

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

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subject: Valuing Conservation Easements under § 1.170A-14(h)(3) of the Income Tax Regulations

This Chief Counsel Advice responds to your request for assistance regarding the valuation of perpetual conservation restrictions, or “conservation easements.” Specifically, you have asked about the application of the “Contiguous Parcel Rule” and the “Enhancement Rule” found in § 1.170A-14(h)(3)(i) of the Income Tax Regulations.

Section 170 of the Internal Revenue Code allows as a deduction any charitable contribution payment of which is made within the taxable year.

Under § 170(f)(3), no deduction is allowed for a contribution of an interest in property that consists of less than the taxpayer's entire interest in the property. However, under § 170(f)(3)(B)(iii), a deduction is allowed for a qualified conservation contribution, even though it is a contribution of a partial interest.

Section 170(h)(1) and § 1.170A-14(a) provide that a qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. One such qualified real property interest is a conservation easement.

Section 1.170A-1(c) provides that, if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution. The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. For purposes of § 170(h), the value of a contribution of a conservation easement is its fair market value at the time of the contribution. Section 1.170A-14(h)(3)(i) (first sentence). Section 1.170A-14(h)(3)(i) (second sentence) provides that, if there is a substantial record of sales of easements comparable to the donated easement, the fair market value of the donated easement is based on the sales prices of the comparable easements.

Section 1.170A-14(h)(3)(i) (third sentence) provides that, if no substantial record of market-place sales of comparable easements is available to use as a meaningful or valid comparison, as a general rule (but not necessarily in all cases) the fair market value of a conservation easement is equal to the difference between the fair market value of the property it encumbers before the granting of the easement and the fair market value of the encumbered property after the granting of the easement. This is generally referred to as “before and after” valuation.

Under § 1.170A-14(h)(3)(ii), if before and after valuation is used, the fair market value of the property before the contribution of the 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 easement, would in fact be developed, as well as any effect from zoning, conservation, or historic preservation laws that already restrict the property’s potential highest and best use. Additionally, an appraisal of the property after contribution of the easement must take into account the effect of restrictions that will result in a reduction of the potential fair market value represented by highest and best use but will, nevertheless, permit uses of the property that will increase its fair market value above that represented by the property’s current use.

Under the Contiguous Parcel Rule found in § 1.170A-14(h)(3)(i) (fourth sentence), in the case of a charitable contribution of a conservation easement covering a portion of contiguous property owned by a donor and the donor’s family, the amount of the deduction is the difference between the fair market value of the entire contiguous parcel of property before and after the granting of the easement.¹ For purposes of the Contiguous Parcel Rule, “family” includes brothers and sisters (whether by whole or half blood), spouse, ancestors, and lineal descendants. Section 267(c)(4). “Family” does not include an entity, such as a corporation or partnership, that is classified as separate from its owner under the entity classification rules described below.

¹ Whether the entire contiguous parcel is valued as one large property or as separate properties depends on the highest and best use of the entire contiguous parcel. See § 1.170A-14(h)(3)(ii).

Under the Enhancement Rule found in § 1.170A-14(h)(3)(i) (fifth sentence), if the granting of a conservation easement increases the value of any other property owned by the donor or a related person, the amount of the deduction must be reduced by the amount of the increase in the value of the other property, whether or not that other property is contiguous. For purposes of the Enhancement Rule, “related person” has the same meaning as in either § 267(b) or § 707(b). Section 1.170A-14(h)(3)(i) (eighth sentence).

The relationships listed in § 267(b) include, but are not limited to, the relationships between (1) an individual and members of a family (as defined in § 267(c)(4)), and (2) an individual and a corporation more than 50% in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual. The relationships listed in § 707(b) are those between (1) a partnership and a person owning, directly or indirectly, more than 50% of the capital interest, or the profits interest, in such partnership, and (2) two partnerships in which the same persons own, directly or indirectly, more than 50% of the capital interests or profits interests.

