

Important Advisory: Tax Shelter Abuse of Conservation Donations

All Land Trust Alliance (the “Alliance”) member land trusts adopt and commit to implement *Land Trust Standards and Practices* (“the Standards”), the ethical and technical guidelines for the responsible operation of a land trust. Those guidelines require that all Alliance member land trusts refuse to knowingly participate in tax shelter transactions. To assist land trusts in avoiding these transactions, the Alliance is providing this updated Advisory, **which updates and supersedes in full all prior versions.**

The purpose of this Advisory is to:

- assist land trusts in understanding tax shelter transactions that use conservation tax incentives;
- explain applicable practices, requirements and regulations
- describe due diligence that land trusts can use to identify tax shelter transactions;
- make clear a land trust’s options and obligations once it has identified a likely tax shelter transaction;
- and
- make clear that Practice 10C4 in the Standards and this Advisory do not apply to donations of conservation easements or land by an individual or sole proprietorship, or by a pass-through entity that consists of related parties.

Background

The Alliance is concerned about transactions that disguise a tax shelter designed to generate profits from a charitable donation for conservation. In these tax shelter transactions, unrelated investors acquire interests in various pass-through entities, such as partnerships or limited liability companies, which entities hold title to land. Then, after a short holding period, usually fewer than three years, the entities donate conservation easements (or land) to land trusts and claim deductions based on appraised values that are significantly in excess (often by three to 10 times) of the original acquisition price. As a result, investors each receive tax benefits that are worth significantly more than each investor’s initial investment. Typically, promoters organize these transactions in return for high fees. Sometimes promoters offer extraordinary stewardship donations to the participating land trusts.

These transactions are antithetical to the concept of charity that Section 170(h) of the Internal Revenue Code was designed to reward. As such, the Alliance is acutely concerned that congressional support for the federal charitable deduction for conservation donations is imperiled by these transactions, which is a major threat to the conservation work of land trusts. Because of these concerns, the Alliance has taken a number of actions to help its land trust members identify and avoid these transactions.

In February 2017, the Alliance released the revised Standards, which include a new Practice 10C4. That practice prohibits Alliance land trust members from engaging in these transactions. The Alliance is also aggressively advocating for legislation in Congress to stop tax shelters that use conservation tax incentives, including preventing passive partnership investors from profiting from these types of transactions by claiming excessive federal tax deductions.

The IRS was so concerned about these transactions that it took the extraordinary step of issuing Notice 2017-10 (the “Notice”) to describe these transactions, to classify them as “listed transactions” and to require disclosures by participants in, and material advisors to, these transactions. Notably, the IRS also indicated in the Notice that it considers the transactions to be “tax avoidance transactions” that it intends to challenge. The description of tax shelter transactions in the Notice is similar to the text of Practice 10C4, and it also focuses on the fact that promoters typically market these transactions to investors using promotional materials that highlight the potential for outsized federal tax deductions.

The purpose of the Notice is to require participants and material advisors in these transactions to disclose them to the IRS for further scrutiny. Merely being a transaction described in the Notice does not automatically make the transaction illegal; however, it underscores the likelihood that the transaction violates federal tax law.

Duties of Alliance Land Trust Members

The Standards state that land trust members of the Alliance shall not knowingly participate in potentially fraudulent or possibly abusive transactions (see Practice 1A3). Practice 10C contains exact criteria for each land trust to evaluate transactions with pass-through entities consisting of *unrelated* parties so that land trusts are able to make an informed independent determination regarding Practice 1A3. Practice 8C3 requires land trusts to evaluate projects for potential risks, including credibility issues. Practice 9A1 requires a land trust to obtain a legal review by an attorney of every transaction appropriate to its complexity.

