

TO REVIEW THE TAX DEDUCTION FOR FAÇADE EASEMENTS

HEARING BEFORE THE SUBCOMMITTEE ON OVERSIGHT OF THE COMMITTEE ON WAYS AND MEANS U.S. HOUSE OF REPRESENTATIVES ONE HUNDRED NINTH CONGRESS

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TO REVIEW THE TAX DEDUCTION FOR FAÇADE EASEMENTS

THURSDAY, JUNE 23, 2005

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:01 p.m., in room 1100, Longworth House Office Building, Hon. Jim Ramstad (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
June 16, 2005
OV-2

CONTACT: (202) 225-1721

Ramstad Announces Hearing to Review the Tax Deduction for Façade Easements

Congressman Jim Ramstad (R-MN), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing to review the tax deduction for façade easements. **The hearing will take place on Thursday, June 23, 2005, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 2:00 p.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include officials from the Internal Revenue Service (IRS) and easement-holding organizations.

BACKGROUND:

In 1980, Congress passed the Tax Treatment Extension Act (P.L. 96-541), which made permanent a charitable tax deduction for certain conservation contributions to a qualified organization for conservation purposes. This law supplemented two previous laws—the 1966 National Historic Preservation Act (P.L. 89-665), which set guidelines for defining and listing historic properties, and the 1976 Tax Reform Act (P.L. 94-455), which established the historic preservation tax deduction on a temporary basis. Federal law allows a charitable deduction under Section 170(h) of the Internal Revenue Code for donations of qualified real property interests, including easements with respect to a certified historic structure granted in perpetuity to a qualified organization. A “certified historic structure,” is any building, structure or land area listed in the National Register or located in a registered historic district. The building must be certified by the National Park Service as contributing to the historic character of the district.

A historic preservation easement, like other deed restrictions, is a voluntary legal agreement made between the property owner and a qualified organization to protect a significant historic, archeological or cultural resource in perpetuity from demolition, alteration or development. Under the terms of this type of easement, the property owner grants a portion of, or interest in, the owner’s property rights to a qualified organization whose mission includes historic preservation. By donating a façade easement to a qualified organization, a property owner promises in perpetuity not to alter the façade of his or her structure without the permission of the easement-holding organization. In return, the property owner may take a deduction equal to the value of the easement.

In recent years, there has been a dramatic growth in the number of façade easements. Recent media reports have raised concerns about abuse, especially relating to inflated deductions that some taxpayers may be claiming. Some reports have also raised questions about the role of for-profit facilitators in marketing and promoting the donation of façade easements. According to some reports, some facilitators are advising potential donors that the easement will not negatively impact the value of the property, while at the same time encouraging the property owner to take a large deduction. In addition, when conducting a valuation of an easement, many appraisers appear to be applying similar percentage values to easements, regardless of the

location, local historic ordinance restrictions or the varying types of restrictions in the easement deed.

In announcing the hearing, Chairman Ramstad stated, "The Subcommittee is interested in learning if the tax deduction for façade easements has been abused. I think it is important to review this deduction and how it is being administered to make sure American taxpayers are getting their money's worth."

FOCUS OF THE HEARING:

The hearing will review the tax deduction for the donation of façade easements, including the valuation of façade easements, and potential abuse relating to the marketing and promotion of façade easements.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, <http://waysandmeans.house.gov>, select "109th Congress" from the menu entitled, "Hearing Archives" (<http://waysandmeans.house.gov/Hearings.asp?congress=17>). Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the on-line instructions, completing all informational forms and clicking "submit" on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You **MUST REPLY** to the email and **ATTACH** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business Thursday, July 7, 2005. **Finally**, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225-1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at <http://waysandmeans.house.gov>.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman RAMSTAD. The hearing would please come to order. I would like to welcome our witnesses, distinguished members of the panel, as well as our visitors here today. The last 5 years have witnessed an exponential growth in the number of historic preservation easements donated by property owners. These easements are intended to serve an important historic preservation purpose. However, the rapid growth in easement donations combined with some, I must say, troubling accounts of abuse relating to the easement deduction, led us to hold this hearing today. As you all know, the Tax Code allows a deduction for a number of different conservation-related contributions. Today, we will focus solely on façade easements. Let me repeat: today, we will focus solely on façade easements. When owners donate an easement, they are effectively giving up control over the façade of that structure to a nonprofit organization. The Tax Code allows the property owner to take a deduction for giving up that partial property interest. The policy reason underlying this deduction is to encourage easement donations as a tool for historic preservation, to provide an incentive for historic preservation.

While this deduction and the policy reasons underlying this deduction sound simple in theory, in practice it has become much more complex. The valuation of a façade easement is not a simple matter. How much is it worth for a property owner to not be able to alter the façade of his or her structure? That should depend on a number of different factors for which I believe there is a consensus. First, does the owner have the right to alter the façade of the building? Does the right exist to alter the façade? Many areas of our country are already subject to strict historic preservation laws that keep the property owner from changing the façade. Two, what does the easement cover? Some easements cover simply the façade; others cover the entire building. Different types of easements should obviously be worth different amounts. Three, does the appraisal reflect the actual facts and circumstances of the façade? It appears that some disturbing practices have emerged in the appraisal of easements. Rather than making careful individualized determinations concerning properties, it seems that a number of appraisers are applying a uniform rule in which they estimate all façade easements are worth between 10 and 15 percent of the value of the property. Valuations like this are contrary to Internal Revenue Service (IRS) regulations and cast doubt on the easement deduction, generally.

Today, we will hear testimony from the IRS, from three different easement holding organizations, and from an expert appraiser. We will try to learn more about the role that easement holding groups play in the valuation process and whether there are, in fact, problems with the way these organizations solicit and oversee easement donations. In a book about the easement appraisal process written several years ago, before the growth in easement donations, the Land Trust Alliance and the National Trust for Historic Preservation wrote the following, "Organizations accepting easements should ensure to the extent possible that donors claim deductions based on competent independent appraisals. Failure to do so may result in disallowance of the donor's charitable contribution claim. More fundamentally, excessive deduction claims undermine public

confidence in our tax system and could conceivably lead to congressional curtailment of this very important conservation and preservation tool." I agree with the caveat just read and provided by the Land Trust Alliance and the National Trust for Historic Preservation. I agree with their warning. If historic preservation tools are marketed as a way for some homeowners to take a hefty inappropriate tax deduction without giving anything up, it is clear some changes may be in order. I hope this hearing will allow this Subcommittee to determine the extent of the abuse of the façade easement deduction, so we can consider any necessary and appropriate reforms.

Thank you again to our colleagues who are here today and our witnesses for being here. The Ranking Member, Mr. Lewis, called and said he was unable to be here today, as did a number of other Members on the other side of the aisle. Are there any opening statements from this side? If not, I would ask the panel to begin the testimony, recognizing the 5-minute rule that we have here. If you could keep your comments to 5 minutes, by unanimous consent, the entire text of your prepared testimony will be entered into the record. Now that Mr. Lennhoff has arrived, we have the full complement of five members of the panel. Welcome, Mr. Lennhoff. Thank you for your call. I am sorry you got held up in traffic, but we are glad you are here. The five members of the panel are Mr. Steven T. Miller, Commissioner of the Tax Exempt and Government Entities Division of the IRS; Mr. Steven L. McClain, Director of the National Architectural Trust (NAT), and President of Springfield Management Services (SMS); Paul Edmondson, Vice President and General Counsel of the National Trust for Historic Preservation; Ms. Peg Breen, President of New York Landmarks Conservancy; and Mr. David C. Lennhoff, President of the Appraisal Division of Delta Associates. Mr. Miller, your testimony, please.

STATEMENT OF STEVEN T. MILLER, COMMISSIONER, TAX-EXEMPT AND GOVERNMENT ENTITIES DIVISION, INTERNAL REVENUE SERVICE

Mr. MILLER. Yes. Thank you, Mr. Chairman, distinguished Members of the Subcommittee. Deductions for façade easements appear to be on the rise, as you have mentioned. They warrant our attention because of troubling valuation problems we are finding in this area. While we are still early in our enforcement work, let me say that we are concerned that some homeowners are being misled by charities, promoters, and appraisers into believing that a donation of a façade easement entitles them to a deduction in excess of what we believe is appropriate. I want to make it clear to the Subcommittee and to those in the easement community that those individuals who take improper façade deductions will hear from us. I outlined the law in this area in my written testimony, and while I will touch on it here, I want to concentrate more on our enforcement efforts and our challenges.

Façade easements are intended to preserve historically important land areas or certified historic structures, including buildings, structures, or land areas that are either listed in the National Register of Historic Places, or located in a registered historic district and certified by the National Park Service as being of historic sig-

nificance to that district. Thus, we generally rely upon the Park Service to determine historic significance. If an easement meets Park Service requirements, the question then becomes one of value. Generally, the amount of a deduction may not exceed the value of the property that is given up by the donor. We have enforcement efforts under way in this area. We have established an IRS team to lead our efforts. The team currently is overseeing 30 façade donor audits and is reviewing data to determine which, of an additional 1,600 or more identified donors, we will contact next. We are also examining a number of charities and promoters concerning their easement practices. As in some other areas within our sector, there may be overenthusiasm and commercialism creeping into this area.

It is still too early to draw conclusive findings, but I do have some preliminary observations. The appraisal of façade easement presents opportunities for abuse and manipulation, and we are seeing problems. The validity of an appraisal of the valuation assigned to an easement depends upon the facts and circumstances of each case, and each case is unique. With respect to residential easements, appraisals we have seen to date do not include any meaningful analysis, but instead simply claim a flat percentage, generally between 10 and 15 percent of the value of the property. Let me state plainly that those who say the IRS will uniformly accept the flat 10 to 15 percent as a reasonable valuation without any underlying analysis are wrong. There is no such rule, and promoters, appraisers, and taxpayers should not proceed under the false assumption that this is some sort of safe harbor. Fixed percentage valuations are not based on the facts and circumstances of the individual case, and they ignore local factors, such as zoning ordinances, which must be taken into account. As opposed to residential façades, the issues we find in commercial property façade easements are often more complex. Although we have seen some fixed percentages being taken here as well, there are often additional valuation problems stemming from the way restrictions on further development of the property are valued.

So, although façade easements serve a vital role in the preservation of our heritage, the problems we have seen so far concern us. These problems also present the issue of whether existing rules governing appraiser qualifications, appraisal standards, and the standards for referral to the Office of Professional Responsibility are sufficient. As you consider these issues, I ask you also to consider the IRS challenges and questions outlined by Commissioner Everson in his May testimony before the full Committee. First, are there gaps in the statutory or regulatory framework? For example, are current appraisal standards sufficient and are the standards for referral for disciplinary action workable? A second issue is whether the IRS has the flexibility it needs to respond appropriately to compliance issues. For example, should there be an intermediate sanction, as the Administration proposed in its 2006 budget proposal, for those charities that do not monitor the easements entrusted to their care? A third issue is whether more should be done for transparency purposes. This includes not only form changes and the need for enhanced electronic filing, which I have outlined in my written testimony, but the ability of the IRS

to share information with those in the States and the Federal Government who co-administer the conservation area. I would be happy to take any questions.

[The prepared statement of Mr. Miller follows:]

Statement of Steven T. Miller, Commissioner, Tax-Exempt and Government Entities Division, Internal Revenue Service

Mr. Chairman, Mr. Lewis, and distinguished Members of the Subcommittee, thank you for this opportunity to discuss the law relating to the deductibility of contributions for façade easements, and the steps the Internal Revenue Service is taking to enforce it. Congress has allowed an income tax deduction for owners of certified historic structures who give up the right to change the exterior appearance, the façade, so that the historic qualities of the structure might be preserved for future generations.

The conservation contribution provisions of the Internal Revenue Code¹ play a vital role in the preservation of historic structures with unique public value.

As I will discuss below, donations of façade easements appear to be on the rise based on the number of properties located in registered historic districts that are applying for certification by the National Park Service as of historic significance to the district. The rise in donations of façade easements warrants our attention because the IRS has seen signs that certain valuation practices employed with regard to façade easements may compromise the policies and the public benefit that Congress intended to promote.

Let me say here that we are concerned that some taxpayers are being misled by charities, appraisers, and promoters into believing that the donation of a façade easement entitles them to a deduction greatly in excess of what is allowable. Taxpayers who are taking improper deductions for donated façade easements can expect to hear from us.

Later, I will discuss these trends and problems in more detail, and explain what we are doing about them. But let me first briefly explain the tax provisions relating to conservation easements generally and to façade easements in particular.

Legal Requirements for Deductions for Façade Easements

The analysis of a façade easement focuses on two issues. The threshold question is whether the interest the taxpayer conveys is a valid conservation easement, in this case an easement exclusively for the preservation of a certified historic structure. The second is whether the value of the easement is correct, that is, whether the required appraisal is honest and reasonable, or fanciful and inflated.

Threshold question—conservation easements in general

A façade easement is one of four types of qualified conservation contributions described in section 170(h) of the Code. I will focus on façade easements today, but will cover all four types because they share some common features and sometimes intertwine. As we have recently testified, the Service has a large examination program underway with respect to open space conservation easements where we have seen problems due to a lack of significant public benefit and inflated valuations, but we have also begun an expanded examination program for façade easements.

To begin, let me note an important distinction between donations of real property and donations of qualified conservation contributions, including conservation easements. Under general income tax rules, to be eligible for a deduction for a charitable contribution, a taxpayer must give his or her entire interest in the property to the charity, reserving no substantial rights for himself or herself. Under these rules, the recipient charity becomes the owner of all title and interest in the property. The donor generally may take a charitable contribution deduction for the fair market value of the property. In these cases, as with other gifts of property, our main concern usually is whether the donor has valued the gift correctly.

There are only a few exceptions to this general rule, and a conservation easement is one of them. Section 170(f)(3)(B)(iii) allows a deduction for a qualified conservation contribution, even though it is only a gift of a partial interest in property.

Section 170(h) defines “qualified conservation contribution.” It is a contribution:

- Of a qualified real property interest, including an easement granted in perpetuity that restricts the use that can be made of the property. Section 170(h)(2)(C).

¹ Internal Revenue Code (IRC) Section 170(h).

- To a qualified organization. Generally, these are public charities and governmental units. Section 170(h)(3). Importantly, the recipient charity must have the resources and commitment to monitor and enforce the restrictions.
- Exclusively for conservation purposes.

With respect to the last requirement, there are four allowable conservation purposes.

1. The preservation of land areas for outdoor recreation or education of the general public.

The donation of easements to preserve land areas for the recreational use of the general public or for the education of the public is the first conservation purpose enumerated in section 170(h)(4) of the Code. Examples include the preservation of a water area for public recreation such as boating or fishing, or the preservation of land for a nature trail or hiking trail. Unlike easements for the three other conservation purposes, these easements require regular and substantial physical access by the general public.

2. The protection of a relatively natural habitat of fish, wildlife, plants or similar ecosystem.

The second category of conservation easements is to protect a significant natural habitat or ecosystem in which fish, wildlife, or plants live in a relatively natural state. Significant natural habitats include the habitats of rare, endangered, or threatened species of animals, fish, or plants, or natural areas that represent high quality examples of a terrestrial or aquatic community, or natural areas that contribute to the ecological viability of a park, nature preserve, wildlife refuge, or wilderness area. Limitations on public access to these areas will not render an easement donation nondeductible. For example, a restriction on access to the habitat of a threatened species is consistent with the conservation purpose of the easement.

3. The preservation of open space (including farmland and forest land) for either the scenic enjoyment of the public, or pursuant to a clearly delineated governmental conservation policy.

To determine that an easement will protect the scenic enjoyment of the public, it must be shown that development of the land would result either in an impairment of the scenic character of the landscape, or would interfere with a scenic view that can be enjoyed from a public place. At a minimum, visual access to or across the property is required. Under the terms of an open space easement on scenic property, the entire property need not be visible to the public, although the public benefit from the donation may be insufficient to qualify for a deduction if only a small portion of the property is visible to the public. No matter whether the easement is for the scenic enjoyment of the public or, alternatively, is pursuant to a governmental conservation policy, there must also be a significant public benefit that arises from an open space easement.²

4. The preservation of a historically important land area or a certified historic structure. Façade easements fall within this category, and this is the area that I am primarily concerned with in this testimony. The following discussion covers the law in this area.

Façade Easements for Certified Historic Structures

Historic preservation easements are intended to preserve historically important land areas or certified historic structures. Historically important land areas include:

- An independently significant land area including any related historical resources (such as an archeological site), that meets the National Register Criteria for Evaluation administered by the National Park Service;
- Any land area within a registered historic district including any buildings on the land that contribute to the significance of the district; and

²In determining whether a significant public benefit is present, the regulations provide a non-exclusive list of eleven factors that may be considered. Section 1.170A-14(d)(iv)(A). Some of these factors involve the uniqueness of the land; the intensity of current or foreseeable development; the likelihood of development that would lead to the degradation of the scenic, natural, or historic character of the area; the opportunity for the general public to use the property or appreciate its scenic values; and the importance of the property in maintaining a local or regional landscape or resource that attracts tourism or commerce to the area. These factors indicate the kind of open space contemplated as having a significant public benefit.

- Any land area, including related historical resources, adjacent to a property listed individually in the National Register of Historic Places, if the land contributes to the historic or cultural identity of the listed property.

Certified historic structures mean buildings, structures, or land areas that are:

- Listed in the National Register of Historic Places; or
- Located in a registered historic district and certified by the National Park Service as being of historic significance to the district.

For a contribution of a historically important land area or certified historic structure to qualify for an income tax deduction, the public must have at least some visual access to the donated property. In the case of a historically important land area, the entire property need not be visible to the public, but the public benefit from the donation may be too small to qualify for a deduction if only a small part of the property is visible. If the historic land area or certified historic structure is not visible from a public way (for example, if it is hidden by a wall or by shrubbery, or is too far from the public way), the terms of the easement must be such that the general public is given the opportunity on a regular basis to view the characteristics of the property that are preserved by the easement.

Factors to consider in determining the type and amount of public access include the historical significance of the property, the nature of the features that are the subject of the easement, the remoteness or accessibility of the site, the possibility of physical hazards to the public viewing the property, the extent to which public access would be an unreasonable intrusion on any privacy interests of individuals living on the property, the degree to which public access would impair the preservation interests that are the subject of the donation, and the availability of opportunities for the public to view the property by means other than visits to the site.

If the terms of an easement allow future development in a registered historic district, a deduction is allowable only if the easement requires such development to conform to appropriate local, state or federal standards for construction or rehabilitation within the historic district.

Amount of the deduction—the appraisal and rules of valuation

If the façade easement contribution meets all requirements of section 170, and qualifies as a conservation contribution, the inquiry then turns to the valuation of the easement. Generally, the amount of the deduction may not exceed the fair market value of the easement on the date of the contribution (reduced by the fair market value of anything received by the donor in return). Fair market value is the price at which the contributed property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and each having reasonable knowledge of relevant facts.

If there is a substantial record of sales of easements comparable to the donated easement (such as purchases pursuant to a governmental program), the fair market value of the donated easement is based on the prices of the comparable sales. If no substantial record of marketplace sales is available to use as a meaningful or valid comparison, as a general rule (but not in all cases) the fair market value of a conservation restriction is equal to the difference between the fair market value of the property before the granting of the restriction and the fair market value of the property after the granting of the restriction.

