SPECIAL REPORT

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A Modest Legislative Proposal to Shut Down Specific Tax Shelters

By Stephen J. Small

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In this report, Small provides a proposal for stopping, or at least significantly slowing down, the syndication of conservation easement deductions.

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Table of Contents

I. **Immediate Gratification** 1085
II. **The Proposal** 1086
III. **Like the Wild West** 1086
IV. **Why a Legislative Fix Was Needed** 1087
A. Promoters, Advisers, and Investors . . . 1087
B. Opponents Were Ignored 1087
C. Limited Enforcement, In Fact 1087
D. Stop the Bleeding, Change the Code . . . 1087
V. **So They Changed the Code** 1087
VI. **Protecting Conservation Values** 1087
VII. **'People Will Find a Way to Abuse It'** 1088
VIII. **There's Trouble in River City** 1089
IX. **The Tricks** 1089
X. **Do I Have a Deal for You!** 1090
A. Lowland Plantation Holdings LLC 1090
B. Sand Hills Aggregate Investors LLC 1091
C. Country Mill Properties LLC 1091
D. Pine Hammock Holdings LLC 1091
E. Unknown 1091
F. Saving the Best for Last: Piney Woods . . . 1092
G. Similar 'Tax Shelter' Results, Different Facts 1092
XI. **Why a Legislative Fix Is Needed** 1092
XII. **Target the Legislative Fix** 1092
XIII. **I Despair** 1093

It seems that every month I get a proposal like the following in my email inbox[1]:

> Sandy Lake Retreat. . . . The Sponsor is seeking one or more partners. . . . A 10 percent partnership position could be acquired for around $1.9 million, providing around $9 million of income tax deductions (once an easement is granted), and title to one of four exclusive reserved lots. . . . An accompanying information sheet shows a pro rata deduction of $11.4 million, for a purchase price of $1.9 million, with immediate cash return, in excess of the purchase price, of $2,614,000.

One of the more fascinating expressions that shows up in most of those offerings is the opportunity to "monetize a charitable contribution." Just think about the implications.

Those proposals are, of course, nothing more than old-fashioned tax shelters, dressed up in new clothes, that take advantage of tax code rules and appraisers who don't just push the envelope, but make it disappear.

I. Immediate Gratification

One hallmark of tax shelters is immediate gratification. I write a check, and almost immediately, in the same tax year and often even in the same month, I get a deduction that is a significant multiple of the dollar amount of my check.

We need a legislative fix to stop this foolishness. Promoters, attorneys, other advisers, appraisers, and investors are flaunting the rules, and the IRS is essentially unable to enforce them in a meaningful way. Timothy Lindstrom's article raised awareness of the syndication problem.[2] But I bring a different perspective, not a look at the intricacies of some of the tax code rules and not a plea for common sense (as important as that is) but rather a proposal for how to stop the syndication of a specific kind of tax shelter.

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[1]I have changed the name of the offering.
[2]Lindstrom, "4 Tax Issues for Conservation Easement Transactions," *Tax Notes*, Aug. 31, 2015, p. 953.

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II. The Proposal

My proposal would stop, or at least significantly slow, the syndication of conservation easement deductions. It is tailored to leave alone most mainstream, sensible conservation easement donations, in which important conservation values are protected in perpetuity and taxpayers deduct an appropriate amount.

There are at least a few different legislative fixes that could accomplish that goal. One would require that for some deductions, the taxpayer's holding period begins on the date the taxpayer buys the interest in the property or in the entity through which the deduction for the easement flows. In all the syndicated deals I have seen, that would limit the taxpayer's deduction to its basis in the investment. That would stop the long-standing practice of "bootstrapping" your way into a long-term holding period.

But while the holding period proposal would stop some of the most egregious transactions, it would not stop transactions in which investors are willing to wait until the following tax year for an inflated deduction. For example, an investor buys an interest in a limited liability company in November 2016. In December 2017 (13 months later), the LLC makes a charitable contribution. Secure in the knowledge that the deduction will be available beginning in 2017, the investor lowers estimated tax payments or withholding to take the deduction into account.

Thus, I would add a second prong to the holding period proposal. First, if a taxpayer has owned an interest in the property (or in the entity through which the deduction flows) for less than 18 months and, second, if the claimed deduction is greater than 250 percent of the taxpayer's basis in the investment, the taxpayer's deduction for the donation should be limited to its basis.

