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Destroying Charitable Conservation Easements Is Not Within Congressional Intent

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The U.S. Tax Court, in *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5 (Nov. 9, 2022), analyzed whether the syndicated conservation easements at issue in the case were subject to the §6662A[1] penalty, which is an additional penalty on ''listed'' and ''reportable'' transactions. The IRS in Notice 2017-10 had added syndicated conservation easements to the definition of transactions considered to be ''listed'' — i.e., tax shelters. If a transaction fits within the definition, there are IRS reporting requirements with substantial penalties for a failure to report. The taxpayers argued that the IRS did not follow the procedures outlined in the Administrative Procedures Act (APA) in issuing the Notice, because they did not follow the required notice-and-comment opportunity afforded to taxpayers. The Tax Court agreed. The court held that the taxpayers were not liable for the §6662A penalties. In an apparent response to this opinion, the IRS issued proposed Treasury Regulations to, in effect, replace Notice 2017-10.[2] This time the IRS is providing a Notice and Comment period, as required, before finalizing the new Treasury Regulation.

In *Green Valley*, a reviewed opinion, the Tax Court extensively analyzed the legislative history behind the penalty provision applicable to listed transactions, and did not find the exceptions relied upon by the Commissioner as particularly convincing. The court held: ''. . .we remain unconvinced that Congress expressly authorized the IRS to identify a syndicated conservation easement transaction as a listed transaction without the APA's notice-and-comment procedures, as it did in Notice 2017-10.''[3]

CHARITABLE EASEMENTS AFTER 'GREEN VALLEY'

Reliance on Legislative History Should Apply to the Core Incentive as Well

Similarly as with the penalty provision, the Tax Court and other courts should rely upon legislative history to further protect the advantages afforded taxpayers who donate conservation easements to qualified charities. Section 170(h) provides incentives for property owners to protect disappearing species, to protect open vistas, and to preserve natural habitats and scenic views. Taxpayers receive charitable deductions offsetting up to 50% of adjusted gross income for said donations. However, the IRS has been erecting roadblocks so that taxpayers are unable to take advantage of these tax incentives. By doing so, the IRS is arguably frustrating congressional intent. Notice 2017-10 classifying syndicated easements as listed transactions, the new Proposed Regulations to replace the Notice, and the IRS's litigating posture for the

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[1] All section references are to the Internal Revenue Code, as amended, or the Treasury Regulations thereunder.

[2] Prop. Reg. §1.6011-9, REG-106134-22, 87 Fed. Reg. 75,185 (Dec. 8, 2022).

[3] *Green Valley*, slip. op. at 23.

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hundreds of cases pending have substantially crippled the conservation easement space. Instead of focusing on the valuations of the conservation easements, the IRS and Tax Court have acted to completely eliminate these incentives — contrary to legislative intent.

Earlier courts analyzing conservation easements — before the line of cases in which easements were completely disallowed in reliance on the Proceeds Clause in the Treasury Regulations[4] — were a bit more lenient in allowing the charitable deduction. In *Glass v. Commissioner*[5] (2005), both the Tax Court and the Sixth Circuit Court of Appeals allowed the conservation easement charitable deductions claimed by the taxpayers, with valuation reserved as a subsequent issue. The Tax Court relied upon legislative history and the intent of Congress in allowing the charitable deductions. The court noted that in promulgating §170(h), Congress stated as follows:

> It is intended that a contribution of a conservation easement . . .qualify for a deduction only if the holding of the easement. . .is related to the purpose or function constituting the donee's purpose for exemption. . . and the donee is able to enforce its rights as holder of the easement. . .and protect the conservation purposes which the contribution is intended to advance. The requirement that the contribution be exclusively for conservation purposes is also intended to limit deductible contributions to those transfers which require that the donee hold the easement. . .exclusively for conservation purposes (i.e. that they not be transferable by the donee in exchange for money, other property, or services). H. Conf. Rept. 95-263.[6]

While Congress stated strong support for protecting conservation purposes, it also indicated that the deduction was not without limits and qualifying requirements. However, there is not one word in this legislative history about the distribution of proceeds in the unlikely event of a judicial extinguishment. By turning this hypothetical event into a ''make or break'' criterion for purposes of qualification, the IRS and affirming courts have frustrated the intent of Congress and §170(h).

As discussed in my previous article,[7] the Eleventh Circuit Court of Appeals recently reversed the position of the IRS and Tax Court in favor of allowing taxpayers a deduction.[8] The Sixth Circuit, on the other hand, has affirmed the IRS's and Tax Court's positions completely disallowing the deductions and declaring the easements invalid. The IRS and courts rely upon language in the easement document as it relates to the Proceeds Clause.[9] The Sixth Circuit taxpayers filed a Petition for Writ of Certiorari with the Supreme Court[10] to gain clarity on the issues, but that Petition was denied. The split in the Circuits remains with differing outcomes for taxpayers depending upon the location of the property and taxpayers.

