BLOG

More Government Missteps on Conservation Easement Deductions

by Pete Sepp | November 14, 2019

A fundamental principle of our system is that laws and policies should change only with sufficient public input—and notice.

Imagine the chaos, unfairness, and gradual erosion of confidence in that system if such a principle didn't exist. A police officer could pull over a motorist for obeying a 50 mph speed limit in a zone that's been marked that way for 40 years, and claim: "forget about what the signs say, your local government decided yesterday that beginning in 2016, the limit was 30. You should have guessed this was going to happen, so you owe us three years of speeding tickets." Such behavior – whether by passing new laws with extreme retroactive effects or by enforcing new rules through surprise – is especially abhorrent to taxpayers. Unfortunately, it is also relevant to recent moves by the Internal Revenue Service and Members of Congress to single out a group of taxpayers and stamp out longstanding policy toward tax deductions for conservation easements.

On November 12 the tax agency announced "a significant increase in enforcement actions for syndicated conservation easement transactions" – including considering criminal prosecutions, investigation of practitioners reported to the Office of Professional Responsibility, and an even more aggressive stance in court against the most minute details of easement deductions facilitated by partnerships.

As NTU has pointed out here, here, here, and here, to give just a few examples, the IRS's behavior toward those claiming this deduction has set ominous precedents for the rights of all taxpayers. The problem is encapsulated in the IRS's decision to make what it calls "syndicated" conservation easement deductions a "listed transaction," through IRS Notice 2017-10 issued in December 2016.

The IRS claims that all the enforcement steps it is taking now are perfectly justified and timely, given that taxpayers were warned that these were listed transactions even before the Notice was issued some three years ago. (Though, actually, the agency used it as pretext to examine easements concluded as early as 2010.) Yet, as a recent article in *Tax Notes* (subscription) by legal expert Jenny Johnson Ware contends, the IRS has been effectively moving the goalposts of what it believes are legitimate enforcement actions against taxpayers, creating a clear conflict with two recent NTU-supported Executive Orders that call for regulatory reform. Johnson Ware also showed that more than 80% of the deduction values reported by taxpayers were upheld in tax court cases where decisions were made on valuation.

A specific problem is that IRS actions violate one of the Order's instructions: agencies are to abide by the Supreme Court's interpretation in *Christopher v. SmithKline Beecham Corp.* (2012) of avoiding "unfair surprise" in enforcement actions. This occurs when a government entity gives benign neglect or even asset to what are permissible acts under regulations, only to suddenly reverse course and begin punishing citizens who had no advance warning of a change in policy.

Prior to and with the release of Notice 2017-10, the IRS did indeed indicate that it would be taking a hard look at the overvaluation of conservation easements that led to tax deductions. But taxpayers could not have possibly known that the Service would increasingly begin challenging standard features of easement agreements about their perpetuity (and other matters) that the practitioner community and the tax agency had regarded as standard practice. As Johnson Ware put it:

> [T]he IRS persistently works to avoid the question of the value of the easement, both in audits and litigation. In particular, the agency has been scouring the grant instruments, looking for provisions that it argues run afoul of its newfound interpretation of perpetuity requirements. Taxpayers that have made a good-faith effort to comply with the requirements are caught in a game of 'gotcha,' in which the IRS disallows the entire charitable deduction based on alleged noncompliance with supposed prerequisites that it has never articulated outside litigation and that contravene the legislative purpose of section 170(h) [the conservation easement deduction].

Johnson Ware recommended that the Service "revert to its congressionally mandated role in policing these easement deductions – ensuring that taxpayers are not getting away with excessive valuations – leaving the protection of the conservation purpose to the done organization." Otherwise, the IRS will be in violation of the Trump Administration's Executive Orders, not to mention the basic precept of fairness.

Alas, some in Congress appear willing to compound this troublesome development, with legislation (H.R. 1992 and S. 170) that would claw back certain conservation easement deductions from 2016 onward, tying the clock to IRS Notice 2017-10. Ironically, if this legislation became law tomorrow, taxpayers would lose the value of some of those deductions taken as far back as three years ago, but the underlying easements that reduced the value of their undeveloped land would remain. Retroactivity is bad enough; selective retroactivity is worse.

It is difficult to conceive of a more negative message for taxpayers claiming this or any of a number of other deductions for charitable causes: you can lose your property rights and your tax savings years after your contribution just because Congress believes you should. So much progress toward conserving millions of acres of land thanks to the easement deduction could be seriously damaged.

Supporters of the legislation will respond with the same line of argument as the IRS has made: taxpayers and practitioners knew in 2016 that partnership conservation easement tax deductions were under scrutiny. There is a big difference between scrutiny and legality, and again, the message being telegraphed at the time of the IRS Notice issuance was that the appraisals and associated valuations of those easements were getting a hard look. When the IRS got justifiable pushback from the courts on its exotic theory that the valuation of virtually any partnership easement should be zero, the agency pursued completely unanticipated new tactics, challenging commonly-employed features of easement agreements (see above).

And then, there's that pesky founding document of the United States in the way again. For more than 200 years, the U.S. Supreme Court has interpreted how the Constitution's prohibition on Congress and state legislatures passing ex post facto legislation applies. One of the more recent rulings, *U.S. v. Carlton* (1994), held that retroactive tax laws, in particular, can be constitutional when they are "supported by a legitimate purpose furthered by a rational means." To the Court (and NTU), one limited example of a "legitimate purpose" would be making a technical correction to ensure a law's language was consistent with what the drafters of that law expressly intended. The Court made clear that *Carlton*"established only a modest period of retroactivity" at 14 months, again signaling the limits of the judiciary's patience.

Based on this jurisprudence, it would seem apparent that the three-year retroactivity contemplated under H.R. 1992 and S. 170 is a serious outlier, subject to Constitutional challenge. In most Supreme Court rulings that have upheld retroactivity, justices have made exceptions for the fact that the laws in question did not involve punishments for criminal offenses. It would be highly suspect for the government to claim that a stripped tax deduction isn't a punishment, or that the IRS's criminal investigations don't rise to a more serious level of the law.

Government missteps like these aren't just a problem for those making them – as our filing in the *PBBM-Rose Hill* case attests, taxpayers' rights can get trampled in the process. Both the IRS and Congress need to get increasingly clumsy tax policy toward conservation easements on a surer footing now.