

Enforcement of the Syndicated Conservation Easement Charitable Deduction

By Anthony Box

*Abusive syndicated conservation easement transactions are cancer in our system.*¹

— IRS Commissioner Charles Rettig, March 18, 2021



Wolters Kluwer

For nearly 100 years, the United States has taken proactive steps to set aside land for preservation purposes. In many ways, these efforts have produced notable successes, especially when measured by the number of acres protected by conservation easements.² One of the principal reasons for the continued growth in the preservation of non-federal land is because landowners have readily donated conservation easements in return for generous tax benefits. In fact, the tax benefits have been so generous that in the last decade, both a new breed of conservation easement—the syndicated conservation easement—and an ecosystem supporting them have appeared to promote conservation easements. In most instances, these investments would not be “profitable” for the taxpayer without a large deduction.

The means and methods used by abusive syndicated conservation easement promoters and ultimately by taxpayers have been under intense scrutiny from the Internal Revenue Service (IRS) for years, with no signs of abating. In fact, the government has continued to sharpen its focus on these transactions and is now employing two of the most potent weapons in its arsenal—aggressive civil enforcement and criminal prosecution.

I. Understanding Conservation Easements

Conservation easement is a generic term for easements granted for preservation of land areas for outdoor recreation; protection of natural habitats for fish, wildlife, or plants, or a similar ecosystem; preservation of open space for the scenic enjoyment of the public or pursuant to a federal, state, or local governmental conservation

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policy; and preservation of a historically important land area or historic building.³

These easements permanently restrict how land or buildings are used. The deed of conservation easement describes the restrictions, conservation purpose, and permissible uses of the property. It must be recorded in the public record and contain enforceable and legally binding restrictions. The donor gives up certain rights specified in the deed of conservation easement but retains ownership of the underlying property. The extent and nature of the donee organization's control depend on the terms set forth in the conservation easement deed. The donee organization has an interest in the property, which means its restrictions are binding not only on the landowner who grants the easement but also on all future owners of the property.⁴

II. Evolution of Syndicated Conservation Easements

Historically, taxpayers pursued conservation easements individually and not as part of a partnership. Over time, promoters began to seek out wealthy individuals to invest in “syndicated” conservation easements. After the promoters obtain funds from investors, a conservation easement is granted to the investors for a piece of land that is then donated to a tax-exempt organization, usually a land trust.

There is little doubt that the IRS and the Department of Justice (DOJ) will continue its aggressive enforcement regime surrounding alleged abusive syndicated conservation easements.

It is important to note that since 1969, the Internal Revenue Code has generally denied the deduction for a gift of a partial property interest. Conservation easements were created to be an exception to the normal charitable contribution rules and since Congress overruled the IRS' position on partial interest contribution syndicated conservation easements have flourished. This statutory exception is what has allowed syndicated conservation easements to exist and flourish.

III. Valuation and Economic Substance

The IRS has frequently attacked syndicated conservation easements because they believe that the land has been overvalued and the underlying transactions lack economic substance. Congress has made some adjustments to statutes addressing valuation, but this remains a problematic area of the law.⁵

IV. Valuation

The lynchpin of syndicated conservation easements is the appraisal. Without an appraisal that increases the land value, the financial incentive to invest in a syndicated conservation easement does not exist. However, identifying an inflated conservation easement valuation is not always clear-cut, primarily because doing so requires knowledge that is difficult to obtain about local zoning laws and restrictions, existing or proposed developmental activity, state and local real estate laws, and the values of adjacent lots or properties. When deriving the valuation of the easement, appraisers must also include considerations for the impact of state and local historical preservation ordinances and laws restricting development or use. Regulations require that “the fair market value of the property before contribution of the [easement] must take into account not only the current use of the property but also an objective assessment of how immediate or remote the likelihood is that the property, absent the restriction, would, in fact, be developed.”⁶

V. Economic Substance

Individuals enter into conservation easement transactions to obtain tax benefits passed by Congress to support conservation and provide tax benefits. However, the IRS has alleged that many syndicated conservation easement transactions are only for the preferential tax treatment and not for historical preservation purposes. They have also alleged that promoters entice investors to enter into these transactions who do not understand that their “investment” is purportedly for one or more of the conservation purposes necessary to obtain a conservation easement deduction. Instead, the government frequently contends that these investors think they are purchasing a tax deduction, which runs afoul of the tax law principle of economic substance.

