Browning v. Commissioner, 109 T. C. 303 (1997)

The fair market value of a conservation easement in a bargain sale must be determined using the before-and-after method when the sales market is not indicative of fair market value due to governmental program limitations.

Summary

In Browning v. Commissioner, the taxpayers sold a conservation easement to Howard County, Maryland, under a farmland preservation program. The court had to determine the fair market value of the easement for calculating a charitable contribution deduction. The taxpayers argued for a before-and-after valuation method due to the county's program offering below-market prices. The Tax Court agreed, finding that the county's program did not reflect fair market value because it was characterized by bargain sales. The court valued the easement at $518,000, higher than the $309,000 received, allowing a $209,000 charitable contribution deduction. This decision underscores the importance of using appropriate valuation methods when government programs distort market prices.

Facts

Charles and Patricia Browning conveyed a conservation easement on their 52. 44-acre farmland to Howard County, Maryland, in 1990 under the county's Agricultural Land Preservation Program. The program aimed to preserve farmland by purchasing development rights. The Brownings received $30,000 immediately and a promise of $279,000 over 30 years, totaling $309,000. They claimed a charitable contribution based on the difference between the easement's appraised value ($598,500) and the amount received. Howard County's program limited payments to 50-80% of the fair market value, and participants were aware that they were making a bargain sale.

Procedural History

The Commissioner disallowed the Brownings' claimed charitable contribution deduction, arguing that the program's payments represented fair market value. The Brownings petitioned the Tax Court, which held that the county's program did not reflect fair market value due to its bargain sale nature. The court allowed the Brownings to use the before-and-after valuation method, ultimately determining a charitable contribution of $209,000.

Issue(s)

1. Whether the sales under Howard County's Agricultural Land Preservation Program constitute a "substantial record of sales" under Section 1. 170A-14(h)(3)(i) of the Income Tax Regulations, determinative of the fair market value of the easement.
2. Whether the fair market value of the easement should be determined using the before-and-after method if the sales under the program are not indicative of fair

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market value.
3. Whether the economic benefits of tax deferral, tax-free interest, and the charitable contribution deduction should be considered part of the amount realized from the sale of the easement.

Holding

1. No, because the sales under the program were not indicative of fair market value due to the bargain sale nature of the transactions.
2. Yes, because the before-and-after method was appropriate to determine the fair market value of the easement in the absence of a reliable market.
3. No, because these economic benefits are not part of the amount realized under Section 1001(b) of the Internal Revenue Code.

Court's Reasoning

The Tax Court rejected the Commissioner's argument that the county's program payments were determinative of fair market value. The court found that the program's participants, including the Brownings, intended to make bargain sales, thus creating an inhibited market not reflective of fair market value. The court applied the before-and-after valuation method, comparing the property's value before and after the easement's conveyance. Both parties' experts agreed on the "after" value of $157,000, but disagreed on the "before" value. The court found the "before" value to be $675,000 based on a lot yield of 15 lots at $45,000 per lot, resulting in an easement value of $518,000. The court also ruled that tax benefits associated with the transaction were not part of the amount realized, as they are not considered under Section 1001(b).

Practical Implications

This decision has significant implications for valuing conservation easements in bargain sales, particularly when government programs are involved. Attorneys and appraisers should be aware that sales under such programs may not reflect fair market value if the program is characterized by bargain sales. In these cases, the before-and-after valuation method should be used to determine the easement's value for charitable contribution purposes. This ruling also clarifies that tax benefits associated with the transaction are not part of the amount realized, which is crucial for calculating the charitable contribution deduction. Subsequent cases, such as Carpenter v. Commissioner (T. C. Memo. 2012-1), have followed this approach, emphasizing the need to carefully analyze the nature of the market when valuing conservation easements.

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