TAX POLICY: DRIVER OF GIFTS OR RESTRICTOR OF GIFTS?

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Presentation at Arizona Charitable Gift Planners Annual Conference

May 19, 2023

I. Where We Are Now & How We Got Here

A. Introduction

The Senate Committee on Finance held a hearing in March 2022 on the federal tax treatment of charitable contributions. This type of hearing happens often. However, this time, the Staff of the Joint Committee on Taxation (JCT) expressed concerns prior to the hearing about the following items that deserve our attention:[1]

- The valuation of noncash property
- Conservation easement deductions
- The substantial growth of donor advised funds
- The distributional effects of itemized vs. standard deduction

We will explore these policy concerns raised by the JCT and their impact on charitable giving. Before delving into these topics, we will begin with a summary of tax policies and legislation from 1917 to the present that form the historical basis for how Congress (and the Internal Revenue Service) have contributed their aggregate thinking into what we currently know as our "charitable planning rules." These historical developments are important to understand because they have led to the concerns we now and in the future face.

B. History – 5 Phases That Gave Rise to the Issues We Face Today

1. War Income Tax Revenue Act of 1917 Introduces Charitable Deduction

While humans have embraced charity from the beginning of time for altruistic reasons, in America we also honor charity with a financial incentive: a charitable tax deduction. Our modern American system of taxation came into being with passage of the Revenue Act of 1913, which established a one percent tax on the wealthiest Americans. Just four years later, Congress increased income tax rates considerably to help pay for World War I. A greater number of people

[1] Staff of J. Comm. on Tax'n, Present Law and Background Relating to the Federal Tax Treatment of Charitable Contributions, JCX-2-22 (March 11, 2022) [hereinafter 2022 JCT Report].

were taxed, and the wealthy were taxed at a higher rate.[2] Legislators feared the increased tax rates would reduce the amount of income taxpayers would have left to support charitable work. They feared that if private support for charitable organizations decreased, there would be an increased need for government support, which would then require another tax increase. To address these concerns, Congress pioneered the charitable tax deduction as part of the War Income Tax Revenue Act. Those who itemize tax deductions were given the option to subtract gifts to eligible charities from taxable income. It showed Congressional acknowledgement of and appreciation for the critical role played by philanthropy in American civil society. Initially, the deduction was capped at 15 percent of taxable income.[3] Overtime, lawmakers have increased the percentage of the charitable deduction—to 20 percent of Adjusted Gross Income (AGI) and then 30 percent of AGI.

2. Tax Reform Act of 1969 Attempts to Regulate Self-Dealing and Other Abuse of Charitable Deduction, Instead Spawns the Modern System of Planned Giving

The charitable deduction continued to receive favorable treatment by Congress during the period in between the World Wars and in the aftermath of World War II. Lawmakers depended on the private sector for support of war efforts. A shift began to occur, however, with the rapid growth of industry in post-war America. Wealthy industrialists were placing assets into foundations to receive the charitable tax deduction but continued to manage and control the assets. Congress enacted the Tax Reform Act of 1969 to curb abuse of the charitable deduction for personal gain. The strictly defined rules inevitably created the statutory versions of what we now know as charitable remainder unitrusts, charitable remainder annuity trusts, charitable lead trusts, and pooled income funds.[4]

The 1969 Tax Act also included other notable new rules, among them: 1) the charitable deduction was raised to 50 percent of AGI for cash and ordinary income contributions to public charities and operating private foundations; 2) the distinction between public charities and private foundations was clarified in section 509; and 3) private foundation rules were established, including a minimum charitable payout requirement and a four percent excise tax on net investment income. Gifts of appreciated property to public charities remained at 30 percent. Also, gifts to private nonoperating foundations remained at 20 percent of AGI.

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[2] Crandall-Hollick, Margot, *The Charitable Deduction for Individuals: A Brief Legislative History*, Congressional Research Service, June 26, 2020.
[3] Staff of J. Comm. on Tax'n, Present Law and Background Relating to the Federal Tax Treatment of Charitable Contributions (October 14, 2011), at 4.
[4] The 1969 Tax Act created section 4947. Unless otherwise stated, all section references are to the Internal Revenue Code of 1986, as amended.

3. Launch of the Conservation Easement and Above-the-Line Deduction

Between 1969 and 1984, several laws were enacted that modified the system of taxation. The following are two important changes to the charitable deduction made during that time period. First, tax benefits for gifts of conservation easements were enacted in the Tax Reform Act of 1976 and the Tax Reduction and Simplification Act of 1977, and extended permanently in 1980. Second, in 1981, for the first time, a temporary above-the-line charitable deduction was introduced for taxpayers who did not itemize their deductions. It was intended to stimulate charitable giving after the standard deduction was increased, and it expired in 1986.[5]

4. Deficit Reduction Act of 1984 Recognizes Role of Grantmaking Foundations, Tries to Curb Valuation Abuse

The Deficit Reduction Act of 1984 increased the deduction to 30 percent of AGI for cash or ordinary income gifts made to nonoperating private foundations. Gifts of long-term capital gain property to private nonoperating foundations remained at 20 percent of AGI. In an effort to curb the increasing abuse of valuation rules, Congress, for the first time, enacted rules regarding appraisals.

Among laws enacted after the Deficit Reduction Act of 1984, one of the most noteworthy is the Philanthropy Protection Act of 1995.[6] It exempts a charity that take donations in exchange for charitable gift annuities or other types of investments from securities regulation by states, as long as the charity satisfies certain requirements, including providing a disclosure statements to donors.

