

Charitable Contribution Deductions Under IRC § 170

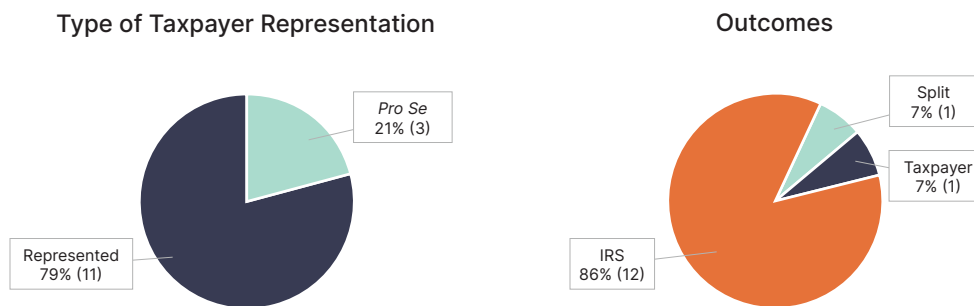
TAXPAYER RIGHTS IMPACTED¹

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

OVERVIEW

We identified 14 opinions issued between June 1, 2019, and May 31, 2020, on the issue of the deductibility of charitable contributions under IRC § 170, which is three fewer cases than in last year's report. Of the 14 cases, the most common issues were whether a donation constituted a qualified conservation easement (eight cases) and whether a claimed deduction was adequately substantiated (six cases). An additional case involved both issues. Taxpayers were usually represented, and the IRS usually prevailed. During this same period, taxpayers petitioned the Tax Court in 401 cases where charitable contributions were an issue during the examination.²

FIGURE 2.9.1³



1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the IRC. See IRC § 7803(a)(3).

2 IRS Appeals response to TAS information request (Dec. 3, 2020) showing cases petitioned to Tax Court between June 1, 2019, and May 31, 2020. TAS matched this data to the cases identified by examination where an adjustment to charitable contributions was recommended as recorded in the Examination Operational Automation Database on the IRS, Compliance Data Warehouse (Dec. 2020).

3 Of the 14 cases, three taxpayers appeared without representation and 11 had representation. Of the 14 cases, the taxpayer prevailed in one case, the IRS prevailed in 12 cases, and there was a split opinion in one case.

ANALYSIS OF LITIGATED CASES

The most significant cases centered on syndicated conservation easements, an arrangement in which an investor purchases an interest in a pass-through entity that holds real property. The pass-through entity contributes a conservation easement encumbering the property to a tax-exempt entity and allocates a charitable contribution deduction to the investor.⁴ Promotional materials for these transactions offer prospective investors the possibility of a charitable contribution deduction of more than two and a half times the amount of the investor's investment.⁵ The IRS contends that promoters obtain an appraisal that greatly inflates the value of the conservation easement by using the highest and best use of the property before it was encumbered with the easement to create a fictional and unrealistic valuation of the property. The IRS also contends that investors in the pass-through entity typically claim charitable contribution deductions that grossly multiply their actual investment in the transaction and defy common sense.

Although the IRS recognizes the important role of conservation easement deductions in incentivizing land preservation for future generations, abusive syndicated conservation easement transactions have been of concern to the IRS for several years. For several years, the IRS has focused on curtailing abuse in this area by designating syndicated conservation easements as a listed transaction and aggressively auditing taxpayers who participate in these transactions.⁶

Nevertheless, between 2017 and 2018, the number of individual participants in these transactions increased from 14,000 to 16,900, with many participating in multiple deals; the total amount of deductions claimed through these tax shelters increased from \$6.8 billion in 2017 to \$9.2 billion in 2018.⁷ In June 2020, the IRS offered to settle docketed Tax Court cases with this issue.⁸ It does not appear that many taxpayers have accepted the offer to date.⁹

4 Although taxpayers generally are not permitted to deduct gifts of property consisting of less than the taxpayer's entire interest in that property, they may deduct the value of a contribution of a partial interest in property that constitutes a "qualified conservation contribution." IRC § 170(f)(3)(B)(iii), (h).

