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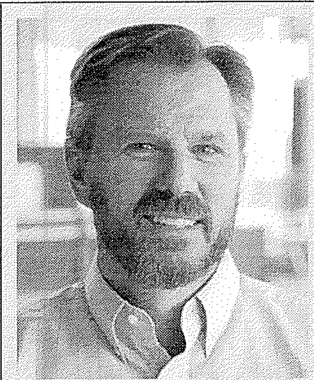
A Dirty Dozen Myths About Conservation Easements and One Sad Truth

by Robert Ramsay



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In this article, Ramsay explores a dozen myths that the IRS uses to wage its war against conservation easements.

The IRS has declared war on conservation easements. It has dedicated an unprecedented amount of resources to stopping taxpayers from claiming valid deductions, and has named conservation easements among its "dirty dozen" tax scams.[1]

The IRS's war is inconsistent with the law. Congress asks taxpayers to grant conservation easements to conserve land and reduce development, and in exchange it has promised a tax deduction. There is nothing "dirty" about following a law that Congress enacted and claiming a deduction when a valid conservation easement has been donated. Congress could change this law if it wanted to, but it has not. Treasury could alter the regulations governing how the law operates, but it has not. Instead, the IRS has chosen to deny deductions through audits and litigation — threatening taxpayers for violating rules that don't exist.

Below are a dirty dozen myths the IRS uses to wage its war against conservation easements, and one sad truth about that war.

Myth 1: Syndicated conservation easements are fraudulent.

Reality: Anyone who buys land can use it in any legally permissible manner. It doesn't matter whether they buy land using a partnership or on their own. When multiple individuals come together in a partnership to purchase and conserve land, it democratizes the allowable conservation easement deduction, making it available to any American who chooses to invest in the partnership. Arguing that use of a partnership is fraudulent is nothing more than a thinly veiled attempt to preserve a tax benefit exclusively for the super-wealthy who can afford to buy large parcels of land on their own.

Myth 2: Transactions identified by the IRS in a "listing notice," like conservation easements,[2] become illegal after the IRS identifies the transactions.

Reality: A "listing notice" is guidance issued by the IRS instructing taxpayers to report their participation in specific transactions. This guidance does not change the law. Deductions for conservation easements have been enshrined in U.S. law since the 1970s, and they have been repeatedly strengthened by Congress in the ensuing decades. A listing notice does not change this fact.

Myth 3: The IRS's attacks against conservation easements are supported by existing guidance.

Reality: The IRS has been attacking conversation easements with an audit and litigate

[1] IR-2019-47.

[2] *See* Notice 2017-10, 2017-4 IRB 544 (as modified by Notice 2017-29, 2017-20 IRB 1243, and Notice 2017-58, 2017-42 IRB 326).

strategy.[3] Instead of providing taxpayers needed guidance based on the law, the IRS has tried to justify its harassment of taxpayers through legal briefs that employ novel arguments that have no basis in its existing guidance. It should not and cannot provide that guidance for the first time in an audit or in a legal brief after it has taken a taxpayer to court.

Myth 4: Sponsors of conservation easement transactions should be "fearful of the IRS."[4]

Reality: From the top of the organization down, the IRS has resorted to scare tactics and wild accusations to try to change behavior. Rogue enforcement actions by the IRS do not transform lawful conduct into illegal activity. Deductions for conservation easements have been congressionally approved for decades. Taking a deduction for a qualifying conservation easement that has been properly appraised is not illegal — even if the IRS doesn't like it.[5] Because the conduct is legal, taxpayers have the right to take those deductions, period.

Myth 5: It is inappropriate to decide to donate a conservation easement based on the expectation that a tax deduction will be received.

Reality: Congress encourages the placement and donation of conservation easements by providing significant tax deductions when those donations are made.[6] As with other donations (for example, to a place of worship, the United Way, or Red Cross), investments (for example, 401(k) and IRA contributions), and real estate investment decisions (for example, buying a residence with a home mortgage or investing in projects eligible for the historic rehabilitation tax credit, low-income housing tax credit, or the Opportunity Zone tax credit), taxpayers make decisions based on their tax implications every day. There is nothing inappropriate about deciding to donate a qualifying conservation easement based on an attendant tax benefit permitted under the law.

[3]*See* IR-2019-182.

[4]Peter Elkind, "The IRS Tried to Crack Down on Rich People Using an 'Abusive' Tax Deduction. It Hasn't Gone So Well," *ProPublica*, Jan. 3, 2020 (quoting Steven T. Miller).

[5]*See* John Burnett, "A Wayward IRS Investigation Should Worry All Taxpayers," Newsmax, Dec. 11, 2019.

[6]Section 170(h).

Myth 6: Partners cannot claim charitable deductions that exceed their investments.

Reality: For decades, the IRS took the position that a partner is entitled to deduct a charitable contribution made by a partnership even if the deduction exceeds the partner's investment in the partnership. Congress codified this rule in 2017. The IRS's recent change of heart, which is limited to conservation easements donated by partnerships, is flatly contradicted by the law.

