



Land Conservation Conference

2020 Vision & Beyond:
Climate, Conservation & Collaboration

Current Federal Tax Issues for Conservation Easements

presented by Timothy Lindstrom, Law Office of Timothy Lindstrom

Tuesday, May 19th, 2020

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CURRENT FEDERAL TAX ISSUES FOR CONSERVATION EASEMENTS

Has it become harder to satisfy the IRS and Tax Court than to get a camel through the eye of a needle?

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Eye of the Needle

- Recent IRS positions, supported by Tax Court decisions, are undermining deductions for potentially thousands of easement donations.
- Positions and decisions are ignoring gross overvaluations and instead are raising novel and questionable technical issues contrary to decades of accepted conservation easement practices.
- “Our holding today will likely deny any charitable deduction to hundreds or thousands of taxpayers who donated the conservation easements that protect perhaps millions of acres. ... This is the second time we’ve taken an ax to entire forests of these deductions.” Judge Holmes dissent, *Oakbrook Holdings v. Commr* 154 T.C 10, 82.

RECENT ISSUES

- Proceeds clause and improvements
- Building envelope location and relocation
- Building envelopes and improvements
- Amendments
- Amendment clauses
- “Deemed approval” clauses
- Commercial forestry
- Golf Courses

Proceeds clause and improvements

- *PBBM-Rose Hill, et al v. Commissioner* 900 F. 3d, 193 (5th Cir., 2018)
- *Coal Property Holdings v. Commissioner*, 153 T.C. No. 7 (2019)
- *TOT Property Holdings v. Commissioner*, T.C. Docket #5600-17 (2019)
- *Railroad Holdings v. Commr*, T.C. Memo 2020-22 (2020)
- *Oakbrook Holdings v. Commr*, 154 T.C. 10 and TC Memo 2020-54

Rule: (i) Proceeds clauses may not exclude the value of existing or future improvements.

(ii) Proceeds clauses may not be limited to value on date of donation.

Proceeds Clause (cont.)

- Example from Oakbrook holdings
- Land worth \$2m before, \$1m after easement
- Improvements added worth \$1m after easement
- Entire parcel condemned.
- At time of condemnation land is worth \$500,000; improvements worth \$1.5m; proceeds from condemnation are \$2m.
- Is amount due holder \$250,000 (50% x \$500,000); or \$1m (50% x \$1m)?

Proceeds clause (cont.)

Land worth \$2m before; \$1m after easement

Improvements added worth \$2m after easement

Land and improvements = \$3m

Easement = 33% of land and improvements

Condemnation of 10 out of 100 acres; proceeds are \$100,000.

Is amount due holder \$50,000 (50% x \$100,000); or \$33,333 (33% x \$100,000)

In this example including improvements reduces amount due donee.

Building envelope/ c.e. location and relocation

- *Belk v. Commr*, 774 F. 3d 221 (4th Cir., 2014) (substitution)
- *Bosque Canyon v. Commissioner*, 867 F.3d 547 (5th Cir., 2017) (5% adjustment of b.e. boundaries within c.e. okay)
- *Pine Mountain Preserve v. Commr*, 151 T.C. 14 (2018) (b.e. relocation not okay)
- *Carter v. Commr*, T.C. Memo 20-21 (2020) (floating b.e. not okay)

Any provision allowing a relocation of c.e. boundaries or relocation of c.e. violates perpetuity clause (conservation purpose & property originally subject to c.e.)

Any provision allowing relocation of a building envelope, or failure to locate building envelopes at time of donation, violate perpetuity req't.

Building envelopes and improvements

- *Pine Mountain Preserve v. Commr*, 151 T.C. 14 (2018) (restrictions on uses within building envelopes meaningless)
- *Carter v. Commr*, T.C. Memo 20-21 (2020) *Carter* facts:
 - 500-acre c.e.
 - Eleven, 2-acre building envelopes reserved (4.4% of property)
 - One single-family residence allowed in each building envelope
 - Locations of building envelopes to be determined in future subject to holder's approval

Carter ruling:

- “Regardless of whether building houses on each of 11 two-acre lots would impair conservation purposes in the easement area as a whole, it would impede the achievement of those purposes within each building area. Pine Mountain establishes that the building of a single family home on a given site does not preserve the site itself as an open space or protect natural habitats or similar ecosystems within the site.”
- **Disregards** decision in *Butler v. Comm’r*, T.C. Memo 2012-72 (2012); Regulations section 1.170A-14(f) example 4; and previous Private Letter Ruling.
- Solution? (1) Exclude all structural improvements from the easement area. (2) Limit improvements to only those necessary to support or accomplish the conservation purposes.
- **See LTA “The Learning Center”**: “Pointers for Balancing Risk When Permitting Structures on Deductible Conservation Easements After the Tax Court Decisions in *Pine Mountain Preserve* and *Carter*”

Amendments

- Conservation easements are contracts and can be amended. *See Pine Mountain Preserve v. Comm’r* 151 T.C. 14 (2018):
- “The 2007 easement involves a conveyance, which is a form of contract. Generally speaking, the parties to a contract are free to amend it, whether or not they explicitly reserve the right to do so. See 2 Restatement, Contracts 2d, sec.311 cmt. a (1981). Viewed from this perspective, this portion of article 6.7 is reasonably regarded as a limiting provision, confining the permissible subset of amendments to those that would not be “inconsistent with the Conservation Purposes.”

