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# Conservation Easements: Congress Giveth and the IRS & Tax Court Taketh Away

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Charitable conservation easements have long been controversial, and there was some concern that the new tax legislation enacted in December 2017[1] would limit the conservation easement charitable deduction. However, there were no limits placed upon conservation easements, and even the syndicated easements[2] were left alone. This particular area of the law is full of landmines, and so it is best to understand the risks of claiming conservation easement deductions prior to finalizing the documentation that will form the basis of your defense, should the IRS come knocking.

To qualify as a charitable deduction, a conservation easement must be donated to a qualified organization, generally a public charity or federal/state/local government entity as defined in §170(h)(3). The easement itself must be a legally binding, permanent restriction on the use, modification and development of real property. The restrictions on the property must be in perpetuity and the deed must be recorded in the public record. The donee organization must have the ability to enforce the restrictions. As set forth in the IRS Conservation Easement Audit Techniques Guide [3], the following documents are required to substantiate the conservation easement charitable deduction:

1. Contemporaneous written acknowledgment from the charity. §170(f)(8)
2. Form 8283, Section B, with supplemental statement
3. Real estate deed stamped with the recording date
4. Qualified appraisal for contributions of more than $5,000
5. Baseline study.[4]

The amount of the tax deduction is determined by an appraisal of the land without the easement, and an appraisal of the land with the easement. The diminution in value as a result of the easement is the amount of the charitable deduction. As long as there is a bona fide value attached to the easement and the other requirements listed above are met, the deduction should be allowed. However, the IRS is actively examining conservation easements, and if a sizable easement is claimed as a charitable deduction, the taxpayer can be relatively safe in assuming that the return will be examined.

The U.S. Tax Court recently decided a conservation easement case denying the taxpayers the charitable deduction in full. In *Wendall Falls Development, LLC v. Commissioner*, T.C.Memo. 2018-45 (April 4, 2018), two real estate developers plus an investor formed a partnership which purchased a large acreage just outside of Wendall, North

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Carolina. The development was a master-planned community with residential areas, commercial spaces, a school and a park. A conservation easement was placed on the 125 acres that was designated to be the park, and the property was then purchased by Wake County. The partnership argued that the County was able to purchase the property for a lower price, since the easement was in place and was donated to the County. The appraisals obtained by the partnership supported their arguments. However, the Tax Court did not find the appraisals to be accurate, and held that the taxpayers intended to obtain a direct or indirect benefit in the form of enhancement in the value or utility of the taxpayer s remaining land to benefit the taxpayer . The Court held that since the value of the remaining property in the community was enhanced due to the presence of the park, there was a quid pro quo. The Court held that the partnership donated the easement with the expectation of receiving a substantial benefit. Thus, the charitable deduction was disallowed and the value of the easement deemed to be zero. The Court, however, did not impose the substantial penalties determined by the IRS since the taxpayers had obtained and relied upon all requisite documentation.

Previous decisions issued by the Tax Court have similarly cast a skeptical eye on the size of the charitable deductions, and/or found fault with some aspect of the structure. For example, in *Belk v. Commissioner,* 140 T.C. 1 (2014), *aff d* 774 F.3d 221 (4th Cir. 2014), the courts disallowed the deduction for a golf course conservation easement donated to a charity. The deduction was disallowed since the easement was not a restriction granted in perpetuity. In *Grave v. Commissioner,* 140 T.C. 377 (2013) the Tax Court disallowed the charitable deduction since the charity to which the easement had been donated provided the taxpayers with a side letter, stating that if their deduction was disallowed, the charity would return the donation. The Court held that it was a conditional, non-deductible gift. In *Minnick v. Commissioner*, T.C.Memo. 2012-345, *aff d.* 796 F.3d 1156 (9th Cir. 2015), the courts held that any prior mortgage on the land must be subordinated at the time of the gift of the conservation easement. Since that was not the situation, the charitable deduction was disallowed. These are just a few examples of issues that the courts find to justify denying the charitable deduction. However, there are also cases in which the charitable deduction is upheld by the court despite the IRS determination to the contrary. Those tend to be situations in which the donation is not as large, and the taxpayers have dotted all of their i s and crossed all of their t s . *See B.C. Ranch II, L.P. v. Commissioner*, 867 F.3d 547 (5th Cir. 2017); *Commissioner v. Simmons*, 646 F.3d 6 (D.C. Cir. 2011).

Conservation easements, if structured and documented correctly, provide an opportunity for owners of real estate to gain sometimes substantial charitable tax deductions and help conserve green space or historic facades at the same time. An increasing number of states also offer state tax credits, some refundable, for donations of charitable conservation easements. Although there is no uniform model, most states loosely follow the Federal guidelines under §170(h) and determine the amount of the tax credit based upon a percentage of the fair market value of the donated easement. Some states also allow the credits to be transferred to other states, which then allow taxpayers to sell the tax credits to third parties. The IRS has acquiesced with court decisions that have established that the receipt of conservation easement state tax credits is not a return benefit and, therefore, does not reduce the amount of the taxpayer s federal charitable contribution deduction under §170. *See Tempel v. Commissioner*, 136 T.C. 341, 351 n.17 (2011), *aff d sub nom, Esgar Corp. v. Commissioner*, 744 F.3d 648 (10th Cir. 2014). *See* IRS Audit Guide: Conservation Easements, pp. 93-95.

Where there is great opportunity there is also great risk, and so prior to claiming charitable deductions for donations of conservation easements, we advise reliance on professional advice.

## FOOTNOTES:

[1] Tax Cuts and Jobs Act ( TCJA ), Dec. 2017
[2] A typical conservation easement syndication is one in which syndicators provide opportunities for investors to purchase an interest in real property that is then subject to a conservation easement, allowing the investors to claim charitable contribution deductions often

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well in excess of the amount of their investment.

[3] Revised January 24, 2018: https://www.irs.gov/pub/irs-utl/conservation_easement.pdf

[4] Id., p. 10.