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TAX MATTERS

Two Easements, Two Outcomes

BY CHARLES J. REICHERT, CPA
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The Tax Court decided two cases involving conservation easements with mixed results for the taxpayers. In one case, the court held that the taxpayer was entitled to a charitable deduction for easements on two properties, since the easements were exclusively for conservation purposes. According to the court, the easements preserved a certified historic structure and were granted in perpetuity; however, the court, based on expert testimony, reduced the amounts of the deductions. In the other case, the court denied a charitable deduction for an easement of unused development rights above a certified historic structure because the easement was not exclusively for conservation purposes, as it did not preserve a historically important land area or a certified historic structure.

A charitable deduction is allowed under [IRC § 170\(h\)](#) for a qualified conservation easement, which is defined as a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. Qualified real property interests include a legally enforceable restriction (granted in perpetuity) on the use of the real property that prevents uses of the retained interest that are inconsistent with the conservation purposes of the contribution. A conservation purpose must be protected in perpetuity and can include the preservation of a historically important land area or a certified historic structure (section 170(h)(4)(A)(iv)). If the property is subject to a mortgage, the mortgagee must subordinate its rights in the property to the right of the qualified organization to enforce the conservation purpose in perpetuity. If a contribution of property exceeds \$5,000, the strict substantiation requirements of [Treas. Reg. § 1.170A-13\(c\)](#) must be satisfied, which include specific requirements for any appraisal used to determine the value of the contribution. To determine the value of an easement, taxpayers have often compared the value of the property before and after the easement was granted.

Dorothy Simmons owned two row houses in Washington, D.C., subject to the Historic Preservation Act of 1978. In 2003 Simmons granted a façade easement on one property to the [L'Enfant Trust](#), a District of Columbia nonprofit corporation that holds conservation easements in the D.C. area. In 2004, she granted a similar easement on a second property to L'Enfant. The easement deeds prohibited Simmons from making any material changes to the façade of either property without L'Enfant's consent and required any work done on the buildings to comply with all federal, state and local laws and regulations. Simmons deducted as charitable contributions \$162,500 and \$93,000, respectively, on her 2003 and 2004 tax returns for the easements. The IRS disallowed both deductions, arguing the easements had no conservation purpose, since the deeds allowed L'Enfant to consent to changes in the façades and the mortgagees of the properties had not subordinated in perpetuity their rights to the rights of L'Enfant. The Service also argued that even if the easements were valid, no deduction should be allowed, since the appraisals were not qualified appraisals and were not credible.

The court held that the easements did serve a conservation purpose even though L'Enfant had the right to consent to changes in the façades. The court noted that [Treas. Reg. § 1.170A-14\(d\)\(5\)](#) permits future development as long as it conforms to federal, state and local standards for construction or rehabilitation within a registered historical district, and these easements required such compliance. The court also noted both deeds contained language acknowledging the lenders' subordination of their rights to L'Enfant or any successors. The court determined that Simmons had complied with the substantiation requirements and that the grant of the easement did reduce the value of the properties. However, it reduced the amount of the deductions to \$56,250 for 2003 and \$42,250 for 2004. The court accepted Simmons' expert's valuation of the properties before the easements but, based on all the expert testimony presented, used higher post-easement valuations.

In the other case, J. Maurice Herman owned an apartment building on Fifth Avenue in New York in the Upper East Side Historic District. In August 1998, he transferred the property to his wholly owned LLC, Windsor Plaza, which later in 1998 transferred back to Herman the unused development rights to the property, including the right to add floors to the building. In 2003, the apartment building was classified as a certified historic structure. Later that year, Herman contributed an easement to the National Architectural Trust Inc. restricting the development of about half of the unused development rights over the existing property. On his 2003 federal tax return, Herman claimed a charitable contribution deduction of \$21,850,000 for the easement. The IRS disallowed the deduction on the grounds the easement was not exclusively for conservation purposes because it did not preserve a historically important land area or a certified historic structure.

The court held there was no conservation purpose, because the agreement creating the easement restricted the development of only a portion of the unused development rights above the apartment building. Nothing in the agreement prevented the alteration or demolition of that building by Herman, Windsor Plaza or any future owners. The court also rejected Herman's claim that the easement preserved a historically important land area, because the underlying land could be a historically important land area only because of its proximity and relation to the apartment building, a certified historic structure. Since the easement did not prevent the building's alteration or demolition, it could not protect the historical significance of the land beneath it, whose sole function is the building's foundation. The court left open the possibility that in some other factual situation a restriction of unused air or development rights might be for a conservation purpose.

- [Dorothy Jean Simmons v. Commissioner](#), TC Memo 2009-208
- [J. Maurice Herman v. Commissioner](#), TC Memo 2009-205

By **Charles J. Reichert**, CPA, professor of accounting, University of Wisconsin-Superior.

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