In order to not violate Practice 10C4 and other provisions in the Standards, and to be able to maintain its membership in the Alliance, a land trust member must not participate in a transaction that falls into one or more of these categories:

1. As Prohibited under Practice 10C4

Practice 10C4 first requires that the land trust obtain a copy of the landowner’s appraisal prior to closing when engaging in transactions with pass-through entities of unrelated parties. Practice 10C4 then requires that the land trust decline to participate in any transaction with pass-through entities consisting of unrelated parties, particularly those offered or assembled by a third party or described in the Notice, or otherwise described as a syndication by the IRS, in which:

- a. the appraisal indicates an increase in value more than 2.5 times the basis in the property *and*
- b. the easement or property is donated within 36 months of the pass-through entity’s acquisition of the property *and*

- c. the value of the donation (not the *deduction*) is \$1 million or greater *and*
- d. the terms of the transaction do not satisfy this Advisory.

2. As Defined in the IRS Notice

By the Notice and a subsequent notice (IRS Notice 2017-29), the IRS has ruled that land trusts are neither a participant in, nor a material advisor to, the tax shelter transactions described in the Notice and, therefore, have no obligation to file a disclosure. Land trust members of the Alliance, however, must decline to participate in any transaction involving a conservation donation by *unrelated parties* that appears to have all of the following characteristics as set forth in the Notice:

- a. A pass-through entity will make the contribution.
- b. Members of the entity are investors who have been solicited to invest in the entity.
- c. The investment is offered to investors in oral or written promotional materials.
- d. The promotional materials offer the possibility of a federal tax deduction that is at least 2.5 times the investor's investment.
- e. The transaction is intended to result in a contribution for which a federal income tax deduction will be claimed by investors.

Donations of land in fee simple that meet the criteria described in the Notice are also subject to its provisions. When the IRS identifies a "listed transaction," the listing applies not only to the exact transaction described but also to transactions that are "substantially similar." A transaction that involves the donation of land in fee simple that meets the above five criteria is "substantially similar" to the conservation easement donation described in the Notice. As such, a land trust member of the Alliance must not participate in such a transaction.

Due Diligence to Avoid Tax Shelter Transactions

To avoid the transactions described above, a land trust should follow these steps:

Step 1: Understand the People Behind the Donor Entity

The tax shelter transactions addressed by this Advisory all involve pass-through entities (i.e., an S corporation, general partnership, limited partnership or limited liability company or any other pass-through entity). As such, this Advisory does not apply to donations of conservation easements or land by individuals or sole proprietorships. Likewise, the Advisory also does *not* apply to transactions involving pass-through entities that solely consist of related parties.

At the commencement of any transaction that appears to involve a donor entity consisting of unrelated parties, the land trust must document the request to and response of the donor entity if it is a partnership or other pass-through entity involving unrelated parties and reach an independent informed conclusion whether it is. If *no*, then this Advisory does not apply to the transaction.

¹Related parties are those individuals related by blood, adoption or marriage to another individual owner of such a family partnership interest. Such relationships by blood, adoption or marriage may include, but are not limited to, the following: spouses, children, siblings, parents, ancestors of parents, nieces and nephews, aunts and uncles, members of the same household of any of the foregoing and spouses of any of the foregoing.

If **yes**, then proceed to Step 2, and then as dictated by the results of the Step 2 due diligence, the Action Steps if a tax shelter transaction, or Practice 10C3 if not a tax shelter transaction but still overvalued or of concern.

Step 2: Conduct Due Diligence to Determine If a Transaction Is a Potential Tax Shelter

a. Obtain the following information from the donor entity

Ask the donor entity to certify all of the following information in writing so that the land trust is able to make an independent informed determination as to whether the transaction meets the criteria in Practice 10C4 or appears to satisfy the criteria in the Notice. The land trust must evaluate the information gathered in its due diligence with outside legal counsel against all the criteria in Practice 10C4, the Notice, this Advisory and, if applicable, any federal legislation addressing tax shelter transactions and determine:

Whether a promoter or third party played a role in facilitating the proposed contribution or otherwise promoted, organized or secured the transaction.

Whether the promoter has produced or disseminated any promotional materials about the transaction, oral or written, including an advertisement, solicitation, prospectus, offering memorandum or similar document, presentation or communication. Ask the donor to provide a copy of the promotional materials. (This information may reveal that the transaction is likely a listed transaction under the Notice because of the potential return on investment that is asserted [often measured in federal tax deductions possibly available to investors] or because the promotional materials disclose that the transaction may qualify as a listed transaction. *Such a disclosure is dispositive that the transaction is a prohibited tax shelter transaction for purposes of this Advisory.*)

The date the donor entity acquired the property to be conserved.