5. Tax Cuts and Jobs Act of 2017 Generates a Substantial Impact on Charitable Giving

One hundred years after the charitable deduction was introduced, new legislation impacting the charitable deduction was signed--the Tax Cuts and Jobs Act of 2017 (TCJA). It is important to take a look at the ways in which charitable giving has changed since the TCJA took effect in 2018. The following are key provisions of the TCJA that impact charitable gifting, all of which are temporary, set to expire at the end of 2025:

- The standard income tax deduction was nearly doubled, reducing the number of people who itemize from approximately 40 percent to about 10 percent.
- Personal exemptions were eliminated.

[5] Staff of J. Comm. On Tax'n, General Explanation of the Economic Recovery Act of 1981, JCS-71-81 (Dec. 29, 1981), at 49.
[6] 15 U.S.C. § 80a-3a.

- State and local taxes (SALT) capped for the first time.
- Pease limitation on itemized deductions was eliminated.
- Top marginal income and corporate tax rates reduced.
- The estate and gift tax exclusion was doubled.
- Deduction for cash donations was increased to 60 percent of AGI.

Before the TCJA was enacted, experts expressed concern about its impact. For example, the Indiana University Lilly Family School of Philanthropy conducted a study which predicted the TCJA's doubling of the standard deduction "would dampen future donations for both religious and secular groups." Sponsors of the legislation hoped the loss would be offset by donors who would contribute more because tax cuts would leave more money in their pockets.[7]

Just a year after enactment of the TCJA, a worldwide pandemic struck, rendering it difficult to measure the successes and failures of the TCJA. Moreover, our young system of taxation was put to new tests, requiring new laws to counter the pandemic's impact. It is with this historical understanding that we begin our examination of the impact of certain tax laws on charitable giving.

II. The Elephant in the Room—Property Donations

A. Introduction

Noncash gifts donated to a qualified charitable organization are eligible for an income tax charitable deduction. Such donations deducted as an itemized deduction totaled $83.5 billion in 2018. Of that, $70.8 billion were deducted using Form 8283, which must be filed by a donor when a noncash donation exceeds $500.[8] An IRS Statistics of Income Bulletin breaks down the types of noncash donations in 2018 as follows:

Corporate stock, mutual funds, other investments	$42.69 billion
Food, clothing, and accessories	$7.13 billion
Conservation easements	$6.50 billion
Electronics and household items	$5.09 billion
Other types of assets	$4.32 billion
Real estate and land	$3.16 billion
Art and collectibles	$1.55 billion
Cars, planes, and boats	$0.39 billion

[7] Husock, Howard, *The Tax Cuts and Jobs Act and Charitable Giving by Select High-Income Households*, American Enterprise Institute Report, April 2022, at 1-2.

[8] IRS SOI Bulletin, Individual Noncash Charitable Contributions, Tax Year 2013-2018, as reported in 2022 JCT Report, *supra* note 1, at 47.

While complexities and fraud do arise with valuation of corporate stock, mutual funds, and other investments, the JCT Report is specifically focused on vehicles, intellectual property, food, clothing, and household items.[9] The JCT Report identifies misstated valuations and failure to comply with substantiation requirements as two critical factors concerning these noncash assets.

B. Valuation and Substantiation Requirements

1. Valuation

In a very general sense, the value for tax deduction purposes of a charitable gift of property will be either the 1) fair market value (FMV), 2) the cost basis (if less than FMV), or 3) zero. There are many exceptions, however, and there are also exceptions to the exceptions, making valuation a complex matter for the average taxpayer. The most advantageous valuation a donor can receive is typically the FMV,[10] defined as:

> "the price that property would sell for on the open market. It is the price that would be agreed on between a willing buyer and a willing seller, with neither being required to act, and both having reasonable knowledge of the relevant facts."[11]

Valuation requirements depend on the type of property at issue. Household goods and clothing, jewelry, books and collections, vehicles, boats, aircraft, inventory, patents, stocks, real estate, remainder interests in real estate, conservation easements, life insurance policies, and fractional interests each have distinct requirements that must be considered for valuation purposes. The requirements, set forth in Publication 561, are very specific and include factors such as desirability, use, scarcity, original cost of the property, etc.. Typically, the best method to establish FMV when claiming a charitable deduction is by a qualified appraisal. Taxpayers who overstate the value of noncash donations may be required to pay a penalty of either 20 percent or 40 percent, depending on how much the valuation was overstated.[12]

2. Substantiation

The value of the donation determines the type of substantiation required. The rules can be complex and there are exceptions to the general rules, so it is very important to review the requirements closely.

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[9] 2022 JCT Report, *supra* note 1, at 16.
[10] James, Russell, *Valuing Charitable Gifts of Property, 1: The Rules*, Lecture. Feb. 11, 2017. www.youtube.com/watch?v=VW961RzLg0w
[11] I.R.S. Pub. 561 (Jan. 2022). www.irs.gov/publications/p561
[12] *Id*. at 8-11.

