ORAL ARGUMENT NOT SCHEDULED

No. 10-1063

IN THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

DOROTHY JEAN SIMMONS,

Petitioner-Appellee

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellant

ON APPEAL FROM THE DECISION OF THE UNITED STATES TAX COURT

BRIEF FOR THE APPELLANT (PROOF)

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CERTIFICATE OF PARTIES, RULINGS AND RELATED CASES

A. *Parties and Amici*. The parties in the Tax Court and in this Court are Dorothy Jean Simmons and the Commissioner of Internal Revenue. The National Trust for Historic Preservation, the L'Enfant Trust, and the Foundation for the Preservation of Historic Georgetown appeared as *amici curiae*.

B. *Rulings under Review*. The rulings under review are the memorandum opinion of the Tax Court (Judge Robert Goeke) dated September 15, 2009, and the court's accompanying decisions entered on December 16, 2009.

C. *Related Cases*. To the best of their knowledge, counsel for the Commissioner are not aware of any previous or pending related cases in this Court.

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GLOSSARY

DEFRA	Deficit Reduction Act of 1984
IRS	Internal Revenue Service
L'Enfant	L'Enfant Trust

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ON APPEAL FROM THE DECISION OF THE UNITED STATES TAX COURT

BRIEF FOR THE APPELLANT

JURISDICTIONAL STATEMENT

The Commissioner of Internal Revenue appeals from the December 16, 2009 decisions of the United States Tax Court (Judge Robert Goeke) in two consolidated cases, which determined statutory deficiencies in the federal income taxes of Dorothy Jean Simmons

(taxpayer) for her 2003 and 2004 tax years. (Doc. 43; A. ___.)[1] Taxpayer filed in the Tax Court petitions for redetermination relating to these years on September 15, 2006. (Doc. 1; A. ___.) The Tax Court had jurisdiction over these petitions under Section 6213 of the Internal Revenue Code (26 U.S.C.) (I.R.C. or the Code) because they were filed within ninety days after the Commissioner mailed notices of deficiency, as authorized by I.R.C. § 6212(a).[2]

The Tax Court's decisions disposed of all the claims of all the parties for both years. (Doc. 43; A. ___.) The Commissioner filed notices of appeal on March 9, 2010 (Doc. 44; A. ___), which were timely

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[1] "Doc." references are to documents contained in the record, as numbered by the Clerk of the United States Tax Court. Although taxpayer filed a separate petition for each tax year, the court consolidated taxpayer's two cases on May 22, 2008, pursuant to Tax Ct. R. 141. (Doc. 22; A. ___.) The Tax Court continued, however, to treat the cases independently for purposes of maintaining the docket entries in the respective records. We shall not refer to documents filed in each case separately, unless necessary for purposes of clarity. "Ex." references are to the exhibits admitted at trial.

[2] Although the court did not enter the petitions until September 15, 2006, which was outside the ninety-day period, there is evidence to show that they were postmarked on September 11, 2006. Under I.R.C. § 7502, a properly addressed petition for redetermination that is post-marked within the 90-day period is deemed to be timely filed.

under I.R.C. § 7483 and Fed. R. App. P. 13(a)(2). This Court has jurisdiction under I.R.C. § 7482.

STATEMENT OF THE ISSUES

Whether the Tax Court erred in holding that façade easements taxpayer donated to L'Enfant Trust, Inc., in 2003 and 2004 with respect to two rowhouses she owned were "exclusively for conservation purposes" within the meaning of I.R.C. §§ 170(h)(1)(C) and (h)(5), and that the appraisals taxpayer obtained to establish the value of the easements satisfied the requirements of Section 155(a) of the Deficit Reduction Act of 1984 and 26 C.F.R. (Treas. Reg.) § 1.170A-13(c)(3)(ii), so that taxpayer was entitled to charitable contribution deductions for "qualified conservation contributions" under I.R.C. §§ 170(a), (f)(3)(B)(iii), and (h).

STATUTES AND REGULATIONS

The most apposite statutory authority is 26 U.S.C. § 170(a), (f), and (h), and the most pertinent regulation is 26 C.F.R. §§ 1.170A-13, 1.170A-14, which are set forth in an Addendum to this brief.

STATEMENT OF THE CASE

Taxpayer filed petitions in the Tax Court contesting the Commissioner's determinations of deficiencies in her 2003 and 2004 federal income taxes, as well as penalties relating thereto. (Doc. 1; A. ___.) Taxpayer argued that she was entitled to claim charitable contribution deductions for donations to the L'Enfant Trust of easements with respect to two rowhouses that she owned. Following a trial, the Tax Court concluded that, contrary to the determination of the Commissioner, taxpayer could claim charitable contribution deductions for the easements, but disagreed with the valuations of the easements offered by taxpayer. (Doc. 41; A. ___.) The Tax Court subsequently entered decisions consistent with its memorandum opinion (Doc. 43), and this appeal followed (Doc. 44; A. ___.)

STATEMENT OF FACTS

1. Taxpayer's properties

Taxpayer Dorothy Simmons owns two properties in fee simple in the Logan Circle neighborhood of Washington, D.C. Taxpayer's first property, where she also lived (Doc. 32 at ¶ 1; A. ___), is located at 17

Logan Circle (Ex. 9; A. ___). On this property sits a three-story rowhouse, which was built in 1870, and faces Logan Circle Park. (*Id.*) Taxpayer's other property is located at 1503 Vermont Ave, and consists of another three-story rowhouse, which taxpayer has divided into rental units. (Ex. 10; A. ___.) This rowhouse is northeast of Logan Circle and does not look onto the park. (*Id.*)

2. Pre-existing legal restrictions on the use of the properties

The Historic Landmark and Historic District Preservation Act of 1978, D.C. Code § 6-1101, *et seq.*, set forth the governing preservation regime for historic districts in the District of Columbia. All in all, the law applies to approximately 25,000 properties in the District, including, as relevant here, the Logan Circle neighborhood. (Doc. 36 at 74; A. ___).

The District's historic preservation scheme relies on a nine-member Historic Preservation Review Board, which advises the Mayor regarding the issuance of permits for demolition (§ 6-1104), alteration (§ 6-1105), subdivision (§ 6-1106), or new construction (§ 6-1107) in a historic district. D.C. Code § 6-1103(c)(1). Before a permit may issue

for demolition, alteration, subdivision, or new construction in a historic district in the District of Columbia, "the Mayor shall review the permit application in accordance with this section and place notice of the application in the District of Columbia Register." D.C. Code § 6-1104(a). *See also* D.C. Code §§ 6-1105(a), 6-1106(a), 6-1107(a). The code further requires referral of such applications for permits to the Historic Preservation Review Board for its recommendation. *See* D.C. Code §§ 6-1104(b), 6-1105(b), 6-1106(b), 6-1107(b). The D.C. Code also requires property owners in a historic district to maintain their property, providing that the "buildings or structures shall be preserved against decay and deterioration and shall be made and kept free from structural defects through prompt correction of defects." D.C. Code § 6-1109.02(a).

The historic preservation scheme entrusts the Historic Preservation Office with "responsib[ility] for enforcement," placing both criminal and civil enforcement mechanisms at its disposal. D.C. Code § 6-1110(d)(1). A person in violation of "any provision of this subchapter or of any regulation under the authority of this subchapter

shall, upon conviction, be fined not more than $1,000 for each day a violation occurs or continues or be imprisoned for not more than 90 days, or both." D.C. Code § 6-1110(a). Moreover, any "person who demolishes, alters or constructs a building or structure in violation of § 6-1104, § 6-1105, or § 6-1107 shall be required to restore the building or structure and its site to its appearance prior to the violation." D.C. Code § 6-1110(b). "Civil fines, penalties, and fees may be imposed as alternative sanctions for any infraction." D.C. Code § 6-1110(b).

In addition to reviewing applications submitted pursuant to the law, the Office's inspectors visit properties "if someone doesn't obtain a permit prior to performing the work on a façade." (Doc. 36 at 78; A. ___.) During 2003 and 2004, the Office conducted approximately 1,000 inspections per year. (*Id.*) According to the State Historic Preservation Officer, "in those years, we were running, I believe, . . 200 to 250 stop work orders, maybe 100 to 150 violation notices, and probably around 75 to 100, maybe not quite that many, maybe 75 notices of infraction." (*Id.*)

3. Taxpayer's grants of easements

On November 18, 2003, taxpayer executed a document styled as a "Conservation Easement Deed of Gift," by which she purported to grant "an easement in gross, in perpetuity, in, on, and to the Property, the Building and the Façade"[3] to the L'Enfant Trust (L'Enfant), relating to her property at 17 Logan Circle. (Ex. 7 at 2; A. ___.) L'Enfant is a tax exempt entity under I.R.C. § 501(c)(3), which, according to the testimony of its president at trial, aims to "promote a 'public, aesthetic, land-use planning,'" or, in other words, "to keep the streets and buildings in Washington beautiful." (Doc. 36 at 12; A. ___.)

The deed provided that "without the express written consent of [L'Enfant], which consent may be withheld, conditioned or delayed in the sole and absolute discretion of [L'Enfant]," taxpayer would not undertake: (i) any "alteration, construction, or remodeling of existing improvements on the Property;" (ii) the extension of existing improvements on the property, or erection of any new or additional

[3] "The term 'Façade' as used herein consists of all exterior surfaces of the improvements on the Property, including all walls, roofs, and chimneys . . . ." (*Id.* at 1; A. ___.)

improvements; and (iii) the painting or cleaning of the Façade in a manner incompatible with the protection and preservation of the Façade." (*Id.*) The deed continued that taxpayer "further undertakes periodically to clean the Façade, to keep [L'Enfant's] marker polished and visible from the street, and to maintain the Property, Building and Façade in good repair and condition at all times." (*Id.*) The deed also provided that any work on the property "will comply with the requirements of all applicable federal, state and local government law and regulations." (*Id.*) The parties further stated that L'Enfant had the right to inspect the property, and, in the event of a violation, could institute legal proceedings against taxpayer to enforce its easement. (*Id.* at 3; A. ___.) According to the deed, the easement was binding "upon [taxpayer's] successors, heirs and assigns and all other successors in interest," and would "survive any termination of [L'Enfant's] or [taxpayer's] existence." (*Id.*)

While establishing the general contours of L'Enfant's rights under the easement, the deed also explicitly recited that "nothing herein contained shall be construed to limit [L'Enfant's] right to give its

consent (e.g., to changes in a Façade) or to abandon some or all of its rights hereunder." (*Id.*) The parties did not set forth a mechanism in the deed for the maintenance of the easement should L'Enfant cease to exist or abandon its rights. (*Id.*)

The deed finally noted that the property "is currently encumbered by . . . loans payable to National City Mortgage and Countrywide Home Loans." (*Id.* at 4; A. ___.) According to the deed, "[l]enders hereby subordinate their rights in the Property to the right of [L'Enfant], its successors or assigns, to enforce the conservation purposes of this easement in perpetuity." (*Id.*) Representatives of both lenders executed acknowledgments of the conservation easements, which were attached to the deed. (*Id.* at 5-6; A. ___.) Neither acknowledgment indicated assent to the proposition set forth in the easement that the lenders' rights were subordinated to the easement.