Whether parties are related for purposes of the Contiguous Parcel Rule and the Enhancement Rule may depend on property constructively owned by the donor, the donor’s family, or a related party. Section 267(c) sets forth rules to determine constructive ownership of stock under § 267(b). Under § 707(b)(3), the ownership of a capital or profits interest in a partnership is determined in accordance with the rules for constructive ownership of stock provided in § 267(c) (other than § 267(c)(3)).

Section 301.7701-3(a) of the Procedure and Administration Regulations provides that a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an “eligible entity”) can elect its classification for federal tax purposes. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under § 301.7701-2(b)(2)) or a partnership, and an eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner. Under § 301.7701-3(b), unless the entity elects otherwise, a domestic eligible entity is a partnership if it has two or more members, or is disregarded as an entity separate from its owner if it has a single member. All of the assets of a disregarded entity are treated as if they are owned by the single member. See § 301.7701-2(a); Ann. 99-102, 1999-2 C.B. 545.

Included below are examples applying § 1.170A-14(h)(3) and the other above provisions to various factual scenarios. Any entities involved herein are domestic eligible entities for purposes of § 301.7701-3(b). In no scenario is there a substantial record of market-place sales of comparable easements.

SCENARIO 1: CONTIGUOUS PARCEL OWNED BY DONOR AND DONOR’S FAMILY

Scenario 1(a). Contiguous Parcel Owned by Donor. Donor owns Parcel A and contiguous Parcel B. Donor places a conservation easement on Parcel A.

Under the Contiguous Parcel Rule, the amount of the deduction is equal to the difference between the fair market value of the entire contiguous parcel owned by the donor and the donor's family (as defined in § 267(c)(4)) before and after the granting of the easement.

Accordingly, the amount of the deduction is equal to the difference between the fair market value of the entire contiguous parcel comprised of Parcels A and B before and after the granting of the easement.

Scenario 1(b). Contiguous Parcel Owned by Donor's Family. Donor owns Parcel A, and Donor's mother owns contiguous Parcel B. Donor places a conservation easement on Parcel A.

Under the Contiguous Parcel Rule, the amount of the deduction is equal to the difference between the fair market value of the entire contiguous parcel owned by the donor and the donor's family (as defined in § 267(c)(4)) before and after the granting of the easement. "Family" includes ancestors, such as a mother. Section 267(c)(4).

Since Donor's mother is a member of Donor's family as defined in § 267(c)(4), the entire contiguous parcel comprised of Parcels A and Parcel B is owned by Donor and Donor's family. Accordingly, the amount of the deduction is equal to the difference between the fair market value of the entire contiguous parcel comprised of Parcels A and B before and after the granting of the easement.

SCENARIO 2: CONTIGUOUS AND NONCONTIGUOUS PARCELS OWNED BY DONOR

Donor owns Parcel A and contiguous Parcel B. Donor also owns non-contiguous Parcel C, located near Parcel A. Donor places a conservation easement on Parcel A, and as a result Parcel C will always have a view of a river that abuts Parcel A, thereby increasing the value of Parcel C.

Under the Contiguous Parcel Rule, the amount of the deduction is equal to the difference between the fair market value of the entire contiguous parcel owned by the donor and the donor's family (as defined in § 267(c)(4)) before and after the granting of the easement.

Additionally, the Enhancement Rule provides that, if the granting of the restriction increases the value of any other property owned by the donor or a related person (within the meaning of § 267(b) or § 707(b)), the amount of the deduction for the

conservation contribution is reduced by the amount of the increase in the value of the other property, whether or not that other property is contiguous.

Accordingly, because Donor owns Parcel A and contiguous Parcel B, the amount of the deduction is first determined by valuing the entire contiguous parcel comprised of Parcel A and Parcel B before and after the granting of the easement. Second, because non-contiguous Parcel C is also owned by Donor, the amount of the deduction is reduced by the value of the enhancement to Parcel C from the granting of the easement.

SCENARIO 3: CONTIGUOUS PARCELS OWNED BY DONOR AND DISREGARDED ENTITY

Scenario 3(a). Contiguous Parcel Owned by a Limited Liability Company, of Which Donor Is the Single Member. Donor owns Parcel A and is the single member of SMLLC. SMLLC owns contiguous Parcel B. Donor places a conservation easement on Parcel A. SMLLC has not made an entity classification election under § 301.7701-3(c).