5 IRS Notice 2017-10, 2017-4 I.R.B. 544 at 3, *Syndicated Conservation Easement Transactions*. See also S. Comm. on Finance, S. PRt. 116-44 at 11, 116th Cong., 2d Sess., *Committee Print on Syndicated Conservation-Easement Transactions* (Aug. 2020), describing transactions in which the real property held by the pass-through entity was sold in an arm's length transaction, followed shortly thereafter by an appraisal asserting a value multiple times higher than the value established in that prior arm's length transaction, which calls into question the accuracy of the appraisal.

6 See IRS Notice 2017-10, 2017-4 I.R.B. 544, *Syndicated Conservation Easement Transactions*. Promoters and participants in these transactions must disclose them to the IRS pursuant to IRC §§ 6011, 6111, 6112, and the regulations thereunder. See also S. Comm. on Finance, S. PRt. 116-44 at 3, 116th Cong., 2d Sess., *Committee Print on Syndicated Conservation-Easement Transactions* (Aug. 2020), noting that as of Feb. 2020 the IRS is auditing or plans to audit 84 percent of the partnerships that participated in syndicated conservation easements from 2015-2017.

7 Letter from Charles P. Rettig, Commissioner, IRS, to Sen. Charles Grassley, Chairman, Committee on Finance (Sept. 17, 2020). See also, e.g., Kristen A. Parillo, *Deluge of Tax Court Easement Petitions Continues*, 2020 TNTF 205-9 (Oct. 23, 2020), noting that "In the last few weeks, 27 easement-related petitions were filed, with \$481,505,985 in claimed deductions on the line."

8 IRS, IR-2020-130, *IRS Offers Settlement for Syndicated Conservation Easements; Letters Being Mailed to Certain Taxpayers With Pending Litigation*; IRS, IR-2020-152, *IRS Urges Taxpayers to Accept Easement Settlement Offers*. Among other things, the settlement requires a concession of the tax benefits claimed by the taxpayers and imposes penalties: all partners in an electing partnership must agree to settle to receive these terms, and the partnership must make a lump-sum payment representing the aggregate tax, penalties and interest for all of the partners before settlement is accepted by the IRS; the IRS Office of Chief Counsel will allow investors to deduct the cost of acquiring their partnership interests, but it will require a penalty of at least ten percent; partners who are promoters of conservation easement schemes are not allowed any deductions and must pay the maximum penalty asserted by IRS (typically 40 percent); if less than all the partners agree to settle, the IRS may settle with those partners but will normally impose less favorable terms on the settling partners. As of Nov. 2019, there were 80 such docketed Tax Court cases. See IRS, IR-2019-192, *IRS Increases Enforcement Action on Syndicated Conservation Easements* (Nov. 12, 2019).

9 See, however, IR-2020-196, *Settlements Begin in Syndicated Conservation Easement Transaction Initiative* (Aug. 31, 2020), announcing the completion of the first settlement under the initiative.

In this year's reporting cycle, the IRS prevailed in seven of the eight cases in which the deductibility of a donation of a conservation easement was at issue (including the case in which adequate substantiation was also at issue).¹⁰ As the Tax Court noted in one of this year's opinions:

[i]n recent years the Commissioner has attacked a popular form of charitable contribution — the donation of conservation easements. Many of these attacks are surgical strikes on what he believes are gross exaggerations of the value of particular easements. But he has also launched three sorties — all predicated on the requirement that such easements be “perpetual” — that he hopes will cause more widespread casualties.¹¹

The perpetuity requirement of IRC § 170(h)(5)(A) was primarily at issue in the conservation easement cases included in this year's analysis, rather than the value of the easement.¹² For example, in three Tax Court cases, the taxpayers lost because the deeds they used to convey the easements provided that in the event of a sale of the property following judicial extinguishment of the easement, the donee would receive a fixed amount, rather than a proportion, of the sale proceeds.¹³ This provision did not satisfy the requirement that the conservation purpose of the easement must be protected in perpetuity.¹⁴ The court in one of the cases acknowledged that many other conservation easement deeds contain the same inadequate language.¹⁵

