SCENIC AND CONSERVATION EASEMENTS: KEYS TO A SUCCESSFUL VALUATION CHALLENGE

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This article discusses the statutory, regulatory, and judicial guidance governing the valuation of scenic and conservation easements for charitable contribution deduction purposes.

Introduction

Valuation plays a key role in numerous areas of taxation. One area that relies heavily on valuation is the arena of scenic easements and conservation easements with scenic views. Naturally, determining an easement's value is subjective and will differ from taxpayer to taxpayer. Once a value is determined and the amount of the charitable contribution deduction can be calculated, it can be included on the appropriate return. Nonetheless, the subjective nature of valuing a piece of property for tax purposes tends to garner attention from the IRS, leading to frequent litigation. As a result, more IRS guidance in this highly challenged area would be helpful. This article is divided into several sections. First, the statutory authority is discussed. Second, the appropriate administrative authority is explained. Last, applicable cases are reviewed with planning criteria included.

Background

An example is provided below to illustrate the tax implications of a scenic and conservation easement.

Example. Blake and Elizabeth Myers own 100 acres of land around Yonah Mountain in Georgia. The land would be very attractive for building homes because of the incredible view. Moreover, the Georgia Conservancy has consistently been in communication with the Myers in trying to get the couple to donate, but the organization has been unsuccessful so far. At this point in their lives, the timing for donating a scenic easement seems appropriate. The corresponding tax consequences and their belief in the organization's purpose motivate the contribution. The value of the selected property encompassing the scenic easement totals $10 million. The easement's value is $4.5 million. As a result, the couple's charitable contribution amount is $4.5 million (before determining if charitable contribution limitations apply). The highest tax bracket currently is 37% in 2020. This means that the tax savings would be $1,665,000. Also, property tax would decrease from $50,000 per year to $35,000 per year. The tax savings would be significant.

Statutory guidance: Section 170

The Internal Revenue Code ("the Code") addresses this portion of taxation. First, Section 170(a) permits a charitable contribution deduction when property is given or cash is donated within a particular tax year. Next, the property or cash being contributed must be given to an educational institution,[1] church association/convention of churches,[2] or an organization with a principal motive of providing medical care/medical

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education/medical research,[3] etc. Additionally, a qualified conservation contribution includes a donation of an interest of qualified real property,[4] to an organization that is qualified,[5] and it is exclusively for conservation purposes.[6] Furthermore, a qualified real property interest includes one of the following three interests: (1) the donor's whole interest in the property other than a qualified mineral interest; (2) a remainder interest; and (3) a limitation on how the real property can be used. Naturally, a "qualified organization" includes Section 501(c)(3) organizations[7] and other organizations outlined in Section 170(h)(3)(A). The Code goes on to describe a conservation purpose as outdoor recreation land preservation,[8] natural habitat protection for the ecosystem and living creatures such as plants, fish, and wildlife,[9] preservation of undeveloped space which allows for scenic enjoyment[10] or based on guidelines identified by the appropriate local, federal, or state conservation policy,[11] and will provide a significant benefit to the public[12] or help maintain a land area of historical significance.[13] Also, the exclusively for conservation purposes of a donation will not be satisfied unless the purpose is protected in perpetuity.[14]

Administrative guidance: Reg. 1.170A-14

Reg. 1.170A-14 addresses the scenic enjoyment portion of an easement. That is, an easement granting will qualify as a charitable contribution if the donation made for open space protection is also for the general public's scenic enjoyment.[15] More specifically, the impairment of scenic enjoyment will occur if the property's development results in the damaging of scenic character or the interruption of scenic panorama. Various factors affect a property's scenic view, for example, the ability of a visual scene to allow for variety and contrast. Regs. 1.170A-14(d)(4)(ii)(A)(1)-(8) provide seven other factors as well:

1. The land use's compatibility with other land in the area;
2. The land's openness;
3. Being free from urban closeness;
4. The balanced variety of textures and shapes;
5. How the use of the land keeps the urban landscape's character and scale to maintain visual enjoyment, open space, and sunlight for the areas surrounding it;
6. The proposed scenic view's alignment with a methodical state scenic identification program; and
7. The offered scenic view's agreement with a local or regional landscape inventory made in accordance with a suitably thorough review process.

