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The Honorable Michael Capuano
Member, U.S. House of Representatives
110 First Street
Cambridge, MA 02141

Attention:

Dear Congressman Capuano:

Thank you for your letter dated August 18, 2010. You asked for clarification on the "Federal Historic Preservation Tax Incentives Program."

The enclosed booklet prepared by the National Park Service (NPS) explains that the NPS administers a program providing information about certain incentives designed to encourage taxpayers to rehabilitate certified historic structures. These incentives include certain state and local benefits and a federal income tax credit for expenditures that taxpayers incur to rehabilitate historic properties (see section 47 of the Internal Revenue Code (the Code)). The booklet briefly mentions charitable contributions for the preservation of historic façades; however, deductions for these contributions are not part of the NPS informational program for rehabilitating historic structures. Rather, completely separate statutory and regulatory provisions under section 170 of the Code govern charitable contribution deductions. The amounts of those deductions generally are equal to the fair market value of the property contributed, not the amounts expended to rehabilitate the structures.

<u>Rules for Deductibility under Section 170 of the Code</u>

Your inquiry includes questions about historic preservation easements, which are also called façade easements. A façade easement generally is an agreement between a taxpayer and a charitable organization to limit the development of, or changes to, the exterior of a certified historic structure. As such, a façade easement is a contribution of a partial interest in real property. Generally, the law does not permit a deduction for a contribution of a partial interest in property (section 170(f)(3) of the Code). However, in 1976, the Congress temporarily allowed a deduction for the contribution of an easement of not less than 30-years duration (section 2124(e) of the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976)). In 1977, the Congress extended the effective dates of this temporary deduction and also required that the taxpayer grant the easement in perpetuity (section 309(a) of the Tax Reduction and Simplification Act of 1977, Pub. L. No. 95-30 (1977)). Finally, in 1980, the Congress made permanent the statutory allowance of a deduction for a “qualified conservation contribution” (section 6(a) of Pub. L. No. 96-541, 94 Stat. 3204 (1980); see section 170(f)(3)(B)(iii) and 170(h)(1) of the Code and section 1.170A-14(a) of the Treasury Regulations (the Regulations)).

Also in 1980, the Congress imposed many requirements taxpayers must meet to satisfy the definition of a qualified conservation contribution. A qualified conservation contribution is a contribution (1) of a “qualified real property interest” (2) to a “qualified organization” (3) “exclusively for conservation purposes” (section 170(h)(1) of the Code). One permissible conservation purpose is the preservation of a certified historic structure (section 170(h)(4)(iv) of the Code; see section 1.170A-14(d)(5) of the Regulations). To meet the exclusively for conservation purposes requirement, the conservation purpose must, among other things, be enforceable in perpetuity, and the easement generally may not permit a use that is destructive of other significant conservation interests (section 170(h)(5) of the Code; see section 1.170A-14(e) and (g) of the Regulations).

In 2006, the Congress enacted legislation that imposed even more stringent rules for a taxpayer to deduct a charitable contribution of an easement on the exterior of a building in a registered historic district (section 1213 of the Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006)). The Secretary of the Interior must first certify the building as being of historic significance to the district (see section 170(h)(4)(C)(ii) of the Code). In addition, the easement must preserve the entire exterior of the building, and it must prohibit any change in the exterior of the building which is inconsistent with the historical character of the exterior of the building. The taxpayer also must attach to the return a qualified appraisal, photographs of the entire exterior of the building, and a description of all restrictions on development of the building (see section 170(h)(4)(B) of the Code).

Substantiation

In addition to the above requirements, taxpayers must adequately substantiate their deductions. In 1984, the Congress required taxpayers claiming deductions for noncash charitable contributions in excess of $5,000 to satisfy several detailed requirements to substantiate their contributions by obtaining qualified appraisals (section 155(a) of the Deficit Reduction Act of 1984 (DEFRA), Pub. L. No. 98-369, 98 Stat. 691 (1984)). Section 155(a) of DEFRA required the Secretary to prescribe regulations implementing these requirements. Under this legislative mandate, the IRS and the Treasury Department promulgated regulations providing that a taxpayer cannot take a deduction for a noncash contribution in excess of $5,000, unless the taxpayer obtains a qualified appraisal prepared by a qualified appraiser and attaches a fully-completed appraisal summary to the tax return on which the taxpayer first claims a deduction for the contribution (section 1.170A-13(c) of the Regulations).

