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Facade easements alive and well?

A historical easement or a façade easement is a grant or transfer by a property owner of certain rights the owner has in a building and/or land. Typically, the recipient is a not-for-profit organization. The purpose of such an easement is to preserve the exterior appearance of a historical building (or, in the case of a conservation easement, to preserve open land or wildlife habitat). In essence, the owner transfers to the not-for-profit certain future rights to all or a portion of the building or land and/or imposes negative restrictions on the future use or development of the property. Through the grant of easement, these development rights are conveyed (or lost) in perpetuity regardless of any subsequent changes in ownership, zoning, or economic conditions. However, the historical building itself is also protected in perpetuity regardless of any such subsequent changes.

As an additional benefit to the owner and as a Congressionally mandated incentive for historical preservation and redevelopment, federal law allows a grant of a historic preservation easement to a qualified 501(c)(3) not-for-profit organization to be treated as a charitable con-



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tribution or tax-deductible gift on the property owner's tax returns. Under Internal Revenue Code Section 170(h), the owner of property located in a designated historical district or listed in the National Register of Historic Places who conveys a preservation easement in the property qualifies for a tax-deductible charitable contribution equivalent to the fair market value of the easement, as determined by a qualified real estate appraiser.

Generally speaking, the value of the easement or gift is the diminution of the property's economic value because of the easement, i.e., the difference between the value of the property before or without the easement and its diminished value after or because of the easement (called the "before and after" analysis). This amount may be considered a charitable

contribution for tax purposes and, traditionally, this deduction has been between 10% and 15% of the property's value. However, a proper valuation of the easement depends on variables that are unique to each property, including existing local zoning and historic preservation laws, and the Internal Revenue Service has rejected a "mechanical" application of any "generally recognized" percentage in the valuation of an easement.

In the past few years, there has been significant media, Congressional and IRS attention paid to abuses involving historical easement transactions, particularly, in the overvaluation of easements and in the qualifications of some not-for-profit organizations. Questions have also been raised about the value or necessity of easements in historical districts where changes to exteriors of buildings are believed to be already forbidden or at least restricted. In response, and with the support of prominent preservation organizations, Congress passed legislation in 2006 which establishes special rules for preservation easements, imposes new qualification standards for appraisals and appraisers, requires more detailed substantiation,

and increases penalties for overvaluation. (Public Law No. 109-280 (signed into law on August 17, 2006)). In doing so, and in rejecting calls to substantially curtail or eliminate the tax deduction, Congress effectively addressed the abuses but also emphatically reiterated its support for preservation easements and the federal tax incentives available for them.

More recently, concern has been expressed about the IRS's approach or attitude to historical easements, notwithstanding Congress's reforms in 2006 and its unequivocal continuing support for the tax incentive. The National Trust for Historic Preservation, together with the National Housing & Rehabilitation Association, raised this concern directly with the IRS in July 2007. The resulting dialogue led to a letter from the IRS, dated March 13, 2008, which the National Trust has characterized as a "positive response." The letter confirmed that the IRS recognizes the "importance of preservation," the "legitimacy of properly granted façade easement," and that "Congress, in enacting and amending section 170(h), has clearly endorsed a program to encourage the preservation of certified historic structures." The goal of

the IRS, the letter further stated, "is to carry out Congressional intent faithfully; we wish to do nothing to discourage or deter the donation of legitimate façade easements." Nonetheless, a self-admitted challenge for the IRS (and donors seeking the charitable deduction) is the proper valuation of façade easements, which the IRS concludes is difficult to properly value in many instances.

Therefore, although it is clear that façade easements are alive and well, they may be subject to a degree of uncertainty while the IRS and donors work-out the valuation challenges.

For additional information, including copies of applicable federal law and the communications referenced above, see the web sites of the National Trust for Historic Preservation (www.preservationnation.org) or the Preservation Alliance for Greater Philadelphia (www.preservationalliance.com).

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