On January 26, 2004, taxpayer executed a "Conservation Easement Deed of Gift" for 1503 Vermont Avenue, pursuant to which she granted an easement to the L'Enfant Trust. (Ex. 8; A. ___.) This deed was, in pertinent part, identical to the deed relating to 17 Logan

Circle, and contained a lender acknowledgment of conservation easement by a representative of National City Mortgage, the mortgage holder on that property. (*Id.*)

4. Taxpayer's claim of charitable deductions for the grants of the facade easements

Despite several extensions, taxpayer did not file timely tax returns for 2003 and 2004. The Internal Revenue Service (IRS) prepared a substitute for return for each year, as permitted by I.R.C. § 6020(b), and thereafter issued notices of deficiency to taxpayer. (Exs. 3-4; A. ___.) The deficiency notice for 2003 asserted a tax deficiency of $84,739.60, as well as penalties for failure to file a return (I.R.C. § 6651(a)(1)) in the amount of $19,066.41, failure to pay tax (I.R.C. § 6651(a)(2)) in the amount of $10,168.75, and failure to pay estimated income tax (I.R.C. § 6654) in the amount of $2,217.64. (Ex. 3; A. ___.) The deficiency notice for 2004 asserted a tax deficiency of $67,752, as well as penalties for failure to file a return (I.R.C. § 6651(a)(1)) in the amount of $15,244.20, failure to pay tax (I.R.C. § 6651(a)(2)) in the amount of $4,065.12, and failure to pay estimated income tax (I.R.C. § 6654) in the amount of $1,966.63. (Ex. 4; A. ___.)

Taxpayer timely filed petitions for redetermination in the Tax Court relating to each year. (Doc. 1; A. ___.) Taxpayer did not elaborate on the grounds underlying these petitions, but rather stated identically in both that "I am entitled to such relief because I have documentation to prove that the IRS determination is in error, and . . . after this date – September 11, 2006 – I will lose my right to the Court's relief." (*Id.*)

Thereafter, taxpayer filed returns for each year.[4] On the 2003 return, taxpayer claimed a charitable deduction of $162,500 with respect to the donation of the facade easement on the Logan Circle property to L'Enfant. (Ex. 5; A. ___.) On the 2004 return, taxpayer claimed a charitable deduction of $93,000 with respect to the donation of the facade easement on the Vermont Avenue property to L'Enfant.[5] (Ex. 6; A. ___.)

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[4] The IRS did not process the returns because of the pending Tax Court litigation. (Doc. 32 at ¶ 20; A. ___.)

[5] Taxpayer also claimed charitable deductions for cash donations to L'Enfant of $8,625 in 2003 and $4,378 in 2004. (Exs. 5-6; A. ___.) L'Enfant required donors of conservation easements to make such cash contributions in order to fund the monitoring and enforcement of the contributed easements. (Doc. 36 at 17; A. ___.)

In support of the claimed charitable deductions, taxpayer submitted the appraisal of the fair market value of each easement by James Donnelly. (Exs. 9-10; A. ___.) Each appraisal notes that "the owners [*sic*] of the subject property are contemplating a donation of a conservation easement to L'Enfant Trust." (Ex. 9 at 15; A. ___; Ex. 10 at 28; A. ___.) Each appraisal also states that the easements were "far more onerous" than District of Columbia law, as that law could be changed, and, further, that L'Enfant could require "that actions be carried out with respect to the property that go far beyond anything carried in D.C. law." (Ex. 9 at 19-20; A. ___; Ex. 10 at 32-33; A. ___.)

Donnelly began by using a sales comparison approach to determine the values of the properties before the granting of the easements. After considering three sales Donnelly found to be comparable, Donnelly determined that, prior to the grant of the easement, the Logan Circle property had a fair market value of $1,250,000. (Ex. 9 at 9-13; A. ___.) After considering five sales Donnelly found to be comparable, Donnelly determined that, prior to

the grant of the easement, the Vermont Avenue property had a fair market value of $845,000. (Ex. 10 at 13-26; A. ___.)

In determining the after-easement value of the properties, Donnelly merely reduced the before-easement value by a percentage of its value. Each appraisal stated (Ex. 9 at 21; A. ___; Ex. 10 at 34; A. ___) in this regard as follows:

> We have examined numerous sales of easement-encumbered properties and have talked to various parties at interest. We have also considered the potential costs of owning a facade easement property that may be in excess of those ordinarily expected for comparable structures. Beyond the factors from which a dollar figure can reasonably be derived based on hard cost data, our discussions with others active in the marketplace has led us to consider subjective and conjectural factors which we believe may impact on value.

The appraisals do not specifically identify the properties examined or the parties spoken with, nor do they identify what subjective and conjectural factors were considered.

The appraisal of the Logan Circle property continued (Ex. 9 at 21; A. ___) as follows:

> it is generally recognized by the Internal Revenue Service (IRS) that the donation of a facade easement of a single family property results in a loss of value ("dedicated

> charitable contribution") between 10% and 15%.[6] The donation of a commercial property results in a loss of value between 10% and 12% or higher if development rights are lost. The inclusive data support at least these ranges. Since the subject is a very valuable building and land parcel with extensive facade area, we estimate that the subject's loss of value from the donation of the easement is 13% of the value before the easement, $1,250,000, which equates a loss (dedicated charitable contribution) of: One Hundred Sixty Two Thousand Five Hundred Dollars ($162,500.00) (Rounded).

The appraisal of the Vermont Avenue property contains an identical paragraph, except that it concludes that the diminution in value as a result of the granting of the easement was approximately 11% of the pre-easement value of that property of $845,000, and thus that the fair market value of the easement was $93,000. (Ex. 10 at 34; A. ___.)

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[6] Earlier in each appraisal, it was stated that IRS engineers had concluded that a facade easement donation resulted in a 10% to 15% diminution in value to the property, citing an IRS "article." (Ex. 9 at 19; A. ___; Ex. 10 at 32; A. ___.) The IRS, in fact has specifically disavowed having any such "safe harbor." *See* Chief Counsel Memorandum 201002038 (Jan. 15, 2010); Chief Counsel Memorandum 200738013 (Sept. 21, 2007).

5. The Tax Court proceedings

In the Tax Court, the parties settled all issues except the claimed deductions for the facade easement donations. I.R.C. § 170(a) allows a deduction for charitable contributions. Under I.R.C. § 170(f)(3)(A), no deduction is allowed with respect to contributions of a partial interest in property. I.R.C. §170(f)(3)(B)(iii) provides, however, that a deduction for a contribution of a partial interest in property is allowable for a "qualified conservation contribution." I.R.C. § 170(h)(1) defines a "qualified conservation contribution" as a contribution "(A) of a qualified real property interest, (B) to a qualified organization, (C) exclusively for conservation purposes." As relevant here, a "qualified real property interest" is defined by I.R.C. § 170(h)(2)(C) as "a restriction (granted in perpetuity) on the use which may be made of the real property." A "qualified organization" includes organizations exempt from federal income tax under I.R.C. § 501(c)(3). A "conservation purpose" is defined, as relevant here, by I.R.C. § 170(h)(4)(A)(iv) as "the preservation of an historically important land area or a certified historic structure." Finally, I.R.C. § 170(h)(5)(A)

provides that "[a] contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity."

As relevant here, Section 155(a)(1) and (2) of the Deficit Reduction Act of 1984 (DEFRA), Pub. L. No. 98-369, 98 Stat. 691, required the Secretary of the Treasury to prescribe regulations which require individuals claiming charitable deductions to obtain "qualified appraisals" for any property valued at greater than $5,000. Section 155(a)(4) of DEFRA defined a "qualified appraisal" as an appraisal by a qualified appraiser that includes "(A) a description of the property, (B) the fair market value of such property on the date of the contribution and the specific basis for the valuation, (C) a statement that such appraisal was prepared for income tax purposes, (D) the qualifications of the qualified appraiser, (E) the signature and TIN [taxpayer identification number] of such appraiser, and (F) such additional information as the Secretary prescribes in such regulations." In accordance with Section 155 of DEFRA, the IRS issued Treas. Reg.

§ 1.170A-13. Under that regulation, a qualified appraisal "shall" include: (A) a sufficiently detailed description of the property so a person who is not generally familiar with the type of property can ascertain that the property appraised is the property to be donated; (B) the physical condition of the property; (C) the date (or expected date) of the donation; (D) the terms of any restrictions, use, or any other agreement made by or on behalf of the donor or donee with respect to the property donated; (E); the name and address of the appraiser; (F) the qualifications of the appraiser; (G) a statement that the appraisal was prepared for income tax purposes; (H) the date on which the property was appraised; (I) the fair market value of the property on the date (or expected date) of contribution; (J) "[t]he method of valuation used to determine the fair market value, such as the income approach, the market-data approach, and the replacement-cost-less-depreciation approach"; and (K) "[t]he specific basis for the valuation, such as specific comparable sales transactions or statistical sampling, including a justification for using sampling and an explanation of the sampling procedure employed." Treas. Reg.

§ 1.170A-13(c)(3)(ii).

