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An Unwelcome Gift From The IRS On Conservation Easements

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Law360, New York (January 9, 2017, 5:46 PM EST) -- As taxpayers settled into the holidays on December 23, the IRS slipped an unwelcomed present under the tree. Among the growing number of 11th-hour edicts by the outgoing administration, Notice 2017-10 declared some conservation easement donations to be "listed transactions," giving a chill to many year-end donations. No doubt the chilling effect of Notice 2017-10 was intended by the IRS to discourage a popular type of conservation easement donation.

The deduction for donating conservation easements is an innovative conservation funding mechanism and a powerful, effective tool for the conservation of private land in America. Conservation easements have preserved millions of acres of agricultural lands and wildlife habitat, protected water quality, and preserved America's open spaces.

A conservation easement is a voluntary binding agreement that perpetually protects sensitive land from adverse use, modification or development. Conservation easements are donated to nonprofit organizations, usually land trusts, which become stewards of the land responsible for enforcing the easement restrictions. The property remains privately owned, and limited development and activities such as farming, ranching, hunting and timber harvesting may continue so long as those activities are consistent with the easement's conservation values.

Although the first conservation easements date back to 1891, they were not commonly used as a conservation tool until 1976, when Congress reworked the tax code — primarily Section 170(h) — to provide a tax deduction to landowners when conservation easements were donated. In December of 2015, Congress, on a bi-partisan basis, made enhanced federal tax benefits for conservation easements permanent.

This was meant to further encourage landowners to use this powerful conservation tool. Under 2015 law, landowners can take a deduction for the value of the donated easement up to 50 percent of their adjusted gross income. Landowners may also carryover the value of the deduction for up to 15 years. Farmers and ranchers who receive more than 50 percent of their gross income from agriculture may take a deduction of up to 100 percent of their adjusted gross income.

Given dwindling government conservation dollars, these private conservation easement



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donations have significantly increased in importance relative to public conservation efforts. However, some have raised concerns about taxpayer abuse of this tax deduction and have questioned whether Americans are paying too much for conservation in the form of loss of tax revenue. As can be expected when tax deductions are tied to the value of the donation, many disputes have arisen between taxpayers and the IRS about the fair market value of the donation.

The IRS has expressed these concerns for some time. Over the years, it has proposed limitations to Section 170(h) aimed at alleviating some of these concerns, but Congress has not concurred. So it is surprising that on Dec. 23, 2016, just over a year after the benefits of Section 170(h) were reiterated and reinforced by Congress, the IRS took matters into its own hands by designating certain donations of conservation easements as a type of "tax avoidance transaction" known as a "listed transaction."

Specifically, Notice 2017-10 targets transactions where taxpayers invest in a pass-through entity, and receive information (oral or written) describing the tax benefits of a possible donation of a conservation easement by the entity and suggesting that the value of the donation may be 250 percent or more of the taxpayer's investment. A taxpayer who has participated in such a transaction, or in one that is "substantially similar," is required to file a Form 8886 (Reportable Transaction Disclosure Statement) with the IRS, disclosing the pertinent facts of the transaction.[1] The notice also requires disclosure, retroactively, of participation in such a transaction in any tax year for which the three-year statute of limitations is still open, even if the income tax return for that year is already filed.

The failure to file a required Form 8886 carries significant consequences, including a penalty of 75 percent of any tax savings, capped at \$100,000 for natural persons and \$200,000 for other entities. In addition, there is no relief from the penalty — even if there is reasonable cause for failing to file.

It is in everyone's best interest to ensure that good conservation is being furthered by Section 170(h), that America is getting value for the deductions allowed for this conservation, and that enforcement of this provision is effective to prevent abuses in this area. However, Notice 2017-10 completely missed the mark in meeting these goals.

Rather, in an arbitrary and ham-fisted manner and without opportunity for constructive comment, the executive branch usurped the power to legislate. Congress provided by legislative grace a tax deduction for donations meeting the statutory requirements. The IRS has decreed that certain donations, even if they follow the letter of the Section 170(h), should be taken away by administrative fiat.

The Treasury Department or the IRS will counter that the notice merely requires more transparency that will aid the IRS in enforcement, and that there is no definitive ruling as to the legality of any particular donation. Such an assertion is a red herring. Notice 2017-10 undoubtedly is an attempt by the IRS to derail certain donations, notwithstanding their compliance with Section 170(h) and the presence of solid conservation values.

If more transparency and disclosure were the real motivation of the IRS, there are easier and less damaging ways to accomplish it. The IRS could simply add disclosure requirements to the already existing disclosure form required of all taxpayers claiming a tax deduction for donation of a conservation easement, Form 8283. Designation as a listed transaction is burdensome, duplicative and unnecessarily pejorative. If the problem is "overvaluation," as the IRS says in the notice, then additional information concerning value can be required on Form 8283.

In the era of dwindling IRS budgets and inability to meet even basic taxpayer needs, it is hard to imagine that this influx of data will actually help the IRS in its enforcement. More likely these forms dutifully filled out by taxpayers will sit in an IRS warehouse in Ogden,

Utah. The IRS has been applying tremendous resources to conservation easement audits. It is unlikely to devote even more resources to deal with the mountain of new data.

Part of the IRS's problem is its inefficient use of resources. Agents of the IRS are notorious for grossly undervaluing easements, making erroneous determinations regarding the legal requirements of donations and supporting documents, and concluding that every audited conservation easement lacks conservation purpose. The beneficial process of settlement is too often thwarted by the IRS hierarchy. The IRS squanders its resources in battles that need not have been fought.

Members of Congress from both sides of the aisle recently and separately wrote the IRS commissioner to express concerns about IRS audits of taxpayers who made charitable donations of conservation easements, suggesting that the IRS's process and procedures were thwarting the very donations Congress was trying to encourage. It is difficult to see how this notice helps allay congressional concerns over taxpayer treatment.

The real threat of abuse in conservation easement deductions lies in overvaluation of the easement. The IRS admits this in Notice 2017-10. The IRS would be better served by rolling up its sleeves and addressing overvaluation by changing its own internal audit procedures to obtain more accurate results in a more efficient manner, rather than publishing a notice without the opportunity for stakeholder input on December 23, days before the end of the calendar year when many donations were to be completed.

It is hoped that the next administration will take a hard look at this issue and come to the same conclusion that many stakeholders have: that Section 170(h) is working as intended, with rare exceptions. When the rare exception does surface, it is as a result of overvaluation of the property, and the recent IRS notice does nothing to address this underlying issue. It only places an undue burden on taxpayers making charitable donations.

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[1] Additionally, "material advisors" will have to file a Form 8918 (Material Advisor Disclosure Statement) and maintain lists of the people who participated in such transactions.

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