The original purchase price or basis of the property to be conserved.

Whether the donor entity intends to claim a federal tax deduction based on the donation of a conservation easement or land. (The donation of a conservation easement or land is often listed as one of a number of options for how the donor entity might use aggregated investor funds [e.g., often described as the “Conservation Option” or “Green Option”], which would be sufficient evidence of such intent).

Whether the donor entity’s expectations for value of the land or easement to be donated compared to the purchase price approach or exceed an increase in value of more than 2.5 times the basis in the property.

Whether the appraisal reveals a value that meets or exceeds the thresholds stated in Practice 10C4 or the Notice, regardless of any justifications in the appraisal or elsewhere in the transaction documentation.

b. Notify the donor in writing

At the commencement of any transaction involving a donor entity, inform the donor entity in writing of the land trust's requirements for accepting a donation of land or a conservation easement, including, without limitation, that:

The donor entity and each of its partners or members have been informed and understand that the land trust will only close on the transaction and subsequently sign a Form 8283 if the fully completed form is presented to the land trust with the full appraisal sufficiently prior to the closing to enable the land trust to read and understand the full completed Form 8283 with all attachments, *and* the land trust determines that the transaction does not violate Practice 10C4, does not appear to be a listed transaction under the Notice and does not otherwise violate this Advisory.

The qualified appraisal shall identify the donee land trust, by name or by organization type as an *intended* user of the appraisal.

If the donee is an accredited land trust, the qualified appraisal shall identify the Land Trust Accreditation Commission by name, as an *intended user* of the appraisal.

The qualified appraisal shall identify "verification of valuation compliance with the Advisory" as an *intended use* of the appraisal.

The donor entity and each of its partners or members have been informed by the land trust in writing and understand that the land trust reserves the right not to accept the land or conservation easement, the right to withdraw from the transaction at any point and the right to refuse to sign Form 8283, all at no risk or liability to the land trust.

The donor entity and each of its partners or members have been informed and understand that the donor entity and each of its partners or members are solely responsible for relying on their own judgment and professional advice furnished by the appraiser and all legal, financial and accounting professionals engaged by the donor entity and its partners or members in connection with the conservation donation.

The land trust is providing no representation with respect to the availability, amount or effect of any deduction, credit or other benefit to the donor entity, its partners or members under the Internal Revenue Code, the Treasury regulations or other applicable law as to any of these values:

the fee interest if a gift of fee,

the conservation easement or any other partial interest,

the land subject to the conservation easement or any other partial interest.

The donor entity understands the IRS rules and the penalties associated with overvaluation and has been fully and competently advised by the donor's tax adviser as to all the tax rules associated with a qualified contribution of a conservation easement or land.

c. Secure opinion from outside counsel expert in tax matters

Obtain a written legal opinion from outside legal counsel who is an expert in tax law, to determine if the *entire* conservation transaction complies with all applicable state and federal laws, the Standards, this Advisory and the Internal Revenue Code and U.S. Treasury regulations, including, without limitation, a full

assessment and opinion of the legal compliance of the appraisal with all applicable Internal Revenue Code and U.S. Treasury regulations (“qualifying opinion letter”). Please note that counsel’s failure to directly opine on appraisal compliance with the Internal Revenue Code and U.S. Treasury regulations fails to satisfy this step. *The land trust must withdraw from the transaction if it does not have such a qualifying opinion letter.*

d. Review the due diligence documents and appraisal before closing

The land trust must carefully review with appropriate experts before closing: the information provided by the donor entity, the appraisal and other due diligence findings to determine whether the transaction appears to be a tax shelter transaction. If it is, the land trust must decline to accept the land or conservation easement, as stated below.

Remember, that for the purposes of pass-through entity transactions of unrelated parties, Practice 10C4 requires that the land trust *must* obtain the appraisal prior to closing.