Under § 301.7701-3(b), a domestic eligible entity with a single member generally is disregarded, unless the entity elects to be regarded separately from its owner. All of the assets of a disregarded entity are treated as if they are owned by the single member.

Under the Contiguous Parcel Rule, the amount of the deduction is equal to the difference between the fair market value of the entire contiguous parcel owned by the donor and the donor's family (as defined in § 267(c)(4)) before and after the granting of the easement.

Since SMLLC did not make an entity classification election, SMLLC is disregarded, and Donor is treated as the owner of both Parcel A and Parcel B. Accordingly, the amount of the deduction is equal to the difference between the fair market value of the entire contiguous parcel comprised of Parcels A and B before and after the granting of the easement.

Scenario 3(b). Contiguous Parcel Owned by a Limited Liability Company, of Which Donor's Child Is the Single Member. Donor owns Parcel A. SMLLC owns contiguous Parcel B, and Donor's daughter is the single member of SMLLC. Donor places a conservation easement on Parcel A. SMLLC has not made an entity classification election under § 301.7701-3(c).

Under § 301.7701-3(b), a domestic eligible entity with a single member generally is disregarded, unless the entity elects to be regarded separately from its owner. All of the assets of a disregarded entity are treated as if they are owned by the single member.

Under the Contiguous Parcel Rule, the amount of the deduction is equal to the difference between the fair market value of the entire contiguous parcel owned by the donor and the donor's family (as defined in § 267(c)(4)) before and after the granting of the easement. "Family" includes lineal descendants, such as a daughter. Section 267(c)(4).

Since SMLLC did not make an entity classification election, SMLLC is disregarded, and Donor's daughter is treated as the owner of Parcel B. Accordingly, since Parcel A and Parcel B are treated as owned by Donor and Donor's family, the amount of the deduction is equal to the difference between the fair market value of the entire contiguous parcel comprised of Parcels A and B before and after the granting of the easement.

Scenario 3(c). Contiguous Parcels Owned by Limited Liability Companies, of Which Donor and Donor's Parent Are the Single Members. SMLLC 1 owns Parcel A, and Donor is the single member of SMLLC 1. SMLLC 2 owns contiguous Parcel B, and Donor's mother is the single member of SMLLC 2. SMLLC 1 places a conservation easement on Parcel A. Neither SMLLC 1 nor SMLLC 2 has made an entity classification election under § 301.7701-3(c).

Under § 301.7701-3(b), a domestic eligible entity with a single member generally is disregarded, unless the entity elects to be regarded separately from its owner. All of the assets of a disregarded entity are treated as if they are owned by the single member.

Under the Contiguous Parcel Rule, the amount of the deduction is equal to the difference between the fair market value of the entire contiguous parcel owned by the donor and the donor's family (as defined in § 267(c)(4)) before and after the granting of the easement. "Family" includes ancestors, such as a mother. Section 267(c)(4).

Since neither SMLLC 1 nor SMLLC 2 made an entity classification election, both SMLLC 1 and SMLLC 2 are disregarded. Donor is treated as the owner of Parcel A, and Donor's mother is treated as the owner of Parcel B. Accordingly, since Parcel A and Parcel B are treated as owned by Donor and Donor's family, the amount of the deduction is equal to the difference between the fair market value of the entire contiguous parcel comprised of Parcels A and B before and after the granting of the easement.

SCENARIO 4: CONTIGUOUS PARCELS OWNED BY DONOR AND REGARDED ENTITY

Scenario 4(a). Contiguous Parcel Owned by a Limited Liability Company Classified As a Corporation, of Which Donor Is the Single Member. Donor owns Parcel A, and LLC owns contiguous Parcel B. Donor is the single member of LLC. Donor places a conservation easement on Parcel A, and as a result Parcel B will always have a view of a river that abuts Parcel A, thereby increasing the value of Parcel B. LLC elects under § 301.7701-3(c) to be classified as a corporation.