Myth 7: A conservation easement's value cannot exceed the current value of the land.

Reality: A conservation easement's value is the value of the development rights that are forfeited in perpetuity when an easement is placed. Treasury's own regulations require that these rights be valued based on the land's highest and best use.[7] When the existing state of land is different from its highest and best use, giving up the opportunity to develop the land forgoes substantial value. It is that value that the law permits as a deduction. The IRS ignores Treasury regulations, and years of court cases, when it asserts that a conservation easement deduction cannot exceed the value of the land itself. If the IRS wants to change these rules, it must do so through a legitimate rulemaking process,[8] but it has not done so.

Myth 8: Appraisers inflate the value of development rights associated with conservation easements by using the discounted cash flow method of valuation.

Reality: In determining the value of development rights, the appropriate method of valuation is the discounted cash flow method. Every appraiser — whether on behalf of a partnership or an individual — uses this method to determine the value of extinguished development rights associated with a conservation easement. The IRS itself has repeatedly and consistently endorsed this method of valuing real property in the estate tax context. The IRS's recent challenge to this method is selective and contrary to its position in other contexts.

[7]Reg. section 1.170A-14(h).

[8]*See* section 7805(a) (authorizing Treasury to promulgate rules and regulations).

Myth 9: Appraisals are not qualified unless they comply with the Uniform Standards of Professional Appraisal Practice (USPAP).

Reality: In its own regulations, the IRS has expressly declined to adopt USPAP as the controlling standard for qualified appraisals of conservation easements.[9] The IRS's own appraisers refuse to apply USPAP when valuing conservation easements and real property in estate tax and other contexts. The IRS cannot hold others to standards that are inapplicable under the law and that the IRS itself does not adhere to.

Myth 10: A conservation easement must protect a "significant" natural habitat.

Reality: A conservation easement protects a valid conservation purpose if it protects a "relatively natural habitat."[10] Congress intentionally identified a relatively natural habitat to protect common habitats. Without the protection of common habitats, ecosystems are destroyed. This immediately affects air and water quality, and risks additional species becoming rare, threatened, or endangered.

Myth 11: A conservation easement protects a relatively natural habitat *only* if rare, threatened, or endangered fish, plants, or wildlife live on a substantial portion of the land in question.

Reality: In addition to the other qualifying conservation purposes, land has a valid conservation purpose if it protects habitat — for fish, wildlife, or plants — where they normally live or are likely to occur. Moreover, qualifying habitats "include, but are not limited to," habitats for rare, endangered, or threatened species.[11] There is no requirement that a conservation easement protect land only where a rare, threatened, or endangered species resides. The broader conservation purpose to protect habitat more broadly remains an important feature of existing law.

Myth 12: The IRS's attacks are intended only to stop syndicated conservation easements.

Reality: The IRS's aggressive attacks on conservation easements are not limited to syndicated conservation easements. New positions being taken in audits and litigation by the IRS undermine decades-old understandings of how conservation easements should be structured. Indeed, the IRS now claims that best practices recommended by groups like the Land Trust Alliance, which have been used almost universally in both syndicated and non-syndicated easement deeds for years, are contrary to the law and, if used, eliminate any ability to claim a deduction.

One Sad Truth: Too many of the IRS's latest enforcement efforts against those involved in projects involving conservation easements are a thinly veiled and illegal attempt to revoke a congressionally enacted tax law.

Reality: Congress passes tax laws, and the IRS's job is to enforce them. In the 1970s, Congress sought a public-private partnership in its land conservation efforts.[12] Rather than have the federal government buy land itself, and then permanently fund the expensive monitoring, protection, and maintenance efforts necessary to conserve the acquired land, Congress instead asked the public to undertake these efforts on its behalf. In exchange for easing and perpetually conserving land, the government promised a one-time tax benefit to the owner of the property. The IRS's latest enforcement efforts seek to undo this promise, to revoke a benefit, and to unmake the law. Taxpayers have held up their end of the bargain.[13] They have eased and conserved land just like Congress asked them to do — a particularly important action in the face of today's unprecedented environmental and climate challenges. These easements were placed at Congress's behest and cannot be undone. It is time for the IRS and the rest of the U.S. government to uphold their part of the deal.

[9] *See* reg. section 1.170A-17.

[10] Section 170(h)(4)(A).

[11] Reg. section 1.170A-14(d)(3)(i).

[12] *See* P.L. 95-30, section 309(a) (May 23, 1977).

[13] Robert Ramsay, "Increase Land Conservation With Improved Legislation," *The Hill*, Mar. 26, 2019 ("Current conservation easement law was passed with bipartisan support and was approved by both the Bush and Obama administrations. Between 2005 and 2015, nearly 20 million acres of land across the U.S. were conserved by individuals, families and partnerships. Clearly, the system is working as Congress intended.").