

NATIONAL TRUST FOR HISTORIC PRESERVATION®

SUMMARY OF CHANGES RELATING TO PRESERVATION EASEMENTS in the PENSION PROTECTION ACT OF 2006 Pub. L. No. 109-280, 120 Stat. 780 (2006)

Historic preservation organizations that accept—or plan to accept—preservation or conservation easements should be aware that, in August 2006, the U.S. Congress enacted significant legislative changes to address abuses in the area of façade easement donations as part of an omnibus pension reform bill, the Pension Protection Act of 2006 (H.R. 4). The new law, which included a number of other reforms in the charitable sector as well as several enhancements to charitable giving incentives, was signed into law by the President on August 17, 2006, as Public Law 109-280.

These changes constitute the first major reforms in the law relating to tax deductions for historic preservation easements in twenty-five years. Many of the changes are logical reforms to address questionable practices by some easement holding organizations and promoters, as highlighted in recent years by Congress, the IRS, and the news media. In particular, section 1213 of Public Law 109-280 includes new “special rules” for easements on contributing buildings in registered historic districts:

- Disallowing deductions for preservation easements that fail to protect the *entire* exterior of a property;
- Prohibiting deductions for easements that allow changes that are incompatible with a building’s historic character;
- Requiring the donor and donee to certify under perjury that the easement-holding organization is qualified to accept easements, and has the resources and commitment to manage and enforce the easement;
- Requiring the owner to provide the IRS more detailed substantiation to prove the value of the donation; and
- Imposing a new filing fee of \$500 for easement deductions over \$10,000

Section 1219 of the law includes other reforms applicable to all charitable property donations, such as:

- Lowering thresholds for overvaluation penalties for donors, and imposing new overvaluation penalties for appraisers; and
- Imposing new qualification standards for appraisals and appraisers.

This summary was prepared by the Law Department of the National Trust for Historic Preservation, 1785 Massachusetts Avenue, N.W., Washington DC 20036. Additional information on preservation easements is available at www.nationaltrust.org/easements. Please note that this publication is not intended to offer legal, accounting, or tax planning advice; because of the complexity of the subject, if legal advice or other expert assistance is required, the services of a competent professional should be sought. Copyright © 2007, National Trust for Historic Preservation. All rights reserved.

At the same time, Public Law 109-280 also includes several provisions that appear less logical or warranted, for example eliminating deductions for non-building structures or land areas in registered historic districts unless individually listed on the National Register, and imposing a new reduction for easements on structures that have also qualified for the rehabilitation tax credit.

All in all, however, the changes included in Public Law 109-280 should help to encourage higher standards of practice for easement holding organizations, easement promoters, and appraisers. Equally important, by reforming the law providing tax incentives for historic preservation easements—and rejecting an earlier congressional recommendation to substantially reduce or eliminate the deduction—Congress has soundly affirmed the validity of preservation easements and the federal tax incentives that encourage them. Indeed, Public Law 109-280 even includes a provision (section 1206) that actually *expands* the availability of the deduction for easements donated in 2006 and 2007, by increasing the amount available for deduction for most taxpayers in any given year (to 50 percent of a taxpayer’s contribution base, versus 30 percent at present), and extending the carry-over period for deductions from five to fifteen years.

The principal revisions included in Public Law 109-280 are summarized below. For more information, check the National Trust’s web site at www.nationaltrust.org/easements, or contact the National Trust’s Law Department at law@nthp.org.

New “Special Rules” for Charitable Contributions of Easements on Buildings in Registered Historic Districts. Public Law 109-280 includes a number of reforms designed to address congressional concerns about questionable promotions and overvaluation of deductions claimed by some taxpayers for the donation of simple façade easements in historic districts. Specifically, Section 1213 of Public Law 109-280 imposes strict new limitations on the tax deduction available for the donation of historic preservation easements¹ on buildings qualifying as certified historic structures by virtue of having been certified as being of historic significance to a “registered historic district”² under IRC § 170(h)(2)(C)(ii), as amended.³

The law includes six ways that tax benefits for such donations would be limited:

- First, the law (in Section 1213(a)(1)) **permits a deduction for the contribution of an easement on a building in a registered historic district only if the easement includes a restriction to preserve the “entire exterior” of the building, including the front,**

¹ This summary generally uses the term “easement” to describe conservation restrictions under IRC § 170(h)(2)(C), but the changes also relate to other qualifying conservation “restrictions” on real property under state law, such as, for example, covenants, equitable servitudes, or preservation restrictions.

