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In this article, the authors examine the IRS's recent decision to limit income tax deductions for donations of conservation easements to adjusted basis despite its history of allowing them based on fair market value.

In 1980 Congress enacted section 170(h), providing a charitable deduction to encourage taxpayers to conserve (rather than develop) real estate that is suitable as relatively natural habitat for species of conservation concern or provides recreational or scenic enjoyment for the public. In general, the amount of the section 170 deduction for restricting development should equal the lost development potential of the real estate. Landowners, including developers, were the obvious targets for the congressional incentive. For years the IRS raised no issues with deductions taken by developers who sought to conserve, rather than develop, land.

Consider, for example, *Palmer Ranch*,[1] *Champions Retreat*,[2] *Kiva Dunes*,[3] and *Pine Mountain*.[4] In those cases, the donor retained title and all incidents of ownership except the right to fully develop the property; the government even admitted as much when asked to provide an example of a syndicated partnership donation that would pass muster. The government explained that a partnership donation of development property when the developer no longer wants to develop the property is an acceptable way for the partnership to donate a conservation easement.[5] Indeed, that is exactly what Congress intended: donations of valuable development property for "the preservation of our country's natural resources and cultural heritage."[6]

But the IRS has decided that all conservation easements are worthless. Because few partnerships accepted the global settlement offer

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[1] *Palmer Ranch Holdings Ltd. v. Commissioner*, T.C. Memo. 2014-79, *aff'd in part, rev'd in part, and remanded*, 812 F.3d 982 (11th Cir. 2016), *on remand*, T.C. Memo. 2016-190.

[2] *Champions Retreat Golf Founders LLC v. Commissioner*, T.C. Memo. 2018-146, *vacated and remanded*, 959 F.3d 1033 (11th Cir. 2020), *on remand*, T.C. Memo. 2022-106.

[3] *Kiva Dunes Conservation LLC v. Commissioner*, T.C. Memo. 2009-145.

[4] *Pine Mountain Preserve LLLP v. Commissioner*, 151 T.C. 247 (2018), *aff'd in part, rev'd in part, and remanded*, 978 F.3d 1200 (11th Cir. 2020).

[5] *United States v. Zak*, No. 1:18-cv-05774-AT (N.D. Ga. June 26, 2019).

[6] Senate Finance Committee, Tax Treatment Extension Act of 1980, S. Rep. No. 96-1007, at 9 (June 12, 1980).

of a complete disallowance plus penalties,[7] the Tax Court must now try all easement cases. Indeed, the IRS has been unwilling to mediate. As Judge David Gustafson lamented in denying a request for compelled mediation, the Tax Court can lead the IRS to water, but it cannot make the agency drink.[8]

With a reported inventory of more than 750 cases and anecdotal suggestions that the Tax Court is trying about 30 cases a year, it could take 25 years to clear the Tax Court docket of the current easement cases. Even after a case is tried, some issues may remain unresolved. Settling the issue of conservation purpose took about a decade in *Champions Retreat*. Resolving the floating homesite issue in *Pine Mountain* took about the same amount of time. The proceeds clause issue continues to percolate.[9]

The Government's New Argument

Given that background, it should come as little surprise that the IRS has embarked on a new frontier of issues, hoping to create rules that disallow large groups of deductions. One such issue is the government's new argument that a deduction for an easement on property that had been owned by a developer within five years before the donation of the easement should be limited to the basis in the property rather than a deduction based on its fair market value. But just because the government comes up with a new theory does not mean that the theory is correct. As explained below, the government's new theory is incorrect based on the plain language of the relevant statutes, the history of the statutory provisions, and the IRS's own regulations and practice.

The government's new theory is premised on the idea that by restricting the development of property under a qualified conservation contribution, a donor may have disposed of inventory in violation of either section 724(b)'s five-year disposition rule or section 170(e)'s inventory rule, and thus the charitable contribution deduction should be limited to the donor's basis. This theory ignores the definition of inventory and the nature of the property right that the donee of a conservation easement actually receives.

