Shortsighted:

How the IRS's Campaign Against Conservation Easement Deductions Threatens Taxpayers and the Environment

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Introduction

The struggle for taxpayer rights and safeguards against overreach from the Internal Revenue Service has occupied National Taxpayers Union (NTU) for the better part of five decades, involving at least 10 significant legislative or administrative reform initiatives such as the Taxpayer's Bill of Rights and the Taxpayer First Act.

Each of these necessary course corrections has been preceded by a few seemingly small but telltale signs that the system of tax administration is headed for a major malfunction. Conventional, rarely-used tools of enforcement such as civil asset forfeiture, joint liability for couples in tax disputes, and the designated summons power for uncooperative taxpayers become weaponized to threaten much larger portions of the filing population. These developments in turn often portend a more aggressive Service-wide stance toward taxpayers, one that requires swift intervention from policymakers.

So it is today with the IRS's actions toward conservation easements and the agency's misguided policy toward conservation partnerships. In a conservation partnership – be it organized in an LLC, S-corporation, or other form of partnership – two or more unrelated individuals own an interest in environmentally-important land and forego the option of developing the land to instead make a conservation easement donation. These partnerships have helped increase U.S. land under conservation by over 175% between 2005 and 2015[1]. Despite the fact that conservation partnerships have facilitated Congress's goal of increasing the area of land under environmental protection through private-sector initiatives, the IRS in late December 2016 arbitrarily decided to make a partnership arrangement a "listed transaction".

As one of the IRS's harshest enforcement mechanisms, carrying with it intrusive examinations, onerous taxpayer recordkeeping burdens, and stiff penalties, the "listed transaction" designation need never have been unleashed against conservation partnerships. These taxpayers were already providing the IRS with abundant tax filing disclosures that furnish the government with ample means to audit partnership transactions. Simple, straightforward adjustments to reporting, appraisal, and other compliance matters, in due consultation with the public and Congress, could have addressed any legitimate concerns.

As this paper will show, tax administrators have trampled upon key protections of NTU-backed laws while pursuing their agenda, and taxpayers in all kinds of compliance and collection due process situations are now endangered from the precedents established by the government's capricious behavior. Equally troubling, by imposing new opportunity costs on Americans participating in conservation partnerships the IRS has undermined the benefits to taxpayers across the country of allowing private citizens instead of the government to exercise stewardship over our precious lands.

This policy paper, the first in a new NTU series on tax administration issues, will explore the history of the IRS's unjustified attacks on conservation easement donations in general and partnership donations in particular, while dispelling the myths that led to these missteps. In so doing, we hope to demonstrate that conscientious public officials in all branches of government must not only right current wrongs, but avoid future ones.

The Conservation Easement Donation: A Success by Any Measure

Arrangements setting aside land for conservation can take several forms, only one of which is direct government ownership and administration. "Fee simple" donations or sales of property, transfers of development rights, and charitable gift annuities are other options for landowners to set aside property for conservation in the future. Over the past several decades, however, easement-based donations are an increasingly popular option. Most conservation easements are accepted and administered by land trusts, which are established as non-profit organizations.

The concept of an "easement" – whereby a property owner grants a non-owner access to the land for specific purposes – is embedded in centuries-old English common law. An easement for purposes of conservation is simply a variant of this time-honored mechanism: it is a legal agreement (more formally a vested property interest) between a property owner and a government or non-governmental entity that allows the owner to retain title and some use of the land, but within the limits of conservation purposes defined in the agreement. The easement governs land use even after the owner dies and the property is bequeathed or sold to others. Typical conservation uses might include preservation of farmland against commercial development, habitat preservation, responsible fishing and hunting on otherwise undeveloped property, a public park, or maintenance of a timber forest as a carbon sink.

The term "conservation easement" did not enter the common American lexicon until journalist William Whyte began using it in the late 1950s. Whyte's book *The Last Landscape* was instrumental in the formulation of land policy options employing private rights.

In the United States, one of the first recorded instances of what would today be called a conservation easement was Frederick Law Olmsted's protection of the Boston Greenways for public use. In the 1930s and 1940s, easements helped to establish what would over time become significant tracts under the jurisdiction of the National Park Service (NPS).[2] But few Americans appreciate the fact that the NPS is but one component of conservation across the country.

All told, more than 55 million acres have been set aside for conservation voluntarily through land trusts[3], much of which comes from conservation easements. A public-private data tracking partnership reports that there are more than 158,000 conservation easements in effect today, covering over 27 million acres of vital wildlife habitat, open spaces, wetlands and rangelands, historically important property, and areas for public enjoyment.[4] This is a conservative estimate, but even so, the "low-end" figure of 27 million acres under conservation easements almost exactly matches the total land ownership of NPS in the Continental U.S.[5] While other federal agencies own much greater acreage, the percentage growth in voluntarily conserved land has been dramatic – increasing eight-fold in 30 years.[6]

One key to this rising success has been the establishment and expansion of the federal charitable income tax deduction for conservation easements, as well as state programs that preceded and followed the implementation of the easement deduction.[7]

Congressional Support for the Deduction: A Bipartisan Compact

It was the Internal Revenue Service itself that first opened the door for federal tax deductions related to conservation easements. A 1964 IRS Revenue Ruling declared that "a restrictive easement in real property to enable the federal government to preserve the scenic view afforded certain public properties, is a charitable contribution within the meaning of Section 170 of the Internal Revenue Code."[8]

Congress decided to create a statutory deduction (Section 170(h)) for conservation-related charitable contributions in the Tax Reform Act of 1976, immediately following a section of the bill establishing accelerated depreciation and amortization of expenses for rehabilitating historic structures. According to the Joint Committee on Taxation's general explanation of the Act:

> Congress believes that the rehabilitation and preservation of historic structures and neighborhoods is an important national goal. Congress believes that the achievement of this goal is largely dependent upon whether private funds can be enlisted in the preservation movement.[9]

The philosophy of enlisting the private sector to achieve public policy goals also guided the creation of the conservation deduction, but the provision was initially given a mere one-year lifespan. Donations of leases, options to purchase, or easements of 30 years or more to a government or a qualified charity were eligible, provided they were exclusively for conservation purposes (defined as land for public recreation, natural habitats, open space, or historic preservation). The Tax Reduction and Simplification Act of 1977 subsequently extended the provision for a year and required easements to be "in perpetuity" to qualify for a donation. The Tax Treatment Extension Act of 1980 cemented the deduction more permanently in the Tax Code.

