MLI #9

Charitable Contribution Deductions Under IRC § 170

SUMMARY

Subject to certain limitations, taxpayers can take deductions from their adjusted gross incomes (AGIs) for contributions of cash or other property to or for the use of charitable organizations.[1] To take a charitable deduction, taxpayers must contribute to a qualifying organization.[2] Taxpayers must also comply with certain substantiation requirements when making a contribution of $250 or more.[3] Litigation generally occurred in this reporting cycle in the following three areas:

- Substantiation of the charitable contribution;
- Valuation of the charitable contribution; and
- Requirements for a qualified conservation contribution.

We identified and reviewed 17 cases decided between June 1, 2018, and May 31, 2019, with charitable deductions as a contested issue. The IRS prevailed in 13 cases, and four cases resulted in split decisions. Taxpayers represented themselves (appearing *pro se*) in seven of the 17 cases (41 percent). The IRS prevailed in all seven *pro se* cases. The deduction of conservation easement contributions is an emerging issue during this reporting period as the IRS is focused on curtailing abuse in this area by designating syndicated conservation easements as a listed transaction.[4] We expect to see continued litigation on this issue in the future. Taxpayers must pay close attention to the elements of donating a qualified conservation easement in the absence of safe harbors or other guidance from the IRS on how they may construct a conservation easement deed that satisfies the strict statutory requirements.

TAXPAYER RIGHTS IMPACTED[5]

- *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*

PRESENT LAW

Charitable contributions made within the taxable year are generally deductible by taxpayers, but in the case of individual taxpayers, a taxpayer must itemize deductions from income on his or her income tax return in order to deduct the contribution.[6] Transfers to qualifying organizations are deductible only if

1 Internal Revenue Code (IRC) § 170.

2 IRC § 170(c).

3 IRC § 170(f)(8).

4 *See* IRS Notice 2017-10, 2017-4 I.R.B. 544, Syndicated Conservation Easement Transactions; IRS, IR-2019-47, Abusive Tax Shelters, Trusts, Conservation Easements Make IRS' 2019 "Dirty Dozen" List of Tax Scams to Avoid (Mar. 19, 2019).

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

6 IRC §§ 63(d) & (e), 161, and 170(a).

they are contributions or gifts,[7] not payments or other consideration in exchange for goods or services.[8] A contribution or gift will be allowed as a deduction under Internal Revenue Code (IRC) § 170 only if it is made "to" or "for the use of" a qualifying organization.[9] Taxpayers cannot deduct services that they offer to charitable organizations; however, incidental expenditures incurred while serving a charitable organization and not reimbursed may constitute a deductible contribution.[10]

Under prior law, individual taxpayers' charitable contribution deductions were generally limited to 50 percent of the taxpayer's contribution base (AGI computed without regard to any net operating loss carryback to the taxable year under IRC § 172).[11] The Tax Cuts and Jobs Act (TCJA) increased the limitation to 60 percent for cash donations in tax years (TYs) 2018 through 2025.[12] Subject to certain limitations, individual taxpayers can carry forward unused charitable contributions in excess of these limitations for up to five years.[13]

For corporate taxpayers, charitable deductions are generally limited to ten percent of the taxpayer's taxable income and are also available for carryforward for up to five years, subject to limitations.[14]

Substantiation

For cash contributions, taxpayers must maintain receipts from the charitable organization, copies of cancelled checks, or other reliable records showing the name of the organization, the date, and the amount contributed.[15] Deductions for single charitable contributions of $250 or more are disallowed in the absence of a contemporaneous written acknowledgement from the charitable organization.[16] The taxpayer is generally required to obtain the contemporaneous written acknowledgment no later than the date he or she files the return for the year in which the contribution is made.[17] The contemporaneous written acknowledgement must include:

- The name of the organization;
- The amount of the cash contribution;
- A description (but not the value) of the noncash contribution;
- A statement that no goods or services were provided by the organization in return for the contribution, if that was the case;
- A description and good faith estimate of the value of goods or services, if any, that an organization provided in return for the contribution; and

7 The Supreme Court of the United States has defined "gift" as a transfer proceeding from a "detached and disinterested generosity." *Comm'r v. Duberstein*, 363 U.S. 278, 285 (1960).

8 Treas. Reg. § 1.170A-1(h).

9 IRC § 170(c).

10 Treas. Reg. § 1.170A-1(g). Meal expenditures in conjunction with offering services to qualifying organizations are not deductible unless the expenditures are away from the taxpayer's home. *Id.* Likewise, travel expenses associated with contributions are not deductible if there is a significant element of personal pleasure involved with the travel. IRC § 170(j).

