

Conservation Easement Donations: Great for the Environment, Thorny for Taxpayers

Thursday, March 18, 2021

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Agenda Topics

1. Conservation Easements from a Real Estate Perspective
2. Legal Requirements (Best Practices and Pitfalls)
3. Syndicated v. Non-Syndicated Easements

Polling Question 1

According to the National Conservation Easement Database, approximately how many acres of U.S. land are currently subject to a conservation easement?

- a) 13 million
- b) 23 million
- c) 33 million

Conservation Easement from a Real Estate Perspective

Conservation Easements

You gave away your rights –
and cannot easily get them back



Law in General

- **conservation easement.** A real-estate covenant binding a parcel of land in a way that preserves a native plant or animal, a natural or physical feature of the land, or some aspect of the land that has some historical, cultural, or scientific significance. • The easement is a recorded, perpetual, individually tailored agreement creating a nonpossessory interest in real property, the interest being held by a government entity or by a qualified nonprofit. It permanently restricts or imposes affirmative obligations on the property's owner or lessee to retain or protect natural, scenic, or open-space values of real property, ensure its availability for agricultural, forest, recreational, or open-space use, protect natural resources and habitat, maintain or enhance air or water quality, or preserve the historical, architectural, archeological, or cultural aspects of the real property while allowing the landowner to continue to own and use the land, sell it, or transfer it to heirs. EASEMENT, Black's Law Dictionary (11th ed. 2019)



Other definitions

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- *The Dictionary of Real Estate Appraisal*, 6th ed defines a conservation easement as:
 - An interest in real property restricting future land use to preservation, conservation, wildlife habitat, or some combination of those uses. A conservation easement may permit farming, timber harvesting, or other uses of a rural nature to continue, subject to the easement. In some locations, a conservation easement may be referred to as a conservation restriction.
 - Treas. Reg. Section 1.170A-14(b)(2) defines perpetual conservation restriction as follows:
 - A perpetual conservation restriction is a qualified real property interest. A 'perpetual conservation restriction' is a restriction granted in perpetuity on the use which may be made of real property – including, an easement or other interest in real property that under state law has attributes similar to an easement (e.g., a restrictive covenant or equitable servitude). For purposes of this section, the terms 'easement,' 'conservation restriction,' and 'perpetual conservation restriction' have the same meaning



This





Becomes This



A conservation easement is generally a negative easement

- **negative easement:** An easement that prohibits the servient-estate owner from doing something, such as building an obstruction
 - NEGATIVE EASEMENT, Black's Law Dictionary (11th ed. 2019)
- However, the grantee, does have certain rights such as the right to access the property for inspection, enforcement and monitoring.

Typical Language

- **CONSERVATION INTENT.** The Owner and the [Qualified Non-Profit] are committed to protecting and preserving the Conservation Values of the Protected Property in perpetuity. Accordingly, it is their intent to create and implement a conservation easement that is binding upon the current Owner and all future owners of the Protected Property and that conveys to the [Qualified Non-Profit] the right to protect and preserve the Conservation Values of the Protected Property for the benefit of this generation and generations to come.

Typical Language

- **CONSERVATION PURPOSE.** The Conservation Purpose of this Easement is to provide significant public benefit by preserving and protecting in perpetuity the Conservation Values of the Protected Property identified above as those values exist at the time of this conveyance and as they may evolve in the future. But for this Easement, the Owner would be entitled to develop the Protected Property or sell the Protected Property for development in accordance with law.
- This Conservation Purpose is accomplished by confining the otherwise permissible development, management and use of the Protected Property to activities and improvements that are consistent with the preservation of these Conservation Values, by prohibiting activities and improvements that significantly impair or interfere with these Conservation Values, and by providing for remedies in the event of any violation of this Easement.
- **RESTRICTIONS.** Any activity or improvement on or use of the Protected Property in a manner that may significantly impair or interfere with a Conservation Value of the Protected Property or that is inconsistent with the terms or the Conservation Purpose of this Easement is prohibited except as set forth in this Easement.
- Structures and Improvements. No temporary or permanent buildings, structures, utilities, roads or other improvements of any kind may be placed or constructed on the Protected Property except as specifically permitted in this Easement
- Except as specifically permitted in this Easement and without limiting the general prohibition above, restrictions imposed upon the Protected Property expressly include the following:
 - Industrial Activity.
 - Commercial Activity.
 - Agricultural Use.
 - Residential Use and Development.