Last, another requirement must be satisfied, which provides that the general public must have access to or from the property visually.

Judicial guidance: *Pine Mountain Preserve*

In *Pine Mountain Preserve*,[16] a father and son obtained plots of land in Alabama beginning in 2004. These portions of land totaled 6,224 acres. Next, Chelsea Preserve, LLLP (LLLP is a limited liability limited partnership and it differs from an LLP because an LLLP is a limited partnership with limited liability protection whereas an LLP is a general partnership with areas of limited liability protection[17]), was created by Eddleman Properties. The purpose of this entity was to hold property. It initially purchased its first plot of land for $225,120. This parcel covered 18.76 acres. Months later, Eddleman transferred the property to Pine Mountain. Then options were obtained giving Eddleman Properties the ability to buy 4,180 acres of forest. These rights were also transferred to Pine Mountain. One particular option was exercised. This resulted in the procurement of 1,189.90 acres. The next two purchases were for plots covering 7.53 acres and 26.55 acres, which were acquired for $250,000 and $1,460,250, respectively. Pine Mountain had discussions with two municipalities and found that Westover would result in more tax benefit. Later, another 365.01 acres were bought at a price of $1,642,545.

The subjective nature of valuing a piece of property for tax purposes tends to garner attention from the IRS, leading to frequent litigation.

1 Section 170(b)(1)(A)(ii).
2 Section 170(b)(1)(A)(i).
3 Section 170(b)(1)(A)(iii).
4 Section 170(h)(1)(A).
5 Section 170(h)(1)(B).
6 Section 170(h)(1)(C).
7 Section 170(h)(3)(B).
8 Section 170(h)(4)(A)(i).
9 Section 170(h)(4)(A)(ii).
10 Section 170(h)(4)(A)(iii)(I).
11 Section 170(h)(4)(A)(iii)(II).
12 Section 170(h)(4)(A)(iv).
13 *Id.*
14 Section 170(h)(5)(A).
15 Reg. 1.170A-14(d)(4)(ii).
16 *Pine Mountain Preserve, LLLP*, 151 TC 247 (2018) and *Pine Mountain Preserve, LLLP, et al.*, TCM 2018-214.
17 Retrieved from https://www.upcounsel.com/lllp-vs-llp on Feb. 18, 2021.

Pine Mountain then gave up 50% of its partnership profits, losses, and cash flows to investors, while retaining the other 50%. In November of 2005, 1,273.21 acres were acquired by Pine Mountain.

The first easement under investigation spanned 559.48 acres and was contributed to the National American Land Trust (NALT) by Pine Mountain on December 27, 2005. It was composed of a manufactured lake and ridgeline areas. In October of 2006, two tracts of land covering 1,352.72 and 794.64 acres were obtained. Subsequently, investors purchased more limited partnership units still owning 50% of profits, losses, and cash flows. That same year a rezoning application was sent into Westover. The rezoning request was submitted to change the area from "agricultural preserve" to "planned unit development." A second easement was contributed to the NALT which included 499.23 acres. In 2007, two more plots were bought spanning 676 and 519.91 acres. The municipality, in 2007, rezoned the property to a planned unit development (from an agricultural preserve). The third easement was donated at the end of 2007. That contribution consisted of 240.24 acres.

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The 2005 easement was composed of ridgelines, a man-made lake, and high elevation land. Its purpose was to protect natural habitats for plants, wildlife, and fish. Additionally, it was supposed to serve as open space allowing for scenic enjoyment for everyone. Specifically, three tree communities were to be guarded and a scenic woodland view would be available, to name a few. However, the building of a single-family unit was permitted. Moreover, property alterations were acceptable as long as both parties (Pine Mountain and NALT) agreed. The 2005 easement included a list of allowable activities. Also, the Trust had no power to do anything that would disqualify the contribution from being allowed as a qualified charitable contribution. The easement contributed in 2006 encompassed 499.23 acres. The main difference between the easements contributed in 2005 and 2006 was wording indicating that the contribution must advance the conservation policy of local, state, or federal governments with regards to the latter donation. Last, the third easement contributed (2007 easement) totaled 224.55 acres. The language in the 2007 easement was similar to the 2005 contribution. The amount of deductions taken as a result of the 2005, 2006, and 2007 easements were $16,550,000, $12,726,000, and $4,100,000, respectively. An appraisal and appropriate schedules accompanied each of the taxpayer's returns.