> Even as the IRS initiates hundreds of conservation contribution examinations and sends dozens of cases to the Tax Court, the IRS is well aware of the sustained congressional support of the conservation contribution deduction.[65]

Yet even though the deduction carried significant Congressional support, attacks from outside Congress and the Treasury have sometimes taken a toll on the goal of private conservation. In 2003 and 2004, *The Washington Post* published a series of articles claiming that taxpayers were abusing the easement deduction for historic building and land preservation (sometimes called "façade easements") by obtaining inflated valuations.[10]

The appraised value of the conservation easement donation determines the amount of the deduction a taxpayer can claim from making the choice to conserve property. As a result, ensuring that the qualified appraisal of the conservation easement is equal to the fair market value of the development rights being forfeited by the landowner is a key issue.

During the time of the *Post's* reports, the IRS had already dramatically stepped up its audit and enforcement activity surrounding these deductions. Following Congressional deliberation, the Pension Protection Act of 2006 tightened the rules on façade easements, such as widening applicability of accuracy-related penalties and adding statutory definitions of what constituted qualified appraisals and their appraisers. Lawmakers also gave special recognition to the importance of the conservation easement deduction by making deductibility rules more generous than those for other capital assets. Instead of providing for a conventional 30 percent maximum deduction against Adjusted Gross Income (AGI), with any excess carried over for up to five years, the enhanced levels for conservation easements were 50 percent of AGI and 15 years of carry-over.

Since that time, a great deal of bipartisan unity over the merits of the conservation easement deduction has endured, despite often bitter disputes between Democrats and Republicans on the overall direction of tax policy. In 2015, when the Republican-controlled House Ways and Means Committee marked up H.R. 641, the Conservation Easement Incentive Act of 2015, to strengthen and make Section 170(h) permanent, Chairman Paul Ryan and his colleagues noted:

> The deduction for qualified conservation contributions was intended to spur new donations of conservation easements. According to testimony received by the Committee, in the first two years following its original enactment, the temporary rule doubled the number of conservation easement donations in comparison to the two prior years, and increased the acreage conserved by about 32 percent. H.R. 641, will continue these results by providing certainty and stability to individuals and businesses seeking to contribute conservation easements.[11]

The vote to report H.R. 641 to the floor split across party lines, but that is not the end of the story. In their dissenting statement to the Committee's report, Democrats objected to this and other bills making certain deductions permanent because of their fiscal impact as well as what they perceived as a piecemeal approach to tax reform. Democrats on the panel were still remarkably unified over the conservation easement deduction as wise tax policy, stating:

> We all support the good works of the charitable community and strive to provide the resources that encourage taxpayers to make decisions that preserve our environment. The markup was not to debate the conservation efforts across this country, or the merits of H.R. 641, which would make permanent provisions to encourage taxpayers to make qualified conservation contributions.[12]

Congress made the enhanced conservation easement deduction from 2006 permanent with passage of the Protecting Americans from Tax Hikes (PATH) Act of 2015. One aspect of this exercise was that the PATH Act contained a codification of a Taxpayer Bill of Rights that IRS National Taxpayer Advocate Nina Olson had originally formulated. First adopted administratively, this document outlined 10 taxpayer protections such as the Right to be Informed, the Right to Challenge the IRS's Position and be Heard, the Right to Finality in disputes, and the Right to Appeal an IRS Decision in an Independent Forum.

As the next section will detail, since passage of the PATH Act the IRS has often disregarded all of the rights articulated above in its campaign against conservation easement deductions, despite a large body of evidence showing they underwrite a form of private land stewardship that is far more efficient than the government's own programs.

Private Land Stewardship: A Tremendous Value for Taxpayers

Americans who claim conservation easement deductions as provided by Section 170(h) of the Tax Code are able to keep more of their hard-earned money. This is not a "cost" to the Treasury any more than the standard deduction for non-itemizing tax filers may be. The 150 million-plus federal taxpayers who *don't* claim easement deductions collectively benefit to an even greater degree than those who do.

According to the most recent IRS statistics available, individuals reported deductible noncash contributions of easements totaling $2.3 billion in 2015, down from $3.2 billion in 2014.[13] A recent IRS communication to the Senate Finance Committee estimated that 2016 deductions from taxpayers making easement donations (including businesses and partnerships) could total more than $6 billion for 2016,[14] but without access to the underlying data it is difficult to conduct a consistent comparison. Whether the amount of taxpayer deductions is $3 billion or $6 billion, there are a number of additional fiscal and societal benefits that can be associated with the conservation easement deduction. In any case, a deduction is not the same as actual tax savings: $1 deducted from taxable income might at most result in about 40 cents of lower tax liability.

First and foremost, taxpayers are spared more expenditures coming directly from their pockets for government conservation agencies. An entire alphabet soup of federal entities own and administer lands, ranging from the Bureau of Land Management (BLM) and the Fish and Wildlife Service to the National Park Service and the U.S. Forest Service. A precise inventory of all federal lands has yet to be established, but the best estimates are that Washington controls some 640 million acres in the United States.[15] Nor is there a detailed accounting of how much the federal government spends each year on land management. However, based on the budgets of the federal agencies most responsible for overseeing this property, Washington expends at least $15 billion per year doing so.[16] According to the Property and Environment Research Center (PERC), expenditures associated with state trust lands amount to another $16.5 billion.[17] Even local agencies are involved in conservation.