Care should be taken to describe what is permitted; permitted uses, however, cannot undo the conservation purposes [Examples]

Recreational and Educational Uses. The Protected Property may be used for nature education or study, hiking, cross-country skiing, horseback riding, camping, hunting, fishing, trapping and other non-intensive recreational and educational programs or activities that have no more than minimal impact on the Conservation Values of the Protected Property. Such permitted uses are not required under this Easement and may be further restricted, regulated and managed by the Owner at the discretion of the Owner.


Three “Shoreland Use Zones” have been identified for the Protected Property as generally depicted on Exhibit B of this easement. Within these Shoreland Use Areas, picnic shelters, canoe/kayak racks, storage sheds and similar small structures associated with the educational and recreational use of the Protected Property may be constructed or placed. The three permitted docks may also be located within these Shoreland Use Areas.

Once Granted – It's Permanent

- "It is elementary that an easement once granted is an estate which cannot be abridged or taken away, either by the grantor or his subsequent grantees. *Minneapolis Athletic Club v. Cohler*, 287 Minn. 254, 258, 177 N.W.2d 786, 789 (1970).
- It does not matter if the IRS rejects the deduction. The easement remains unless released by the grantee or there is some other legal basis to terminate the easement. The easement is granted "in perpetuity."

Valuing the Conservation Easement

- Estimated Fair Market Value of Property Unencumbered by the Conservation Easement
 - (Less) – Estimated Fair Market Value of Property Encumbered by the Conservation Easement
 - (Less) – any increase in the value of other land owned by the donor or a related party
- Equals Fair Market Value of the Conservation Easement



Highest and Best Use

Example

As an example, let's consider the valuation of a forested and ecologically significant land site with total CFOP area of 5,000 acres. It is suitable for immediate subdivision development with residential housing, but a conservation easement is granted over 3,000 acres of the CFOP. The area subject to the conservation easement now prohibits the anticipated residential development. However, the remaining 2,000 acres of the land parcel owned in fee simple is still available for development. In the before situation, the HBU of the 5,000-acre parcel is for residential development. In the after condition, only the 2,000-acre larger parcel retains the HBU of residential development. In the after scenario, the value of the 3,000-acre donation represents the loss in value attributable to the conservation easement (highest and best use before condition vs. highest and best use after condition).

- Courtesy of Shenehon Companies

The valuation in the “before and after” will change (presumably be reduced) primarily because the highest and best use will change.

Polling Question 2

True or false, if I've created a valid conservation easement under state law, I do not need to fulfill any other requirements to deduct the contribution on my federal tax return?

- A. True
- B. False
- C. Does the IRS ever make things that simple?

Tax Requirements: Best Practices & Pitfalls

I.R.C. § 170(h)

- Qualified Conservation Contribution
- A contribution of:
 - (A) of a qualified real property interest,
 - (B) to a qualified organization,
 - (C) exclusively for conservation purposes
- Treas. Reg. § 1.170A-14

Qualified Real Property Interest

Any of the following:

(A) the entire interest of the donor other than a qualified mineral interest,

(B) a remainder interest, and

(C) a restriction (granted in perpetuity) on the use which may be made of the real property.

Perpetuity

- I.R.C. § 170(h)(2)(C) – perpetual restriction on the real property
- I.R.C. § 170(h)(5)(A) – conservation purpose is protected in perpetuity

Perpetuity Required

- *Belk v. Commissioner*, 774 F.3d 221 (4th Cir. 2014)
- *Pine Mountain Preserve, LLLP v. Commissioner*, 978 F.3d 1200 (11th Cir. 2020)
- *Englewood Place, LLC*, T.C. Memo. 2020-105

Practice Tips

- I.R.C. § 170(h)(2)(A) (perpetual restriction) *and* I.R.C. § 170(h)(5)(A) (perpetual protection)
- Define the area
- Be careful with judicial extinguishment provisions

Conservation Purpose

I.R.C. 170(h)(4)(A): [T]he term “conservation purpose” means—

- (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 open space (including farmland and forest land) where such preservation is—
 - (I)**for the scenic enjoyment of the general public, or
 - (II)**pursuant to a clearly delineated Federal, State, or local governmental conservation policy,and will yield a significant public benefit, or
- (iv)**the preservation of an historically important land area or a certified historic structure.