An expert witness (Raymond Veal) testified on behalf of the taxpayer. This appraiser had experience deriving property worth for golf courses, commercial buildings, and hotels to name a few. This expert based his decision-making on a market feasibility study when calculating the contribution amount. The three contributions, based on his analysis, were worth $97.37 million. This number far exceeded what the taxpayer originally deducted on the return ($33,376,000). Gary McGurrin was the appraiser the Service brought before the Tax Court. His examination involved analyzing property that was similar. His main investigation focused on the most recent six easement purchases. After weighing the evidence, he believed a per acre price of $2,000 was adequate. As a result, the three easement values end up totaling $1,119,000 (2007), $998,000 (2006), and $449,000 (2005) per the Service's expert witness.

The IRS contended that the easement did not satisfy the granted in perpetuity requirement. This argument was supported by the ability of the contributing party to take ownership of the easement property, thereby leading to the development of the property into 16 family residences. With regards to the 2005 easement, the wording provided that the borders of the areas where building was permitted could be changed as long as the trust and Pine Mountain agreed. The judiciary first acknowledged that Pine Mountain was given considerable rights. For instance, these included the ability to move the building areas to more attractive sites multiple times. Furthermore, considerable freedom was granted with regard to buildings and structures that could be added to the buildings. Also, the easement's restrictions had no impact on how the builder could create a 16-unit residence. As a result, the easement did not qualify as a "qualified real property" interest and could not be deducted.

Next, the 2006 easement was being challenged. It allowed for six areas where buildings

could be built, and the location of the building areas were not set out with regards to the easement. The only wording used was that the trust must approve the location. This meant that the developer could build anywhere, which indicates the protected in perpetuity requirement would not be satisfied. Additionally, no perpetual use restriction was attached to the property. Once again, the donation claimed did not qualify as a legitimate charitable contribution.

The easement donated in 2007 had strong wording. First, the easement explicitly stated the areas where building was not allowed. On the other hand, a water tower could be constructed. Nevertheless, the decision rendered by the court held that the easement qualifies as a "qualified real property interest." Consequently, the deduction was allowed. The IRS did argue that the exclusively for conservation purposes requirement was not met, but this position was rejected by the judiciary. The other argument brought forth by the IRS focused on language that gave the parties freedom to change the easement, which meant the restrictions attached to the easements were not actually perpetual. The judge's response indicated that the Service's argument would prevent any type of modification and, therefore, was without support.

The judge determined the value of the 2007 easement was $4,779,500. The rationale behind this rendering was quite involved. The court first evaluated each appraiser's arguments. The taxpayer's appraiser utilized two approaches to determine a value. These methods included the discounted cash-flow method and the sales comparison method. This analysis deemed the value of the 2007 easement to be $9,119,000. The Service's expert witness implemented the before-and-after method as well as the sales-comparison method. After careful consideration, he valued the easement at $449,000. One key finding by the judge was that the property had a possibility of being developed. Additionally, the Service's witness found useful information consisting of other conservation easement prices. Next, the scenic views on the easement added value to the property owned by Pine Mountain. As a result, the taxpayer's appraiser overestimated and the Service's appraiser underestimated the easement's value, leading to the Tax Court's final decision. Nonetheless, the amount by which one of the parties overestimated the easement value seemed to be very close to the number by which the other party underestimated the value of the contribution. This led to the value of the easement being deemed to be $4,779,500.

On appeal,[18] the Eleventh Circuit decided that the granted-in-perpetuity requirement was satisfied for both the 2005 and 2006 easement. First, there was a limitation on the real property's use. Additionally, there was no language suggesting that the property could go back to the contributing party. The restriction that was placed on the use of the property was broad, which still allowed the test to be met. Moreover, the company's preexisting development rights were broadly limited when evaluating the 2005 and 2006 easements, which supported the donation being restricted. The court next focused on whether the conservation purposes were sufficiently guarded and whether the actual boundaries of the contribution were modified. Since the entire parcel of land was restricted, the court indicated that Section 170(h)(2)(C) was met.

