as precedent for any other case. *See* I.R.C. § 7463(b).

16. The residences were subject to the Historic Landmark and Historic Preservation Act of 1978.

17. The Tax Court held that the taxpayer was entitled to a deduction equal to 5 percent of the $1,250,000 before-easement value of the first property, but miscalculated the amount of that deduction (5 percent of $1,250,000 is $62,500, not $56,250).

18. The Whitehouse Hotel partnership purchased the property—the Maison Blanche building—to rehabilitate it for use as a Ritz-Carlton Hotel.

Appendix C: Conservation Easements

Early Cases[1]	Year Donated	Acres	Property Location	Donee	TP's CE Value[2]	Court's CE Value[3]	TP's Over-statement	Penalty %[4]	Penalty[5]
Thayer, T.C. Memo. 1977-370	1969	60	Fairfax County, VA	Virginia Outdoors Foundation (VOF)	$ 146,000	$ 113,000	**$ 33,000**	**129%**	No[6]
Stanley Works, 87 T.C. 389 (1986)	1977	668[7]	Litchfield, CT	Housatonic Valley Assoc.	$ 12,000,000	$ 4,970,000[8]	**$ 7,030,000**	**241%**	Yes[9]
Akers, 799 F.2d 243 (6th Cir. 1986)	1977	1,343	Cheatham County, TN	Tennessee Conservation League	$ 789,000	$ 114,000[10]	**$ 675,000**	**692%**	No[11]
Fannon, T.C. Memo. 1989-136	1978	142	Rappahannock County, VA	VOF	$ 158,682	$ 65,860	**$ 92,822**	**241%**	No[12]
Symington, 87 T.C. 892 (1986)	1979	61	Middleburg, VA	VOF	$ 150,000[13]	$ 92,370	**$ 57,630**	**162%**	No[14]
Stotler et al., T.C. Memo. 1987-275	1979	1,584	Monterey County, CA	Monterey County	$ 1,065,000	$ 1,065,000	**$ 0**	**100%**[15]	No[16]
Fannon, 842 F.2d 1290 (4th Cir. 1988)[17]	1979	308	Rappahannock County, VA	VOF	$ 236,752	$ 121,781	**$ 114,971**	**194%**	No[18]
Todd, 617 F.Supp. 253 (W.D. Pa. 1985)	1979	104	Westmoreland County, PA	Western Pennsylvania Conservancy (WPC)	$ 353,000	$ 31,000	**$ 322,000**	**1139%**	No[19]
Dennis, 1992 WL 330398 (E.D.Va)	1980	83	Rappahannock County, VA	VOF	$ 66,400	$ 50,610	**$ 15,790**	**131%**	No[20]
McLennan, 994 F.2d 839 (Fed. Cir. 1993)	1980	170[21]	Westmoreland County, PA	WPC	$ 430,600	$ 233,260	**$ 197,340**	**185%**	No[22]
Higgins, T.C. Memo. 1990-103	1981	23	Talbot County, MD	Maryland Envtl. Trust (MET)	$ 114,200	$ 103,000	**$ 11,200**	**111%**	No[23]
Schapiro, T.C. Memo. 1991-128	1981 1984	165 30	Baltimore & Harford Cnties, MD	MET	$ 344,250 $ 160,350	$ 375,000 $ 220,031	**($ 30,750)** **($ 59,681)**	**(92%)**[24] **(73%)**	No[25]
Clemens et al., T.C. Memo. 1992-436	1982	140	Martha's Vineyard, MA	Vineyard Open Land Foundation	$ 910,000	$ 703,000	**$ 207,000**	**129%**	No[26]
Schwab, T.C. Memo. 1994-232	1983	1,558[27]	Glen County, CA	American Farmland Trust	$ 900,000	$ 544,000	**$ 356,000**	**165%**	No[28]
Johnston et al., T.C. Memo. 1997-475	1989	4,898	Sheridan County, WY	The Nature Conservancy	$ 960,000	$ 1,131,438	**($ 171,438)**	**(85%)**	No[29]
Browning, 109 T.C. 303 (1997)	1990	52	Howard County, MD	Howard County	$ 598,500[30]	$ 518,000	**$ 80,500**	**116%**	No[31]
Strasburg, T.C. Memo. 2000-94	1993 1994[32]	320	Sweet Grass County, MT	Montana Land Reliance	$ 1,080,000 $ 290,000	$ 839,680[33] $ 290,000	**$ 280,000**[34] **$ 0**	**135%** **100%**	No[35]
Total: **Average:**							**$ 9,211,384**[36] **$ 511,744**	**--** **196%**	