Amendments (cont.)

- “Respondent contends that article 6.7 could enable the parties to amend the 2007 easement in ways that would clearly violate the statutory “perpetuity” requirements, e.g., by reducing the size of the 2007 Conservation Area or by permitting residential construction within it. But it is hard to imagine how NALT could conscientiously find such amendments to be ‘consistent with the conservation purposes’ set forth in the easement.”

Amendment clauses

- IRS Chief Counsel Advisory AM 2020-001:
- With the caveat that the inquiry is based on the deed as a whole and the surrounding facts and circumstances, the following provision is compliant with the perpetuity requirements of section 170(h):
- Grantee and Grantor may amend this Easement to enhance the Property's conservation values or add real property subject to the restrictions set forth in this deed to the restricted property by an amended deed of easement, provided that no amendment shall (i) affect this Easement's perpetual duration, (ii) permit development, improvements, or uses prohibited by this Easement on its effective date, (iii) conflict with or be contrary to or inconsistent with the conservation purposes of this Easement, (iv) reduce the protection of the conservation values, (v) affect the qualification of this Easement as a "qualified conservation contribution" or "interest in land", (vi) affect the status of Grantee as a "qualified organization" or "eligible donee", or (vii) create an impermissible private benefit or private inurement in violation of federal tax law. No amendment shall be effective unless documented in a notarized writing executed by Grantee and Grantor and recorded in the Clerk's Office of the Circuit Court of [County, State].

“Deemed approval” clauses

- A conservation easement may not provide for an automatic “default” approval.
- IRS Chief Counsel Memo Number: **202002011**:

“Constructive Denial. For activities or uses that are expressly permitted by the terms of the easement only with the easement holder’s approval, the property owner’s request for approval shall be in writing and shall describe the nature, scope, design, location, timetable, and any other material aspect of the proposed activity or use in sufficient detail to permit the easement holder to make an informed determination regarding approval or denial of the request. Such a request shall be delivered to the easement holder at least sixty (60) days prior to the anticipated start date of such activity or use. The easement holder agrees to use reasonable diligence to respond to such a request within the sixty (60) days of delivery. The easement holder’s failure to respond to such a request within the sixty (60) day period shall be deemed a constructive denial. Because a constructive denial is not a decision by the easement holder based on the merits of the property owner’s request, it is not final or binding on the easement holder, and the property owner can resubmit the same or a similar request for approval.”

Commercial forestry

- *TOT Property Holdings v. Commissioner*, T.C. Docket #5600-17 (2019)

IRS argued that reserved right to undertake commercial forestry violated the conservation purposes of the conservation easement.

Court did not address that argument instead disallowing deduction due to defective “proceeds clause”

How to defend against such a challenge?

Commercial Forestry (cont.)

- See “Pointers for Balancing IRS Audit Risk When Permitting Commercial Forestry on Tax-Deductible Conservation Easements” from LTA
- Forestry activities on the Protected Property permitted by this subparagraph (vii) shall only be conducted in a manner that protects sensitive or endangered species or habitat on the Protected Property. Prior to commencement of any forest management or timber harvesting for which a written forest management plan is required by this Easement, a survey of any part of the Protected Property intended to be subject to such activities shall be conducted by a qualified wildlife professional to determine the location and extent on the Protected Property of any species, or habitat therefore, of any “listed endangered”, “listed threatened”, “proposed endangered,” “proposed threatened”, “special concern”, or candidate for any such listing or characterization, identified at the time of such proposed forest management or timber harvest by the Virginia Department of Conservation and Recreation or the Virginia Department of Game and Inland Fisheries. The recommendations of such professional shall be incorporated into the forest management required by the preceding paragraph, and subject to the prior, written approval of Grantee.

Golf Courses

- *Champions Retreat v. Commr*, 11th Cir. No. 18-14817 (May, 2020)
- Circuit Court reverses Tax Court opinion denying deduction for lack of conservation purpose where the easement was over a golf course. T.C. Memo 2018-146.
- Court ruled that there was nothing in Regs. disallowing deductions for golf courses so long as other legitimate conservation purposes existed. Court remanded to Tax Court to determine easement value.
- Court agreed with landowner's experts regarding conservation values

Final Observation

- IRS and Tax Court are attacking syndications, not by challenging their absurd values, but by advancing new and highly technical arguments that undermine thousands of legitimate conservation contributions.

- WHY?



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