The perpetuity requirement was also addressed. One point the appeals court discussed was the fact that the boundaries were fixed but the building areas could be relocated within the easement's border. No property outside of the donation could be traded for property within the contribution. The key determination made by the court was the fact that the property was restricted in perpetuity. All three of the easements thereby would be eligible to be deducted on the appropriate tax return. As a result, the appeals court decided to remand the decision back to the Tax Court to consider the protected-in-perpetuity requirement for the 2005 and 2006 easements.

Next, the appeals court weighed the arguments by the IRS regarding the 2007 easement in two areas. The first area was whether the protected-in-perpetuity requirement was satisfied. Then, if all protected-in-perpetuity tests were found to be met, the Service did not agree with the valuation.

Modification of the easement was permitted based on the easement's language, but must be agreed to by both parties. This ability to modify the easement had been raised by the Service as having a lot of discretion with regards to the easement. The appeals court disagreed with this particular argument. Additionally, perpetuity, as interpreted by the court, looked more

[18] *Pine Mountain Preserve, LLLP*, 126 AFTR2d 2020-6617, 978 F.3d 1200 (CA-11, 2020).

at the common-law meaning and the fact that the property did not automatically go back to the contributing party. The court disagreed with the Service because two parties involved in a contract always have the ability to adjust their arrangement. Consequently, the power to modify did not cause the protected-in-perpetuity requirement to be violated. The appeals court investigated the Tax Court judge's rationale for ruling on a figure that was approximately the average between the taxpayer's appraiser's value and the Service's appraiser's value. The appellate court, as a result, reiterated that the value of the easement should be determined as the conservation restriction's fair market value. This would need an examination

Careful planning and structuring can create significant tax benefits from an easement granting.

of similar easement sales or an analysis of the difference between the property's value both before and after the easement's granting. Therefore, the Eleventh Circuit remanded the case back to the Tax Court so that the proper valuation could be determined.

***Fannon* (1989)**

In *Fannon*,[19] the taxpayers (husband and wife) possessed scenic property located in a rural area spanning 147 acres in close proximity to Washington, Virginia (this county seat is situated southwest of Washington, D.C.). Most of the property was undeveloped. Part of the plot was covered by the individuals' barn and other buildings. Wells provided water to the property and there was also an on-site septic system. On December 6, 1978, the husband and wife granted an open-space easement to the Virginia Outdoors Foundation (an organization that meets the requirements as a qualified charitable organization). Moreover, the 142 acres of land were protected in perpetuity. However, the scenic easement did not include a portion of the taxpayers' property which measured around five acres. The following restrictions were placed on the easement: (1) no trash dumping; (2) outdoor and sign advertising limitations; (3) each parcel subdivided must cover at least 45 acres; (4) allowance of the cutting of specific timber; (5) limitations with regard to blasting, grading, and earth removal; (6) limitations on what types of structures and the amount of structures that could be built on each subdivided plot of land; and (7) limitations on certain activities (industrial and commercial).

The couple claimed the deduction on their return with the easement valued at $158,682.12. This figure was substantiated from a local real estate expert's appraisal letter dated May 1, 1978. The Service, on the other hand, determined the value of the easement to be zero. As a result, the Service's ruling disallowed the deduction relating to the easement for the 1979, 1980, and 1981 tax years. Consequently, the case concerned the adjudication of the value of the easement contribution.

First, the expert selected by the taxpayers had over 20 years of experience as a real estate agent and worked as a real estate appraiser in that area. Additionally, his experience also covered land use and zoning. Moreover, he served in the capacity as mayor and the Soil and Water Conservation District Director. When analyzing the scenic easement, Miller (the taxpayers' expert) determined that the property's highest and best use before the easement was contributed was residential development. On the other hand, the post-easement highest and best use would be for agriculture. Next, the appraiser implemented the "before and after" method. When determining the $158,682.12 deduction amount, he used the projected value of development without the easement ($211,250) and subtracted out the agricultural land value after the easement was contributed ($52,567.88). He used the per acre price of similar agricultural land located near where the easement was located and multiplied that figure by the number of acres from the easement to get the development value. To obtain the second value (agricultural land value), Miller used a special farm valuation formula that the IRS implements for estate tax purposes. Later, when the case made it to trial, the expert witness calculated a higher easement value.