There are two additional important points behind that targeted two-prong proposal.

First, no self-respecting tax shelter would offer investors less than a 3-to-1 write-off, and probably not less than a 4- or 5-to-1 write-off. That would make absolutely no tax-savings sense.

Second, there are legitimate cases in which buyers have acquired property in a distress sale at a significant discount. But even then, proving a 250 percent increase in value over cost basis in less than 18 months is a stretch. To the extent the spread is supportable, under my proposal the buyer would simply have to wait a little longer before making the donation.

I don't pretend that my proposal is the best solution or that I have written the correct technical language for what many of us in the mainstream of private land protection work see as the growing problem of syndicated deductions, but I hope it starts an intelligent conversation.

III. Like the Wild West

I have some general observations about some of the most popular pre-1986 tax shelters.

In 1983, when I was newly into private practice after four years as an attorney-adviser in the legislation and regulations division of the IRS Office of Chief Counsel (L&R), I attended an American Law Institute-American Bar Association seminar in Houston called "Sophisticated Real Estate Transactions." I think Stefan Tucker served as one of the speakers at that Houston program, and Bill Wasserman was another. One of Wasserman's concepts intrigued me: using new S corporations with different tax years as partners in a partnership, forcing (under then-existing rules) the deferment by a year of the receipt of taxable income by the partners-investors (who owned their respective S corporations). I later used that structure with some enthusiastic real estate developer clients. It worked, but the real estate market tanked, so the timing of the receipt of taxable income never became an issue.

But the strongest memory I have from that program was a point made by David H. Brockway. Brockway was then the staff director for the Joint Committee on Taxation, and I knew him from some of the legislative and drafting projects I had worked on as the IRS representative from L&R, including the drafting of new section 170(h), regarding qualified conservation contributions (more particularly as it turned out historically, the donation of conservation easements). While in L&R, I wrote the regulations on conservation easement donations and helped draft the regulations on carryover basis (although those code provisions were later repealed).

Brockway said something like this: "In 1980, which is the last year for which we have good data, taxpayers claimed more than $40 billion in losses from real estate investments. The committee has been paying careful attention to this, and we are likely to propose changes to the law."

In hindsight, it is clear that this was an understated heads up.

Creating tax losses from real estate tax shelters relied on several different tax rules, including those on accelerated depreciation for some real estate, as well as other techniques such as special (non-pro rata) allocation of income and losses. Tomes have been written about those transactions, and it is not the purpose of this article to revisit them, except for context and tax history. I remember thinking in the early 1980s that some of those "investments" were like the old days in the Wild West. An early favorite

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was simply allocating losses to high-taxable-income partners and income to partners with net operating losses.

The success of most of those real estate (and other) tax shelter transactions was based on the following: (1) a lot of impressive paper, most notably multipage opinion letters blessing transactions that relied on things such as sale-leaseback issues, nonrecourse debt, and special allocations; and (2) the fact that any investor, regardless of what the investor did for a living, could write a check, usually close to year-end, and almost immediately be allocated deductions that were a significant multiple of the dollar amount of the check. They were essentially passive investors who never had to participate in any of the management decisions or business activities of the partnership. I don't recall the passive characterization of investors being central to Brockway's remarks, although he may have been thinking about it.

IV. Why a Legislative Fix Was Needed

Some will argue that those tax shelters didn't work in the first place, that there were already code provisions and case law that could pierce the paper and render the losses nondeductible. But looking back, it's clear we needed a legislative fix then and that we need one now.

A. Promoters, Advisers, and Investors

Whether they worked or not, those transactions were rampant. Promoters were making a lot of money, investors were sheltering a lot of income, and those who maintained that the deals didn't work were either ignored, laughed at, shouted down, or papered over with opinion letters stating that they did work.

B. Opponents Were Ignored

Because the transactions were rampant and because the promoters and investors ignored the scholarly articles crying foul, preaching about shutting them down was useless.

C. Limited Enforcement, In Fact

Then, as now, the IRS was outnumbered, outgunned, and did not have the audit capacity to stop those transactions. When the IRS did audit them, the IRS could be out-lawyered. Even when the IRS was not out-lawyered and actually won a case, the legal resolution happened years after the investment (at least five or six years and often more), so an adverse decision was of no use in stopping transactions and eliminating deductions that were already a minimum of five or six years old. To wit, some recent Tax Court decisions on conservation easement donations involve donations as far back as 2003 and 2005. Finally, opinion letters have always been good at distinguishing adverse court decisions from the current investment you are buying into. In other words, the IRS was not completely helpless but was close to completely helpless in shutting them down.