² The term “registered historic district” as used in the tax code is roughly synonymous with historic districts listed in the National Register of Historic Places, designated by the Secretary of the Interior.

³ IRC § 170(h)(2)(C)(ii), as amended, refers to buildings qualifying as certified historic structures because they have been certified by the Secretary of the Interior to be of historic significance to a registered historic district. The new “special rules” only apply to historic buildings qualifying under this provision, and do not appear to be applicable to properties that separately qualify as certified historic structures under IRC § 170(h)(2)(C)(i) (i.e., by virtue of having been listed in the National Register of Historic Places). However, donors and preservation organizations would be well advised to follow the common-sense guidance reflected in the special rules in any case, such as ensuring that the entire building is protected, and that incompatible changes are prohibited.

sides, rear, and “height” of the building. This provision eliminates charitable deductions, for example, for easements that only protect the front façade of a historic building in a registered historic district.⁴ *This change is effective for easement donations made after July 25, 2006.*

- Second, the law requires that, in order to qualify for the deduction, **an easement protecting a historic building in a registered historic district must prohibit any change to the exterior of the building that would be inconsistent with its historical character.** This requirement would eliminate deductions for easements that purport to preserve a historic structure as provided by section 170(h) of the Internal Revenue Code, but do not include restrictions sufficient to prevent the owner from damaging or destroying a building’s historic character. *This provision is also effective for donations made after July 25, 2006.*
- Third, the law **requires the donor and the recipient easement-holding organization to enter into a written agreement certifying, under penalty of perjury, that the easement-holding organization is a “qualified organization” entitled to receive such donations under the tax code, and that the organization has the resources and commitment to manage and enforce the easement’s restrictions.** *This provision is effective for donations made after July 25, 2006.*
- Fourth, the law imposes new substantiation requirements for taxpayers claiming charitable conservation contributions of easements on buildings located in registered historic districts. Specifically, **the taxpayer must include with his or her return a “qualified appraisal,” photographs of the entire exterior of the building, and a description of “all restrictions on the development of the building.”** Presumably the description of restrictions would include those imposed by the easement as well as those imposed under local zoning, planning, or historic preservation laws, since many of the concerns raised about the donation of simple façade easements in historic districts relate to the redundancy between easement restrictions and those restrictions already imposed by such laws. *This provision applies to returns filed for contributions made in the taxable year beginning after the date of enactment of the law (August 17, 2006).* (The law also includes revisions to what constitutes a “qualified appraisal” and a “qualified appraiser”—see the discussion below.)
- Fifth, the law (in Section 1213(c)) provides that **a taxpayer would not be able to claim a deduction for an easement or other qualified conservation restriction on a building in a registered historic district in excess of \$10,000 unless the taxpayer includes with his or her tax return a new \$500 filing fee, to be used by the IRS to enforce the**

⁴ The requirement to preserve the “height” of a historic building is not further defined in the statute. The Joint Committee on Taxation, in its explanation of H.R. 4, appears to interpret this language as requiring that the easement “must preserve . . . the space above the building.” JCT Report JCX-38-06 at 296 (August 3, 2006). It is worth noting, however, that the guidelines implementing the Secretary of the Interior’s Standards for Rehabilitation—often used as criteria for preservation easements—recognize that rooftop additions may be appropriate for historic properties in limited circumstances (i.e., when they are: required for a new use; set back from the wall plane; designed to be as inconspicuous as possible when viewed from the street; and do not radically change the historic appearance of the building). Whether such additions would comply with the requirement to preserve the “height” of a historic building may require further guidance from the IRS.

requirements of the tax code relating to qualified conservation contributions. In other words, taxpayers granting easements on buildings in registered historic districts may claim a deduction in excess of \$10,000 only if the claim is accompanied by the new \$500 filing fee. Fees paid by taxpayers claiming such deductions will provide a dedicated source of funding to assist the IRS in reviewing such claims to ensure their validity. *This provision is to be applied to contributions made 180 days after the bill's enactment into law (February 13, 2007).*

- Sixth, the law (in Section 1213(d)) includes a new provision that **reduces the deduction for easement donations involving properties for which the taxpayer has benefited from the Rehabilitation Tax Credit within the previous five years.** The percentage-based reduction is to be equivalent to the proportion of tax credits allowed to the taxpayer over the previous five years compared to the fair market value of the building at the time of the easement contribution. *This provision is to be effective for easements donated after the date of enactment of the law (August 17, 2006).*