Action Steps If a Tax Shelter Transaction

Withdraw from the Transaction as Early as Possible

Land trust members of the Alliance are required by the Standards to decline to participate in prohibited tax shelter transactions, even when the donation would lead to extraordinary conservation (participation in tax shelter transactions for purposes of this Advisory by land trust members of the Alliance means promoting, facilitating or enabling the transaction by serving as the recipient of a conservation easement or fee interest in land). A land trust must withdraw from the transaction with the pass-through entity of unrelated parties before accepting the proposed conservation easement or land gift if:

information gained during the due diligence phase indicates the appraisal shows or will show an increase in value of more than 2.5 times the basis in the property within 36 months, the value of the donation (not the resulting deduction) is \$1 million or greater and the transaction does not qualify under the “Potential Exception” described below; or

the transaction appears to be a listed transaction under the Notice; or

the transaction is prohibited or federal tax deductions for such transactions are prohibited by federal law; or

the transaction otherwise violates this Advisory.

Refuse to Sign Form 8283

If the land trust has already accepted a gift of a conservation easement or land from a pass-through entity of unrelated parties and is subsequently presented with a Form 8283 or an appraisal or both and the transaction falls into one or more of the four categories described immediately above, the land trust *must* refuse to sign Form 8283. Also remember that, in other transactions that are not tax shelters, but where a land trust is uncomfortable with the valuation or any other aspect of the transaction, the land trust is under no obligation to participate or to sign Form 8283 until the donor adequately addresses the land trust’s concerns.

Potential Exception Related to Practice 10C4

In the unlikely event that the land trust completes all of the required due diligence and concludes that, even though a transaction meets or exceeds the thresholds of Practice 10C4 and is presumptively a prohibited tax shelter, there are extenuating circumstances that make it a legitimate transaction, it may proceed if **all** of the following conditions are met:

1. The transaction does not appear to be a listed transaction under the Notice.
2. The appraisal:
 - a. has fully documented assumptions;
 - b. does not use a subdivision, development, income or mineral extraction methodology to value the transaction unless the value determined using such methodology is confirmed by comparable sales as described in subsection c below; and
 - c. uses the before and after method with current comparable sales from adjacent counties or the same county as the subject property; unless the appraisal convincingly establishes that the property being appraised has a highest and best use that is regional or national.
3. If the donor entity requires any permits or approvals to justify the appraised value, the donor entity has obtained all such permits and approvals.
4. The land trust board, after receiving and carefully reviewing all of the above due diligence documents, finds that the transaction is not a prohibited tax shelter, as defined in this Advisory, and votes to approve the transaction.

Discuss Substantial Concerns with Legal Counsel and the Donor

Even if the review of due diligence determines that the transaction is not a prohibited tax shelter, Practice 10C3 requires that the land trust discuss any substantial concerns about the appraisal or the transaction with legal counsel and take appropriate action, such as:

- documenting that the land trust has shared those concerns with the donor;
- seeking additional substantiation of value;
- withdrawing from the transaction prior to closing; or
- refusing to sign the Form 8283.

Land trust permanent records should also include copies of all of the information collected during the due diligence step and the land trust's written assessment of those materials, including outside experts' opinion letters.

Evaluate Land Trust Policies

Evaluate your existing acquisition policies and procedures with the advice of outside legal and tax advisers (not a board member or staff) in light of this Advisory. Include cautionary measures, such as those in this Advisory, to ensure that your land trust does not unwittingly participate in tax shelter transactions.

The Land Trust Alliance Is Here to Help You

This is a complex topic. Land Trust Alliance regional and national staff are available to assist you in working through this Advisory. If you become aware of a tax shelter transaction or have questions or concerns, call or write to Leslie Ratley-Beach, 802-262-6051, or Sylvia Bates, 603-708-1073.

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Approved by the Conservation Defense Committee February 1, 2018.

Nonsubstantive corrections March 1, 2018, and May 23, 2018, that do not impact the substance, intent or contents of the document. Please contact Leslie Ratley-Beach, lrbeach@lta.org, with any questions.

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