



IRS and Tax Court Deny Charitable Deduction for Historic Preservation Easement



While Congress and the states provide tax incentives through deductions and credits, the IRS and state tax administrators can deny those benefits based on questionable and overly strict interpretations of requirements for the benefits. At a time when Congress is providing numerous tax incentives, such as new market credits, energy credits, and credits for new hires, it is particularly important to remember that the IRS and the courts will interpret the incentives narrowly. Careful attention to detail in meeting all technical requirements to qualify for tax incentives is essential to avoid losing the benefits in an IRS or state audit.

Most recently, in *Scheidelman v. Commissioner*, T.C. Memo. 2010-151 (July 14, 2010), the Tax Court determined that an individual's grant of a historic preservation easement did not qualify for a charitable contribution deduction because the technical substantiation requirements for a deduction, as interpreted by the court, were not met. Although there was no dispute that a transfer of property was made to a qualified recipient, a deduction was not allowed under the court's strict reading of requirements to verify a contribution. The court also rejected the donor's arguments that even if there was not strict compliance with the requirements, there was reasonable cause for failure to comply, or at least there was substantial compliance. The decision in *Scheidelman* is at odds with other court decisions, and there is still time for the decision to be reconsidered or appealed.

The requirements to substantiate a charitable contribution deduction for a transfer of a conservation easement are more detailed than the requirements for some other types of charitable gifts. It is necessary to have a qualified appraisal done by a qualified appraiser, to attach certain documentation to the tax return for the year of the transfer (Form 8283 and appraisal summary), and to meet record-keeping requirements. Special rules apply to determine whether an appraisal is a qualified appraisal and whether an appraiser is a qualified appraiser.

In *Scheidelman*, the court noted that the Form 8283 attached to the individual's tax return did not include the date or manner in which the donor acquired the property or the cost of the property contributed. As viewed by the court, those defects alone demonstrated failure to strictly comply with the requirements of the regulations.

Because the appraisal obtained by the donor did not meet the court's standard for a "method of valuation" or state a "specific basis for the valuation," the court determined that there was not reasonable cause that would excuse failure to meet the substantiation requirements.

Also, although other cases have concluded that only substantial compliance with the regulations is required because they relate to information reporting, the court in *Scheidelman* determined that substantial compliance is not enough. The court's view was that the appraiser had not used a "recognized methodology" and that failure prevented substantial compliance with the regulations. In other words, although the appraisal stated how the appraisal had been done, the court rejected the methodology and concluded that the appraisal was not a "qualified appraisal."

Because the court determined that the verification requirements in the regulations, including the requirement for a "qualified appraisal" were not met, a deduction was not allowed. The court did not even reach the issue of the value of the donated easement.

A few years ago, the IRS identified charitable contributions of easements as an area of IRS focus because of perceived abuses. Although there are undoubtedly abusive situations, it appears the IRS is looking for "foot faults" to prevent taxpayers from claiming charitable contribution deductions for grants of easements. These issues will continue to be aggressively litigated in the courts by donors, who may ultimately be successful.

The IRS focus on this particular tax incentive should serve as a reminder that anyone intending to claim any type of tax incentive offered by Congress should be extremely careful to meet (and try to anticipate) all substantive and technical reporting requirements.

For more information, please contact:

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