

# Rulings of the Tax Commissioner

**Document Number:** 10-75

**Tax Type:** Land Preservation Tax Credit

**Brief Description:** Taxpayer transferred the Credit to other parties based on the appraised value

**Topics:** Credits; Local Taxes Discussion

**Date Issued:** 05/18/2010

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May 18, 2010

Re: § 581-1821 Application: Land Preservation Tax Credit

Dear \*\*\*\*\*:

This will reply to your letter in which you contest the disallowance of an amended application claiming Land Preservation Tax Credits (the "Credits") by the \*\*\*\*\* (the "Taxpayer"). I apologize for the delay in responding to your appeal.

## FACTS

The Taxpayer purchased an undeveloped tract of land totaling approximately \*\*\*\* acres in \*\*\*\*\* (the "County") in 1999. At the time of purchase, the land was zoned to allow up to \*\*\*\*\* residences, or one residence per \*\*\*\*\* acres.

In January 2003, the County's board of supervisors passed an ordinance and downzoned the land that contained the Taxpayer's tract. The new zoning designation allowed one new residence per \*\*\*\*\* acres of land, or a cluster development of one residence per \*\*\*\*\* acres on a minimum \*\*\*\*\* acre site.

The Taxpayer sold the development rights to the property to the County in September 2003, conveying a perpetual open space conservation easement to the County, qualifying for the Credit under *Va. Code* § 58.1-512. In 2004, the Taxpayer filed a Notification of Transfer of Land Preservation Credit showing that the Credit had been transferred to other parties.

An appraisal was completed in June 2004 that valued the land based on the downzoning by the County. As permitted by *Va. Code* § 58.1-513, the Taxpayer transferred the Credit to other parties based on the appraised value of the land sold less the amount paid by the County for the development rights.

Prior to the sale of the development rights, a number of land owners filed suit seeking

to overturn the downzoning ordinance. In March 2004, the Loudon County Circuit Court (the "Circuit Court") upheld the ordinance. The Virginia Supreme Court (the "Court") later overturned the County's downzoning ordinance in *Gas Mart Corp. v. Bd. of Supervisors of Loudoun County*, 269 Va. 334, 611 S.E.2d. 340 (2005). The Court ruled that the zoning ordinance that downzoned the land was void, *ab initio*. Under this decision, the downzoning was deemed never to have occurred and the original zoning remained in effect.

Based on the Court's decision that the downzoning was deemed never to have occurred, the Taxpayer hired another appraiser to execute a new appraisal (the "second appraisal"). The appraiser based the second appraisal on the zoning of the land prior to the County passing the downzoning ordinance. As such, the tract of land was appraised at a significantly higher value. An amended credit notification was filed with the Department that increased the value of the Credit. The additional Credit was transferred to other parties.

The Department disallowed the amended Credit notification and second appraisal on which the amended Credit was based, asserting that the original appraisal should have taken into account the possibility of the downzoning ordinance being reversed through the litigation pending at the time. The additional Credit was disallowed, and assessments were issued against other parties who received the transferred Credits.

The Taxpayer contends that the original appraiser followed the accepted professional standards for appraisers and could not base his appraisal on the potential reversing of the downzoning ordinance. The Taxpayer further asserts that the second appraisal reflects the actual value of the donated easement because the downzoning ordinance was determined to be void.

## **DETERMINATION**

*Virginia Code* § 58.1-512, as in effect at the time of the donation, states in pertinent part:

For taxable years beginning on or after January 1, 2000, there shall be allowed as a credit against the tax liability . . . , an amount equal to fifty percent of the **fair market value** of any land or interest in land located in Virginia which is conveyed for the purpose of agricultural and forestry use, open space, natural resource, and/or biodiversity conservation, or land, agricultural, watershed and/or historic preservation, as an unconditional donation in perpetuity by the landowner/taxpayer to a public or private conservation agency eligible to hold such land and interests therein for conservation or preservation purposes. The fair market value of qualified donations . . . shall be substantiated by a 'qualified appraisal' prepared by a

'qualified appraiser,' as those terms are defined under applicable federal law and regulations governing charitable contributions. [Emphasis added.]

Treasury Reg. § 1.170 *et seq.* governs charitable contributions. Under Treas. Reg. § 1.170A-13(c)(3)(ii), a qualified appraisal must include the appraised fair market value of the property on the date of the contribution. Treas. Reg. § 1.170A-1(c)(2) further states that the fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the facts.

In Public Document 07-9 (3/12/2007), the Department incorporated by reference the Uniform Standards of Professional Appraisal Practice (USPAP), as developed by the Appraisal Standards Board of the Appraisal Foundation, in their entirety. Standard 1 of USPAP states that in developing a real property appraisal, an appraiser must identify the problem to be solved, determine the scope of the work necessary to solve the problem and correctly complete research and analyses necessary to produce a credible appraisal.

Generally, USPAP requires appraisals to be conducted based on known easements, restrictions, encumbrances, leases, reservations, covenants, contracts, declarations, special assessments, ordinances, or other items of similar nature. The standards allow for exceptions for extraordinary assumptions including the identity and analysis of probable modifications to land use regulations.

An official comment to Standards Rule 1-2(f) [requiring an appraiser to identify "extraordinary assumptions" necessary in the assignment] describes the limited circumstances under which an extraordinary assumption may be used in an appraisal assignment. The Comment allows an extraordinary assumption only if:

It is required to properly develop opinions and conclusions;

The appraiser has a reasonable basis for the extraordinary assumption;

The use of the extraordinary assumption results in a credible analysis; and

The appraiser makes disclosure of the extraordinary assumption under the requirements of USPAP.