These financial resources, like the public lands they are supposed to support, are not always administered wisely. Troubling anecdotal incidents as well as structural flaws in agency budgets should give taxpayers pause. A small sample of these follows.

- Since the 1980s, NTU has raised concerns about the federal government's poor oversight of economically valuable resources on public lands. From 2008 through 2013, the Forest Service spent $139.1 million (including road construction) to support timber sales in the Tongass National Forest, while receiving just $8.6 million in return.[18] Other organizations have critiqued programs such as the Bureau of Land Management's grazing fee system, which massively underprices its charges compared to the fees levied on private lands.[19]
- At the behest of particular lawmakers, the National Park Service (NPS) has historically been forced to maintain sites of relatively low importance that attract few visitors. A house that Edgar Allan Poe rented for roughly a year consumed an average of $25 per visitor to

maintain, while a Eugene O'Neill site devoured $175 per visitor. Both sites were actually managed locally before Members of Congress added them to NPS. Perhaps most ironically, the Frederick Law Olmsted site in Massachusetts required an expenditure of nearly $500 per visitor.[20]

- Aside from management issues with lands, the federal government has serious difficulties managing facilities sitting on those lands. The Government Accountability Office (GAO) has designated "Federal Real Property" as a "High Risk" area for wasted tax dollars since 2003. Twelve years after this designation, federal agencies reported over 7,000 excess or underutilized properties, costing billions of dollars in maintenance as well as foregone revenues from potential disposals; this survey is incomplete owing to deficient data standards. One challenge the GAO noted in reconciling this imbalance is the cost of environmental remediation for many facilities. Stewardship of these assets is often poor.[21]
- Despite tens of thousands of public employees and hundreds of thousands of volunteers, maintenance backlogs for facilities, infrastructure, fencing, and other necessities on public lands have remained high. The Congressional Research Service estimated the combined Fiscal Year 2016 backlog for NPS, the Bureau of Land Management, the Fish and Wildlife Service, and the Forest Service at $18.6 billion.[22]
- Individual programs within the federal conservation sphere consistently come under criticism for lack of fiscal or environmental diligence. Among these is BLM's wild horse and burro sterilization program, which a National Academies of Science study took to task: "How Appropriate Management Levels (AMLS) are established, monitored, and adjusted is not transparent to stakeholders, supported by scientific information, or amenable to adaptation with new information and environmental and social change. Continuation of 'business as usual' practices will be expensive and unproductive for BLM and the public it serves."[23]

The fact remains that relentless, demographically-propelled increases in federal expenditures on major entitlement programs, and a recent ramp-up in Pentagon spending[24] have made massive funding increases for federal conservation programs unlikely in the near term. Voluntary, private methods of conservation, such as easements, will become all the more critical in the future. As a Colorado State University Study put it:

> Given the perpetual requirements of conservation easements, the benefits they provide are expected to continue to accrue into the future and increase on a per-acre basis due to …increasing population and wealth and decreasing supply of open lands. *The cost of making such investments is lower now than it will be in the future* [emphasis added].

Unlike hopeful agency budget requests or government restructuring plans that take years to implement, conservation easement deductions are available in the "now" to make these types of investments.

> The tension between these two positions on conservation easement deductions – aggressive enforcement and preservation of preferential treatment – sends a mixed signal to donors and taxpayers.[66]

Voluntarism is already relieving the fiscal strain at some of the federal government's own agencies. NPS relies on a network of over 315,000 volunteers who perform everything from park stewardship to assisting in archeological digs. A September 2018 *Washington Post* article – alas, uncovering what volunteers called a "hostile and unsafe work environment" – reported that the 65,000 hours of service volunteers put in at just one park had a value of $1.6 million. Extrapolated across NPS's claim of 7.2 million hours across the entire system, this would mean that the federal government received the equivalent of $177 million in "free" labor for National Parks last year.[25]

An equally important question in evaluating the contribution of private conservation is its efficiency compared to the public sector, especially the federal government. While no two parcels of land are the same, some interesting comparisons can be made.

As stated previously, by one estimate some 55 million acres are conserved under land trusts, which employ just over 8,000 part-time and full-time staff and nearly 208,000 volunteers.[26] The National Park Service, by contrast, administers 85 million acres (more than two-thirds of it in Alaska alone), with over 20,000 employees and roughly 315,000 volunteers.[27] On a per-acre basis, land trusts manage nearly 40 percent more area per employee than NPS. That difference would likely be even greater if Alaskan holdings were excluded. Critically, the ratio of acreage managed on a per-volunteer basis is roughly the same for land trusts as it is for NPS – an indication that even in a bureaucratic setting, non-government labor is more efficient.

Yet there are also major differences in the efficiency of federal versus state management of lands. Because state trust lands are statutorily required to raise revenues in perpetuity for the fiduciary benefit of their citizens, they are motivated to manage overhead while maintaining economic viability over the long term. According to PERC's analysis of multiple-use federal lands and a sampling of four Western States trust lands, Washington spends an average of six times more per acre on management than states do. On the other hand, states net ten times more revenue per employee than the federal government does with its land. Adjusted for cash flows, the states

PERC analyzed earned $14.51 per acre for every dollar spent, while the federal government could only generate 73 cents (a loss).[28]

It would be a mistake to attribute this difference to higher-quality land owned by states, or wanton exploitation of resource extraction. Again, states must manage their land in perpetuity, and in fact an increasing number of states are leasing trust lands to environmental groups that pay to preserve the properties. According to PERC:

> Unlike state trust lands, federal lands generally cannot be leased for conservation purposes. Instead, conservation on federal lands is accomplished primarily through regulatory restrictions or congressional designations such as parks or wilderness areas. In other words, conflicting demands on the federal estate are resolved through a political process rather than a market-like process of competitive bidding on state trust lands. This competitive bidding process on state trust lands forces groups to bear the costs of alternate land uses that must be foregone, regardless of whether the land is leased for resource extraction or viewshed protection.[29]

The parallels here to private conservation easements are unmistakable. State trust lands balance economic interests with other public uses and societal goals, encouraging the kind of collaboration that easement donors routinely have with land trusts and environmental organizations. States administer trust lands with the same type of perpetuity requirement under which easements must be drawn in order to qualify for a tax deduction. Finally, states tend to take the more realistic view that regulatory, penalty-based approaches toward conservation will not foster the entrepreneurial, innovative stewardship that incentive-based approaches can.