Recent Cases	Year Donated	Acres	Property Location	Donee	TP's CE Value	Court's CE Value	TP's Over-statement	Penalty %	Penalty
Hughes, T.C. Memo. 2009-94	2000	2,413[37]	Gunnison County, CO	Valley Land Conservancy	$ 3,100,000	$ 1,992,375	**$ 1,107,625**	**156%**	No[38]
Kiva Dunes, T.C. Memo. 2009-145	2002	141	Baldwin County, AL	North American Land Trust	$ 30,588,235	$ 28,656,004	**$ 1,932,231**	**107%**	No/bt[39]
Boltar, 136 T.C. 326 (2011)	2003	8[40]	Lake County, IN	Shirley Heinze Land Trust	$ 3,245,000	$ 42,400	**$ 3,202,600**	**7653%**	No[41]
Trout Ranch, 493 Fed.Appx. 944 (10th Cir. 2012) [42]	2003	384[43]	Gunnison County, CO	Crested Butte Land Trust	$ 2,179,849	$ 560,000	**$ 1,619,849**	**389%**	No[44]
Schmidt, T.C. Memo. 2014-159	2003	40	El Paso County, CO	El Paso County	$ 1,600,000	$ 1,152,445	**$ 447,555**	**139%**	No/rc/bt[45]
Butler, T.C. Memo. 2012-72	2003 2003 2003 2004	393 13[46] 1,780 2,450[47]	Muscogee County, GA Calhoun & Early Counties, GA	Chattahoochee Valley Land Trust Georgia Land Trust[48]	$ 4,684,000 $ 191,000 $ 2,550,000 $ 2,936,000	$ 2,458,300 $ 139,400 $ 1,637,600 $ 2,312,800	**$ 2,225,700** **$ 51,600** **$ 912,400** **$ 623,200**	**191%** **137%** **156%** **127%**	No/rc/bt[49]
Esgar Corp. et al., 744 F.3d 648 (10th Cir. 2014)	2004 2004 2004	54 54 54	Prowers County, CO	Greenlands Reserve	$ 570,500 $ 867,500 $ 836,500	$ 49,774 $ 49,503 $ 49,774	**$ 520,726** **$ 817,998** **$ 786,726**	**1146%** **1752%** **1681%**	No/rc[50]
Mountanos, T.C. Memo. 2014-38	2005	882	Lake County, CA	Golden State Land Conservancy	$ 4,691,500	$ 0	**$ 4,691,500**	**400%**[51]	Yes/sl[52]
SWF Real Estate, T.C. Memo. 2015-63	2005	675	Albemarle County, VA	Albemarle County Public Rec. Facilities Authority	$ 7,398,333	$ 7,350,000[53]	**$ 48,333**	**101%**	No[54]
Palmer Ranch, T.C. Memo. 2014-79	2006	82	Sarasota County, FL	Sarasota County	$ 23,940,000	$19,955,014	**$ 3,984,986**	**120%**	No/rc/bt[55]
Legg, 145 T.C. No. 13 (2015)	2007	80	CO[56]	Colorado Natural Land Trust	$ 1,418,500	$ 80,000[57]	**$ 1,338,500**	**1773%**	Yes/sl[58]
Total: **Average:**							**$ 24,311,529** **$ 1,519,471**	**--** **1002%**	

1. The early and recent cases are listed in order of the date of the first donation (some cases involved more than one donation).
2. This column lists the conservation easement (CE) values the taxpayers asserted on their income tax returns.
3. This column lists the court-determined correct values for the conservation easements.
4. These percentages represent the easement value asserted by a taxpayer on a return divided by the value determined by the court to be the correct value, multiplied by 100. For the recent cases, these percentages are used to determine whether a taxpayer made a substantial or gross valuation misstatement for

penalty purposes. For example, in *Trout Ranch*, the taxpayer asserted that the easement had a value of $2,179,849, the court determined that the correct value was $560,000, and the taxpayer thus asserted a value for the easement that was almost 4 times (or 389 percent of) the correct value (i.e., $2,179,849/$560,000 x 100 = 389). Under pre-PPA law this constituted a substantial valuation overstatement. Under post-PPA law it would be a gross valuation misstatement.