11 IRC § 170(b)(1)(A).

12 IRC § 170(b)(1)(G); Tax Cuts and Jobs Act, Pub. L. 115-97, § 11023, 131 Stat. 2054 (2017) ¶ 230.

13 IRC § 170(b)(1)(G)(i) & (d)(1).

14 IRC § 170(b)(2) & (d)(2).

15 Treas. Reg. § 1.170A-13(a)(1).

16 IRC § 170(f)(8); Treas. Reg. § 1.170A-13(f).

17 Treas. Reg. § 1.170A-13(f)(3).

- A statement that goods or services, if any, that an organization provided in return for the contribution consisted entirely of intangible religious benefits, if that was the case.[18]

For each contribution of property other than money, taxpayers generally must maintain a receipt showing the name of the recipient, the date and location of the contribution, and a description of the property.[19] Generally, when taxpayers contribute property other than money, the amount of the allowable deduction is the fair market value of the property at the time of the contribution.[20] For contributions of property that result in a taxpayer claiming a deduction in excess of $5,000, the taxpayer must obtain a qualified appraisal prepared by a qualified appraiser.[21]

Valuation

The amount of a charitable contribution that is noncash property is the fair market value of the property at the time of its contribution.[22] 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 relevant facts."[23] This is generally true even when the donation is for a partial interest in property, such as a conservation easement.[24] The value of a conservation easement is "the fair market value of the perpetual conservation restriction at the time of the contribution."[25]

Qualified Conservation Contributions

For a gift to constitute a qualified contribution under IRC § 170, the donor must possess a transferrable interest in the property and intend to irrevocably relinquish all rights, title, and interest to the property without any expectation of some benefit in return.[26] Taxpayers generally are not permitted to deduct gifts of property consisting of less than the taxpayer's entire interest in that property.[27] Nevertheless, taxpayers may deduct the value of a contribution of a partial interest in property that constitutes a "qualified conservation contribution,"[28] also known as a conservation easement. A contribution will constitute a qualified conservation contribution only if it is of a "qualified real property interest," made to a "qualified organization," "exclusively for conservation purposes."[29] All three conditions must be satisfied for the donation to be deemed a "qualified conservation contribution."[30]

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18 IRC § 170(f)(8)(B); Treas. Reg. § 1.170A-13(f)(2); IRS Pub. 1771, Charitable Contributions Substantiation and Disclosure Requirements (Rev. Mar. 2016).

19 Treas. Reg. §§ 1.170A-13(b)(1)(i) to (iii).

20 Treas. Reg. § 1.170A-1(c)(1). This general rule is subject to certain exceptions that in some cases limit the deduction to the taxpayer's cost basis in the property, or otherwise reduced for certain contributions of ordinary income and capital gain property. *See* IRC § 170(e).

21 IRC § 170(f)(11)(C); Treas. Reg. § 1.170A-13(c). "Qualified appraisal" and "qualified appraiser" are defined in IRC § 170(f)(11)(E)(i) and (ii), respectively. Further, taxpayers must attach that qualified appraisal to their Federal income tax returns when claiming a deduction of more than $500,000. IRC § 170(f)(11)(D).

22 Treas. Reg. § 1.170A-1(c)(1).

23 Treas. Reg. § 1.170A-1(c)(2). The calculation of the fair market value is generally determined by a number of factors outlined in the regulations. *See* Treas. Reg. § 1.170A-14(h).

24 *Browning v. Comm'r*, 109 T.C. 303, 311-314 (1997) (citing Treas. Reg. § 1.170A-7(c)).

25 Treas. Reg. §§ 1.170A-7(c) & 1.170A-14(h)(3).

26 IRC § 170(f)(3); *Goldstein v. Comm'r*, 89 T.C 535, 541-542 (1987).

27 IRC § 170(f)(3).

28 IRC § 170 (f)(3)(B)(i), (h).

29 IRC § 170(h)(1).

30 *Id.*

Recent Development: Payments Resulting in State or Local Tax Benefits

The TCJA capped the state and local tax deduction that taxpayers could take at $10,000, for TYs 2018 through 2025.[31] This aspect of the TCJA resulted in numerous states developing workarounds to circumvent the limitation, including the creation of charities which residents can donate to in exchange for state and local tax credits.[32]