3. Mistakes, Misunderstandings, and Abuse are Common

Since 1984, rules regarding valuation and substantiation have been enacted to curb abuses of the charitable deduction. Nevertheless, abuse is common. The JCT Report notes:

> "The valuation of contributions of noncash property presents significant tax compliance challenges. In particular, the determination of fair market value creates a significant opportunity for error or abuse by taxpayers making charitable contributions of property. To the extent that taxpayers claim inflated valuations that are not corrected by the Service, the Treasury loses revenue that should be collected under present law because charitable contribution deductions are greater than are warranted. Whether due to mistake, incompetence, misunderstanding of the law or facts, or efforts to evade taxes, valuation misstatements are common."
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> "Unlike the parties in many arm's length negotiations, in the case of a charitable contribution, the interests of a donor and a donee organization are often aligned. A donee organization may have no knowledge of the value a donor claims for the contribution of noncash property, and even if known, has no incentive to question a donor's claimed value because there is no countervailing tax consequence to the donee of an inflated claim. That is, the donee generally does not pay tax on the receipt of the contribution or any subsequent disposition of the contributed property. Some donees may even directly or indirectly support an inflated value in order to secure a desired gift. Such circumstances contribute to the difficulties in accurately valuing noncash property in the charitable contribution context."[13]

As a result of inflated and false valuations, over time, the Internal Revenue Service ("the Service") has been scrutinizing noncash donations more closely.

C. Martha's case

In a verdict issued earlier this year, *Albrecht v. Commissioner*, the Tax Court disallowed a charitable deduction for failure to comply with the substantiation requirements set forth in section 170(f)(8). Martha Albrecht donated 120 items of Native American jewelry and artifacts to the Wheelwright Museum of the American Indian. Martha and the museum signed a "Deed of Gift" on the date the gift was made. Among other things, the deed stated that the donation was "unconditional and irrevocable; that all rights, titles and interests held by the donor in the property are included in the donation, unless otherwise stated in the Gift Agreement." The Deed of Gift was attached to Martha's tax return in order to substantiate the claimed charitable deduction. The Service denied the charitable deduction on the basis that the Deed of Gift did not specify whether anything of value was received by Martha from the museum in exchange for the

[13] *Id.*

donation. The Service also pointed to the ambiguity created by the reference to a "Gift Agreement" that was not submitted with the tax return. The Tax Court noted that based on the language included in the deed, the terms of the deed were subject to this separate agreement, which was not provided to Martha by the museum. Martha failed, therefore, to meet the substantiation requirements. The Tax Court noted that the fact pattern left open the possibility for a "quid pro quo arrangement" or "side agreement" that included superseding terms.[14]

The Tax Court's holding in *Albrecht* is consistent with other cases in which the charitable deduction has been denied based on failure to adhere to the requirements by the donor or the donee.[15] Donors and the charitable organizations they wish to support must make sure they adhere to rules with respect to valuation and substantiation requirements.

D. The Rules

1. Valuation–Qualified Appraisal by a Qualified Appraiser

While there are exceptions, such as securities, as a general rule, if the FMV of property to be donated is greater than $5,000, the donor must obtain a "qualified appraisal" that is made by a "qualified appraiser." A "qualified appraiser" is an appraiser who meets the following criteria:[16]

- Meets very specifically defined educational and professional experience requirements.
- Declares in the appraisal that, because of the appraiser's education and experience, the appraiser is qualified to make appraisals of the type of property being valued.

The following individuals do not meet the requirements of a qualified appraiser:[17]

- A person who receives a fee that is prohibited by the rules.
- The donor or the donee of the property.
- Anyone else who served as a party to the transaction, unless the property is donated within two months and its appraised value does not exceed the acquisition price.
- A person who is related to (as defined in section 267(b)) or an employee of the donor, donee, or other party to the transaction. This includes an independent contractor who is regularly used as an appraiser by the parties and who does not perform a majority of his or her appraisals for others during the taxable year.
- Anyone who is prohibited from practicing before the Service at any time during the three-year period prior to the date of the appraisal.

[14] Albrecht v. Commissioner, T.C. Memo. 2022-53, at *5.
[15] *See e.g.* Durden v. Commissioner, T.C. Memo. 2012-140, Estate of Evenchik v. Gadarian, T.C. Memo. 2013-34 (U.S.T.C. Feb. 4, 2013), and Oakhill Woods, LLC v. Comm'r, T.C. Memo. 2020-24 (U.S.T.C. Feb. 13, 2020).
[16] Treas. Reg. Sec. 170A-17(b).
[17] Treas. Reg. Sec. 170A-17(b)(5)(i)-(vi).

A "qualified appraisal" is one that is prepared by a "qualified appraiser" and fulfills the specific, detailed list of requirements set forth in the regulations.[18]

2. Substantiation

Generally speaking, there are four categories of substantiation requirements set forth in section 170(f)(8). The value of the donation determines the type of substantiation required. The rules can be complex and there are exceptions to the general rules, so it is important to review all the requirements closely. The four general categories of donations are as follows:[19]

- Less than $250: donor is required to maintain a record of the contribution, preferably with receipts. If the contribution is in cash, the records must show the name of the charity as well as date and amount of the contribution. For noncash donations, the receipt must include the name and address of the charity, date of contribution, and a detailed description of the property. Additional rules apply for securities, Donors who do not keep receipts run the risk of losing their deduction depending on the adequacy of their records, which is facts-and-circumstances based.
- Between $250 and $500: donor can claim a deduction only if the donor has a contemporaneous, written acknowledgement (CWA) from the charitable organization. The donor is responsible for requesting and obtaining the CWA from the charitable organization. An organization that does not provide a CWA incurs no penalty.
- Between $500 and $5,000: donor must meet the previous requirements and file Form 8283 and/or other reporting requirements, depending on the type of asset donated.
- Greater than $5,000: donor must meet all previous requirements and obtain a qualified appraisal. Donor must submit a summary of the appraisal with their tax return but if donation is over $500,000 ($20,000 for artwork; any amount for conservation easement) then the entire appraisal must be submitted. In addition, Form 8283 must be signed by an official representative of the charity.