5. This column indicates whether the taxpayers were found liable for penalties due to the overstatement of the value of the easements. The initials "rc" indicate that the taxpayers qualified for the reasonable cause exception; "bt" indicates that the amount reported by the taxpayers fell below the threshold for the penalty; "sl" indicates that the penalty imposed was the post-PPA strict liability gross valuation misstatement penalty.

6. Penalties were not addressed in the opinion.

7. The easement encumbered 668 of the 2,100 acres owned by the taxpayer.

8. The *Stanley Works* easement had a 30.5-year term. For a brief period, the deduction for the donation of an easement was available with regard to easements having a minimum term of at least 30 years. *See* RICHARD R. POWELL, POWELL ON REAL PROPERTY § 34A.04[2].

9. The taxpayer was found liable for the increased interest rate on substantial underpayments attributable to tax motivated transactions under I.R.C. § 6621(d) (1954).

10. The *Akers* easement had a term of 30 years and approximately 1 month. *See supra* note 8.

11. Penalties were not addressed in the opinion.

12. Penalties were not addressed in the opinion.

13. This was the value asserted by the taxpayers' expert at trial. It is not clear if this is the value asserted by the taxpayers on their income tax return.

14. Penalties were not addressed in the opinion.

15. The taxpayers asserted a value for the easement that was determined to be exactly (or 100 percent of) the value determined by the court to be the correct value. Accordingly, the taxpayers did not overstate the value of the easement.

16. Penalties were asserted but not imposed because the court determined the easement was not overvalued.

17. The 4th Circuit opinion, which increased the value of the easement by $100 per acre, was unpublished.

18. Penalties were not addressed in the opinion.

19. Penalties were not addressed in the opinion.

20. Penalties were not addressed in the opinion.

21. The easement encumbered 107 of the 407 acres owned by the taxpayers.

22. Penalties were not addressed in the opinion.

23. The taxpayers were not liable for the I.R.C. § 6659 addition to tax for valuation overstatements or the I.R.C. § 6621(c) increase in interest for underpayments attributable to a tax motivated transaction because the value of the easement the taxpayers claimed on their return was not 150 percent or more of the correct value.

24. In *Shapiro*, the court determined that the taxpayers had understated the value of the easements. For example, the taxpayers asserted a value of $344,250 with regard to the 165-acre parcel, the court determined the correct value was $375,000, and the taxpayer thus asserted a value for the easement that was slightly less than (or only 92 percent of) the correct value (i.e., $344,250/$375,000 x 100 = 91.8).

25. The parties stipulated that, for purposes of the penalty provisions, there were no valuation overstatements and the transactions were not tax motivated.

26. The taxpayers were not liable for the I.R.C. § 6659 addition to tax for valuation overstatements or the I.R.C. § 6621(c) increase in interest for underpayments attributable to a tax motivated transaction because the value of the easement the taxpayers claimed on their return was not 150 percent or more of the correct value.

27. The Schwabs purchased certain rights in the 1,558-acre tract, including the right to prevent development as well as hunting and fishing rights. The Schwabs then donated the right to prevent development to the American Farmland Trust.

28. The IRS asserted penalties in its notice of deficiency but the court did not address them in its opinion. The IRS may have conceded the issue.

29. Because the court held for the taxpayers, it did not address whether they were liable for penalties.

30. The taxpayers in *Browning* were paid $309,000 for the easement (i.e., they conveyed it in a "bargain sale" transaction). They claimed a deduction of $289,500.

31. Penalties were not addressed in the opinion.

32. The taxpayer amended her easement in 1994 to relinquish one of the two rights she retained in the easement to build additional residences on the property. This was treated as an additional donation under I.R.C. § 170(h).

33. The taxpayer's deduction was limited to her $800,000 basis in the easement because she donated the easement less than one year after purchasing the property. *See* I.R.C. § 170(e)(1)(A). The court determined that the fair market value of the easement was $839,680.

34. This is the amount by which the taxpayer overstated her deduction (the excess of $1,080,000 over $800,000, or $280,000).