Under the regulations, if such before-and-after valuation is used, the fair market value of the property before contribution must take into account not only the current use of the property but also an objective assessment of how immediate or remote is the likelihood that the property, absent the restriction, would in fact have been developed, or its historic character modified. The valuation also must take into account the effect of any zoning, conservation or historic preservation laws that already restrict the property's potential highest and best use. Further, there may be instances where the grant of a conservation restriction may have no material effect on the value of a property, or may in fact enhance, rather than reduce, the value of property. In such instances, no deduction would be allowable. For certified historic structures, the fair market value of the property after contribution of the restriction must take into account the amount of access permitted by terms of the easement. Additionally, if before-and-after valuation is used, an appraisal of the property after contribution of the restriction must take into account the effect of restrictions that reduce the potential fair market value represented by highest and best use, but nevertheless permit uses of the property that will increase its fair market value above that represented by its current use.

If the donor reasonably can expect to receive financial or economic benefits greater than those to be obtained by the general public as a result of the donation of a conservation easement, no deduction is allowable. If development is permitted on

the property to be protected, the fair market value of the property after contribution of the restriction must take into account the effect of the development.

The recipient of the easement—qualified organizations

To be qualified to receive a conservation easement, an organization must be a governmental unit, or one of several types of public charities. To be a qualified organization, the organization also must be committed to protect the conservation purposes of the donation, and must have the resources to enforce the restrictions. However, it need not set aside funds for this purpose.

As with any charity, a qualified organization is subject to certain rules described in section 501(c)(3). The organization must operate exclusively for charitable, educational, or other tax-exempt purposes. It cannot serve private interests unless such interests are only incidental to its exempt purposes, and it cannot serve a substantial nonexempt purpose. If the organization becomes derelict in its duties to ensure that donated easements continue to serve an exempt purpose, or if the organization subordinates the interests of the public to the interests of the donor, the organization's tax exemption may be open to question.

Role of the National Park Service and Trends with Respect to Façade Easements

A principal qualification for eligibility for a historic easement income tax deduction is that the National Park Service (NPS) list the property in the National Register of Historic Places, or recognize the property as located in a registered historic district and certify that the property is of historic significance to that district. Thus, the NPS serves as a gatekeeper for what is historically significant. The Service relies upon the NPS for this determination. As years pass, the NPS, using its criteria for evaluation of these properties, will certify as historic an increasing number of our older houses, buildings, and neighborhoods that significantly or uniquely represent our past. We should expect more and more neighborhoods that meet the NPS criteria to apply for certification and be deemed historic. We also should expect the owners of more and more structures in those and in existing historic districts to apply for certification as the tax benefits of façade easement donations are promoted.

As we work these cases, there appear to be two distinct categories of property with respect to which a façade easement is donated: residential and commercial. The distinction matters to our discussion because the valuation problems discussed below vary by type of property. That is, appraisers have used different approaches in valuing these two categories.

The number of possible façade easements is large. NPS data tells us that there are more than 1.27 million buildings that either are already listed in the National Register of Historic Places or are existing properties that may contribute to the historic character of an existing historic district (a new building in a historic district would not be included in the above number).

Our information systems do not currently provide us with the ability to identify the number of current easements or the claimed value of deductions for these easements, including any façade easements. However, it appears that the number of façade easements is increasing based on the number of certifications applied for and approved by NPS. The number of applications to NPS for certification of historic property has grown in the last five years. NPS data shows that 74 applications were submitted between 1995 and 1999; 154 were submitted in 2001; 705 in 2003, and 750 last year. While we believe that this growth is reflected in the number of residential façade easements, it is less clear whether commercial façade easements are also increasing.

Certifications also seem to be geographically clustered. The largest number of façade easements is concentrated in three locations: Washington, D.C., New York City, and Chicago. We believe that qualified recipient organizations actively solicit easements in selected neighborhoods by promising large deductions. One resident on a street applies, and then another, and soon the whole block may be dotted with them.

Internal Revenue Service Enforcement in the Area of Façade Conservation Easements

Overview

In this portion of my testimony I will outline the enforcement actions the IRS has taken in this area and what we have found to date. First, I will discuss the reporting requirements for exempt organizations and their donors, and steps the IRS is taking to improve such reporting. Then, I will discuss our examination activity in the area.

Reporting

Facade easements are easier for us to track than other types of conservation easements because of valuable data we receive from the NPS. At least with respect to newer certifications, NPS has information that identifies the owners of properties eligible for facade easement donations. Consequently, the reporting improvements for donors which I will outline, while helpful in the facade easement area, will assist us primarily with respect to open space, wildlife habitat, and recreational easements, for which we do not have a source of information similar to the NPS.

We need to be able to determine systematically which organizations and individuals have been involved in conservation easement transactions. To address this, we are revising our tax forms to gather more information about organizations with conservation easement programs and their donors. We recently revised Form 1023, "*Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*," to add new questions that will help us identify organizations with conservation easement donation programs in order to ensure that they meet the requirements for exemption, including the ability to meet conservation responsibilities.

Charities and other tax-exempt organizations annually file Form 990, "*Return of Organization Exempt From Income Tax*," an information return that reports income, expenses, assets, and liabilities of these organizations, along with specific information about their operations and programs. We are concerned that the public is not getting enough information from Form 990 to understand what activities many of our charities are engaged in. As an interim step, we will revise the 2005 Form 990 so that both the IRS and the public have a better understanding of which organizations receive easements. We expect that this will be in the form of a new checkbox that will identify those organizations that received a conservation easement donation during the year.

All exempt organizations can now file their annual returns electronically. Electronic filing was available for Form 990 and 990EZ filers in 2004, and is available this year as well for private foundations, which file Form 990-PF. We want to encourage e-filing because it reduces taxpayer errors and omissions and allows us, and ultimately the public, ready access to the information on the return. For this reason, we have required e-filing in certain cases. Under proposed and temporary regulations, we will require electronic filing for larger public charities and all private foundations by 2007.

We also are working on larger scale improvements to the Form 990. The current form could be more user-friendly while also eliciting more of the information that we need. We anticipate that the revised form will have specific questions or separate schedules that focus on certain problem areas. For example, filers should not be surprised to find specific schedules or detailed questions relating to credit counseling activities, supporting organizations, compensation practices, and organizational governance. The easement area is also under consideration. The timing of the revision of the Form 990 is dependent on budget issues and our partners, including the states, 37 of which use the Form 990 as a state filing, and software developers.

When donors make gifts of property in one year with a claimed value that exceeds \$500, they file Form 8283, "*Noncash Charitable Contributions*," with their income tax returns. On the form donors list the property they are donating. For most donations with a claimed value that exceeds \$5,000, the form requires a written appraisal³ and the identity and signature of the appraiser, along with a signed acknowledgement of the gift by an officer of the charity that receives the gift.

We are revising Form 8283 to provide a new checkbox to identify donors of conservation easements, and we are modifying the form's instructions to better describe what is permissible and to obtain better information on the type of property donated. The revised form also will reflect new qualified appraisal requirements enacted by Congress last year in section 170(f)(11). Where the donation is in excess of \$500,000, the form will require taxpayers to attach the appraisal to the return.

Once implemented, these changes will enable us to better identify the universe of organizations and donors who are involved in conservation easement transactions, including facade easement transactions, and they will allow us to better target our

³The requirements for qualified appraisals are set forth in section 1.170A-13(c)(3) of the Income Tax Regulations. Such appraisals must be made by a qualified appraiser no earlier than 60 days before the date of the donation and no later than the due date of the return (including extensions) on which a deduction is claimed. The appraiser must sign and date the appraisal and may not charge a fee based upon a percentage of the value of the property or based upon the amount of the deduction claimed by the donor. The appraisal must include certain specified information.

future enforcement efforts. In the meantime, we will pursue the active enforcement program we have in place now.

Examination Activity in the Area of Façade Conservation Easements—Review and Findings to Date

Formation of a cross-functional team

Earlier this year, we formed a cross-functional team to attack all aspects of the problem of conservation easements. The team includes members from three IRS business units (Large and Midsize Business, Small Business and Self-Employed, and Tax Exempt and Government Entities), as well as representatives from the IRS Appeals Office, Chief Counsel, and the Office of Professional Responsibility.

Our team has selected cases and set strategic priorities as to which cases are worked first. It has trained and is continuing to train IRS agents and appraisers on conservation easement issues, and will serve as a resource for legal and technical questions for our field personnel.

Toward this end, the IRS is sponsoring an e-mail address to receive questions and concerns from the community, so that the group can collect stakeholder input as we move forward in this area. The address is easementquestions@irs.gov, and it is up and running.

We are looking not only at donors and recipient charitable organizations, but also at promoters. The team will be alert for developing patterns of abuse and will identify promoters of potentially abusive easement donations. In the course of our examinations, we are finding appraisers that appear to be associated with abusive promotions on a recurring basis. We are going to shine a searchlight in their direction, and will use all civil and criminal tools at our disposal to combat abuses. We also will continue to partner effectively with both the NPS and state and local preservation offices.

Inventory of cases and findings to date

Donor Audits. As noted, the Service has a more mature enforcement program looking at open space easements. However, we also have done work in the façade area and will be doing much more into the future.

Currently, we have 30 façade easement audits underway, including 9 audits of façade easement donations relating to commercial property. With regard to residential properties, the team is currently comparing the NPS data on some 1,600 certifications to our master file to determine which cases to pursue next. We are also comparing this data to partnership return data in order to identify and select appropriate cases involving commercial property.

In some of the geographic areas where residential façade easements are clustered, we may also pursue market studies to determine the proper valuation of easements in those areas to use in our enforcement program.

Our findings to date indicate that while the threshold requirements for a qualified conservation contribution are being met, taxpayers are taking excessive deductions for façade easements. As I have mentioned, there are two categories of property, residential and commercial. Generally, appraisers have used different approaches to these two categories, but with inflated results in both.

In granting a façade easement, residential owners agree not to modify the façade of their historic house and they give an easement to this effect to a recognized charity. However, if the façade was already subject to restrictions under local zoning ordinances, the taxpayers may, in fact, have nothing or very little to give up. A taxpayer cannot give up a right to change the façade of a building if he or she does not hold the right in the first place, as may be the case where a zoning ordinance has taken this right from the property owner. Even if a zoning variance is possible, both the likelihood of that variance and the extent of change likely to be permitted under a variance would reduce the value of a façade easement.

Some rather troubling valuation practices in residential housing have come to our attention. Based upon a sample of cases from Washington, D.C., New York City, Chicago, and Cleveland, it appears that appraisers are not undertaking any meaningful analyses with respect to façade easements, but instead may simply be placing a value on a donated façade easement that is equal to a fixed percentage (generally 10–15%) of the value of the underlying property, with little support provided for the percentage selected.

Let me state plainly that those who say the Service will accept a flat percentage of 10–15% as a reasonable residential façade valuation without any underlying analysis are wrong. There is no such rule, and taxpayers and appraisers should not proceed under the assumption that this constitutes a safe harbor. It does not.

Issues we find in commercial property façade easements are different. Although we have seen fixed percentages being taken in these cases, there are often addi-

tional valuation problems. In some cases, the appraiser may use extraordinary valuation methods to achieve a high value for the donation. These methods include inflating the value of the property before the donation by ignoring sales of comparable properties and asserting instead an inflated value for a theoretical highest and best use of the property. The commercial cases tend to resemble the issues we see in the valuation of open space easements, such as how to value restrictions on future development. Appraisals may ignore one or more important issues, such as whether the claimed highest and best use is in fact economically feasible. We have seen cases where development is assumed to be successful (for example, added office or hotel space) where such development actually is questionable because of current market conditions (for example, where there is a glut of such space).

Other assumptions are made that are equally troubling. Existing zoning restrictions are disregarded by assuming that the restrictions will be waived by local authorities, where experience indicates otherwise. Some appraisals may even assert an enhanced valuation of the property before the easement is donated by assuming the foregone development has already taken place, and by ignoring the time and expense associated with carrying out the potential development.

Audits of the recipient charity. We are also looking at a number of charities that are engaged in the receipt of conservation easements generally, including some that pertain specifically to façade easements. This includes some charities that we believe may have been involved in particular abuses. Currently, we have seven organizations under examination, and we will begin examination of four more organizations shortly. As I mentioned, it appears that certain of these organizations actively solicit façade easements within historic neighborhoods. The promotional materials offer the possibility of large deductions to the owners, and supply everything the owner needs to complete the conveyance of the easement. The solicitation materials may refer the owner to preferred appraisers, and may require the owner to pay a fee to the organization for arranging the transaction and, ostensibly, for monitoring the easement into the future.

Promoter referrals and audits. We are also seeing promoted investor syndications seeking to profit from conservation easements. To date these appear to be limited to areas other than façade easements. This may be more prevalent in certain states that allow transfers of tax credits. Some of these states have provided referral information to us on questionable easement donations.

We are currently looking or have looked at the activity of more than 20 promoters, including some involving façade easements, and five promoters involved in easements have been recommended for investigation. Promoters and other persons involved in these transactions may be subject to penalties under sections 6700, 6701, and 6694, or an injunction under section 7408.

Sanctions against appraisers. Before 1984, attorneys and accountants, but not appraisers, could be barred from practice before the IRS. In 1984, Congress amended the law, and Circular 230 was modified to include appraisers. Circular 230 currently requires that the section 6701 penalty, aiding and abetting in the understatement of tax, be imposed before action may be taken against an appraiser. The IRS must demonstrate, by a preponderance of the evidence, that the appraiser had actual knowledge that the taxpayer would rely on a document that would lead to an understatement of tax by the taxpayer.

When a section 6701 penalty is asserted against an appraiser, an information referral to the Office of Professional Responsibility is mandatory. The Office of Professional Responsibility may disqualify any appraiser against whom such a penalty has been assessed. Thereafter, a disqualified appraiser is barred from presenting evidence or testimony in any administrative proceeding before the Department of the Treasury or the IRS, and an appraisal he or she makes after the date of disqualification will have no probative effect.

In light of the appraisal practices I have outlined above, we are actively considering penalties against appraisers. We have alerted the Director, Office of Professional Responsibility, of possible referrals of at least three appraisers arising out of questionable valuations of donated easements. To date, these appraisers work in the open space easement area.

IRS Challenges

Although the conservation contribution provisions of the Internal Revenue Code play a vital role in the preservation of our historic structures, we are concerned with valuations of property that appear to be informed primarily by tax considerations rather than actual property values. In challenging such valuations, our outstanding but small staff of appraisers (48 in all, 20 of who work wholly or in part on 170(h) cases) must perform detailed appraisal work using accepted and recognized valuation standards. It is neither easy nor quick work. Our work to date raises the ques-

tion of whether rules governing appraiser qualifications, appraisal standards, and the standards for referral to the Office of Professional Responsibility are sufficient.

As you discuss changes in this and other areas involving the tax-exempt sector, I also ask you to recall and consider the focus areas outlined in Commissioner Everson's testimony before the Committee on Ways and Means on May 26, 2005. You may recall that these focus areas include whether there are gaps in the statutory or regulatory framework; whether the IRS has the flexibility it needs to respond appropriately to compliance issues; whether more should be done to promote transparency; and whether we have the resources we need to do the job. In this regard, please consider the intermediate sanction recommended by the Administration when taxpayers claim charitable contribution deductions for contributions of perpetual conservation restrictions, but the charities that receive those contributions fail to monitor and enforce the conservation restrictions for which the charitable contribution deductions were claimed.

The Administration has made this recommendation in its FY 2006 budget proposals.⁴ Specifically, the proposal would impose significant penalties on any charity that removes or fails to enforce a conservation restriction for which a charitable contribution was claimed, or transfers such an easement without ensuring that the conservation purposes will be protected in perpetuity. The amount of the penalty would be determined based on the value of the conservation restriction shown on the appraisal summary provided to the charity by the donor.

The Secretary would be authorized to waive the penalty in certain cases, such as if it is established to the satisfaction of the Secretary that, due to an unexpected change in the conditions surrounding the real property, retention of the restriction is impossible or impractical, the charity receives an amount that reflects the fair market value of the easement, and the proceeds are used by the charity in furtherance of conservation purposes. The Secretary also would be authorized to require such additional reporting as may be necessary or appropriate to ensure that the conservation purposes are protected in perpetuity.

In conclusion, the IRS remains committed to doing all it can to make the conservation easement provisions of the tax code work in the manner Congress intended. Legitimate conservation easements serve an important role in the preservation of our open lands and our cultural heritage. However, what began as a laudable conservation easement program to save our open space, natural habitats, and historic sites may have become distorted. We are committed, as we progress through our enforcement program, to determine the size of this distortion and to take all steps necessary to stem the abuse of these programs. Clearly, the public should be able to expect that only those donations of façade and other easements that are fairly valued and that result in an identified public good will result in favorable tax treatment.

Chairman RAMSTAD. Thank you, Mr. Miller. Mr. McClain, please.

STATEMENT OF STEVEN L. McCLAIN, DIRECTOR, NATIONAL ARCHITECTURAL TRUST, AND PRESIDENT, SPRINGFIELD MANAGEMENT SERVICES

Mr. MCCLAIN. Mr. Chairman, Congressman Lewis, Members of the Subcommittee, thank you for the opportunity to testify in this hearing on conservation easements. I am Steve McClain, Senior Vice President of NAT. Formed in 2001, the Trust is a Section 501(c)(3) organization dedicated to the protection of property certified as historic by the Secretary of the Interior. While Federal legislation provides for the Department of the Interior to be the resource for listing historic places, the Constitution does not give the Federal Government the authority to regulate the preservation of these properties. This authority only exists with the State and municipal governments. Destruction of many historic properties dur-

⁴ *General Explanations of the Administration's Fiscal Year 2006 Revenue Proposals*, Department of the Treasury, February 2005, pp. 112–113.

ing the urban renewal era of the 1960s and 1970s brought to light the fact that political and economic pressure on municipal and State governments have and will result in destruction of our historic resources. Critics of the program argue that properties in which conservation easements are granted are already protected through local ordinances. This criticism is not supported by facts. Many, but not all, of the properties in our portfolio are located in cities that have passed local ordinances restricting changes to historic properties.

For approximately 25 percent of the properties in which NAT holds an easement, there is no local protection of any kind. The National Architectural Trust is the only institution with the legal authority to protect these properties from changes, neglect, or demolition, and to retain and restore property in the event the property owners fail to act. Our easements are permanent and carry on in perpetuity. Local ordinances may be canceled at any time. Conservation easements are an effective tool for neighborhood revitalization. In fact, 50 percent of all properties in Federal historic districts are in poverty areas as defined by the last census. A report by the Federal Reserve Bank of New York states that "Conservation easements, when combined with other economic incentives such as the historic rehabilitation tax credit, have proven to be effective in revitalizing neighborhoods throughout the United States." Some nearby examples include the Willard Hotel, the Old Post Office Building, and the planned development within the Anacostia Historic District.

Some question whether an easement granted on a property covered by local ordinances and commissions should qualify as a charity deduction-donation. This position is taken in spite of the fact that the value of conservation easements granted on such properties was thoroughly considered six times by U.S. tax court. In each case, the court ruled that easements generate a loss of value through a reduction in the property owners' bundle of rights that constitutes property ownership in this country. In each of the six cases, the property was located in a district protected by local ordinances. There is criticism of the monitoring and enforcement of conservation easements by easement holding organizations. The NAT currently holds approximately 550 easements. We take the responsibility to monitor and enforce the easements forever as our most important responsibility; in so doing, NAT has taken the necessary steps to ensure that it has the resources to carry out all its responsibilities in perpetuity.

