

# Syndicated conservation easement transactions identified as new 'listed transactions'

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On December 23 2016 the Internal Revenue Service (IRS) issued Notice 2017-10, identifying certain transactions involving conservation easements as 'listed transactions'. For several years the IRS has been actively examining conservation easements and litigating such cases in the US Tax Court. The new listed transaction designation puts certain conservation easement transactions into a tax reporting and record-keeping regime that may lead to additional IRS income tax and promoter examinations and potentially significant penalties.

Section 170(f)(3)(B)(iii) of the Internal Revenue Code allows a deduction for qualified conservation contributions. In general, a qualified conservation contribution is a donation of an interest in real property to a qualified charitable organisation exclusively for conservation purposes. The donated real property must be subject to a permanent use restriction promoting its preservation (see Section 170(h) of the code). Conservation easements were intended to incentivise private land owners to restrict development of environmentally and historically sensitive lands. However, recent growth in the popularity of conservation easements has led to the development of a sub-industry in the financial services market, which involves the syndication of real property investments to obtain the charitable contribution deduction under Section 170 of the code.

Notice 2017-10 states that syndicated conservation easement transactions with certain characteristics are tax avoidance transactions and identifies such transactions, and substantially similar transactions, as listed transactions within the meaning of the code. A syndicated conservation easement transaction constitutes a listed transaction in the following situation. The transaction promoter identifies or forms a pass-through entity (eg, a partnership or Subchapter S corporation) that owns real property. The promoter seeks out prospective investors by suggesting that they may be entitled to a share of the charitable contribution deduction that equals or exceeds two-and-one-half times the amount of the investment. Investors purchase interests in the pass-through entity either directly or through another pass-through entity. The pass-through entity:

- obtains an appraisal that may inflate the value of the real property;
- places a restriction on use of the property; and
- donates the property to a tax-exempt organisation.

The investors claim charitable contribution deductions with respect to the donation.

Each investor, pass-through entity, promoter, appraiser and any material adviser must report the transaction to the IRS, including the IRS Office of Tax Shelter Analysis. For transactions entered into during a tax year for which the participant's federal tax return is due between December 23 2016 and May 1 2017, the participant must file a Form 8886 by May 1 2017. By June 21 2017 participants will also have to file Forms 8886 for each transaction entered into during a prior tax year for which the participant's federal tax return has already been filed. Finally, they must report any additional participation in syndicated conservation easement transactions by filing Form 8886 with future annual tax returns. Under Section 6707A of the code, each incomplete, unfiled or late-filed Form 8886 is subject to a penalty of 75% of the decrease in tax shown on the taxpayer's return as a result of the transaction, up to a maximum penalty of \$100,000 for natural persons and \$200,000 for all other taxpayers. There may be other consequences from such failures as well, such as an extended period of limitations on assessment. The tax-exempt organisation to which the property was donated

## AUTHORS

[Christopher S Rizek](#)



[Charles M Ruchelman](#)



[Arianna Caldwell](#)



is not considered a participant and does not have to report under the notice.

'Material advisers', as defined under Section 6111 of the code, must report the transaction by filing Form 8918 by May 1 2017. Under Section 6707 of the code, each incomplete, unfiled or late-filed Form 8918 is subject to a penalty of the greater of \$200,000 or 50% of the gross income derived by the material adviser from the transaction. According to the notice, retroactive reporting is required for syndicated conservation easement transactions entered into on or after January 1 2010. Further, material advisers become subject to additional record-keeping ('list maintenance') obligations under Section 6112 of the code, and may be subject to further penalties for failure to timely supply the required list to the IRS in a timely manner on request.

*For further information on this topic please contact [Christopher S Rizek](mailto:crizek@capdale.com), [Charles M Ruchelman](mailto:cruchelman@capdale.com) or [Arianna Caldwell](mailto:acaldwell@capdale.com) at Caplin & Drysdale, Chartered by telephone (+1 202 862 5000) or email ([crizek@capdale.com](mailto:crizek@capdale.com), [cruchelman@capdale.com](mailto:cruchelman@capdale.com) or [acaldwell@capdale.com](mailto:acaldwell@capdale.com)). The Caplin & Drysdale, Chartered website can be accessed at [www.caplindrysdale.com](http://www.caplindrysdale.com).*

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