Syndicated Conservation Easement Transactions: Internal Revenue Service Announces First Settlement

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The Internal Revenue Service ("IRS") in an August 31st news release announced what it described as:

. . . the completion of the first settlement under its initiative to resolve certain docketed cases involving syndicated conservation easement transactions ("Transactions").

The IRS had previously issued a November 12, 2019 announcement stating it was increasing from an enforcement standpoint its focus on such Transactions (characterizing them as a "priority compliance area").

Conservation easement deductions have been in place for decades. Congress intended the deduction to incentivize property owners to conserve land natural and historic sites by offering a charitable deduction. The amount of the tax deduction is based on the value of what was donated. This is determined by an independent appraiser.

Section 170(f)(3)(B)(iii) of the Internal Revenue Code ("IRC") specifies that the deduction is only available for a qualified conservation contribution. A qualified conservation contribution is described as a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. See § 170(h)(1) through (5); § 1.170A-14. Further, qualified real property interest includes a restriction, granted in perpetuity, on the use that may be made of real property. A qualified real property interest is typically denominated a conservation easement.

To fit within the scope of the term "qualified conservation contribution" certain criteria must be met. These include the property being utilized exclusively for conservation purposes. If such criteria are met, the taxpayer may claim a charitable contribution deduction for the fair market value of the conservation easement that is donated.

The IRS previously published a "Listing Notice" in 2017 addressing syndicated conservation easement transactions. See Notice 2017-10 ("Notice"). The 2017 Notice stated that the IRS is aware that:

. . . some promoters are syndicating conservation easement transactions that purport to give investors the opportunity to claim charitable contribution deductions in amounts that significantly exceed the amount invested.

The intent of the Notice was to alert both taxpayers and their representatives that such transactions constitute a tax avoidance transaction. It further delineated the elements of a prohibited transaction.

The previously referenced 2019 enforcement announcement stated that the IRS was conducting coordinated examinations in various divisions. These included investigations initiated by the IRS's Criminal Investigation Division.

The IRS has previously described promoters of these transactions as identifying a pass-through entity that owns real property or forms a pass-through entity to acquire real property. They are stated to syndicate ownership interest in the pass-through entity or tiered entities that own the real property. Suggestions are stated to be made to prospective investors that they may be entitled to a share of the charitable contribution deduction that greatly exceeds the amount of an investor's investment. The promoters are stated to obtain an inflated appraisal of the conservation easement based on an unreasonable factual assumption and conclusion about the development potential of the real property.

The August 31st news release notes that the IRS Office of Chief Counsel had previously announced that it would offer to settle certain cases involving abusive syndicated conservation easement transactions. It states that the Chief Counsel has sent letters to dozens of partnerships involved in such transactions whose cases are pending before the United States Tax Court.

A settlement is described as requiring a concession of the tax benefits claimed by the taxpayers and imposes penalties:

- All partners in an electing partnership must agree to settle to receive these terms, and the partnership must make a lump-sum payment representing the aggregate tax, penalties and interest for all of the partners before settlement is accepted by the IRS.
- Chief Counsel will allow investors to deduct the cost of acquiring their partnership interests but it will require a penalty of at least 10 percent.
- Partners who are promoters of conservation easement schemes are not allowed any deductions and must pay the maximum penalty asserted by IRS (typically 40 percent).
- If less than all the partners agree to settle, the IRS may settle with those partners but will normally impose less favorable terms on the settling partners.

The first settlement is stated to involve Coal Property Holdings, LLC and its partners. They are stated to have agreed to a disallowance of the entire $155 million charitable contribution deduction claimed for an easement placed on a 3,700-acre tract of land in Tennessee.

The IRS further notes in the August 31st news release:

Under the terms of the settlement, the investor partners were permitted to deduct their cost of investing in the conservation easement transactions and paid a 10 percent penalty, whereas the promoter partner was denied any deduction and paid a 40% penalty. The taxpayers also fully paid all tax, penalties, and interest in conjunction with the settlement. The settlement will be reflected in a stipulated decision document entered by the Tax Court and in a separately entered closing agreement. A public statement acknowledging the settlement was part of the agreement between the IRS and the taxpayer.

A copy of the news release can be downloaded here.