Where a CWA is required, a charitable organization must make sure the CWA contains the following:[20]

1. Name of the charitable organization
2. The amount of cash donated, or a description (but not necessarily the value) of the noncash property donated.
3. If applicable, a statement that no goods or services were provided by the organization in return for the donation, either in whole or in part.

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[18] Treas. Reg. Sec. 170A-17(a)(1)-(12).
[19] Treas. Reg. Sec. 1.170A-16(a)-(f); Code Section 170(f)(8).
[20] Treas. Reg. Sec. 1.170A-13(f).

4. If goods or services were provided by the charity, include a description and good faith estimate of the value of goods or services that were provided in return for the contribution.[21]
5. If the goods or services provided in return for the contribution consisted entirely of intangible religious benefits, a statement to that effect must be included.

Any amount contributed over the value of what was received is eligible for a Schedule A charitable deduction. If the donation is to a donor advised fund, the CWA must also include a statement that the sponsoring organization of the DAF has exclusive legal control over the assets distributed. The CWA must be provided to the taxpayer on or before the earlier of (1) the date the taxpayer files their return or (2) the due date (including extensions) for filing such return.

E. Best Practice—Just Follow the Rules

It is essential, before all else, that gift officers educate themselves about valuation and substantiation. Establishing internal systems, protocols, checklists, and procedures will help organizations be better prepared. Not doing so can be harmful to the organization's reputation, cause donors to have unrealistic expectations, and perhaps even cause donors to suffer financial loss, thereby damaging the relationship between the donor and the charity.

Charitable organizations should then take steps to educate donors about the importance of valuation and the substantiation requirements. Consider written materials that are shared with donors on the organization's website, email bulletin, and as pamphlets.

Where necessary, donors should be educated about the consequences of falsely inflated valuation of donated property. As the Tax Court stated in *Albrecht*, donors will be held strictly to the requirements set forth in section 170(f)(8)(B).[22] It is in each charitable organization's interest to do all it can to help donors comply with substantiation requirements. If donors are unable to receive the tax benefits, they are likely to lose some motivation to make gifts. The charity's reputation may also suffer among donors if several donors find they are unable to obtain a deduction for their donation.

III. Conservation Easements—From Sea to Shining Sea

Qualified conservation easements are legal agreements between landowners and charitable organizations that allow for geographic areas of natural beauty, historical significance, or environmental importance to be protected and preserved for public use and enjoyment, now and for perpetuity. They save the federal, state, and local governments hundreds of millions of

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[21] I.R.S. Pub. 1771, at 5 (Mar. 2016). www.irs.gov/publications/p1771.
[22] *Albrecht*, *supra* note 14.

dollars that would otherwise be spent to purchase and maintain such areas. In return for the landowner's commitment to protect the property, the landowner receives a charitable deduction for tax purposes. For some, it helps alleviate concerns about property taxes or other taxes that future generations may not be able to afford.

Charitable organizations, such as the 950 members of the Land Trust Alliance, and numerous others, have been collaborating with donors to establish traditional conservation easements for almost 50 years.[23] They are dedicated to protecting, preserving, and enhancing the lands and environments that Americans hold so dear from sea to shining sea.[24] These include mountains, hills, shorelines, parklands, rivers, streams, wetlands, and historic structures that are preserved and protected for perpetuity.[25]

A. The Rules

Conservation easements can be granted to local, state, and federal governments, as well as some qualified charitable organizations (generally an organization that receives at least one-third of its contributions from the general public). Landowners cannot arbitrarily allocate any real estate for a conservation easement. The donation must be exclusively for a conservation purpose, defined as follows:

(i) The preservation of land areas for outdoor recreation by, or the education of, the general public;

(ii) The protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem,

(iii) The preservation of certain open space (including farmland and forest land), if such preservation is:

  a. Pursuant to a clearly delineated federal, state, or local governmental conservation policy and will yield a significant public benefit, or

  b. For the scenic enjoyment of the general public and will yield a significant public benefit.

(iv) The preservation of a historically important land area or a certified historic structure.[26]

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[23] Elkind, Peter, *The Tax Scam That Won't Die*, ProPublica.org (June 17, 2022), www.propublica.org/article/syndicated-conservation-easement-irs-tax-scam
[24] Looney, Adam*, Charitable Contributions of Conservation Easements*, Tax Policy Center. May 2017, at 15.
[25] Gilbert, Paul, Op. Ed., *The Uses and Abuses of Conservation Easements*, Washington Post, Jan. 3, 2004.
[26] 26 U.S.C. § 170(h)(4)(A); Treas. Reg. Sec.1.170A-14(d)(1); and S. Rep. No. 96-1007, at 10 (1980).

The donation of a conservation easement is considered a partial interest gift since the landowner retains ownership and certain rights to continue use and enjoyment of the property. The law allows a deduction for the FMV of a qualified conservation easement donation. A qualified appraisal is required to determine the FMV at the time of the donation. The landowner can claim an income tax deduction in the year in which the charitable donation occurs, up to 50 percent of AGI (qualified farmers and ranchers may deduct up to 100 percent of AGI). The donation is deductible against the estate tax. Form 8283 is required if claiming itemized deductions. The landowner must also record a deed of conservation easement (or similar document) to the qualified charitable organization.

Charitable organizations are required to disclose conservation easement contributions and holdings on Form 990 or Form 990EZ. A value for the easements does not have to be disclosed.