The Tax Court in its majority opinion in *Oakbrook*[11] discussed that the Treasury Regulations interpreting §170(h) were promulgated in January 1986 and have never been amended. The court also relied upon its observation that Congress has amended the statutory provisions of §170 without any indication that the Treasury Regulations interpreting §170(h) were problematic.[12] However, these statutory amendments do not address the extinguishment provisions and the Proceeds Clause[13] which has the effect of disallowing the entire deduction. Instead, Congress has focused on whether there is actually a conservation purpose and a reasonable value. It has been easier for the IRS and the Tax Court to disallow the entire easement in contravention of the legislative history, rather than follow prior precedent that focused on charitable qualifications and valuation issues.

A Matter of Language

One solution to this quagmire would be for the IRS to offer a settlement initiative in which the taxpayers are allowed to amend the language in their easements, assuming there has not been a judicial extinguishment action and proceeds have not yet been distributed. The charitable qualification and valuation issues could be separately negotiated, with valuation limited to 2.5 times the fair market value of the property, as recently

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[4] Reg. §1.170A-14(g)(6). *See* Kuhn, *Insight: Charitable Conservation Easements — IRS and Tax Court Act to Shut Them Down*, Bloomberg Tax Insights, July 22, 2020.

[5] *Glass v. Commissioner*, 124 T.C. 258 (2005), *aff'd,* 471 F.3d 698 (6th Cir. 2006).

[6] 124 T.C. 258 at 283.

[7] Kuhn, *A Split in the Circuits: Will the Supreme Court Take Up the Easement Challenge?* Bloomberg Tax Insights, Apr. 4, 2022.

[8] *Hewitt v. Commissioner*, 21 F.4th 1336 (11th Cir. 2021), *rev'g and rem'g* T.C. Memo 2020-89.

[9] *Oakbrook Land Holdings v. Commissioner*, 28 F.4th 700 (6th Cir. 2022), *aff'g* 154 T.C. 180 (2020).

[10] *Oakbrook Land Holdings, LLC v. Commissioner*, Petition for Writ of Certiorari, S. Ct. No. 22-323 (Oct. 4, 2022). ''Brief for the Respondent in Opposition'' filed December 7, 2022. *Petition denied*, 598 U.S. _____ (Jan. 10, 2023).

[11] 154 T.C. 180 (2020).

[12] ''. . . these amendments have never suggested any disagreement with the construction of the statute that Treasury adopted in section 1.170A-14(g)(6), Income Tax Regs. This 'strongly suggests that * * * [Congress] did not view Treasury's construction * * * as unreasonable or contrary to the law's purpose.''

[13] Reg. §1.170A-14(g)(6).

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enacted in the 2023 Omnibus Legislation.[14] This new law only applies prospectively and does not impact all of the cases in the Federal courts, or any of the ongoing IRS examinations. An interpretation of a Treasury Regulation regarding the distribution of proceeds of a judicial sale (that is very unlikely to happen) is also not impacted by this new statutory amendment to §170.

The goal of §170(h) is for the easement to be perpetual. The standard language in easement documents specifies that the easement is perpetual. The extinguishment is hypothetical. My review of case law does not reveal a single case among the hundreds of cases pending and decided in which a judicial extinguishment has occurred and proceeds from the sale distributed. It seems there is an argument that the IRS cannot base an examination on a hypothetical set of facts that has not occurred. Nothing has happened. The easement is perpetual. Instead, the IRS finds the prototype language in the easement, used by hundreds or thousands of projects, and says ''gotcha.'' The taxpayer used the wrong language and so the entire easement fails, even though the easement is perpetually valid and there will be nothing to disrupt that easement until there is a judicial extinguishment such as an eminent domain action. There has been no harm, other than arguable harm to the federal fisc if the valuation of the easement is not reasonable. That loss is better dealt with in an examination of valuation of the easement. As Tax Court Judge Holmes stated in his dissenting opinion in *Oakbrook*: ''Our holding today will likely deny any charitable deduction to hundreds or thousands of taxpayers who donated conservation easements that protect perhaps millions of acres.''[15]

CONCLUSION

Now that the Supreme Court has denied review of *Oakbrook Land Holdings* and thus declined to resolve the conflict between the Sixth and Eleventh Circuits, the tax treatment of conservation easements will vary widely depending upon where the property is located. Property in the Eleventh Circuit, i.e., Alabama, Florida, and Georgia, will be conserved, while there will be little incentive for taxpayers in the Sixth Circuit to donate to qualified conservation charities to preserve the birds, trees, and animals of Kentucky, Michigan, Ohio, and Tennessee. This divisiveness was not envisioned by Congress when originally enacting §170(h). Moreover, the recently enacted statutory requirements will not prevent the IRS and courts from dealing the ''gotcha'' card. The IRS and courts will presumably continue to completely disallow conservation easements without regard to value everywhere except the Eleventh Circuit, based upon a technicality. These actions continue to frustrate longstanding Congressional intent. Although Congress limited the valuation of easements in its recent amendments, it did not limit the validity of conservation easements themselves. By doing so, Congress signaled that using a technicality to completely invalidate conservation easements is outside the intent of the statute. More focus should be trained on furthering legislative intent, rather than frustrating legitimate conservation activities.

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[14] Consolidated Appropriations Act, 2023 (Pub. L. No. 117-328) (Dec. 29, 2022).

[15] 154 T.C. 180 *230.

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