Even more direct comparisons are possible between public and private stewardship of so-called "working lands" – places where economic production and conservation coexist. In 2009 PERC conducted an extensive analysis between two forests bordering each other in Montana – one (the Lolo National Forest) managed by the U.S. Forest Service, the other (the Flathead Reservation Forest) managed by the Confederated Salish and Kootenai Tribes. Both properties devoted close to the same proportion of forest to timber production, and both employed roughly the same methods of management. Although the type of timber was somewhat different, both forests had similar volumes of harvestable growth within their confines. Both charged fees for recreational use of their property, and both had robust wildlife conservation programs. PERC Research Fellow Alison Berry determined that over a seven-year period, the federally-run forest averaged just 11 cents of return on every dollar spent for cultivating timber. The Flathead Reservation Forest managed a return of $1.04. Management costs at Lolo were as much as 62 percent higher than Flathead, due to both the number and compensation of personnel to do similar work.[30]

A comprehensive overview of land trusts and market-based environmentalism by Eric Montague of the Washington Policy Center provided another useful comparison and contrast between government and private management of property, with Seattle's Ravenna Park. Originally created by the Beck family in the late 19th century, the park was an admission-based venue open to the public with all manner of exotic plants and old-growth trees. By any perspective, the park was a popular and well-run habitat. In the early 20th century, however, the City of Seattle used condemnation power to strip the Becks of their ownership. It was later discovered that under government ownership, old-growth trees were being removed for firewood under the corrupt leadership of the City's Park Superintendent. As Montague noted, "Park engineers assured the community the trees would remain, but soon all the trees were gone, removing any hope residents once had of restoring and preserving the once magnificent stand of old growth destroyed under public management."[31]

Private conservation easements can deliver even more important benefits. In the presence of the federal estate tax, financial planning for taxpayers who want their productive lands to remain intact is imperative. A conservation easement donation can assist in this task. By donating part of a ranch or farmland that is less productive agriculturally than the rest of a given property, the owners limit the taxable value for estate or gift tax purposes while protecting open space and creating a legacy for the next generation of owners. Although the Tax Cuts and Jobs Act reduced estate tax burdens, the top rate remains high at 40 percent. Private conservation easements can provide vital financial breathing room for establishments that might otherwise not be economically viable.[32]

> "Conservation will ultimately boil down to rewarding the private landowner who conserves the public interest."
> - Aldo Leopold[67]

Taxpayers are likewise left to wonder how a private-easement architecture could have saved long-run costs from natural disasters. In 2006, National Taxpayers Union joined with Taxpayers for Common Sense, Environmental Defense, and the National Wildlife Federation to examine government planning failures that worsened the impact of Hurricane Katrina in Louisiana. One major factor was the Army Corps of Engineers' politicized funding process that shortchanges key projects. In the name of flood control, the Corps built levees in Louisiana that prevent the interchange of silt and freshwater that once re-nourished wetlands near New Orleans and other populated areas. In addition, it created the Mississippi River Gulf Outlet Canal, a waterway that was never cost-effective despite large government expenditures. Meanwhile, other wetlands were drained by the Corps to support crops.

With these policies in effect, there was a loss of tens of thousands of acres in Louisiana wetlands, which are scientifically demonstrated to absorb storm surge. What if, instead, conservation easement programs had been allowed to supplant the Corps' clumsy policies and wetlands had instead been preserved? We will never know for certain, but taxpayers cannot help but wonder if some of the $100 billion-plus government expenditure to rebuild after Katrina might have been mitigated.[33]

While most public servants in the conservation field are conscientious and well-intentioned, Washington Policy Center's Montague illustrates a key advantage of private land conservation and easements: decision-making is based on the owner's good will as well as economics, instead of public policy directives that can have political motives behind them. Critics often complain that easement deductions facilitate transactions involving ecologically undesirable land. Yet, they fail to mention that governments themselves blatantly engage in such transactions. Accusations were leveled at President Obama for abusing the Antiquities Act to set aside land under monument designations, while President Trump has come under criticism for allowing more development on government property.[34]

A great deal has been written on the advantages to taxpayers of private conservation, but what of easements themselves, and the federal and state tax deductions that have helped to strengthen them? Because so much conservation policy has been driven by punitive government restrictions and regulations, cost-benefit analyses of easements and tax policies built around them is still formative.

One important study conducted in July 2017 by Colorado State University (CSU) researchers employed some of the most sophisticated econometric methods to examine the economic benefits from Colorado's $1.1 billion "investment" (in 2017 dollars) in conservation programs over 22 years. Approximately ¾ of this sum consisted of state conservation easement tax credits, with the remainder consisting of state grants to purchase easements that are backed by lottery proceeds. Researchers examined 11 separate ecosystems affected by the two programs, assessing benefits ranging from flood control to pollination of crops. The study concluded that each dollar of tax credits and/or grants returns between $4 and $12 in public environmental goods and services benefits.[35]

CSU relied in part on a research framework developed by the Trust for Public Lands (TPL) for the Commonwealth of Virginia's conservation programs, which found a 4 to 1 return on investment. Interestingly, this report found a correlation with land stewardship and property taxes:

> Research conducted in six Virginia counties shows that on average, residential lands require $1.18 in services for every dollar paid in local taxes. At the same time, working and open lands only require $0.35 in services for every dollar contributed in property taxes. Virginia

> communities recognize the importance of balancing growth and conservation in a way that maintains fiscal health.

