UNDERSTANDING THE IRS CONSERVATION EASEMENT GUIDE

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IRS Conservation Easement Audit Techniques Guide

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68 pages of IRS Guidance

www.irs.gov/businesses/small/article/0,,id=249135,00.html
• Taxpayers must satisfy numerous statutory provisions in order to claim a noncash charitable contribution deduction for the donation of a conservation easement. Some deficiencies revealed in examinations of conservation easements include:
Tax Issues

- Failure to meet charitable contributions rules.
- Noncompliance with substantiation requirements.
- Inadequate documentation or lack of conservation purpose.
- Lack of perpetuity evidenced by deeds allowing for abandonment or termination of easement.
- Reserved property rights inconsistent with the claimed conservation purpose.
- Failure to comply with subordination rules.
- Failure to provide the donee organization with a right to proceeds in the event of termination.
- Use of improper appraisal methodologies and overvalued conservation easements.
- Failure to report income from the sale of state tax credits.
• The IRS has also identified some promoters and appraisers involved in conservation easement tax schemes.
Qualification Issues

• Relatively Natural Habitat or Ecosystem
  – The conservation easement must protect a habitat that is significant. Treas. Reg. § 1.170A-14(d)(3).
  – Significant habitats and ecosystems include, but are not limited to:
    • Habitats for rare, endangered or threatened species.
    • Natural areas that are relatively intact and are considered high quality examples of land or aquatic communities.
Qualification Issues

• Natural areas that are in or contribute to the ecological viability of a park, preserve, wildlife refuge, wilderness area, or other similar conservation area.

• For this conservation purpose, limitations on public access are allowable. For example, a restriction on all public access to the habitat of a threatened native animal species would not defeat the claimed deduction. Treas. Reg. § 1.170A-14(d)(3)(iii).
Qualification Issues

• Open Space – Scenic Enjoyment

• A conservation easement of open space preserved for the scenic enjoyment of the general public does not require physical access. Visual access to or across the property by the general public is sufficient. Although the entire property need not be visible to the public in order to qualify for a deduction, the public benefit from the donation may be insufficient to qualify if only a small portion of the property is visible to the public. Treas. Reg. § 1.170A-14(d)(4)(ii)(B).
Qualification Issues

• Government Conservation Policy – Significant Public Benefit
  
  
  – The legislative history underlying section 170(h) shows that Congress did not intend for every easement to qualify for a deduction. A deduction is not allowed unless there is an assurance that the public benefit furthered by the contribution would be substantial enough to justify the allowance of a deduction. S. Rep. 96-1007, at 9-10 (1980), reprinted in 1980 U.S.C.C.A.N. 6736, 6744-45.
• Transaction Fees and Stewardship Contributions
  – A voluntary transfer of money or property to a qualified organization is generally deductible as a charitable contribution.
  – If a taxpayer received goods or services from the organization in exchange for making the cash contribution, the deduction is limited to the excess of the cash over the FMV of the goods and services. Goods and services include cash, property, services, benefits or privileges.
  – Any cash payment made in conjunction with the conservation easement must be addressed as part of the examination. Examination steps should include an interview of the taxpayer and a review of documents provided by the taxpayer and the donee organization.
Factors that may indicate that the cash payment was in exchange for goods or services include:

- Negotiations between the donor and donee as to the amount of the payment and timing of the payment, and discounts generally found only in commercial transactions.
- Offering of substantial services to facilitate the donation process.
- Refusal of the donee organization to sign the Form 8283 until full payment of the cash.
- Use of cash payment amounts tied to the value of the conservation easement.
- Conditional or refundable donations dependent on some event such as an IRS examination.
– Audit Tip: The Examiner may need to issue a summons to the donee organization for relevant documents (including the application, correspondence, donation agreements, processing documents, and other documents relevant to the cash and easement donations).
Land Trust Commitment and Resources

- Organizations that accept easement contributions and are committed to conservation will generally have an established monitoring program such as annual property inspections to ensure compliance with the conservation easement terms and to protect the easement in perpetuity.

- The organization must also have the resources to enforce the restrictions of the conservation easement. Resources do not necessarily mean cash. Resources may be in the form of volunteer services such as lawyers who provide legal services or people who inspect and prepare monitoring reports.
• Some of the information used to evaluate this factor includes:
  – The donee organization’s Web site.
  – The donee organization’s tax returns (Forms 990), obtained from Guidestar.org or the Economic Research Institute.
  – Interviews of the taxpayer and representatives of the donee organization.
  – Observations during the property inspection.
  – Property monitoring reports.
  – Written agreements between the organization and the taxpayer (required for contributions of easements of registered historic districts made after July 25, 2006).
Audit Tips

• Appraisal fees are deductible only as miscellaneous deductions subject to adjusted gross income limitation. Taxpayers will sometimes improperly claim the appraisal fees and other costs as cash contributions.