The Commissioner argued that the easements were not granted "exclusively for conservation purposes" within the meaning of I.R.C. § 170(h)(1) and (5). (Doc. 38 at 35-38.) The Commissioner explained that the deeds' explicit reservations of L'Enfant's right to consent to any changes, or abandon its rights altogether, meant that the easements failed to "prohibit[] any change in the exterior of building which is inconsistent with the historical character of such exterior," as required by I.R.C. § 170(h)(4). (*Id.* at 35-37.)

The Commissioner further asserted that L'Enfant's right to abandon its obligations, sanction changes, or simply not enforce its rights under the easements (either through negligence or non-existence) meant that the easements did not ensure that the conservation purpose would be protected "in perpetuity," as required by I.R.C. § 170(h)(5). (*Id.* at 37.) The Commissioner also argued that the easements were not "granted in perpetuity because the subordination requirement of Treas. Reg. § 1.170A-14(g)(2) was not satisfied." (*Id.*) On this point, the Commissioner observed that the mortgage holders'

acknowledgments of the easements did not explicitly subordinate their interests to that of L'Enfant, as necessary to be deemed enforceable in perpetuity under the regulation. (*Id.* at 37-38.)

The Commissioner further argued that, even if the easements were exclusively for conservation purposes, taxpayer still could not claim the deduction because she failed to submit qualified appraisals (*id.* at 38-50), or meet her burden of proof to establish the claimed fair market value of the easements donated (*id.* at 50-59). The Commissioner argued that the Donnelly appraisals were not qualified appraisals because they did not identify the bases for their valuation conclusions, instead relying on "an unacceptable mechanical application of nonexistent methodology." (*Id.* at 47.) The Commissioner concluded that, given the lack of analysis in the appraisals, taxpayer had failed to establish the fair market value of the easement. (*Id.* at 50-59.) The Commissioner further observed that the appraisals did not describe the property donated accurately (*id.* at 40-43), did not include statements that the appraisals were prepared for tax purposes (*id.* at 48), and did not include the dates of the contributions (*id.* at 49).

In support of his arguments, the Commissioner submitted appraisals for both properties from Peter Wolman, a senior appraiser with the IRS. (Exs. 16-17; A. ___.) For the Logan Circle property, Wolman utilized a sales comparison approach, which relied on a "before and after valuation technique used to ascertain market reaction to a façade conservation easement to L'Enfant Trust." (Ex. 16 at 25; A. ___.) After reviewing several sales of similar properties, Wolman determined that the "indicated subject value before easement is reconciled to $1,175,000." (*Id.* at 28; A. ___.) For the "after" façade easement valuation, Wolman looked for properties that shared the identical attributes of the properties used for the before valuation, "except that all comparable sales sold encumbered by a façade conservation easement to L'Enfant Trust." (*Id.* at 34; A. ___.) Wolman explained that he discussed the effect of façade easements on selling prices with the listing agents for each of the properties he examined, and the agents uniformly stated that such an easement "did not affect the selling price of their transactions." (*Id.* at 35; A. ___.) Wolman ultimately determined that the "indicated subject value after easement

is reconciled to $1,175,000" (*id.* at 36; A. ___), "which indicated no market reaction of significance to a façade conservation easement to L'Enfant Trust" (*id.* at 43; A. ___). Wolman explained that, "[d]espite the technical diminishment of property rights in the after situation, certain easements have such a minimal effect on market value that no discernible difference in the before and after can be ascertained." (*Id.*)

For the valuation of the easement relating to the Vermont Avenue property, Wolman again employed the sales comparison approach.[7] (Ex. 17 at 23-24; A. ___.) Wolman analyzed the sale of three properties as the comparables for the before easement valuation, which "indicated subject value before easement is reconciled to $860,000." (*Id.* at 29;

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[7] Wolman also employed a second method, the income capitalization model, because the Vermont Avenue property was a rental property. He noted, however, that the "income approach is distinctly secondary to sales comparison in this situation" (Ex. 17 at 25; A. ___), because "many owner-occupied dwellings in the subject's market area also have one or more rental units" (*id.* at 24; A. ___). Wolman ultimately concluded that "insufficient market data were available to directly demonstrate the effect upon market rent" of a façade easement, but that "it's simply illogical to presume that market rent would change" because "a façade easement is irrelevant to tenants and it's certainly not reasonable to expect that landlords would promptly reduce of increase rents solely due to the easement." (*Id.* at 44; A. ___.)

A. ___.) For the after easement valuation, he "specifically asked the listing broker and buyer broker for each sale to discuss the effect of the L'Enfant Trust easement upon the selling price and marketability, all of whom stated that it had no impact of significance." (*Id.* at 35; A. ___.) Consistent with this market evidence, the "subject value via sales comparison after easement is equal to that concluded before easement of $860,000." (*Id.* at 36; A. ___.) Wolman concluded "the fair market value of the façade conservation easement placed on the subject property at the effective date is $0." (*Id.* at 45; A. ___.)

Taxpayer argued that the easements complied with the requirements for a charitable contribution under I.R.C. § 170, and that the Donnelly appraisals both constituted qualified appraisals and established the fair market value. (Doc. 37.) In addition to the Donnelly appraisals, taxpayer relied on the testimony of the president of L'Enfant. She testified that she believed L'Enfant provided much more rigorous supervision of the properties than did the District of Columbia. (Doc. 36 at 28-29, 39-41; A. ___.)

6. The Tax Court opinion

The Tax Court held that the easements constituted charitable contributions deductible under I.R.C. § 170. (Doc. 41; A. ___.) The court first concluded that the easements were "exclusively for conservation purposes," based on Treas. Reg. § 1.170A-14(d)(5). (*Id.* at 11; A. ___.) According to the court, this regulation "specifically allows a donation to satisfy the conservation purposes test even if future development is allowed, as long as that future development is subject to local, State, and Federal laws and regulations." (*Id.*) Given that "the grants require any rehabilitative work or new construction on the façades to comply" with such law, the court concluded that the necessary conservation purpose had been established. (*Id.*) The court also found that both deeds explicitly incorporated the lender acknowledgments, and concluded therefrom that the interests of the mortgage holders thus had been properly subordinated to L'Enfant's rights. (*Id.* at 12; A. ___.)

Turning to whether taxpayer had submitted qualified appraisals as to the values of the easements, the court determined that the

appraisals "were qualified" (*id.* at 17; A. ___) because they substantially complied with the requirements of Treas. Reg. § 1.170A-13. The court held that the "appraisals adequately describe the parcels of land owned by petitioner and the structures built thereon." (*Id.*) The court further stated that "the appraisals contain statistics gathered by L'Enfant and the Capital Preservation Alliance that Mr. Donnelly took into account in preparing the appraisals," and that they "identify the method of valuation used and the basis for the valuations reached." (*Id.* at 17-18; A. ___.) The court further stated that, while the appraisals did not contain an explicit statement that they were prepared for income tax purposes as required by the regulation, they did contain statements that taxpayer was contemplating donating the easements to L'Enfant. (*Id.* at 18; A. ___.)

The Tax Court then proceeded to value the easements employing the "before and after" approach utilized by both parties. (*Id.* at 18-26; A. ___.) The court noted that the "before" valuations of the Logan Circle and Vermont Avenue properties of the parties were very close–$1,250,000 and $845,000 by taxpayer and $1,175,000 and

$860,000 by the IRS, respectively. (*Id.* at 20; A. ___.) The court adopted the taxpayer's before valuations, concluding that the Donnelly appraisals "were completed closer to when the easements were granted," and that Donnelly had credibly testified that "the Logan Circle parcel's view would be taken into account when determining the fair market value of the property." (*Id.* at 21; A. ___.)

As to the "after" valuation, the Tax Court concluded that "the easements resulted in only a 5-percent reduction in the values of the subject properties." (*Id.* at 24-25; A. ___.) The court stated that "[t]his decrease stemmed "from the heightened financial burdens of an eased façade and L'Enfant's affirmative enforcement of its easements," and "[b]ecause the restrictions imposed by the easements are the same for both the Logan Circle and Vermont Avenue parcels, the subject properties are entitled to the same reductions." (*Id.* at 25; A. ___.) The court further stated that the fact that the properties were already subject to District of Columbia preservation laws did not prevent charitable contribution deductions, as "granted easements to L'Enfant meant that petitioner would be subject to a higher level of enforcement

than that provided by the District of Columbia," and "L'Enfant could also dictate what types of supplies and materials had to be used when work was being done on a donated easement." (*Id.* at 25-26; A. ___.) "Even if we were to accept respondent's contention that the easements did not impose any restrictions on petitioner over and above those imposed by the District of Columbia," the court continued, "the easements still added an additional level of approval before any changes could be made to the properties." (*Id.* at 26; A. ___.) The court did not explain in any greater detail how it determined that the value of the easements amounted to 5% of the property value, rather than some other number. Nor did the court explain why it is correct to use any percentage of value of the underlying property as the value of the easement.

Accordingly, the court held that taxpayer was entitled to charitable contribution deductions of $56,250 for 2003 (5% of the "before" value of $1,250,000 of the Logan Circle property) and $42,250 for 2004 (5% of the "before" value of $845,000 of the Vermont Avenue property). (Doc. 43; A. ___.)

The Commissioner now appeals. (Doc. 44; A. ___.)

SUMMARY OF ARGUMENT

This federal income tax case concerns charitable contribution deductions that taxpayer claimed with respect to easements she granted to L'Enfant on two pieces of property. Donations of partial interests in property generally are not deductible as charitable contributions. An exception exists, however, for donations of partial interests that are "qualified conservation contributions," as that term is defined in the Internal Revenue Code. At issue here is whether the easements were "qualified conservation contributions," and, further, whether taxpayer obtained qualified appraisals, as required to claim a deduction for a charitable contribution property in excess of $5,000. Provisions for deductions, being a matter of legislative grace, are construed narrowly, and the burden is on taxpayer to show that she is entitled to her claimed deductions.

1. As relevant here, the donation of an easement constitutes a qualified conservation contribution only if it is made "exclusively for conservation purposes." I.R.C. § 170(h)(1). In addition, the

conservation purpose must be protected in perpetuity under I.R.C. § 170(h)(5). Under the relevant Treasury Regulation, the easement must contain "legally enforceable restrictions . . . that will prevent uses of the retained interest inconsistent with the conservation purposes of the donation." Treas. Reg. § 1.170A-14(g)(1).