B. Horrendous Abuse of Conservation Easements—It Hurts Us All

In the past six years, traditional conservation easements have been hijacked by promoters who sell the rights to claim conservation easement deductions to groups of investors. With little regard for natural resources or environmental impact, their key goal is personal gain. They also create charitable organizations that do not fulfill conservation purposes but exist for the sole purpose of receiving their donated easements.[27] Such syndicated conservation easement schemes have already cost the U.S. Treasury billions in lost taxes.[28] They are syndicated because they involve the practice of selling off deductions to investors.[29] In a syndicated conservation easement scheme:

> "Instead of seeking to protect a bucolic reserve for wildlife or humans, profit-seeking intermediaries have turned the likes of abandoned golf course or remote scrubland into high-return investment vehicles. These promoters snatch up vacant land that till then was worth little. Then they hire an appraiser willing to declare that it has huge, previously unrecognized development value—perhaps for luxury vacation homes or a solar farm—and thus is really worth many times its purchase price. The promoters sell stakes in the donation to individuals, who claim charitable deductions that are four or five times their investment. The promoters reap millions in fees."[30]

Due to this abuse, charitable contribution deductions for conservation easements have come under close scrutiny by the Service. For example, in Notice 2017-10, the Service notifies

[27] Looney, *supra* note 24, at 1.
[28] Elkind, *supra* note 23.
[29] Looney, *supra* note 24, at 1.
[30] Elkind, *supra* note 23.

taxpayers that syndicated conservation easements constitute "a tax avoidance transaction…"[31] The Service notes:

> "The Treasury Department and the Service have become aware that some promoters are syndicating conservation easement transactions that purport to give investors the opportunity to claim charitable contribution deductions in amounts that significantly exceed the amount invested. In such a syndicated conservation easement transaction, a promoter offers prospective investors in a partnership or other pass-through entity ("pass-through entity") the possibility of a charitable contribution deduction for donation of a conservation easement.
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> The promoters (i) identify a pass-through entity that owns real property, or (ii) form a pass-through entity to acquire real property. Additional tiers of pass-through entities may be formed. The promoters then syndicate ownership interests in the pass-through entity that owns the real property, or in one or more of the tiers of pass-through entities, using promotional materials suggesting to prospective investors that an investor may be entitled to a share of a charitable contribution deduction that equals or exceeds an amount that is two and one-half times the amount of the investor's investment. The promoters obtain an appraisal that purports to be a qualified appraisal as defined in §170(f)(11)(E)(i) but that greatly inflates the value of the conservation easement based on unreasonable conclusions about the development potential of the real property. After an investor invests in the pass-through entity, either directly or through one or more tiers of pass-through entities, the pass-through entity donates a conservation easement encumbering the property to a tax-exempt entity. Investors who held their direct or indirect interests in the pass-through entity for one year or less may rely on the pass-through entity's holding period in the underlying real property to treat the donated conservation easement as long-term capital gain property under §170(e)(1). The promoter receives a fee or other consideration with respect to the promotion, which may be in the form of an interest in the pass-through entity. The Service intends to challenge the purported tax benefits from this transaction based on the overvaluation of the conservation easement. The Service may also challenge the purported tax benefits from this transaction based on the partnership anti-abuse rule, economic substance, or other rules or doctrines."[32]

The Service calls syndicated conservation easements among "the worse of the worst tax scams" and has pursued "tens of thousands of audits and warned of hefty penalties facing anyone who exploits it."[33] In January 2022, the Service announced plans to hire up to 200 additional attorneys to help the agency combat syndicated conservation easements and two other tax

[31] I.R.S. Notice 2017-10, at 1.
[32] *Id.,* at 2-3.
[33] Elkind, *supra* note 23.

schemes.[34] In addition, the Justice Department has responded by bringing criminal charges and civil lawsuits against the promoters of syndicated conservation easement schemes.[35]

Since 2017, a bipartisan group of lawmakers have tried, unsuccessfully, to pass the Charitable Conservation Easement Program Integrity Act, legislation which attempts to end syndicated easements by making them less profitable. The proposed legislation would bar taxpayers claiming easement deductions that exceed 2.5 times their investments. According to the Office of Management and Budget, closing this loophole would generate $12 billion in additional tax revenue through 2027. But promoters of syndicated conservation easements have far outspent supporters of traditional conservation easements on efforts to lobby lawmakers.[36] Their efforts appear to be succeeding because some lawmakers have expressed reluctance to support legislation aimed at preventing syndicated conservation easements.

The Land Trust Alliance is fearful that promoters of syndicated easements will eventually drive Congress to bring a complete halt to the conservation easement program. The Alliance barred its 950 members from accepting conservation easement donations from syndicated deals.[37]

C. Best Practice—Just Follow the Rules

While the extra scrutiny is intended to keep out syndicated conservation easements, it also applies to legitimate charitable organizations. It is, therefore, critical to keep up with changes in procedural requirements as they are modified to keep up with the latest schemes by promoters. One way to do this is by paying close attention to Tax Court findings in recent cases involving syndicated conservation easements.

Charities must be able to distinguish syndicated conservation easements from traditional conservation easements in case they are approached with an offer from a syndicated scheme. In addition to the organization's usual checklist for consideration of a conservation easement, the organization should pay attention to the following to ensure that the easement is not a syndicated conservation easement scheme.

- Thoroughly research the landowner—who are they, where do they live, how closely connected are they to the subject property? When did they purchase it? How much time do they spend there? What do they know about the land they want to turn into a

[34] Haliburton, Cory, *Syndicated Conservation Easements (and Other Tax Schemes) Beware*, Freemanlaw.com, (Feb. 2, 2022), freemanlaw.com/syndicated-conservation-easements-and-other-tax-schemes-beware/
[35] Elkind, *supra* note 23.
[36] *Id*.
[37] *Id*.

conservation easement? How much do they know about local conservation efforts, available public resources, and local environmental concerns?