D. Stop the Bleeding, Change the Code

Therefore, the only way to stop the bleeding, to throw the sandbags against the flood of losses Brockway talked about, was to change the code.

As an aside, this year's IRS list of "Dirty Dozen" tax scams includes unscrupulous tax return preparers, offshore tax avoidance, falsely padding deductions on tax returns, and abusive tax shelters. In IR-2016-29, the IRS notes that "everyone should be on the lookout for people peddling tax shelters that sound too good to be true. When in doubt, taxpayers should seek an independent opinion regarding complex products they are offered." While I agree, of course, I refer the IRS to IV.A and IV.C, immediately above.

V. So They Changed the Code

In the Tax Reform Act of 1986, Congress stopped those tax shelters with a remarkably simple concept: If you were a "passive" investor in a transaction, you were not entitled to take those losses against income from wages, dividends, interest, or capital gains, regardless of how the losses were generated (that is, accelerated depreciation, nonrecourse debt, special allocations, etc.). In other words, if you just wrote a check to buy into a deal that threw off losses that were a multiple of your investment, your ability to take losses from that investment were severely limited if not completely curtailed. To this day, there are good-faith debates about whether the passive-loss rules were the best way to shut down tax shelters or whether the claimed harm to the U.S. real estate market resulting from the passive loss rules outweighed the gain. But the passive loss rules, a relatively simple tax code change, essentially shut down that tax shelter business.

VI. Protecting Conservation Values

Section 170(h) was added to the code in 1980 as an incentive for landowners to protect property with important conservation values. It was, essentially, an extension and amendment of a provision that was first added to the code in TRA 1976.

I went to work in L&R in 1978, and one of the projects on my desk was the draft regulation implementing the 1976 conservation incentives, which

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included a five-year sunset date (that is, the provision was due to expire in 1981).[3] It was understood in 1979 that the provision would be amended and extended, and I was involved as the IRS representative in hearings and the later drafting sessions from which section 170(h) emerged.

It was clear at the time that this was intended to be an incentive to provide some federal income tax benefit (a deduction) for landowners who decided to protect in perpetuity important conservation values (wildlife habitat and scenic property, for example) by giving up most or all of their development rights. But you don't get a deduction for agreeing to build less than you are entitled to under local zoning rules. You get a deduction for protecting in perpetuity land with important conservation values (as defined in the code and regulations).

That was simple enough. The concept was that Aunt Sally, who owned a farm or ranch, or Uncle Bob, who owned acres of forestland with an important habitat, could give up their development rights (which mostly means prohibiting industrial, commercial, or residential development) in perpetuity, and by doing so they were entitled to a federal income tax deduction for the forgone value.

The concepts and terms were novel as a tax code matter, although many terms in section 170(h) were taken from, or grew out of, code provisions enacted as part of TRA 1976. For those of us who drafted regulations, the concepts (''significant natural habitat of fish, wildlife, or plants, or similar ecosystem'') were complex and not routine IRS work. But the premise was simple: If a landowner gives up most or all of her development rights to protect property with significant conservation values in more or less its current state, rather than selling the property to the highest bidder for maximum permissible development, a deduction is available for the forgone value.

VII. 'People Will Find a Way to Abuse It'

I was at a roundtable discussion about conservation easements at the Lincoln Institute for Land Policy in Cambridge, Massachusetts, at least a decade ago, and the subject of abusive conservation easement transactions came up — transactions with too much development or with inflated appraisals — that were not at all what Congress had in mind in 1980.

A participant in the roundtable said, ''You know, this discussion just proves that if any provision survives in the tax code long enough, people will find a way to abuse it.''

[3]*See* Stephen J. Small, ''The Tax Benefits of Donating Easements in Scenic and Historic Property,'' 7 *Real Est. L.J.* 304 (1979).

Based on my experience and extensive travel and work around the country from the late 1980s through the 1990s, the overwhelming use of conservation easements during that time was of the Aunt Sally had a farm, or Uncle Bob had a ranch, variety. Large (and smaller) tracts of northern forestland, mid-Atlantic and New England farms, western ranches, single-owner or family-owned real estate, open space with important wildlife habitat or wildlife corridors, waterfowl habitat, southern plantations, country property, riverfront property, property owned by the same owners, or the same family, for years, if not decades, if not generations — these were typical of the properties protected by conservation easements during this period. The incentive was working the way Congress had intended.

