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From:
Sent: Wednesday, March 03, 2010 4:38:00 PM
To:
Cc:
Subject: , Appeals Memo

All:
Please disregard the previous message. My computer was having some problems and didn't send the email or its attachment out as a CCA. I've attached our memo to this message. Hopefully my computer issues have resolved and the message will be classified correctly.

Thanks for your patience!

ATTACHMENT 1

Legal Analysis for ACM based on contribution of a façade easement

Section 170(a)(1) of the Internal Revenue Code (Code) provides that a deduction shall be allowed for any charitable contribution made during the taxable year. Section 170(a)(1) further provides that a charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary.

Generally, section 170(f)(3) denies a deduction for a charitable gift of property consisting of less than the donor's entire interest in that property. Section 170(f)(3)(B)(iii), however, provides an exception to this general rule in the case of a "qualified conservation contribution". Section 170(h)(1) provides that a contribution is a qualified conservation contribution if the contribution is of a "qualified real property interest," the donee is a "qualified organization", and the contribution is "exclusively for conservation purposes."

Section 170(h)(2)(C) provides that for purposes of section 170(h), the term "qualified real property interest" means a "restriction (granted in perpetuity) on the use which may be made of the real property." Any interest retained by the donor must be subject to legally enforceable restrictions that will prevent uses of the retained interest in the property that are inconsistent with the conservation purposes of the contribution. Section 1.170A-14(g)(1) of the Income Tax Regulations.

Section 170(h)(4)(A)(iv) provides in pertinent part that for purposes of section 170(h), the term "conservation purpose" means the preservation of a certified historic structure. Section 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.

The Pension Protection Act of 2006, P.L. 109-280 (PPA), amended the requirements in section 170(h)(4) for a contribution of a façade easement. Section 170(h)(4)(B), as amended by the PPA, provides that in the case of a restriction with respect to the exterior of a building located in a registered historic district (as defined in section 47(c)(3)(B)) and certified by the Secretary of the Interior to the Secretary as being of historic significance to the district, the qualified real property interest must include a restriction that protects the entire exterior of the building (including the front, sides, rear and height of the building) and prohibit any change in the exterior that is inconsistent with the historical character of the exterior. Further, the donor must enter into a written agreement with the donee certifying under penalties of perjury that the donee is a qualified organization, and has the resources to manage and enforce the restriction and the commitment to do so. See section 170(h)(4)(B)(ii). These rules are effective for contributions made after July 25, 2006. Additional requirements, set forth in section 170(h)(4)(B)(iii), apply for contributions made in taxable years beginning after August 17, 2006. See also section 170 (f)(13) ($500 filing fee), applicable to contributions made 180 days after 8/17/06.

Substantiation

In the Deficit Reduction Act of 1984 (DEFRA), Congress authorized and required the Commissioner to obtain sufficient return information in order to deal more effectively with charitable contribution overvaluations. Hewitt v. Commissioner, 109 T.C. 258, 265 (1997) (citing S. Comm. on Finance, Deficit Reduction Act of 1984, S. Rep. 98-169 (Vol. I), at 444-445 (S. Comm. Print 1984), and Staff of Joint Comm. on Taxation, General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984 (J. Comm. Print 1985)), aff'd without published opinion, 166 F.3d 332 (4th Cir. 1998).

In section 155(a) of DEFRA, Congress addressed the potential for abuse in valuing noncash contributions by requiring the Secretary to prescribe regulations under section 170(a)(1) to require a taxpayer who claims a charitable contribution deduction for property the claimed value of which exceeds $5,000 to obtain a qualified appraisal of the property contributed and to attach an appraisal summary (Form 8283) to the return. Pursuant to this mandate, the Secretary issued § 1.170A-13(c)(2)(i), stating that a deduction for a noncash contribution in excess of $5,000 will not be allowed unless the taxpayer obtains a "qualified appraisal" and attaches a "fully completed appraisal summary" to the tax return on which the taxpayer claims a deduction.

Section 883 of the American Jobs Creation Act of 2004, Pub. L. 108-357, 118 Stat. 1418 (2004) (Jobs Act) added section 170(f)(11), which contains reporting and substantiation requirements relating to noncash charitable contributions. It is effective for contributions made after June 3, 2004. Section 170(f)(11) was amended in the PPA. As explained by the Service in Notice 2006-96, 2006-46, I.R.B. 902, for appraisals prepared with respect to returns filed on or before August 17, 2006, definitions of the terms "qualified appraisal" and "qualified appraiser" in existing Treasury Regulations remain in effect for purposes of section 170(f)(11).

Section 170(f)(11)(C), as added by the Jobs Act, provides that for contributions valued at more than $5,000, the taxpayer must obtain a qualified appraisal and attach to the return for the taxable year in which the deduction is claimed such information and such appraisal as the Secretary may require. The appraisal must be attached to returns reporting contributions of property for which a deduction of more than $500,000 is claimed. Section 170(f)(11)(D).