Under the Contiguous Parcel Rule, the amount of the deduction is equal to the difference between the fair market value of the entire contiguous parcel owned by the donor and the donor's family (as defined in § 267(c)(4)) before and after the granting of the easement. "Family" does not include an entity, such as a corporation or partnership, that is classified as separate from its owner under the entity classification rules. The Contiguous Parcel Rule does not apply when an entity classified as a corporation owns the contiguous property.

The Enhancement Rule provides that, if the granting of a conservation easement increases the value of any other property owned by the donor or a related person (within the meaning of § 267(b) or § 707(b)), the amount of the deduction for the conservation contribution is reduced by the amount of the increase in the value of the other property, whether or not that other property is contiguous.

Under § 267(b)(2), an individual is related to a corporation if that individual owns, directly or indirectly, more than 50% of the value of the outstanding stock of that corporation.

Since Donor owns all of the outstanding shares of LLC, LLC is related to Donor. Accordingly, the amount of the deduction is first determined by valuing Parcel A before and after the granting of the easement. Second, because a related party that is not a family member (LLC) owns contiguous Parcel B, the amount of the deduction is reduced by the value of the enhancement to Parcel B from the granting of the easement.

Scenario 4(b). Contiguous Parcel Owned by a Limited Liability Company Classified As a Partnership, of Which Donor and Donor's Family Are Members. Donor owns Parcel A, and LLC owns contiguous Parcel B. Donor owns 48% of LLC, Donor's wife owns 30% of LLC, and Donor's son owns 22% of LLC. Donor places a conservation easement on Parcel A, and as a result Parcel B will always have a view of a river that abuts Parcel A, thereby increasing the value of Parcel B. LLC has not made an entity classification election under § 301.7701-3(c).

Under § 301.7701-3(b), a domestic eligible entity is a partnership if it has two or more members, unless the entity elects otherwise.

Under the Contiguous Parcel Rule, the amount of the deduction is equal to the difference between the fair market value of the entire contiguous parcel owned by the donor and the donor's family (as defined in § 267(c)(4)) before and after the granting of the easement. "Family" does not include an entity, such as a corporation or partnership, that is classified as separate from its owner under the entity classification rules. The Contiguous Parcel Rule does not apply when an entity classified as a partnership owns the contiguous property.

The Enhancement Rule provides that, if the granting of a conservation easement increases the value of any other property owned by the donor or a related person (within the meaning of § 267(b) or § 707(b)), the amount of the deduction for the conservation contribution is reduced by the amount of the increase in the value of the other property, whether or not that other property is contiguous.

A partnership and a person owning, directly or indirectly, more than 50% of the capital or profits interest in the partnership are related for purposes of § 707(b). Under §§ 707(b)(3) and 267(c)(2), an individual is considered to own all of the partnership interests owned by himself and by his family members.

Since LLC did not make an entity classification election, LLC is a partnership. Because Donor owns 48% of LLC, and the remaining interests are held by Donor's family (wife and son), Donor is considered to own 100% of LLC. Therefore, LLC is related to Donor. Accordingly, the amount of the deduction is first determined by valuing Parcel A before and after the granting of the easement. Second, because a related party that is not a family member (LLC) owns contiguous Parcel B, the amount of the deduction is reduced by the value of the enhancement to Parcel B from the granting of the easement.

Scenario 4(c). Contiguous Parcel Owned by a Limited Liability Company Classified As a Partnership, of Which Donor's Spouse and Unrelated Individuals Are Members.

Donor owns Parcel A, and LLC owns contiguous Parcel B. Donor's wife owns 60% of LLC, and two unrelated individuals own 25% and 15% of LLC, respectively. Donor places a conservation easement on Parcel A, and as a result, Parcel B will always have a view of a river that abuts Parcel A, thereby increasing the value of Parcel B. LLC has not made an entity classification election under § 301.7701-3(c).

Under § 301.7701-3(b), a domestic eligible entity is a partnership if it has two or more members, unless the entity elects otherwise.

