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Alert | Tax Controversy and Litigation

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IRS Issues Final Regulations for Syndicated Conservation Easement Transactions

On Oct. 8, 2024, the Treasury Department and Internal Revenue Service issued final regulations identifying syndicated conservation easement transactions as listed transactions for purposes of I.R.C. § 6011. The regulations are a response to a series of taxpayer victories involving the Administrative Procedure Act (APA)'s application to the IRS's identification of listed transactions, including the syndicated conservation easement transaction listing notice (Notice 2017-10). For a more detailed explanation of taxpayer victories, see our December 2022 GT Alert.

Treasury and IRS first issued proposed regulations on Dec. 8, 2022, and, a few weeks later, Congress signed the SECURE 2.0 Act of 2022, which added section 170(h)(7) to the Internal Revenue Code. Section 170(h)(7) limits qualified conservation contributions by partnerships and S corporations. Commenting on the SECURE 2.0 Act, Treasury and IRS stated that they took a "more surgical approach" to defining syndicated conservation easement transactions based on the law and commenters' recommendations from the 2022 proposed regulations.

Summary of the Final Regulations

- **Syndicated Conservation Easements as Listed Transactions:** Under the final regulations, a syndicated conservation easement transaction qualifies as a listed transaction for disclosure purposes, list maintenance requirements, and related penalties. The final regulations adopt Notice 2017-10's four-part definition of a syndicated conservation easement transaction: (i) the taxpayer receives

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promotional materials promising a charitable contribution deduction equal to or exceeding 2.5 times the taxpayer's investment in the passthrough entity (the 2.5 times rule); (ii) the taxpayer invests directly or indirectly through a passthrough entity; (iii) the passthrough entity contributes the conservation easement to a qualified organization and allocates the charitable contribution deduction to its partners; and (iv) the taxpayer reports the charitable contribution deduction on the taxpayer's federal tax return.

  - *Definition of a Conservation Easement*: The Treasury adopts a definition of "conservation easement" consistent with the SECURE 2.0 Act. Under the final regulations, a conservation easement is a restriction exclusively for conservation purposes, granted in perpetuity, on the use that may be made of the specified property.
  - *Definition of a Participant*: Under the final regulations, a class of participants includes participants in transactions that are the same as, or substantially similar to, syndicated conservation easement transactions. The final regulations clarify that a participant who reports the tax consequences of a substantially similar transaction to a syndicated conservation easement qualifies as a member of the participant class.

- **Three Classes of Abusive Easement Transactions:** The final regulations categorize syndicated conservation easement transactions (and substantially similar transactions) into three major groups: (i) contributions made before Dec. 30, 2022, (ii) contributions not immediately disallowed by I.R.C. § 170(h)(7), and (iii) contributions of a fee simple interest in real property.
  - *Contributions before Dec. 30, 2022*: Section 170(h)(7) does not apply to contributions made on or before Dec. 29, 2022. As a result, under the final regulations, taxpayers who fully disclosed participation in syndicated conservation easement transactions need not disclose again.
  - *Transactions Not Automatically Disallowed by I.R.C. § 170(h)(7)*: Section 170(h)(7) of the automatic disallowance rule excludes three different kinds of transactions: (i) a conservation easement transaction that satisfies a three-year holding period, (ii) a donation made by family-owned pass-through entities, and (iii) a donated building certified as a historic property for preservation purposes. The final regulations still require disclosure when a charitable contribution deduction equals or exceeds 2.5 times the sum of a partner's relevant basis in the property, or any partner receives promotional materials offering an allocation equaling or exceeding 2.5 times their investment.
  - *Contributions of a Fee Simple Interest in Real Property*: Any contributions of property (including fee simple interests) that meet the requirements of a syndicated conservation easement are substantially similar transactions. Under the final regulations, contributions of a fee simple interest and other substantially similar transactions must be reported under I.R.C. § 6011.

- **Guidance on the 2.5 Times Rule:** The final regulations clarify guidance on promotional materials and calculating a partner's basis or real property contribution for a charitable deduction.
  - *Promotional Materials Broadly Defined*: The Treasury and IRS assert that to deter abuse of the regulations, a broad definition of "promotional materials" is required. To that end, promotional materials include any written or oral communications taxpayers receive. The highest charitable deduction from the promotional materials will be used when applying the 2.5 times rule. There is a rebuttable presumption that the 2.5 times rule is satisfied where (i) the passthrough entity donates the conservation easement within three years of the taxpayer's investment; (ii) the passthrough entity allocates a charitable contribution to the taxpayer that equals or exceeds 2.5 times the amount of the taxpayer's investment; and (iii) the taxpayer claims a charitable deduction equaling or exceeding 2.5 times the amount of the taxpayer's investment.

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  - *Anti-Stuffing Rule*: The final regulations include an anti-stuffing rule to deter taxpayers from investing excess amounts into a passthrough entity to avoid applying the 2.5 times rule. Treasury and IRS only consider the amount of the taxpayer's investment attributable to the real property subject to the conservation easement when calculating the taxpayer's investment under the anti-stuffing method.
  - *Relevant Basis Method Inclusion*: Treasury and IRS recognize that these regulations should be consistent with I.R.C. § 170(h)(7) and allow the use of the relevant basis method. A partner's relevant basis is that partner's portion of their modified basis in the partnership allocable to the real property in which the conservation easement is made. A partner's modified basis is that partner's adjusted basis in the partnership (i) immediately before the contribution; (ii) without accounting for liabilities under I.R.C. § 752, and (iii) by the partnership after considering adjustments in the first two items, as well as other adjustments the secretary may provide. Under the final regulations, the taxpayer may use either the relevant basis method for transactions after Dec. 30, 2022, or the anti-stuffing method for applying the 2.5 times rule.
  - *The 2.5 Times Rule Is a Bright Line*: Treasury and IRS note that the 2.5 times threshold is a bright line to provide certainty for transactions. Under the final regulations, a pass-through entity engaging in multiple transactions below the 2.5 times threshold may have those transactions "recharacterized in accordance with its substance" to prevent abuse.
- **Keeping the I.R.C. §4965 Carveout:** I.R.C. § 4965 imposes an excise tax on tax-exempt entities that become a party to prohibited tax-shelter transactions. The amount of the excise tax depends on whether the qualified organization had knowledge of or reason to know it was a party to a prohibited tax-shelter transaction. Treasury and IRS note that it is appropriate to maintain the I.R.C. § 4965 excise tax carveout in the final regulations. Treasury and IRS may consider proposals to eliminate or limit the carveout should qualified organizations continue facilitating syndicated conservation easement transactions.
  - *Donee Organizations Are Not Material Advisors*: Treasury and IRS recognize the need to differentiate material advisors and done-qualified organizations in syndicated conservation easement transactions. Under the final regulations, a qualified organization "acting solely in its capacity as a qualified organization" by accepting a conservation easement and separate payments or contributions to monitor and enforce that easement would not be considered a material advisor. Treasury and IRS caution that a qualified organization engaging in activities that would meet the material advisor requirements would still be subject to penalties for non-disclosure.

Conclusion

The final regulations highlight Treasury and IRS's commitment to challenging conservation easement transactions despite attacks under the APA. Taxpayers, material advisors, and qualified organizations involved in these transactions should consult with their tax advisors to understand how the final regulations may affect them.

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