The Department of Treasury and the IRS promulgated regulations that address these workarounds, and require taxpayers, under certain circumstances, to reduce their charitable contribution deductions by the amount of any state or local tax credits they receive or expect to receive in return.[33] The reasoning in the new regulation is that if a taxpayer expects to receive a state or local tax credit in exchange for a payment or property transfer considered in IRC § 170(c), that credit is generally a *quid pro quo*, and will reduce the taxpayer's deduction by the amount of the credit.[34] These regulations apply to contributions made after August 27, 2018.[35]

There are a few exceptions to the general rule established by the new regulation. If the state or local tax credits received or expected by the taxpayer amount to 15 percent or less of the taxpayer's payment or the fair market value of their property contribution, the taxpayer may claim the deduction without reducing the federal charitable contribution deduction under IRC § 170.[36]

If the taxpayer receives or expects to receive state or local tax deductions, the taxpayer will not be required to reduce his or her federal charitable contribution deduction, so long as the state and local deductions do not exceed the value of the taxpayer's charitable contribution.[37] Because the regulations became effective after our reporting period ended, we did not review any cases involving the new regulations, though we anticipate that we may see cases involving them in the coming years.

ANALYSIS OF LITIGATED CASES

TAS reviewed 17 decisions entered between June 1, 2018, and May 31, 2019, involving charitable contribution deductions claimed by taxpayers. Table 9 in Appendix 5 contains a detailed list of those cases. Of the 17 cases, the most common issues were: substantiation (or lack thereof) of the claimed contribution (ten cases), valuation of the property contributed (six cases), and contribution of an easement (seven cases).[38]

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31 *See* IRC § 164(b)(6)(B); Tax Cuts and Jobs Act, Pub. L. 115-97, §11042, 131 Stat. 2054 (2017) ¶ 215.

32 For a discussion of the various state workarounds, see Cynthia M. Pedersen, *States' Workarounds to the State and Local Tax Deduction Limitation*, The Tax Adviser (Aug. 1, 2018), https://www.thetaxadviser.com/issues/2018/aug/workarounds-state-local-tax-deduction-limitation.html.

33 Treas. Reg. § 1.170A-1(h)(3) *as amended by* 84 Fed. Reg. 27,513 (June 13, 2019) (effective Aug. 12, 2019). The IRS also issued Notice 2019-12 to provide a safe harbor for itemizing taxpayers to be able to add some payments that are or will be disallowed under the new regulation to their state and local tax deductions (up to the $10,000 limit for single and married filing jointly taxpayers; $5,000 if married filing separately). IRS, Notice 2019-12: Guidance Providing a Safe Harbor Under Section 164 for Certain Individuals Who Make a Payment to or for the Use of an Entity Described in Section 170(c) in Return for a State or Local Tax Credit (June 11, 2019).

34 84 Fed. Reg. 27,513 (June 13, 2019), https://www.federalregister.gov/documents/2019/06/13/2019-12418/contributions-in-exchange-for-state-or-local-tax-credits (providing an explanation of the new rules).

35 Treas. Reg. § 1.170A-1(h)(3)(viii). Regulations were effective on August 12, 2019.

36 Treas. Reg. § 1.170A-1(h)(3)(vi).

37 Treas. Reg. § 1.170A-1(h)(3)(ii).

38 Cases addressing more than one described issue are counted for each issue. For example, cases addressing the valuation of easements are counted once as a valuation issue case and again as a conservation easement issue case. As a result, the breakdown of case issues above will not add up to the total number of cases reviewed by TAS.

Substantiation

Ten cases involved the substantiation of deductions for charitable contributions. When determining whether a claimed charitable contribution deduction is adequately substantiated, courts tend to follow a strict interpretation of IRC § 170. As noted earlier, deductions for single charitable contributions of $250 or more are disallowed in the absence of a contemporaneous written acknowledgement from the charitable organization.[39]

Blau, LLC v. Commissioner

Blau, LLC v. Commissioner involved the issue of whether the taxpayer, RERI Holdings I, LLC (RERI), substantiated its noncash charitable contribution.[40] RERI claimed a charitable contribution deduction of approximately $33 million for its donation of a noncash asset, a future interest in a piece of commercial property, to the University of Michigan.[41] This valuation was based on an appraisal, which RERI attached to its Form 8283, Noncash Charitable Contributions.[42] However, on the Form 8283, RERI did not fill in the space for "Donor's cost or adjusted basis," or explain why it omitted the basis.[43]