The economic substance doctrine was created to address transactions that produce tax benefits but do not have any non-tax economic substance or business purpose.⁷ The

Internal Revenue Code declares that “a transaction has economic substance if: (1) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer’s economic position; and (2) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.”⁸ The Code further clarifies that “[t]he term ‘transaction’ includes a series of transactions.”⁹ The Third Circuit described the economic substance doctrine as a transaction that technically meets the requirements of the Code but lacks “economic substance separate and distinct from the economic benefit achieved solely by tax reduction.”¹⁰

A U.S. Senate report detailed what it believed to be a typical syndicated conservation easement investment scenario—a promoter sells the syndicated conservation easement to wealthy individuals by telling them that they can reduce their tax liability by a certain amount, for example, \$2 for every \$1 invested. Only later does the promoter mention that the investment is related to conserving land. The investment is marketed as low or no risk because the syndication’s vote for the conservation easements and the path to the tax benefit is all but guaranteed to be smooth and straightforward.¹¹

In response, syndicated conservation easement promoters and taxpayers have argued one or more of the following: that the taxpayer or investors (1) may decide to use the land for its highest and best use, such as building a mall; (2) may earn income from the property by renting it investors; (3) may hold the property with the belief that it will appreciate in value; and (4) may hold it for development or sale to a developer. In situations where these options are seriously considered, tax benefits should not be disallowed under the economic

substance doctrine. However, according to government officials, where the options are presented in a perfunctory, cover-your-tracks manner, the economic substance doctrine should be applied, and the tax deduction should be disallowed.

VI. Audits and Prosecutions

According to a recent congressional report, about 84 percent of syndicated easements are in some stage of audit.¹² In addition to using the IRS’ audit authority, the federal government has also filed a high-profile indictment filled with an unusual amount of detail from an undercover investigation used to snare various players involved in the case involving numerous syndicated conservation easement promoters, accountants, and appraisers.¹³ Presumably, the prosecutors have filed such a detailed indictment to send a message and put the syndicated conservation easement industry on notice that they will use all of the tools in their toolbox to criminally prosecute individuals who intentionally promote and utilize alleged abusive syndicated conservation easements.

VII. Conclusion

There is little doubt that the IRS and the Department of Justice (DOJ) will continue its aggressive enforcement regime surrounding alleged abusive syndicated conservation easements. And with the addition of billions of dollars to the IRS’ enforcement budget, they will have the resources to pursue syndicated conservation easement cases civilly, criminally, or in both venues. Past and present investors in syndicated conservation easements should take heed.

ENDNOTES

¹ The 2021 Filing Season: Hearing Before the House Ways and Means Oversight Subcommittee, 117 Cong. (2021) (Statement of IRS Commissioner Charles Rettig). Available at [waysandmeans.house.gov/legislation/hearings/oversight-subcommittee-hearing-irs-commissioner-2021-filing-season](https://www.irs.gov/legislation/hearings/oversight-subcommittee-hearing-irs-commissioner-2021-filing-season).

² Land Trust Alliance (2011). 2010 National Land Trust census report 5. www.landtrustalliance.org/land-trust/land-trustcensus/census/. (According to the Land Trust Alliance, total acres conserved by state, local, and national land trusts grew to 47 million as of year-end 2010, an increase of about 10 million acres since 2005 and 23 million since 2000.)

³ IRS (Jan. 24, 2018). Conservation easement audit techniques guide. www.irs.gov/pub/irs-utl/conservation_easement.pdf.

⁴ *Id.*

⁵ Pension Protection Act of 2006, 120 Stat. 780 (codified at 1056 “PPA”).

⁶ Reg. §1.170A-14(h)(3)(ii).

⁷ Code Sec. 7701(o). See generally Rebecca Rosenberg, Codification of the Economic Substance Doctrine: Substantive Impact and Unintended Consequences, 15 HASTINGS BUS. L.J., papers.ssrn.com/sol3/papers.cfm?abstract_id=3158795 (discussing changes that Code Sec. 7701(o) made to the economic substance doctrine).

⁸ Code Sec. 7701(o)(1).

⁹ Code Sec. 7701(o)(5)(D).

¹⁰ *AMC Partnership*, 73 TC 2189, Dec. 51,922(M), TC Memo. 1997-115 (1997), *aff’d*, CA-3, 157 F3d 231 (1998).

¹¹ United States Senate Committee on Finance (Aug. 25, 2020). Finance Committee releases report on syndicated conservation-easement transactions. www.finance.senate.gov/Chairmans-News/finance-committee-releases-report-on-syndicated-conservation-easement-transactions.

¹² *Id.*

¹³ *U.S. v. Fisher*, ND.Ga. No. 21-CR-231, First Superseding Criminal Indictment dated Feb. 24, 2022. Doc.#28.

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