Change in the Definition of “Certified Historic Structure” Remove the Reference to Structures and Land Areas in Registered Historic Districts. Public Law 109-280 also includes a provision (Section 1213(b)) entitled “Disallowance of Deduction for Structures and Land in Registered Historic Districts,” which **amends the definition of a Certified Historic Structure under Section 170(h) of the Internal Revenue Code to eliminate the reference to non-building structures or land areas in Registered Historic Districts.**

Previous law authorized tax deductions for the charitable contribution of conservation easements given for two specific historic preservation purposes: first, for the preservation of a “historically important land area,” and second for the preservation of a “certified historic structure.” IRC § 170(h)(4)(A)(iv). The latter term currently includes buildings, structures, and land areas that are (1) listed in the National Register of Historic Places or (2) located in a registered historic district and certified to be of historic significance to the district. The change made by section 1213(b) of Public Law 109-280 does not amend the definition of “historically important land area” but amends the term “certified historic structure” to strike the words “structure” and “land area” in the description of eligible historic resources located in a registered historic district—narrowing the definition of certified historic structures in registered historic districts to encompass only “buildings.” *This provision is to become effective for qualified conservation contributions made after the date of enactment of Public Law 109-280 into law (August 17, 2006).*

The intent suggested by the title of this subsection appears to be to disallow any deduction for easements that preserve non-building structures or land areas in registered historic districts, at least under the definition set out in IRC § 170(h)(4)(C)(ii) [previously IRC § 170(h)(4)(B)(ii)]. At the same time, this change leaves intact the definitions that allow deductions for easements that preserve non-building structures or land areas that are individually listed on the National Register of Historic Places under IRC § 170(h)(4)(C)(i), or those that otherwise qualify under the separate deduction criteria for easements to preserve “historically important land areas,” under IRC § 170(h)(4)(A)(iv).

Donors and easement-holding organizations should be aware that, depending on how this language is interpreted, it may affect the deductibility of easements that protect land areas or

ancillary structures that help preserve the historic context of historic buildings in registered historic districts. The revision may also reduce the availability of easement donations as a tool for preserving privately-owned land areas that encompass battlefields, archaeological sites, and rural historic landscapes, since many of these resources may not be individually listed in the National Register, but otherwise contribute to the historic significance of National Register historic districts. (Many of these properties include non-building structures, such as fortifications, monuments, stone fences, ruins, and other similar resources of historic value). These areas, however, may separately qualify as “historically important land areas” under IRC § 170(h)(4)(A)(iv).

Changes Relating to Valuation Penalties for Taxpayers and Appraisers. Section 1219 of Public Law 109-280 includes several different provisions that would discourage overstatements of valuations by both taxpayers and appraisers.

Immediately following media reports in December 2004 raising serious questions about the overvaluation of façade easement donations on historic buildings in highly-restricted locally-regulated historic districts, Chairman Chuck Grassley of the Senate Finance Committee and Senator Max Baucus, ranking member of the Committee, issued a joint statement describing their intention to introduce new legislation that would increase and create additional fines and penalties on promoters, taxpayers, and appraisers who participate, aid or assist in the donation of façade easements found to be “significantly overvalued.”

Consistent with that statement, Public Law 109-280 lowers the threshold percentages for overvaluation penalties, making it easier to impose such penalties on taxpayers. The law also imposes new overvaluation penalties on appraisers.

Section 1219 makes the following changes to prior law:

- First, Section 1219(a)(1) **amends the tax code to lower the threshold for accuracy-related taxpayer penalties for “substantial” and “gross” valuation misstatements relating to charitable deduction property, including easement interests.** The threshold for determining whether a taxpayer has made a “substantial valuation misstatement” is to be set at 150 percent of the amount determined to be the correct amount of the value of the property subject to the deduction (reduced from 200 percent). The new law lowers the threshold for a “gross valuation misstatement” for charitable deduction property to 200 percent of the amount determined to be the correct value of the property (reduced from 400 percent). The law (Section 1219(a)(2)) also eliminates an existing “reasonable cause” exception in the case of underpayments that reflect “gross valuation misstatements” of charitable deduction property, based on the revised thresholds. *These changes would generally apply to returns filed after the date of enactment of the bill into law (August 17, 2006), except that these penalty changes would be retroactive to returns filed after July 25, 2006, in the case of a contribution of an easement or other conservation restriction on the exterior of a building located in a registered historic district.*
- Second, Section 1219(b) adds a new provision to the tax code **to impose penalties on appraisers who knew or who “reasonably should have known” that an appraisal would be used in connection with a tax return if the claimed value of the property**

results in a substantial or gross valuation misstatement. This provision would not be limited to charitable deduction property, but the lowered valuation misstatement thresholds for charitable deduction property would presumably apply. The amount of the penalty would be the lesser of (1) 10 percent of the amount of the underpayment attributable to the misstatement or \$1,000 (whichever is greater), or (2) 125 percent of the gross income received by the appraiser. The law includes a limited exception if the Secretary of the Treasury determines that the value established in the appraisal was “more likely than not” the real value. *These prospective appraiser penalties would generally be applicable with respect to returns filed after the date of enactment of the bill into law (August 17, 2006), except that, again, they would be retroactive to returns filed after July 25, 2006, in the case of a contribution of an easement or other conservation restriction on the exterior of a building located in a registered historic district.*