Section 724(b) Does Not Apply to Easements

Section 724(b) provides:

> In the case of any property which was contributed to the partnership by a partner and *was an inventory item* in the hands of such partner immediately before such contribution, any gain or loss recognized by the partnership on the *disposition of such property* during the 5-year period beginning on the date of such contribution shall be treated as ordinary income or ordinary loss as the case may be. [Emphasis added.]

Inventory is further defined in sections 751(d) and 1221 as "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

By its plain terms, section 724(b) applies only when the property disposed of is an inventory item in the hands of the partner immediately before the contribution. Therefore, a determination must be made regarding the property interest contributed. After all, not all property interests are the same:

> If one conceives of property as likened thus to a bundle of rights, privileges, immunities and liabilities adaptable to any physical thing, the fee simple absolute is the largest segment thereof that the political philosophy of the time and place permits any private individual to obtain.[10]

On the other hand, an owner may transfer less than a fee simple interest. That lesser interest is an interest in the property, but that interest is not necessarily inventory. When a developer contributes property to a partnership and then sells interests in the partnership, the analysis on a

[7] At the time of the global settlement offer, the IRS was not offering a basis deduction to partnerships when a developer donated inventory, suggesting that the new theory is a recent invention. *See* IR-2020-130, IR-2020-228, and CC-2021-001.

[8] *Habitat Green Investments LLC v. Commissioner*, No. 14433-17 (T.C. Mar. 22, 2022).

[9] *See Hewitt v. Commissioner*, 21 F.4th 1336 (11th Cir. 2021), *rev'g and remanding* T.C. Memo. 2020-89.

[10] *Oakbrook Land Holdings LLC v. Commissioner*, 154 T.C. 180, 205 n.4 (2020) (citing 9 *Thompson on Real Property*, section 80.08(b)(2)(ii)).

subsequent conveyance by that partnership is twofold: (1) Is the property right disposed of inventory, and (2) does section 724(b) apply to the conveyance?

For a conservation easement, the donated interest is merely a restriction on development, which is the antithesis of a dealer's normal inventory. The donor has not disposed of the bundle of rights that establish ownership in the land. The donor still owns the land and can enjoy the use of it. The donor still pays the property taxes and insurance on the land. The donee has simply received the right to enforce the restriction. The donee has no right to develop or sell the underlying property for development. Indeed, the donee has no right to use the property outside the terms of the easement. Such a property right cannot reasonably be deemed an inventory item of the donor.[11] Nor has there been a "disposition" of property as that term is normally used because no transfer of title has occurred.

In other words, property in terms of section 724(b) means inventory, and inventory means the "thing" that is held out for sale to customers in the ordinary course of a trade or business. If real estate is derived from a "developer," the inventory item is the land. Section 724(b) is triggered when there has been a disposition of the "thing" (that is, the land). Any gain or loss recognized by the partnership on the disposition of the land would be treated as ordinary income or ordinary loss.

But by its terms, section 724(b) has no application to the contribution of a "qualified conservation contribution." There has been no disposition of the purported inventory that would trigger section 724(b)'s ordinary income or ordinary loss provisions. Rather, the donor still owns the land after the donation of a "qualified conservation contribution." Thus, even after an easement has been established, the donor could still sell the land and trigger section 724(b) within the five-year window.

Moreover, by its plain terms section 724(b) applies only to transactions that produce ordinary income or ordinary loss. A charitable contribution produces neither. It results in a charitable contribution deduction. Had Congress meant for section 724(b) to apply to charitable contributions, it would have explicitly said so in the statute.[12]

The Plain Language of Section 170(e) Is in Accord

A plain reading of section 170 also confirms that Congress deliberately excluded a "qualified conservation contribution" from the adjusted basis limitation of section 170(e). Each word in the code has meaning and should be given its due significance.[13] Applying that rule of statutory construction to section 170 shows that Congress did not intend for section 170(e) to apply to qualified conservation contributions under section 170(h). Again, had Congress intended that result, it would have said so.