The growth in the easement donation business was accompanied by an increase in the number of charitable organizations, local, state, regional, and national ''land trusts,'' and other conservation organizations working with landowners to conserve land. While parts of the country lagged behind others, word was getting out and use of conservation easements was spreading, again, the way Congress had intended. I recall a telephone conversation then with a colleague who said, ''I'm going to the Las Vegas area to look at a big tract of land for The Nature Conservancy.'' I replied, ''I think that's the first time anyone has ever used 'Las Vegas' and 'The Nature Conservancy' in the same sentence.''

I am still a purist, and some say I'm too conservative about what conservation easements can be used for. Nevertheless, when the incentive was being used and was working how Congress had intended, the terms ''real estate developer'' and ''conservation easement'' never even appeared in the same sentence, and the term ''syndicated conservation easement deductions'' never appeared anywhere. When the conservation easement deduction was amended and extended in 1980, Congress's principal concerns were how to define (and limit) the important conservation values — the protection of which deserved an incentive — and the role of tax-exempt conservation organizations in ensuring donor compliance with the rules.

Then things began to change. Landowners, promoters, advisers, appraisers, and some easement-holding organizations began to push the envelope. Easements were showing up ''protecting open space'' between a limited number of house lots in high-end or otherwise upscale ''conservation developments.'' Appraisers in these transactions always argued that the highest and best use of the subject was for much more intensive development, which represented a much more valuable ''highest and best use'' than the end-result estate lots — say, 10 or

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15 houses on 100 or 200 acres. (Most of the time, I think, that argument was bogus and that in these settings, an estate-lot limited development scenario was in fact the highest and best use — that is, the most dollar-valuable use — for the property.)

In some cases, developers were devising complicated transactions in which an investor bought into the project and received a deduction for a conservation easement *plus* the ownership of a house lot. (One version of this structure was part of the underlying transaction discussed in the Tax Court's recent decision in *Bosque Canyon Ranch v. Commissioner*, T.C. Memo. 2015-130. In connection with my observation that IRS enforcement doesn't work very well, note that the two donated easements under examination in this 2015 decision were donated in 2005 and 2007.) In many cases donors, advisers, and appraisers either were unaware of or were blatantly ignoring the technical easement appraisal method rules in the section 170(h) regulations — *not* following the rules often meant significantly higher deductions.

While the good, mainstream, constructive, conservation-oriented easement business continued to flourish, there were disturbing developments. Promoters, advisers, appraisers, and consultants were devising more and more transactions that went well beyond the conservation incentives Congress had in mind in 1980. As it turns out, most of those aggressive transactions that were in full bloom in the early 2000s relied on grossly inflated appraisals, which relied at least in part on a hot real estate market. All that changed when the economy and the real estate market took a serious downward turn, particularly after Lehman Brothers Holdings Inc. closed in September 2008.

The earlier versions of those aggressive transactions have now apparently morphed into something else. And I would like to suggest how to shut down the most aggressive of those transactions, with a targeted legislative fix, before a current version of Brockway and colleagues use too large a hammer and shut down conservation easement donations that should be allowed to continue.

VIII. There's Trouble in River City

In 2014 I started a small project of writing a series of notes on various tax, appraisal, and related issues of interest to the private land protection community.[4] Note 6, written in November 2014, is titled, "'Syndications' of Conservation Easement Deductions — Or, There's Trouble in River City."

Here are descriptions of some of the syndication transactions that have crossed my desk, mostly in the past year. Most of the transactions with which I am familiar seem to originate in the Atlanta area. And for some time the pool of potential investors seemed to be confined to the Southeast. But before we get to specifics, I would add that I am contacted almost weekly by potential investors and mainstream land conservation people about new versions of these deals that are landing on their desks. "These are rampant," a colleague told me. "They are spreading like wildfire across the country." A few months ago I learned of promoters trying to put together a deal like these in California. The report came from a conservation organization that saw what was coming and refused to participate as a donee.