- Was there any advertisement or promotion offered to attract investors?
- Does the appraisal meet all the requirements of a qualified appraisal?
- Was the appraisal performed by a qualified appraiser? Perhaps maintain a list of appraisers vetted and approved by the charitable organization.

IV. DAFs—An Issue Still Not Resolved

A Donor Advised Fund (DAF) is an account owned by a public charity to which a donor makes a deductible contribution of cash and certain noncash assets. The donor retains the right to determine which charitable organization(s) will receive funds from the account, in what amounts, and when. The donor can also provide advice concerning investment of the funds. A DAF allows a donor to set aside money for the benefit of charity and receive a tax deduction without giving away the entire amount at one time.

In 1991, Fidelity Investments became the first for-profit financial institution to offer DAFs. Such financial institution hosted DAFs are sometimes referred to as "commercial" DAFs.[38] They received formal legal recognition with the Pension Protection Act of 2006.

According to one estimate, DAFs have grown by 376 percent over the past 10 years, from $34 billion in 2010 to $160 billion in 2020. In its 2021 Donor-Advised Fund Report, the National Philanthropic Trust noted that the number of individual DAF accounts in the US is above one million for the first time. In 2020, contributions to DAF accounts made up approximately 10.1 percent of total giving. That number rose by five percent in 2021.[39]

For the most part, DAF accounts have operated with little regulation.[40] In addition to basic reporting requirements about the number of DAFs, asset values, contributions, and grants, there are few rules. The sponsoring organization of a DAF is subject to excise tax if distributions are made for a noncharitable purpose. An excise tax may also be due if a DAF distribution provides a direct or indirect benefit to the donor or advisor. Excise business holdings rules of section 4943 that apply to private foundations also apply to DAFs.[41]

Critics contend that DAFs do little more than serve as tax avoidance vehicles that line the pockets of financial institutions that serve as fund administrators. They point out that the largest commercial DAF sponsors now receive more funds annually than the nation's largest public

[38] *Id.*

[39] *2021 Donor-Advised Fund Report*, National Philanthropic Trust (Oct. 12, 2022, 8:30 AM), www.nptrust.org/wp-content/uploads/2021/11/2021-Donor-Advised-Fund-Report-NPT-Single-Page.pdf Page 3

[40] 2022 JCT Report, *supra* note 1, at 24.

[41] *Id.*

charities.[42] Their concern is that most funds remain in the DAFs for years rather than benefitting charities.

The Accelerating Charitable Efforts Act (ACE Act)[43] was introduced in the House of Representatives in early February 2022. It is very similar to a bill introduced in the Senate in June 2021. Under the proposed rules, DAFs would be categorized as either 15-year DAFs or 50-year DAFs.

> 15-year DAFs: donors would continue to receive the tax benefits they currently receive upon contribution to a DAF, provided the funds are distributed within 15 years of the year of contribution.
>
> 50-year DAFs: if a donor wants more than 15 years to complete distributions from the DAF, their tax benefits would be slightly different. The donor would continue to receive capital gains and estate tax benefits upon contribution but would not receive an income tax deduction until the funds are actually distributed to a charitable recipient. All funds would have to be distributed within 50 years of contribution.

The proposed ACE Act also provides that the contribution of a non-publicly traded asset to a "qualified DAF" or a "qualified community foundation DAF" would not be deductible until the asset is sold, with the deduction being limited to the gross proceeds received from the sale and credited to the DAF (instead of the appraised value). Any funds remaining past the 15-year date of the contribution would be subject to an excise tax in an amount equal to 50% of any portion of the contribution not distributed within 15 years of the year of contribution.[44]

The proposed ACE Act describes a "qualified community foundation DAF" as a section 501(c)(3) organization that is owned and controlled by a qualified community foundation organized and operated for the purpose of serving the needs of a particular geographic community that is no larger than four states and that holds at least 25% of its assets outside of DAFs. It would also have to meet one of the following two requirements: 1) allow donors to hold up to $1 million in DAFs without being subject to the proposed new payout rules, or 2) allow donors to hold more than $1 million in DAFs and still receive up-front tax benefits as long as the DAF requires a 5 percent annual payout or make all distributions within 15 years of contribution.[45]

The ACE Act will likely not impact funds already held in DAFs—the new rules would impact contributions and distributions made after the date of enactment. Under the Senate

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[42] *Id.*
[43] H.R. 6595, 117th Cong. (2021-2022).
[44] *Id.*
[45] *Id.*

version of the ACE Act, salaries or travel expenses to a donor's family members, or through distributions to DAFs, would no longer be counted toward payout obligations.[46]

Let's Take the Pulse of This Issue: Where Do You Stand?

Several groups are opposed to the proposed ACE Act, including the Council on Foundations and the Community Foundation Public Awareness Initiative. At this time, it is unclear how the ACE Act will fare. Charitable organizations need not make changes at the moment but should follow these bills in case they come closer to enactment.

V. Three Other Issues Impacting the Charitable Deduction

A. Cap on SALT Deductions

To avoid double taxation, taxpayers have always been allowed to deduct the full amount of state and local taxes (SALT) on their federal tax return. This includes property taxes paid for any real estate that is not used for business purposes; levies on vehicle or boat registration; and income tax or sales tax (can deduct either income or sales tax, but not both).