The NAT has had growing pains. Everything we have done has been in consultation with legal advisers and was done to further the mission of NAT. However, in response to criticism of our organization and to ensure that there is no doubt about our commitment to our mission, we have taken the following actions: We have adopted the practice of having an annual financial audit conducted by an independent accounting firm; we have adopted the Land Trust Alliance's new standards and practices; we have terminated NAT's contractual relationship with SMS, a for-profit company that previously provided marketing and processing services to NAT.

In conclusion, I would like to discuss possible reforms to the conservation easement program. First, NAT, along with other preser-

vation and conservation organizations, opposes the Joint Committee on Taxation's recommendations regarding conservation easements. These recommendations would effectively dismantle what has proven to be a highly effective, cost-efficient conservation and historic preservation program. Second, to ensure that the program continues as an effective preservation tool and to eliminate possible abuses of the program, NAT suggests for the Subcommittee's consideration the following: One, adopt the President's fiscal year 2006 budget proposal to impose penalties on easement holding organizations that fail to enforce the restrictions contained in their conservation easements; Two, adopt the Appraisal Institute's recommendations to require all appraisals to be certified as competent in easement donation valuation, and to follow accepted Uniform Standards of Professional Appraisal Practice (USPAP) appraisal standards; Three, require easement holding organizations to be certified by an organization such as the Land Trust Alliance; and four, require easement holding organizations to set aside sufficient financial resources to enable them to monitor and enforce the easements they hold in perpetuity. That concludes my statement. Thank you again for allowing me to testify today. I will try to answer any questions.

[The prepared statement of Mr. McClain follows:]

Statement of Steven L. McClain, Director, National Architectural Trust and President, Springfield Management Services

Mr. Chairman, Congressman Lewis and members of the Subcommittee, thank you for the opportunity to present the views of the National Architectural Trust at this hearing on conservation easements. I am Steven McClain, Senior Vice President of the National Architectural Trust. Formed in 2001, the National Architectural Trust is a Section 501(c)(3) tax-exempt, nonprofit organization dedicated to the protection of properties certified as historic by the U.S. Secretary of the Interior. The legal mechanism the National Architectural Trust uses to protect historic properties is a Conservation Easement which is recorded in the local land records and runs with the land in perpetuity. This easement legally requires the current and all future owners to honor its restrictive provisions forever. The easement identifies the external historic features of the property; prohibits changes to the appearance of the protected features without the National Architectural Trust's specific consent; requires that the structural integrity of the entire property be properly maintained; grants the National Architectural Trust enforcement rights; and includes all provisions required by IRS regulations Sec. 1.170A-14 to qualify as a charitable donation.

The National Architectural Trust supports "voluntary preservation," whereby property owners protect their historic properties by granting an easement on the property to the National Architectural Trust. In accepting the easement, the National Architectural Trust pledges to monitor and enforce the easement forever. Since the acceptance of our first easement in 2001, our portfolio of protected historic properties has grown to approximately 550. The National Architectural Trust has accepted these easements on historic properties in New York, Massachusetts, Maryland, Virginia and New Jersey.

While Federal legislation provides for the Department of the Interior to be the resource for listing historic places, the United States Constitution does not give the Federal Government the authority to regulate the preservation of these properties. This authority only exists with state and municipal governments. Congress is forced to rely on these governments through the adoption of local ordinances to protect our nation's architectural heritage. If allowed by state or municipal governments, any building identified as an individual landmark or contributing to a historic district on the National Register can be legally destroyed.

The destruction of many such historic properties during the urban renewal era of the 1960's and 1970's brought to light the fact that political and economic pressures on municipal and state governments have and will result in the destruction of our historic resources. Thus, Congress passed Public Law 94-445 in 1976 which provides a tax incentive for the preservation of certified historic properties. The pro-

gram was designed to encourage owners of properties on the National Register to participate directly, and voluntarily, in the historic preservation process.

Conservation easements remain an effective tool for permanently protecting America's historic treasures by encouraging owners of properties deemed to be of high historic importance to voluntarily ensure that these architectural treasures remain intact for the enjoyment and enrichment of future generations. A donation of a conservation easement provides a personal income tax deduction to the owner, which is an important incentive that ensures participation in the program. After all, these owners are surrendering property rights and assuming a number of obligations for the benefit of the public.

The National Architectural Trust and the many other nonprofit organizations that accept easement donations exist for the purpose of championing historic preservation. The National Architectural Trust was co-founded four and a half years ago by me and James Kearns. Mr. Kearns was a career public servant who retired as a Vice President of the World Bank. I have been a preservationist for twenty-five years, and am a member of numerous preservation organizations, such as:

- Society of Architectural Historians
- Institute of Classical Architecture
- DC Preservation League
- National Housing & Rehabilitation Association's Historic Preservation Development Council

The National Architectural Trust's primary mission is to protect historic properties and the historic neighborhoods they anchor by accepting easement donations that are monitored and enforced in perpetuity.

Municipal Ordinances Fail to Protect Historic Properties

Critics of the program argue that properties on which conservation easements are granted are already protected through local ordinances. This criticism is not supported by the facts.

Many but not all of the properties in our portfolio are located in cities that have passed local ordinances restricting changes to historic properties and that have created local historic preservation commissions. For approximately 25% of the properties on which the National Architectural Trust holds an easement, there is no local protection of any kind. The National Architectural Trust is the only institution with the legal authority to protect these properties from changes, neglect or demolition, and to maintain and restore property in the event that property owners fail to act. Even for the properties covered by local restrictive ordinances, the protection that our easement provides goes much further than the local protection mechanisms. Our easements are permanent and carry on in perpetuity; local ordinances may be cancelled at any time.

For example, the *Chicago Tribune* reported that after the city identified 17,000 historically significant buildings as requiring protection in a survey published in 1996, nearly 800 of them had been destroyed by 2002. Chicago is not alone. Boston recently granted permission for demolition of the historic Gaiety Theater despite the objections of historians and preservation advocates. Historic buildings continue to disappear all across the country despite local protections.

In addition, recent studies and reports reveal that local ordinances and enforcement commissions have significant weaknesses. A report of a survey conducted by the National Alliance of Preservation Commissions in 1998 revealed many weaknesses, including:

- 42% of the commissions lack an operating budget;
- 30% have no professional staff;
- 41% need owner consent to designate a building historic; and,
- Only 60% have the power to enforce their orders, while 40% are just advisory.

Even in Washington, DC, which is thought to have the best historic preservation ordinances and enforcement in the nation, Tresh Boasborg, Chairman of the DC Historic Preservation Review Board, was recently quoted in the *North West Current* as saying to the DC Council: "We don't have the power to enforce our own orders."

Architectural Historian Anthony Robins prepared a recent report at the request of the National Architectural Trust entitled *THE CASE FOR PRESERVATION EASEMENTS—When Municipal Ordinances Fail to Protect Historic Properties*. In it Mr. Robins, once an employee for the New York Landmarks Preservation Commission, wrote the following:

"One major reason for the continuing losses is that most landmarks regulation takes place at the local level, and the hundreds of landmarks or historic district commissions across the country vary enormously in their abil-

ity to protect landmarks. . . . Even the strongest commissions are hobbled by limited resources, political pressure, and weak enforcement powers. And many—perhaps most—communities still lack preservation ordinances of any kind.”

Additionally, Mr. Robins found that:

“One of the major issues facing local communities is the price of preservation. Historic preservation is a public benefit that is often purchased at a private cost. Ultimately, owners of historic properties are the ones who bear that cost, either through lost development opportunities or through the extra costs associated with restoring or maintaining an historic property. . . .”

“Today there is only one tool available that both offers a level of protection for historic landmarks that is consistent across the country, and also provides a nationally available source of financial support for the owners of historic properties: historic preservation easements. . . .”

Mr. Robins concludes that “Preservation easements make a major contribution to historic preservation, and therefore both to the livability of our towns and cities and to their economic development. Undoing such a successful—and in the long run economical—program would be a serious blow to the future of preservation. Given the minor savings that, at best, would accrue to the Treasury, the country is likely to lose far more than it would gain by eliminating preservation easements.” I request permission to add to the record the Executive Summary of Mr. Robins’ report.

Conservation Easements Revitalize Historic Neighborhoods

Conservation easements are an effective tool for neighborhood revitalization. Not only does the conservation easement program preserve historic properties, many donors apply their tax benefit to the restoration of their properties, thereby furthering the preservation effort and boosting their local economy.

In addition, 50% of all properties in Federal Historic Districts are in poverty areas as defined by the last Census. The Federal Reserve Bank of New York has completed a report stating that conservation easements when combined with other economic incentives such as the Historic Rehabilitation Tax Credit have proven to be effective at revitalizing neighborhoods throughout the United States. The conservation easement tax benefit has been combined with the Historic Rehabilitation Tax Credit to revitalize many historic neighborhoods. Some examples are:

- Downtown Washington, DC
- Willard Hotel
- Old Post Office Building—offices
- Woodward & Lothrop Building—offices and retail
- Anacostia Historic District
- New York
- 100 Atlantic Avenue, Brooklyn—condominiums
- 21–23 South William Street—offices
- 20 Exchange Place—offices
- Pittsburg, Pennsylvania
- H.J. Heinz Factory—300 loft apartments
- Armstrong Cork Building—offices and retail
- Richmond, Virginia
- Projects in the Fan Historic District
- Projects in the Franklin Street Historic District
- Georgia
- Projects in Savannah’s North Historic District
- Atlanta, Americus Hardware Building—offices
- Athens, The Sun Trust Bank Offices
- Denver, Colorado
- Wynkoop Brewing Company—restaurant
- 1818 Blake Street—offices
- Cleveland, Ohio
- Colonial Arcade—offices
- Bingham Building, West 9th Street—offices
- Marshall Building—offices
- Indianapolis, Indiana
- Black Building—offices and retail
- Detroit, Michigan
- Book Cadillac Hotel Project

These revitalization projects may never have been initiated in these historic neighborhoods had the developer not had federal tax incentives to help make the project financially feasible.

Loss of Value Created by Conservation Easements

There is criticism of the appraisal process when determining loss of value created by conservation easements. Tax deductions taken for easement donations, as with all deductions for non-cash donations valued at greater than \$5,000 require an independent, professional appraisal to determine proper valuation. The National Architectural Trust has received easement appraisals from over sixty different appraisal companies; some of these companies are the largest and most respected in the United States, including: Jefferson & Lee; Cushman Wakefield; Mitchell, Maxwell and Jackson; Jerome Haines and Associates. The National Architectural Trust has never accepted a donation without a qualified appraisal.

Some people question whether an easement granted on a property covered by local ordinances and commissions should qualify as a charitable donation. This position is taken in spite of the fact that during the 1980s the value of conservation easements granted on such properties was thoroughly considered six times by the U.S. Tax Court. In each of the six cases, the Tax Court ruled that easements generate a loss of value through a reduction in the bundle of rights that constitute property ownership in this country. In each of these six cases, the property was located in a district covered by a local ordinance enforced by a local commission.

The Appraisal Institute and the American Society of Appraisers have written the members of the House Committee on Ways and Means recommending that Congress should require that appraisers adhere to the Uniform Standards of Professional Appraisal Practice (USPAP) to correct appraisal abuse for conservation easements. The National Architectural Trust supports this recommendation.

In the book: *Appraising Easements*, 3rd edition, published by the Land Trust Alliance, there is guidance to appraisers and easement holding organizations. The guidance to easement holding organizations is:

1. Appraisals must be adequately documented.
2. Easement holding organizations should have a basic understanding of the appraisal process.
3. The easement holding organization may not be involved in the appraisal process; the appraiser must be independent, however the organization may reject a donation if the appraisal seems over-valued.

The National Architectural Trust follows this guidance.

Monitoring and Enforcement of Conservation Easements

There is criticism of the monitoring and enforcement of conservation easements by easement holding organizations.

The National Architectural Trust supports President Bush's fiscal year 2006 budget proposal to impose penalties on easement holding organizations that fail to enforce restrictions contained in their conservation easements.

The National Architectural Trust currently holds approximately 550 easements. The National Architectural Trust takes its responsibility to monitor and enforce the easement forever as its most important responsibility. And, in doing so, the National Architectural Trust has taken the necessary steps to ensure that it has the resources to carry out all of its responsibilities in perpetuity.

As such, the National Architectural Trust has demonstrated its full commitment to easement monitoring and enforcement by:

1. Creating a Stewardship Fund of approximately \$12.5 million that is reserved exclusively for future year monitoring and enforcement—55% of all cash contributions to the National Architectural Trust, since its inception, have been and continue to be deposited and remain securely in the Stewardship Fund;
2. Creating a state-of-the-art database to store data and images about each easement the National Architectural Trust holds with appropriate backup and security protections;
3. Annually informing each owner of property on which the National Architectural Trust holds an easement of his obligations and the beginning of the annual monitoring effort;
4. Visiting properties each year to photograph the protected façade and observe the structural condition of the building; and
5. Reviewing the new photographs against the originals and subsequent photographs to detect any unauthorized changes.

The National Architectural Trust is extremely proud of its vigilant monitoring process and believes its process and thoroughness is unrivaled in the historic preservation community. To review easements the National Architectural Trust has three university-trained architectural historians on staff and relationships with other respected architectural historians in cities the National Architectural Trust serves.

Conservation Easement Quality Control

In addition to the care and attention the National Architectural Trust applies to easement monitoring and enforcement, the National Architectural Trust is also highly attentive to ensuring that the easements it accepts are proper in every respect.

Donating an easement is complicated and time-consuming. There are numerous IRS regulations that must be strictly followed. The National Architectural Trust is committed to making sure that each easement it accepts is proper in every respect. The actions the National Architectural Trust takes to review each conservation easement application are essential to ensure the legality and appropriateness of the donation. The National Architectural Trust's efforts ensure:

- The required photographs are those of the actual property being donated and are of sufficient quality to serve our ongoing monitoring and enforcement efforts.
- The property has been properly certified as historically significant by the Secretary of the Interior.
- The mortgage holder(s) has subordinated to the easement's restrictive and enforcement provisions.
- The appraiser chosen by the client understands the laws and history associated with the conservation easement program.
- Donors seek and follow the advice of their own legal and tax professionals.
- Sufficient cash funds are donated along with the easement to cover the current operating costs and to supplement the Stewardship Fund to cover the future costs of monitoring and enforcement; and
- The appraisal report specifies both the fair market value of the property and the loss of value produced by the donated easement; incorporates a copy of the easement; has followed appropriate valuation methodologies; and contains reasonable valuations.

The National Architectural Trust also ensures that its representatives are trained and competent in the National Architectural Trust's policies, practices and ethical values.

National Architectural Trust Internal Reforms

The National Architectural Trust has had growing pains. Everything we have done has been in consultation with legal advisors and was done to further the mission of the National Architectural Trust. However, in response to criticism of our organization and to ensure that there is no doubt about the National Architectural Trust's commitment to its mission, the National Architectural Trust's Board of Directors has taken the following actions:

1. Adopted the practice of having an annual financial audit conducted by an accounting firm that is completely independent of the National Architectural Trust and reports its findings directly to its Board of Directors. The National Architectural Trust has completed its audit for 2003 and is about to complete the audit for 2004. The auditors have made helpful recommendations but have found no irregularities or weakness in our operations;
2. Adopted the Land Trust Alliance's New Standards and Practices and have developed, with the approval of the Board, a plan to be in full compliance by June, 2006;
3. Adopted a strict conflict of interest policy and obtained conflict of interest disclosure statements from all officers, directors and staff members;
4. Worked closely with expert legal counsel and tax advisers to ensure that all policies and practices of the National Architectural Trust are in strict compliance with all applicable laws and regulations;
5. Adopted compensation practices that are in strict accordance with the standards of the Association of Fundraising Professionals; and
6. Terminated the National Architectural Trust's contractual relationship with Springfield Management Services, a for-profit company that previously provided marketing services to the National Architectural Trust and easement donors.

Recommended Reforms to the Conservation Easement Program

In conclusion, I would like to discuss possible reforms to the conservation easement program.

First: The National Architectural Trust, along with other preservation and conservation organizations opposes the Joint Committee on Taxation's recommendations regarding conservation easements. These recommendations would effectively dismantle what has proven to be a highly effective, cost-efficient and long standing conservation and historic preservation program.

Second: To ensure that the program continues as an effective preservation tool and to eliminate potential abuses of the program, the National Architectural Trust suggests for the Subcommittee's consideration the following:

Recommended Reforms for Easement Holding Organizations

1. Adopt the President's fiscal year 2006 budget proposal to impose penalties on easement holding organizations that fail to enforce the restrictions contained in their conservation easements;
2. Establish credentialing or standard setting for organizations that accept easements on properties for conservation and preservation purposes; and
3. Require additional information on IRS Form 8283, which is required of all non-cash charitable donations. This additional information could be collected on an additional form that would better allow the IRS to identify possible abuse.

Possible additional disclosures might include:

Whether the value of the donation is significantly greater than the donee's cost or basis (which would be normal in long-held properties, but an indicator of potential problems in properties held for a shorter period of time);

Whether the donee or any employee or board member of the donee has had a business relationship with the easement donor within the past 5 years, and the nature of that relationship;

Require two independent appraisals of properties where large donations are taken. The average of the two appraisals could be used for the final donation amount. These additional appraisals should only be required in cases where there is a very large deduction; otherwise the additional appraisal costs could be prohibitive; and

Prohibit donations by any board member of the accepting easement holding organization.

Recommended Reforms for an Independent Appraisal

1. Require appraisals of conservation easement donations to be performed by state-licensed general certified appraisers. This is the highest of three state licensing standards required of states by federal statute (Financial Institutions Reform Recovery and Enforcement Act (FIRREA));
2. Require that appraisals conform to the Uniform Standards of Professionals Appraisal Practice (USPAP). All appraisals used for federally related mortgages and all federal property acquisition appraisals are required to meet the USPAP standard;
3. Require that appraisers include in the appraisal report the effect existing local historic preservation laws, if any, have on the appraiser's valuation of a loss from a façade conservation easement and certify that this has been taken into consideration in the value reflected on the IRS Form 8283;
4. Increase penalties for over-valuation of donations by donors, promoters and appraisers. Taxpayers can be fined based on the amount by which they have inflated the value of their donation. There is no objection to raising those fines, or to increase penalties for appraisers and other parties to an inflated appraisal, who currently face only a \$1,000 maximum penalty; and
5. Disqualify an appraiser who is found to have "substantially misstated" a valuation in an appraisal used for tax purposes from being allowed to submit future appraisals for federal tax purposes. Current law defines a "substantial misstatement" as being 200 percent of the actual value (see IRC 6662(E)).

That concludes my statement. Thank you again for the opportunity to testify before the Subcommittee.

I am prepared to answer any questions you may have.