First, section 170(e) applies to any *charitable contribution* of property. A charitable contribution is defined in section 170(c) to mean a *contribution or gift* to specific charitable organizations. Section 170(e) does not apply to the donation of a qualified conservation contribution for at least two reasons. First, the property contributed is merely a restriction — not a donation of the fee simple interest or any right resembling the right to develop the property. There has been no disposition of an interest that would equate to a sale of enough rights to call the interest inventory. Second, Congress did not specifically apply section 170(e) to a qualified conservation contribution and instead used different words.

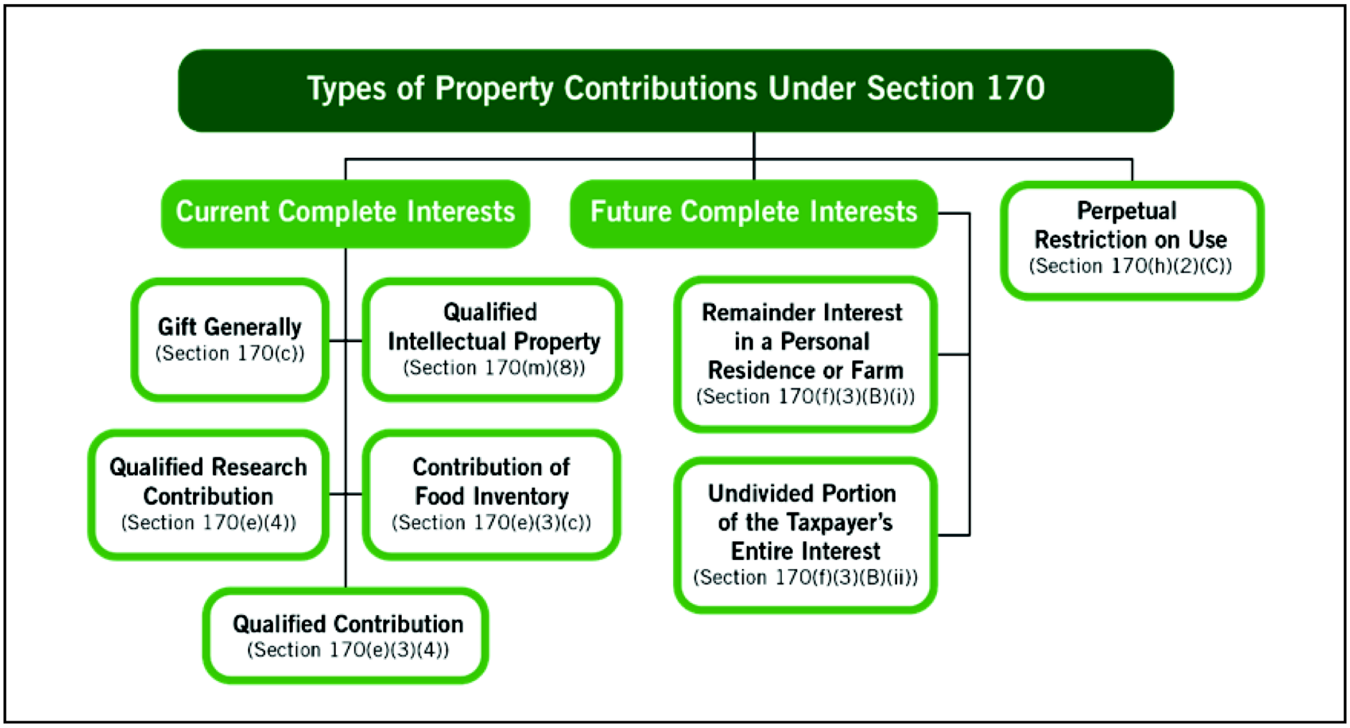
Those words matter. A charitable contribution consists of a gift of a donor's entire interest in the donated property. Donations of less than a donor's entire interest are generally not allowed.[14] As with section 724, section 170(e) specifies that its analysis depends on whether "*the property contributed* had been sold by the taxpayer at its fair market value." Again, the relevant question is what interest was donated.