• Depending on the location of the property and time of year, casual attire and boots may be necessary.
• Penalties exist to encourage voluntary compliance by supporting the standards of behavior required by the IRC. Examiners are required to consider penalties and document their determination in all taxpayer examinations.
Questions?

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ADDENDUM - Problems in Respect of the IRS Conservation Easement Audit Techniques Guide
As to each of the following hypotheticals, assume the perspective of the donee land trust CEO, the taxpayer's advisor, or the IRS examiner, as suggested.
(1) CONSERVATION PURPOSES

IRS examiner Henry Credenza has commenced an audit of the 2009 income tax return of Jim Bob "Jumbo" Witofsky, the principal issue being the qualification of a conservation easement granted to the Whispering Pines Land Trust over a 10-acre suburban parcel. The easement recites "natural habitat" among the conservation objectives, and you, Whispering Pines' executive director, have been asked to offer documentary support for that purpose. (The easement also states, in its recitals, the intent to offer the public "educational and recreational access," and to preserve "scenic values.") You have no recollection of the genesis of the habitat claim. How do you respond?
You represent the taxpayer, Bernie Replevin, as to an audit of his 2010 return that focuses on his easement donation to Happy Trails Conservancy. The protected property, a 320-acre farm in upstate New York, was subject at the time of the easement's creation to a $65,000 mortgage to Winsome State Bank of Saratoga. Before the gift, the farm was valued at $780,000; the "after" value was $400,000. Pursuant to the Conservancy's advice Bernie secured a subordination agreement from Winsome Bank which acknowledged the easement's primacy, but reserved to the Bank a prior claim to all insurance proceeds to be received in case of a casualty loss, up to the Bank's then-current lien. How would you respond?
Please refer to the attached Appendix to this problem, and assume, from the perspective of Incandescent Sunset Land Trust's executive director, Georgia Peach, that your board approved the easement modification therein described. The IRS examiner, Henny Redoubt, assessing the deductibility of the excess of the value of the new easement over the value to the donor of the modification of the old easement, has asserted that the land trust's policy as to easement amendments indicates that all subsequently executed easements may be subject to such conservation-destroying amendments, and thus fail to meet the "perpetuity" test, despite the fact that the subject easement (i.e., the subject of Henny's scrutiny) contains no amendments provision. The donor looks to you for advice (and comfort). What can you offer?
• (3) Please refer to the attached Appendix to this problem, and assume, from the perspective of Incandescent Sunset Land Trust's executive director, Georgia Peach, that your board approved the easement modification therein described. The IRS examiner, Henny Redoubt, assessing the deductibility of the excess of the value of the new easement over the value to the donor of the modification of the old easement, has asserted that the land trust's policy as to easement amendments indicates that all subsequently executed easements may be subject to such conservation-destroying amendments, and thus fail to meet the "perpetuity" test, despite the fact that the subject easement (i.e., the subject of Henny's scrutiny) contains no amendments provision. The donor looks to you for advice (and comfort). What can you offer?
(4) Same basic facts as in (3), except the audit is of the land trust's 2010 return, which revealed the amendment of the older easement, conveyed to Incandescent Sunset in 2003.
(5) In 2009 the Owl Roost Land Reliance accepted a donated conservation easement on a 2,600-acre ranch near Alder, Montana. The protected property has an abundance of conservation attributes, and the deed of conveyance exhibits none of the myriad possible deficiencies cited in the IRS Audit Guide. Nor has the before-and-after appraisal been challenged by the IRS examiner, Belinda Gooch. Nonetheless, Belinda proposes a categorical disallowance of the deduction on account of the donor's inability to produce an Owl Roost Letter thanking the donor for the gift (the so-called "section 170(f)(8) letter"). Owl Roost's files reveal no such letter, although Form 8283 was timely filed. As the Owl Roost attorney, would you suggest that the organization may be exposed to a taxpayer assertion of negligence or breach of an implied obligation?
(6) Robin Magenta's deduction for the asserted $8 million before-and-after-measured value attributable to a conservation easement over an indubitably subdividable 400-acre property near Tucson, Arizona, has been proposed to be denied in its entirety on account of the use of an improper appraisal method: a development scenario that assumed retail sales of 30 ten-acre lots at an average price of $500,000, with infrastructure costs of $3 million and a six-year absorption period. The appraiser was unable to find any sales of comparable properties in the Tucson area, a deficiency evidently deemed fatal to the asserted deduction. Does the IRS examiner have sound grounds to deny the deduction?
Questions?

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