Under the Contiguous Parcel Rule, the amount of the deduction is equal to the difference between the fair market value of the entire contiguous parcel owned by the donor and the donor's family (as defined in § 267(c)(4)) before and after the granting of the easement. "Family" does not include an entity, such as a corporation or partnership, that is classified as separate from its owner under the entity classification

rules. The Contiguous Parcel Rule does not apply when an entity classified as a partnership owns the contiguous property.

The Enhancement Rule provides that, if the granting of a conservation easement increases the value of any other property owned by the donor or a related person ((within the meaning of § 267(b) or § 707(b)), the amount of the deduction for the conservation contribution is reduced by the amount of the increase in the value of the other property, whether or not that other property is contiguous.

A partnership and a person owning, directly or indirectly, more than 50% of the capital or profits interest in the partnership are related for purposes of § 707(b). Under §§ 707(b)(3) and 267(c)(2), an individual is considered to own all of the partnership interests owned by himself and by his family members.

Since LLC did not make an entity classification election, LLC is a partnership. Donor's wife owns 60% of the capital or profits interest in LLC, and an individual is considered to own all of the partnership interests owned by his family members. Therefore, Donor is considered to own 60% of LLC. In addition, because Donor is considered to own more than 50% of the capital or profits interest in LLC, LLC is related to Donor. Accordingly, the amount of the deduction is first determined by valuing Parcel A before and after the granting of the easement. Second, because a related party that is not a family member (LLC) owns contiguous Parcel B, the amount of the deduction is reduced by the value of the enhancement to Parcel B.

Scenario 4(d). Contiguous Parcel Owned by a Limited Liability Company Classified As a Partnership, of Which Donor and an Unrelated Individual Are Members. Donor owns Parcel A, and LLC owns contiguous Parcel B. Donor and an unrelated person each own 50% of LLC. Donor places a conservation easement on Parcel A. LLC has not made an entity classification election under § 301.7701-3(c).

Under § 301.7701-3(b), a domestic eligible entity is a partnership if it has two or more members, unless the entity elects otherwise.

Under the Contiguous Parcel Rule, the amount of the deduction is equal to the difference between the fair market value of the entire contiguous parcel owned by the donor and the donor's family (as defined in § 267(c)(4)) before and after the granting of the easement. "Family" does not include an entity, such as a corporation or partnership, that is classified as separate from its owner under the entity classification rules. The Contiguous Parcel Rule does not apply when an entity classified as a partnership owns the contiguous property.

The Enhancement Rule provides that, if the granting of a conservation easement increases the value of any other property owned by the donor or a related person (within the meaning of § 267(b) or § 707(b)), the amount of the deduction for the

conservation contribution is reduced by the amount of the increase in the value of the other property, whether or not that other property is contiguous.

A partnership and a person owning, directly or indirectly, more than 50% of the capital or profits interest in the partnership are related for purposes of § 707(b).

Since LLC did not make an entity classification election, LLC is a partnership. Because Donor does not own more than 50% of the capital or profits interest in LLC, LLC is not related to Donor. Accordingly, the amount of the deduction is equal to the difference between the fair market value of only Parcel A before and after the granting of the easement.

SCENARIO 5: CONTIGUOUS PARCEL SCENARIOS INVOLVING MULTIPLE REGARDED ENTITIES

Scenario 5(a). Contiguous Parcel Owned by a Limited Liability Company Classified As a Partnership, of Which Donor Is Considered to Own More Than 50%. Donor owns Parcel A, and LLC 2 owns contiguous Parcel B. LLC 1 owns 90% of LLC 2, and X, an unrelated party, owns the remaining 10% of LLC 2. Donor owns 60% of LLC 1, and Y, another unrelated party, owns the remaining 40% of LLC 1. Donor places a conservation easement on Parcel A, and as a result, Parcel B will always have a view of a river that abuts Parcel A, thereby increasing the value of Parcel B. Neither LLC 1 nor LLC 2 has made an entity classification election under § 301.7701-3(c).

Under § 301.7701-3(b), a domestic eligible entity is a partnership if it has two or more members, unless the entity elects otherwise.