The TCJA took the unprecedented, controversial step of capping SALT deductions at $10,000 (for married couples; $5,000 for single filers) for the 2018-2025 tax years. Lawmakers contended that for most people, the new, higher standard deduction is sufficient to offset any losses from SALT deductions over $10,000. While this appears to be the case for most voters, the cap has had a substantial impact on high-income taxpayers in high-tax states where local property and state income tax bills can be much higher than $10,000. These are typically blue leaning states, such as California, Connecticut, Illinois, New Jersey, and New York. [47] This unlimited deduction allowed taxpayers in states with high state tax rates to ease the burden of state taxes with the federal deduction. For example, according to an analysis from The Pew Charitable Trusts, New York taxpayers claimed, on average, $22,169 in state and local taxes on their federal income tax returns prior to the TCJA. The $10,000 cap means the average New York taxpayer loses out on more than $12,000 of SALT deductions each year.[48]

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[46]S. 1981, 117th Cong. (2021-2021).

[47] *Id*.

[48] Oliff, Phillip and Samms, Brakeyshia, *Cap on the State and Local Tax Deduction Likely to Affect States Beyond New York and California*, Pewtrusts.org (10 April 2018), www.pewtrusts.org/en/research-and-analysis/articles/2018/04/10/cap-on-the-state-and-local-tax-deduction-likely-to-affect-states-beyond-new-york-and-california

3. Impact on Charitable Giving

Since the TCJA left the deduction for charitable donations unchanged, that deduction remains available for the minority of Americans who still itemize--high-income taxpayers. Some advisors suggested high-income taxpayers in high-tax states could use charitable giving to reduce taxes if they have SALT deductions in excess of the $10,000 cap.[49] Some lawmakers even predicted that charitable donations in high-tax states would increase as a result of the SALT deductions cap.[50]

Results show, however, that the value of charitable deductions in the most impacted states has decreased. The American Enterprise Institute (AEI), a conservative thinktank, examined taxpayer data maintained by the Service for 2018-19, the first two years under the TCJA. Researchers found:

> "Contrary to what legislative sponsors may have hoped, in almost all instances, charitable giving in select high-SALT counties in California, Connecticut, Illinois, New Jersey, and New York has actually decreased."[51]

The researchers noted that while <u>total giving</u> has increased, the <u>percent</u> of Americans giving has slightly decreased. Since benefits of a SALT deductions cap repeal would flow heavily to highest earners, the AEI researchers contend a repeal would not lead to an increase in the number of Americans who give. In light of this, they speculated that perhaps people need time for gradual adjustment to the tax changes.[52]

In order to achieve the goal of increased giving by a higher number of people, AEI makes two recommendations regarding the charitable deduction: 1) create an above-the-line charitable deduction, or tax credit, that is available even for households that do not itemize their tax returns; or 2) replace the charitable deduction with a 25 percent nonrefundable tax credit. According to AEI, the second recommendation is projected to have the most favorable impact on charitable giving and would increase the number of new, tax-incentivized donors.[53]

There has been much discussion in the Biden administration about repealing the SALT deductions cap or raising the deduction limit. Several bills have been proposed by lawmakers, but none have been enacted. At this time, there is no indication whether any temporary change will be instituted prior to the cap's elimination in 2025. In the meantime, 22 states have enacted workarounds for some taxpayers, typically business owners.[54]

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[49] Husock, *supra* note 7, at 2.
[50] *Id.*
[51] *Id.*
[52] *Id.*
[53] *Id.*, at 4-5.
[54] Berry-Johnson, Janet, *What Do They Mean By The SALT Tax Deduction?*, Forbes, Aug. 29, 2022.

4. Best Practices for Charitable Organizations

Charitable organizations located in high SALT states should understand what impact, if any, the SALT deductions cap has had on their high-income donors. If there is an impact, consider an educational campaign focused on those donors. For example, let's say Andy and Tina live in Orange County, California. Before the TCJA, they claimed, on average, $15,524 in SALT deductions on their federal income tax returns. They typically itemize their deductions. This means, as a result of the SALT deduction cap, they will lose out on $5,524 in deductions. Are they interested in donating a higher percentage in order to offset that loss with a charitable deduction? With some education about their options and calculations about how much they can save if they also utilized the charitable deduction, perhaps they will donate as a way to offset their $5,524 loss of deduction due to the cap for the SALT deduction.

B. Itemized v Standard Deductions

The ability to itemize deductions has always been part of our system of taxation. But the way in which the Treasury Department has defined exemptions and deductions has changed considerably over time, often in response to wars, other emergencies, and natural disasters. Deductions were available from the beginning for excise taxes, state and local taxes, casualty and theft losses, and business expenses. Deductions for charitable contributions were introduced in 1917. Other deductions added over time include: medical expenses (1942); state excise taxes (1964); gasoline taxes (1979); state sales tax (1987), and personal interest (1991).[55]

The standard deduction option was first introduced in 1944. The goal was to simplify the process for both taxpayers and officers of the Service. From 1944-1969, the standard deduction was equal to 10 percent of AGI. Instead of having to maintain receipts, taxpayers could simply deduct 10 percent from their taxable income, up to a maximum amount.[56] In 2017, the final tax year before the TCJA took effect, taxpayers could use both a personal exemption of $4,050 and the standard deduction. The TCJA eliminated the personal exemption but nearly doubled the standard deduction for all classes of tax filers.

