

Introduction to Conservation Easements and a Historical Perspective

Prepared by:
William R. Sylvester, Esq.
Baker, Donelson, Bearman, Caldwell & Berkowitz, PC

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Published on www.lorman.com April 1, 2022

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INTRODUCTION TO CONSERVATION EASEMENTS AND A HISTORICAL PERSPECTIVE.

1. Conservation Easement Generally Defined. A conservation easement is created by a landowner (a “**Donor**”) through permanent restrictions (known as a “**Conservation Easement**”) placed against land.
2. Filed of Record. The restrictions must be granted under a document filed in the real estate records of the county or counties that contain the subject property (the “**Restricted Land**”) to a charitable or governmental organization (the “**Qualified Organization**” or “**Land Trust**”), which conveys to the Qualified Organization the right to enforce the Conservation Easement against the landowner, successors, and assigns.
3. All States Except One. Conservation Easements are creatures of state law. So-called easements **in gross** were generally **not** recognized at common law. However, all states with the lone exception of North Dakota have adopted specific statutes authorizing landowners to grant Conservation Easements to Qualified Organizations.
4. Congressional Intent. Congress has chosen to encourage Conservation Easements to Qualified Organizations by allowing landowners to deduct, subject to limitations set forth in the Internal Revenue Code of 1986, as amended (the “**Code**”), the value of a Conservation Easement.

5. Earliest Recognition by the IRS. Under Revenue Ruling 64-205, the taxpayers were allowed a charitable contribution deduction equal to the fair market value of a restrictive easement granted to the United States. The basis of the retained property was required to be reduced by part of the total basis allocable to the easement. In 1965, the IRS issued news release No. 784 (November 15, 1965) indicating that a charitable deduction was allowable for gifts of “scenic easements” to qualified recipients.
6. The Tax Reform Act. In 1976, Congress temporarily codified the deductibility of conservation easement donations. The 1976 Act allowed a deduction for an easement of at least **thirty (30) years**. No reason was given for the easement provisions of the 1976 Act. The Act’s legislative history included no testimony or debate by interested legislators or stakeholders.
7. Permanent Extension in 1980. IRC Section 170(h) was added to the Code in 1980 with the Tax Treatment Extension of 1980 (the “**1980 Act**”). Because of concerns about the enduring effect of conservation restrictions as expressed in the legislative history of the Act, Conservation Easements were thenceforth required to be **permanent**. See Senate Finance Committee (“**SFC**”) Report No. 96-1007 (“**SFC Report 96-1007**”), at pages 8-16. SFC Report 96-1007 estimated the revenue effect of Code Section 170(h) as of 1980 as **\$5M annually**.

8. Washington Post Series. In late 2003, the *Washington Post* published an article entitled “**Developers Find Payoff in Preservation**”. This article followed a revelation of certain practices, since discontinued, of the Nature Conservancy. The *Post* story related details about Conservation Easements placed against private golf courses in Florida, North Carolina, and elsewhere. According to the 2003 *Post* account “companies and individuals claiming huge write-offs face little risk of audit.” According to the General Accounting Office there were **no** audits in the 2002 or 2003 “because of competing priorities”.
9. Amendments in 2006. After hearings before the SFC, the Pension Protect Act of 2006 (the “**PPA**”) was enacted and included several provisions affecting Conservation Easements. The Code Section 170(h) deduction for individuals was increased to fifty percent (50%), while the carryover was increased to fifteen (15) years. The PPA included a **sunset** provision that made these changes effective only for tax years 2006 and 2007. The threshold levels for **substantial** and **gross valuation misstatement** under Code Section 6662 were also broadened under the PPA and Code Section 170(h) was added.
10. 500+ Colorado Audits. In a December 2009 response (the “**IRS 2009 Reply**”) to an inquiry of Colorado Senators Udall and Bennett, the IRS reported that for fiscal years 2005-2009 four hundred eighteen (418) Conservation Easements had been **closed** and eight-four (84) Colorado Conservation Easements were under **then-current** examination. In most of the early Colorado exams the IRS