In 1993, the Congress added an additional substantiation requirement. Under section 170(f)(8), a taxpayer cannot take a deduction for contributions of $250 or more unless the taxpayer obtains a contemporaneous written acknowledgment (see section 1.170A-13(f)). In 2004, the Congress added section 170(f)(11) to the Internal Revenue Code, effective for contributions made after June 3, 2004 (section 883 of the American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (2004)). This legislation restated certain requirements of section 155(a) of DEFRA and also added new requirements (see section 170(f)(11)). In 2006, the Congress again added significant new requirements to the substantiation rules, for appraisals prepared for returns filed after August 17, 2006 (see section 1219 of the Pension Protection Act of 2006).

In 2008, the IRS and the Treasury Department issued proposed regulations implementing all of the substantiation and reporting rules (Substantiation and Reporting Requirements for Cash and Noncash Charitable Contribution Deductions, 73 Federal Register 45908 (proposed August 7, 2008)). Notice 2006-96, 2006-2 C.B. 902 (copy enclosed), gives transitional guidance that applies until the regulations are finalized and effective.

Easement Valuation

As stated in the Report of the Senate Finance Committee in 1980 and later reflected in the Treasury Regulations, the deduction for a gift of a facade easement generally is equal to the fair market value of the easement at the time of the contribution. (S. Rep. 96-1007 at 14-15, *reprinted in* 1980 U.S.C.C.A.N. 6736, and section 1.170A-14(h)(3)(i) of the Regulations). If a substantial record of sales of comparable easements exists, the fair market value of the donated easement is based on those sale prices. If no record of easement sales is available, then as a general rule the fair market value equals the difference between the fair market value of the underlying property before the granting of the easement and the fair market value of the underlying property after the granting of the easement. This is generally referred to as “before and after” valuation.

If a taxpayer’s appraisal employs a before and after valuation, the fair market value of the property “before” contribution of a façade easement must take into account not only the current use of the property but also an objective assessment of how immediate or remote the likelihood is that the property, absent the restriction, would in fact be developed, as well as any effect from zoning, conservation, or historic preservation laws that already restrict the property’s highest and best use (S. Rep. 96-1007 at 14-15 and section 1.170A-14(h)(3)(ii) of the Regulations). “After” valuation must take into account the amount of access the terms of the easement permit and the effect that the particular restrictions in the easement will have on the value of the property subject to the easement (section 1.170A-14(h)(3)(ii) of the Regulations).

The Regulations on conservation easement valuation echo the legislative history of section 170(h). They provide that, because each property is unique, the specific, individual attributes of the property both before and after the granting of the easement must be examined. Where the before and after method is used, a "mechanical" application of any valuation methodology is unacceptable. Thus, the value of each easement is based on the particular facts and circumstances of each property on which the façade is located and the particular restrictions imposed (see S. Rep. 96-1007 at 14-15 and section 1.170A-14(h)(3) and (4) of the Regulations).

As you suggest in your letter, valuation of easements is complicated. In some cases, the Service has found that taxpayers are overvaluing their easement contributions. During an audit, the Service carefully examines the easement documents and other factors to determine deductibility. The Service employs appraisers to review taxpayers' appraisals. As appropriate, the Service hires outside appraisers to perform appraisal reviews as well as independent appraisals.

Some have suggested that the Service should allow tax deductions of approximately 10 to 15 percent of the fair market value of the underlying property. There is no safe harbor percentage by which an easement reduces the value of property. The specific facts and circumstances of each easement contribution determine the value of a particular contribution.

I hope this information is helpful. I also have enclosed Publication 526, *Charitable Contributions*, and Publication 561, *Determining the Value of Donated Property*. Please contact me, , or at if we can be of further assistance.

This letter provides certain general principles of the law and is intended for informational purposes only. It does not constitute a ruling.

Sincerely,

John P. Moriarty
Branch Chief, Branch 1
(Income Tax and Accounting)

Enclosures (4)