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VIA REGULAR AND ELECTRONIC MAIL

Internal Revenue Service
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Room 5203, P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Comments by The Land Trust Alliance, The Nature Conservancy and The Trust for Public Land on the proposed IRS Rule on Contributions in exchange for state or local tax credits, proposed on August 11, 2018

The Land Trust Alliance
Founded in 1982 in Massachusetts, the Land Trust Alliance is a nonprofit corporation and national land conservation organization based in Washington, D.C., that works to save the places people need and love by strengthening land conservation across America. The Alliance represents 1,000 member land trusts supported by more than 4.6 million financial supporters, 207,000 volunteers and 8,000 paid staff nationwide. The Alliance is the voice of private land conservation, unifying the American ideals premised on personal initiative, landowner empowerment and individual private property rights.

The Nature Conservancy
The Nature Conservancy is a global conservation organization dedicated to "…conserving the lands and waters on which all life depends." Guided by science, TNC creates innovative, on-the-ground solutions to our world's toughest challenges so that nature and people can thrive together. We are working to conserve lands, waters and oceans at unprecedented scale, provide food and water sustainably address climate change and help make cities more sustainable. TNC works in all 50 states and 72 countries and uses a collaborative approach that engages local communities, governments, the private sector, and other partners, including farmers, ranchers, and other landowners. Within the United States, the Conservancy itself owns over 2 million acres of land and has acquired from willing landowners and now holds conservation easements covering over 3.1 million acres. Nearly all of these land transactions have benefited from state and federal incentives encouraging landowners to protect their land working with conservation organizations such as the Conservancy and therefore TNC is directly affected by the regulatory change under consideration.

The Trust for Public Land
The Trust for Public Land creates parks and protects land for people, ensuring healthy, livable communities for generations to come. Millions of people live within a 10-minute walk of a Trust for Public Land park, garden, or natural area, and millions more visit these sites every year.

Overview
On behalf of our organizations and the millions of members we represent, we thank the IRS for the opportunity to comment on these proposed new rules that will modify 26 CFR 1.170A-1, which directly affect the deductibility of donations of land and of qualified conservation interests in land received by our member organizations and by state and local governments across the country.

We have significant concerns with the proposed new rule, which we detail below, including the effect on conservation outcomes. The proposed rule clearly reduces the federal tax incentive for donations of conservation easements made a permanent part of the tax code by Congress in 2015, in full knowledge of the various state and local incentives for conservation.

Our further concerns stem from the fact that the proposed rule would overturn a well-established system where states provide additional charitable incentives without affecting a donors' federal tax liability and replace it with a new system that would create great inequities in the treatment among different states and of individual taxpayers who are making charitable donations favored by long-standing state and federal tax policy.

The proposed rule, initiated by a desire to prevent state governments from allowing their citizens to avoid the effects of the new Internal Revenue Code sec. 162(b), goes far beyond that needed to end a cash-based tax avoidance of a new law. Accordingly, we urge the Service to withdraw the proposed rule. At minimum, the Service should exempt truly charitable donations, as exemplified by conservation gifts.

This resolution is appropriate because the conservation donations that are the subject of our concern with the proposed rule are in no way tax avoidance. They are not donations in lieu of a state tax bill that must otherwise be paid – they are entirely voluntary donations. The impact of including state conservation incentives in the proposed rule which seeks to prohibit avoidance of sec. 162(b), creates a myriad of inequities and filing complications for taxpayers who are doing what both the federal tax code and state legislatures want them to do for the benefit of their fellow citizens. Finally conservation deductions are for real property interests and not cash which is a significant difference from the sec. 162(b) avoidance the Service seeks to address. In this area, the result of the proposed rule will not be less avoided tax – it will be fewer conservation donations – quite contrary to the intent of Congress, which expanded the deductibility of sec. 170(h) donations in 2015 and declined to limit them in any way in their 2017 tax reform legislation.

In addition, we are concerned there is an error that merits correction. Section 1.170A-1(h)(3) of the proposed regulation says "Except as provided in paragraph (h)(3)(v) of this section, if a taxpayer makes a payment or transfers property… the amount of the taxpayer's charitable deduction… is reduced by the amount of any state or local tax credit that the taxpayer receives…." We believe the intended reference should be paragraph (h)(3)(vi) of the section, which is the exception for tax credits of 15% or less.

The Rule Will Undermine State Tax Incentives in Many States

We are particularly concerned, of course, about the effects of the proposed rule on conservation outcomes desired by the states, and on the effectiveness of state tax credits created to incentivize donations of land, water and conservation easements to advance the public good.