requisitioned **Valuation Reports** created by IRS engineers with backgrounds in the oil and gas or mining industries. The IRS frequently took aggressive positions and initially asserted that the value of any given Conservation Easement donation was **zero**. Beginning in November 2008, taxpayers began to receive settlement offers from the IRS involving 30%, 60%, or 75% of the amount claimed on the return, as described in the IRS 2009 Reply. According to the IRS 2009 Reply, eighty (80) eligible taxpayers, or 44%, accepted the offer. Among the properties excluded from settlement eligibility were: (i) properties where the HBU for extraction of natural resources; (ii) property sold within eighteen (18) months of the charitable contribution; or (iii) real estate developer or promoter transactions.

11. Amendments in 2015. In February 2015 Congress enacted the Conservation Easement Incentive Act of 2015 (the “**2015 Act**”). The 2015 Act adopted as a permanent feature of the current Code both a multiple of fifty (50) percent and a fifteen (15) year carryforward further discussed below. The effective date of the 2015 Act applied to all Conservation Easements donated after December 31, 2014.
12. IRS Release of Notice 2017-10. IRS Notice 2017-10 (“**Notice 2017-10**”) was issued on December 23, 2016. As summarized in Notice 2017-10, a typical syndicated Conservation Easement transaction (“**SCET**”) that is reportable under the Notice has the following elements: (a) the promoter; (b) the Pass-Through Entity as the real estate owner; (c) the syndication of interest by the promoter to

investors; (d) the inflated value of the real estate based on unreasonable conclusions about its development potential; and (e) the allocation to each investor of a charitable contribution deduction that equals or exceeds two and one-half times (2.5 X) of the investor's investment. Under the Notice, SCETs and transactions "that are the same as, or substantially **similar to**, the transaction" particularly described in the Notice are **listed transactions** for purposes of Code Sections 6111 and 6112 and Treasury Regulation Section 1.6011-4(b)(2). *See* additional treatment in Section I herein. For attendees to this Webinar who are **not** primarily involved in attacking, defending, or marketing SCETs, the principal portion this time should perhaps be the "**similar to**" discussion.

13. Eco-Vest Litigation Commenced in 2018. The Department of Justice filed *U.S. v. Zak, et al.* on December 18, 2018. With the permission of the Court, an Amended Complaint was filed on November 9, 2020. The Amended Complaint asserted that since 2009 the defendants promoted at least one hundred thirty-eight (138) SCETs reporting over \$3B of conservation deductions. The Amended Complaint characterizes these SCETs as a "**highly structured**" scheme. Central to this approach are final appraisal using "**flawed assumptions and methodology**" to arrive at "**grossly overstated value**". The EcoVest Parties filed their Answer to the Amended Complaint on December 21, 2020, contended that they had "complied fully with all of their legal obligations" had undertaken "rigorous processes to ensure its projects" and had obtained "independent qualified

appraisal”. On April 12, 2021, Ms. Zak dropped out of the litigation and agreed to a Permanent Injunction to discontinue facilitating Conservation Easement for compensation. The US and the remainder of the Defendants are currently scheduled for trial starting April 17, 2023, some forty (40) months after this matter was commenced.

14. Latest Proposed Legislative Revisions to Section 170(h). In September 2021 Senate bill S 2256 and House bill ____, were introduced. This proposed legislation has **not** progressed out of Committee, If the proposal is adopted, it would add a new Code Section 170(h)(7) limiting Conservation Easement deductions to two and one-half (2.5X) each **partner’s** adjusted basis in the partnership. Exceptions are provided for: (a) contributions outside a three-year holding period; and (b) family partnerships. As proposed the legislation would have an effective date of **December 23, 2016**. In March 22, 2021 correspondence, the Appraisal Institute, the Land Trust Alliance, and ten (10) other national stakeholders supported the enactment of this provision.



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