[11] *See Black v. Commissioner*, 38 T.C. 673 (1962); *see also Helvering v. Clifford*, 309 U.S. 331 (1940).

[12] *See, e.g.*, section 724(d)(3)(A).

[13] *Keene Corp. v. United States*, 508 U.S. 200, 208 (1993) (noting the duty to refrain from reading a phrase into a statute when Congress left it out); *Russello v. United States*, 464 U.S. 16, 23 (1983) (explaining that when "Congress includes particular language in one section of a statute but omits it in another . . . it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion").

[14] Section 170(f).



As explained above, the property interest that has been donated in a conservation easement is a restriction. The donee does not have any right to develop the land. The "inventory" owned by the donor has not been donated; the donor still owns the land. Unless a court determines that the donor is a dealer in restrictions or easements, there has been no disposition of inventory to which section 170(e) could attach.

Congress has not specifically applied section 170(e) to a qualified conservation contribution, but it *has* specifically applied it to defined "qualified contributions."[15] Congress has also specifically applied it to "qualified intellectual property contributions," as referenced in section 170(m)(8)(A). Thus, Congress has established a pattern of explicitly referencing section 170(e) whenever the legislature intends for the limitation to apply.

On the other hand, Congress did not reference section 170(e) in section 170(h)'s provisions related to the donation of a "*qualified conservation contribution*" (that is, a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes).[16] A qualified real property interest includes a restriction (granted in perpetuity) on the use that may be made of the real property (such as a conservation easement).[17]

Congress could have defined a qualified conservation contribution to require a section 170(e) adjustment, but it did not. It could have included a reference to section 170(e) in section 170(h), as it did in defining qualified IP contributions in section 170(m), but it did not. Congress could have added a subparagraph under section 170(e) for qualified conservation contributions, as it did with qualified contributions in section 170(e)(3) and qualified research contributions in section 170(e)(4), but it did not. And Congress could have limited the deduction for developers under section 170(f), which disallows or limits the deduction,[18] but it did not.

Those important legislative decisions are summarized in the figure.

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[15] Section 170(e)(3) (qualified contributions); section 170(e)(4) (qualified research contributions); and section 170(e)(5) (qualified appreciated stock contributions).

[16] Section 170(h)(1).

[17] Section 170(h)(2).

[18] *See, e.g.*, section 170(f)(14) (reducing the deduction for amounts attributable to the section 47 rehabilitation credit).

The terms "charitable contributions" and "qualified conservation contributions" are defined separately in section 170, and each should be given its own meaning. Because it separately defined a qualified conservation contribution but did not include that type of contribution in, or refer to, section 170(e), Congress indicated that it does not intend for section 170(e) to apply to qualified conservation contributions.[19]

Legislative History Confirms as Much

The legislative history of section 170 confirms that section 170(e) does not apply to a section 170(h) restriction. As originally codified in 1962, section 170(e) applied solely to section 1245 depreciable property.[20]

Congress was initially concerned with double deductions (that is, taxpayers claiming depreciation deductions against ordinary income, donating the depreciable property to charity, and then claiming charitable deductions against ordinary income).[21] In 1964 and again in 1966, Congress expanded the scope of section 170(e) to include inherent recapture gain under sections 1250(a) and 617(d), respectively.[22] In 1969 Congress again amended section 170(e) to be substantially identical to the current codification.[23] Nothing in that history indicates that Congress intended for section 170(e) to apply to qualified conservation contributions.[24]

If that omission were not clear enough, since 1962 Congress has amended section 170 to delineate six "qualified" categories: (1) contributions, (2) conservation contributions, (3) research contributions, (4) elementary or secondary education contributions, (5) computer contributions,[25] and (6) IP contributions.[26] The only qualified contribution that is not in and does not reference section 170(e) is a qualified conservation contribution.[27]

Given the timing of the amendments, that must have been a deliberate choice. After adding section 170(h) in 1980, Congress added the qualified research contribution (1981), qualified elementary or second education contribution (1997), qualified computer contribution (2000), and qualified IP contribution (2004) to section 170. Except for section 170(h) qualified conservation contributions, all of those qualified contributions were either added as subsections to section 170(e) or made specific reference to section 170(e). For example, a qualified IP contribution as defined in section 170(m) means "any charitable contribution of qualified intellectual property . . . the amount of which . . . is reduced by reason of [section 170(e)(1)]."

