# CONSERVATION EASEMENTS: AN ENTIRELY DIFFERENT SORT OF MESS

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Qualified conservation easements provide a taxpayer with the opportunity to obtain a charitable deduction without actually giving up her property; if property is encumbered by an easement in favor of a charitable organization for conservation purposes, Section 170(h)(1) of the Code provides for a charitable deduction.

This deceptively simple concept has spawned a great deal of litigation because the requirements to qualify for the deduction are fairly complex. Inadequate appraisals are a common source of problems for taxpayers. Other taxpayers have been tripped up by the failure to obtain a subordination agreement from the mortgage holder in a timely fashion. A recent case raises a different problem: the taxpayer took the deduction in the wrong year. *Mecox v. United States*, 2016 U.S. Dist. LEXIS 11511 (S.D.N.Y. Feb. 1, 2016).

Mecox Partners LP owned a building on Jane Street in Greenwich Village, and it created a façade and open space easement in favor of the National Architectural Trust in December 2004. *Id.* at *4-*5. The easement barred alterations to the building's façade and was expressly for conservation purposes. *Id.* at *4. After the deed was signed and delivered in December of 2004, Mecox filed its partnership return in July 2005; the return was accompanied by an appraisal, and the taxpayer asserted a claim for a deduction based on the $2.2. million appraised value of the easement.

The IRS was underwhelmed: in 2011, it issued a Notice of Final Partnership Administrative Adjustments for the 2004 tax year:

- The $2.2 million charitable deduction was disallowed;
- A deduction for $37,700 in legal fees and appraisal fees was disallowed;
- A forty percent accuracy-related penalty was assessed under Section 6662(h) of the Code; and
- As an alternative, a twenty percent accuracy-related penalty was assessed under Sections 6662(a) and 6662(b).

The taxpayer filed an action challenging the adjustments, and the government responded with a summary judgment motion, arguing that the easement was not created in 2004. *Id.* at *7. Mecox opposed that motion, arguing that the contribution was made when the easement deed was delivered in December 2004. The relevant regulations seemed to support the taxpayer's position, as they provide that "[o]rdinarily, a contribution is made at the time delivery is effected." Treas. Reg. § 1.170A-1(b).

Mecox lost. It lost because a seemingly minor detail had major consequences: while the easement deed was delivered in December 2004, it was not recorded until November 2005. *Mecox*, 2016 U.S. Dist. LEXIS 11511 at *5. As the district court explained, this made all the difference.

Judge Ramos began his analysis by noting that state law generally determines the nature of property interests, while federal law determines the tax consequences that attach to those interests. *Id.* at *8-*9 (citations omitted). Looking to applicable state law, the court readily determined that the easement deed fell within the scope of New York's Environmental Conservation Law. *Id.* at *9 (citing N.Y. ENVTL. CONSERV. LAW § 49-0303(1)). Under that statute, a variety of requirements apply to conservation easements, "[o]ne of these is that the deed of conservation easement be 'duly recorded.'" *Id.* at *11 (citing N.Y. ENVTL. CONSERV. LAW § 49-0305(4)).

Noting that the plain language of the New York statute made recording a prerequisite to enforcement, Judge Ramos readily concluded that "Mecox erred in taking a deduction for a qualified conservation contribution in 2004, because no contribution had been made up to that point." *Id.* at *12. While Mecox offered a variety of arguments why the New York statute governing conservation easements did not apply to its particular conservation easement, the court rejected all of them.

The court then closed by touching on an issue concerning the appraisal: the delay in recording the deed also had the effect of invalidating the appraisal, which can be prepared no more than sixty days before the contribution. *Id*. (citing Treas. Reg. § 1.170A-13(c)(3)(i)). Practitioners handling conservation easements in New York state (or in any other jurisdiction with a similar rule on the effectiveness of a conservation easement) should keep this issue in mind. The regulations provided that an appraisal must be prepared within a specific period of time:

- It cannot be prepared more than sixty days before the contribution, Treas. Reg. § 1.170A-13(c)(3)(i)(A); and
- It cannot be prepared after the due date for the return on which it is first claimed, including any extension, Treas. Reg. § 1.170A-13(c)(3)(i)(A), (c)(3)(iv)(B).

These rules mean that a problem with the appraisal cannot be cured during the course of an audit.

In the case of Mecox, if it had focused on the recording date of the easement deed, it could have re-done its appraisal and claimed the deduction for 2005, the year the easement became effective

under New York law. Since it apparently did not learn of the problem until years later, it was too late too perfect its deduction.

The broader lesson is that attention to detail is critical in handling conservation easements.

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