Under the Contiguous Parcel Rule, the amount of the deduction is equal to the difference between the fair market value of the entire contiguous parcel owned by the donor and the donor's family (as defined in § 267(c)(4)) before and after the granting of the easement. "Family" does not include an entity, such as a corporation or partnership, that is classified as separate from its owner under the entity classification rules. The Contiguous Parcel Rule does not apply when an entity classified as a partnership owns the contiguous property.

The Enhancement Rule provides that, if the granting of a conservation easement increases the value of any other property owned by the donor or a related person (within the meaning of § 267(b) or § 707(b)), the amount of the deduction for the conservation contribution is reduced by the amount of the increase in the value of the other property, whether or not that other property is contiguous.

A partnership and a person owning, directly or indirectly, more than 50% of the capital or profits interest in the partnership are related for purposes of § 707(b). Under §§ 707(b)(3) and 267(c)(1), a partnership interest owned, directly or indirectly, by or

for a corporation, partnership, estate, or trust is considered to be owned proportionately by or for its shareholders, partners, or beneficiaries.

Since neither LLC 1 nor LLC 2 made an entity classification election, both LLC 1 and LLC 2 are partnerships. Because Donor owns 60% of LLC 1, Donor is considered to own 54% of LLC 2 (i.e., 60% of 90%). In addition, because Donor is considered to own more than 50% of the capital or profits interest in LLC 2, LLC 2 is related to Donor. Accordingly, the amount of the deduction is first determined by valuing Parcel A before and after the granting of the easement. Second, because a related party that is not a family member (LLC 2) owns contiguous Parcel B, the amount of the deduction is reduced by the value of the enhancement to Parcel B from the granting of the easement.

Scenario 5(b). Contiguous Parcel Owned by a Limited Liability Company Classified as a Partnership, of Which Donor Is Considered to Own Less Than 50%. Donor owns Parcel A, and LLC 2 owns contiguous Parcel B. LLC 1 owns 60% of LLC 2, and X, an unrelated party, owns the remaining 40% of LLC 2. Donor owns 51% of LLC 1, and Y, another unrelated party, owns the remaining 49% of LLC 1. Donor places a conservation easement on Parcel A, and as a result, Parcel B will always have a view of a river that abuts Parcel A, thereby increasing the value of Parcel B. Neither LLC 1 nor LLC 2 has made an entity classification election under § 301.7701-3(c).

Under § 301.7701-3(b), a domestic eligible entity is a partnership if it has two or more members, unless the entity elects otherwise.

Under the Contiguous Parcel Rule, the amount of the deduction is equal to the difference between the fair market value of the entire contiguous parcel owned by the donor and the donor's family (as defined in § 267(c)(4)) before and after the granting of the easement. "Family" does not include an entity, such as a corporation or partnership, that is classified as separate from its owner under the entity classification rules. The Contiguous Parcel Rule does not apply when an entity classified as a partnership owns the contiguous property.

The Enhancement Rule provides that, if the granting of a conservation easement increases the value of any other property owned by the donor or a related person (within the meaning of § 267(b) or § 707(b)), the amount of the deduction for the conservation contribution is reduced by the amount of the increase in the value of the other property, whether or not that other property is contiguous.

A partnership and a person owning, directly or indirectly, more than 50% of the capital or profits interest in the partnership are related for purposes of § 707(b). Under §§ 707(b)(3) and 267(c)(1), a partnership interest owned, directly or indirectly, by or for a corporation, partnership, estate, or trust is considered to be owned proportionately by or for its shareholders, partners, or beneficiaries.

Since neither LLC 1 nor LLC 2 made an entity classification election, both LLC 1 and LLC 2 are partnerships. Because Donor owns 51% of LLC 1, Donor is considered to own 30.6% of LLC 2 (i.e., 51% of 60%). Accordingly, because Donor does not own more than 50% of LLC 2, Donor and LLC 2 are not related, and the amount of the deduction is equal to the difference between the fair market value of only Parcel A before and after the granting of the easement.

Please contact Jason Kristall at (202) 622-5020 if you would like further assistance or have any questions about the contents of this memorandum.