THE CASE FOR PRESERVATION EASEMENTS

How Municipal Ordinances Fail to Protect Historic Properties¹

EXECUTIVE SUMMARY

During the past half century, historic preservation in the United States has grown from a marginal activity focusing on house museums and memorials into a major cultural and economic force at the local, state and national levels. Preservation is generally recognized as a major success story—a movement that contributes to a common sense of shared American history, helps create attractive environments and stable neighborhoods, and plays a constructive role in economic development and urban revitalization.

Most landmarks regulation takes place at the local level, where it is overseen by hundreds of landmarks commissions and historic district commissions all across the country. Contrary to popular belief, however, those commissions vary widely in the resources at their disposal, and in the level of protection they bring to local historic properties. Many areas have no local commission at all. Many have weak commissions—some because their powers are strictly advisory, others because their regulatory decisions can be, and often are, overruled by higher bodies.

Even strong commissions have weaknesses. Some commissions with the legal power to turn down inappropriate alterations and demolitions sometimes approve them instead. Some commissions lack the resources to enforce their decisions. Some commissions offer strong protection to many of their landmarks, but a lesser level of protection to other historic properties. In general, commissions are only as effective as their political support allows them to be, and can only protect the buildings that their often limited resources enable them to designate as official landmarks.

One of the chief issues facing local commissions is the price of preservation. Specifically, historic preservation is a public benefit that is purchased at a private cost. Ultimately it is the owners of historic properties who bear that cost, either through lost development opportunities, or through the extra costs associated with caring for an historic property. Various states and cities attempt to offer some financial relief, but such attempts are spotty and inconsistent. In the meantime, sentiment against imposing private costs for land-use regulation is growing nationwide. There is only one nationally available source of financial support for owners of historic properties: preservation easements. In exchange for a one-time federal tax deduction, owners voluntarily give up—in perpetuity—the right to make inappropriate alterations to their historic properties.

Created in 1976 as part of a major national initiative to support historic preservation, easements are a carefully constructed tool that supports preservation in two ways. On the one hand, easements help property owners pay the private cost of the public benefit of preservation. On the other, easements provide an additional layer of protection for those properties, no matter how strong the local landmarks commission may be.

Easements bring additional benefits to historic preservation. Being national in scope, easements operate independently of local politics. Being voluntary, easements eliminate the contentious issue of owner opposition to landmarks designation. And being financially attractive, easements eliminate a major impediment to owner acceptance of preservation.

Moreover, many historic properties are protected by easements but not by local commissions. To qualify for an easement, a property must be listed in the National Register of Historic Places, a program administered by the states in partnership with the National Parks Service. Unlike local commissions, which designate new landmarks according to their own schedules and priorities, the State Historic Preservation Offices will consider any meritorious nomination presented to them. In response to the financial incentive offered by easements, the owners of many historic properties not yet protected by local commissions have supported the nomination of their properties to the National Register, and donated preservation easements that are now protecting those properties.

The value of preservation easements has long been recognized by dozens of organizations across the country. Easements today are accepted by national nonprofit organizations, statewide organizations, citywide organizations, and even local governments.

Yet, despite their proven worth, preservation easements—and the protection they bring to the nation's historic resources—might disappear, in whole or in part. On January 27th of this year, the staff of Congress's Joint Committee on Taxation released a study, *Options To Improve Tax Compliance And Reform Tax Expenditures*,

¹Prepared by Anthony Robins, Thompson & Columbus, Inc., February 15, 2005.

which includes a proposal to “Modify Charitable Deduction for Contributions of Conservation and Façade Easements” (sec. 170). The study proposes dramatically reducing the value of the easement for non-residential properties, and *completely eliminating* the availability of easements for residential properties.

Preservation easements currently offer the only nationally available tool for protecting historic properties. They offer the only nationally consistent mechanism for helping private property owners bear the cost of the public good of preservation. They bring those owners to a commitment to preservation voluntarily. And in the long term, they represent a bargain: The cost of an easement, in foregone tax revenues, is paid just once, but the easement continues in perpetuity—over time, the cost amortizes to very little. And the cost of monitoring and regulating those easements is borne not by the public, but by the nonprofit easement-holding organizations—financed by property-owner donations. Undoing such a successful—and in the long run economical—program will harm the nation’s historic preservation efforts, while realizing only minor savings to the Treasury.

Chairman RAMSTAD. Thank you, Mr. McClain. Mr. Edmondson, please.

**STATEMENT OF PAUL W. EDMONDSON, VICE PRESIDENT AND
GENERAL COUNSEL, NATIONAL TRUST FOR HISTORIC PRES-
ERVATION**

Mr. EDMONDSON. Good afternoon, Mr. Chairman, and Members of the Subcommittee. I appreciate being invited to appear today. For more than 50 years, the National Trust has worked to protect the Nation’s heritage as the congressionally chartered leader of the private preservation movement in America. Consistent with our congressional charter and with the support of a quarter of a million members, we carry out a wide variety of programs and activities to ensure that the places that reflect our history as Americans will continue to be enjoyed for future generations. Since 1973, the National Trust has effectively used easements as a tool for historic preservation. We protect some 100 historic sites around the country with easements, and we also assist and encourage preservation organizations, at the statewide and local levels, to use easements as a preservation tool. There are many qualified preservation organizations that accept and administer easements as part of a broad range of statewide or community-based preservation activities, including nonprofit organizations like the Florida Trust for Historic Preservation, Historic Denver, The Preservation Alliance of Minnesota, The New York Landmarks Conservancy, or the Georgia Trust for Historic Preservation, just to name a few.

A number of governmental entities at the State level also hold preservation easements. These organizations take seriously their responsibility to monitor and enforce easement restrictions to ensure the effective, long-term preservation of these historic places. In fact, our policy is to encourage easement donations to be given to statewide and local organizations rather than to us. Because we consider preservation easements to be such an effective tool and because we value the tax incentive that supports them, reports of abuses in this area are alarming to us. My written statement provides a more detailed discussion of the subject, but I would offer a few observations that may be of interest to the Subcommittee.

First, regarding the problem of exaggerated deductions, we fully agree that taxpayers who grant simple façade easements in tightly regulated historic districts should not expect to be well rewarded

under the Tax Code. A simple façade easement on a residential property, particularly an easement that only restricts changes to the front, should not produce a significant tax deduction if the easement does little more than is already required by strong local preservation law. That is, of course, a big “if.” Many local preservation laws, in fact, provide little more than honorific recognition, and many historic properties actually have no level of local protection. In addition, many preservation organizations use easements and impose restrictions going well beyond the obligations imposed by local preservation laws, and in those cases, an easement deduction may justify significant tax benefits. To suggest that simple easements in strong local districts shouldn’t produce significant deductions is not simply a matter of common sense, but it is a concept embodied in the IRS regulations that cover this area. It also happens to be the guidance that the National Trust has provided to preservation organizations and to the public for the past 20 years through the publication of *Appraising Easements*, which the Chairman noted. Another area of concern relates to the way that façade easements have been aggressively promoted in recent years as a tax-saving device. While most preservation organizations are highly responsible, we have seen too many examples of promotions that grossly oversimplify the tax benefits of easement deductions, in particular by suggesting a standard 10 to 15-percent deduction for simple façade easements. We think that those who solicit easement donations have an obligation to be clear that significant deductions are only available if the obligations of the easement significantly reduce the value of the property. Unfortunately, this has not always been the case.

How can these problems be addressed? First, it is worth noting that actions already taken by the IRS, in particular statements that it will aggressively audit in this area, are already having an effect. We have seen both historic preservation organizations and appraisers approach this issue with a new sense of caution. Steps can also be taken, and are being taken, by the broader preservation community. The National Trust and our preservation partners are committed to developing standards and practices that will help to ensure the integrity of this important program. We also believe that Congress should consider changes that would, in particular, address valuation problems. Appraisal standards should be enhanced to ensure that appraisers are properly trained and certified, that valuations are accurate, and that the impact of local preservation and zoning laws are fully considered. Stronger penalties should be adopted for valuation misstatements; easement deductions should not be granted for easements that protect only a façade if other significant historic features of a property are unprotected or if the structure is at risk; and easements, as well as easement holding organizations, should adhere to the highest professional standards. Thank you again for the opportunity to provide the views of the National Trust for Historic Preservation. We stand ready to work with Congress to address these issues and to ensure that this important incentive is retained.

[The prepared statement of Mr. Edmondson follows:]

**Statement of Paul W. Edmondson, Vice President and General Counsel,
National Trust for Historic Preservation**

Good afternoon, Mr. Chairman and members of the Subcommittee. I appreciate this opportunity to assist the Subcommittee as it reviews the federal tax incentives for historic preservation easements. The National Trust considers easements and the tax deductions that support them to be valuable tools for historic preservation, and we are deeply concerned by reports of abuses in this area. We are eager to work with Congress to ensure that steps are taken to ensure the integrity of this important incentive for historic preservation.

By way of background, the National Trust is the only nonprofit organization chartered by Congress to promote public participation in the preservation of America's heritage. For more than half a century, the National Trust has actively pursued this mission—through the operation of historic sites open to the public; through public education, financial assistance, and advocacy; by providing technical assistance to hundreds of independent historic preservation organizations operating at the state-wide and local levels; and by using preservation as the core focus of community revitalization activities across the country. With the support of more than a quarter of a million members, the National Trust has sought to ensure that the places that reflect our history as Americans will continue to be enjoyed by future generations.

With the pressures of urban sprawl, in-town tear-downs, and the bottom-line realities of the real estate development world, the preservation of America's historic places could not be accomplished without effective public policy tools and incentives at the federal, state, and local levels. Municipal landmark laws, state regulations and incentives, and federal laws that promote rehabilitation and reuse of historic properties all create a framework of policies and incentives that help to promote historic preservation as a strong public value. While these policies and incentives are relatively modest in scope and cost, they are incredibly important, because without them our history would simply *be* history.

Historic Preservation Easements Serve as a Valuable Preservation Tool

Preservation easements are a uniquely effective preservation tool—a tool that uses *private*—and *voluntary*—agreements to protect historic structures and significant historic areas from demolition or inappropriate alteration. For well over three decades, hundreds of nonprofit organizations—and governmental agencies at the federal, state, and local levels—have responsibly used preservation easements to protect many thousands of historic structures, archaeological sites, battlefields, and rural landscapes. For many of these properties, easements serve as the only legal protection to preserve their historic or architectural values. And, for more than a quarter of a century, Congress has recognized the value of such easements by granting tax incentives to taxpayers who donate them to qualified easement-holding organizations.

Since the early 1970s, the National Trust has actively encouraged the use of conservation and preservation easements to preserve historic places. Pursuant to our mission and Congressional Charter, the National Trust has published reference materials on easements, and has provided advice and assistance to other preservation and conservation organizations holding easements. Over that same period—over the past 30 years—the National Trust has itself acquired approximately 100 easements, protecting a variety of historic sites in 21 states and the District of Columbia. Some of these easements were donated to the National Trust, some were obtained by the National Trust as a condition of grants or other financial assistance, and many were imposed on historic properties given outright to the National Trust for other disposition.

The easements that the National Trust holds and administers protect a wide variety of historic resources, including archaeological ruins in rural Colorado, open farmland next to our historic sites in Virginia, a modest but unaltered Cape Cod saltbox cottage in Massachusetts, a modernist classic in California, a frontier fort in Texas, and a number of important National Historic Landmark structures from Florida to Oregon. Our easements are very restrictive, going far beyond a simple “façade” easement, by protecting the entire structure, its historic setting, and, very often, interior historic features as well. And these restrictions are backed up by an active monitoring and enforcement program, with support from an endowment of more than \$1 million, and with the help of an on-staff architect specifically assigned to this area.

While the National Trust is an easement-holding organization, it is worth noting that the National Trust does *not* actively solicit easement donations for itself. Instead, pursuant to a board policy adopted in 1995, we first encourage prospective donors to work with qualified statewide and local preservation organizations that

accept and administer easements as part of their mission to serve a broad range of community-based preservation activities. There are many capable easement-holding organizations at the state and local levels that also rely on restrictive easements, and that take seriously their responsibility to monitor and enforce easement restrictions to ensure the effective long-term preservation of these historic places. Some of these organizations include prominent nonprofit preservation groups, such as the New York Landmarks Conservancy, the Preservation Resource Center of New Orleans, Historic Denver, the Cleveland Restoration Society, the Pittsburgh History & Landmarks Foundation, the Georgia Trust for Historic Preservation, the Florida Trust for Historic Preservation, the Utah Heritage Foundation, the Foundation for San Francisco's Architectural Heritage, the Historic Charleston Foundation—just to name a handful. Others are state government offices that are specifically dedicated to protecting historic sites, such as the Texas Historical Commission, the Minnesota Historical Society, the Virginia Department of Historic Resources, and the Maryland Historical Trust.

Concerns About “Façade” Easement Valuation Abuses

Because of our longstanding interest in easements, and the tax incentives that help to encourage them, the National Trust is seriously concerned by reports that some donors of historic “façade” easements have abused this important tax incentive by submitting exaggerated deduction claims. While we have no specific information regarding the actions of individual taxpayers, the fact that the IRS believes that there has been widespread overvaluation of façade easement donations should be of concern to any easement-holding organization. On the other hand, the recent announcement by the IRS that it plans to conduct pre-audit reviews of a large number of façade easement donations is an important sign that the agency plans to take a more active and critical role in this area, which we hope will in turn lead to greater caution on the part of easement donors, and the appraisers, accountants, lawyers—and, yes, the preservation organizations—who advise them.

Statements made by the IRS on this topic note one concern in particular: that donors often claim significant deductions for simple façade easements on historic properties located in historic districts that are already tightly regulated by local municipalities, and where the imposition of new restrictions would likely have little valuation impact. While each situation must be addressed on its own merits (for example, many historic district laws are actually quite weak, or poorly enforced), the National Trust agrees that simple façade easements—particularly those that only restrict changes to the front of a historic structure—are generally not likely to justify significant tax deductions for historic properties already subject to strong local preservation laws, and especially for properties that have substantial market value because of their historic character. This is not only a matter of common sense, but it is a concept embodied in the regulations accompanying this area of the tax code. It also happens to be the guidance that the National Trust has long provided, first published in the 1984 manual “Appraising Easements” (jointly produced by the National Trust and the Land Trust Alliance, and currently in its third edition).

On the other hand, it is essential to stress that many qualified easement-holding organizations use restrictive easements that go well beyond the preservation restrictions of local preservation laws, and that many easement donations protect historic sites that are not protected in any other manner. In these cases, both the IRS regulations and the guidance available to appraisers suggest that significant deductions *should* be permitted for such easements, again depending on the circumstances of any individual case.

And, it is important to state that, from a substantive preservation standpoint, most easements *do* provide important preservation values, even for properties already regulated by local historic preservation laws. Such easements can serve—and indeed have served—as an important “backstop” to local preservation ordinances, which are often subject to economic hardship or special merit exemptions, variances, or changes to permit development as a result of political or economic pressure. These additional protections should be considered as part of the valuation process, as noted in the applicable IRS regulations.

Concerns About Over-Promotion of “Façade” Easement Donations

In addition to concerns raised about exaggerated valuation claims for façade easements, recent media reports have focused on the significant increase over the past several years in activities by organizations and individuals involved in promoting façade easement donations as a tax-saving device.

There is nothing wrong, *per se*, with easement-holding organizations—or private promoters—encouraging donors to take advantage of duly authorized tax incentives. Congress created the tax incentive in 1976 to encourage the use of this tool for his-

toric preservation, and it is important for potential donors to understand that such incentives exist. However, the National Trust has been quite concerned with the marketing practices used by some organizations in recent years to solicit donations of simple façade easements. Some of those promotions have prominently claimed that easement donations should be worth between ten and fifteen percent of a historic property's overall value, without making any qualification regarding the nature of the easement or the other restrictions to which the property may already be subject. Although promotion of this ten to fifteen percent figure may have been prompted by guidance once used by the IRS, the Service's regulations and the decisions of the Tax Court in this area have long made it clear that there is no ten to fifteen percent "safe harbor" for easement donations. Deductions may be far less—or in some cases even greater—than these percentages, depending on the type of property, the restrictiveness of the easement, and the effect of existing local preservation and zoning controls.

The National Trust has also been concerned that many easement promoters have failed to provide any meaningful acknowledgement that significant tax deductions for easement donations can only be obtained if the easement's restrictions result in a corresponding *reduction* in the value of the property encumbered by the easement. Instead, a number of statements in promotional materials have effectively reassured donors that the real impact of easements on property rights is truly minimal—particularly when the property is already regulated as part of a local historic district. And, for easements that truly have a minimal impact on property rights—such as easements that only protect the view of the front façade of a property from the other side of the main frontage street—the easement may actually be *less* restrictive than local preservation laws, and have little or no value at all, both from a substantive preservation standpoint, and from a valuation standpoint.

Recommendations

As previously indicated, it is the view of the National Trust that historic preservation easements, and the tax incentives that support them, serve as important tools to promote the preservation of America's historic places. The National Trust is committed to working with our partner organizations to provide increased training and guidance, and to develop standards and practices that will help to ensure that the integrity of this important program is not compromised. We have also discussed with our partners the concept of creating a voluntary system of accreditation for historic preservation organizations that accept easement donations. In addition, we have had discussions with representatives of the appraisal industry about creating better guidance and additional training for appraisers.

Fundamentally, however, we believe that many of the concerns raised about valuation problems, and about questionable promotion of easement deductions can—and should—be addressed by Congress. Appraisal and appraiser standards should be enhanced to ensure that appraisers are properly trained and certified, that valuations are accurate, and that the impact of local preservation and zoning laws are fully considered. Stronger penalties should be adopted for valuation misstatements, and appraisers who significantly misstate easement values should be barred from practice before the IRS. Easement deductions should not be granted for easements that protect only a façade if other significant historic features of a property are unprotected, or if the structure itself is at risk. And easements—as well as easement-holding organizations—should also adhere to the highest professional standards for review and approval of changes.

We stand ready to work with the Ways & Means Committee to address these issues, and to ensure that this important incentive is retained.

Chairman RAMSTAD. Thank you, Mr. Edmondson. Ms. Breen, please.

STATEMENT OF PEG BREEN, PRESIDENT, NEW YORK LANDMARKS CONSERVANCY, NEW YORK, NEW YORK

Ms. BREEN. Mr. Chairman, Members of the Subcommittee, I am Peg Breen. I am President of the New York Landmarks Conservancy, and I thank you for this opportunity to testify. The Landmarks Conservancy is a 31-year-old, private, nonprofit organization based in New York City. We offer financial and technical help to

building owners. Our professional staff includes architects, an engineer, and trained building conservators. The Landmarks Conservancy holds 34 preservation easements. These range from Fraunces Tavern in Lower Manhattan, where General Washington bade farewell to his troops, to individual row houses, a Civil War-era loft building, to a small Dutch-era farmhouse in southern Brooklyn. None of these easements are limited to the front façade; they protect the entire structure. Some of these properties are within local historic districts, several are not. There are several historic neighborhoods in New York, many, in fact, that have no local protection. Conservancy staff monitors each of these properties annually. Every 5 years we also hire outside architects and engineers to inspect the buildings and prepare thorough condition assessment reports. Any deficiencies identified in the reports must be repaired by the owner in a timely manner. Our easement agreement is 41 pages long and emphasizes the owner's preservation and maintenance responsibilities. We must also review and approve any proposed changes or alterations. If a property is within a historic district, the owner then must also seek approval from the city's Landmarks Commission. If an owner does not comply with the provisions of our easement agreement, we have the right to seek redress in court. In two recent instances we came close to commencing court actions. Fortunately, the required repairs were made prior to the actual start of legal action, but if we had to go to court, we would not hesitate to do so. Our ability to enforce the easement provisions gives us an unmatched ability to proactively safeguard the historic significance of each property.