In this case, the original appraisal did not identify or analyze the modifications to the County's ordinance resulting from the *Gas Mart* decision by the Court. At the time the original appraisal was completed, the circuit court had rendered its decision upholding the County's ordinance and the Court had not yet certified or accepted an appeal to hear the case. The Taxpayer argues that, when preparing the original appraisal, the

appraiser had no reasonable basis to assume the downzoning ordinance would later be held void *ab initio* by the Court. In fact, if the appraiser assumed the downzoning ordinance in effect for 16 months and upheld by the circuit court would be held void, he would have had no credible reason to support that extraordinary assumption in his appraisal.

Neither *Va. Code* § 58.1-512, as in effect at the time of the donation, nor the applicable federal laws and regulations expressly prohibit the submission of amended, revised, or alternative appraisals. Accordingly, there is nothing to prohibit the Taxpayer from obtaining a revised appraisal if the original appraisal was determined to be inadequate.

The Taxpayer convincingly argues that USPAP did not require the appraiser to include in the original appraisal an extraordinary assumption that the downzoning ordinance could be overturned or declared void *ab initio* by the Court. It was the *Gas Mart* decision, however, that prompted the Taxpayer to obtain a revised appraisal. This leads to the question as to whether the Taxpayer was entitled to file an amended Credit notification and second appraisal based on the Court's decision in *Gas Mart*.

In *Cummings v. U.S.*, 409 F. Supp. 1064 (1976), the United States District Court, M.D. North Carolina, Greensboro Division deemed a restriction in a deed unlawful under North Carolina law and concluded that such restriction could not affect the fair market value of land donated to a local school district. Like the taxpayers in *Cummings*, the Taxpayer's land was restricted by an unenforceable or voided action. Although the case is not clear as to whether the taxpayers knew the deed restriction was unenforceable at the time of the donation, the court clearly concluded unenforceable or voided actions cannot be considered in determining the fair market value of property.

In the Taxpayer's case, the zoning ordinance was enacted in January 2003 and the suit was filed before the donation was made in September 2003. As such, the legality of the zoning on the land was in question when the donation was made. Ultimately, the Court struck down the ordinance, *ab initio*. The question is, could the facts that the zoning was in question at the time of the donation and was subsequently struck down as if it had never existed lead a reasonable person to conclude that the illegality was known at the time of the donation, and permit that information to be considered to have been available at the time of donation?

In *Cummings*, the deed restriction was clearly unenforceable pursuant to North Carolina law at the time the deeds were issued even if the taxpayers were not specifically aware of the illegality. In *Doherty v. C.I.R.*, 16 F.3d 338 (1994), a painting's authenticity was considered to have been in question at the time of the donation even though the taxpayers claimed they were unaware of the authenticity issue. In this case, the United States Court of Appeals, Ninth District (the "Ninth District Court") stated on several occasions that the authenticity of the painting was questionable at the time of the donation. There is no indication in the opinion that the painting was known to be a

fraud at the time of the donation. Instead, the Ninth District Court decided that reasonable hypothetical buyers would have known of the questionable authenticity at the time of the contribution was a correct assumption by the United States Tax Court.

Under the reasoning provided in *Doherty*, a reasonable hypothetical buyer would have known that the zoning ordinance was under review of the courts, which could have affected the price such buyer was willing to pay for the property regardless of the appraisal standards under USPAP. However, such a buyer would not have paid for the land as if the zoning were overturned in the courts, although some consideration might have been negotiated based on a speculation that the zoning would be overturned.

Further, while all of the facts that formed the basis of the Court's decision in *Gas Mart* were in existence at the time of the contribution, the circuit court upheld the ordinance that resulted in the lower value. Certainly, the circuit court would be considered to be at least as informed as a reasonable hypothetical buyer. As such, the value of Taxpayer's property based on the amended appraisal cannot be accepted.

The denial of the second appraisal in this case should not be interpreted to mean that the Department will never consider an amended appraisal. The Department has commissioned its own appraisals in cases in which it found deficiencies in the appraisals submitted by landowners making donations.

In fact, a review of the appraisals does indicate that the second appraiser provided significantly more analysis with regard to the property with out regard to the zoning issue. Such analysis may enhance the value of property at the time of donation. In addition, a reexamination of the information concerning the zoning issue available at the time of the donation could reveal a possible effect on the value of the easement. As such, the Taxpayer may provide the Department with an amended appraisal reflecting this additional analysis under the standards established by UPAP.

An amended appraisal may be submitted to the Virginia Department of Taxation, Office of Customer Services, P. O. Box 1115, Richmond, VA 23218-1115, Attn: \*\*\*\*\* within 60 days of the date of this letter. This amended appraisal will be subject to review by the Department, which may at that time commission its own appraisal. If an amended appraisal is not provided within the time allotted, the assessments will be upheld.

The *Code of Virginia* section cited, along with other reference documents are available on-line at [www.tax.virginia.gov](http://www.tax.virginia.gov) in the Tax Policy Library section of the Department's web site. If you have any questions about this determination, or if the Taxpayer intends to file an amended appraisal, you may contact \*\*\*\*\* in the Office of Tax Policy, Appeals and Rulings, at \*\*\*\*\*.

Sincerely,

Janie E. Bowen  
Tax Commissioner

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