The Service's appraiser was John A. Davidson from the Philadelphia district. His experience before working for the IRS included holding the title of Chief Appraiser with the U.S. Army Corps of Engineers and being deemed an expert by the Tax Court and various federal courts. His methodology consisted of collecting data from other scenic easement cases. He opted out of discussing the real estate markets with knowledgeable people from the area where the easement was located. Davidson decided to determine the value of the easement by calculating the before value and the after value, which was similar to the approach taken by the taxpayers' appraiser. The Service's ex-

pert analysis resulted in a $215,000 value for the property before and after the easement was contributed. Those values would indicate a zero value for the easement. Davidson examined the surrounding areas since sales within the immediate area were not readily available. Based on his investigation, similar situations to the case at hand showed appreciation in the property value when having easement restrictions. This led to a final determination that there was no reduction in property value because of the scenic easement.

The court first focused on determining the easement's fair market value. When weighing the facts of the case, the judge acknowledged that both appraisers used the before and after method. Both parties also agreed that agricultural use was the property's highest and best use following the contribution of the easement. The difference in the experts came from the value before the easement's contribution. The court first weighed the testimony put forth by the Service's witness, which argued for a zero easement value. This position did not have a lot of merit because Davidson made this decision based on the faulty assumptions that the development of this area from a residential standpoint had not occurred. During the trial, the Service's witness did say that a potential buyer would prefer to make a purchase of a plot without an easement if given the choice. This statement seemed to indicate that an easement encompassing property would affect its value. The judge, therefore, reasoned that the expert witness's failure to find the appropriate parties in the area of the easement had led to his wrong valuation of the easement. On the other hand, the Tax Court determined that the taxpayers' appraiser had greater knowledge in terms of valuing the property and the area around the property. However, the information provided by Miller lacked sufficient evidence to support his calculation. Also, at the trial, his valuation was not properly supported when his testimony was given.

The next step involved the taxpayer providing evidence that the highest and best use of the property was for residential development. The other item being weighed was ascertaining if the chances of residential development were reasonable in the foreseeable future. Several factors played an important role in the court's decision-making. These factors included:

- The agricultural land near the location of the easement being less valuable than the residential land;
- The incorporation of land structures into a residential community;
- The adequacy of soils allowing for the building of numerous residences;
- Examining the ability of the soils to handle septic tank sewage;
- The highway accessibility of the property;
- The ability to be rezoned; and
- The possibility of population increasing in the future.

The court, therefore, sided with the taxpayers' witness that the highest and best use was residential development.

The next task in front of the judge was determining the impact of the easement granting on the value and how much it decreased the property's value. Of the two methods presented to the Tax Court by Miller for the easement value before the easement was granted, the court agreed with the first method. This method outlined by Miller was very close to the before-easement contribution determined by Davidson. Conversely, the two methods described by Miller for the after-easement contribution value were found to be unsupported by the court. The judge referred to another *Fannon* case involving the taxpayer's brother to help determine the easement's value. In the brother's case, the value of the easement was computed to be 37% of the easement prior to the granting. As a result, the judge in the current *Fannon* case decided that 37% of the average of the experts' valuing ($213,000) of the easement before granting would be used as the scenic easement's value. Keep in mind, the easement valuation was lessened by the amount of improvements ($35,000). This resulted in a value of $65,860 ((213,000-35,000) x 37%) for the easement and charitable contribution deduction amount.

Fannon (1986)

In *Fannon*,[20] the taxpayers were a married couple possessing rural property totaling 333 acres in Virginia. This property consisted of wood, meadowlands, and land for crops. Most of the property was undeveloped. However, the taxpayers did have some buildings as well as a pool and barn on the portion of land. Wells provided water to the property and on the land there was an individual on-site septic system. An easement was granted to the Virginia Outdoors Foundation by deed in late

[19] *Fannon*, TCM 1989-136.
[20] *Fannon*, TCM 1986-572.