Seventeen states – Alabama, Arkansas, Colorado, Connecticut, Delaware, Florida, Georgia, Iowa, Maryland, Massachusetts, Mississippi, New Mexico, New York, North Carolina[1], South Carolina and Virginia -- have created state tax credits or enhanced deductions to incentivize conservation donations. So has Puerto Rico. All of these incentives predated section 162(b), and in fact have no interaction with that section of the code.

The states created these additional incentives to enhance and direct conservation efforts specific to their states.

[1] North Carolina's incentive was deauthorized in 2013, but there is currently legislation in the state legislature to reinstate it.

In creating these credits, states were well aware and mindful of the benefits the federal government already provided for donations of land or of conservation easements. The new rule withdraws those federal benefits in the amount each state has itself provided. This seems to conflict with the intent of Congress in renewing its own enhancement of the federal deductions allowed for conservation donations, which it enacted in 2006 and reauthorized in 2008, 2010, 2013, and 2014 before making it a permanent part of the tax code in 2015.

The various conservation incentives offered by state governments were designed to enhance the federal deduction and support the federal government's policy in support of conservation. This proposed rule would inhibit that conservation incentive and likely slow the pace of conservation donations. In some cases these complimentary incentives resulted in states picking up monitoring and enforcement over these donations. In Colorado and Georgia, for example, state experts review each and every appraisal submitted to substantiate a state credit.

The Rule Overturns Existing Policy That Has Worked Well

The IRS previously laid out a policy (in the Office of Chief Counsel Memorandum # 20110505010 of October 27, 2010) that clearly states that "The tax benefit of a federal or state charitable contribution deduction is not regarded as a return benefit that negates charitable intent, reducing or eliminating the deduction itself," citing the findings in McLennan v. United States, 23 Cl. Ct. 99 (1991) and its subsequent proceedings, including its affirmation by the appeals court (994 F. 2nd 839 (Fed. Cir. 1993), as well as Skripak v. Commissioner (84 T.C. 285, 319); Allen v. Commissioner (92 T.C. 1, 7 (1989) and its affirmation (925 F 2nd 348 (9th Cir. 1991), and Browning v. Commissioner (109 T.C. 303 (1997), which made it clear that state and federal tax benefits were not part of the income realized in a bargain sale of donated property.

Similarly, the IRS and the courts have agreed in the past that state tax benefits – including tradable tax credits – are not income.

This stance properly accords the states the flexibility they need for their own tax policy choices.

The proposed rule reverses this, leaning on distinguishing a state tax credit from a state deduction, a distinction that makes little sense given that low state tax rates (relative to federal tax rates) almost guarantee that states will often use tax credits rather than deductions (which are worth only the product of the low tax rate and the deduction value) to create meaningful incentives for their citizens for the benefit of the public.

The Proposed Rule Creates Inequality Between States

The proposed rule creates challenges for the states when it says that "the amount of the taxpayer's charitable contribution under section 170(a) is reduced by the amount of any state or local tax credit that the taxpayer <u>receives or expects to receive</u> in consideration for the taxpayer's payment or transfer." In essence, this is an income tax provision based not on real benefits to the taxpayer, but on a projection of what those benefits might possibly be. This penalizes states that have premised their incentives on something more modest than a lump sum tax credit that is immediately available to the donor.

Section (B)(iv) attempts to resolve this by saying that "the amount of any state of local tax credit is <u>the maximum credit allowable that corresponds to the amount of the taxpayer's payment or transfer</u>."

The proposed rule decreases the federal deduction for a charitable donation by the theoretical sum total benefit of a state tax incentive (that is greater than a state income tax deduction) regardless of when or if the taxpayer actually sees that benefit.

To illustrate the detrimental impact of the proposed rule, we offer the example of a conservation donation in the state of New York. New York has a very modest incentive for its easement donors – a tax credit equal to 25% of their local property tax on the conserved property. Local property taxes in New York average 1.65% of the assessed value of the property per year. That is an average tax credit of 0.41% of the value of the donation, which the donor receives as long as they own the property, so that the total of those credits will be 100% of the fair market value of the donation after 244 years. The premises of the rulemaking would appear to eliminate any federal deduction for a conservation donation in New York, despite the fact that its state tax incentive is actually quite modest.

As another example, Florida law provides a full exemption from property taxes for lands protected by a permanent conservation easement – four times the incentive provided by New York. It is not, however, in the form of a tax credit or deduction, since Florida has no income tax. If this is treated as if it were a credit, it would negate all federal deductions for donations of easements in Florida.