Other effects identified in TPL's research include employment from outdoor recreation and reductions in health care costs from more active lifestyles – factors which the Trust has analyzed in more than a dozen other states.[36]

Still, it is important to remember that private land conservation efforts are not some cost-free exercise, whereby the landowner simply reaps the rewards of tax deductions and land trusts blithely sit on donations. As far back as 2000, economists had calculated that the overhead of properly structuring an easement – such as a title search, an appraisal, and surveying – amounted to an average of $83 per acre.[37]

As the next section will detail, this amount has certainly increased a great deal, primarily because of government pressure. Appraisers willing to value easements could be becoming scarcer as the IRS wages its battle against Section 170(h), while taxpayers attempting to take lawful deductions must make many additional expensive preparations with the assistance of tax practitioners to audit-proof their transactions. Unless the IRS rethinks its overly aggressive stance against conservation easements, or Congress steps in to once again affirm its intent, the progress and momentum that voluntary, private initiatives have given to conservation could be endangered.

The IRS Attack on Easements

The Treasury and IRS have claimed to respect the will of Congress throughout the history of the conservation easement deduction. In 2007 for example, the IRS's Tax Exempt and Government Entities Division Commissioner wrote of the historic structures deduction, "As we administer Section 170(h), our goal is to carry out Congressional intent faithfully; we wish to do nothing to discourage or deter the donation of legitimate façade easements."[38] In 2015, the Treasury signaled that it would agree with Congress's subsequent decision (in the PATH Act) to make permanent the enhanced deduction:

> The current tax deduction for conservation easement donations has been an important incentive for conservation, but it has been of limited value to some donors. Although these donors may own very valuable property, if they have relatively modest incomes, then the current percentage of income limitations and five-year carryforward provision limit their ability to deduct the full value of their conservation easement donations.[39]

In reality, the agencies' words have proven to be contradictory. The IRS and Treasury have continued to make statements that appear innocuous, yet impose massive compliance burdens, thereby creating precisely the "limited value" they decried when criticizing the law prior to PATH. Their actions have left little doubt where their intent lies. Despite the clear, distinguished legislative pedigree and demonstrable fiscal and social utility, the deduction is under full assault today.

Opposition to conservation easement deductions inside and outside of government initially centered on a few points:

1) Valuations. In order to determine the most accurate amount for a conservation easement tax deduction, an arm's length appraisal of a property's value must be conducted. IRS regulations require that a qualified appraisal be based first on comparable sales of easements – a misnomer in the sense that a "sale" is a one-time only transaction of a single easement that is then no longer marketable. But since such comparability of easements is so rare, the alternative "Before and After" method is most often used. The Fair Market Value of a property is calculated at its "highest and best use," defined by the Appraisal Institute under four criteria of "legal permissibility, physical possibility, financial feasibility, and maximum productivity."[40] The reduction of the Fair Market Value based on highest and best use *before* the easement is granted versus *after* becomes the value of the deduction. It is important to remember that a conservation easement itself does not have any conventional cash value to the land trust or other organization receiving it, because a donated easement cannot be resold for the amount of the deduction claimed by the donor. In fact, most land trusts list a conservation easement as an asset that had a less-than-zero value, given the perpetual obligation to steward it.

> Private land conservation is already the wave of the future. Congress and the environmental community should encourage this trend because the environment is likely to be a winner, not a loser.[68]

Since Congress created the conservation easement deduction, the IRS has often challenged the appraisals underlying them. In fact, the agency has often taken a "zero valuation" stance in audits and collection due process actions against taxpayers, for various and sometimes absurd reasons.

In some cases, however, legitimate differences exist in appraisers' opinions that affect the value of a property. NTU has encountered this very phenomenon in the residential property tax appeals process.[41] But differences of opinion should not serve as a reason for the government to assume nefarious motives on the part of taxpayers. *Cave Buttes, LLC v. Commissioner* (147 T.C. 338 2016), is a case where the taxpayer's appraiser valued a deduction on a property sold to a local government at nearly $2.2 million, while the IRS's appraiser estimated the proper deduction to be no more than $500,000. The gap was attributable to differing opinions on whether the property actually had legal access attached to it. The Court sided with the taxpayer.[42]

2) Qualifications. Congress has through legislative history stipulated that an easement qualifying for a deduction must be contributed "exclusively for conservation purposes," which are defined in statute as preservation of land areas for "outdoor recreation," "protection of a relatively natural habitat," "the preservation of open space," or "the preservation of a historically important land area or certified historic structure."[43] The IRS can and has quibbled in court over every single word of this area of law.

For example, the IRS has recently adopted the strategy of attacking the deductibility of conservation easements by arguing that, notwithstanding the donated easement undeniably achieving at least one of the Congressionally-mandated conservation purposes, the donation did not achieve "enough" of the targeted conservation purpose. This approach was, unfortunately, recently sustained by the Tax Court in its opinion in *Champions Retreat v. Commissioner*, T.C. Memo. 2018-146. Despite the presence of threatened and endangered species on the conserved land, the Court provided an in-depth explanation of why the present species were not threatened or endangered sufficiently to warrant a deduction.

Most of the waves that threaten to drown taxpayers' rights have been preceded by a few barely discernable ripples.

This development is profoundly concerning because it means the IRS and the judiciary may now subsume the decisions of what makes good conservation – decisions that were formerly left to land trusts and governmental conservation experts.

