Treasury Easement Reg Fails *Chevron* 'Step Zero,' Says Amicus

Posted on Dec. 31, 2020

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A land trust is urging an appeals court in a conservation easement case to invalidate Treasury 's judicial extinguishment regulation because it usurps the states' role in determining property rights.

"The allocation of condemnation proceeds is a matter traditionally reserved for state law, and there is no indication that Congress intended the IRS to jettison basic principles of federalism by invading this area," the Southern Conservation Trust Inc. asserted in a December 17 amicus brief to the Eleventh Circuit in *Hewitt v. Commissioner*.

The North American Land Trust filed an amicus brief the same day. Both groups support the position of David and Tammy Hewitt, who are appealing a June 17 Tax Court holding, T.C. Memo. 2020-89, that they couldn't claim carryover charitable contribution deductions of $2.7 million in 2013 and 2014 for donating an easement over their family farm to Atlantic Coast Conservancy Inc.

The Tax Court held that the easement deed's judicial extinguishment provisions didn't satisfy the perpetuity requirements of reg. section 1.170A-14(g)(6) because the deed would subtract the value of post-easement improvements made by the donor when determining the donee's share of the proceeds if the easement were judicially extinguished and the property sold.

The court rejected the Hewitts' argument that reg. section 1.170A-14(g)(6) is invalid, noting that the Tax Court upheld that regulation in a May 12 reviewed opinion in *Oakbrook Land Holdings LLC v. Commissioner*, 154 T.C. No. 10 (2020).

The couple's December 10 brief to the Eleventh Circuit argued that the regulation violated the Administrative Procedure Act because Treasury failed to address comments regarding the treatment of donor improvements during the promulgation of the section 170A regs in the 1980s.

No appellate court has addressed the validity of reg. section 1.170A-14(g)(6), although the partnership in *Oakbrook* has an appeal pending in the Sixth Circuit.

Steps on State Toes

Southern Conservation's amicus brief contends that reg. section 1.170A-14(g)(6) should be invalidated for a more fundamental reason — Treasury and the IRS have no right to reallocate property rights.

The regulation isn't entitled to deference "because it falls beyond the Commissioner's substantive expertise," the brief says. "The threshold requirement for deference — sometimes termed '*Chevron* Step Zero' — is that the rule falls within the agency's substantive expertise."

The brief asserts that because rights in real property are created under state law, an agency of the federal government has no authority to reallocate the property interests of parties by regulation. "It has long been the rule that *state law* defines a taxpayer's property interest, with the tax consequences of those interests dictated by *federal law*," it said.

The brief notes that under Alabama law, which would apply to the Hewitts' easement, the court or jury determines the apportionment and distribution of condemnation proceeds among those with an interest in the relevant property.

"The Regulation, however, takes that issue out of the factfinder's purview and places it in the Commissioner's hands," the brief says. "According to the new interpretation of the Regulation, the value of the donee's interest must increase in a predetermined amount along with any appreciation over time — regardless of whether the donor spends money, time, and effort to improve the property after the donation."

The regulation also has constitutional implications, the brief says, noting that requiring donors like the Hewitts to include the value of post-easement improvements in the proceeds allocation formula would deprive them of compensation to which they are otherwise entitled.

"By the same token, the Regulation could grant the donee an interest in the donor's property greater than what the donee would receive under state law," the brief says. "There is no indication that Congress intended the Commissioner to promulgate regulations to do so."

Avoiding a Windfall

The possibility that a donee could receive a windfall is addressed more thoroughly in the North American Land Trust's amicus brief.

The brief points out that most easement deeds don't convey an ownership interest in the donor's reserved rights to the donee. Rather, the deed gives the donee the right to enforce prescribed limits on the types of improvements that the donor can make to the property. "This principle is embedded in the Regulations which refers to the land trust's 'vested right' as 'the perpetual conservation restriction,'" it said.

The brief asserts that if the value of donor improvements is included in the donee's share of the proceeds following a court-mandated sale of the property, the donee "is being compensated for the value of the reserved rights that were not given to [it] in the first place."

Requiring post-easement improvements in the proceeds allocation formula is at odds with Treasury's rules on valuing the easement when calculating the amount of the charitable

contribution deduction, the brief argues. It pointed out that the donor gets no deduction for the value of reserved rights or value of any improvements actually made.

“The Regulations should not be interpreted to be inconsistent with the very scheme, a calculated income tax deduction, that it is intended to regulate,” the brief says.

The brief further notes that the judicial extinguishment clause in the Hewitts’ easement deed was modeled on the version that was recommended by the Land Trust Alliance in 1988 and has been widely adopted by the land trust community and easement donors.

Upholding reg. section 1.170A-14(g)(6) would affect not just the Hewitts but potentially thousands of other donors, the brief says.

“The Commissioner’s assertion that the Improvements Clause now, after many years of use, does not comply with the Regulations has thrust these easement donors, who are still within the general federal income tax statute of limitations, into a position of incurring additional income taxes, interest and penalties,” it said.

In *Hewitt v. Commissioner*, No. 20-13700 (11th Cir.), amicus Southern Conservation Trust Inc. is represented by Vivian D. Hoard and Kip D. Nelson of Fox Rothschild LLP, while amicus North American Land Trust is represented by George Asimos and Harry D. Shapiro of Saul Ewing Arnstein & Lehr LLP.