Further, the legislative history of section 170(h) itself, including Treasury's initial concerns about its enactment and proposed alternative approaches, reflects that neither Congress nor Treasury ever considered section 170(e) to apply to the section 170(h) deduction. In enacting section 170(h), Congress believed that "deductions for conservation easements should be directed at the preservation of unique or other significant land areas or structures."[28]

To preserve recreational or educational lands, natural habitats, open space, and historic structures, Congress granted a charitable contribution deduction for limiting development of such properties through conservation easements — without regard to basis.[29] Congress even stated that "the amount of the deduction for

[19]Even the author of the section 170(h) regulations, Stephen J. Small, acknowledged that the issue of whether a conservation easement is a capital asset or inventory did not come up when the regulations were promulgated. Stephen J. Small, "Proper — And Improper — Deductions for Conservation Easement Donations, Including Developer Donations," *Tax Notes*, Oct. 11, 2004, p. 217, 222; *see also* Small, *The Federal Tax Law of Conservation Easements* 20-2 (1997).

[20]Revenue Act of 1962, P.L. 87-834, section 13(d).

[21]S. Rep. 1881, 87th Cong. 2d Sess., p. 99-101 (1962); and H. Rep. No. 1447, 87th Cong. 2d Sess. (1962), 1962-3 C.B. 405, 470-476.

[22]Revenue Act of 1964, P.L. 88-272, section 231(b)(1); and Act Relating to the Income Tax Treatment of Exploration Expenditures in the Case of Mining, P.L. 89-570, section 1(b)(1).

[23]Tax Reform Act of 1969, P.L. 91-172, section 201(a)

[24]*See, e.g.*, Staff of Joint Committee on Taxation, "Options to Improve Tax Compliance and Reform Tax Expenditures," JCS-02-05, 277-287, 297 n.634 (2005).

[25]In 1997 Congress enacted section 170(e)(6), which originally applied to a qualified elementary or secondary education contribution. *See* P.L. 105-34, section 224(a). In 2000 Congress amended the statute to substitute qualified computer contribution. *See* P.L. 106-554, section 1(a)(7). In 2014 Congress eliminated section 170(e)(6). *See* P.L. 113-295, section 221(a)(28)(B).

[26]Section 170(m) defines a qualified IP contribution as "any charitable contribution of qualified intellectual property — (A) the amount of which taken into account under this section is reduced by reason of subsection (e)(1)."

[27]Before the subdivision's deletion, qualified computer contributions were in section 170(e)(6). *See* P.L. 113-295, section 221(a)(28)(B).

[28]Senate Finance Committee, *supra* note 6.

[29]*Id.* at 9-12.

the contribution of a conservation easement or other restriction is the fair market value of the interest conveyed to the recipient."[30] When Congress intended to limit a deduction, it specifically did so.[31] Congress did not say that the section 170(h) deduction should be reduced in any way, including under section 170(e).

To be sure, Treasury expressed its concerns with deductions for conservation easements generally — but not even Treasury during congressional hearings proposed limiting such deductions to basis for real estate developers or dealers.[32] Treasury was concerned with valuing development property and ensuring that such property would continue to be used for conservation purposes and for the benefit of the public after donation of an easement.[33] To address those concerns, Treasury proposed that easements be on land near federal, regional, or state conservation areas and be donated to governmental authorities or established conservation organizations with land management capabilities.[34]

Treasury proposed narrowing the definition of conservation purpose to ensure that the public would derive some identifiable benefit from the easement.[35] Neither approach considered nor addressed limiting easement deductions to a donor's basis. Even though section 170(e) had been in place for more than a decade, Treasury's purported concerns in 1980 did not even mention limiting qualified conservation contributions under section 170(e). Nor did the most recent legislation.[36]

IRS Regulations and Practices Confirm the Same

Until recently, it seemed commonly accepted that the section 170(e) inventory limitation applied only to conveyances involving the disposition of the fee simple interest — not to a section 170(h) qualified conservation contribution restriction on development. Indeed, there is no incentive to donate valuable property at adjusted basis. A deduction limited to adjusted basis might not cover any remaining debt on the property, thus preventing its conservation and thwarting the congressional incentive.