3) Easement Structures. A host of regulatory requirements must be met in order for an easement contribution to be eligible for a tax deduction, including proper definition of a qualified interest and protection in perpetuity/survivability clauses. Whereas tax practitioners had generally been able to rely on certain easement features as taken for granted by the tax agency, this has recently come into question through a number of court cases involving the IRS. Tax experts Gregory Rhodes and Tucker Thoni warned of six "IRS attacks" on the easement deduction that have evolved through recent litigation and other activities. One example they cite as "troubling" is the IRS taking issue with "amendment clauses" in easement agreements, which allow both parties, by mutual consent, to make prudent adjustments that ensure evolving realities are taken into account for preserving land in perpetuity. Amendment clauses are common, hitherto noncontroversial features of many easement agreements.[44]

4) Procedural Issues. Claiming a conservation easement deduction requires donors to prepare, obtain, and file with the IRS (and others) a significant amount of paperwork about all aspects of the easement transaction. IRS examiners have focused microscopically on matters such as these, even while turning a blind eye to their own lapses. In the *Cave Buttes* case, the IRS quibbled that the appraisers' report did not list the qualifications of both personnel involved, that the appraisal team did not sign Form 8283 (there is only one signature line on the IRS Form), and that the appraisers' report stated it was made for "filing with the IRS" instead of using the "magic words" of "for income tax purposes." The Court threw out these assertions.[45]

5) Demographics. Critics in the policy community with ideological views argue that easement deductions are growing "too rapidly," or are being claimed by the "wrong people," or are facilitating ecologically undesirable conservation projects, or that "syndicated" easements are somehow sinister compared to "regular" easements (whatever that term may mean).

Standards can and should be improved to ensure that "conservation purpose" is designed to weed out easements that are of little benefit to society. In that process, however, it is important to recognize that small parcels of land in highly-valued areas can indeed improve the local ecology.

Conservation land trusts have become increasingly popular in large American cities such as Baltimore, New York, and Philadelphia.[46] Many of these parcels are little more than the size of gardens or front lawns. To give just one example, the nonprofit group Oregon Conservation Strategy observes:

> Urban areas have an important role to play in imperiled species protection and recovery. Many imperiled plant and animal species occur in urban areas. For example, the Eugene area serves as a stronghold for many federally-listed prairie species; the recently federally-listed Streaked Horned Lark is found in mostly urban and agricultural habitats. Some of the largest populations of sensitive painted turtles are found in urban areas. The formerly threatened but now delisted Peregrine Falcon benefited from using artificial nesting structures, such as bridges, in urban areas.[47]

Certainly, not many of these lands are being conserved under easements offering tax deductions, but they illustrate that "quality" conservation projects can be any place, in any size, with many values.

The more immediate practical question is whether the conservation easement deduction can serve limited government ends while being policed in a manner that respects taxpayer rights. The answer is that it can, but current policy may not be doing so. More important is the question of whether enforcement strategies toward conservation partnership deductions are serving as a bellwether of worse things to come for the entire system of tax administration. In NTU's experience, the answer is that they could be.

"Listed Transaction": An Extreme Response with Extreme Consequences

In December 2016, IRS pressure intensified when the tax agency issued Notice 2017-10 that declared certain "syndicated" conservation easement deduction arrangements to be "listed transactions." According to the IRS, such transactions "purport to give investors the opportunity to obtain charitable contribution deductions in amounts that significantly exceed the amount invested." As a result, any participant in a partnership-based easement since 2010 resulting in a deduction greater than 2.5 times the amount of the investment must file IRS Form 8886, a Reportable Transaction Disclosure Statement. People the IRS identifies as "Material Advisors" must file their own disclosures on IRS Form 8918.[48] Taxpayers had six months to digest and implement the massive, retroactive changes to procedure that this notice entailed.

Notice 2017-10 is written in the typically dry language of tax regulations, decipherable only to a few. This document in reality sanctions a plethora of enforcement actions that have a grave impact on taxpayers and practitioners. The Notice is really taking aim at what is conventionally known as a partnership easement deduction – which is nothing more than an arrangement allowing several taxpayers to share in an easement and report proportional deductions based on their participation amount.

Listed transactions are the most severe level of the IRS's suite of "reportable transactions" overseen by the Office of Tax Shelter Analysis at the Large Business and International Division of the IRS. Since their creation in 1990, a total of 36 listed transactions have been issued, only two of which have been announced since 2009.

The introduction to this paper warned that historically, most of the waves that threatened to drown taxpayers' rights have been preceded by a few barely discernable ripples. The departure of IRS Notice 2017-10 from established listed transaction norms is a troubling enough sign, but there are other aspects of the IRS's crusade in this area that should concern all taxpayers. NTU has observed all of them in previous incarnations applying to other areas of the Tax Code.

1) Retroactivity. Besides a short six-month timeline for implementation, IRS Notice 2017-10 applied to all tax returns filed in Tax Years 2010 to the present. The recordkeeping, substantiation, and compliance requirements that taxpayers and their advisors met prior to the notice were already quite considerable. Of the 10 most recent listed transactions, only two (including Notice 2017-10) have been made retroactive, and for good reason.

For the agency to impose new form filings, expand the circle of parties subject to its enforcement, create new penalties, and assert its new positions in court against common features of easements is a sufficiently daunting compliance task going forward. To force taxpayers and their advisors to look back eight years and be prepared to meet this task for past returns sends the unmistakable message that the IRS is substituting its own opinion rather than that of Congress on the legitimacy of the deduction.