Champions Retreat, 959 F.3d 1033 (11th Cir. 2020)

- Reversed Tax Court (2-1 decision)
- \$10.4 million deduction
- Conservation Purpose:
 - “The record establishes without genuine dispute that this property is home to abundant species of birds, some rare, to the regionally declining southern fox squirrel, and to a rare plant species”
 - Public’s scenic enjoyment



Champions Retreat, 959 F.3d 1033 (11th Cir. 2020)

- Conservation Purpose:
 - “relatively natural habitat . . . or similar ecosystem” – I.R.C. § 170(h)(4)(A)(ii)
 - deduction available even if the land “has been altered to some extent by human activity” - Treas. Reg. § 1-170A-14(d)(3)(i)
- Concurrence/Dissent
 - public’s scenic enjoyment
 - harsh chemicals on course (“thorny” natural habitat question)

Practice Tips

- Habitat or ecosystem must be “relatively natural,” not the land itself
- Golf Course – not a bright-line denial
- Syndicated Easement?

Filing Requirements

- Treas. Reg. § 1.170A-13
- Treas. Reg. § 1.170A-16
- Treas. Reg. § 1.170A-17
- Form 8283
- IRS Audit Technique Guide
- Between July and October 2020, over \$659 million in easement petitions at the Tax Court



Treas. Reg. § 1.170A-13

- **Recordkeeping and Return Requirements for Charitable Contribution Deductions**
- Donor's manner of acquisition
- Donor's cost or other basis
- Obtain qualified appraisal
- Attach appraisal summary to return (Form 8283)
- Effective for contributions made between Dec. 16, 1996 and July 30, 2018? – Audit Technique Guide

Treas. Reg. § 1.170A-16

- **Substantiation and Reporting Requirements for Noncash Charitable Contributions**
- § 1.170A-16(d) or (e)
- Contemporaneous written acknowledgment from donee
- Obtain qualified appraisal prepared by qualified appraiser
- Complete Form 8283 (copies to all partners)
- Attach Appraisal to Return (>\$500,000 contribution)
- Applies to contributions made after July 30, 2018

Treas. Reg. § 1.170A-17(a)

- Qualified Appraisal
- Prepared by qualified appraiser in accordance with generally accepted appraisal standards (USPAP)
- Contents:
 - Description/Condition of property
 - Valuation date (no earlier than 60 days before contribution date; or contribution date)
 - Contribution date
 - FMV (Treas. Reg. § 1.170A-1(c)(2))
 - Terms of Agreement (i.e. restrictions, rights to income)
 - Information about appraiser
 - Statement that appraisal was prepared for income tax purposes
 - Valuation method and basis
- Signed and dated by appraiser (date requirements)

Treas. Reg. § 1.170A-17(b)

- Qualified Appraiser
- Education (coursework, designation)
- Experience (property type)
- Declaration
- Individuals who are *not* qualified appraisers:
 - Donor of property
 - Donee of property
 - Spouses
 - One who is paid based on the value of the deduction
- Applies to contributions made on or after Jan. 1, 2019

Form 8283

- Treas. Reg. § 1.170A-16(d)(3)
- Donor's name, TIN
- Donee's name, TIN (signed Acknowledgement)
- Appraiser must sign a Declaration (include their name and SSN or EIN)
- Fair Market Value
- Manner and date of donor's acquisition
- Donor's adjusted basis

Prior IRS Successes

- ***Oakhill Woods, LLC*, T.C. Memo. 2020-24** (Strict Compliance v. Substantial Compliance)
- ***Englewood Place, LLC*, T.C. Memo. 2020-105** (denying deduction in part because taxpayer failed to provide basis information with Form 8283)
- ***Belair Woods, LLC*, T.C. Memo. 2018-159** (taxpayer failed to provide basis information, could not cure during audit, reliance on professional advice defense allowed to continue)

IRS Audit Technique Guide

- Updated Nov. 9, 2020
- Common “deficiencies”
 - Noncompliance with substantiation requirements (contemporaneous written acknowledgement, Form 8283, qualified appraisal)
 - Lack of perpetuity
 - Lack of conservation purpose
 - Use of improper appraisal methods
 - Overvalued conservation easements

Practice Tips

- Expect an audit (and prepare your clients)
- Always provide the donor's basis
- If mortgaged real property, lender must subordinate its rights to donee

Polling Question 3

True or false, for contributions made after July 30, 2018, donors must attach a qualified appraisal to the returns.

