Hilborn v. Commissioner, 85 T. C. 677 (1985)

The value of a historic facade easement donation is determined using the ‘before and after’ valuation approach, considering both the cost of the property and committed renovation expenses.

Summary

In Hilborn v. Commissioner, the U. S. Tax Court determined the fair market value of a historic facade easement donated by a limited partnership to the Vieux Carre Commission. The partnership, St. Louis Partners, acquired a building in New Orleans’ French Quarter and agreed to a servitude agreement that included facade renovations costing $47,780. The court used the ‘before and after’ valuation method, factoring in the purchase price and committed renovation costs, and concluded that the easement resulted in a 10% diminution in property value, valuing the donation at $55,278. This decision emphasizes the need to include both the property cost and committed expenses when valuing easements for tax deduction purposes.

Facts

St. Louis Partners, Ltd. , a limited partnership, purchased a building in the historic French Quarter of New Orleans for $300,000. The purchase agreement required the partnership to donate the building’s facade to the Vieux Carre Commission (VCC) and to spend up to $185,000 on interior renovations and $47,780 on facade renovations. On December 28, 1979, the partnership granted a servitude in perpetuity to the VCC, effectively donating the facade. The servitude agreement imposed significant obligations and restrictions on the partnership, including specific facade repairs and renovations.

Procedural History

The IRS determined a deficiency in the petitioners’ 1979 federal income tax due to the claimed deduction for the facade donation. The case proceeded to the U. S. Tax Court, where the petitioners contested the valuation of the facade easement. The court heard testimony from expert witnesses for both parties and reviewed detailed appraisals to determine the fair market value of the easement.

Issue(s)

1. Whether the fair market value of the facade easement donated to the Vieux Carre Commission should be determined using the ‘before and after’ valuation approach?
2. Whether the valuation should include both the cost of the property and the committed renovation expenses?

Holding

1. Yes, because the ‘before and after’ approach is the most feasible method for

valuing easements where no established market exists.
2. Yes, because the partnership was irrevocably committed to the renovation expenses, which were necessary for the completion of the facade donation.

Court's Reasoning

The court accepted the 'before and after' valuation method, as recommended by the National Trust for Historic Preservation and the IRS, to determine the value of the easement. This approach involved calculating the difference in the property's value before and after the easement was granted. The court found that the highest and best use of the property was for residential rental units with potential for condominium conversion. The court agreed with the respondent's expert, Derbes, that the easement resulted in a 10% diminution in value, rejecting the petitioners' expert's subjective 12% figure. The court also ruled that the committed renovation expenses, including the $47,780 for facade renovations, must be included in the valuation, as these costs were irrevocably committed by the partnership. The court's decision was influenced by the policy of encouraging historic preservation through tax incentives while ensuring accurate valuations for deductions.

Practical Implications

This decision impacts how historic facade easements are valued for tax purposes, emphasizing the inclusion of both property cost and committed renovation expenses in the 'before and after' valuation. Attorneys and appraisers should carefully document all commitments related to property acquisitions and renovations when valuing easements. The ruling supports the use of objective data in determining diminution in value, which may affect how similar cases are analyzed in the future. It also encourages the preservation of historic properties by clarifying the tax benefits available for such donations. Subsequent cases involving easement valuations, such as Stanley Works & Subsidiaries v. Commissioner, have cited Hilborn for its approach to valuation and commitment considerations.