I do not know if any of the following deals closed, nor have I communicated with any of the promoters or others involved. I learned about almost all of these deals from potential investors. I told them that I knew they could find other advisers who would tell them to buy in and some who would say, "Small is wrong." But I advised them to stay away. That is what I told a potential investor in the proposed "Sandy Lake Retreat" transaction, discussed briefly at the beginning of this report.

I said the IRS does not like these deals and that for various reasons they do not work as a tax code and tax rules matter. I told them that in many cases, if they were audited, the IRS would attempt to deny the deduction. And if the case goes to Tax Court, the court will deny the deduction; and there will be a deficiency, interest, and stiff penalties. I said the bottom line was that these deals relied for their success on grossly inflated appraisals.

IX. The Tricks

There are two tricks here, one old and aggressive but legitimate and one that is not.

The first trick relies on the holding period rules.

In a simplified version of the transactions that I have seen, Owner has owned Property for more than one year. Owner conveys Property into an LLC and takes back all of the LLC interests. Owner and LLC retain Owner's long-term holding period of Property. (If one donates an asset to charity and has not owned that asset for more than one year, the donor's deduction is limited to the donor's cost or basis of that asset, even if donor's appraiser can prove irrefutably that the fair market value of the asset is significantly higher than basis.) Owner then sells most but not all of the LLC interests to investors. LLC then donates a conservation easement on Property. Because the LLC is treated as having owned Property for more than one year, the full FMV deduction flows through to the individual

[4]These are available at http://www.stevesmall.com.

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members of the LLC, even though the investor-members of the LLC have owned their LLC interests for less than one year, sometimes much less than one year.

In other words, I can buy an LLC interest on December 25, the LLC can donate a conservation easement on December 26, and my share of the full FMV of the deduction will flow through to me, even though my holding period really could not be any shorter. As I recall, this ''bootstrapping'' into the LLC's long-term holding period was one of the hallmarks of many of the tax shelters before TRA 1986.

The second trick, which is not a trick at all, is a grossly inflated appraisal.

X. Do I Have a Deal for You!

I have some examples below. I have omitted or simplified discussion of the history of the property, when various participating LLCs were formed, percentage interests of various tiers of LLCs and members when relevant, and other complicated smoke-and-mirrors structural details. The devil is in the spread.

A. Lowland Plantation Holdings LLC

This was a proposed 2014 investment. The property is 325 acres of ''raw land'' in a relatively rural area of Georgia. The total proposed investment is $3.8 million. Promoters, previous owners, and others retain a small ownership percentage (2 percent). A 150-page appraisal values the conservation easement at $17.7 million. For an investment of $40,000, an investor will receive an ''allocated federal deduction'' of $168,256. State tax credits are also potentially available.

In other words, the ''owner'' apparently values the property at slightly less than $4 million (essentially selling 98 percent of the value for $3.8 million), and the promoter's appraiser values the property at $18,290,000 before the easement and $590,000 after the easement.

Investors are invited to ''buy in'' during calendar year 2014, the easement will be donated in 2014, and because the LLC owner of the subject property will have owned the property for more than one year, the ''holding period, adjusted basis and character of the assets of the Company (including the Company Property) are unaffected,'' according to the offering materials. The federal income tax result is that, even though the investors will have a short-term holding period in their LLC interests, the donation of the conservation easement will be treated as the donation of a capital asset held for more than one year, and the investors' deduction will *not* be limited to their basis, or in this case, the amount of their investment.

The offering materials from this transaction are a beautiful piece of work. There is a handsome private placement memorandum, operating agreements, amended operating agreements, certificates of organization, an appealing report with photos and tax code text to illustrate how a conservation easement on the property will qualify for a deduction under section 170(h); a draft deed of the conservation easement to the named donee organization; a 60-page feasibility report on a proposed mixed-use development of the property (curiously enough, the feasibility report is dated October 2006 — one seems to recall a different real estate market in 2006); and a 30-page opinion letter. There is a review appraisal letter blessing the appraisal.

In my work I have probably read and reviewed more than 100 qualified appraisal reports prepared to substantiate conservation easement deductions. The quality has ranged from awful to outstanding. When I reviewed this material, the first question that came to mind was, ''How does the appraiser get to $18 million? This is America! Who sells an $18 million property for $4 million?'' I found the answer more than 70 pages into the appraisal: as *comparable sales for a relatively rural Georgia property*, the appraiser used sales *in the Orlando, Florida, metropolitan area*. The appraiser notes the sales were from ''contiguous Florida.''