35. The taxpayer was not liable for the I.R.C. § 6662 penalty because the values for the easement and amendment that she reported on her return did not meet the penalty thresholds.

36. The total of the overstatements was divided by 18—the number of easements. The easement and amendment in *Strasburg* were treated as one easement.

37. The property consisted of two parcels.

38. Penalties were not addressed in the opinion.

39. The taxpayer was not liable for the I.R.C. § 6662 accuracy-related penalty because the value for the easement it reported on its return was below the penalty thresholds.

40. The easement encumbered 8 of the 20 acres owned by the taxpayer.

41. IRS did not assert penalties in a timely fashion.

42. The 10th Circuit opinion was not selected for publication in the Federal Reporter and is not binding precedent but it may be cited for its persuasive value.

43. The easement encumbered 384 of the 453 acres owned by the taxpayer.

44. Penalties were not addressed in the opinion.

45. The taxpayer was not liable for a penalty due to a substantial understatement of income tax because the taxpayer qualified for the reasonable cause exception. The taxpayer was found not liable for a substantial valuation misstatement penalty because the amount the taxpayer claimed on his return with regard to the easement was below the penalty threshold.

46. Two easements were placed on properties owned by the taxpayers across the road from one another, with one of the easements excluding 24.5 acres surrounding the taxpayers' home.

47. The two easements excluded 1,370 acres of the subject plantation.

48. The Georgia Land Trust was formerly known as the Chattowah Open Land Trust.

49. The taxpayers were found not liable for a penalty due to a substantial understatement of income tax because the taxpayers qualified for the reasonable cause exception. The taxpayers were found not liable for valuation misstatement penalties because the amounts they claimed on their returns with regard to the easements were below the penalty thresholds.

50. Two of the three taxpayers were found not liable for a penalty due to a substantial understatement of income tax or a valuation misstatement because they qualified for the reasonable cause exception. The IRS conceded that one of the taxpayers was not liable for the accuracy-related penalty for the 2005 and 2006 tax years, and that taxpayer conceded it was liable for an I.R.C. § 6651(a)(1) addition to tax (for failure to file a return or pay tax). The latter penalty was not based on the taxpayers' valuation overstatement.

51. If the correct value of the easement is determined to be zero, the value claimed by the taxpayer on the return is considered to be 400 percent or more of the correct amount and, thus, there is a gross valuation misstatement. *See* Reg. § 1.6662–5(g).

52. The taxpayer was found liable for the strict liability gross valuation misstatement penalty with regard to his 2006, 07, and 08 returns.

53. This reflects a reduction in the court-determined value of the easement to account for $70,000 of enhancement in the value of the taxpayer's nearby property as a result of the easement.

54. Penalties were not addressed in the opinion.

55. The taxpayer was found not liable for a gross valuation misstatement because the amount claimed on its return with regard to the easement was below the penalty threshold. The taxpayer was found not liable for an accuracy-related penalty for an underpayment of tax attributable to negligence or disregard of rules or regulations, a substantial understatement of income tax, or a substantial valuation misstatement because it qualified for the reasonable cause exception.

56. The opinion does not indicate the county in which the subject land is located.

57. The parties stipulated that value of the easement was $80,000.

58. The taxpayers were found liable for the strict liability gross valuation misstatement penalty with regard to their 2007, 2008, 2009, and 2010 returns.