Generally, IRC § 170 allows taxpayers to claim deductions for donations to charitable organizations, but "only if verified under regulations prescribed by the [IRS]."[44] To fulfill this requirement, as well as the direction from Congress[45] to make stricter the verification requirements for noncash donations, the Department of Treasury and the IRS promulgated Treas. Reg. § 1.170A-13(c). This regulation requires taxpayers that donate certain noncash property to:

> (A) "[o]btain a qualified appraisal"; (B) "[a]ttach a fully completed appraisal summary ... to the tax return"; and (C) "[m]aintain records" containing specified information. Paragraph (c)(3) defines a "qualified appraisal" and paragraph (c)(4) details the necessary elements of an "appraisal summary," one of which is "[t]he cost or other basis of the property." The taxpayer must provide the appraisal summary on IRS Form 8283.[46]

If these requirements are not met, the deduction is generally not allowed. However, there is an exception for reasonable cause if a taxpayer cannot provide information in the appraisal summary on the manner of acquisition and the basis of the contributed property.[47]

On review, the U.S. Court of Appeals for the D.C. Circuit had to decide whether RERI substantially complied with the substantiation regulations, and thus whether it was entitled to its claimed charitable contribution deduction.

At the trial level, the Tax Court held that RERI was not entitled to a charitable contribution deduction because RERI had failed to "substantially comply" with the requirements of the substantiation regulations by failing to disclose its basis in the donated property.[48]

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39 IRC § 170(f)(8); Treas. Reg. § 1.170A-13(f).
40 *Blau v. Comm'r*, 924 F.3d 1261 (D.C. Cir. 2019), *aff'g* 149 T.C. 1 (2017).
41 *Id.* at 1265.
42 *Id.* at 1267.
43 *Id.*
44 IRC § 170(a)(1).
45 Deficit Reduction Act of 1984, Pub. L. No. 983-69, § 155(a)(1), 98 Stat. 494,691.
46 *Blau*, 924 F.3d at 1268 (quoting Treas. Reg. § 1.170A-13(c)).
47 Treas. Reg. § 1.170A-13(c)(4)(iv)(C)(1).
48 *RERI Holdings I, LLC v. Comm'r*, 149 T.C. 1, 15 (2017).

The U.S. Court of Appeals for the D.C. Circuit reviewed this issue *de novo*, as it had not previously decided whether substantial compliance was enough to satisfy the substantiation regulation.[49] On appeal, the IRS argued that the test should be stricter than the test applied by the Tax Court, citing substantial compliance standards used by the Fourth, Fifth, and Seventh Circuits, and proposing that anything short of full compliance could be excused only if "(1) [the taxpayer] had a good excuse for failing to comply with the regulation and (2) the regulation's requirement is unimportant, unclear, or confusingly stated in the regulations or statute."[50]

The Court assumed, but did not decide, that substantial compliance with the regulations would suffice, but determined that RERI's failure to disclose its basis in the donated property meant that it did not substantially comply with Treas. Reg. § 1.170A-13.[51] RERI argued that the Tax Court's ruling conflicted with its prior holding in *Dunlap v. Commissioner*,[52] where the court had excused the petitioner's failure to provide their basis on Form 8283 because providing the basis was not necessary to substantially comply.[53] However, the Tax Court distinguished its non-precedential memorandum opinion in *Dunlap*, which did not consider whether the taxpayers fulfilled the substantiation requirements, and where there was no significant difference in the basis and the claimed deduction.[54] Regardless of whether substantial compliance with the regulations is sufficient, the Court of Appeals agreed with the Tax Court that RERI "fell short of the substantiation requirements by omitting its basis in the donated property"[55] and affirmed the Tax Court judgement. Thus, the taxpayer's charitable contribution deduction was disallowed.[56]

Value of the Property Contributed

Value of the property contribution (valuation) made up six of the 17 cases that TAS reviewed. Three of the six valuation cases arose from the donation of conservation easements.

Pine Mountain Preserve, LLLP v. Commissioner

In *Pine Mountain Preserve, LLLP v. Commissioner*,[57] the Tax Court entered a decision for the IRS on two of three conservation easements at issue. The Tax Court determined the fair market value of the third easement in a separate memorandum opinion filed concurrently, for which the court allowed a charitable contribution deduction.[58] The valuation of the third easement, a conservation easement from 2007, involved the IRS's and the taxpayer's experts computing the valuation using different methodology and reasoning. We will analyze this separate opinion in greater detail.

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49 *Blau*, 924 F.3d at 1269.