The IRS's own regulations and past practices recognize this reality. For example, reg. section 1.170A-14 specifies the rules for valuing the donation of a conservation easement. Those rules confirm that what is donated (and subsequently valued) is a restriction — and not the fee simple estate. Thus, the value of the donation is determined by comparing the value of the property before the restriction (based on the property's highest and best use) with the value of the property after the restriction (again based on the property's highest and best use). That rule applies across the board; the diminution in value is always the value of the charitable contribution. The property interest valued is the restriction, not the underlying fee interest. And the restriction is not inventory. After all, no developer holds a set of easements that could be sold to consumers.

If the IRS believed that Congress intended to treat developer donor property differently, surely it would have outlined separate rules for determining that value in the regulations with specificity and examples. But it did not do so.[37]

Nor would the IRS have a proper basis to treat a developer's donation of property differently

[30] *Id.* at 14.

[31] *See, e.g.*, section 170(f)(14).

[32] *See* Miscellaneous Tax Bills: Hearing on H.R. 3874, H.R. 4103, H.R. 4503, H.R. 4611, H.R. 4634, H.R. 4968, and H.R. 5391 Before Subcommittee on Select Revenue Measures of the House Committee on Ways and Means, 96th Con. 5-6, 11-13 (Nov. 9, 1979) (statement of Daniel Halperin, Treasury deputy assistant secretary for tax policy) (referencing H.R. 4611); Minor Tax Bills: Hearing Before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means Committee, 96th Cong., 2d. Sess. 155-156, 165-166 (June 26, 1980) (statement of Daniel Halperin, Treasury deputy assistant secretary) (referencing H.R. 7318).

[33] In his testimony, Halperin used the word "develop" or variations thereof 16 times, but notably he did not refer to "dealer," "inventory," "ordinary income," "capital gain," or section 170(e).

[34] Minor Tax Bills: Hearing Before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means, 96th Cong., 2d. Sess. 168 (June 26, 1980).

[35] *Id.*

[36] P.L. 117-328, div. T, Title VI, section 605(a)(1), (b).

[37] The only reference to section 170(e) in reg. section 1.170A-14 is in subsection (h)(4), which provides, in part, that "in examples illustrating the value or deductibility of donations, the *applicable* restrictions and limitations of section 1.170A-4, with respect to reduction in amount of charitable contributions of certain appreciated property, . . . must also be taken into account" (emphasis added). The regulation no doubt refers to items subject to section 170(e) as outlined in the statute, but a qualified conservation contribution is not subject to section 170(e).

from a donation by any other person. In enacting section 170(h), and to offer incentives for the preservation of developable land, Congress declared that "*the amount of the deduction* for the contribution of a conservation easement or other restriction *is the fair market value of the interest* conveyed to the recipient."[38] (Emphasis added.) It is not the IRS's prerogative to declare something else. The restrictions and limitations of regulations under section 170(e) cannot apply to conservation easements because that would directly conflict with Congress's unambiguous intent.[39]

Moreover, until recently the IRS has never taken the position that a restriction is inventory under sections 724(b) and 170(e). Treasury has issued no regulations alleging as much. The IRS offered no section 170(e) basis deduction for the partnership in its global settlement offer.[40] And excluding the recent decision in *Glade Creek* (discussed below), only 10 reported opinions related to conservation easements have cited section 170(e).[41] Three of those cases limited a deduction under section 170(e), but in each the taxpayer did not satisfy the one-year holding period requirement.[42] The government's theory is, indeed, new.