2) Lack of Public Input. Any substantial administrative action or policy can benefit from the advice of stakeholders. Nowhere is this truer than with the Tax Code, whose twists and turns are difficult to navigate for both the public and private sector. National Taxpayers Union has participated in numerous public comment opportunities on IRS and Treasury rulemakings, including Internal Revenue Code Section 385 regulations affecting corporate inversions,[49] Section 2704 regulations on valuation discounts in the estate tax,[50] and Section 7602 rules on IRS retention of outside counsel.[51]

Adam Looney of the Brookings Institution, himself a critic of the conservation easement deduction, told Politico that "there is a reason we have a public comment process, and that's because it was intended to democratize a not very democratic part of policymaking."[52]

As a pronouncement of administrative guidance, Notice 2017-10 would not necessarily fall under Administrative Procedure Act processes for comment. Nonetheless, the tax agency had numerous other tools available to solicit public input. The IRS could have worked with the National Taxpayer Advocate in designing field hearings on the topic of conservation easement deductions and partnerships. As an alternative, the IRS's own Taxpayer Advocacy Panel system, which is designed to obtain the practitioner community's views on matters such as tax form filing requirements and information return procedures, could have been directed through a task force or hearings of its own to explore conservation easement deduction transparency.

> The IRS can easily levy combined penalties well above 100 percent on a single party, or multiple hundreds of percent on all parties to a transaction.

3) Draconian and Counterproductive Enforcement. In making these conservation donations a listed transaction, the IRS expanded the scope and level of penalties connected to what the government deems to be improper compliance with the requirements of the conservation easement deduction.

Prior to that, however, the penalties were hardly light. In addition to understatement of liabilities, non-payment of tax, due diligence, and other penalties normally associated with any tax return, taxpayers faced a penalty of 20-40 percent of the extra tax owed if the IRS contested the taxpayer's reported value of the easement diminution (percentage dependent on IRS's determination of overstatement).

This type of conundrum is likely to worsen and spread with the penalties under Notices 2017-10 and 2017-29 (which subsequently modified 2017-10). The penalty for failing to file the disclosure Form 8886 can be up to $100,000 or even $200,000 depending on whether the taxpayer is an individual or other filing entity. The penalty on Material Advisors for failing to file or properly complete Form 8918 is $200,000 for listed transactions or 50 percent of the gross income from providing advice or assistance to the taxpayer (75 percent if the action is deemed "intentional").

All told, the IRS can easily levy combined penalties well above 100 percent on a single party, or in the multiple hundreds of percent on all parties to the transaction. This exceeds the maximum 25 percent penalty for failing to timely file a return, or 75 percent for civil fraud, or even the dreaded 100 percent penalty for unpaid amounts of income and Social Security tax withholding.

Worse, the "parties" could be unsuspecting. A Material Advisor is defined by the IRS as anyone who, earning above $50,000 from the transaction, provides "any material aid, assistance, or advice with respect to the organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction."[53] With no "reasonable cause" exception for noncompliance, it is not difficult to imagine a host of appraisers, investors, and other facilitators of the easement transactions who could be snared in this penalty trap.

4) Massive Compliance Burdens. According to the IRS's instruction publications, Form 8886 consumes an average of 21.5 hours for a taxpayer to complete and file.[54] Form 8918 consumes 14.5 hours.[55]

Based on NTU's experience, these time figures, plus the associated cost in labor and out-of-pocket expenses, are likely underestimated. When the IRS issued its Section 385 rule on corporate inversions, the government apparently assumed that the compensation for employees who would need to advise companies on compliance with the 385 rule would amount to $18 per hour – an absurdly low figure that varied by an order of magnitude with the compliance burden estimates by the business community. Our testimony to the House Committee on Small Business in 2015 noted through 35 years of evolution, the IRS's survey-based paperwork burden methodology originally developed by Arthur D. Little has been flawed. Citing the work *Costly Returns* by James L. Payne, NTU President Pete Sepp noted:

> Payne also noted how other discrepancies in the Little study (sometimes applicable to its successors) could lead to underestimated compliance burdens. Respondents were told to not report

recordkeeping hours for financial profit and loss statements, though many small business owners told researchers that a primary reason for preparing such information was for tax compliance. Even the act of learning about tax-law requirements isn't always confined to studying IRS instructions prior to filing a form; numerous additional hours are spent in classrooms, or in personal discussions among professionals and laypeople alike.[56]

This situation is absolutely analogous to the paperwork burdens behind conservation easement deductions and deadweight losses inflicted by Notice 2017-10. A single conservation easement partnership could easily involve 50 investors and 20 material advisors, each of whom would need to prepare the Form 8886 or 8918. Using the IRS's own understated figures, Notice 2017-10 racks up 1,475 more hours of paperwork requiring the services of highly-compensated tax professionals. The labor and out-of-pocket expense associated with this one exercise would likely exceed one million dollars for a single year – resources that instead could have been directed toward more conservation efforts or other productive pursuits. The Service's issuance of two Notices after 2017-10, providing an extension of some filing disclosure requirements and an extended due date for some hurricane victims, is only a small comfort to taxpayers.

According to NTU Foundation's annual study of Tax Code complexity, the Tax Cuts and Jobs Act offers opportunities to reduce IRS-generated paperwork loads by more than 250 million hours.[57] Schemes like Notice 2017-10 reverse this progress toward simplification.

Those Who Cannot Remember the Past…

Perhaps the worst aspect of this ordeal for taxpayers is its preventability. The IRS could have learned from its own guidance processes a decade before Notice 2017-10 about how to address any genuine administrative issues with the conservation easement deduction.