50 *Id.* at 1269 (citing *Volvo Trucks of N. Am., Inc. v. United States*, 367 F.3d 204, 210 (4th Cir. 2004); *McAlpine v. Comm'r*, 968 F.2d 459, 462 (5th Cir. 1992); *Prussner v. United States*, 896 F.2d 218, 224 (7th Cir. 1990)).

51 *Blau*, 924 F.3d at 1269.

52 103 T.C.M. (CCH) 1689 (2012).

53 *Blau*, 924 F.3d at 1270.

54 *Id.* at 1270-1271 (citing *Dunaway v. Comm'r*, 124 T.C. 80, 87 (2005) for the proposition that the Tax Court is not bound by its non-precedential memorandum opinions).

55 *Id.*

56 *Id.* at 1280.

57 *Pine Mountain Pres., LLLP v. Comm'r*, 151 T.C. 247 (2018), *appeal docketed*, Nos. 19-11795 and 19-12173 (11th Cir. May 8, 2019, and June 5, 2019).

58 *Pine Mountain Pres., LLLP v. Comm'r*, T.C. Memo. 2018-214, *appeal docketed*, Nos. 19-11795 and 19-12173 (11th Cir. May 8, 2019, and June 5, 2019).

The value of a charitable contribution of noncash property is the fair market value of the property at the time of its contribution.[59] 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 relevant facts."[60] Treas. Reg. § 1.170A-14(h)(3) provides the rules for determining the fair market value of a charitable qualified conservation contribution.[61] In its separate memorandum opinion the court broke down those rules into five salient points:

1. The value of the easement is the fair market value at the time it is contributed.
2. To determine the fair market value, look to see if there is a substantial record of comparable sales of similar easements to the donated one. If so, base the valuation on those sales prices.
3. If no record of comparable easements exists, the general rule is that the fair market value of the conservation contribution equals the difference in the value of the encumbered property before granting the easement minus the fair market value of the property after granting the easement.
4. If the easement is only on a portion of the taxpayer's land, its value is calculated by ascertaining the difference between the fair market value of the taxpayer's contiguous property minus the fair market value of the same after the easement is granted.
5. Further, if the donation of the easement increased the value of other property owned by the donor or a related person, the deduction for the conservation easement is reduced by the amount of the increase in the value of the other property (even if the property is not contiguous).[62]

Both the taxpayer, and the IRS had their own experts testify as to the valuation of the conservation easement, and argued that the other expert's method of valuation did not comply with the Treasury Regulation § 1.170A-14(h)(3).[63] The court went through the regulation sentence by sentence and compared the regulation to each expert's method of calculation to evaluate how the easement should be valued.[64]

To determine the fair market value at the time the easement was contributed, the court first looked at the second sentence of the regulation to determine if there were comparable sales that could guide the valuation of the easement at issue in the case. The IRS expert valued the easement based on other sales of easements he thought were comparable to the 2007 easement. However, Pine Mountain Preserve argued that the easements the IRS expert used had little development potential, while the 2007 easement could be developed in the future. It is standard to price a property at its "highest and best" use, so the valuation depended on whether it was reasonably probable that the donated land would be developed. The court examined the relevant facts — "the access from the property to highways, the likelihood that one of the municipalities would approve a real-estate subdivision, and the changing state of the real-estate market" — and reasoned that the Pine Mountain property did have development potential.[65] Because there was development potential, the court determined that "the Pine Mountain property could have been sold to a third-party buyer and the buyer would have paid a relatively high price that corresponded

59 Treas. Reg. § 1.170A-1(c)(1).
60 Treas. Reg. § 1.170A-1(c)(2).
61 Treas. Reg. § 1.170A-14(h)(3).
62 *Pine Mountain Preserve, LLLP*, T.C. Memo. 2018-214 at *4–5 (citing Treas. Reg. § 1.170A-14(h)(3)(i)).
63 *Id.* at *6–16.
64 *Id.* at *16–28.
65 *Id.* at *6.

to the development potential of the property."[66] Therefore, "the second sentence of the regulation does not compel the use of the comparable sales method as employed by [the IRS expert]."[67]

The court next examined how the Pine Mountain Preserve's expert calculated the value of the easement based on the third sentence of the regulation, the general rule that the value equals the fair market value before less the fair market value after. This is the general rule, but the court noted that the easement was only for a portion of Pine Mountain Preserve's contiguous property, governed by the fourth sentence of the regulation. The court reasoned that the expert's opinion did not account for the beneficial effects of the easement on the unencumbered parts of the donor's property. Thus, it was not in compliance with the fourth sentence of the regulation, to consider the fair market value of the whole property both before and after the grant of an easement to a portion of the donor's property. Because the court found that the expert's method was not in compliance with the fourth sentence of the regulation, it did not consider whether the expert's method was also contrary to the fifth sentence.

