

Preservation Easements: Recent IRS & Appraisal Profession Initiatives

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Preservation Easements: IRS & Appraisal Profession Initiatives

- ▶ Why is appraising easements a timely and important topic?
 - Recent IRS initiatives and challenges
 - Recent appraisal profession initiatives & courses
 - Preservation organization responsibilities to review appraisals
 - Appraiser responsibilities to review effectiveness of past easement organization enforcement activities compared to local historic preservation law enforcement

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- ▶ Recent IRS initiatives
 - Appointment of an Issue Management Team for easement donations
 - More than 900 easement files opened
 - IRS Chief Counsel Advice – September 2007
 - IRS market studies of easements in Washington, D.C., New York City & Chicago
 - Aggressive posture (zero value) in many recent reviews & recent Tax Court cases

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- ▶ What prompted IRS initiatives?
 - *Washington Post & Philadelphia Inquirer* news stories
 - Congressional hearings
 - Aggressive promotion of easement donations on single-family homes by some preservation organizations

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Preservation Easements: IRS & Appraisal Profession Initiatives

- ▶ Results in new IRS initiatives
 - Appointment of an Issue Management Team for easement donations
 - More than 900 easement files opened
 - IRS market studies of easements in Washington, D.C., New York City & Chicago
 - Aggressive posture (zero value) in many recent reviews & recent Tax Court cases
 - IRS Chief Counsel Advice – September 2007

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- IRS Washington, New York & Chicago market studies
 - Studies involved collection and analysis of sales of single-family properties protected by easements
 - IRS retained outside appraisal experts to undertake the studies

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- ▶ IRS has recently provided copies of the Washington, New York & Chicago studies to attorneys for taxpayers & preservation organizations

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- ▶ IRS Washington, D.C. market study
 - Sales of easement protected single-family homes during 2003 to 2007
 - Five DC historic neighborhoods
 - Paired Data Analysis – 27 easement encumbered sales compared to unencumbered comparables
 - Adjusted comparables for differences

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- ▶ IRS D.C. market study (cont.)
 - Encumbered properties sold within a range of +11.6% higher to -10.4% lower
 - Average adjusted price for easement properties was +1.2% higher
 - Median adjusted price was +0.5% higher

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- ▶ IRS D.C. market study (cont.)
 - Study also included broker interviews
 - "Virtually all" brokers interviewed said residential facade easements had no effect on price or value

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- ▶ IRS D.C. market study (cont.)
- ▶ Study conclusion - preservation easements on single-family residential properties in D.C. historic districts have "no influence" on fair market value

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- ▶ IRS D.C. market study (cont.)
 - Study did not involve any actual appraisals on individual properties
 - Study acknowledged that each property must be looked at on a case-by-case basis and that "proper way" to measure easement impact is a "before and after" appraisal

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- ▶ IRS New York market study
 - Used ACRIS and Property Shark to gather information on 361 New York City easement encumbered properties
 - Found 57 sales of easement protected townhouses & analyzed 28 “arms length” sales between 2003 and 2007
 - Compared the 28 sales to 150 sales of similar but unencumbered townhouses

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- ▶ IRS New York market study (cont.)
 - Study also analyzed sales/resale of a few easement properties & conducted broker interviews
 - Study conclusion – no impact on FMV of townhouse properties from imposition of a preservation easement

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- ▶ IRS reportedly using the New York and Washington, D.C. studies as basis for letters to easement donors in those cities stating that the value of a preservation easement donation on residential properties is “zero”

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- ▶ IRS Chicago study – single family homes
 - In three City of Chicago historic neighborhoods and two suburban historic areas
 - Found small impacts in some neighborhoods and no impacts in other neighborhoods
 - Used methodologies similar to those used in D.C. and NYC

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- IRS Chief Counsel Advice of Sept. 2007
 - IRS will not accept any facade easement appraisal based on a stipulated percentage of value.
 - Former IRS audit manual discussing 15% to 20% market impact was for training purposes and could not be used or cited as authority.
 - There is no generally recognized percentage by which a preservation easement reduces value.

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- Congressional investigations and IRS initiatives result in new appraisal profession initiatives
 - Lobbying -- leads to Pension Protection Act 2006
 - Joint task force: Land Trust Alliance, National Trust, Appraisal Institute, ASA, ASFMRA
 - Two new courses for appraisers
 - Pressure IRS to accept USPAP as appropriate standard for conducting easement appraisals

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- Industry Joint Task Force concludes that appraising easements is a timely and important topic
- Joint appraisal profession and easement movement task force recognized need for additional appraisal training based upon a commonly accepted methodology.