- a) True
- b) False
- c) True, if the contribution is higher than \$500,000

Syndicated vs. Non-Syndicated Conservation Easements

Listed Transactions Are Bad News

- 2016: In Revenue Notice 2017-10, IRS announced that “syndicated conservation easements” are designated as tax avoidance transactions and as **listed transactions** under sections 6111 and 6112.
- 2019: IRS added syndicated conservation easement transactions to annual “**Dirty Dozen**” list of tax scams

What is a listed transaction?

- A listed transaction is a transaction that is the same as or substantially similar to a type of transaction that the IRS has identified as a tax avoidance transaction.
- Listed transactions are identified by notice, regulation, or other form of published guidance.
- Listed transactions must be disclosed on Form 8886.

What is a “substantially similar transaction”?

- A transaction is substantially similar if it is expected to obtain the same or similar types of tax consequences and is either factually similar or based on the same or similar strategy.
- The term “substantially similar” is to be broadly construed in favor of disclosure.
- A transaction may be substantially similar to a listed transaction even though it involves different entities or uses different IRC provisions.
- Transactions that are substantially similar to listed transactions must be disclosed on Form 8886.

Revenue Notice 2017-10 (2016)

- Prospective investor receives promotional materials:
 - Invest in a pass-through entity that holds real estate and
 - Receive possibility of a charitable contribution deduction that is at least 2.5 times the amount of the investment;
- Promotional materials may be oral or written;
- Investor purchases an interest (directly or indirectly) in the pass-through entity that holds the real estate;
 - May have multiple tiers of entities
- Pass-through entity contributes a conservation easement encumbering the property to a tax-exempt entity and allocates (directly or indirectly) a charitable contribution deduction to the investor; and
- The investor reports a charitable contribution deduction on his/her income tax return.

Revenue Notice 2017-10

- Transactions entered in or after 1/1/2010 that are the same as, or substantially similar to, the transactions described in the notice are “listed transactions.”
- The transactions must be disclosed for each taxable year in which the taxpayer participated in the transactions.
- Material advisors, including appraisers, who make a tax statement on or after 1/1/2010 regarding such transactions also have disclosure and list maintenance obligations.
- Failing to disclose transactions will subject participants to penalties and an extended period of limitations.

Form 8886

- Any taxpayer, including an individual, trust, estate, partnership, S corporation, or other corporation, that participates in a reportable transaction and is required to file a federal tax return or information return must file Form 8886
 - Attached to income tax return
 - In initial year of filing, a copy should be sent to the Office of Tax Shelter Analysis (OTSA)
- Penalties for Not Filing:
 - I.R.C. § 6707A – 75% of the reduction in tax reported but not less than \$5,000/\$10,000 and not more than \$100,000/\$200,000
 - I.R.C. § 6662A(c) – Accuracy penalty up to 40%
 - I.R.C. § 6501(c)(10) – Statute of limitations does not run until one year after the information is actually provided to IRS

IRS Settlement Initiative

- Announced June 25, 2020
 - Time-limited settlement initiative; applies to docketed Tax Court cases
 - Applies to syndicated conservation easements and substantially similar transactions
 - Take it or leave it
- The settlement offer's key terms will include:
 - the deduction for the contributed easement is disallowed in full;
 - all partners must agree to settle, and the partnership must pay the full amount of tax, penalties, and interest before settlement;
 - “investor” partners can deduct their cost of acquiring their partnership interests and pay a reduced penalty of 10 percent to 20 percent, depending on the ratio of the deduction claimed to their partnership investment; and
 - partners who provided services in connection with any syndicated conservation easement transaction must pay the maximum penalty asserted by the IRS, typically 40 percent, with no deduction for costs.
- Taxpayers should not expect to settle docketed Tax Court cases on better terms