EXHIBIT 1
Summary of Characteristics that Create a Strong Taxpayer Position and a Weak Taxpayer Position when Contributing Scenic or Conservation Easements

Characteristics of A Strong Taxpayer Position
- Hiring an appraiser with knowledge of the area and surrounding parts (Thayer, Fannon) - Meet granted-in-perpetuity requirements by eliminating the ability of the property to transfer back to the contributing party (Pine Mountain Preserve) - Use appropriate valuation methods: sales comparison, before-and-after, discounted cash flow method (Pine Mountain Preserve, Fannon, Thayer)
Characteristics of a Weak Taxpayer Position
- Hiring a general appraiser with no extensive knowledge of easement area - Failing to restrict the party contributing the easement from getting the property back - Failing to use appropriate valuation methods described by the Regulations

1979. The contribution did qualify for deduction treatment since the foundation was a qualified charitable organization. There were several restrictions placed on the easement. These consisted of: (1) no garbage dumping; (2) limitations on the type of advertising; (3) only lots of 50 acres or more could be divided out (one lot of 38 acres was permitted); (4) limited timber removal; (5) limitations on removing, grading, and blasting of the land; (6) limitations on how many structures could be built as well as the type of structures permitted to be built; and (7) restricting the types of activities (commercial and industrial). The easement value was determined by the taxpayer to be $236,752. The IRS said the contribution value was zero.

The appraiser for the taxpayers was Miller. He lived in the county the easement was granted in for the greater portion of his life. Additionally, he was employed as a realtor for more than 20 years and served on multiple realtor boards. One particular area of considerable experience included the land use and zoning in the county where the easement was granted. Moreover, he also held the position as mayor and District Director for the Soil and Water Conservation Service. The taxpayer argued that the highest and best use for the property after the easement was donated was agricultural. On the other hand, the highest and best use before the contribution was residential development. Consequently, by using the "before and after" approach, the easement's value was determined to be $236,752 ($305,000-$68,248). The taxpayer's expert made the following points in court: (1) the plot contained special attributes; (2) the parcel could be the site for residential homes; and (3) the property was filled with streams and trees. Based on the testimony given, the value at trial increased to $336,000 from $305,000. Additionally, the value per acre was calculated to be $2,500. Next, the couple also mentioned some outside parties and their analyses as support for their position. One of these studies examined composition of the soil. The purpose behind this analysis was to see if residential development was possible. A different report was prepared giving a lower per acre value. Once, in front of the judge, the appraiser found a comparable sale of property occurring in Rappahannock County.

The Service's appraiser, on the other hand, did not actually step foot on the parcel. He examined the plot from afar. His main analysis point was derived from another Tax Court case. The method used by the Service's expert was the before and after method. The $345,000 before and after value determined by the Service's witness resulted in a zero charitable contribution deduction. He also looked at market data. Encumbered property resales were found in counties around Rappahannock and were used in the examination. This same individual determined that the before and after best use was for agriculture. The main argument against the use of residential development was the zoning restrictions.

The court started its analysis by looking at the Service's appraiser. The before-use value of $345,000 was reasonable. Conversely, the court did recognize that with the easement, the value

EXHIBIT 2
Key Scenic and Conservation Easement Case Characteristics

Cases	Taxpayer Presented Appraiser?	IRS Presented Appraiser?	Main Issue	Winning Party
Pine Mountain Preserve - (Regular and Memorandum Decisions)				
2005 Easement	Yes	Yes	Granted-in-perpetuity	IRS
2006 Easement	Yes	Yes	Granted-in-perpetuity	IRS
2007 Easement	Yes	Yes	Granted-in-perpetuity/ Valuation	Closer to IRS's value
Pine Mountain Preserve - (Appellate Decision)				
2005 Easement	Yes	Yes	Granted-in-perpetuity	Taxpayer
2006 Easement	Yes	Yes	Granted-in-perpetuity	Taxpayer
2007 Easement	Yes	Yes	Granted-in-perpetuity/ Valuation	Remand*
Fannon	Yes	Yes	Valuation	Closer to IRS's value
Fannon	Yes	Yes	Valuation	Closer to IRS's value
Thayer	Yes	Yes	Valuation	Closer to Taxpayer's value