In 2004, the IRS distributed Notice 2004-41 announcing that section 170(h) deductions for conservation easements were falling under heightened scrutiny (though they were not designated as listed transactions). Although much of the Service's effort was focused on historic preservation easement deductions, these too raised concerns about the accuracy of appraisals, qualifying conservation purposes, and other matters that bear resemblance to the land-tied conservation easements that the IRS is leaning on now:

> [I]n appropriate cases, the Service intends to disallow such deductions and may impose penalties and excise taxes. Furthermore, the Service may, in appropriate cases, challenge the tax-exempt status of a charitable organization that participates in these transactions. In addition, this notice advises promoters and appraisers that the Service intends to review promotions of transactions involving these improper

deductions, and that the promoters and appraisers may be subject to penalties.[58]

The IRS Advisory Council (IRSAC), which has functioned under various names for 65 years, is a respected federally-chartered advisory committee designed to "advise the IRS regarding tax administration policy, programs, and initiatives" whose "membership is balanced to include representation from the taxpaying public, the tax professional community, small and large businesses, state tax administration, and the payroll community."[59] IRSAC's 2009 account of the events surrounding Notice 2004-41 is highly instructive.[60]

While acknowledging Congress's intent to strengthen the conservation easement deduction, IRSAC outlined how the tax agency continually audited and litigated the matter in the years surrounding 2004-41, mostly centering upon the appropriateness of valuation diminutions backing deductions taxpayers were claiming. After losing many valuation challenges in Tax Court, the IRS issued a "Topical Tax Brief" in which it asserted that the government's "engineers" (technical analysts) believed the "proper valuation" of a preservation easement equated to 10-15 percent of a given property. Taxpayers regarded this document as creating a "safe harbor" that would keep an IRS audit from being triggered so long as filers respected the 10-15 percent level. The Service subsequently issued Notice 2004-41, and put conservation easements on its "Dirty Dozen" list of tax scams in 2005 and then in 2006 – the year Congress *expanded* the deduction. Later the agency denied its role in conveying a safe harbor, and declared it would conduct pre-audit reviews of about one-third of all easement deductions.

Tax practitioners told IRSAC that as a practical matter, the Service had adopted a "zero outcome" audit strategy, asserting that mostly every easement deduction that fell under examination was denied. Tax agency officials also appeared to be harassing organizations accepting the donations. "The result," IRSAC reported, "is that donee organizations have discontinued accepting donations, for fear of promoter penalties; at the same time, donors are understandably reluctant to donate to an organization that is under active IRS investigation."

To reiterate, IRSAC's report was issued for 2009, several years *after* Congress upgraded the conservation easement deduction. At the time the panel wisely observed that "the current IRS audit effort strains the agency's resources and may fail to distinguish between a legitimate deduction authorized by statute and an abusive tax shelter." Those words are applicable to the IRS's actions today, as are IRSAC's recommendations:

- Allow taxpayers to revise appraisals found to have technical deficiencies during an audit;
- Announce an end to the Service's position of zero value for easements;

- Construct and publicize a safe harbor;
- Allow taxpayers to ask for reconsiderations of audits based on these three circumstances;
- Use certified outside appraisers (as opposed to IRS employees) in most cases challenging values of easements; and
- Constitute an advisory panel to create a body of nonbinding but formative expert guidance on how appraised value disputes can be avoided or resolved. This policy was successfully tested in another context: the IRS's Art Advisory Panel, which thoughtfully informs the development of valuations for donations of artworks.[61]

That the IRS would, today, not only disregard this advice but also take the drastic step of making certain conservation easement partnerships listed transactions, is a worrisome development for all taxpayers.

Conclusion: Clean Up the Environment for Easement Deductions

Earlier this year, IRS Commissioner Chuck Rettig told Senate Finance Committee lawmakers at his confirmation hearing that with regard to conservation partnership easement transactions, "I will work with IRS officials to ensure an appropriate enforcement strategy is in place to uphold the law as Congress intended."[62] Rettig's statement hopefully reflects the beginning of a balanced policy framework going forward.

Ensuring an appropriate enforcement strategy toward conservation easement deductions means the IRS should abandon the counterproductive and heavy-handed tactic of the listed transaction. Other tactics could be employed instead, such as:

- "Job Aids" to encourage working-level dialogue among practitioners and administrators;
- An easement valuation advisory panel whose guidance can head off costly disputes between taxpayers and the IRS;
- A binding Alternative Dispute Resolution process for appraisal differences between taxpayers and the IRS. A pilot ADR project already exists for certain small business tax examinations, and NTU has recently called for expansion of this initiative.[63]
- Improvements in existing tax documents like Form 8283, which could include more useful data on the quality and quantity of acreage under easements. The IRS Form 990 that donee organizations file could also be carefully re-calibrated to provide more details of donated easements, paying careful attention to the reporting burdens that small nonprofit organizations must already carry.
- A more professional and transparent appraisal process. This can be achieved through greater appraiser education and adherence to the Uniform Standards of Professional Appraisal Practice on the part of both taxpayers and the IRS. It is unfair for the government to demand

more professional qualifications from its citizens than its own employees.
- Public comment processes to allow for more dialogue not only on rules but guidance.

These are but a few ideas for strengthening appropriate tax enforcement while respecting taxpayer rights. Additional recommendations will be explored at length in a forthcoming paper.

Upholding the law as Congress intended means that Congress itself should carefully review the legislative history established by its predecessors before taking any action that could adversely impact the spirit of the conservation easement deduction. In the current Congress, H.R. 4459 and S. 2436 would effectively codify part of the IRS's listed transaction – an unwise and unnecessary legislative response. Instead, lawmakers should be working to complete the effort to update and strengthen the system of taxpayer safeguards that began with the House's passage of the Taxpayer First Act earlier this year and is currently being reconciled in the Senate.[64]

The IRS's toxic approach toward conservation easement deductions is emblematic of many tax administration maladies that have been increasingly fouling the environment for law-abiding taxpayers. Many areas of the law as well as Executive Branch practice must be reviewed to ensure that the ideals not only of this deduction but of the IRS Restructuring and Reform Act and other laws are more closely respected in every day practice. It is time for the clean-up effort to begin. Just as conservation is a forward-looking gift for future generations, a government that respects checks and balances as well as its citizens' rights can be.

About the Author

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National Taxpayers Union (NTU)

Founded in 1969, NTU is a 501(c)(4) nonprofit, nonpartisan citizens group that works for lower taxes, limited government, and economic freedom at all levels.

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