PUBLICATION

Lessons Learned in Conservation Partnerships

Authors: Allen Brooks Blow
July 22, 2015

The Internal Revenue Code has provided an incentive under Section 170(h) for charitable conservation gifts. Since at least 2002 there has been an interest in combining through partnership those land owners who may have little need for additional "conservation easement" deductions and high bracket taxpayers who may have a desire to participate in these gifts.

PLR 200208019 ruled that two former employees of a farm could partner with a local resident "heavily involved in conservation" to take their distributive shares of a conservation easement for the farm. While Private Letter Rulings may be indicative of the IRS's position on an issue at a particular point in time, they are not binding on the IRS with respect to any taxpayer other than the taxpayer to whom the letter is issued, and they may not be cited as precedent or authority under Internal Revenue Code Section 6110(k)(3).

Also, in 2002 the well-known Kiva Dunes easement was granted in coastal Alabama. Sixty-one percent of the members acquired their interests in late December, and a conservation gift followed immediately. When the IRS challenged the deduction, a 2009 opinion sustained $27.5 million of a $29 million claim. *Kiva Dunes Conservation, LLC v. Commissioner*, T.C.M. Memo. 209-145. Each member (latecomers included) received his or her distributive share of the deduction.

Since the *Kiva Dunes* case there has been an increased interest in "conservation partnerships." As this type of enterprise has grown popular, the IRS has increased its scrutiny. In 2012 an IRS official noted that there were roughly 240 conservation easement matters docketed before the Tax Court. A number of these cases dealt with deductions taken by partners. More of these cases are adjusted on examination or through negotiations with an IRS appeals conferee.

On July 15, 2015, the Tax Court released its decision in *Bosque Canyon Ranch, L.P. et al. v. Commissioner*, T.C.M. 2015-130. This decision serves as a reminder of the complex relationship between the fundamental real property concepts; the labyrinth of conservation easement requirements; the complex guidelines pertaining to partnership taxation; and the general rules that govern all types of charitable giving. *Bosque* disallowed two conservation easements for a residential development in the Texas Hill Country. Certain details follow:

- Taxpayers were not entitled to any of the $15.9 million in deductions claimed under Section 170(h) because: (1) certain permissible changes of the encumbered land resulted in the failure of the restrictions to be "permanent" (following the Fourth Circuit case of *Belk*); and (2) taxpayers' "baseline documentation reports" were insufficient to establish the conditions of each property prior to granting of conservation easements.

- The general partners had income under the "disguised sale" doctrine. The marketing campaign was that each "limited partner" paid into the partnership a set amount of cash, and designated a specific homesite to be received through a "distribution" by the partnership. The partnership funded certain community amenities, and all remaining cash was "distributed" to the general partner. This sequence was determined to be a disguised sale under IRC Section 707(a)(2)(B).

- "Gross valuation misstatement" penalties of 40% of the tax liabilities were imposed for claiming the conservation easement deductions without, according to the Tax Court, "reasonable cause."

We have closely followed the *Bosque* case since the government's Summary Judgment Motion in 2011, which raised two partnership tax related issues: (1) whether the limited partners were "*bona fide*" partners; and (2) whether the marketing concept was in fact a disguised sale. The opinion relied on the disguised sale structure.

With *Bosque* added to the jurisprudence of conservation partnerships, we are reminded once again of the numerous lessons to be learned and applied to these proposed deals where applicable:

1. The property must have unique attributes to support one or more of the "conservation purposes" named in IRC Section 170(h)(4).

2. The easement must be "permanent."

3. Where rights are retained by the partnership, complete "baseline documentation" should be timely prepared.

4. An evaluation of the land may be required to establish that zoning, access, utilities and other infrastructure exist or are assured.

5. A real estate title report, including a mineral abstract and opinion, should be completed to verify that title is consistent with the gift.

6. Mortgages of record must be timely released or subordinated to the conservation restrictions.

7. Both a top-notch "qualified appraisal" and "review appraisal" under the Uniform Standards of Professional Appraisal Practice are essential.

8. Under some circumstances, experts should produce market demand and "highest and best use" reports.

9. The partnership should be properly structured; and

10. The partnership must receive a "contemporaneous written acknowledgement" from its "qualified organization."

Decisions in this complex area of the law should be made on a case-by-case basis with your tax and real estate counsel and advisors.

Should you have questions or otherwise wish to discuss the *Bosque* decision or other matters regarding conservation easements, please contact Allen Blow or any attorney in the Firm's Tax Group or Real Estate Group.