*The precise value is yet to be determined on remand.

would decrease. The main flaw in the Service's argument was failing to take into account the growth in the Rappahannock County. Moreover, one plot near where the easement was granted was used for residential purposes. Furthermore, the Service's expert did distinguish between buying property with and without an easement. It was made clear that the Service's witness did not clearly understand what would make the parcel adept for residential development, and that he did not seek out experienced individuals from that area. The Service's report also did not include a sale that was very similar to the property in question. Although the taxpayer's appraiser had more knowledge, the numbers were not clear with regards to how they were computed. Additionally, the decrease in value related to the easement granting was too steep.

As a result, the taxpayer was given the task of showing that the highest and best use of the property was residential development. Seven factors had an impact on the judge's decision. These included:

1. Agricultural land in the area is valued less than residential property in the surrounding area;
2. The characteristics of the land could exist in a residential community;
3. Numerous residences can be built on the soil;
4. Septic tank sewage systems can be built on the soil;
5. Two highways can reach the property;
6. A successful rezoning could be accomplished; and
7. Residential development is possible based on an increase in population.

These together supported the decision for the taxpayer.

The court believed the highest and best use was residential development, which meant the next step in the process was determining the decrease in value related to the easement. The first two methods (using a special use valuation formula and using 30 ten acre lots for developing) used by the taxpayer's expert were without merit. The necessary land coverage for subdividing per lot was ten acres instead of five. Additionally, the petitioner's appraiser did not provide support for dividing the property into 30 ten acre lots. The last portion of evidence brought before the judge was a Commissioner of Revenue of Rappahannock County Report. As a result, the assessor's value was weighed in helping determine the value of the easement. The court did agree that the before use is agricultural and, based on a similar sale, that the

value of the plot was lessened because of the easement. On the other hand, the judge did not comprehend the taxpayer's devaluation of the property. The decision by the judge resulted in the easement being valued at $90,956 because the decrease in value per acre was deemed to be $200 per acre.

Thayer

In *Thayer*,[21] the taxpayer owned property spanning 59.327 acres called Overlook Farm. This parcel of land was in Fairfax County, VA. The plot was situated between the Potomac River and the Gunston Hall Plantation. Improvements were made to the farm, which included adding a farm and masonry house, a dock, a boathouse, a garden, two cottages, a toolshed, two barns, and a house for pheasants. There were wooded parts of the property as well as portions cleared for pasturelands. The plot of land was segregated from the Gunston Hall in the late 1800s and was secluded. Additionally, this property had a tremendous view of the Potomac River. Overlook Farm's main component was a plateau. Also, the parcel was composed of an open field, wooded land, and a garden. The farm could be accessed by a thin dirt road. A septic tank was used on the plot to assist with sewage. Public water was not openly accessible by the farm, either. There was a portion of 11 acres that were developable for single-family homes. The other part of the property was too difficult for developing houses because it was very steep and hilly. Moreover, the sediment was full of gravel and could suffer from erosion and surface sliding. As a result, the ability of the plot to have adequate septic tank drainage fields was not very good.

In the years leading up to 1969, land around the farm was being procured by government agencies and organizations wanting to conserve natural beauty. One particular organization that obtained some of the surrounding land was the Virginia Outdoors Foundation. During 1969, this tract of land was deemed as a RE-2. This indicated the land could be used for agricultural purposes. Next, the taxpayer contributed a scenic easement to the Virginia Outdoors Foundation, which permitted it to be protected in perpetuity. The limitations placed on the easement included no activities, either commercial or industrial; farm buildings and a singular family dwelling unit were the only types of buildings permitted to be built on the plot; outdoor and sign advertising was not permitted; no trash dumping; removal of only certain types of timber; and no subdividing of the parcel. These restrictions prevented the contributing taxpayer from land development.

The petitioner determined that the value of the easement contribution was $146,000. However, the IRS indicated that the easement had a value of $60,000. Later, on January 30, 1969, the taxpayer determined the easement's fair market value was $147,688, with the Service's value remaining at $60,000.