Despite a strong landmarks law, in most respects, our local Landmarks Commission does not have the power to proactively require that buildings be kept in good repair. Our easement agreement gives us that clear authority. We believe that the public value of an easement is directly related to the easement holding organization's ability to enforce it, and their expertise in historic preservation and the regulation of historic properties. We have never advertised nor promoted our easement program. We received several of our early easements from a separate nonprofit organization that realized it did not have the staff nor expertise to monitor them. The city's Landmarks Commission required the owners of some individual landmarks to give us an easement in return for the ability to sell unused development rights. Since NAT started vigorously promoting easements in New York City, we have received hundreds of calls from property owners possibly interested in donating easements. As a result, we have accepted 10 new easements in the past 2 years. We took many early easements without asking for a donation from the property owner; then we realized that we needed to cover inspection costs and possible legal costs associated with enforcing the easements.

We do not have a set formula or percentage to determine donations. We look at each property and try to determine the costs of our cyclical inspections. We keep an easement reserve fund of more than \$1 million. The interest generated helps to defray the inspection costs, and the fund is there in case we need to go to court or make repairs ourselves. We have always kept at arm's length from the appraisal process. We believe it is between the owner and the

IRS. We only see the appraised value when we receive the IRS Form 8283 for our signature.

Since we firmly believe that easements are an important preservation tool, let me suggest some reforms and refinements that might help eliminate any abuses or concerns. Several of the panelists have already mentioned them, but we also agree that appraisers should receive specific training, that very high appraised valuations over a set threshold should trigger a second independent appraisal; and these should be the property owners' responsibility. Nonprofit groups do not have the expertise to second-guess or judge the accuracy of appraised valuations. Easement holders should perform regular inspections and have sufficient easement reserve funds. We also have no problem with President Bush's suggestion of fines for groups that fail to perform proper inspections. Easement holders should not agree to accept proposed changes that don't conform to the highest standards of accepted historic preservation practice. Groups should be very cautious in promoting specific tax benefits to individuals. Property owners should be guided to think of easements as long-term preservation protection for property they care about. While we welcome constructive suggestions or changes, we believe Congress was right to have created tax incentives for preservation easements. We hope to work with you so that responsible groups may continue to employ this program which is doing so much to save our Nation's architectural heritage.

[The prepared statement of Ms. Breen follows:]

**Statement of Peg Breen, President, New York Landmarks Conservancy,
New York, New York**

Good afternoon Chairman Ramstad, Ranking Member Lewis, Members of the Committee.

I'm Peg Breen, President of the New York Landmarks Conservancy, and I thank you for the opportunity to testify as you examine easements, an important preservation tool.

The Landmarks Conservancy is a 31-year-old private nonprofit organization based in New York City. We offer financial and technical help to building owners throughout the City and State of New York. We have so far lent or granted over 28 million dollars to individual building owners seeking to preserve and restore New York's historic buildings. We have a professional staff of architects, an engineer and trained building conservators. We also advocate for preservation at the city, state and federal levels of government.

The Landmarks Conservancy holds 34 preservation easements. Over twenty years ago, the Conservancy saved an entire block of early nineteenth century buildings from demolition through preservation easements. That block includes the Fraunces Tavern, where General Washington bid farewell to his troops after the Revolutionary War. Recently, we accepted an easement on a small, Dutch-era farmhouse in southern Brooklyn, in an area that would not qualify as an historic district. Many of our easements protect row houses. We also hold easements on two historic commercial office buildings, on several apartment buildings, on a Civil War-era loft building and on an 1854 former bank in Lower Manhattan that now houses a club and restaurant. None of these easements are limited to the front façade, they protect the entire structure.

Some of these properties are within local historic districts, several are not. Conservancy staff monitors each of the properties annually. In addition, every 5 years, we hire outside architects and engineers to inspect the buildings and prepare a thorough conditions assessment reports. Copies of these reports are mailed to the owners and any deficiencies identified in the reports must be repaired in a timely manner by the owner. These inspections ensure that the buildings are kept in sound, first-class condition.

Any changes or alterations proposed by the owners are also reviewed by us and require our written approval prior to their execution. In cases where a property is located within an historic district, we review the changes first. If we approve the

proposed changes the application goes on to the City's Landmarks Commission for their review.

In cases where an owner does not comply with the provisions of our easement agreement, we have the right to seek redress in court. In two recent instances, we have come close to commencing court actions to ensure that proper repairs and restoration occurred. In these cases, the required repairs were made prior to the actual start of legal action. But if we had to go to court, we would not hesitate to do so.

The ability of our organization to enforce the provisions of the easement gives us an unmatched ability to pro-actively safeguard the historic significance of each property. Ongoing maintenance is crucial to the conservation of historic buildings. Despite a strong Landmarks law in most respects, our local Landmarks Commission does not have the power to pro-actively require that buildings be kept in good repair. Our easement agreement does give us the clear authority to require that each of our historic buildings be kept in good repair and that they receive appropriate levels of maintenance based on the findings of our cyclical inspections.

We believe that the public value of an easement is directly related to the easement holding organization's ability to enforce the easement's preservation requirements and their expertise in historic preservation and the regulation of historic properties. Our easement agreement is 41 pages long and emphasizes the owner's responsibility to maintain and keep the building in good repair.

We received several of our early easements from a separate nonprofit organization that was affiliated with the City's Landmarks Preservation Commission. That group realized that it did not have the staff or the expertise to monitor easements. We have also accepted several easements on properties that received special permits from the Landmarks Commission allowing the transfer of unused development rights. As part of the stipulations of those special permits, the historic properties were always to be maintained in excellent repair. The City's Landmarks Preservation Commission understood that the best way to ensure this was to have the owners donate an easement to the Conservancy.

We have not advertised nor promoted our easement program. Since the National Architectural Trust started vigorously promoting easements in New York City, we have received hundreds of calls from property owners possibly interested in donating easements. People seek our advice because we are the long-established nonprofit group in the city dealing with historic preservation issues. As a result of these many calls, we have accepted a total of ten new easements in the past two years.

We took many early easements without asking for a donation from the property owner but then realized that we needed to cover inspection costs and possible legal costs associated with enforcing the easements. We don't have a set percentage to determine the size of each donation's endowment. We look at each property and try to determine the costs of our cyclical inspections. We keep an easement reserve fund of more than \$1 million, which generates interest income that defrays the cost of the inspections and which is there in case we need to go to court to enforce an easement or make repairs ourselves.

In terms of the appraisal report, we have no idea what it contains until after we have closed on the easement and the owners send us the IRS form 8283 for our signature. We have always kept at arms length from the appraisal process because we believe that it is between the donor and the IRS. Our interest in the property and amount of contribution to us has nothing to do with the amounts contained in the appraisal report.

Since we start from the firm belief that easements are an important preservation tool, let me suggest some reforms and refinements that might help eliminate any abuses or concerns.

We believe it would be helpful if real estate appraisers involved in appraisals of easements were specifically trained and certified. We believe that any easement appraisal needs to take into account whether the property is subject to landmarks regulations at a local level and how strict those regulations are.

In cases where very high appraised valuations are involved, a threshold should be set that when exceeded would trigger the need for a second independent appraisal. These should be the responsibility of the property owner. Nonprofit groups do not have the expertise to second guess or judge the accuracy of appraised valuations.

Easement holders should perform regular inspections and have sufficient funds set aside that would allow them to go to court or to make emergency repairs. We have no problem with President Bush's suggestion of fines for groups that fail to perform proper inspections.

Easement holders should not agree to accept proposed changes that do not conform to the highest standards of accepted practice in the field of historic preservation. Groups should be very cautious in promoting specific tax benefits to individ-

uals. Property owners should be guided to think of easements as long term preservation protection for property they care about.

In conclusion, we believe very strongly that easements on significant historic buildings have important public benefits. They help to ensure that buildings that are important to the cultural and aesthetic history of communities are protected from demolition or unsympathetic alteration. Easements also ensure that these properties are properly maintained and kept up regardless of who owns them or how often they change hands. While we welcome constructive suggestions or changes, we believe that Congress was right to have created tax incentives for preservation easements and we urge Congress to allow responsible groups to continue to employ this program, which is doing so much to save our nation's architectural heritage.

Chairman RAMSTAD. Thank you, Ms. Breen. Mr. Lennhoff, please.

STATEMENT OF DAVID C. LENNHOF, PRESIDENT, APPRAISAL DIVISION, DELTA ASSOCIATES, VIENNA, VIRGINIA

Mr. LENNHOF. Mr. Chairman, good afternoon. Distinguished Members of the Committee, I am David Lennhoff. I am a local real estate appraiser, a Member-Appraisal Institute (MAI), and appreciate the opportunity to talk with you. I apologize again for being late. I have been asked to address a few issues related to the appraisal process in façade easements, specifically from an appraiser's perspective; I have selected three general areas. Number one has already been touched on, and that is the propriety of a benchmark percentage adjustment as representative of the value of an easement. The second area that I am going to address briefly will be the appropriate methodology for valuing an easement, which gives you a little bit of an insight into the first issue. The third area I am going to address is the significance or importance of employing qualified appraisers and having a regular review of the appraisal process in place to protect the integrity of the process.

The premise of the façade easement is that something is lost when an easement is given; otherwise, no one would give it. If they expect to be paid for something, it is because they feel something is being lost, and, in fact, there are two possibilities for a loss. One is, it restricts what you can do to the property, and it forces you to do certain things, depending on the specific easement. It might restrict additions to the property, it might restrict demolition. On the other hand, it may force you to paint it a particular color, it may force you to use particular people to repair the property. Those are the areas that create the perception that there is a value loss; and when a donation is made, people expect such a benefit. In 1985, the Hilborn court decision involving the IRS resulted in a decision by the judge that 10 percent was the appropriate value lost due to the easement, and perhaps it was. What happened, unfortunately, was that a lot of appraisers globbed onto that as being the right answer to every façade easement question, and it simply is not.

There is no one answer to every façade easement value problem. They are very complex appraisal assignments, and they have to be approached individually. So, the answer to the question of the propriety of a percentage benchmark is, "It is not appropriate." With respect to the appropriate methodology, there is a method. It is a

method that is used in almost all condemnation appraisal. It is a method that is supported by coursework in private-professional organizations such as the Appraisal Institute and in the Federal Government itself in publications such as the Yellow Book, which describes the way that government values takings. The method is the before-and-after method, and it is a simple concept. You value the property as if there was no easement in it before, and then you value the same property, as of the same date, recognizing the restriction placed on it, and the difference between the two represents the loss in value due to the easement. If it is 10 percent, it is 10 percent. The fact is, empirical research evidence suggests that an urban row house in a historic district—the example I am thinking of was in New Orleans—incurs minimal loss. On the other hand, empirical research evidence of a couple of office buildings in the Pioneer Square district of Seattle, where we are talking about façade easements, indicates that they sustained huge losses. So, the point is, the 10 percent figure is insignificant; you have to do an appraisal through an individual process.

My last issue is competent appraisers. This is an area where you can solve a lot of the problems by requiring that competent appraisers be hired. Competent appraisers mean people with education, especially in this area, people with experience in this particular valuation problem, and people with accreditation beyond just licensing, which is pretty much just an accounting mechanism. Organizations like the Appraisal Institute, which award professional designations, give you some assurance that you are going to get a quality product. Notwithstanding that, the last area that I wanted to touch on was the need for the donor to have in place a review appraisal process; that also is a specialized area that requires a reviewer with specific education and experience in this particular problem. If you do have that, I think what you do is, number one, you impress upon the appraisers that there is some accountability there; if you are starting with the high-level appraisers to begin with, you eliminate most of the problem. Those are my comments. Thank you very much for listening to me. I look forward to any questions that you might have.

[The prepared statement of Mr. Lennhoff follows:]

Statement of David C. Lennhoff, President, Appraisal Division, Delta Associates, Vienna, Virginia

INTRODUCTION

The purpose of a historic preservation easement is “to preserve and conserve the historic, architectural, scenic, and cultural values of a certified historic structure. In the case of properties located in registered historic districts, the easement will also protect the historic district through limitations on uses that might jeopardize the architectural scale, style, and sense of cultural identity of the district. The easement does this by restricting alteration and modification of the property in ways that would change its historic appearance or remove or replace historic building fabric.”

Federal tax law provides for a donation of an easement to a nonprofit organization or a government body, and that donors will receive a deduction from income taxes equal to the market value of the rights donated. “The major premise underlying easement tax deductions is that the value of property so encumbered is diminished. An encumbrance that transfers rights in a parcel of real estate to another entity cannot fail to affect the encumbered property.” Usually, the question is the matter of how much. Sometimes the value can be greatly diminished, such as when the highest and best use of the property is prohibited. On the other hand, if the easement is no more restrictive than the controlling local landmark ordinances, then the loss might be negligible. Furthermore, it has been noted that the imposition of a

façade easement, especially of the sort found on historic urban row houses, may call attention to “the character and prestige of a particular building and possibly enhance its market value.”

Since the Hilborn decision in 1985, 10% has been widely used to represent the diminution in value caused by a façade easement that does not involve a potential change in use, with little property specific analysis to support its appropriateness. This amount may or may not be the correct market value of the easement. The value of the potential loss will vary from property to property, situation to situation. No one percentage applies to all situations equally. Accurate estimation requires an expert real property appraisal. My testimony will describe the appropriate methodology for estimating the market value of the easement, and highlight the importance of properly selecting the appraiser and carefully reviewing the appraisal.

BEFORE AND AFTER METHOD

“Before and After” is the universally accepted method for estimating the loss, if any, caused by a façade easement. The method begins with an estimation of the market value of the real property before the easement, from which the market value of the property as encumbered by the easement is subtracted. Although simple sounding, the calculation is not a simple matter. The “before” calculation must take into account not only the value of the property for its existing use, but the suitability of the property for other, more profitable and presumably higher and better uses. The “after” calculation also must consider any possible economic benefits to the value of the property from the donation of the easement.

Both before and after valuations can be accomplished by whatever combination of the three traditional approaches to value—Cost, Sales Comparison, and Income Capitalization—might be applicable and appropriate. Any method used in the before easement valuation, however, should also be used in the after valuation.

The Cost Approach is helpful because it isolates the land and building components; easement donors must reduce their building basis in the property in proportion to the diminution caused by the easement. The Income Capitalization Approach is best suited for identifying changes in expenses. If sales of easement-encumbered properties are available, the Sales Comparison Approach provides the most direct and convincing measure of the after easement value.

The “before” valuation methodology does not differ from appraisals for any other purpose. The “after” analysis, on the other hand, must take into account the easement restrictions. Special consideration should be given to restrictions that affect future use, diminish anticipated future income, and increase operating expenses. Market yield rates and overall capitalization rates are influenced by risk and changes in income and value.

Some of the specific factors that can affect use and value include:

- *Effects on Operational Income*

1. Because of the preserved components’ age, normal maintenance may be more expensive.
2. Maintenance in conformity with agreed upon standards to protect the historic structure may be required. Typically, the maintenance costs involved exceed the costs ordinarily anticipated for comparable structures.
3. The owner may be required to keep the property fully insured against casualty loss, and to reconstruct the improvements if they are destroyed.

- *Effects on Reversionary Income*

1. Prohibit demolition.
2. Prohibit or severely limit subdivision.
3. Prohibit or limit further construction or development (additions, for examples).
4. Prohibit changes to the exterior (and sometimes interiors) of historic or architecturally significant buildings.

QUALIFIED APPRAISERS

An accurate appraisal is the key element in any façade easement donation program: it will influence the taxpayer’s deduction on his or her tax return, the donee organization that is seeking to preserve the community appearance, the federal and state governments facing impacts on revenue, and the public. Selection of a qualified appraiser, therefore, is critical to the success of the process. That individual must be competent—as indicated by a combination of specialized education, experience and professional accreditation—to handle the particular type of property and assignment conditions.

The current IRS definition of “Qualified Appraiser” includes anyone who declares himself or herself capable of doing the valuations. This low performance standard,

unfortunately, opens the door for participation by both the unscrupulous and unqualified.

A new definition of "Qualified Appraiser" has been proposed and, if adopted, should greatly improve the situation. From "Options to Improve Tax Compliance and Reform Tax Expenditures," Joint Committee on Taxation Staff Report, January 27, 2005,

Under the proposal, a qualified appraiser is "an individual who affirms: (1) that the fair market value of the subject property has been determined in accordance with generally accepted appraisal standards; (2) with respect to the specific property and transaction type, that he or she: (a) has successfully completed educational coursework, including for continuing education credits, in generally accepted appraisal practices, principles, concepts, methodologies, and ethics from a recognized provider of such courses; or has earned an appraisal designation from a recognized organization that teaches, tests, and provides continuing education to its members in valuation; and (b) regularly performs appraisals for which he or she receives compensation and has a minimum of two years experience in doing so; and (3) has not been subject to disbarment from practice before the IRS by the Secretary pursuant to 31 U.S.C. section 330(c).514."

APPRAISAL REVIEW

Closely related to the selection of an appropriate appraiser is careful review of the individual appraisals submitted to support the denotation deduction amount. This highly specialized job requires equally specific skills that include education, experience and impartiality. This quality control mechanism is indispensable: no program of this type will be reliable without regular, quality reviews of the appraiser work product.

CONCLUDING COMMENTS

Rules of thumb are simply not adequate as a methodology for estimating the market value of an individual façade easement. 10% is just not the universal answer to the value question. These highly complex appraisal problems require the services of specially educated, impartial appraisers, with experience in easement valuation and professional accreditation such as the designations MAI and SRA awarded by the Appraisal Institute, which bind their members to adherence to the Uniform Standards of Professional Appraisal Practice (USPAP) and Code of Professional Conduct. Furthermore, the appraisers' work product needs scrutiny by competent and experienced appraisal reviewers.

Proper, impartial easement valuations benefit and protect the taxpayer, the donee organizations, governmental agencies and the public. An understanding of the appraisal issues, and the need for qualified, quality appraiser and appraisal review participation will support the integrity of the program.

Thank you for allowing me the opportunity to share these comments with you. I am hopeful they will be useful in your evaluation of this important matter.

Chairman RAMSTAD. Thank you, Mr. Lennhoff. I want to thank all five of you for your testimony here today. As I said earlier, the complete text of your testimony will be printed in the record. My first question is addressed to you, Commissioner Miller. I understand that over the past several years a substantial number, indeed a growing number, of easements have been valued consistently between 10 and 15 percent—the bulk at 11 percent—of the value of the underlying property. I also understand that a number of appraisers claim the IRS set a guideline that façade easements should be valued between 10 and 15 percent of the property, and they point to an article which we will put up on the screen here, Exhibit 6. As you can see, the article from the mid-1990s states that "IRS engineers have concluded that the proper valuation of a façade easement should range from approximately 10 percent to 15 percent of the value of the property."