Here, the terms of the easement deeds defeat a conclusion that the easements were donated "exclusively for conservation purposes," as necessary to constitute a qualified conservation contribution, and thus taxpayer is not entitled to the claimed deductions. Although the deeds state that the easements are granted "in perpetuity," they both expressly provide that "nothing herein contained shall be construed to limit the Grantee's right to give its consent (e.g., to changes in the Façade) or to abandon some or all of its rights hereunder." (Ex. 7 at 3; A. ___; Ex. 8 at 3; A. ___.) This language certainly does not prohibit changes "inconsistent with the historical character of such exterior," as necessary to satisfy the regulation, since L'Enfant can consent to changes without regard to preservation purposes. Moreover, L'Enfant reserved its right to abandon its rights for any number of reasons, thus

eliminating the necessary assurance that L'Enfant "will" prohibit uses inconsistent with the conservation purpose. These reserved rights also foreclose the conclusion that the easements protect the conservation purpose in perpetuity pursuant to I.R.C. § 170(h)(5). Should L'Enfant abandon its rights of enforcement, as expressly considered and permitted in the deeds, or cease to exist, the easements would become paper tigers, powerless to ward off inconsistent uses, and, therefore, clearly not protecting conservation purposes in perpetuity. The rights granted to L'Enfant dictate that the easements cannot be qualified conservation contributions.

Nor does the Tax Court's opinion compel otherwise. The Tax Court asserted that the easements are valid conservation easements based on its erroneous belief that Treas. Reg. § 1.170A-14(d)(5) specifically allows a donation to satisfy the conservation purposes test even if future development is allowed, as long as that future development is subject to local, State, and Federal laws. (Doc. 41 at 11; A. ___.) The Tax Court misinterpreted this regulation; in fact, the Treasury Regulation sets forth a minimum requirement for the

charitable contribution deduction, not a safe harbor. Compliance with the local laws is a necessary, but not sufficient, condition, and thus the Tax Court was incorrect to conclude that such compliance alone meant that taxpayer's donations had been made "exclusively for conservation purposes."

2. Taxpayer also fails to qualify for a charitable contribution deduction because she did not obtain "qualified appraisals." In Section 155 of the Deficit Reduction Act of 1984 (DEFRA), Congress required that a taxpayer submit a qualified appraisal to claim a charitable contribution deduction of property in excess of $5,000, and specifically delegated to the IRS the authority to define the elements of such a qualified appraisal. The IRS subsequently issued Treas. Reg. § 1.170A-13, which set forth various required elements for a qualified appraisal, including: "[t]he method of valuation used to determine the fair market value"; and "[t]he specific basis for the valuation." Treas. Reg. § 1.170A-13(c)(3)(ii). The Donnelly appraisals did not comply with the requirements set forth in the Treasury Regulation, failing to include, *inter alia*, the valuation method for determining the fair

market value of the properties in the wake of the easements, and specific bases for the valuations.

The Tax Court ruled, however, that taxpayer's appraisals substantially complied with the terms of the regulation. The Tax Court's holding was in error. The doctrine of substantial compliance has no place here, as the Treasury Regulation promulgated in response to Congress' specific delegation of authority offers no suggestion whatsoever that its requirements are directory, not mandatory. Moreover, even if the regulation could be satisfied by substantial compliance, the doctrine still would not rescue the appraisals in this case. The doctrine applies to absolve an appraisal's procedural failings, not to excuse the lack of substantive analysis that must be at an appraisal's core. Devoid of any such substantive analysis, the Donnelly appraisals, and the Tax Court's valuations that grew out of them, were exercises in mere guesswork. Taxpayer's failure to meet the procedural and substantive requirements for a qualified appraisal, therefore, prevents her from claiming charitable contribution deductions for her donations to L'Enfant.

The decisions of the Tax Court should be reversed.

ARGUMENT

The Tax Court erred in holding that taxpayer was entitled to charitable contribution deductions for the façade easements granted to L'Enfant because the easements were not qualified conservation contributions, and taxpayer failed to obtain qualified appraisals

Standard of Review

This Court reviews the Tax Court's findings of fact for clear error, and questions of law *de novo*. *See, e.g., Jombo v. Commissioner*, 398 F.3d 661, 663 (D.C. Cir. 2005); *Andantech, L.L.C. v. Commissioner*, 331 F.3d 972, 976 (D.C. Cir. 2003).

I

The Tax Court erred in holding that the 2003 and 2004 easements were "qualified conservation contributions"

A. Introduction

At issue in this case is taxpayer's attempt to deduct as charitable contributions under I.R.C. § 170 two façade easements she gave to L'Enfant on property that she owned. It is well-settled that provisions "granting a deduction are matters of 'legislative grace,'" *Chrysler Corp.*

v. Commissioner, 436 F.3d 644, 654 (6th Cir. 2006), which "are strictly construed and allowed only 'as there is a clear provision therefor.'" *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992) (quoting *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934)). *See also Deputy v. duPont*, 308 U.S. 488, 493 (1940); *Kirk v. Commissioner*, 425 F.2d 492, 494 (D.C. Cir. 1970). Thus "a taxpayer who seeks a deduction bears the burden of demonstrating a clear entitlement." *Telecom*USA, Inc. v. United States*, 192 F.3d 1068, 1072 (D.C. Cir. 1999). *See also INDOPCO, Inc.*, 503 U.S. at 84. Although the Tax Court acknowledged the general principle that a taxpayer has the burden of proving entitlement to the deductions claimed (Doc. 41 at 7; A. ___), it adopted a broad reading of the deduction at issue. As we demonstrate below, however, whether interpreted broadly or (as we believe to be correct) narrowly, the Tax Court's decision here is erroneous.

1. Section 170(a) of the Code provides for the deduction of charitable contributions.[8] No deduction is allowable, however, for

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[8] As will be discussed in greater detail *infra*, to claim a charitable contribution deduction "[i]n the case of contributions of property for (continued...)

contributions to charity of less than the taxpayer's entire interest in property. I.R.C. § 170(f)(3)(A). An exception to this rule, provided in I.R.C. § 170(f)(3)(B)(iii), allows a deduction for a contribution of a partial interest in property which constitutes a "qualified conservation contribution." The term "qualified conservation contribution" is defined in I.R.C. § 170(h).

Present I.R.C. § 170(h) was enacted by the Tax Treatment Extension Act of 1980, Pub. L. 96-541, § 6(a), 94 Stat. 3206. Prior to that enactment, deductions for conservation easements were available under less comprehensive statutory schemes. When Congress, in the Tax Reform Act of 1969, Pub. L. 91-172, § 201(a), 83 Stat. 549, initially prohibited the deduction for contributions of partial interests in property, it carved out an exception for the contribution of "an undivided portion of the taxpayer's entire interest in property." I.R.C. § 170(f)(3)(B)(ii) (1969).

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[8](...continued)
which a deduction of more than $5,000 is claimed," the taxpayer also must obtain a "qualified appraisal." I.R.C. § 170(f)(11)(C).

Seven years later, Congress added two items to the list of exceptions from the general rule that gifts of partial interests are not deductible: first, a lease, option to purchase, or easement over real property of not less than 30 years duration granted exclusively for conservation purposes; and second, a remainder interest granted exclusively for conservation purposes. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2124(e)(1)(C) & (D); enacted as I.R.C. § 170(f)(3)(B)(iii) and (iv) (1976). The statute also defined the term "conservation purposes" to include "the preservation of historically important land areas or structures." I.R.C. § 170(f)(3)(C)(ii) (1976). Both changes were part of an amendment proposed on the Senate floor, for the purpose of altering the tax incentives relating to historical structures. *See* 122 Cong. Rec. S24317-24323 (daily ed. July 28, 1976) (discussion of amendment 1905). All these provisions were set to expire on June 14, 1977, one year after they became effective. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2124(e)(4). The next year, Congress substituted, for the requirement that the partial interest be "of not less than 30 years duration," the requirement that the interest be granted "in

perpetuity." Tax Reduction and Simplification Act of 1977, P.L. 95-30, § 309(a) (enacted as I.R.C. § 170(f)(3)(B)(iii) (1977)). Congress also extended the sunset date for an additional four years, to June 14, 1981. *Id.* § 309(b).

As part of the Tax Treatment Extension Act of 1980, Congress modified and reorganized these provisions and reenacted them as present I.R.C. § 170(h). Pub. L. 96-541, § 6(a), 94 Stat. 3206. The Tax Treatment Extension Act of 1980 also made the provision permanent for the first time. In this final enactment,[9] Congress recognized that, in permitting deductions for conservation easements, it was necessary to balance the importance of preserving this country's natural resources and cultural heritage against the "recogni[tion] that it is not in the country's best interest to restrict or prohibit the development of all land areas and existing structures," S. Rep. No. 96-1007, at 9 (1980), 1980-2 C.B. 599, 603, and further to balance the potential public benefit from conservation easements against the potential for abuse, *id.*; *see also*

[9] Though there have been minor changes to I.R.C. § 170(h) since 1980, the provisions at issue here have not been modified since that time.

H.R. Rep. No. 96-1278, at 15 (1980). To balance these considerations, the Senate Committee on Finance indicated that "provisions allowing deductions for conservation easements should be directed at the preservation of unique or otherwise significant land areas or structures," S. Rep. No. 96-1007, at 9-10, 1980-2 C.B. at 603, and explained that "the committee bill would restrict the qualifying contributions where there is no assurance that the public benefit, if any, furthered by the contribution would be substantial enough to justify the allowance of a deduction," *id.*; *see also* H.R. Rep. No. 96-1278, at 15 (1980).