Both parties had expert witnesses testify on their behalf. Fred C. Forberg was the taxpayer's appraiser. He served as the director of the Division of Real Estate Appraisal and Mapping of the Virginia Department of Taxation. Also, he was involved in determining the value of nine out of ten of the easements that the department made for the Virginia Historic Landmarks Foundation and the Virginia Outdoors Foundation. In June of 1972, the appraiser derived the easement value of $147,688 by calculating the before value of the easement at $347,005 (land value of $296,635 plus building and improvements value of $50,370) and the after value of the easement at $199,317 (the land value post-easement was $104,327 and the buildings value post-easement was $94,990). The valuation expert for the IRS had 20 years of experience conducting valuations with three different organizations (the IRS, State Road Department of Florida, and Corps. of Engineers). His before-easement value was calculated at $300,000 with his after-easement value computed at $240,000. Next, a soil scientist was employed by the taxpayer to distinguish the land's ability to have an on-site sewage disposal system. The study found there were several locations that could be a site for septic tank drain-fields. The tax assessor for Fairfax county calculated two figures for the ad valorem real estate taxes, $74,395 and $62,260 (includes both land and improvements). The first number failed to appropriately account for the easement. However, the second number properly included the easement.

The taxpayer and the IRS agreed that the party receiving the easement qualified as a charitable organization. Moreover, the IRS did not dispute whether the easement contribution could be deducted. The only argument was the value of the easement contribution. The loss in value of the property was used to determine the easement's worth because there was no established market for easements. Furthermore, the taxpayer and the Service implemented the "be-

fore and after" approach, which examined the fair market value of the property both before and after the easement donation. Then, the difference would represent the value of the easement. The petitioner's expert witness failed to prepare a written appraisal report and was not hired by the taxpayer but by the Virginia Division of Conservation and Economic Development. He also used general knowledge of the area in determining the easement's value. The court did find that the Service's expert witness was more detail-oriented in trying to find the easement's value and put in more time in trying to find sales that were comparable. One key difference in how the parties' expert witnesses derived their figures was the before-the-easement donated value. The taxpayer's appraiser argued that the best use of the property before the granting was for the building of five to eight luxury homesites. On the other hand, the Service's witness believed the pre-easement highest and best use was for a country gentleman's estate.

Naturally, both parties do agree that the highest and best use for the post-easement property is a country gentleman's estate. The court did agree that luxury homesites were the highest and best use of the pre-easement property. The property was visited and the views were described as magnificent. Conversely, the number of luxury homesites would more reasonably be between two and four. Additionally, the judge did not think that adequate sewage system implementation could serve more than two to four homesites. The court disagreed with the taxpayer's value of $5,000 per acre, siding more with the IRS and mentioning that the price per acre was too high. Also, in calculating the pre-easement value, the improvements should be used in the analysis but have no impact since they were the same both before and after the easement granting. The post-easement granting value was deemed to be $342,500 based on the information brought before the judge. The price per acre determined by the taxpayer's appraiser was approximately $1,750, with improvements totaling $94,990. The Service's valuation witness did believe the limitations and restrictions on the easement decreased the value of the property to be used as a gentleman's estate. These limits resulted in a $1,000 per acre decrease. His after-contribution value of the property was $240,000. The judge found the property after the easement contribution had a fair market value of $229,500. As a result, the amount of the easement using the before and after approach was $113,000.

Discussion

The area of scenic easements and conservation easements with scenic views will continue to be frequently challenged by the IRS due to the subjective nature of this area of taxation. However, careful planning and structuring can create significant tax benefits from an easement granting. First, following appropriate guidelines when determining the value will be essential. Next, locating knowledgeable appraisers also plays a key role in the proper valuing of easement property. The familiarity of the area, awareness of comparable sales, understanding the limitations on the property, determining highest and best use before and after easement granting, and understanding that the easement must be protected in perpetuity should also be under consideration by an expert witness. Exhibit 1, above, highlights characteristics that are indicative of a strong taxpayer position and a weak taxpayer position.

Until more guidance is released by the IRS, this arena of taxation will continue to be consistently litigated by taxpayers. See Exhibit 2, also above, for a summary of characteristics of scenic and conservation easement cases outlined above. ■

[21] *Thayer*, TCM 1977-370.