Application of the Issue in *Glade Creek Partners*

Although it did not address the statutory language of section 170(h),[43] the Tax Court recently addressed the government's new theory in *Glade Creek Partners*.[44] In *Glade Creek*, the Tax Court held that a partnership's charitable contribution deduction for a donation of a conservation easement should be limited to the partnership's adjusted basis in the property under sections 724(b) and 170(e). Fortunately, the decision did not announce a rule for all taxpayers because the taxpayer in *Glade Creek*, according to the Tax Court, did not provide "a satisfactory explanation with reference to the statute as to why" the property was not inventory.

Also, the history of the property in *Glade Creek*, and the prior owner's reporting, was important to the Tax Court's analysis given that the taxpayer did not argue a different statutory interpretation. In *Glade Creek*, the taxpayer had acquired property from a failed real estate developer to provide an investor with an ownership interest in the property and reassure a bank that provided infrastructure loans for developing the property. The real estate developer (ILC) had acquired the property to develop a residential vacation community. The property was made up of three tracts (the easement property).

ILC recorded lots on Tract I, obtained infrastructure loans, and constructed improvements as part of its development plans. Initially, it was successful in marketing and selling Tract I lots, but sales slowed significantly because of financial difficulties caused by the 2008 recession. In 2009 ILC stopped advertising the lots because of lack of funds. Three owners walked away from the development project, and the remaining owners faced increased pressure from the bank that had funded the infrastructure loans.

In 2010 the remaining lots on Tract I and the easement property were transferred to Hawks Bluff Investment Group Inc. in exchange for Hawks Bluff's assumption of ILC's debt. With the real estate market in a tailspin, the owners faced increasing financial pressures to the extent that they contributed unrelated property to Hawks Bluff as a payment on the outstanding mortgage. This stopgap measure did not solve Hawks Bluff's problems, which left only one owner who continued to make debt payments to the bank.

[38] Senate Finance Committee, *supra* note 6, at 14.

[39] Nor was there any "gap" for Treasury to fill. Any attempt to twist the regulation into contravening congressional intent would be invalid under *Chevron* "step zero" and the Administrative Procedure Act. *See King v. Burwell*, 576 U.S. 473 (2015); *Aquilino v. United States*, 363 U.S. 509 (1960); *Perez v. Mortgage Bankers Association*, 575 U.S. 92 (2015); and *3M Co. v. Commissioner*, 160 T.C. No. 3, at 231 (2023).

[40] *See supra* note 7.

[41] *Blau v. Commissioner*, 924 F.3d 1261 (D.C. Cir. 2019); *Tempel v. Commissioner*, 136 T.C. 341 (2011); *RERI Holdings I LLC v. Commissioner*, 149 T.C. 1 (2017); *Hughes v. Commissioner*, T.C. Memo. 2009-94; *Strasburg v. Commissioner*, T.C. Memo. 2000-94; *Griffin v. Commissioner*, T.C. Memo. 1989-130; *Dorsey v. Commissioner*, T.C. Memo. 1990-242; *Oakhill Woods LLC v. Commissioner*, T.C. Memo. 2020-24; *Belair Woods LLC v. Commissioner*, T.C. Memo. 2018-159; and *Foster v. Commissioner*, T.C. Summ. Op. 2012-90.

[42] *Hughes*, T.C. Memo. 2009-94; *Strasburg*, T.C. Memo. 2000-94; and *Griffin*, T.C. Memo. 1989-130.

[43] Again, section 170(m) (qualified IP donations) specifically incorporates the inventory limitation of section 170(e). By contrast, section 170(h) (qualified conservation contributions) does *not* reference section 170(e) — nor do the regulations specifying how such contributions are to be valued.

[44] *Glade Creek Partners LLC v. Commissioner*, T.C. Memo. 2023-82.

Understanding that he could not continue paying the debt by himself, that owner identified a conservation easement as a potential way for Hawks Bluff to pay off the remaining mortgage and retain the unsold lots for future development.