2. The term "qualified conservation contribution" is defined in present I.R.C. § 170(h) as a contribution "of a qualified real property interest" (I.R.C. § 170(h)(1)(A)), "to a qualified organization" (I.R.C. § 170(h)(1)(B)), "exclusively for conservation purposes" (I.R.C. § 170(h)(1)(C)). The term "qualified real property interest" is defined, as relevant here, as "a restriction (granted in perpetuity) on the use which may be made of the real property." I.R.C. § 170(h)(2)(C). There is no dispute that the easements here at issue are qualified real

property interests. The term “qualified organization” is defined as an organization exempt from federal income tax under I.R.C. § 501(c)(3). I.R.C. § 170(h)(3)(B). There is no dispute that L’Enfant was a qualified organization. The term “conservation purpose” is defined as any of four statutory purposes, with the fourth purpose being the only one relevant to the instant case: “the preservation of an historically important land area or a certified historic structure.” I.R.C. § 170(h)(4)(A)(iv). It is undisputed that the Logan Circle and Vermont Avenue properties are certified historic structures. What is in dispute is whether the façade easements were granted “exclusively for conservation purposes” as required by I.R.C. § 170(h)(1)(C).

Section 170(h)(5) provides that “[a] contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.” The regulations provide that “any interest in the property retained by the donor (and the donor’s successors in interest) must be subject to legally enforceable restrictions . . . that will prevent uses of the retained interest inconsistent with the conservation purposes of the donation.” Treas.

Reg. § 1.170A-14(g)(1). Treas. Reg. § 1.170A-14(g)(2) further states that "no deduction will be permitted . . . for an interest in property which is subject to a mortgage unless the mortgagee subordinates its rights in the property to the right of the qualified organization to enforce the conservation purposes of the gift in perpetuity."

B. The easements are not "qualified conservation contributions"

As noted above, to be considered "exclusively for conservation purposes," an easement must be granted in perpetuity (I.R.C. § 170 (h)(5)(A)) and must contain "legally enforceable restrictions . . . that *will* prevent uses of the retained interest inconsistent with the conservation purposes of the donation" (Treas. Reg. § 1.170A-14(g)(1) (emphasis supplied)). The easements granted by taxpayer do not satisfy these requirements. The easement deeds both expressly provide that "nothing herein contained shall be construed to limit the Grantee's right to give its consent (e.g., to changes in the Façade) or to abandon some or all of its rights hereunder." (Ex. 7 at 3; A. ___; Ex. 8 at 3; A. ___.) This language eliminates any claim to a prohibition on changes "inconsistent with the historical character of such exterior," as

necessary to be "exclusively for conservation purposes," since L'Enfant can consent to any type of façade change, irrespective of its compatibility with historical preservation. The lack of a firm prohibition is brought into starker relief by L'Enfant's reservation of its right to walk away from the rights granted to it. L'Enfant can abandon its rights, including its right to enforce the conservation restrictions provided for by the easements. In such a case, the easement would not serve as an impediment should taxpayer wish to make changes, even if the changes were inconsistent. Thus, there is no guarantee that the easement "will" prevent uses inconsistent with the conservation purpose as required by Treas. Reg. § 1.170A-14(g)(1). Accordingly, the easements themselves provide for the possibility of uses and alterations inconsistent with preserving the historic nature of the subject properties and, thus, cannot be said to be *exclusively* for conservation purposes.[10]

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[10] Regardless of whether L'Enfant is likely to forsake its rights, L'Enfant or its successors can abandon their rights, and the parties deemed this ability to abandon their rights as significant enough to explicitly permit unrestricted changes and abandonment in the

(continued...)

In addition, although the easements state that they were granted "in perpetuity," this was not the case. For the reasons stated above, the restrictions granted in the easements can hardly be said to protect the conservation purpose in perpetuity. Again, L'Enfant has the right, *at any time*, to permit taxpayer to make changes to the subject properties that are inconsistent with preserving the historic nature of the subject properties. Moreover, the rights are largely legally enforceable by L'Enfant alone, or by a designated successor. (Ex. 7 at 3; A. ___; Ex. 8 at 3; A. ___.) Although the easements provide that they survive the termination of L'Enfant's existence, they do not contain any provisions detailing what happens to the easements in such a case. Similarly, the easements do not state what happens to them should L'Enfant abandon its right of enforcement. Should L'Enfant cease to exist before it transfers, assigns, or conveys its rights under the easement, or should

[10](...continued)
easements themselves. The easements fail to shut the door to any changes that would be inconsistent with the historical character of the rowhouses, and, thus, cannot pass muster under I.R.C. § 170(h)(1)(C).

it decide to abandon its rights, it does not seem that any legally enforceable restriction would exist that "will prevent" inconsistent uses.

Finally, we note that the easements were not granted in perpetuity because, although the mortgagees of the subject properties executed an "Acknowledgment" of the easement, the documents do not expressly state that the mortgagee recognizes that its interest is subordinated to the rights granted to L'Enfant, as required by Treas. Reg. §1.170A-14(g)(2). Although the Tax Court assumed the Acknowledgments meant that the lenders had agreed to subordinate their interests, in the absence of plain language, there is at least a possibility of future litigation that could test that proposition.

C. The Tax Court incorrectly held that the donation of an easement satisfies the "exclusively for conservation purposes" test so long as the easement provides for compliance with local laws governing development in historic districts

In rejecting the IRS's argument that the easements did not constitute qualified conservation easements because of L'Enfant's right to permit any change in the façade or to abandon its enforcement function, the Tax Court noted that the easements provided that any

"rehabilitative work or new construction on the façades" had to comply with all applicable Federal, State, and local government laws, and held that Treas. Reg. § 1.170A-14(d)(5) "specifically allows a donation to satisfy the conservation purposes test even if future development is allowed, as long as that future development is subject to local, State, and Federal laws and regulations." (Doc. 41 at 11; A. ___.) The court's conclusion that these were "valid conservation easements," however, rests on a misreading of the regulation.

Treas. Reg. § 1.170A-14(d)(5)(i) provides that, "[w]hen restrictions to preserve a building or land area within a registered historic district permit future development on the site, a deduction will be allowed under this section only if the terms of the restrictions require that such development conform with appropriate local, state, or Federal standards for construction or rehabilitation within the district." The regulation provides a minimum requirement: "only if" the terms of the restriction comply with appropriate federal, state, and local standards will the deduction be allowed. In other words, compliance with appropriate federal, state, and local preservation laws is the baseline

for the deduction; it is a necessary, but not a sufficient, condition. The Tax Court's interpretation, *viz.*, that the regulation "specifically allows a donation to satisfy the conservation purposes test even if future development is allowed, as long as that future development is subject to local, State, and Federal laws and regulations" (Doc. 41 at 11; A. ___), thus flips the regulation on its head, incorrectly interpreting it to provide a safe harbor where none exists.[11]

Indeed, if taxpayer conveyed to L'Enfant nothing more than a promise not to do what she was already prohibited from doing by local law, it is difficult to understand how what she donated had any value at all.[12] In finding that the easements nevertheless had value, the Tax

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[11] The IRS's construction of one of its own regulations is entitled to substantial deference. *See United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200, 219 (2001). "[S]uch deference is not to be withheld merely because the agency's reading of the regulation comes in form of a legal brief." *Drake v. Fed. Aviation Admin.*, 291 F.3d 59, 68 (D.C. Cir. 2002).

[12] As the Tax Court appeared to recognize (Doc. 41 at 25; A. ___), the record does not clearly establish that the restrictions contained in the easements are any more onerous than those provided for by the District of Columbia's Historic Landmark and Historic District Protection Act of 1978, and the regulations promulgated thereunder. The Tax Court stated that even if the easements did not provide for

(continued...)

Court looked to "the heightened financial burdens of an eased facade and L'Enfant's affirmative enforcement of its easements." But if the easements (and associated paperwork) did not, in fact, provide any real restrictions on property use greater than what was already in place under the local law pertaining to historic properties, these "factors" relied on by the Tax Court cannot provide a legitimate basis for a tax deduction. Plainly, mere compliance with Federal, State, and local restrictions does not suffice for purposes of the deduction; the Internal Revenue Code does not recognize a deduction simply for following the law. As the Tax Court has observed previously, "it is difficult to justify a charitable contribution deduction for an owner's agreement to refrain

[12](...continued)
restrictions greater than those under local law, the easements created a second layer of necessary approval for changes and would result in a more rigorous enforcement of the restrictions (Doc. 41 at 25-26; A. ___). We submit that more rigorous enforcement of restrictions alone cannot support a deduction. After all, a taxpayer should be presumed to follow the law, and the need to make a second application is hardly what Congress had in mind in providing for the deduction. Moreover, as discussed above, L'Enfant may abandon its rights, the District of Columbia could amend its law to make the restrictions provided for therein more onerous, or the District of Columbia may decide to enforce more rigorously the restrictions that exist.

from doing what he is already legally forbidden to do." *Herman v. Commissioner*, 98 T.C.M. (CCH) 197, 203 n. 5 (2009).

II

Taxpayer failed to obtain qualified appraisals of the value of the easements, because the Donnelly appraisals failed to abide by a cognizable valuation method or to provide a specific basis for their ultimate conclusions

A. Introduction

1. A taxpayer who seeks to claim a charitable contribution deduction for the donation of property, such as a conservation easement, must satisfy requirements in addition to those set forth in I.R.C. § 170(h). Section 155(a)(1) and (2) of the Deficit Reduction Act of 1984 ("DEFRA"), Pub. L. No. 98-369, 98 Stat. 691, required the Secretary of the Treasury to prescribe regulations which require individuals claiming charitable deductions to obtain "qualified appraisals" for any property valued at greater than $5,000. *See also* I.R.C. § 170(f)(11)(C) ("In the case of contributions of property for which a deduction of more than $5,000 is claimed, the requirements of this subparagraph are met if the [taxpayer] obtains a qualified appraisal of

such property . . . .”).[13] Section 155(a)(4) of DEFRA defined a “qualified appraisal” as an appraisal by a qualified appraiser that includes:

> (A) a description of the property, (B) the fair market value of such property on the date of the contribution and the specific basis for the valuation, (C) a statement that such appraisal was prepared for income tax purposes, (D) the qualifications of the qualified appraiser, (E) the signature and TIN [taxpayer identification number] of such appraiser, and (F) such additional information as the Secretary prescribes in such regulations.