- Finally, Section 1219(d) amends current law to provide that appraisers may be barred from practice before the Department of the Treasury or the IRS after notice and a hearing even without having been assessed a penalty for aiding and abetting the understatement of a tax liability. This provision would be effective for returns filed after the date of enactment (August 17, 2006).

Changes Relating to Appraisal and Appraiser Qualifications. Section 1219 of Public Law 109-280 would also strengthen qualification requirements for appraisals, as well as for appraisers who value property given for a charitable deduction:

- Section 1219(c) of Public Law 109-280 revises the statutory definition of “qualified appraisal,” and also adds new “qualified appraiser” requirements for substantiating the value of charitable donations. The term “qualified appraisal” would continue to be defined in the tax code by reference to guidance or regulations issued by the Treasury Department, but with the addition of a new statutory requirement that a **“qualified appraisal” must be prepared by a “qualified appraiser in accordance with generally accepted appraisal standards.”** Following the enactment of Public Law 109-280, one key issue for determining whether a taxpayer has substantiated a deduction with a “qualified appraisal” will be whether the appraiser who prepared it is deemed to be a “qualified appraiser.”
- The term **“qualified appraiser” is defined under the new law as an individual who (1) has earned an appraisal designation from a recognized professional appraiser organization (or has otherwise met minimum education and experience requirements established by the Secretary of the Treasury), (2) regularly performs appraisals for compensation, and (3) meets any other requirements that the Secretary of the Treasury may establish.** In addition, the law requires that **an individual would not be considered to be a “qualified appraiser” with respect to a specific appraisal unless he or she “demonstrates verifiable education and experience in valuing the type of property” in question** and has not been barred from practice before the IRS or the Treasury Department during the previous three years. *These requirements would apply to appraisals prepared for any tax return filed after the date of enactment, so any taxpayer who anticipates filing a return in 2007 for an easement deduction in 2006 should keep in mind that these new appraisal and appraiser standards would apply.*

Changes Relating to Annual Deduction Limitations and Carryover Period for Qualified Conservation Contributions. Finally, Public Law 109-280 includes a number of other provisions relating to charitable deductions, ranging from expanding tax deductions for contributions of book inventory, to reforms for charitable contributions of taxidermy property. One of these additional provisions, unrelated to the reform provisions of Sections 1213 and 1219 of Public Law 109-280, makes several important and positive changes to current limitations imposed with respect to the availability of the deduction of all types of qualified conservation contributions (including conservation and preservation easements) under Section 170(h) of the Internal Revenue Code.

Under current law, a donor of a qualified conservation contribution is entitled to a charitable contribution deduction in the amount of the appraised value of the donated property interest, but in most cases such deductions are generally limited (in the aggregate, including other charitable deductions) to 30 percent of a taxpayer's contribution base for the year in which the donation is made. (The "contribution base" is a taxpayer's adjusted gross income without regard to any net operating loss carryback). Any excess deduction over this limitation may be carried forward under the same terms for up to five additional years. (Different deduction limitations apply to taxpayers who use a cost basis for determining the value of their property, most commonly for those who donate an easement within a year after purchasing a property.)

For taxable years beginning in 2006 and 2007, Section 1206 of Public Law 109-280 increases the amount of the deduction limitation for individual taxpayers from 30 percent to 50 percent of the taxpayer's contribution base in the year the donation is made, and would extend the carryover period to 15 years. For qualified farmers and ranchers, the aggregated contribution limitation would be extended to 100 percent of the taxpayer's contribution base in the year of the donation, with a 15 year carry forward period. This change would provide a significant additional enhancement to the charitable conservation deduction, particularly for those property owners—farmers and ranchers especially—who have limited annual incomes, but high-value property with significant conservation or preservation values. *Unless extended, these changes would be effective, however, only for the two tax years noted above: it expressly applies to contributions made in taxable years beginning after December 31, 2005, but has a "sunset" provision stating that it is inapplicable to contributions made in taxable years beginning after December 31, 2007.*

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