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- One result of task force meetings are two new certificate courses prepared in response to recent IRS regulatory initiatives:
 - Pension Protection Act of 2006 AND
 - IRS Transitional Guidance Rule of November 2006
- BOTH PPA 2006 and Transitional Guidance Rule require appraisers to have the "combination of education and experience relevant to the property being valued."

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- New courses developed to assist appraisers in avoiding appraiser penalty provisions added by PPA of 2006
- If appraiser provides a “substantial” or “gross” overvaluation, appraiser can be penalized lesser of:
 - 10% of the tax underpayment or \$1,000, whichever is greater, OR
 - 125% of the gross income received by the appraiser from the assignment
- Appraisers can also be barred from practice before Department of Treasury or IRS.

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Valuation of Conservation Easements & Appraising Historic Preservation Easements



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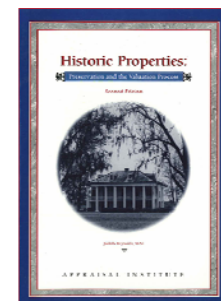
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- ▶ *Appraising Historic Preservation Easements*
– 3–Day Course
 - Premiered in Chicago early October
 - Upcoming programs scheduled in NYC in mid–November, D.C. area in January, and Florida in February
 - Other programs later next year
- ▶ The new courses and a book to be published next year will replace prior publications on easement appraising

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- Pension Protection Act of 2006
 - Appraisals must be done “in accordance with generally accepted appraisal standards.”
 - New courses intended by the appraisal profession to establish the generally accepted appraisal standards

Preservation Easements: IRS & Appraisal Profession Initiatives

- ▶ Two essential questions when reviewing a preservation easement appraisal:
 - Is the appraiser a “qualified appraiser”?
 - Is the appraisal a “qualified appraisal”?

Preservation Easements: IRS & Appraisal Profession Initiatives

- ▶ Meaning of *qualified appraiser* – Treas. Reg. 1.170A-13
 - Holds self out to public as an appraiser
 - Is qualified to appraise the type of property being appraised – e.g., a preservation easement
 - IS NOT ANY OF THE FOLLOWING:
 - The property owner or the taxpayer claiming the deduction
 - A party to the transaction in which the property was acquired
 - A person employed by or related to the property owner, the taxpayer, a party to the acquisition, or the easement holder

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- ▶ Meaning of *qualified appraiser* – additional requirements added by PPA 2006
 - Has an appraisal designation OR otherwise has met minimum education and experience requirements set forth by Secretary of the Treasury
 - Regularly performs appraisals for compensation
 - Meets other requirements established by Secretary of Treasury
 - Demonstrates verifiable education and experience in valuing type of property involved –e.g., preservation easements
 - Has not been prohibited from practicing before IRS last three years

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- ▶ Meaning of *qualified appraiser* – additional Transitional Guidance statements in IRS Notice 2006-96
 - Treated as having verifiable education and experience if a declaration is made in the appraisal that because of background, education, experience, and membership in professional associations, the appraiser is qualified to appraise the type of property being valued.
 - Licensed or certified appraisers in the state in which the property is located will be treated as having met the minimum education and experience requirements (for returns filed after October, 19, 2006).
 - The Transitional Guidance statement does not distinguish between permanent and temporary licensees.

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- ▶ Qualified appraisals
 - I.R.C. Section 170(a)(4) and (a)(5)(A)
 - Treas. Regs. Section 1.170A-13(c)(3) and (c)(5)
 - Must be completed if value of the charitable donation exceeds \$5,000

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- ▶ A qualified appraisal **MUST** contain
 - Description of the property
 - Description of physical condition of the property
 - Date of the charitable donation
 - Terms of any agreement between donor and donee related to the use, sale, or disposition of the property

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- A qualified appraisal **MUST** contain (cont.)
 - Name, address, and taxpayer ID number of qualified appraiser and appraiser's employer
 - Summary of appraiser's qualifications including background, experience, education, and membership in professional appraisal organizations
 - Statement that appraisal was prepared for income tax purposes

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- ▶ A qualified appraisal **MUST** contain (cont.)
 - Date of the appraisal report
 - Appraised fair market value on date of donation
 - Method of valuation used
 - Specific basis for valuation (e.g., comp sales, before and after method)
 - Description of appraisal fee arrangement

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- ▶ Also, to be a qualified appraisal
 - Fee cannot be based upon a percentage of the appraised value
 - This rule complies with USPAP requirement

