

IRS OFFERS TO SETTLE TAX COURT SYNDICATED CONSERVATION EASEMENT CASES

The IRS recently [announced](#) a time-limited settlement offer to taxpayers with pending Tax Court cases involving syndicated conservation easements. The IRS encourages taxpayers who receive a settlement offer letter to consult with their own independent attorney (*i.e.*, an attorney who was not involved in promoting the transaction or recommended by the promoter of the transaction) to evaluate the litigation risks and the settlement offer.

WHAT ARE SYNDICATED CONSERVATION EASEMENTS?

A charitable deduction is allowed for the grant of a qualified conservation easement (*i.e.*, a permanent restriction on the use of real property for any purpose other than a conservation purpose) to a qualified charity or governmental entity. The policy goal of the qualified conservation easement charitable deduction is to encourage the preservation of land, natural habitats (including native wildlife), open spaces, and historically important areas. The amount of the charitable deduction is the difference between the value of the property before the easement is granted and the value of the property once it is subject to the easement restrictions. The “before” value of the property generally is determined based on the “highest and best use” of the property rather than on how the property is actually being used at the time. For example, property being used as a ranch may have a “highest and best use” as a mountain resort and therefore be valued as such.

In a typical syndicated conservation easement transaction, a taxpayer owns real estate (or a promoter acquires real estate) and wants to syndicate (*i.e.*, sell) the charitable deduction from the grant of a qualified conservation easement on the property. The taxpayer or promoter first contributes the property to a partnership or LLC, and investors buy an interest in the partnership or LLC. The partnership then grants a qualified conservation easement to a qualified charity or governmental entity, claims a charitable deduction, and allocates the deduction to its partners or members.

WHY DOES THE IRS VIEW SYNDICATED CONSERVATION EASEMENTS AS ABUSIVE?

The IRS views these transactions as abusive because the charitable deductions are frequently based on inflated property valuations and unrealistic “highest and best uses” of the property. In addition to the valuation issues, these transactions also frequently fail to comply with the basic requirements for claiming a charitable deduction for a donated conservation easement. For example, many of the easement deeds fail the requirement that the conservation purposes be protected in perpetuity. Others fail the legal requirements for a qualified appraisal. The IRS has developed a comprehensive enforcement strategy to investigate syndicated conservation easement transactions, including through the creation of two new offices—the Promoter Investigation Coordinator and the Office of Fraud Enforcement.

WHAT IS THE SETTLEMENT OFFER?

Following multiple significant IRS victories in Tax Court, the IRS has offered to settle pending Tax Court syndicated conservation easement cases on standardized terms. While the specific terms of the settlement offer will be sent to the taxpayer in a letter, a recent IRS announcement summarized the following key terms:

- The deduction for the conservation easement donation 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 penalty of 10-20% (reduced from 40%) depending on the ratio of the claimed deduction to the partner's investment in the partnership.
- Partners who provided services in connection with any syndicated conservation easement transaction must pay the maximum penalty asserted by the IRS with no deduction for the cost of acquiring a partnership interest.

There are a number of unanswered questions in the IRS's announcement that a taxpayer will need to consider before deciding whether to accept the settlement offer. For example, it is unclear from the announcement how the investor partners may deduct the cost of acquiring their partnership interests (*i.e.*, as a charitable contribution deduction or a capital loss on the partnership interest) and in what year the deduction is available.

WHAT CAN YOU DO?

Taxpayers who receive a settlement offer letter should consult with their own attorney to evaluate the litigation risks and the settlement offer. As the IRS recognized in the announcement, promoters may tell their clients their particular transaction is "better" than or "different" from transactions previously rejected by the Tax Court, and encourage their clients to continue litigating the case in the Tax Court instead of accepting the IRS's settlement offer. Therefore, the IRS recommends taxpayers consult with independent counsel. Taxpayers will want independent counsel to consider whether their case is more like those in which the IRS has been prevailing or more like the taxpayer's Eleventh Circuit victory in [Champions Retreat Golf Founders](#).

In addition, taxpayers who have invested in a syndicated conservation easement transaction but do not have a pending Tax Court case should consult with an attorney about the IRS's enforcement efforts and recommended steps to mitigate penalties.

WE ARE AVAILABLE TO HELP

Thompson & Knight attorneys have significant experience in assisting taxpayers involved in conservation easements and can counsel you on whether to accept the settlement offer or advise you on a possible IRS audit. In addition to expertise on the substantive tax issues, Thompson & Knight attorneys have significant [experience](#) advising on the complex partnership audit and litigation procedural rules that

apply to the conservation easement cases. If you have any questions about the information contained in this Client Alert, please contact the Thompson & Knight attorney with whom you regularly work or one of the attorneys listed below.

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