In accordance with Section 155 of DEFRA, the IRS issued Treas. Reg. § 1.170A-13. Under that regulation, a qualified appraisal “shall” include: (A) a sufficiently detailed description of the property so a person who is not generally familiar with the type of property can ascertain that the property appraised is the property to be donated; (B) the physical condition of the property; (C) the date (or expected date) of the donation; (D) the terms of any restrictions, use, or any other agreement made by or on behalf of the donor or donee with respect to the property donated; (E) the name and address of the appraiser;

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[13] Section 170(f)(11)(C), which applies to contributions made after June 3, 2004, contains the same “qualified appraisal” requirement as DEFRA and the relevant regulations.

(F) the qualifications of the appraiser; (G) a statement that the appraisal was prepared for income tax purposes; (H) the date on which the property was appraised; (I) the fair market value of the property on the date (or expected date) of contribution; (J) "[t]he method of valuation used to determine the fair market value, such as the income approach, the market-data approach, and the replacement-cost-less-depreciation approach"; and (K) "[t]he specific basis for the valuation, such as specific comparable sales transactions or statistical sampling, including a justification for using sampling and an explanation of the sampling procedure employed." Treas. Reg. § 1.170A-13(c)(3)(ii).

2. The Tax Court held that the Donnelly appraisals substantially complied with the requirements of this regulation. (Doc. 41 at 17-18.) As we shall demonstrate, the Tax Court erred in determining that the appraisals were "qualified appraisals" because taxpayer's appraisals failed to explain the methods of valuation, and failed to include any substantive bases for their valuations. Without such an analytical

mooring, the appraisals -- and the Tax Court's decision as to the values of the easements -- amount to little more than guesswork.

B. The Tax Court erred in concluding that the Donnelly appraisals were qualified appraisals and that taxpayer had substantiated her deduction

1. As explained above, Treas. Reg. § 1.170A-13(c)(3)(ii)(J) provides that a qualified appraisal must explain "[t]he method of valuation used to determine the fair market value, such as the income approach, the market-data approach, and the replacement-cost-less-depreciation approach." Treas. Reg. § 1.170A-13(c)(3)(ii)(K) further provides that a qualified appraisal must provide "[t]he specific basis for the valuation, such as specific comparable sales transactions or statistical sampling, including a justification for using sampling and an explanation of the sampling procedure employed."

Generally, "fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts." Treas. Reg. § 1.170A-1(c)(2).

The deduction allowed for the donation of a qualified conservation contribution under I.R.C. § 170(f)(3)(B) and (h) is equal to "the fair market value of the [easement] at the time of the contribution." I.R.C. § 1.170A-14(h)(3)(i). If there is "a substantial record of sales of easements comparable to the donated easement . . . , the fair market value of the donated easement is based on the sales price of such comparable easements." *Id.* In the usual case, however, as here, no substantial record of comparable sales exists, and the value of the easement is determined instead using the before-and-after method, that is, the value of the easement is "the difference between the fair market value of the property it encumbers before the granting of the restriction and the fair market value of the encumbered property after the granting of the restriction." *Id.* "[T]o the extent possible, the three commonly recognized methods of valuing property (capitalized net operating income, replacement cost and comparable sales [*i.e.*, market-data approach]) are used" for both the "before" and "after" values. *Hilborn v. Commissioner*, 85 T.C. 677, 689 (1985). The regulations recognize 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. In such instances no deduction would be allowable." Treas. Reg. § 1.170A-14(h)(3)(ii).

2. The Tax Court stated that the appraisals "identify the method of valuation used and the basis for the valuations reached" (Doc. 41 at 17-18; A. ___), but an examination of the appraisals belies this conclusion. Although Donnelly used the comparable sales approach (*i.e.* the market-data approach) to determine the before-easement fair market value of the properties, he did not purport to use any identifiable method to determine the after-easement value. (Ex. 9 at 20-21 ; A. ___; Ex. 10 at 33-34; A. ___.) Rather, he claimed that the IRS had accepted reductions in value within a certain range and picked a number within that range.[14] (Ex. 9 at 21; A. ___; Ex. 10 at 34; A. ___.)

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[14] Donnelly referred to an "article" written by an IRS employee. However, this "article" did not reflect the IRS's official position and did not purport to do so. There is nothing in any official publication of the IRS to this effect. To the contrary, the IRS has specifically disavowed having any such "safe harbor." *See* Chief Counsel Memorandum 201002038 (Jan. 15, 2010); Chief Counsel Memorandum 200738013 (continued...)

The only explanation contained in the appraisals regarding his determinations in this regard was as follows:

> We have examined numerous sales of easement-encumbered properties and have talked to various parties at interest. We have also considered the potential costs of owning a façade easement property that may be in excess of those ordinarily expected for comparable structures. Beyond the factors from which a dollar figure can reasonably be derived based on hard cost data, our discussions with others active in the marketplace has led us to consider subjective and conjectural factors which we believe may impact on value.

(*Id.*) The appraisals do not specifically identify the properties examined or the parties with whom Donnelly spoke. The appraisals also fail to identify what "subjective and conjectural" factors were considered. And, the appraisals contain no analysis of how the properties examined, parties spoken to, and subjective and conjectural factors considered, played into the determinations of the after-easement fair market values of the properties. The appraisals thus wholly fail to identify the method used for the "after" valuation, or to provide the specific basis for the valuation, as required under Treas.

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[14](...continued)
(Sept. 21, 2007). Indeed, such a notion would be contrary to very essence of the pertinent regulations.

Reg. §§ 1.170A-13(c)(3)(ii)(J) and (K), and, therefore, are not qualified appraisals as required by I.R.C. § 170(f)(11)(C).[15] Indeed, the Tax Court did not even attempt to explain how the appraisals satisfied Treas. Reg. §§ 1.170A-13(c)(3)(ii)(J) and (K).

3. Nor can the doctrine of substantial compliance salvage the Donnelly appraisals. According to this doctrine, the requirements of the regulation addressing qualified appraisals are directory rather than mandatory, and thus "may be fulfilled by substantial, if not strict compliance." *Bond v. Commissioner*, 100 T.C. 32, 41 (1993) (quoting *Taylor v. Commissioner*, 67 T.C. 1071, 1077-78 (1977)).

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[15] We further note that the appraisals failed to satisfy other requirements of Treas. Reg. § 1.170A-13(c)(3)(ii). While the appraisals note that taxpayer was "contemplating a donation of a conservation easement" to L'Enfant, they do not specifically state that they were prepared for income tax purposes, as required by Treas. Reg. § 1.170A-13(c)(3)(ii)(G) and Section 155(a)(4)(C) of DEFRA. Also, the appraisals do not expressly state the date of the intended donation, as required by Treas. Reg. § 1.170A-13(c)(3)(ii)(C). Although these omissions might seem venal sins, the mandatory language of the regulation suggests such transgressions doom an appraisal, as discussed below. *See Lord v. Commissioner*, T.C. Memo. 2010-196, 2010 WL 3565240, at * 2 (Sept. 10, 2010).

As an initial matter, this Court has recognized, "'[i]f Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. Such legislative regulations are given controlling weight unless they are . . . manifestly contrary to the statute.'" *Nat'l Assn. of Clean Air Agencies v. Envtl. Prot. Agency*, 489 F.3d 1221, 1228 (D.C. Cir. 2007) (quoting *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843-44 (1984)). *See also United States v. Mead Corp.*, 533 U.S. 218, 228 (2001) (when Congress makes an express delegation of authority to an agency, "any ensuing regulation is binding in the courts unless procedurally defective, arbitrary or capricious in substance, or manifestly contrary to the statute").

Here, Congress specifically left a gap in DEFRA for the agency to fill with requirements, which it did with Treas. Reg. § 1.170A-13(c)(3)(ii). This regulation provides that a qualified appraisal "shall" include the information required thereunder. There is no suggestion that these requirements are directory, rather than mandatory. This view is bolstered by the fact that a number of the

requirements of the regulation mirror the requirements expressly contained in Section 155 of DEFRA. Thus, to the extent the Tax Court believes the regulation's provisions may be satisfied by substantial compliance, we submit it is in error.

Even if the doctrine has some place, it is inapplicable here where the defect concerns a lack of substantive information critical to the appraisal, and not a mere procedural glitch. The Tax Court has recognized that the "critical question to be answered is whether the requirements relate 'to the substance or essence of the statute.'" *Bond*, 100 T.C. at 41 (quoting *Taylor*, 67 T.C. at 1077-78). "[I]t is clear that the principal objective of section 155 was to provide a mechanism whereby respondent would obtain sufficient return information in support of the claimed valuation of charitable contributions of property to enable respondent to deal more effectively with the prevalent use of overvaluations." *Hewitt v. Commissioner*, 109 T.C. 258, 265 (1997), *aff'd by unpublished opinion*, 166 F.3d 332 (4th Cir. 1998). Such information is not provided by appraisals that neglect to explain in any sort of detail how they deduced the amount of diminution of property

value attributable to the easements. As in *Hewitt*, "what petitioners are seeking is not the application of the substantial compliance principle but an exemption from the clear requirement of the statute and regulations in a situation where there is no overvaluation of the charitable contribution." *Id.* at 265-66.

The appraisals, therefore, neither comply with the procedural requirements of Treas. Reg. § 1.170A-13(c)(3)(ii), nor provide the crucial substance necessary to evaluate their ultimate conclusions. The failure to satisfy the procedural requirements by itself compels a conclusion that taxpayer failed to obtain qualified appraisals, as required to claim a charitable contribution deduction under I.R.C. §§ 170(a)(1) and (f)(11)(C). The appraisals' total lack of substantive analysis deprives them of any legitimacy, furthermore. "An expert must offer good reasons to think that his approach produces an accurate estimate using professional methods, and this estimate must be testable. Someone else using the same data and methods must be able to replicate the result." *Zenith Elec. Corp. v. WH-TV Broad. Corp.* 395 F.3d 416, 419

(7th Cir. 2005). So far as the appraisals show, Donnelly merely picked the percentages out of thin air.