Appendix D: Conservation Easements

Early Cases[1]	Property Location	Acres	HBU Before[2]	HBU After[3]	Before-Value[4]	After-Value[5]	Easement Value[6]	Per-Acre CE Value[7]	Reduction in Value[8]
Todd, 617 F.Supp. 253 (W.D. Pa. 1985)	Westmoreland County, PA	104	country estate (1 homesite)	country estate (1 homesite)[9]	$ 875,000	$ 844,000	$ 31,000[10]	**$ 298**	**4%**[11]
Akers, 799 F.2d 243 (6th Cir. 1986)	Cheatham County, TN	1,343	multiple secluded recreational retreats[12]	6 secluded recreational retreats[13]	$ 694,000	$ 580,000	$ 114,000	**$ 85**	**16%**
Fannon, T.C. Memo. 1989-136	Rappahannock County, VA	142	28-lot residential development	agriculture & 3 residential lots	$ 213,000	$ 147,140	$ 65,860	**$ 464**	**31%**
Symington, 87 T.C. 892 (1986)	Middleburg, VA	61	4-6 homesites	country estate (1 homesite)[14]	$ 294,370	$ 202,000	$ 92,370	**$ 1,514**	**31%**
Thayer, T.C. Memo. 1977-370	Fairfax County, VA	60	3-5 luxury homesites	country estate (1 homesite)[15]	$ 342,500	$ 229,500	$ 113,000	**$ 1,883**	**33%**
Clemens et al., T.C. Memo. 1992-436	Martha's Vineyard, MA	140	40-lot subdivision	24-lot subdivision	$ 2,025,000	$ 1,322,000	$ 703,000	**$ 5,021**	**35%**
Fannon, 842 F.2d 1290 (4th Cir. 1988)[16]	Rappahannock County, VA	308	30-lot residential development	agriculture & 6 residential lots	$ 337,556	$ 215,775	$ 121,781	**$ 395**	**36%**
Dennis, 1992 WL 330398 (E.D.Va)	Rappahannock County, VA	83	---[17]	agriculture & 3 residential lots	$ 120,500	$ 69,890	$ 50,610	**$ 610**	**42%**
Strasburg, T.C. Memo. 2000-94	Sweet Grass County, MT	320	5 40-acre parcels or 10 parcels with approval[18]	2 parcels, 2 residences[19]	$ 2,624,000	$ 1,784,320	$ 839,680[20] $ 290,000[21]	**$ 3,530**	**43%**[22]
Higgins, T.C. Memo. 1990-103	Talbot County, MD	23	4 residential lots	1 residential lot	$ 235,000	$ 132,000	$ 103,000	**$ 4,478**	**44%**
Johnston et al., T.C. Memo. 1997-475	Sheridan County, WY	4,898	35+-acre lots; recreation & agriculture	recreation & limited agriculture[23]	$ 2,057,160	$ 925,722	$ 1,131,438	**$ 231**	**55%**
Stanley Works, 87 T.C. 389 (1986)	Litchfield, CT	668[24]	hydroelectric power plant	farmland	$ 6,650,000	$ 1,680,000	$ 4,970,000[25]	**$ 7,440**	**75%**
Browning, 109 T.C. 303 (1997)	Howard County, MD	52	15 residential lots	farm with 1 residence	$ 675,000	$ 157,000	$ 518,000[26]	**$ 9,962**	**77%**
Stotler et al., T.C. Memo. 1987-275	Monterey County, CA	1,584	low density residential subdivision[27]	scenic & habitat (1 stone cabin)[28]	$ 1,165,000	$ 100,000	$ 1,065,000	**$ 672**	**91%**
McLennan, 994 F.2d 839 (Fed. Cir. 1993)	Westmoreland County, PA	170[29]	country estate & 12-13 residential lots	country estate & 8 residential lots[30]	---	---[31]	$ 233,260	**$ 1,372**	**---**[32]
Schapiro, T.C. Memo. 1991-128	Baltimore & Harford Counties, MD	165 30	10 residential lots	agriculture & 1 residential lot[33]	---	---[34]	$ 375,000 $ 220,031	**$ 3,051**[35]	**---**
Schwab, T.C. Memo. 1994-232	Glen County, CA	1,558	farming & duck hunting club	hunting and fishing[36]	---	---[37]	$ 544,000	**$ 349**	**---**