The court found neither experts' methods complied with the regulation.[68] The court concluded that it could weigh the testimony of each expert to determine how to come to the correct valuation, and that it "[was] not bound by the opinion of any expert witness."[69] The court noted: "(1) how both experts' opinions have aspects that are useful to the determination of the easement's value, (2) the nature of the errors made by each expert, and (3) how weighting the two experts' opinions tends to correct the errors in their respective approaches."[70] Considering these factors, the court believed that the errors present in the two experts' values balanced comparably (equally overestimated by Pine Mountain's expert and underestimated by the IRS's expert).[71] Therefore, the court reasoned that combining the two valuations could correct for each expert's errors. Thus, the court added together fifty percent of each expert's valuation to calculate the allowable charitable deduction.[72]

The IRS and the taxpayer have filed cross-appeals with regard to the Court's decisions in this case.

Qualified Conservation Contribution

The question of whether a donation constituted a qualified conservation contribution arose as an issue in seven of the cases reviewed by TAS. This is also a threshold issue in the two cases discussed above. If the taxpayer fails to establish that the easement is a qualified conservation contribution then the Court will never need to answer questions about valuation and substantial compliance. All of the conservation contribution cases involved business taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships: Schedules C, E, F). The Court of Appeals for the Fifth Circuit also decided a conservation easement case during our reporting period. That case is discussed below.

PBBM-Rose Hill, Ltd. v. Commissioner

In *PBBM-Rose Hill, Ltd. v. Commissioner*,[73] the taxpayer, PBBM-Rose Hill, Ltd. (PBBM), appealed the Tax Court's decision that PBBM's contribution of a conservation easement to a land trust did

66 *Pine Mountain Preserve, LLLP*, T.C. Memo. 2018-214 at *6.
67 *Id.* at *7 (citing Treas. Reg. § 1.170A-14(h)(3)(i)).
68 *Id.* at *28-30 (citing Treas. Reg. § 1.170A-14(h)(3)(i)).
69 *Id.* at *28-29.
70 *Id.* at *29-30.
71 *Id.* *31-36.
72 *Id.* at *36.
73 *PBBM-Rose Hill, Ltd. v. Comm'r*, 900 F.3d 193 (5th Cir. 2019), *aff'g* No. 26096-14 (T.C. Jan. 9, 2017).

not constitute a qualified conservation contribution and therefore it disallowed PBBM's charitable contribution deduction and sustained a penalty for overvaluing the easement.

In general, a charitable contribution deduction may be permitted when a taxpayer's donation of an easement constitutes the donation of a qualified conservation contribution.[74] To qualify as a qualified conservation contribution, the easement donation must be (1) of a qualified real property interest, (2) to a qualified organization, and (3) made exclusively for conservation purposes.[75]

The main issue in this case was whether the easement donated by PBBM was made exclusively for conservation purposes.[76] The statute outlines specific easement purposes that constitute a conservation purpose.[77] Each specific purpose has a different requirement for how much public access must be granted.[78] The statute also states that in order for an easement to qualify as having been made "exclusively" for such a conservation purpose, the conservation purpose must be protected in perpetuity.[79]

The Department of Treasury and the IRS issued the "extinguishment regulation"[80] to require that a donated easement's conservation purpose is "protected in perpetuity" in the event that the property underlying the donated easement changes in such a way that it is impossible or impractical for the continued use of the donated property for the conservation purposes.[81] Of particular importance in this case is the part of that regulation that explains that

> [A]t the time of the gift the donor must agree that the donation of the perpetual conservation restriction gives rise to a property right … with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction at the time of the gift, bears to the value of the property as a whole at that time…. [T]hat ***proportionate value*** of the donee's property rights shall remain constant…. [When the unexpected change occurs, the donee] must be entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction.[82]

On the question of whether the donated easement was meant to serve a conservation purpose, there was no substantive dispute; the easement ostensibly served the purpose of preserving "land areas for outdoor

74 IRC § 170(f)(3)(B)(iii) & (h).

75 IRC § 170(h)(1).

76 IRC § 170(h)(4), (5).

77 These purposes are:

"(i) the preservation of land areas for outdoor recreation by, or the education of, the general public,

(ii) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem,

(iii) the preservation of open space (including farmland and forest land) where such preservation is—(I) for the scenic enjoyment of the general public, or (II) pursuant to a clearly delineated Federal, State, or local governmental conservation policy, and will yield a significant public benefit, or

(iv) the preservation of an historically important land area or a certified historic structure." IRC § 170(h)(4).