4. By failing to recognize the procedural and substantive failings of the Donnelly appraisals, the Tax Court not only sanctioned deductions that taxpayer did not merit, it also followed the appraisals in determining values for the easements that were wholly untethered from any substantive basis. It, too, appeared to have picked a percentage out of thin air. It stated that "this decrease stems from the heightened financial burdens of an eased façade and L'Enfant's affirmative enforcement of its easements." (*Id.* at 25; A. ___.) The Tax Court stated that "L'Enfant actively enforces its easements in a way that the District of Columbia does not" (*id.*), and that, at least, "the easement still added an additional level of approval before any change could be made to the properties" (*id.* at 26; A. ___). In rejecting the valuation of the IRS's expert, Wolman, the Tax Court also suggested that it could not be the case that an easement could have no value. (*Id.*)

The Tax Court first erred by divining a common 5% diminution of value for both properties based on the easements granted to L'Enfant. As explained above, Treas. Reg. § 1.170A-13(c)(3)(ii) mandates that a qualified appraisal describe the method underlying a valuation, the specific bases for the appraiser's conclusions, and various other information specific to the property being appraised. The requirements of the Treasury Regulation thus are directed to ensuring that a valuation is based on specific analysis of factors relating to that property. The Tax Court's actions here undercut the thrust of the regulations.

Moreover, in this case, the record does not clearly establish that the restrictions contained in the easements are any more onerous than those provided for by the District of Columbia's Historic Landmark and Historic District Protection Act of 1978, and the regulations promulgated thereunder. As explained previously, the District of Columbia has a detailed historic preservation scheme that expressly forbids, absent a permit: (i) changes to the exterior appearance of a building or structure or its site, not covered by the definition of

demolition, for which a permit is required; (ii) changes in any interior space that has been specifically designated as an historic landmark; and (iii) the painting of unpainted masonry on a historic landmark or on a façade restored as a condition of a previously approved permit. D.C. Code § 6-1102(1). The scheme is not toothless, but provides the Historic Preservation Office with both criminal and civil enforcement mechanisms, including the imposition of criminal fines or prison for violations, D.C. Code § 6-1110(a), as well as the ability to require the restoration of any building, *see* D.C. Code § 6-1110(b). Moreover, "[c]ivil fines, penalties, and fees may be imposed as alternative sanctions for any infraction." D.C. Code § 6-1110(c).

In short, the District of Columbia historic preservation scheme seems to govern, and forbid without permission, any changes to buildings in a historic district such as Logan Circle. The easements do no more. As stated previously, "it is difficult to justify a charitable contribution deduction for an owner's agreement from doing what he is already legally forbidden to do." *Herman*, 98 T.C.M. (CCH) at 203, n. 5.

Given that the District's historic preservation scheme can prohibit the same activity as the easements, the Tax Court's holding that the easements result in a 5% diminution of value seems to hinge solely on the manner of enforcement. At trial, the president of L'Enfant offered several anecdotes suggesting that the organization has withheld consent in some cases in which the District of Columbia has not. (Doc. 36 at 28-30, 39-41; A. ___.) As an initial matter, attaching much weight to anecdotal evidence about the relative strictness of the District and L'Enfant is hazardous because, as discussed above, L'Enfant may, under the terms of the deeds, abandon its rights, the District of Columbia could amend its law to make the restrictions provided for therein more onerous, or the District of Columbia may decide to enforce more rigorously the restrictions that exist. The issue is not what the parties to the easements currently are doing; the issue is how the deeds bind L'Enfant and its successors in perpetuity.

There is no doubt, however, that the District of Columbia actively inspects and enforces its rights under its historic preservation scheme, according to the testimony of the State Historic Preservation Officer.

(*Id.* at 78-79; A. ___.) As the State Historic Preservation Officer explained at trial:

> The inspectors can do one of several things when they are looking at a property. They can merely do an inspection and take no particular action. They may give a verbal warning or determine that there is no cause for any action. They may issue a stop work order. They may issue a notice of violation, which is, essentially, a directive to obtain a proper permit.

(*Id.* at 80; A. ___.) According to the State Historic Preservation Officer, "in [2003-2004], we were running, I believe, . . 200 to 250 stop work orders, maybe 100 to 150 violation notices, and probably around 75 to 100, maybe not quite that many, maybe 75 notices of infraction." (*Id.*) Given the active enforcement of historic preservation restrictions by the District of Columbia, it is difficult to see how the mere specter of L'Enfant enforcing the same type of restrictions leads to the hearty diminution of property value determined by the Tax Court.[16]

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[16] The fragility of the Tax Court's determination is further illustrated by its reliance on the sole instance of a comparable sale that purportedly had a reduction in value based on an easement. (Doc. 41 at 26; A. ___.) The IRS appraisal report noted that, in one case, a credit of $10,000 was given at closing after the buyer discovered a façade easement on the property, although the parties disputed the reason for (continued...)

Nor is the Tax Court correct in its assumption that an easement must have some value. (Doc. 41 at 26; A. ___.) As noted above, the regulation itself recognizes 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." Treas. Reg. § 1.170A-14(h)(3)(ii).

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[16](...continued)
the credit. (Ex. 16 at 35; A. ___.) Even assuming that this credit stemmed from the existence of the easement, the Tax Court does not explain why its easement valuations deviated so greatly from the $10,000 credit in that instance. The Tax Court's determination of a 5% diminution of the "before" values of $1,250,000 for the Logan Circle property and $845,000 for the Vermont Avenue property, produces easements in the amount of $62,500 and $42,250 respectively, a far cry from the purported $10,000 credit in that single comparable sale.

CONCLUSION

The Tax Court's decisions should be reversed.

Respectfully submitted,

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It is hereby certified that this brief was filed with the Clerk and served on counsel for the appellee and counsel for *amici curiae* on this 1st day of October, 2010 via the CM/ECF system. It is further certified that eight (8) copies of the brief were mailed to the Clerk via First Class Mail on the 1st day of October, 2010. It is also certified that service of this brief has been made on counsel for the appellee and counsel for *amici curiae* on this 1st day of October, 2010, by sending, via First Class Mail, two copies in envelopes properly addressed as follows:

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ADDENDUM

Internal Revenue Code (26 U.S.C.):

§ 170. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS.

(a) Allowance of Deduction.–

(1) General Rule.– There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary.

. . . . .

(f) Disallowance of Deduction in Certain Cases and Special Rules.–

(1) In General.–No deduction shall be allowed under this section for a contribution to or for the use of an organization or trust described in section 508(d) or 4948(c)(4) subject to the conditions specified in such sections.

. . . . .

(3) Denial of deduction in case of certain contributions of partial interests in property.–

(A) In general.–In the case of a contribution (not made by a transfer in trust) of an interest in property which consists of less than the taxpayer's entire interest in such property, a deduction shall be allowed under this section only to the extent that the value of the interest contributed would be allowable as a deduction under this section if such interest had been transferred in trust. For purposes of this

subparagraph, a contribution by a taxpayer of the right to use property shall be treated as a contribution of less than the taxpayer's entire interest in such property.

(B) Exceptions.–Subparagraph (A) shall not apply to–

(i) a contribution of a remainder interest in a personal residence or farm,

(ii) a contribution of an undivided portion of the taxpayer's entire interest in property, and

(iii) a qualified conservation contribution.

. . . . .

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

(A) In general.–

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

(ii) Exceptions.–

(I) Readily valued property.--Subparagraphs (C) and (D) shall not apply to cash, property described in subsection (e)(1)(B)(iii) or section 1221(a)(1), publicly traded securities (as defined in section 6050L(a)(2)(B)), and any qualified vehicle described in paragraph

(12)(A)(ii) for which an acknowledgement under paragraph (12)(B)(iii) is provided.

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

. . . . .

(C) Qualified appraisal for contributions of more than $5,000–In the case of contributions of property for which a deduction of more than $5,000 is claimed, the requirements of this subparagraph are met if the individual, partnership, or corporation obtains a qualified appraisal of such property and attaches to the return for the taxable year in which such contribution is made such information regarding such property and such appraisal as the Secretary may require.

. . . . .

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

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

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

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

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

. . . . .

(h) Qualified conservation contribution.–

(1) In general.--For purposes of subsection (f)(3)(B)(iii), the term "qualified conservation contribution" means a contribution–

(A) of a qualified real property interest,

(B) to a qualified organization,

(C) exclusively for conservation purposes.

(2) Qualified real property interest.–For purposes of this subsection, the term "qualified real property interest" means any of the following interests in real property:

(A) the entire interest of the donor other than a qualified mineral interest,

(B) a remainder interest, and

(C) a restriction (granted in perpetuity) on the use which may be made of the real property.

(3) Qualified organization.–For purposes of paragraph (1), the term "qualified organization" means an organization which–

(A) is described in clause (v) or (vi) of subsection (b)(1)(A), or

(B) is described in section 501(c)(3) and–

(i) meets the requirements of section 509(a)(2), or

(ii) meets the requirements of section 509(a)(3) and is controlled by an organization described in subparagraph (A) or in clause (i) of this subparagraph.

(4) Conservation purpose defined.–

(A) In general.–For purposes of this subsection, the term "conservation purpose" means–

(i) the preservation of land areas for outdoor recreation by, or the education of, the general public,

(ii) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem,

(iii) the preservation of open space (including farmland and forest land) where such preservation is–

(I) for the scenic enjoyment of the general public, or

(II) pursuant to a clearly delineated Federal, State, or local governmental conservation policy,

and will yield a significant public benefit, or

(iv) the preservation of an historically important land area or a certified historic structure.

(B) Special rules with respect to buildings in registered historic districts.–In the case of any contribution of a

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

(i) such interest--

(I) includes a restriction which preserves the entire exterior of the building (including the front, sides, rear, and height of the building), and

(II) prohibits any change in the exterior of the building which is inconsistent with the historical character of such exterior,

(ii) the donor and donee enter into a written agreement certifying, under penalty of perjury, that the donee--

(I) is a qualified organization (as defined in paragraph (3)) with a purpose of environmental protection, land conservation, open space preservation, or historic preservation, and

(II) has the resources to manage and enforce the restriction and a commitment to do so, and

(iii) in the case of any contribution made in a taxable year beginning after the date of the enactment of this subparagraph, the taxpayer includes with the taxpayer's return for the taxable year of the contribution--

(I) a qualified appraisal (within the meaning of subsection (f)(11)(E)) of the qualified property interest,

(II) photographs of the entire exterior of the building, and

(III) a description of all restrictions on the development of the building.