IRS Settlement Initiative

- Does not prohibit IRS from later asserting criminal penalties, promoter penalties, appraiser penalties, return preparer penalties, etc.
- IRS is offering settlements in newer docketed cases
 - First settlement in docketed case: Coal Property Holdings LLC (June 2020)
 - Deduction of \$155 million in 2013
 - Tax Court denied deduction because deed didn't satisfy perpetuity requirements, but 40% gross valuation misstatement penalty remained at issue
 - Investor partners paid 10% penalty and were permitted to deduct their cost of investing in the easement transaction
 - Promoter partner paid a 40% penalty and was denied any deduction
- IRS deputy chief counsel Drita Tonuzi:
 - “The conservation easement settlement initiative is going really well.”

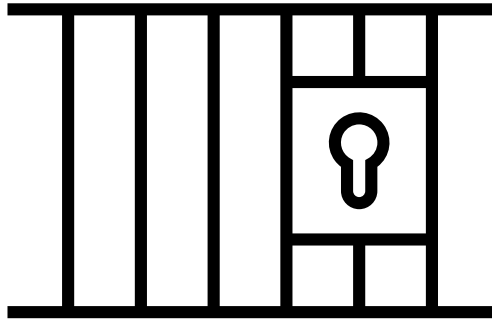
Professional Responsibility Consequences

- IRS referring practitioners to Office of Professional Responsibility (OPR) “as soon as it’s clear that **a practitioner aided or abetted in understating tax** through one of these abusive schemes.” – De Lon Harris (deputy commissioner for examinations)

Criminal Consequences

- December 2020 – two Atlanta accountants who promoted syndicated deals plead guilty (aged 42 and 38)
 - First criminal case involving conservation easements
 - Marketed transactions by promising investors that **for every \$1 invested in the partnership, they would receive more than \$4 in charitable contribution deductions.**
 - Solicited investors after the end of the tax year and advised them to **fraudulently backdate** subscription agreements, checks, and promissory notes to facilitate and disguise the late sales, according to the court documents.
 - Helped prepare **false tax returns** for clients who agreed to invest in the syndicated deals
 - Received more than **\$1.7 million in commissions**
 - Overall tax loss estimated to be more than \$250 million

IRS Promises More Criminal Charges



Criminal tax investigations of syndicated conservation easements are ongoing and more criminal charges are coming

(IRS Criminal Investigation Division Chief Jim Lee)

Polling Question 4

Syndicated conservation easements: tax avoidance or creative tax planning?

- a) Absolutely avoidance
- b) Creative and insightful
- c) A and B

Future of Conservation Easements

IRS Continues to Challenge Conservation Easements

- Practitioners note a nearly 100% IRS audit rate of partnership-based conservation easement transactions, dating back to years before Notice 2017-10.
- Conservation easement audits are adversarial and lengthy
- Litigation focus continues to evolve:
 - Syndicated conservation easements
 - Garden-variety conservation easements
 - Valuation focus
 - Technical details of easement agreements

IRS Considering Issuing New Guidance

- March 10, 2021: Coalition of advocacy groups asked Treasury Secretary Janet Yellen to develop guidance containing sample conservation easement provisions.
- Sample language necessary because IRS continuing to challenge conservation easements.

S. 5019/H.R. 8848: Charitable Conservation Easement Program Integrity Act

- Introduced in Senate on 12/15/20 by Steve Daines, R-Montana
 - 8 co-sponsors, D and R
 - Referred to Senate Finance Committee
- Introduced in House on 12/2/20 by Mike Thompson, D-California-5
 - 1 co-sponsor, R
 - Referred to House Ways and Means Committee
- Would limit charitable deduction for conservation easement contributions of a partnership if the aggregate amount of a partner's distributive share of such contribution exceeds 2.5 times the partner's adjusted basis in the partnership
- Various exceptions in bill
 - Contribution made more than 3 years after the date the partnership acquired the entirety of the real property interest
 - Partner acquired entire interest in partnership more than 3 years before the contribution date
 - Family partnerships

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