Other state tax benefits may even be illusory under the proposed rule. Colorado, Delaware, Georgia, Massachusetts and Virginia have an explicit dollar cap on total credits issued in their state per year. In those states, a taxpayer making a donation may not receive a state credit at all if demand greatly exceeds the cap.

Most states have conformed their standard for charitable donations of conservation easements to the federal government standards, and in doing so they have provided an array of different means for conferring state tax incentives to donors. We are concerned that the proposed rule will inhibit more states from creating incentives for conservation donations because it creates a disincentive for states to do so. This is unfortunate because conservation tax incentives are a proven and cost-effective way to provide significant public benefits. The proposed rule, in attempting to quantify these incentives, will inevitably lead to inequities in the treatment of the different state programs, as well as inequities between different taxpayers, even within the same state.

Examples of Inequitable Treatment of Taxpayers under the Proposed Rule

We find it particularly inequitable and unfair for a donor to lose their federal deductions for the amount of the maximum state tax credit where the taxpayer cannot use the state tax credit because it exceeds the taxpayer's state tax liability. This is precisely the case with many land-rich, cash-poor agricultural landowners, the particular target of the enhanced federal deduction.

Additionally, a credit carried over and used over many years should not be treated the same as one used entirely in the year of donation.

Many states have dollar caps on their tax credits for conservation donations. Under the current system, that caps the benefits available to the largest donations, but the proposed rule reverses that and could penalize smaller donors.

Iowa, for example, has a tax credit for 50% of the value of the donation, but it is capped at $100,000 per donation. If the donation is worth $200,000, the donor must reduce his or her federal deductions by $100,000. If the donation is worth $1 million, the credit is limited to $100,000 by state law, which is less than the 15% of fair market value *de minimus* exception for state tax credits in the proposed rule. The $1 million donor does not have to reduce their federal deduction at all. If, on the other hand, the proposed rule is interpreted to apply to the 50% tax credit regardless of the explicit limit to that credit in the state law, then smaller donors – those who need the incentive most – would be penalized.

Transferable tax credits provide their own special inequities. The donor who sells his or her tax credit in Colorado, New Mexico, South Carolina or Virginia may get only 70 or 80 percent of the nominal credit amount. In addition to which, they will pay federal income tax on the sale, further reducing what they gained from the credit. In addition, some donors have been unable to sell their transferable credits, and do not have sufficient income to utilize the credits themselves.

While the proposed rule assumes that a state tax credit is worth what its maximum could be, the truth of the value of the state conservation incentive is far more complicated.

Basing a reduction in deductions on a theoretical state benefit will cause innumerable inequities in the treatment of different taxpayers who are making a charitable donation for which both the state and federal governments have created incentives.

Creates Challenges Calculating Actual Benefits
As the examples above demonstrate, a donor's actual tax benefit from a state tax incentive may not be known for 20 years. Requiring taxpayers to calculate that benefit with any accuracy is impractical and brings all sorts of complications.

Colorado recently had several years where its tax credits were not awarded in the same year as the donation, providing obvious complications for donors filing their federal taxes. In addition, Colorado's credits are not based on the federal tax return valuation, but on the state's own independent appraisal review, meaning that the actual credit issued by the state may well not be the "the maximum credit allowable that corresponds to the amount of the taxpayer's… transfer" because the state's assessment of that amount may well be different than the value claimed on the taxpayer's federal return.

The proposed rule also fails to address what will happen when the federal government itself challenges the valuation of the gift, and itself changes the value of the donation asserted by the taxpayer. It is unclear how that would affect the calculation of "the maximum (state) credit allowable that corresponds to the amount of the taxpayer's payment or transfer".

Conclusion
This rule would be a remarkable departure from existing tax administration that would generate significant inequities in the treatment of states and of individual donors and create an unnecessary and quite avoidable intrusion into state prerogatives in public policy. Most importantly, it would seriously reduce the federal incentive for conservation donations, directly eroding the explicit intent of Congress in enhancing the federal deduction for conservation easement donations enacted in 2015 and left completely untouched by the major tax reform legislation of 2017. We urge the Service to withdraw the proposed rule. At minimum, the Service should exempt truly charitable donations, as exemplified by conservation gifts.

Thank you again. We realize the challenges of regulating in this complex area and welcome the opportunity to assist the Service to craft an exemption for truly charitable donations should it decline to withdraw the proposed rule.

Sincerely,

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