[The information follows:]

Tim Maywalt, Area Manager of SMS/CPA Exhibit 1



"As for marketability, the property generally becomes more valuable with the easement because buyers place a premium on the architectural integrity of all such properties in the community; moreover, the easement tends to give the property a uniqueness, and few are on the market at any given time." (Article by Tim Maywalt in *FPA Headlines*, January 2004)



"Maywalt emphasized in a talk to prospective donors that 'prior approval of façade changes are already restricted in exactly the same way by the city's historic preservation review board.' A tape recording of Maywalt's talk was provided to the *Post* by a participant." (*Washington Post*, Dec. 12, 2004)

CPA Marketing Materials Exhibit 2



"The tax deduction is usually 10% to 15% of the fair market value of your property as determined by a qualified appraiser."



"The Federal Historic Preservation Tax Incentive Program provides owners like you a potential income tax deduction equaling ten to fifteen percent of the fair market value of your property."

James Kearns, President and Co-founder,
National Architectural Trust
Practical Real Estate Lawyer, vol. 19
March 2003
Exhibit 3



"[The Federal Historic Preservation Tax Incentive Program] provides a tax deduction of approximately 11 percent of the property's fair market value, generating for a \$1 million property a tax deduction of \$110,000, and in pocket savings of \$55,000."

James Kearns
CPA Journal, March 2003
Exhibit 4



"Properties qualifying for this program are usually regulated by local government ordinances that restrict exterior changes."

"The buying behavior of individuals that purchase property in historic districts is one that values architectural integrity across all properties within the community, and buyers of such properties are supportive of regulations guarding historic preservation."

"Properties in historic districts are uniquely different from each other, and few are available on the market at any given time."

Letter from James Kearns to the National Trust for Historic Preservation Exhibit 5

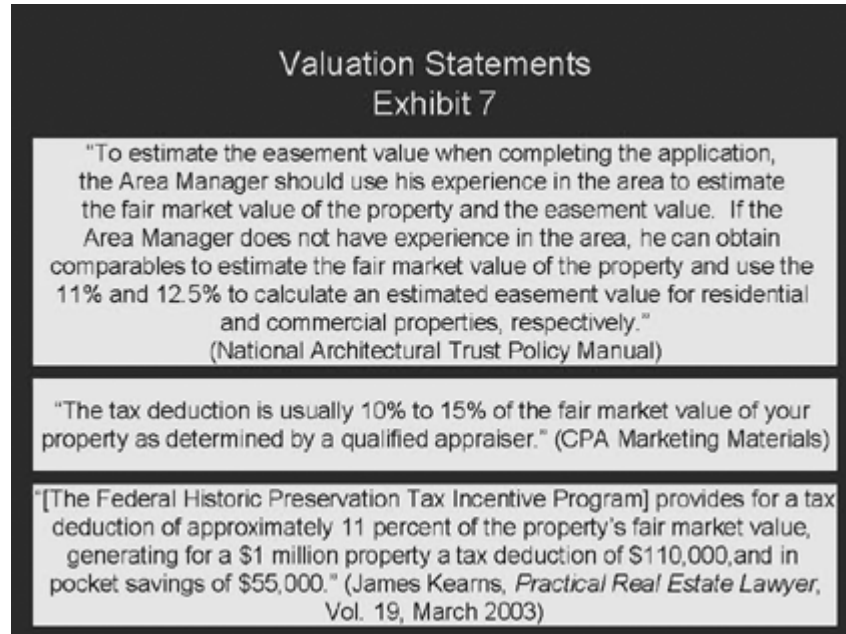


"The fact of the matter is that tax losses and market prices are not directly correlated, especially in the short-term. The IRS knows and accepts this and so does the U.S. Tax Court."

Mark Primoli, Internal Revenue Service Exhibit 6



"IRS engineers have concluded that the proper valuation of a façade easement should range from approximately 10 percent to 15 percent of the value of the property." ("Façade Easement Contributions")



Chairman RAMSTAD. My question for you, Commissioner Miller: Is it reasonable for appraisers to think this article established the guideline for the appraisal of façade easements?

Mr. MILLER. Thank you, Mr. Chairman. I will start with a flat, "No," it is not reasonable, and then I will explain why I have that view. That article stems from an old audit guideline that was used as a training mechanism for our agents. It was not intended nor did it have any impact on the regulation which requires a facts and circumstances appraisal on each property. At best, it was a rule of thumb for an agent who is taking a look at the tax return. Again, it didn't say, "Appraisers, you do not have to do your job; you do not have to do an appraisal, you can just use this percentage."

Chairman RAMSTAD. I appreciate that explanation. So, the simple answer to the question is, "no," and it is not a guideline?

Mr. MILLER. Right.

Chairman RAMSTAD. I appreciate also the explanation which does shed some light certainly on the question.

Mr. McClain, do you use the acronym NAT?

Mr. MCCLAIN. National Architectural Trust? Yes.

Chairman RAMSTAD. National Architectural Trust. Most of your easements are valued where?

Mr. MCCLAIN. Our easements vary from 6 percent to 15.5 percent.

Chairman RAMSTAD. It is true that most of them, the bulk of them, the majority of them are valued between 10 and 12 percent?

Mr. MCCLAIN. Yes.

Chairman RAMSTAD. In fact, is it true that 99 percent of your easements are valued at 10 or 11 percent of the property value?

Mr. MCCLAIN. No.

Chairman RAMSTAD. It is not true that 99 percent of your easements were valued between 10 and 11 percent of the property value?

Mr. MCCLAIN. No.

Chairman RAMSTAD. Do you recall a meeting on April 8, 2005, with members of the staff of this Subcommittee?

Mr. MCCLAIN. Well, I have had meetings with your Subcommittee staff. I don't know the dates, sir.

Chairman RAMSTAD. You don't recall telling our staff that 99 percent of your easements, NAT's easements, were valued at 10 to 11 percent of the property value?

Mr. MCCLAIN. We had done a study—we had a statistics guy go through all our easements, and basically, 46 percent of our easements are not at 11 percent, and they vary from 6 percent to 15.5. If I misspoke—

Chairman RAMSTAD. I am just trying to establish if it is factually correct, the statement you made on April 8, 2005 to members of our Subcommittee staff that—and I am quoting now—"99 percent of your easements are valued at 10 to 11 percent of the property value." Is that factually correct?

Mr. MCCLAIN. If indeed I did say that, then I misspoke. I apologize.

Chairman RAMSTAD. I am sorry.

Mr. MCCLAIN. If indeed I did say that, then I misspoke, and I apologize.

Chairman RAMSTAD. Let us digress for a minute. Where are the bulk of your appraisals?

Mr. MCCLAIN. Over 50 percent are at about 11 percent. That is true.

Chairman RAMSTAD. Over 50. Does that mean 60 or 90?

Mr. MCCLAIN. Fifty-four percent.

Chairman RAMSTAD. Fifty-four percent. Now, we have received from various sources a number of examples of the ways in which NAT has encouraged, has provided incentives to its donors to expect an easement value of about 11 percent. We have three statements we will put on the screen for you to see from your marketing materials or from solicitors and facilitators operating on your behalf, on behalf of NAT. The first: "The tax deduction is usually 10 to 15 percent of the fair market value of your property as determined by a qualified appraiser." The second: "To estimate the easement value, when completing the application the area manager should use his experience in the area to estimate the fair market value of the property and the easement value. If the area manager does not have enough experience in the area, he can obtain comparables to estimate the fair market value of the property and use 11 percent or 12.5 percent to calculate an estimated easement value for residential and commercial properties, respectively. Thirdly: "The Federal historic preservation tax incentive program provides for a tax deduction of approximately 11 percent of the property's fair market value, generating for a \$1 million property a tax deduction of \$110,000 and in-pocket savings of \$55,000." That

is Exhibit 7. Let me just ask you, Mr. McClain, wouldn't you agree that NAT and solicitors, facilitators working on behalf of NAT gave donors at least the impression that their easement would be worth between 10 to 15 percent, usually 10 or 11 percent of the value of the property?

Mr. MCCLAIN. Yes, sir, but all that material is old material. We don't have any of that material.

Chairman RAMSTAD. How old, Mr. McClain?

Mr. MCCLAIN. Well, 2003. We have altered everything as of around 2004, except for the very top one, and that has been changed as well. People do ask us, sir. They say, well, if I am going to go through—it is a complex program. It takes 3 or 4 months; you have to have an independent appraisal. What do you have—what is your estimate? We are not saying we have changed this to say that it completely depends on the appraiser, but the way they have been coming in is within this range; that is an accurate statement. It is based on what the appraisals that we are receiving are typifying.

Chairman RAMSTAD. Thank you, Mr. McClain. Ms. Breen, your organization operated in the same market, I know, as Mr. McClain's. Did you ever see any evidence that potential easement donors had been given the impression by other organizations that their façade easements should be worth about 10 or 11 percent of the property value? Is that common practice? Did you see any examples of it?

Ms. BREEN. We saw examples of fliers that NAT distributed in neighborhoods when they asked people to come to meetings to talk about it, that initially had these percentages. It was clear to us when people, who had been first approached by NAT, called us, that the amount of the tax break was utmost in those people's minds.

Chairman RAMSTAD. My time is up, and I am going to also try to honor the 5-minute rule. Thank you, Ms. Breen. At this time, the Chair recognizes Mr. Linder.

Mr. LINDER. Mr. Miller, you had 72 of these in 2000. Is that correct?

Mr. MILLER. I am sorry, sir?

Mr. LINDER. You had 72 of these in 2000, and 760 last year?

Mr. MILLER. We have—I think the numbers you are referring to, sir, are National Park Service certifications that they have approved in those years. Last year I think it was in the 750 range or something like that, and it has spiraled up 95 to 99, I think it was, less than 100, maybe in the 74 range.

Mr. LINDER. How many people would be willing to save this valued national architecture if they didn't have a tax break?

Mr. MILLER. That, I wouldn't know, sir. I am sure people are driven by different things; I am quite sure it is an incentive, and that was Congress's intention, obviously.

Mr. LINDER. Mr. McClain?

Mr. MCCLAIN. Yes, sir.

Mr. LINDER. How many people would be dealing with this if there were no tax break for them? Do you sell the tax break first before you sell the idea?

Mr. MCCLAIN. No, sir. Basically, the taxpayer receives a benefit when these historic resources are protected. There are aesthetic, historic, social and cultural benefits to all taxpayers. The issue, though, is that the burden for protecting these historic districts is borne by the individual property owner; and it is unlikely that the property owner would put permanent restrictions on his property that would reduce its value without some kind of tax incentive.

Mr. LINDER. It is also unlikely that they would come to your meetings without looking for some tax incentive, right?

Mr. MCCLAIN. Well, the incentive is in the law to incentivize people to participate in the program, yes, sir.

Mr. LINDER. Ms. Breen, you have a private not-for-profit organization?

Ms. BREEN. Yes, sir.

Mr. LINDER. How do you operate? Do you sell the idea to various people based on tax deductibility?

Ms. BREEN. No. We don't advertise our program at all. We have never promoted it.

Mr. LINDER. Then how do you do it?

Ms. BREEN. Many of our easements were required by the city itself when an individual landmark sold unused development rights, the city required them to give us an easement. We received many from another nonprofit organization that realized they didn't have the staff or expertise, and then, quite honestly, it has never been much of an issue, but when NAT started promoting them in New York, we received many more calls coming in to us from people who were possibly interested in donating easements.

Mr. LINDER. So, the instigation, in your case, comes from the city wanting to protect façades?

Ms. BREEN. In a few of our instances. Again, there have been instances where we have required easements. We saved a group of early 19th century buildings next to Fraunces Tavern. We bought them when a developer wanted to tear them down, and then resold them to a developer who would use them, and placed easements on them before the resale so that we could protect them in perpetuity.

Mr. LINDER. At times when you get the easements, you get a cash donation at the same time?

Ms. BREEN. In many of our early ones we didn't get a tax donation. Then we realized that it costs us staff time and the cost of outside experts—every 5 years we have our outside experts do a thorough assessment report. So, we do ask for that so that we can defray those costs.

Mr. LINDER. Are the cash contributions somehow related to the size of the deduction?

Ms. BREEN. Not at all. Again, we don't know what the appraised value is or the amount of their easement valuation is until we see their tax forms. We tell everyone that that is between—we ask them to get a qualified appraiser, and say that the actual amount of their deduction is between them and the IRS; and we have kept it at total arm's length.

Mr. LINDER. Then how do you determine what the cash contribution is going to be?

Ms. BREEN. We look at each property and try to assess its size, its complexity, and kind of cast out into the future how much it is

going to take to inspect it. There is no set formula. We really look at each property as an individual. Obviously, a smaller townhouse we would ask less for than a commercial building, but we don't have set formulas.

Mr. LINDER. Mr. McClain, do you have a formula?

Mr. MCCLAIN. We ask for a contribution of around 10 percent, but it varies.

Mr. LINDER. Ten percent of the deduction?

Mr. MCCLAIN. Of the deduction amount. It is our feeling that the greater the benefit to the property owner, the more they should contribute to the stewardship fund for enforcing and monitoring the program. It varies, though, all the way down to 2 percent.

Mr. LINDER. Do the stewardship fund and NAT commingle—

Mr. MCCLAIN. National Architectural Trust.

Mr. LINDER. Do they commingle the moneys?

Mr. MCCLAIN. Commingle the money? Absolutely not.

Mr. LINDER. Thank you, Mr. Chairman.

Chairman RAMSTAD. The Chair now recognizes Mr. Nunes from California.

Mr. NUNES. Thank you, Mr. Chairman, and thank you for welcoming me to the Committee. It is a pleasure to be here. Thank you for taking up this very important issue. I worked in the Committee on Resources earlier this year on reauthorizing the National Historic Preservation Act (P.L. 89-665), which—of course, this is one part of the Historic Preservation Act. I want to urge you to continue down this road of monitoring what is happening with this act, because I think that there are some abuses.

I want to say, Mr. Edmondson, that when I released a draft—we had someone else from your nonprofit come and testify before the Committee on Resources, and the comments that were being made there were that we were trying to—with our draft, we were trying to eliminate 70 percent of the historic sites in America, which is complete rhetoric. It got to the point where your group was sending out e-mails and conjuring up my own constituents and other people's constituents such that other Members on the floor were coming to discuss this with me, about my elimination proposal of 70 percent of the historic sites in America, which had to do with a change in Section 106, which I am sure you are familiar with, of the Historic Preservation Act. I would be curious to know, because I don't know this: You are a nonprofit agency, correct?

Mr. EDMONDSON. We are a nonprofit, but we are congressionally chartered. A Federal statute passed in 1949 that sets up the National Trust.

Mr. NUNES. Up until 1998, you received Federal dollars?

Mr. EDMONDSON. A portion of our operating funds were covered by an appropriation from an appropriated grant, essentially through the National Park Service; that was eliminated some years ago. We have been on private funding ever since.

Mr. NUNES. So, when you say you are privately funded, how do you receive your funding? For example, who contributes to you? Is it small donations? Large donations?

Mr. EDMONDSON. It is a mixture. Like many nonprofits, we rely on a variety of sources of revenues. We have a quarter of a million members who pay membership dues, which is a very impor-

tant source of revenue. We have grants that are received from various foundations. We do have a very active fundraising component and seek funding support from individuals and corporations and others.

Mr. NUNES. You also have an active lobbying arm to some extent?

Mr. EDMONDSON. Like any nonprofit organization at the national level, we do engage in public policy issues, and that includes lobbying. I have to say, I am not familiar with the specifics of the circumstances that you just mentioned. If there was some misstatement, I certainly would apologize for that on behalf of the organization. I would be happy to convey those concerns that you have raised to our policy staff and have them contact your staff and figure out what, exactly, was going on.

Mr. NUNES. Well, I think it is important, because I believe—although I haven't gotten into enough on this Committee with these tax provisions—that a lot of this is being generated not to save historic America. I have just a hunch that it is to save—there are a lot of people who are profiting from these tax credits, not only from money that is being authorized by the Park Service to give money to rebuild these façades, but also through the tax credit side. A bigger concern, other than the money trail that I think has definitely happened in the past—I would like to ask you this, have you seen these preservation easements as a tool to stop development?

Mr. EDMONDSON. As a tool to stop development? Sometimes easements are used as a tool to stop inappropriate development. Sometimes they are actually used by developers. This is because the incentive can be packaged with other types of tax incentives at the Federal and State level, which provides funding for redevelopment and rehabilitation of historic properties.

Mr. NUNES. To be deemed historic, it has to be 50 years old or older? Is that the same with these façades?

Mr. EDMONDSON. These properties have to be listed on the National Register of Historic Places. That usually means at least 50 years old. There are some exceptions to that. Or they have to be certified as contributing structures in a National Register historic district.

Mr. NUNES. Thank you, Mr. Chairman. My time has expired.

Chairman RAMSTAD. I want to say, as Chairman of the Subcommittee, it is a real privilege and pleasure to welcome you to the Subcommittee. You are a bright, rising star in the Congress and we are grateful to have you on the Subcommittee on Oversight. The Chair now would recognize Mr. Shaw, the distinguished gentleman from Florida.

Mr. SHAW. If you would like to say something nice about me before—

Chairman RAMSTAD. It would take too long. We have to adjourn by 4:00.

Mr. SHAW. Maybe the falling star or something? Mr. Miller, what type of documentation would be filed with one's income tax return to substantiate—if any, to substantiate a deduction for this type of a contribution?

Mr. MILLER. Well, Congressman, the individual would file a Form 8283 with their tax return if, in fact, more than a \$500 value was placed on this. If it was over \$5,000, they would have to fill

out a portion of that that involves an appraisal. So, they have to get an appraisal at \$5,000. At \$500,000, they have to attach the appraisal as well, but it is the 8283 that would be attached.

Mr. SHAW. Where does that document originate?

Mr. MILLER. It originates with the donor. It gets signed by the donee organization as well.

Mr. SHAW. The donee signs it as well?

Mr. MILLER. Correct.

Mr. SHAW. That is just an attachment to the 1040?

Mr. MILLER. Yes, sir.

Mr. SHAW. In your experience, does this type of deduction trigger an audit?

Mr. MILLER. In my experience—the experience is changing; we will put it that way. In recent days when we have seen what we are perceiving to be problems in valuation in the façade area, those individuals who have taken deductions generally will have gone to the National Park Service; and so they are not difficult for us to identify and to take a look at and classify as to whether we should begin an examination. We are in that process as we speak.

Mr. SHAW. Mr. Lennhoff, when you go out and make an appraisal, what has been your experience? Do you go and look at the city ordinances or the applicable laws in the area that might affect what one can do?

Mr. LENNHOF. Yes, sir.

Mr. SHAW. I will give you an example. Here in Washington I have a townhouse here on the Hill. I don't think I could change the front of it if I wanted to.

Mr. LENNHOF. That fact is, what creates the minimal diminution, typically—or I would expect minimal diminution with an urban row house in an historic district—it already is restricted. It does raise a question of why, then, would someone give a preservation easement if there is nothing to be gained from it. Others have suggested that it may in some situations enhance the value of the property because it calls attention to the character and lends some prestige to the particular building. The direct answer to your question is, it would be my responsibility to investigate the neighborhood and local ordinance, as well as the individual property regulation.

