



NOVEMBER 2019 • NO. 3

IRS Announces Uptick in Conservation Easement Enforcement Actions

Taxpayers who have claimed charitable contribution deductions based on conservation easement arrangements should immediately contact a tax professional. Professionals who have engaged in the marketing of these arrangements should contact counsel.

On November 12, 2019, the Internal Revenue Service (“IRS”) announced that it has started coordinating examinations of conservation easement transactions across several of its divisions, including the Small Business and Self-Employed Division, the Large Business and International Division, and the Tax Exempt and Government Entities Division. The IRS also announced that it has begun criminal investigations into some of these transactions.

A conservation easement is an arrangement whereby a property owner donates, to a conservation group, a covenant (*i.e.*, a promise) not to build. The easements take many different forms, but invariably involve a covenant not to develop the property further. For example, the owner of a historic building may give a conservation easement on the façade of her property to a charitable organization. The donor agrees to maintain the property consistent with its historic character, while the charitable organization promises to enforce this covenant if the property owner, or subsequent owner(s),

remodels the façade of the home. The donation is reported by the taxpayer on his or her tax return as a charitable contribution deduction on his or her Schedule A.

Conservation easements have been criticized by Congress and the IRS because, in many cases, the appraised value of the gift is highly inflated. It is also alleged that the charitable organizations do not enforce the terms of the covenant, which effectively makes the gift (and hence the deduction) worthless.

Conservation easements have been on the IRS’s radar for a few years. In 2017, [the IRS identified](#) syndicated conservation easements as a listed (*i.e.*, reportable) transaction, meaning that the taxpayer must identify the conservation easement deduction on a Form 8886, Reportable Transaction Disclosure Statement. A syndicated conservation easement was defined by the IRS as a transaction whereby a taxpayer invests in a

pass-through entity to receive a charitable contribution deduction on a conservation donation. There were several criteria, but, critically, to be deemed a listed transaction, the charitable contribution deduction had to be worth at least two-and-a-half times the investment. In many transactions, the deduction taken exceeds 250 percent of the price paid to join the partnership. Syndicated conservation easements were also included on the IRS's 2019 "Dirty Dozen" list of tax scams. In March 2019, the Senate Finance Committee announced that it started an investigation into some conservation easement promoters and has since issued several subpoenas.

No doubt, the increased Congressional scrutiny has spurred the IRS into action. According to the IRS, these audits and investigations cover billions of dollars of potentially inflated deductions as well as hundreds of partnerships and thousands of investors. The IRS announcement mentions the range of tools available to it, including a 40 percent accuracy-related penalty against taxpayers, penalties for substantial and gross valuation misstatements against appraisers, penalties against shelter promoters, and penalties against return preparers.

Not all conservation easements are improper. Taxpayers have the right to challenge disallowed deductions in Tax Court. In many cases, the Tax Court has sided with the taxpayer and permitted the deduction. Taxpayers who have claimed charitable contributions based upon gifts of conservation easements may have a permissible basis for the deduction.

In its announcement, the IRS wrote: "Taxpayers may avoid the imposition of penalties relating to improper contribution deductions if they fully remove the improper contribution and related tax benefits from their returns by timely filing a qualified amended return or timely administrative adjustment request." Oftentimes, taxpayers are the least qualified to determine whether the IRS will challenge a deduction and would be well

advised to seek advice from someone other than the shelter promoter.

Professionals who have participated in the promotion or sale of conservation easements should contact an attorney immediately. These professionals may face civil or criminal liability that could result in substantial monetary penalties, jeopardize their licensure, or worse, lead to a conviction and possible jail time.

Taxpayers who have claimed deductions for conservation easements on their tax return should prepare an "audit ready" file that includes all documentation pertaining to the conservation easement. This documentation would include a copy of the easement, the appraisal, and communications with other individuals involved in the promotion of the easement. These taxpayers also should consult with a tax professional or attorney to determine whether he or she should file an amended tax return.

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