Recent Cases	Property Location	Acres	HBU Before	HBU After	Before-Value	After-Value	Easement Value	Per-Acre CE Value	Reduction in Value
Mountanos, T.C. Memo. 2014-38	Lake County, CA	882	recreation	recreation	---	---[38]	$ 0	**$ 0**	**0%**
Trout Ranch, 493 Fed.Appx. 944 (10th Cir. 2012))[39]	Gunnison County, CO	384[40]	40-lot residential subdivision	21-lot shared amenities ranch	$ 4,450,000	$ 3,890,000	$ 560,000	**$ 1,458**	**13%**
Butler, T.C. Memo. 2012-72	Calhoun & Early Counties, GA	1,780 2,450[41]	agri- & silviculture, recreation, & residential (rural) development[43]	density reduced to 15 200+-acre tracts	$12,880,000 $11,524,800	$11,242,400 $ 9,212,000	$ 1,637,600 $ 2,312,800	**$ 934**[45]	**16%**[47]
	Muscogee County, GA	393 13[42]	residential development[44]	12 rural estates	$ 4,916,600 $ 279,400	$ 2,458,300 $ 140,000	$ 2,458,300 $ 139,400	**$ 6,398**[46]	**50%**[48]
Esgar Corp., et al., 744 F.3d 648 (10th Cir. 2014)	Prowers County, CO	54 54 54	agriculture	---[49]	$ 73,774 $ 76,503 $ 73,774	$ 24,000 $ 27,000 $ 24,000	$ 49,774 $ 49,503 $ 49,774	**$ 920**[50]	**67%**[51]
SWF Real Estate, T.C. Memo. 2015-63	Albemarle County, VA	675	38 low-density residential estate lots	no subdivision, 5 dwellings; agriculture, forestal & recreation	$10,460,000	$ 3,040,000	$ 7,350,000[52]	**$ 10,889**	**70%**
Schmidt, T.C. Memo. 2014-159	El Paso County, CO	40	13-lot subdivision (required rezoning)	1 homesite	$ 1,422,445	$ 270,000	$ 1,152,445	**$ 28,811**	**81%**
Hughes, T.C. Memo. 2009-94	Gunnison County, CO	2,413[53]	agriculture & recreation	agriculture & recreation; 2 residences[54]	$ 2,381,350	$ 388,975	$ 1,992,375	**$ 826**	**84%**[55]
Kiva Dunes, T.C. Memo. 2009-145	Baldwin County, AL	141	370-lot residential subdivision	golf course, park, agriculture	$31,938,985	$ 2,982,981	$28,656,004[56]	**$ 203,234**	**90%**
Palmer Ranch, T.C. Memo. 2014-79	Sarasota County, FL	82	360 multifamily units (required rezoning)	public recreation	$21,005,278	$ 1,050,264	$19,955,014	**$ 243,354**	**95%**
Boltar, 136 T.C. 326 (2011)	Lake County, IN	8[57]	single-family residential development	single-family residential development	---	---[58]	$ 42,400[59]	**$ 5,300**	**---**
Legg, 145 T.C. No. 13 (2015)	CO	80	---[60]	---	---	---	$ 80,000	**$ 1,000**	**---**

1. The early and recent cases, respectively, are listed in order of the percentage by which the conservation easement decreased the value of the subject property, from the lowest to the highest percentage.
2. This column lists the court-determined highest and best use (HBU) of the subject property before the easement donation.
3. This column lists the court-determined HBU of the subject property after the easement donation.
4. This column lists the court-determined value of the subject property before the easement donation.

5. This column lists the court-determined value of the subject property after the easement donation. In some cases (where the court did not do the computation) this value was computed by subtracting the court-determined easement value from the court-determined before-value.

6. This column lists the court-determined value for the easements.

7. This column lists the per-acre value of the easement, calculated by dividing the court-determined value of the easement by the number of acres the easement encumbers.

8. This column lists the percentage by which the easement or easements reduced the before-value of the subject property, assuming the court-determined values.

9. Even though the easement permitted the grantor and the grantor's heirs to subdivide the property into five parcels, the HBU of the property both before and after the easement was as a country estate because the surrounding area consisted of estate properties (and few subdivisions) and residents of the area historically had been opposed to development.

10. The court held that the IRS's determination of the allowable deduction was correct. According to the opinion, at trial the IRS's expert asserted a before-value of $875,000, an after-value of $854,000, and an easement value of $20,800. However, in its notice of deficiency, the IRS had asserted a value for the easement of $31,000. In entering judgment for the IRS, the court appeared to have accepted $31,000 as the value of the easement. Accordingly, the table lists a before-value of $875,000, an after-value of $844,000, and an easement value of $31,000.

11. The court found "untenable" the taxpayer's position that the diminution in value of their property as a result of the scenic easement was a "staggering" 40 percent.

12. The property consisted of two parcels, an 82-acre parcel consisting of 31 tracts and a 1,261-acre parcel that could be divided into as many as 24 tracts. However, dividing and selling the separate tracts would entail costs and time and the properties had no access to public water or public sewage and were appropriate for secluded recreational retreats. The court found that the IRS's expert reliance on comparable sales of 1,000- and 1,400-acre tracts in the area that could be divided to determine the before-value of the 1,261-acre tract was more appropriate than looking to sales of small lots.