Mr. SHAW. As an appraiser, then, as your testimony was given, you look at the diminution of value of the property more than anything else as far as what type of deduction that you would—

Mr. LENNHOF. Well, Mr. Shaw, there may not be one. You would go in and you would do a “before” and an “after.” I think the appraiser has to be careful that you don't go in assuming that there is going to be, for instance, a 10 percent diminution when, in fact, there may be zero, or there may even be an enhancement. You do go in and estimate the value without the easement, and then you estimate with the easement, and you do the math, and you see what the diminution or lack of diminution is.

Mr. SHAW. So, you never use that 10 percent or 11 percent?

Mr. LENNHOF. No, sir.

Mr. SHAW. Or 10 or 15 percent? That is just not done?

Mr. LENNHOF. It is absolutely not an acceptable, professional appraisal practice. I will say that it is not inappropriate for an ap-

praiser when he finishes his assignment to step back and look at the answer and—okay, say, you come up with 50 percent as a diminution. Typically, for this sort of property, people are suggesting it is closer to 15. So, you go back and look at your problem and see what might explain why yours is so much higher. So, it does serve a purpose as kind of a test of the reasonableness; but as a direct method, it has no validity at all.

Mr. SHAW. Ms. Breen, in your experience do these easements last in perpetuity? Or can something happen that would destroy the easement that you might have, such as a fire or something of that nature?

Ms. BREEN. The only thing that would extinguish our easement would be the total destruction of the building, and we would have to be satisfied that it was beyond repair and could not be rebuilt. That is the only instance. Perpetuity is a long time, but that is how they are supposed to last.

Mr. SHAW. Thank you, Mr. Chairman.

Chairman RAMSTAD. The Chair thanks the distinguished Chairman of the Subcommittee on Trade, and would now recognize Mr. Beauprez, the distinguished gentleman from Colorado.

Mr. BEAUPREZ. I thank the Chairman. Mr. Miller, I want to go back to a point that was raised earlier. I think in your testimony we found that in 2000 you had 72 of these properties; but more recently, 2004, or last year, you had about 706. Is that correct?

Mr. MILLER. The numbers are roughly correct.

Mr. BEAUPREZ. Where are they? I am curious where and what kind of prompts are we finding coming into this program?

Mr. MILLER. Well, let me give you a little more background on the numbers. Again, the numbers are stemming from those people who have gone to the National Park Service to get a certification that their building is of historical significance to the district in which it sits. So, they fill out quite a bit of information. We do have a sharing agreement with the Park Service. We believe that most of the properties can be found—and I think I put this in our testimony—at New York City. The District of Columbia is number one, New York City is number two, Chicago is number three, and there are some in Maryland as well. They are fairly scattered across the other States, mostly in the East, but they are fairly scattered as well.

Mr. BEAUPREZ. Historic preservation is a noble objective. I have been involved in a little bit of that myself, but it crosses my mind, and maybe Mr. Lennhoff wants to respond to this. Have you seen evidence, Mr. Lennhoff, that by providing this kind of tax incentive that what we are really creating—and I guess with all due respect to all of you, you are somewhat evidence of this, we have kind of created another industry out there. More to the point, is it possible that what we are seeing is just an inflationary factor on the value of properties?

Mr. LENNHOF. I think, frankly, to a certain extent that does occur, because when you see 10 to 15 percent amounts as a diminution for a row house on an exterior façade in a historic district that already has restrictions, you have to wonder, why is it so much? On the other hand, there are lots of situations where the diminution is far greater than that, but that usually involves a situation

where the restriction prohibits using the property to its highest and best use; either demolishing and using the land for another use or something else. I think if you see a lot of instances where there is this 10 or 15 percent range on an urban row house, it is questionable. That is why I think quality appraisal and appraisal review are important elements.

Mr. BEAUPREZ. Recently there was a story, I think in the local media, about what is going on out in Georgetown, and specifically that local regulation—and I know this is the case back in many of my communities in Colorado. Local regulation is already—as I think Congressman Shaw mentioned—in place to control, and in some cases prohibit or dictate what you can do with a façade anyway. How necessary is this, I guess, is a legitimate question. Ms. Breen? I see you are wanting to answer.

Ms. BREEN. I see I can't conceal my facial expressions. Sorry, Congressman.

Mr. BEAUPREZ. It will depend on your answer.

Ms. BREEN. Local laws vary. New York City does have a strong local landmarks preservation law, but it varies from community to community. In one case I know, in Pittsburgh, the city rescinded half of a historic district so the buildings could be torn down. So, I think it is very important for appraisers to understand each of the local regulations and how much regulation they actually impose.

Mr. BEAUPREZ. If I could very quickly—and you might want to do this for the record, but I would be interested. Obviously, to me, we have kind of stood up an industry again. There is a layer of regulation and requirement and appraisal, and there is some stuff out there. There is also, it seems to me—and I think we have talked about this at least around the edges, there is maybe an opportunity, almost an incentive, for abuse out there. With that in mind, I would ask all of you if you have advice for this Committee as to how we can better reform the system to make it—if the objective is historic preservation, how can we achieve that objective, not create nightmares for Mr. Miller, undue expense and regulatory headache for everybody else, and also address the possibility of abuse of the system, which I think is this Committee's primary concern, or one of them. With that, I would just ask that you respond in writing, if you would, and I yield back.

[The information was not received at the time of printing.]

Chairman RAMSTAD. Thank you again to all the witnesses. We do have time for some follow-up questions if the Members are so inclined. Again, the 5-minute rule will apply. I would like to ask Mr. Edmondson, is it fair to say that the National Trust for Historic Preservation has had concerns for some time about the relationship between NAT and SMS; and if it is true, could you describe the nature of your concerns?

Mr. EDMONDSON. Mr. Chairman, I think it is fair to say the National Trust for Historic Preservation has had a number of concerns with NAT. We have discussed with the staff some of the concerns we have had over the years. There are three basic areas. One is the name. We feel that there is a problem with public confusion about the name, and we actually have filed a complaint with the U.S. Patent and Trademark Office. It is still pending.

We have also raised issues with respect to their marketing and promotional activities, and those are detailed in some of the letters, exchange of correspondence, we have had with NAT, which the Committee staff has seen. A lot of this relates to this 10 to 15 percent concept. The informational pieces that you provided, Mr. Chairman, on the screen, are just a few examples of many other promotions that we describe as referring, mantra-like, to a 10 to 15 percent reduction. As Mr. McClain has indicated, they have changed their promotional activities in recent years, which we think is important. We think it is very unfortunate that promotions, whether it is by NAT or others, have oversimplified the types of tax benefits that should be available.

The other area of concern that we have raised is with the relationship between NAT and SMS, a for-profit company owned by several of the directors of NAT. We indicated to them last year that we thought that there were some conflicts of interest there—at least the appearance of a conflict of interest—that should be addressed. I understand from Mr. McClain they have been looking at that and have made some changes there as well.

Chairman RAMSTAD. Let me also ask Mr. Edmondson, are there other similar organizations about which you have those concerns?

Mr. EDMONDSON. Since NAT was created and became so active in the last couple of years, really for the last 3 or 4 years, there have been several other organizations that have also recently been created. These are not established organizations, such as the New York Landmarks Conservancy, but they have recently appeared on the scene and they are focused primarily on easement acquisition and often using similar types of promotional activities. We have not had as much experience with those. There is an organization in New Jersey and there is an organization, I believe, in New Orleans. There is also an organization that was created fairly recently in Washington, D.C. I would say that we would express some of the same concerns, particularly about marketing activities, but I think the Committee staff has done a lot more looking into the operations of those organizations than we certainly have.

Chairman RAMSTAD. In fairness, Mr. McClain, do you have any response or any comments concerning those questions or Mr. Edmondson's responses?

Mr. MCCLAIN. Yes, thank you. Everything that NAT has done has been legal and proper. However, as I said in my opening comments, it has been the Board's decision, given some negative press regarding the relationship between SMS and NAT, that we have terminated that relationship and we have adopted the Land Trust Alliance's new best practices. The new best practices not only require you to be legal and proper, but they actually hold you to a higher standard than legal and proper; and basically, you can't even have a perception of a conflict of interest. We have all signed statements to that effect, and we are all following through with that, so thanks for the opportunity to speak on that.

Chairman RAMSTAD. Also, Mr. McClain, is it a fair statement—it is your own statement that you changed your promotional material?

Mr. MCCLAIN. We changed all of our promotional material.

Chairman RAMSTAD. In 2004?

Mr. MCCLAIN. Yes, sir.

Chairman RAMSTAD. I am just curious, how many years did you use those representations? For how long did you use those?

Mr. MCCLAIN. The National Architectural Trust was formed in 2001.

Chairman RAMSTAD. Mr. Nunes, do you have further questions?

Mr. NUNES. Yes, Mr. Chairman, just briefly. Mr. McClain, you are obviously taking some heat here, which may be right, may be not right, but I think—one of the problems, I believe, and I will make a statement here, is the Historic Preservation Act has not been reauthorized for many years, has not been looked over by Congress; and I think a lot of this comes from section 106, which is related to 107. There were administrative changes done in 1978 that were never approved by the Congress, and I think part of that is what has led to some of the problems that you are having. I am interested in not only hearing from you, Mr. McClain, but I think the rest of the panel—other than Mr. Miller, of course, since he is with the government. I would like to know, don't you think it would be beneficial for us, the Congress, to reauthorize historic preservation and to really look at section 106? That way we can clarify a lot of the problems that have happened not only to your organization, but others in the past.

Mr. MCCLAIN. I would have to acquiesce to the judgment of Paul Edmondson. I understand what 106 is, but I have very little involvement with it, and I am not familiar with it.

Mr. NUNES. I understand. Mr. Edmondson?

Mr. EDMONDSON. I think 106 has been a very important piece of legislation. The National Historic Preservation Act has really been one of the core pieces of legislation that has helped to preserve the character of many of America's communities. Easements are really a very useful tool in addressing some of the issues that section 106 raises. When Federal agencies are required to consider the impacts of their actions, and there are major projects that are involved, very often there are mitigation solutions for Federal action that impacts historic properties. Often these are in the context of development, often in the context of things like base closures and so on. Very often, easements are a very important tool that is used by Federal agencies and by developers as well.

Mr. NUNES. I understand that section 106 was—there was an administrative change that basically took power away from the Secretary of the Interior. My question to you is, should we look at this, to clarify the administrative change that was made, and to try to reauthorize the Historic Preservation Act? I think that—without reauthorization, I think section 107 is going to be more heavily scrutinized by this Committee.

Mr. EDMONDSON. Congressman, I guess I am not sure what you are referring to in terms of an administrative change that changed the impact of 106. I would be happy on behalf of the National Trust to talk to you and talk to your staff and figure out exactly how we might help to address some of the issues you are raising.

Mr. NUNES. I think the point I am trying to make is that because this has not been reauthorized, this act, I think it would be beneficial to all involved in the historic community to look at reau-

thorizing the act. Hopefully, that will cut down on some of the rhetoric, like when we hear things like people putting out draft releases that then create commotion that we are going to eliminate 70 percent of historic sites. I don't think that is helpful rhetoric which—you have already heard me discuss this. I would be glad to send you a letter in writing. I think you have already commented on reauthorization of the Historic Preservation Act. Maybe not you, but your organization has.

Mr. EDMONDSON. Certainly any other issues, or the issues specifically you are raising, we would be happy to look at in detail. As I said earlier, I have not been directly involved in that, but on behalf of the organization, I would be certainly happy to address the issues you are raising.

Mr. NUNES. Thank you. Ms. Breen, I don't know if you have any comment.

Ms. BREEN. I am not familiar with the specific administrative changes you are suggesting, but I certainly would welcome a look at any and all practices of historic preservation. I think it would withstand scrutiny. As someone who used to work for the New York City Council and help with legislative proceedings, I think it is healthy to have occasional reviews.

Mr. NUNES. Thank you. Mr. Lennhoff?

Mr. LENNHOF. Mr. Nunes, I am not close enough to that topic. It probably wouldn't be appropriate.

Mr. NUNES. That is fair enough. Thank you, Mr. Chairman.

Chairman RAMSTAD. Thank you, Mr. Nunes. I just have some follow-up questions, Mr. McClain: you said you have terminated the relationship between NAT, and SMS; is that right?

Mr. MCCLAIN. Yes, sir.

Chairman RAMSTAD. Could you just explain why you and Mr. Kearns decided to terminate the relationship? Was it the adverse publicity?

Mr. MCCLAIN. Well, the Board of NAT terminated the relationship because of the adverse publicity and to avoid any sense of a conflict of interest, even though we had legal counsel that said there was none. That is why that was done. The reason SMS was terminated—it also helped a couple of other nonprofits. Given the confusion evident from many of the IRS statements in the press about the valuation of easements, there was no purpose for SMS, because it basically was processing and soliciting easements, and there is no way to solicit easements without knowing under what conditions they would be accepted. So, it wouldn't work. We certainly don't want to misrepresent, so that is why.

Chairman RAMSTAD. It is true that there are six members on the board of directors of NAT? You and Mr. Kearns are two of them?

Mr. MCCLAIN. That is correct.

Chairman RAMSTAD. You appointed the other four?

Mr. MCCLAIN. We didn't appoint them.

Chairman RAMSTAD. Can you tell us how they became board members?

Mr. MCCLAIN. Well, I have been in preservation for 25 years, and I know lawyers and architects who have an interest in that. Two of the people on the board, or one of them is an architect who has been in Washington, D.C., for 25 years, 30 years, and the other

one is a lawyer. Another person is a lady who has been in preservation for a number of years. One of the ladies that was on our board has since passed away. Then we brought on someone who was a public relations expert, because we felt that that would be useful.

Chairman RAMSTAD. A couple more questions: Is it accurate that NAT, a nonprofit organization, loaned \$157,435 to SMS for a period of 5 years?

Mr. MCCLAIN. No, sir

Chairman RAMSTAD. That is not accurate?

Mr. MCCLAIN. No. When SMS was created, there a safe-harbor was created. There was an outside source; an outside accounting firm came in, did an analysis to determine the proper compensation between what the for-profit SMS and the nonprofit NAT should be, to pay for services to a for-profit, for what services SMS was willing to provide. Once SMS was in place, it was thought that since SMS was going to have other clients who might do reasonably well financially, that NAT might benefit from having an investment, which they agreed to. Then outside counsel came in and said, no, because that might compromise NAT's ability to fire SMS should they want to. So, the investment was recharacterized as a loan and it was paid off in full at 10 percent interest.

Chairman RAMSTAD. I want to thank you, Mr. McClain, particularly, and all of the witnesses for being very forthcoming in terms of answering the questions of our Subcommittee staff in anticipation of this hearing. I would also ask unanimous consent that the letter dated May 18, 2005, from Mr. Steven McClain, President of SMS, to Mr. David Kass, Staff Director of the Subcommittee on Oversight of the House Committee on Ways and Means, be entered into the record.

[The information follows:]

Springfield Management Services
Washington, D.C. 20009
May 18, 2005

Mr. David Kass
Staff Director, Subcommittee on Oversight
House Committee on Ways and Means
1136 Longworth House Office Building
Washington, DC 20515

Dear Mr. Kass,

Springfield Management Services appreciates the opportunity to provide the following information:

1. Total Compensation Received by James Kearns and Steven McClain, September 2000 to April 2005
2. Springfield Management Services Compensation to Independent Contractors
3. Tim Maywalt

We hope that this information answers your questions regarding Springfield Management Services and the Historic Preservation Conservation Easement program.

Sincerely,

Steven McClain
President

Total Compensation Received By Kearns and McClain September 2000 to April 2005

A	B	C	D	E	F	G	H	I	J	K	L	M
	NAT						SMS				Total	
	2000	2001	2002	2003	2004	2005	2002	2003	2004	2005	NAT and SMS	Average Annual
Kearns	\$0	\$0	\$ 50,000	\$105,000	\$0	\$16,666	\$0	\$220,000	\$575,000	\$75,000	\$1,041,666	\$227,438
McClain	\$0	\$0	\$125,000	\$0	\$0	\$16,666	\$58,333	\$200,000	\$566,667	\$75,000	\$1,041,666	\$227,438

Notes:

- (1) Columns A-K are actual figures from NAT and SMS accounts.
- (2) Compensation includes all receipts from the organization except expenses for which a documented expense reimbursement request was submitted.
- (3) Averages are calculated using September 1, 2000 as the date Kearns and McClain began additional work that led to the creation of NAT and subsequently SMS.
- (4) Part of Kearns/McClain compensation from SMS is attributable to work SMS performed on donations to the L'Enfant and Tri State/Capital Historic Trusts.

Springfield Management Services Compensation to Independent Contractors

02-03—The highest compensation to an independent contractor for assisting donors to participate in the Historic Preservation Conservation Easement program was approximately \$151,000. The average compensation to independent contractors was \$37,391.

03-04—The highest compensation to an independent contractor for assisting donors to participate in the Historic Preservation Conservation Easement program was approximately \$440,000 (this amount represents 9.6% of the cash contributions to the Trust originated by this independent contractor). The average compensation to independent contractors was \$115,330.

04-05—The highest compensation to an independent contractor for assisting donors to participate in the Historic Preservation Conservation Easement program was approximately \$428,000 (this amount represents 9.9% of the cash contributions to the Trust originated by this independent contractor). The average compensation to independent contractors was \$122,500.

Springfield Management Services Tim Maywalt

During a three-year period, Tim Maywalt assisted approximately 100 donors per year participate in the Historic Preservation Conservation Easement program. The majority of these donors live in Washington, D.C.

Chairman RAMSTAD. I just have one final question, Mr. McClain. According to your letter and your chart here, entitled Total Compensation Received by Kearns and McClain, September 2000 to April 2005, the statement just entered into the record, according to your own statement here, from 2000 to 2005, just from 2002 to 2004, the two principals of NAT and SMS made a total of \$1.9 million from those two organizations, that is, you and Mr. Kearns. I want to ask you, Mr. Edmondson, did you have any idea that their work in promoting façade easements are that lucrative, and are there comparable organizations profiting to that extent?

Mr. EDMONDSON. Mr. Chairman, I am not aware of any other preservation organization that has the type of structure where the directors of the nonprofit organization have contractual relations through a for-profit entity that they own for this type of work. So, I think the answer to that question is “certainly not.” In terms of the compensation level, we were certainly aware that through the reports that NAT has provided publicly that large amounts of funds were being received, primarily through cash donations at the 10 percent of the easement valuation fees, and this was in the range of millions of dollars. That is the first time I have heard the actual compensation numbers.

Chairman RAMSTAD. Mr. McClain, would you care to further comment?

Mr. MCCLAIN. Yes, sir. From 2000 to 2004, my average annual compensation has been \$227,000, which is on that chart as well. My 2004 compensation of \$566,000 is a result of salary, bonuses and deferred compensation. Since SMS, has been—has no employees now and no clients and has to stay dormant for 3 years before it can be closed up, we have had outside human resource experts come in, who are experts in nonprofit compensation, and they have set parameters for every job in NAT, and we are staying within the criterion that they have established.

Chairman RAMSTAD. Thank you, Mr. McClain. Before we adjourn, do any of the other witnesses have any further comments in response to any of the questions that have been asked?

Ms. BREEN. I would just like to thank you again for the opportunity, and say that we have been working with the National Trust and other long-standing preservation groups in recent years on this issue, and we want to be held to the highest standards and keep this valuable program working to the best possible means.