The IRS could help avoid litigation by providing model language taxpayers could use in deeds conveying conservation easements, and the National Taxpayer Advocate has recommended that the IRS provide such guidance.¹⁶ As the IRS explained in response to that recommendation, it has provided sample language for a “constructive denial clause” in conservation easement deeds that is consistent with the perpetuity requirements of IRC § 170(h).¹⁷ This is an encouraging development that may avert unnecessary litigation. Additional guidance and sample language, particularly with respect to other aspects of the perpetuity requirements, may also help taxpayers navigate these complex issues and help prevent unnecessary litigation.

¹⁰ In addition, the IRS prevailed in at least seven conservation easement cases that were decided outside of this year's reporting period. The opinions in three such cases were published on June 23, 2020: *Plateau Holdings, LLC v. Comm'r*, T.C. Memo. 2020-93; *Lumpkin One Five Six LLC v. Comm'r*, T.C. Memo. 2020-94; and *Lumpkin HC v. Comm'r*, T.C. Memo. 2020-95. The opinions in four such cases were published on July 9, 2020: *Effingham, LLC v. Comm'r*, T.C. Memo. 2020-102; *Englewood Place LLC v. Comm'r*, T.C. Memo. 2020-105; *Riverside Place LLC v. Comm'r*, T.C. Memo. 2020-103; and *Maple Landing, LLC v. Comm'r*, T.C. Memo. 2020-104.

¹¹ *Oakbrook Land Holdings, LLC v. Comm'r*, T.C. Memo. 2020-54 at *1 (fn. refs. omitted).

¹² In contrast, last year's report included a discussion of several cases in which the value of the easement was at issue. See, e.g., *Pine Mountain Preserve LLLP v. Comm'r*, 51 T.C. 247 (2018), *aff'd in part, rev'd in part, vacated in part and remanded*, No. 19-11795, 2020 WL 6193897 (11th Cir. Oct. 22, 2020). The Tax Court determined the value of the conservation easement in a concurrently filed separate opinion, T.C. Memo. 2018-214.

¹³ *R.R. Holdings, LLC v. Comm'r*, T.C. Memo. 2020-22; *Oakbrook Land Holdings, LLC v. Comm'r*, T.C. Memo. 2020-54; and *Woodland Properties Holdings, LLC v. Comm'r*, T.C. Memo. 2020-55.

¹⁴ IRC § 170(h)(5)(A); Treas. Reg. § 1.170A-14(g)(6).

¹⁵ *Oakbrook Land Holdings, LLC v. Comm'r*, T.C. Memo. 2020-54.

¹⁶ National Taxpayer Advocate 2019 Annual Report to Congress 203 (Most Litigated Issue: *Charitable Contribution Deductions Under IRC § 170*).

¹⁷ National Taxpayer Advocate Fiscal Year 2021 Objectives Report to Congress vol. 2, at 194, Counsel Narrative Response, citing IRS Chief Counsel Advice 2020-02011 (Jan. 10, 2020). A constructive denial clause provides that if an easement holder does not respond within a specified period to a request by the property owner regarding a proposed use, then the request is considered denied. See also IRS Chief Counsel Generic Legal Advice 2020-001 (Mar. 27, 2020) (providing language to amend a conservation easement that complies with the perpetuity requirements of § 170(h)).

CONCLUSION

For several years, the IRS has focused on curtailing abuse in the area of syndicated conservation easements. However, designating these transactions as potentially abusive tax shelters does not appear to have deterred taxpayers from participating in them, and IRS court victories in this area do not appear to have deterred taxpayers from litigating their cases. Some taxpayers may accept the IRS's offer to settle their cases with this issue, but litigation in this area may very well continue for years.

Recommendation to Mitigate Disputes

The National Taxpayer Advocate recommends that the IRS:

1. Develop and publish additional guidance that contains sample easement provisions to assist taxpayers in drafting deeds that satisfy the statutory requirements for qualified conservation contributions, particularly the perpetuity requirement for those conservation easements that incentivize land preservation for future generations.