13. The easement permitted construction of only 6 residences on the combined properties.

14. The easement prohibited subdivision and allowed only one single-family residential dwelling and ancillary structures and farm building and structures. The court noted that Middleburg, Virginia, is "widely regarded as a wealthy and prestigious section of Virginia containing many large country estates." The court also noted that, despite the acknowledged community attitude against subdivision, there was a ready demand for smaller, individual lots in the Middleburg area at the time of the donation.

15. The conservation easement allowed the existing manor house, maid's cottage, caretaker's cottage, and other ancillary structures, but prohibited any additional residences or subdivision.

16. The 4th Circuit opinion, which increased the value of the easement by $100 per acre, was unpublished.

17. The court did not discuss the HBU of the property before the donation in its short opinion.

18. The county had to approve subdivision of the property into ten parcels.

19. The easement initially permitted subdivision of the property into two parcels and the building of two residences in addition to the existing structures (i.e., owner's residence, caretaker's residence, guest cabin, and a bunkhouse). In a 1994 amendment to the easement, the taxpayer relinquished the right to build one of the two additional residences.

20. The taxpayer's deduction was limited to her $800,000 basis in the easement because she donated the easement less than one year after purchasing the property. *See* I.R.C. § 170(e)(1)(A). The court determined that the fair market value of the easement was $839,680.

21. This was the value of an amendment to the easement in which the taxpayer gave up the right to build an additional residence on the property.

22. This is the percentage by which the easement and the amendment reduced the value of the property.

23. The easement allowed the grazing and ranging of horses, cattle, and buffalo; the continued use of three cabins already existing on the property; and the construction of one additional cabin not to exceed a height of 20 feet and area of 1,500 square feet on each floor. The following activities were prohibited: subdivision and development; all residential, commercial, and industrial uses; oil and mineral exploration and extraction; timber harvesting; and the growing of crops. Livestock grazing was limited by 75 percent. In addition, the easement gave The Nature Conservancy several possessory rights, such as the right to enter the property, to cut and remove vegetation, and to conduct prescribed burns. The taxpayer's expert (whom the court found persuasive) said this was the most restrictive easement he had seen in more than 13 years appraising easements.

24. The easement encumbered 668 of the 2,100 acres owned by the taxpayer. The taxpayer had acquired the property between 1906 and 1916 for $48,582 with the intention of damming the Housatonic River and constructing a hydroelectric power plant. The easement had a 30.5-year term. For a brief period, the deduction for the donation of an easement was available with regard to easements having a minimum term of at least 30 years. *See* RICHARD P. POWELL, POWELL ON REAL PROPERTY §34A.04[2].

25. The easement barred all commercial development and the construction of a hydroelectric power plant and required preservation of the property in its scenic, natural, and open space condition for 30.5 years. The court stated that, "although the easement primarily affected only 668 acres of the property, it affected the value of the entire 2,100 acres because, under the terms of the easement, [the taxpayer] was precluded from constructing a power plant on any portion of the property." Thus, the value of the easement appears to have been based on the difference between the before- and after-values of the entire contiguous 2,100-acre parcel.

26. The taxpayers in *Browning* were paid $309,000 for the easement (i.e., they conveyed it in a "bargain sale" transaction). They claimed a deduction of $289,500.

27. The taxpayers obtained a plan proposing development of the property into 56 lots that "would probably" have received approval from the county. The taxpayers could also have used the "minor subdivision process" to divide the property into four parcels, and then the owner of each parcel could further divide each parcel into four parcels, which parcels could then be resold and divided into parcels as small as 10 acres (known as "4 x 4'ing"). The taxpayer's valuation expert asserted that maximum density on the property was 158 units, although due to the percentage of steep land the total development allowed would probably be less.

28. The easement prohibited structures on the property (except an existing stone cabin), advertising, and the planting of any vegetation not indigenous to the area. The general topography had to be maintained in its present condition. The owners retained the right to prune, trim, and maintain the plant and tree life on the property; the right to possess, use, and enjoy the land in a manner not inconsistent with the restrictions imposed; and the right to use, maintain, repair, and improve the existing stone cabin on the property.