Mr. EDMONDSON. I would like to echo that sentiment. We have had some very frank discussions with the Subcommittee staff, and we also have had a number of ideas that we think would be helpful for the Subcommittee and the full Committee, when it gets to it, to consider in terms of how to address some of these issues. As I mentioned in my opening statement, we are alarmed by the reports of abuses. We do think that the tax incentive is important. It does help motivate donors, and we would like to see it remain as a valuable preservation tool.

Chairman RAMSTAD. Mr. Lennhoff, anything further?

Mr. LENNHOF. No, sir.

Chairman RAMSTAD. Mr. McClain?

Mr. MCCLAIN. No, sir.

Chairman RAMSTAD. Mr. Miller?

Mr. MILLER. No, sir.

Chairman RAMSTAD. I want to thank all five of you for appearing here today. I believe this hearing shed some light on façade easements. Hopefully, it will be a first step in curbing some alleged abuses that have occurred in the past. I want to thank you again for your time and your testimony. Before we adjourn, I ask unanimous consent to include in the record the opening statement of Ranking Member Lewis. Without objection, so ordered.

[The opening statement of Mr. Lewis follows:]

**Opening Statement of the Honorable John Lewis, a Representative in
Congress from the State of Georgia**

June 23, 2005

Today's hearing will focus on the donation of façade conservation easements to charitable organizations. The purpose of such an easement is to ensure that the architectural integrity of a historic property's exterior is maintained permanently. The historic trust organization obtaining the easement is responsible for monitoring the preservation of the structure's façade and for approving any changes. A taxpayer making a façade conservation easement may be eligible to claim a charitable donation income tax deduction for the value of the easement.

There are many important questions that need to be addressed by the Subcommittee. News reports indicate abuse of the current law tax deduction for façade easements. The Joint Committee on Taxation recommends that the deduction be repealed for façade easements on personal residences. Easement-holding historic preservation organizations support continuation of façade easement donations and believe they provide valuable conservation benefits to the public at large.

Getting the facts is always helpful in evaluating the effectiveness of a tax provision. Questions worth pursuing at this hearing include: Do façade easements serve meaningful conservation purposes? Should charitable deductions be allowed where state or local laws already prohibit changes to the fronts of historic properties? Are proposals for increased enforcement and additional standards on appraisers realistic?

I commend Subcommittee Chairman Ramstad for having a hearing on this subject. I look forward to our followup discussions.

Chairman RAMSTAD. Mr. Nunes?

Mr. NUNES. I want to thank you again, Mr. Chairman, for holding this hearing. I think that if the historic community is willing to work to reauthorize this Historic Preservation Act, it would be very beneficial to what you are trying to do here. If they are not supportive of trying to reauthorize that act, I think it is very important that you continue down this path to determine just where the money is going, and if there are abuses by the historic community to the Tax Code and to the taxpayer. So, I hope that we can work closely with the historic community to reauthorize this act, and look forward to working with you in the future.

Chairman RAMSTAD. I certainly associate myself with your remarks and agree 100 percent. If there is no further business before the Subcommittee, the hearing is adjourned.

[Whereupon, at 3:25 p.m., the hearing was adjourned.]

[Questions submitted from Chairman Ramstad to Steven T. Miller, Steven L. McClain, Paul W. Edmondson and Peg Breen, and their responses follow:]

Questions from Chairman Ramstad to Steven T. Miller

Question: Should the extent of existing legal restrictions on the use of property have a significant impact on the appraisal of a façade easement?

Answer: Yes. The extent of existing legal restrictions on the use of property does have a significant impact on the appraised value of a façade easement, and should be considered by the appraiser in determining the change in value due to the placement of the façade easement.

Question: Some argue that even if there are significant legal restrictions on the use of property, an easement can have significant value. This argument claims that because local historic preservation laws can be changed, and because an easement theoretically lasts forever, an easement can still have significant value. How do you respond to this argument?

Answer: We believe that in most circumstances the argument has little merit. To be successful, the taxpayer would have to show that the law change was impending or highly likely to occur, based upon specific evidence. For example, the taxpayer would need to show that local authorities effectively had made the change or were about to do so. However, the mere theoretical possibility that the law might be changed at some unknown time in the future, or that existing legal restrictions might not be enforced, is insufficient.

It is important to note that the change in the value of the taxpayer's property as a result of a granting of an easement is measured as of the date of the donation based upon facts known or reasonably expected on that date, not based on uncertainties and speculation. A taxpayer should not be permitted to value a property today by treating an uncertain event (such as a potential law change) as having occurred.

Questions from Chairman Ramstad to Steven L. McClain

Question: During the hearing, you mentioned that your office had a study of the value of the National Architectural Trust's (NAT) easements. You said that 54% of your easements were valued at 11%. Please provide a breakdown of the number and percentage value of the remaining easements along with their zip codes. Please state how many easements were valued between 5%, 6%, 7%, 8%, 9%, 10%, 12%, etc. and what percentage of NAT's easements were valued at each percentage value. In addition, please provide the study you cited for the record.

Answer: The value for a conservation easement deduction is determined by an independent professional appraiser. Final responsibility for the adequacy and completeness of the appraisal data submitted to substantiate a donor's claim for a charitable contribution deduction rests with the donor. The National Architectural Trust

reviews all submitted conservation easement appraisals to determine that they are done in a competent and professional manner.

When the Oversight Subcommittee staff asked several months ago what proportion of easement donations held by the National Architectural Trust were valued at eleven percent by independent appraisers, the Trust did not have the necessary information to answer this question.

Subsequently, the National Architectural Trust requested that an outside contractor review the easement appraisals the Trust had received to determine the proportion of façade conservation easement donations valued at eleven percent by independent appraisers. The answer provided by the outside contractor was 54%.

After further in-house review and analysis, however, the National Architectural Trust has determined that 52.4% of all façade conservation easements held by the National Architectural Trust have an easement percentage value of 11%. The National Architectural Trust's easement percentage values range from 8% to 16%.

The following table, "Easements Held by National Architectural Trust through December 31, 2004," provides a breakdown of the number and percentage value of easements held by the Trust as well as the zip codes of easements at each easement percentage value.

Easements Held by National Architectural Trust through December 31, 2004

Number of Easements Held by National Architectural Trust	Easement Percentage Value	Percentage of Total Easements Held by National Architectural Trust	Zip Codes
1	8.0%	0.3%	10012
1	9.0%	0.3%	11215
18	10.0%	5.0%	01945, 02568, 07302, 08833, 10024, 11207, 11217, 11231, 21230, 22301, 10014, 11225
188	11.0%	52.4%	01945, 10014, 02116, 02464, 10024, 01983, 02108, 02114, 02118, 07302, 10003, 10011, 10013, 10014, 10021, 10023, 10024, 10025, 10027, 10028, 10128, 11201, 11215, 11217, 11231, 11963, 14801, 20003, 21210, 21217, 21218, 22079, 22301, 22314, 10010, 21224, 11201, 02115, 11225, 02116, 11238, 11225
67	12.0%	18.7%	02116, 10003, 10024, 02116, 11225, 10014, 02108, 10021, 11238, 01746, 01821, 02114, 02118, 02125, 10011, 10013, 10024, 11201, 11215, 11225, 14201, 21210, 21212, 21217, 21218, 21230, 21231, 21401, 01950, 10022, 02118, 02445, 11205, 02120

**Easements Held by National Architectural Trust through December 31,
2004—Continued**

Number of Easements Held by National Architectural Trust	Easement Percentage Value	Percentage of Total Easements Held by National Architectural Trust	Zip Codes
30	13.0%	8.4%	02461, 10011, 11215, 11238, 02116, 11215, 10128, 10018, 11217, 11201, 10028, 02556, 10013, 21210, 21212, 21218, 21401, 10016, 10014, 10128
28	14.0%	7.8%	02108, 02111, 02115, 02116, 02118, 02446, 11226, 10014, 02478, 02468, 01938, 02114, 02445, 02461, 10012, 21210, 10010, 10003, 11379, 10013, 10011
24	15.0%	6.7%	02116, 02118, 10010, 10003, 10024, 10021, 10013, 10027, 10011, 10001, 10023, 10028, 11215, 11235, 10014
2	16.0%	0.6%	10003, 10023
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It is also important to note again (as referenced during the oral testimony of Steven McClain), the National Architectural Trust is completely independent from the appraisal process. The National Architectural Trust accepts easement appraisals from over 60 different appraisal companies and in no way is involved in the determination of the value attached to an easement donation.

We again refer the Subcommittee to Mr. McClain's testimony on June 23rd in its relation to recommended reforms to the appraisal process for façade easement donations.

Question: How many easements did the National Architectural Trust receive before it revised its marketing materials in late 2004 to remove the language indicating that donors could expect the easement to be worth 10 to 15% of the value of the property, and other references to the tax deduction? In addition, please provide a breakdown of the number and percentage value of those easements.

Answer: This question is difficult to answer because a property owner's decision to donate an easement is typically made over a long period of time, after consultations with personal accountants, lawyers, tax specialists, colleagues, and spouses. Although the National Architectural Trust used the "ten to fifteen percent" language in its educational materials for property owners, it is likely that a property owner's final decision was influenced by advice and information from other sources such as the National Park Service¹ (NPS) and the Internal Revenue Service (IRS). The National Architectural Trust was relying on the "ten to fifteen percent"² guideline included in the NPS and IRS publications in the development of its educational material.

¹The National Park Service Publication. Historic Preservation Easements: A Historic Preservation Tool with Federal Tax Benefits.

²Internal Revenue Service Website. "IRS guidelines suggest that in many cases façade easements can be appraised at approximately 10 to 15 percent of the value of the property."

Therefore, even though the National Architectural Trust acted quickly to remove the “ten to fifteen percent” language from the information provided in its materials and website following the issuance of IRS Notice 2004-41 concerning the valuation of façade conservation easements and the removal of this valuation range from two IRS publications, it is not safe to assume that all interested façade easement donors immediately refrained from using the “ten to fifteen percent” language as part of their decisionmaking process.

Although the National Architectural Trust eliminated the reference to the “ten to fifteen percent” language from all marketing materials as of approximately October 15, 2004, it could not change or eliminate materials disseminated prior to that date. There is no way to determine what material donors may have reviewed and how many donors had already used the marketing material in their façade conservation easement decisionmaking process.

The National Architectural Trust held approximately 380 completed easements as of October 15, 2004.

Question: The National Architectural Trust holds approximately 550 easements. Have you ever found a violation of one of your easements? Have you ever enforced an easement? If so, please provide a detailed explanation of the violations and the action taken by the National Architectural Trust and how these violations were resolved.

Answer: The primary mission of the National Architectural Trust is to protect qualified historic properties in perpetuity. The means of accomplishing this mission is the use of conservation deeds of easement. Annually, the National Architectural Trust reminds property owners of the deed restrictions on their property, that the Trust’s approval is required for any property changes, and that the Trust conducts annual on-site inspections.

Many property owners discuss proposed façade changes with the National Architectural Trust prior to the submission of a written request. This discussion can occur during the application process or subsequent to the completion of the easement donation. As a result, the National Architectural Trust is able to address potential issues prior to the submission of a formal change request.

In some cases, property owners in the process of applying for participation in the Federal Historic Preservation Tax Incentive program have consulted the National Architectural Trust regarding proposed changes that did not meet the Secretary of the Interior’s Standards and Guidelines for Preservation and Rehabilitation—the foundation for the National Architectural Trust’s decisions on easement enforcement. These property owners were informed that the proposed changes would be denied. In these few instances, the property owners did not proceed with the easement application process. A specific example of this occurred at 5415 Spring Lake Way in Baltimore, Maryland.

All change requests must be in writing and all changes should be guided by the Secretary of the Interior’s Standards and Guidelines for Preservation and Rehabilitation. The annual review of each property conducted by the National Architectural Trust serves to confirm that the work done is according to specifications authorized by the Trust.

The National Architectural Trust has received formal written change requests for the following properties, among others:

- 439 West 22nd Street, New York, NY 10011
- 120 West 88th Street, New York, NY 10024
- 33 West 81st Street, New York, NY 10024
- 71 Bedford Street, New York, NY 10014
- 117 West 88th Street, New York, NY 10024
- 492 1st Street, Brooklyn, NY 11215
- 18 Fiske Place, Brooklyn, NY 11215
- 5415 Spring Lake Way, Baltimore, MD 21212
- 105 Saint Dunstons Road, Baltimore, MD 21212

The National Architectural Trust is presently conducting its 2005 annual review of each property. Thus far, we have identified the following property changes made without prior written National Architectural Trust approval. These changes were subsequently reviewed and then approved.

- 209 South Saint Asaph Street, Alexandria, VA 22314
- 219 South Alfred Street, Alexandria, VA 22314

The National Architectural Trust 2005 annual review has thus far identified one property (311 East Howell Avenue, Alexandria, VA 22301) where a change was

made without prior written approval and the change violates the National Architectural Trust guidelines. This violation issue has not yet been resolved.

Questions from Chairman Ramstad to Paul W. Edmondson

Question: Are there significant differences between the easement deeds used by various easement holding organizations? For example, the National Architectural Trust uses an easement deed which covers just the front façade of a structure. Many other easement holding groups use a deed which protects the entire building envelope. Should a front-façade only easement be worth less than a whole building easement?

Answer: Yes, significant differences exist among easement deeds used by various easement holding organizations around the country. The National Trust for Historic Preservation publishes a model Preservation and Conservation Easement as guidance for state and local preservation organizations to use when drafting their own preservation and conservation easements, but a number of organizations use different models, and in any case the easement should be adapted to meet the specific circumstances of a particular property.

Many preservation organizations use easements that protect all significant historic features of the exterior of a historic property and its historic setting—and some organizations, including the National Trust, often protect interior historic features as well. It is fairly common for preservation organizations to use easements that protect all exterior façades and roof surfaces, although the specific provisions of an easement may vary considerably in terms of the degree of oversight and/or control held by the easement-holding organization even for an easement that covers the entire exterior envelope of a historic property. Many preservation easements also protect the context of a historic property, for example prohibiting subdivision of historic farm property and protecting historic gardens and outbuildings.

As you note, a small number of organizations accept easements that protect only the publicly visible façades of a historic property *as seen from the other side of the main frontage street*. This form of “front-only” façade easement is much less restrictive from the property owner’s perspective and may permit additional square footage or other development.

Regarding the question of valuation, as a general matter we agree that an easement that protects only the front façade of a building is likely to be worth less than an easement that protects a building’s entire exterior envelope. Of course, easement valuation is a complex process that requires consideration of a number of different variables. But key among those factors is the nature of the restrictions imposed by the easement. Depending on the property, an easement that only limits a property owner’s right to alter a structure’s front façade is likely to be far less restrictive than an easement protecting the entire exterior envelope. A property owner who chooses to donate an easement protecting the entire exterior envelope of a structure gives up a greater portion of her “bundle” of rights to make alterations or changes to her property. In addition, if the easement includes affirmative maintenance obligations (which most do), an owner of a property subject to a “front-only” façade easement may have substantially less affirmative maintenance obligations than an owner subject to an easement requiring maintenance of the entire property.

Question: Are front-façade only easements of much value as preservation tools? For example it is my understanding that the National Architectural Trust easement deed would allow a structure with an easement on it to be entirely torn down, so long as the façade was preserved.

Answer: From a preservation perspective, front-only façade easements may help to maintain the historic ambiance of a streetscape, and they may help to protect the historic or architectural character of properties with character-defining features primarily limited to the front façade, such as a simple row house. But in many other contexts, where significant architectural features exist on other portions of a historic property or where preservation of the property’s setting is important, a front-only façade easement would have limited value as a preservation tool, since it may allow an owner to alter, damage, or even demolish other portions of a historic property that have historic or architectural significance in their own right. In this context, an easement that protects an *entire* historic structure and its setting would be far more valuable as a preservation tool.

In addition, depending on the wording of the easement, front-only façade easements may allow a property owner to make inappropriate alternations to, or even

tear down, the remainder of the building (to replace it with another building), so long as the façade is preserved. This is a practice that is commonly described by preservationists as a “façadomy” or a “façadectomy,” and is not highly valued as an effective preservation technique except as a last resort if other preservation options are unavailable.

Question: Do you agree that an easement in an area where there are strict historic preservation laws is worth less than an area in which there are weak or nonexistent preservation laws?

Answer: Yes, as I indicated in my testimony, the National Trust agrees that—depending on the circumstances of the particular case—a simple preservation easement is likely to have less value in a district that has restrictive preservation laws when compared to the value of a similar easement granted on a similarly situated property subject to weak or minimal restrictions under local law. But, as I also indicated, *many* local jurisdictions have no local preservation controls, or only minimal levels of restrictions, and in those cases even simple façade easements may have substantial value. And, many easements in areas with strict historic preservation laws go well beyond minimalist “front-only” façade easements, and are in fact highly restrictive, and therefore likely to be quite valuable. It is also worth noting that easements on commercial properties may have a significant impact on their value even in highly regulated historic districts, particularly under the income approach to valuation.

Questions from Chairman Ramstad to Peg Breen

Question: Do you have any concerns about an easement holding organization basing the amount of the cash paid to it on the appraised value of the easement?

Answer: The Landmarks Conservancy is concerned about an easement holding organization basing the amount of the donation paid to it on the appraised value of the easement. While there are a number of bona fide preservation organizations that use a percentage-of-value basis for calculating cash contributions accompanying easement donations, we believe that this practice may, either directly or indirectly, provide an incentive to promote higher appraisals. As I mentioned in my testimony, the Landmarks Conservancy has never based our donation request on the appraised valuation of the property or the easement. We base our request on a case by case assessment of the cost of our inspections. In most cases, we do not see appraisal values until we are sent IRS form 8283 to sign.

Question: Have you ever heard complaints from the National Architectural Trust about the New York Landmarks Conservancy charging less of a cash donation than the National Architectural Trust?

Answer: The National Architectural Trust did complain once about the Conservancy charging less of a cash donation than the NAT. James Kearns of the NAT called me in, I believe, the fall of 2003 after we had accepted an easement on a commercial building NAT had solicited. The owners asked the Conservancy if we would be interested in an easement because they had dealt with the Conservancy architect in charge of our easements on other issues in the past. Mr. Kearns took issue with our donation request and I explained how we based such requests on an estimate of inspection costs. Mr. Kearns suggested that we cooperate in the future. NAT would tell us what easements they were interested in and we could tell them if we had easement interests. I told Mr. Kearns I did not wish to cooperate. The Conservancy has avoided contact with NAT since that time.

Question: During the hearing you mentioned that your organization had seen easement holding groups engaging in marketing practices that concerned you. Please describe and provide examples of these practices.

Answer: The Conservancy became concerned about NAT’s marketing practices after we received numerous calls from homeowners NAT had approached. These callers suggested to us that NAT was telling property owners that there would be a tax deduction within a specific, narrow range. Several callers were upset when we said we could not guarantee a specific tax deduction and urged them to consult with their tax attorney. Our understanding that NAT was suggesting a specific range was confirmed when people sent us samples of NAT literature. Two Conser-

vancy staffers who live in separate historic districts also received NAT flyers at their homes and each subsequently attended an information session offered by NAT representatives in their respective neighborhoods. One staffer expressed his concern with NAT's assurances of a specific tax deduction. The other staffer was concerned that NAT representatives told the attendees that they wouldn't have to worry about additional regulation with an easement, that NAT would simply take pictures of their building annually.