(C) Certified historic structure.–For purposes of subparagraph (A)(iv), the term "certified historic structure" means–

(i) any building, structure, or land area which is listed in the National Register, or

(ii) any building which is located in a registered historic district (as defined in section 47(c)(3)(B)) and is certified by the Secretary of the Interior to the Secretary as being of historic significance to the district.

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

(5) Exclusively for conservation purposes.–For purposes of this subsection–

(A) Conservation purpose must be protected.–A contribution shall not be treated as exclusively for

conservation purposes unless the conservation purpose is protected in perpetuity.

. . . . .

Treasury Regulations (26 C.F.R.):

§ 1.170A-13. Recordkeeping and Return Requirements for Deductions for Charitable Contributions.

(c) Deductions in excess of $5,000 for certain charitable contributions of property made after December 31, 1984–

(1) General Rule–

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

(c)(7)(iii) of this section) by the same donor for the same taxable year (whether or not donated to the same donee).

(ii) Special rule for property to which section 170(e) (3) or (4) applies. For purposes of this paragraph (c), in computing the amount claimed or reported as a deduction for donated property to which section 170(e) (3) or (4) applies (pertaining to certain contributions of inventory and scientific equipment) there shall be taken into account only the amount claimed or reported as a deduction in excess of the amount which would have been taken into account for tax purposes by the donor as costs of goods sold if the donor had sold the contributed property to the donee. For example, assume that a donor makes a contribution from inventory of clothing for the care of the needy to which section 170(e)(3) applies. The cost of the property to the donor was $5,000, and, pursuant to section 170(e)(3)(B), the donor claims a charitable contribution deduction of $8,000 with respect to the property. Therefore, $3,000 ($8,000-$5,000) is the amount taken into account for purposes of determining whether the $5,000 threshold of this paragraph (c)(1) is met.

(2) Substantiation requirements–

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

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

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

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

(ii) Special rules for certain nonpublicly traded stock, certain publicly traded securities, and contributions by certain C corporations. (A) In cases described in paragraph (c)(2)(ii)(B) of this section, a qualified appraisal is not required, and only a partially completed appraisal summary form (as described in paragraph (c)(4)(iv)(A) of this section) is required to be attached to the tax or information return specified in paragraph (c)(2)(i)(B) of this section. However, in all cases donors must maintain records containing the information required by paragraph (b)(2)(ii) of this section.

(B) This paragraph (c)(2)(ii) applies in each of the following cases:

(1) The contribution of nonpublicly traded stock, if the amount claimed or reported as a deduction for the charitable contribution of such stock is greater than $5,000 but does not exceed $10,000;

(2) The contribution of a security to which paragraph (c)(7)(xi)(B) of this section applies; and

(3) The contribution of an item of property or of similar items of property described in paragraph (c)(1) of this section made after June

6, 1988, by a C corporation (as defined in section 1361(a)(2) of the Code), other than a closely held corporation or a personal service corporation.

(3) Qualified appraisal–

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

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

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

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

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

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

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

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

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

(D) The terms of any agreement or understanding entered into (or expected to be entered into) by or on behalf of the donor or donee that relates to the use, sale, or other disposition of the property contributed, including, for example, the terms of any agreement or understanding that–

> (1) Restricts temporarily or permanently a donee's right to use or dispose of the donated property,
>
> (2) Reserves to, or confers upon, anyone (other than a donee organization or an organization participating with a donee organization in cooperative fundraising) any right to the income from the contributed property or to the possession of the property, including the right to vote donated securities, to acquire the property by purchase or otherwise, or to designate the person having such income, possession, or right to acquire, or
>
> (3) Earmarks donated property for a particular use;

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

than the donor, the name, address, and taxpayer identification number (if a number is otherwise required by section 6109 and the regulations thereunder) of the partnership or the person who employs or engages the qualified appraiser;

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

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

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

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

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

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

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§ 1.170A-14. Qualified Conservation Contributions.

(e) Exclusively for conservation purposes–

(1) In general. To meet the requirements of this section, a donation must be exclusively for conservation purposes. See paragraphs (c)(1) and (g)(1) through (g)(6)(ii) of this section. A deduction will not be denied under this section when incidental benefit inures to the donor merely as a result of conservation restrictions limiting the uses to which the donor's property may be put.

(2) Inconsistent use. Except as provided in paragraph (e)(4) of this section, a deduction will not be allowed if the contribution would accomplish one of the enumerated conservation purposes but would permit destruction of other significant conservation interests. For example, the preservation of farmland pursuant to a State program for flood prevention and control would not qualify under paragraph (d)(4) of this section if under the terms of the contribution a significant naturally occurring ecosystem could be injured or destroyed by the use of pesticides in the operation of the farm. However, this requirement is not intended to prohibit uses of the property, such as selective timber harvesting or selective farming if, under the circumstances, those uses do not impair significant conservation interests.

(3) Inconsistent use permitted. A use that is destructive of conservation interests will be permitted only if such use is necessary for the protection of the conservation interests that are the subject of the contribution. For example, a deduction for the donation of an easement to preserve an archaeological site that is listed on the National Register of Historic Places will not be disallowed if site excavation consistent with sound archaeological practices may impair a scenic view of which the land is a part. A donor may continue a pre-existing use of the property that does not conflict with the conservation purposes of the gift.

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(g) Enforceable in perpetuity–

(1) In general. In the case of any donation under this section, any interest in the property retained by the donor (and the donor's successors in interest) must be subject to legally enforceable restrictions (for example, by recordation in the land records of the jurisdiction in which the property is located) that will prevent uses of the retained interest inconsistent with the conservation purposes of the donation. In the case of a contribution of a remainder interest, the contribution will not qualify if the tenants, whether they are tenants for life or a term of years, can use the property in a manner that diminishes the conservation values which are intended to be protected by the contribution.

(2) Protection of a conservation purpose in case of donation of property subject to a mortgage. In the case of conservation contributions made after February 13, 1986, no deduction will be permitted under this section for an interest in property which is subject to a mortgage unless the mortgagee subordinates its rights in the property to the right of the qualified organization to enforce the conservation purposes of the gift in perpetuity. For conservation contributions made prior to February 14, 1986, the requirement of section 170 (h)(5)(A) is satisfied in the case of mortgaged property (with respect to which the mortgagee has not subordinated its rights) only if the donor can demonstrate that the conservation purpose is protected in perpetuity without subordination of the mortgagee's rights.

(3) Remote future event. A deduction shall not be disallowed under section 170(f)(3)(B)(iii) and this section merely because the interest which passes to, or is vested in, the donee organization may be defeated by the performance of some act or the happening of some event, if on the date of the gift it appears that the possibility that such act or event will occur is so remote as to be negligible. See paragraph (e) of § 1.170A-1. For example, a state's statutory requirement that use restrictions must be rerecorded

every 30 years to remain enforceable shall not, by itself, render an easement nonperpetual.

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(5) Protection of conservation purpose where taxpayer reserves certain rights–

(i) Documentation. In the case of a donation made after February 13, 1986, of any qualified real property interest when the donor reserves rights the exercise of which may impair the conservation interests associated with the property, for a deduction to be allowable under this section the donor must make available to the donee, prior to the time the donation is made, documentation sufficient to establish the condition of the property at the time of the gift. Such documentation is designed to protect the conservation interests associated with the property, which although protected in perpetuity by the easement, could be adversely affected by the exercise of the reserved rights. Such documentation may include:

(A) The appropriate survey maps from the United States Geological Survey, showing the property line and other contiguous or nearby protected areas;

(B) A map of the area drawn to scale showing all existing man-made improvements or incursions (such as roads, buildings, fences, or gravel pits), vegetation and identification of flora and fauna (including, for example, rare species locations, animal breeding and roosting areas, and migration routes), land use history (including present uses and recent past disturbances), and distinct natural features (such as large trees and aquatic areas);

(C) An aerial photograph of the property at an appropriate scale taken as close as possible to the date the donation is made; and

(D) On-site photographs taken at appropriate locations on the property. If the terms of the donation contain restrictions with regard to a particular natural resource to be protected, such as water quality or air quality, the condition of the resource at or near the time of the gift must be established. The documentation, including the maps and photographs, must be accompanied by a statement signed by the donor and a representative of the donee clearly referencing the documentation and in substance saying "This natural resources inventory is an accurate representation of [the protected property] at the time of the transfer.".

(ii) Donee's right to inspection and legal remedies. In the case of any donation referred to in paragraph (g)(5)(i) of this section, the donor must agree to notify the donee, in writing, before exercising any reserved right, e.g. the right to extract certain minerals which may have an adverse impact on the conservation interests associated with the qualified real property interest. The terms of the donation must provide a right of the donee to enter the property at reasonable times for the purpose of inspecting the property to determine if there is compliance with the terms of the donation. Additionally, the terms of the donation must provide a right of the donee to enforce the conservation restrictions by appropriate legal proceedings, including but not limited to, the right to require the restoration of the property to its condition at the time of the donation.

(6) Extinguishment.

(i) In general. If a subsequent unexpected change in the conditions surrounding the property that is the subject of a donation under this paragraph can make impossible or impractical the continued use of the property for conservation purposes, the conservation purpose can nonetheless be treated as protected in perpetuity if the restrictions are extinguished by judicial proceeding and all of the donee's proceeds (determined under paragraph (g)(6)(ii) of this section) from a subsequent sale or exchange of the property are used by the donee organization in a manner consistent with the conservation purposes of the original contribution.

(ii) Proceeds. In case of a donation made after February 13, 1986, for a deduction to be allowed under this section, at the time of the gift the donor must agree that the donation of the perpetual conservation restriction gives rise to a property right, immediately vested in the donee organization, with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction at the time of the gift, bears to the value of the property as a whole at that time. See § 1.170A-14(h)(3)(iii) relating to the allocation of basis. For purposes of this paragraph (g)(6)(ii), that proportionate value of the donee's property rights shall remain constant. Accordingly, when a change in conditions give rise to the extinguishment of a perpetual conservation restriction under paragraph (g)(6)(i) of this section, the donee organization, on a subsequent sale, exchange, or involuntary conversion of the subject property, must be entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction, unless state law provides that the donor is entitled to the full proceeds from the conversion without regard to the terms of the prior perpetual conservation restriction.