29. The easement encumbered 170 of the 407 acres owned by the taxpayers.

30. The property consisted of two parts: frontage property including the taxpayer's residence, the HBU both before and after the easement of which was an undivided country estate, and the remaining property, the before-easement HBU of which was 12-13 residential lots and the after-easement HBU of which was 8 residential lots.

31. The court did not indicate the before- or after-values of the subject properties in the opinion.

32. The court determined the easement had no impact on the value of the country estate portion of the property. Without a before-value for the remaining portion of the property it is impossible to determine the reduction in the value of that property as a result of the easement donation.

33. The two parcels collectively constituted the taxpayers' "Tally Ho Farm." The property as a whole had a before-easement HBU of ten residential lots and an after-easement HBU of agriculture and one residential lot and a tenant house.

34. The court did not indicate the before- or after-values of the subject properties in the opinion.

35. This is the total value of the easements divided by the total acres encumbered ($595,031/195 = $3,051).

36. The Schwabs purchased certain rights in the 1,558-acre tract, including the right to prevent development as well as hunting and fishing rights. The Schwabs then donated the right to prevent development to the American Farmland Trust.

37. The court did not indicate the before- or after-values of the subject property in the opinion.

38. The court did not indicate the before- or after-easement values of the subject property in the opinion.

39. The 10th Circuit opinion was not selected for publication in the Federal Reporter and is not binding precedent but it may be cited for its persuasive value.

40. The easement encumbered 384 of the 453 acres owned by the taxpayer.

41. The two easements excluded 1,370 acres of the subject plantation.

42. Two easements were placed on properties owned by the taxpayers across the road from one another, with one of the easements excluding 24.5 acres surrounding the taxpayers' home.

43. The taxpayer's expert asserted that the HBU of the plantation before the easement was a working farm and shooting plantation and the IRS's expert asserted it was agriculture, silviculture, recreation, and low-density rural residential develop. The court did not specify the correct HBU of the plantation before the donation of the easements, but it relied on components of both parties' experts' analyses in determining the before value of the plantation.

44. The court concluded that a portion of the larger parcel could be rezoned for density higher than one house per acre. However, there also were lot size restrictions on portions of the larger parcel and some portions were not suitable for development. The court also noted that neighborhood with regard to both parcels was becoming attractive to developers, and the taxpayer had received three unsolicited offers from developers who wanted to purchase a small portion of the larger parcel.

45. This is the total value of the easements divided by the total acres encumbered ($3,950,400/4,230 = $934).

46. This is the total value of the easements divided by the total acres encumbered ($2,597,700/406 = $6,398).

47. This is the percent by which the two easements collectively reduced the value of the property ($24,404,800/$3,950,400 = 16).

48. This is the percent by which the two easements collectively reduced the value of the properties ($5,196,000/$2,597,700 = 50).

49. The court did not specifically address the HBU of the properties after the easement donations. The court did note that the easements grant the holder the right to preserve the natural, open space, wildlife, ecological, and environmental qualities of the properties and specifically prohibit the mining or extraction of sand, gravel, rock, or any other mineral.

50. This is the total value of the easements divided by the total acres encumbered ($149,051/162 = $920).

51. This is the percent by which the three easements collectively reduced the value of the properties ($224,051/$149,051 = 67).

52. This is the difference between the before- and after-values, reduced by $70,000, which is the amount the court determined that the donation of the easement enhanced the value of other property owned by the taxpayer.

53. The property consisted of two parcels.

54. One residence was permitted on each parcel.

55. The IRS did not assert an increased deficiency despite the lower value its expert asserted for the easement at trial, and the court sustained the original deficiency rather than coming up with its own value for the easement or accepting the lower value asserted by the IRS at trial. The court noted, however, that the partnership's expert's determination that the easement reduced the value of the properties by 70 percent was "too high."

56. This is the difference between the before- and after-values, reduced by $300,000, which is the amount the court determined that the donation of the easement enhanced the value of other property owned by the taxpayer.

57. The easement encumbered 8 of the 20 acres owned by the taxpayer.

58. The court did not indicate the before- or after-values of the subject property in the opinion.

59. The IRS did not assert an increased deficiency despite the lower value its expert asserted for the easement at trial, and the court sustained the original deficiency rather than coming up with its own value for the easement or accepting the lower value asserted by the IRS at trial.

60. The court did not address the before and after HBUs or values because the parties stipulated that the easement had a value of $80,000.