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- ▶ Additional qualified appraisal content requirements added by PPA 2006
 - Declaration that because of background, education, experience, and membership in professional associations, appraiser is qualified to appraise the type of property being valued
 - Photos of all exteriors (if in a historic district)
 - Description of all restrictions on the development of the building if in a historic district - include **SPECIFIC** description of easement restrictions (*Simmons* case)

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- ▶ Timing of a qualified appraisal
 - Cannot be completed any earlier than 60 days *before* the date of donation OR submitted *any later than* the date on which the taxpayer files tax return (with extensions) for the year in which donation was made
 - When completing a retrospective appraisal, date of value is the date the easement is donated, NOT the date of report submission

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- Other things to look for when reviewing an easement appraisal report:
 - Is the appraiser's "scope of work" sufficient?
 - Has the appraiser undertaken a "narrative" report rather than a "form" report?
 - Has the appraiser undertaken only a "restricted use" report?

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- ▶ USPAP Scope of Work Rule
- ▶ Scope is "acceptable" when it "meets or exceeds" BOTH expectations of "regularly intended users for similar assignments" AND actions that would be taken by the "appraiser's peers" in similar assignments

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- ▶ USPAP Scope of Work Rule (cont.)
 - IRS is a regularly intended user of preservation easement appraisers
 - So the scope of work must meet IRS expectations related to detailed support for analysis and conclusions

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- ▶ Form reports are NOT appropriate because
 - Preservation easement appraisals require detailed highest and best use analysis
 - Preservation easement appraisals typically require use of the cost approach
 - Form reports lack the necessary content of a qualified appraisal
 - Most experienced easement attorneys do not accept form reports

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- ▶ Form reports are NOT appropriate because
 - Conservation easement valuation course (written by an appraiser's peers) states that an easement appraisal report "requires an exceptionally high level of detail and explanation" and presents an outline for a narrative appraisal report as a model report

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- ▶ Form reports are NOT appropriate because
 - IRS does not commission form reports for Tax Court
 - IRS is a regularly intended user of easement appraisal reports

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- ▶ Other reasons for detailed narrative reports
 - Overvaluation penalties on appraiser argue for detailed analysis and explanations
 - The appraisal report may have to stand on its own
 - In an administrative review proceeding
 - In Tax Court, rules of evidence do not allow appraiser to provide direct testimony – report submitted is the direct report

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- ▶ Restricted use reports are appropriate ONLY IN LIMITED CIRCUMSTANCES
 - By definition, restricted use reports cannot be provided to third parties
 - May be appropriate as preliminary reports for internal easement donation decision making
 - Restricted use reports do not meet the definition of a qualified appraisal

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- ▶ Restricted use reports are appropriate **ONLY** in limited circumstances
- ▶ “Except when specifically commissioned by a federal agency or the IRS, this type of report is virtually never acceptable for use by federal agencies...or in connection with a noncash charitable contribution.” Appraisal Institute course, *Valuation of Conservation Easements*

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- Other things to look for when reviewing an appraisal report
 - Has the appraiser researched actual sales of easement encumbered properties?
 - Has the appraiser described/analyzed the easement restrictions and compared them to any existing historic preservation laws?
 - Has the appraiser recently interviewed the easement holder to determine effectiveness of enforcement program?

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- If the appraiser has NOT found any truly comparable post-easement sales has he/she used any of the alternative market analysis techniques utilized by IRS and referenced in Appraisal Institute course?
 - Paired sales analysis
 - Case studies
 - Interviews with buyers, sellers, brokers

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- ▶ Appraising Preservation Easements Today
 - Especially challenging & complex
 - High likelihood of IRS review
 - Potential risk of overvaluation penalties

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- ▶ Appraising Preservation Easements Today
 - Due to number of easement properties, research and analysis of actual sales of easement properties increasingly possible
 - Appraiser needs cooperation from the easement organizations in understanding its easement program, comparing the easement to existing preservation laws, and finding sales of easement encumbered properties

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- ▶ Role of appraiser will continue to evolve.
- ▶ Professional appraisal organizations will continue to be active with courses, articles, seminars, and books.
- ▶ IRS' close scrutiny will continue.
- ▶ IRS will seek overvaluation penalties against appraisers.
 - Prior to 2007, no appraiser ever penalized by IRS.
 - In 2007, IRS reportedly imposed overvaluation penalties on three appraisers.

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- ▶ States will assist IRS in reviewing appraisals, imposing penalties, and disciplining appraisers.
 - Both Colorado and South Carolina have recently cooperated with IRS in reviewing appraisals.
 - Colorado sanctioned an appraiser in 2007.
- ▶ As a result of IRS reviews, possible overvaluation penalties, and state reviews, fewer appraisers will be willing to undertake an easement appraisal assignment.

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