78 Treas. Reg. § 1.170A-14(d)(2)(ii), (d)(3)(iii), (d)(4)(ii)(B) & (d)(4)(iii)(C).

79 IRC § 170(h)(5).

80 Treas. Reg. § 1.170A-14(g)(6). The court explains that the purpose of the extinguishment regulation is: The purpose of this regulation is "(1) to prevent a taxpayer (or his successor) 'from reaping a windfall if the property is destroyed or condemned' such that the easement cannot remain in place and (2) to assure that the donee can use its portion of any proceeds to advance the conservation purpose elsewhere." *PBBM-Rose Hill, Ltd.*, 900 F.3d at 205.

81 *PBBM-Rose Hill, Ltd.*, 900 F.3d at 205.

82 *Id.* (quoting Treas. Reg. § 1.170A-14(g)(6)(ii)) (emphasis added).

recreation by … the general public."[83] The issue on appeal for the U.S. Court of Appeals for the Fifth Circuit, rather, was whether the conservation easement had sufficiently preserved that land for use by the general public, as the applicable regulations require that land underlying a conservation contribution must be available "for the substantial and regular use of the general public."[84]

At the trial level, the Tax Court held that the conservation easement did not adequately protect public access to the land. It noted that the deed required the donated property to be open for use by the general public, but also that there was not a right of public access. Furthering the Tax Court's conclusion was the fact that after the creation of the easement the land underlying the easement was operated as an 18-hole golf course and a park. Access to the property was controlled by a gatehouse. Upon entry, visitors would be given a pass that would limit their access to certain areas; they could go to the golf course or restaurant, but not the park.[85]

The Court of Appeals analyzed the regulations regarding conservation easements which "indicate that public access should generally be determined by examining the language of the deed."[86] Additionally, the regulations suggest that whether a conservation easement qualifies should be determined at the time of the donation, not what the subsequent owner does with the property.[87]

The court construed the deed as a whole and gave the specific language in the deed more weight than the general language.[88] PBBM included the statutory conservation purposes for IRC § 170(h)(4)(i)-(iii) in its easement deed.[89] The deed stated that "[t]he Property is and shall continue to be and remain open for substantial and regular use by the general public for outdoor recreation."[90] Additionally, it included language that prohibited charging fees that would defeat this public use or "result in the operation of the Property as a private membership club."[91] The court reasoned that this language in the deed was enough to obligate the owner of the property to operate it in such a way that provided access to the public for substantial and regular recreational use, as the regulation required.[92] The court further explained that the general terms in the deed, which did not grant a right of public access, and retained the right for the owner to put up no-trespassing signs, did not override the specific language that did grant certain public access.[93] Lastly, the court decided that these provisions in the deed referred to "[t]he Property" in its entirety. For that reason, the IRS's argument "that the deed allows the owner to prevent the public from accessing certain areas of the land fails."[94] Therefore, the easement's language fulfilled the public-access requirement for the conservation purpose of outdoor recreation for the general public.[95]

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83 *PBBM-Rose Hill, Ltd.*, 900 F.3d at 205. at 201.

84 *Id.* at 205. at 201-202 (citing Treas. Reg. § 1.170A-14(d)(2)(ii)).

85 *Id.* at 202.

86 The Court explained that there is an exception to this general rule when the donor knew or should have known at the time of the donation that the access in actuality would be significantly less than the access under the terms of the deed. Here, however, the court held PBBM failed to meet this exception. *PBBM-Rose Hill, Ltd.,* 900 F.3d at 202-203 (distinguishing Treas. Reg. § 1.170A-14(d)(4)(ii)(B) and (5)(iv)(C)).

87 *PBBM-Rose Hill, Ltd.*, 900 F.3d at 202 (citing Treas. Reg. § 1.170A-14(g)(6)(ii) &(h)(3)).

88 *Id.* at 204-205.

89 *Id.* at 203-204.

90 *Id.* at 204.

91 *Id.*

92 *Id.*

93 *PBBM-Rose Hill, Ltd.,* F.3d at 204.

94 *Id.* at 205.

