IRS and Treasury Issue Final Syndicated Conservation Easement Regulations

Tax Alert
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On October 8, 2024, following a highly contentious rulemaking process, the Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) issued final regulations designating certain Syndicated Conservation Easement (SCE) transactions as listed transactions (*see* T.D. 10007; Treas. Reg. § 1.6011-9). The IRS first identified certain SCEs as listed transactions in Notice 2017-10 (Dec. 23, 2016). In response to successful challenges to Notice 2017-10 under the Administrative Procedure Act (APA), see *Green Rock, LLC v. IRS*, No. 23-11041 (11th Cir. 2024); *Green Valley Investors, LLC v. Comm'r*, 159 T.C. 80 (2022), Treasury promulgated proposed SCE regulations on December 6, 2022, to replace the Notice. For a discussion of the proposed SCE regulations, see our prior coverage here.

In general, the final SCE listed transaction regulations define a syndicated conservation easement transaction as a transaction in which: 1) a taxpayer receives promotional materials that offer investors in a passthrough entity the possibility of being allocated a charitable contribution deduction, the amount of which equals or exceeds an amount that is two and one-half times the amount of the taxpayer's investment (the 2.5 times rule); 2) the taxpayer becomes a direct or indirect investor in the passthrough entity that owns the real property; 3) the passthrough entity that owns the real property contributes an easement on such real property to a qualified organization and allocates, directly or through one or more tiers of passthrough entities, a charitable contribution deduction to the taxpayer; and 4) the taxpayer claims a charitable contribution deduction with respect to the passthrough entity's contribution of the conservation easement.

The final regulations clarify and revise the proposed regulations in response to comments received during the rulemaking process, including the following:

- The final regulations clarify that the 2.5 times rule in Treas. Reg. § 1.6011-9(b)(1) is a bright-line rule, *i.e.*, whether a transaction involving a contribution of less than 2.5 times can be considered a "substantially similar" transaction subject to disclosure. The IRS clarified that any transactions where the promotional materials advertise an amount less than the 2.5 times threshold are generally not reportable, however, if a taxpayer's actual allocation is above the threshold, the rebuttable presumption in Treas. Reg. § 1.6011-9(d)(3) applies. In addition, if a passthrough entity engages in a series of transactions to avoid the 2.5 times threshold, the IRS may disregard or recharacterize the transaction in accordance with its substance.

- The final regulations rephrase the definition of a "conservation easement," to track the language of section 170(h): "a restriction (granted in perpetuity) on the use that may be made of the real property, within the meaning of section 170(h)(2)(C), exclusively for conservation purposes, within the meaning of section 170(h)(1)(C) and (h)(4)."

- The final regulations clarify that a transaction that meets the requirements for a listed SCE transaction under the regulations, but involves the contribution of a fee simple real estate interest, rather than an easement, is a "substantially similar transaction."

- The final regulations expand the definition of participant to include "participants in transactions that are *the same as, or substantially similar to*, syndicated conservation easement transactions" (emphasis added), in addition to owners of a passthrough entity, passthrough entities, and any other taxpayers whose tax returns reflect the tax consequences of an SCE.

The preamble to the final regulations also noted that some commenters questioned whether the SCE regulations should be finalized following Congress's 2022 enactment of section 170(h) as part of the Consolidated Appropriations Act, 2023, P.L. 117-328 § 605 (Dec. 29, 2022). Section 170(h) is intended to address most of the abusive conservation easement transactions by generally disallowing deductions for contributions of conservation easements by a partnership (or other passthrough entity) if the reported

value is more than 2.5 times the partners' "relevant basis" in the partnership and by imposing a strict liability 40 percent penalty. Treasury and the IRS explained that notwithstanding section 170(h)(7), there is still a need for these regulations, which are intended to cover three categories of conservation easements (and substantially similar transactions): 1) those that involve contributions made before December 30, 2022; 2) those that involve charitable contribution deductions which are not automatically disallowed under section 170(h)(7); and 3) those involving a fee simple contribution rather than a conservation easement.

Notably, the final regulations do not address valuation, which is the focal point of many SCE disputes. In response to a comment regarding guidance on valuation, the preamble to the final regulations makes clear that the government will maintain its aggressive position on SCEs: "Any guidance on valuation is outside of the scope of these final regulations, which are limited to identifying a listed transaction....The Treasury Department and the IRS have challenged and will continue to challenge abusive appraisal practices and overvaluation." Thus, we expect to see continued valuation disputes and controversies for any SCE-type transactions that either pre-date or are not otherwise disallowed by section 170(h)(7).

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