The standard deduction is easier for the taxpayer to select and for IRS officers to compute. The amount is adjusted annually for inflation. The standard deductions for 2022 are:

[55] *Historical Federal Income Tax Information,* Milefoot, www.milefoot.com/math/businessmath/taxes/fit.htm (last visited Sept. 4, 2022).
[56] Schrank, Aaron, *The history of income tax's standard deduction is more interesting than you think*, Marketplace *(*May 9, 2017), www.marketplace.org/2017/05/09/history-income-taxs-standard-deduction-more-interesting-than-you-think/

Filing Status	Standard Deduction
Single	$12,950
Head of Household	$19,400
Married Filing Jointly	$25,900

The question for our purposes is how has the TCJA's expansion of the standard deduction impacted charitable donations since it became effective in 2018? Studies conducted by the philanthropic sector conclude that the higher standardized deduction has had a negative impact on charitable giving among the middle class. According to Giving USA, charitable gifts among low-to-middle income households fell 1.7 percent in 2018, the first year that the TCJA took effect. But in 2019, charitable giving was the second-highest level on record when adjusted for inflation. Donations continued to climb in 2020 by an inflation-adjusted 3.8 percent.[57] One key reason for this may have been the above-the-line $300 deduction ($600 for joint filers) that was created during the Covid-19 pandemic to support charitable organizations. According to research cited by the Charitable Giving Coalition, the above-the-line tax deduction, which expired in 2021, was effective. The Coalition notes that in the fourth quarter of 2020, small donations of up to $250 increased by more than 15 percent from the prior year.[58] Steve Taylor, a senior vice president for United Way Worldwide, said the majority of American donors on whom nonprofits depend make small donations. He says another above-the-line deduction would motivate them to keep giving.[59]

The Universal Giving Pandemic Response and Recovery Act (S.618), introduced in the Senate in March 2021, would allow taxpayers who do not otherwise itemize their tax deductions to have an additional, above-the-line deduction limited to one-third of the standard deduction.[60] An identical bill (H.R. 1704) is pending before the House.[61] There is widespread support for the bills from the philanthropic sector. In his press release announcing the bipartisan bill, Congressman Chris Pappas (D-NH) noted that according to the Fundraising Effectiveness Project, "the number of small-dollar donors (under $250) rose by 17.1% in the third quarter of 2020 over the same period in 2019. This figure highlights that the charitable giving incentives included in the CARES Act helped catalyze increased charitable giving."[62] Neither bill has

[57]Weiss, Laura, *Charities lobbying to restore expanded tax deduction for giving*, Roll Call (Jan. 26, 2022), rollcall.com/2022/01/26/charities-lobbying-to-restore-expanded-tax-deduction-for-giving/

[58] *Id.*

[59] Wright, Peggy. *Tax Breaks And IRA Rollovers On Federal Agenda*, The NonProfit Times, June 24, 2022.

[60] S. 618, 117th Cong. (2021-22).

[61] H.R. 1704, 117th Cong. (2021-22).

[62] Pappas, Chris, *Universal Giving Pandemic Response and Recovery Act expands federal tax deductions for charitable giving to support nonprofits and philanthropic Granite Staters*, March 9, 2021, press release.

advanced since its introduction. Charitable organizations should continue to advocate for the above-the-line deduction.

C. IRA Rollover – Qualified Charitable Distributions

Individuals aged 72 and older are required to take the Required Minimum Distribution (RMD) annually from certain types of retirement accounts, such as 401(k), 403(b), and 457(b) plans, and traditional Individual Retirement Accounts (IRA). Income taxes are assessed on the RMD unless it is a Roth plan. It is estimated that collectively, seniors have about $5 trillion in IRA assets.[63]

Many seniors do not need to take the RMD. Some dislike it because the forced distribution places them in a higher tax bracket. One of the ways to offset RMDs is with an IRA Charitable Rollover, or Qualified Charitable Distribution (QCD). It allows individuals over 70 ½ to make an income tax-free gift, up to $100,000 annually, directly from their IRA. This provides benefits for both the individual donor and the charitable organization. Donors can avoid inclusion of the RMD, up to $100,000, for income tax purposes, which may allow them to remain in a lower tax bracket. Charitable organizations can receive more funds because they receive pre-tax dollars rather than post-tax dollars.

In February 2021, a bill was introduced to expand the QCD. (S. 243). It sought to increase the QCD from $100,000 to $400,000, permit split-interest entities, and lower the participation age to 65.[64] The inclusion of split-interest entities would benefit both donors and charitable organizations. Donors would receive fixed payments as part of a charitable gift annuity (CGA), a charitable remainder unitrust, or a charitable remainder annuity trust. The charity would receive the remainder when the donor passes away. Unfortunately, the bill was been weakened—the final version reduced the additional QCD amount from $400,000 to $50,000, while keeping the participation age at 70½.[65] This legislation was enacted in December 2022 as part of the SECURE 2.0 Act. Experts are concerned that the low $50,000 transfer limit will impact the types of giving vehicles that will be funded. It is likely that most gifts under the Legacy IRA Act will be used to fund CGAs, which have an average gift minimum of $10,000."[66]

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[63] *Charitable IRA Rollover/IRA Legacy Act*, AFPGlobal.org (April 20, 2021), afpglobal.org/news/charitable-ira-rolloverira-legacy-act
[64] S. 243, 117TH Cong. (2021-22).
[65] S. 4808, 117th Cong. (2021-22).
[66] Jaarda, Kristen, *IRA Legacy Gifts Are Just Around the Corner*, WealthManagement.com (Aug. 8, 2022), www.wealthmanagement.com/philanthropy/ira-legacy-gifts-are-just-around-corner