95 *Id.*

However, for the easement to be considered exclusively for conservation purposes, it must also protect that conservation purpose in perpetuity. This brings us to the extinguishment regulation, and the term "proportionate value," which was of particular importance in this case. The Court of Appeals for the Fifth Circuit interpreted "proportionate value" to be "a fraction equal to the value of the conservation easement at the time of the gift, divided by the value of the property as a whole at that time."[96] In this case, the easement deed's extinguishment provision provided that the donee would be provided a portion of the proceeds of a sale or conversion of the donated property based on the fair market value at the time of the deed or proceeds after the expenses of the sale and the "amount attributable to improvements constructed upon the Conservation Area … are deducted."[97]

The Tax Court determined that the terms of PBBM's conservation easement failed to comply with the extinguishment regulation because "the donee would not receive the amount required by the extinguishment regulation in some circumstances."[98] The regulation does not include language that any amount may be subtracted from the portion of the proceeds owed to the donee.[99] The conservation easement deed contained language that allows the value of improvements to be subtracted out of the total proceeds from a future sale before the donee receives its portion.[100] On appeal, the IRS argued that the extinguishment provision could not include factors like the value of improvements that could potentially reduce the donee's proceeds below the minimum required by the regulation.[101] The Fifth Circuit agreed that the plain language of the regulation stated that the donee "must be entitled to a portion of the proceeds at least equal to that proportionate value," and included nothing about the subtraction of other amounts to that.[102] In fact, the regulation demands that the donee must receive at least the proportionate value of the proceeds.[103] Because the taxpayer's conservation easement deed allowed for a subtraction of the value of improvements from the proceeds, which could reduce the total donee proceeds below the proportionate value, the court held that the conservation easement violated the requirement set forth in the extinguishment regulation.[104]

Thus, the Court of Appeals for the Fifth Circuit held that PBBM's easement did not constitute a qualified conservation contribution, as its failed to comply with the statute's "exclusively for conservation purposes" requirement and with the terms of the related extinguishment regulation.[105] For that reason, the court held that the taxpayer was not entitled to a charitable contribution deduction.[106]

96 *PBBM-Rose Hill, Ltd.,* F.3d at 207.
97 *Id*.
98 *Id*.
99 *See* Treas. Reg. § 1.170A-14(g)(6).
100 *PBBM-Rose Hill, Ltd.*, 900 F.3d at 207-08.
101 *Id*. at 207.
102 *Id*. (quoting Treas. Reg. § 1.170A-14(g)(6)(ii)).
103 *Id*. at 207-08 (citing Treas. Reg. § 1.170A-14(g)(6)(ii)).
104 *Id*. at 208-09.
105 *Id*. at 209.
106 *PBBM-Rose Hill, Ltd.*, 900 F.3d at 209. The Fifth Circuit additionally decided on the issues of the valuation of the conservation easement and if PBBM was liable for the accuracy-related penalty, finding for the IRS on both issues. *Id*. at 213-215.

CONCLUSION

IRC § 170 and the accompanying Treasury Regulations provide detailed requirements with which taxpayers must strictly comply. The rules and regulations surrounding charitable contributions are complex. The IRS is focused on curtailing abuse in this area by designating syndicated conservation easements as a listed transaction[107] and abusive conservation easements as one of the top tax scams to avoid in 2019.[108] Thus, we anticipate that litigation will likely continue to increase and we will continue to see this topic as a most litigated issue. Taxpayers must carefully follow all aspects of the relevant laws and regulations when attempting to claim a charitable contribution deduction. Particularly, taxpayers must pay attention to the strict requirements for substantiation of a charitable contribution and to the elements of donating a qualified conservation easement.

RECOMMENDATION TO MITIGATE DISPUTES

The National Taxpayer Advocate recommends that the IRS:

- Develop and publish guidance to provide safe harbors and/or sample easement provisions to provide taxpayers with examples of how they may construct a conservation easement deed that satisfies the statutory requirements and prevent unnecessary litigation.

107 *See* IRS Notice 2017-10, 2017-4 I.R.B. 544, Syndicated Conservation Easement Transactions (these transactions deal with promoter companies obtaining inflated appraisals for real property and constructing conservation easement transactions that purport to give investors the opportunity to obtain charitable contribution deductions in amounts that significantly exceed the amount invested).

108 IRS, IR-2019-47, Abusive Tax Shelters, Trusts, Conservation Easements Make IRS' 2019 "Dirty Dozen" List of Tax Scams to Avoid (Mar. 19, 2019).