In late 2012 the following occurred: (1) Hawks Bluff contributed the easement property to Glade Creek in exchange for a 98 percent membership interest; (2) Sequatchie Holdings LLC acquired a 90-95 percent membership interest in Glade Creek; and (3) Sequatchie voted to grant a conservation easement over the easement property. On its 2012 tax return, Hawks Bluff reported that (1) it was a real estate dealer, (2) the easement property was inventory, and (3) its inventory was reduced on the transfer of the property to Glade Creek. Glade Creek did not report the easement property as inventory on its 2012 tax return.

In the ensuing litigation, the IRS argued that the easement property was inventory in Hawks Bluff's hands and retained that character in Glade Creek's hands under section 724(b). Thus, the IRS asserted that Glade Creek's charitable deduction should be limited to its adjusted basis in the easement property under section 170(e). For its part, Glade Creek agreed that the easement property was investment property in Hawks Bluff's hands but argued that its deduction should not be reduced under section 170(e). If the easement property was inventory, Glade Creek also argued that the property's character changed in 2009 when ILC abandoned its development plans because of the recession and lack of funds.

Based on the facts, the Tax Court determined that ILC and Hawks Bluff held the easement property as inventory and that the effects of the 2008 recession did not convert the property to investment property in ILC's, Hawks Bluff's, or Glade Creek's hands. In analyzing whether the easement property was inventory, the court looked to a seven-factor test that contemplated (1) the nature and purpose of the acquisition of the property and the duration of the ownership; (2) the extent and nature of the taxpayer's efforts to sell the property; (3) the number, extent, continuity, and substantiality of the sales; (4) the extent of subdividing, developing, and advertising to increase sales; (5) the use of a business office for the sale of the property; (6) the character and degree of supervision or control exercised by the taxpayer over any representative selling the property; and (7) the time and effort the taxpayer habitually devoted to the sales.[45]

The court analyzed only the first, third, and fourth factors and placed significant weight on an additional factor: Hawks Bluff's tax return reporting. Regarding the first factor, the court found that Hawks Bluff was a real estate dealer that was formed to acquire the easement property from a failing real estate developer. Regarding the third factor, the court placed little weight on the lack of sales on the easement property because ILC made significant improvements to develop all three tracts.

For the fourth factor, the court found that ILC did not segregate the easement property as investment property. The court placed little weight on Hawks Bluff's lack of post-acquisition development activities because it found that Hawks Bluff was formed to acquire ILC's failing real estate business, to provide an ownership interest to an investor, and to reassure the bank that had provided the infrastructure loans. Lastly, the court noted that the value of the easement property increased largely because of ILC's infrastructure improvements and development activities and not because of long-term market appreciation, indicating that the easement property was not a capital asset.

The Tax Court did not address the fact that the partnership still owned the property. Nor did it address the threshold issue of whether there was a disposition of the alleged inventory. Similarly, the Tax Court did not address whether the donation was a restriction on development and resulted in limited development potential. Given the arguments that were presented, the Tax Court did not address the plain language of either section 724 or 170(e) or the application of that plain language to conservation easements generally.

The *Glade Creek* opinion should not be read as a sea change in the law because it was based on specific facts and stipulations. As the Tax Court

[45] *United States v. Winthrop*, 417 F.2d 905, 909-910 (5th Cir. 1969). Decisions of the Fifth Circuit rendered before October 1, 1981, are considered binding in the Eleventh Circuit. *Beech Aircraft Corp. v. Rainey*, 488 U.S. 153, 160 n.4 (1988) (citing *Bonner v. City of Prichard*, 661 F.2d 1206 (11th Cir. 1981)).

noted, the fundamental issues of statutory interpretation were never addressed.

Conclusion

The time for statutory interpretation will come. Congress intended to encourage donations of land from anyone willing to donate. It did not intend for the section 170(h) deduction to be any different for developers than for non-developers. That is clear from the language of the code, the history of the statutes, and the rules for valuations of qualified conservation contributions. For more than 40 years, Congress has allowed taxpayers — including developers — an income tax deduction for donations of conservation easements based on the fair market value of the easement, not adjusted basis. The courts will assuredly recognize as much eventually. But in the meantime, buckle up for a long ride. ■