Under Treas. Reg. § 1.170A-13(c)(3)(ii), a qualified appraisal must 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;

(E) The name, address, and identifying number of 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 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.

For a contribution of $250 or more in cash or other property, no deduction is allowed unless the taxpayer substantiates the contribution with a contemporaneous written acknowledgment from the donee organization. Section 170(f)(8)(A). This acknowledgment must contain a description of the property contributed including the amount of any cash contributed, a statement whether the donee organization provided goods or services in consideration, and if so, a description and an estimate of the value of any such goods or services. Section 170(f)(8)(B). Section 170(f)(8)(C) provides that this acknowledgment must be obtained by the earlier of the date the return is filed or its due date (including extensions).

Substantial Compliance

A judicial doctrine, substantial compliance has been used to allow a deduction for a taxpayer who has substantially, but not strictly, complied with the regulations governing tax elections and deductions. See Bond v. Commissioner, 100 T.C. 32, 41 (1993).

In Prussner v. United States, 896 F.2d 218, 224 (7th Cir. 1990), the Court of Appeals referred to the Tax Court doctrine of substantial compliance as confusing and difficult to apply and concluded:

> The common law doctrine of substantial compliance should not be allowed to spread beyond cases in which the taxpayer had a good excuse (though not a legal justification) for failing to comply with either an unimportant requirement or one unclearly or confusingly stated in the regulations or the statute.

In Bond, supra, the Tax Court considered whether certain aspects of the regulations were mandatory or directory and whether the taxpayer in that case had substantially complied with the regulations. The court found that the taxpayer had substantially complied with the qualified appraisal requirements because substantially all of the information required had been provided, except for the qualifications of the appraiser on the Form 8283 attached to the return. It is worth noting, though, that Bond was decided prior to the enactment of the Jobs Act (2004) and the Pension Act (2006), both of which impose new statutory requirements for qualified appraisals.

In Hewitt v. Commissioner, 109 T.C. 258 (1997), aff'd without published opinion, 166 F.3d 332 (4th Cir. 1998), the taxpayers claimed a deduction for the donation of stock that was not publicly traded. They did not obtain qualified appraisals before filing their return. The taxpayers argued that they had substantially complied with the regulations, but the Tax Court rejected that argument because the taxpayers had not obtained a qualified appraisal and did not attach an appraisal summary to their returns.

In Bruzewicz v. United States, 604 F. Supp. 2d 1197 (N.D. Ill. 2009), the District Court found that taxpayers, who had donated a façade easement on their home, had totally failed to comply with the section 170(f)(8) contemporaneous written acknowledgment requirement. The court noted that that failure alone is fatal to their claimed deduction. The District Court also found that the taxpayers failed to strictly comply with the appraisal requirements of section 1.170A-13 of the Regulations. The court wrote that section 170(f)(8) is not unclear or confusing. Further, the very inclusion of the requirement in the Code itself signals that Congress felt that a contemporaneous written acknowledgment was of the utmost importance. The court stated that other provisions in the regulations, such as appraiser qualifications and a description of donated property, are not unimportant or confusing to follow.

In Simmons v. Commissioner, T.C. Memo. 2009-208, the taxpayer donated a façade easement to charity. The Tax Court allowed the deduction even though the taxpayer did not strictly comply with the substantiation requirements of section 170. The court wrote that based upon the holdings in Bond and Hewitt, there is a standard that the court can use to consider whether the taxpayer had provided enough information to allow the Service to evaluate the reported contributions. The court in Simmons found that the taxpayer complied with the substantiation requirements of section 170 because she "included all of the required information in the appraisals attached to her returns or on the face of the returns."

Valuation of a conservation easement

The donor's qualified appraisal must identify the method of valuation and the specific basis for the valuation of the easement. See sections 1.170A-13(c)(3)(ii)(J) and (K).

Due to the general absence of a market for the sale of conservation easements, the fair market value of an easement is generally determined by comparing the fair market value of the underlying property before the granting of the easement to the fair market value of the underlying property after the granting of the easement (the before and after method). See section 1.170A-14(h)(3)(i); Hilborn v. Commissioner, 85 T.C. 677 (1985); Griffin v. Commissioner, T.C. Memo 1989-130, aff'd, 911 F.2d 1124 (5th Cir. 1990).

However, 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 sale prices of such comparable easement. See section 1.170A-14(h)(3)(i).

The "before" value of the property generally reflects the highest and best use of the property in its condition just before the donation of the easement. See Hilborn, supra at 689. In considering the highest and best use of a property in its "before" condition, the appraiser must take into account the manner by which the property likely would have been developed absent the easement. The evaluation must take into account the effect of existing zoning or historic preservation laws that already restrict the property's development regardless of the existence of the restrictive easement. Section 1.170A-14(h)(3)(ii).

In addition, if the restrictive easement has no material effect on the value of the property, or in fact enhances the value of the property, no deduction will be allowed. See 1.170A-14(h)(3)(ii).