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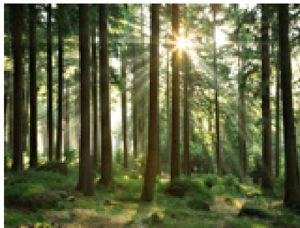
Charitable Contributions

Conservation Easement Deduction Denied for Faulty Formula

BNA Snapshot

Development: Improperly worded sentence disqualified deduction by creating remote possibility that land trusts wouldn't receive any involuntary extinguishment proceeds.

Takeaway: Decision emphasizes importance of using tax adviser experienced with conservation easements, IRS's quest to find any reason to disallow deduction.



By Erin McManus

April 27 — A landowner couldn't claim a deduction for a conservation easement, because the formula for distributing extinguishment proceeds to the benefited land trusts wasn't based on the value of the easement (*Carroll v. Commissioner* , T.C., No. 5445-13, *146 T.C. No. 13*, 4/27/16).

The *U.S. Tax Court ruled* April 27 in a division opinion that the easement wasn't a qualified conservation contribution, because the formula providing for the share of proceeds owed to the land trusts in case of involuntary extinguishment of the easement was based on the amount of the federal tax deduction taken by the landowners, which could be zero even if the easement was valid.

Anson Asbury, a tax attorney at the Asbury Law Firm in Atlanta, described the decision as technically correct but troubling in an April 27 e-mail to Bloomberg BNA.

IRS Nitpicking

Ronald Levitt, a shareholder in the tax and business practice at Sirote & Permutt PC in Birmingham, Ala., told Bloomberg BNA April 27 that “it's too bad the court couldn't find a way out. It leads you to the conclusion that there is no nit too small for the IRS to pick. They are looking for any reason to disallow these deductions, despite what Congress has said.”

Judge Robert P. Ruwe said the easement protecting a rare piece of undeveloped property in Baltimore County, Md., wasn't in perpetuity because of the improperly worded formula, and consequently wasn't a qualified conservation contribution.

“The property was exactly the kind of property the state of Maryland wanted set aside, and the state went through numerous details regarding the property to make sure it met” the requirements, Levitt said. He added that regardless of the adverse outcome, the decision was a primer about local government policy and almost creates a presumption of validity in granting an easement to a government agency.

Ruwe said if the Internal Revenue Service denied the deduction claimed by Douglas G. Carroll III, a physician, and his wife, Deirdre M. Smith, “for reasons other than valuation and the easement is extinguished in a subsequent judicial proceeding,” the Maryland Environmental Trust and the Land Preservation Trust wouldn't receive any proceeds.

Strictly Construed Regulations

The judge said the applicable Treasury Regulations Section 1.170A-14(g)(6)(ii) has “been described as ‘a single—and exceedingly narrow—exception to the requirement that a conservation easement impose a perpetual use restriction' on real property.”

Ruwe said these regulations “are strictly construed; if a grantee is not absolutely entitled to a proportionate share of

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extinguishment proceeds, then the conservation purpose of the contribution is not protected in perpetuity."

"The Court is correct in that this is a technical requirement, but the taxpayer's substantial efforts to comply with the many technical requirements of the law have been undone by what is essentially a single sentence," Asbury said.

Expert Advice Required

The judge also affirmed accuracy-related penalties under tax code Section 6662(a), saying that because of "Dr. Carroll's high level of sophistication and experience with conservation easements," he didn't demonstrate that he acted with reasonable cause and in good faith in not seeking competent tax advice regarding the conservation easement.

Asbury said he agreed with the court that Carroll should have consulted with a tax attorney, "however, when this taxpayer executed this easement in December 2005, I don't know if a seasoned tax attorney would have anticipated the trend of technical readings that have emerged since then. I think that's a pretty tough standard for a taxpayer that seems to have gotten everything else correct."

Levitt said the case "puts a big premium on using a good tax adviser."

Scott A. Schwartzberg, David J. Polashuk and William J. Marchica represented Carroll and Smith. Michael A. Raiken, Elizabeth C. Mourges and Nancy M. Gilmore represented the commissioner.

To contact the reporter on this story: Erin McManus in Washington at emcmanus@bna.com

To contact the editor responsible for this story: Brett Ferguson at bferguson@bna.com

For More Information

Text of the decision is in TaxCore.

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