Just for fun, I looked at the property on Google Earth. Let's just say there's not a lot going on around it (except maybe crops). I also looked at the ''comparable sales'' in the Orlando area on Google Earth and the photos of these sales in the appraisal report, and they are surrounded by heavy metropolitan area development. A common technique used by appraisers to create an inflated deduction is to use ''comparable'' sales that are in no way comparable to the subject property and to bury the reader in detail about each property.

The opinion letter discusses whether the transaction is a ''reportable transaction'' (the letter says it isn't). The letter states that the transaction does not lack economic substance; involved LLCs will be treated as partnerships; the gift will be treated as the gift of a capital asset held for more than one year (and therefore the deduction available to an investor will not be limited to the investor's basis); the donee of the easement is a ''qualified donee'' under section 170(h); the easement meets the requirements for deductibility under section 170(h); and the appraisal meets the ''qualified appraisal'' requirements of the code and Treasury regulations.

There is more. Buried in the material is this: The opinion letter states that because the value of the conservation easement involves a subjective determination by the appraiser, ''We cannot opine on

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whether the value determined'' in the appraisal ''accurately reflects the fair market value of the Conservation Easement.''

Some transactions I have seen are beautifully put together. Some involve reports, long opinion letters, and lots of backup. Some are thin and amateurish (see ''Piney Woods'' below). But, as noted, there are two keys to these deals: (1) the investor's holding period in the investor's interest is irrelevant, and therefore the investor gets to claim the investor's allocable share of a full FMV deduction; and (2) the valuation of the conservation easement is grossly inflated. Counsel can opine on the beauty and validity of all of the documents, all of the tax strategies, and all of the backup. But counsel ducks any opinion on the FMV of the easement because that is a ''subjective judgment'' by the appraiser.

B. Sand Hills Aggregate Investors LLC

I have draft material in which not all numbers are filled in but the structure is substantially the same as Lowland Plantation Holdings, above. A different LLC has owned the subject property, say less than 400 acres, for more than a year. A new LLC is being formed that will hold a 95 percent interest in the existing LLC. The projected ''investment'' is $30 million to $40 million. The anticipated deduction from the donation of a conservation easement is $160 million (that is not a typo), based on the value of sand and aggregate that is presumed to be on the property, which is based on an initial appraisal. The offering material includes the name of a well-respected appraiser from the region. When I contacted him, he told me he was not in fact involved in the transaction. A second appraisal will be commissioned, along with a review appraisal of the first two appraisals.

The draft materials include an extensive discussion of many of the same issues covered in the Plantation Holdings material, with considerable time spent on the valuation of mineral resources, such as sand and aggregate, and considerable discussion of relevant court cases. Further details are not important to the fundamental issue here. One still wonders why a smart businessperson (not under duress, of course) would sell $160 million worth of anything for $40 million.

C. Country Mill Properties LLC

I like the boldness of this one. This involves more than 5,000 acres in rural South Carolina. A page in an initial brochure for the project notes that the total charitable deduction available is a bit less than $148,827,500 (not a typo), and the total investment is $44,648,250. There is no explanation of how the value of the deduction is arrived at, although the material notes the property could be divided into six smaller parcels, with conservation easement donations for each separate parcel and deductions for those conservation easements ranging from $8 million to $41 million. The material notes: ''Price per dollar of Charitable Deduction: $0.30.''

There is one other interesting aspect to this deal. The promotional material notes that there will be a $750,000 ''audit reserve'' set aside, should an audit occur. There is also $2.2 million set aside as ''operating reserve.'' That is clearly a great deal for all the participants.

I think these make the point clear. But while I'm at it, I have three more to report on.

D. Pine Hammock Holdings LLC

The paperwork on this one makes most of the others look thin. This is 1,700 acres, also in rural South Carolina. There must be something about the desirability of that market that makes these seemingly innocuous properties so valuable. Certainly, someone is making a lot of money in these transactions, but of course, that is the American way.

There is a very handsome, professional, polished, and irrefutable conceptual development plan, along with extensive marketing information prepared by consultants to the promoters, to illustrate how simple it will be to build and sell more than 2,200 residential units and commercial development on this highly desirable rural property. The total ''offering size,'' or investment, is estimated at around $15 million, with a minimum investment of $48,768. The appraisal puts the value of the property at just less than $43 million and the value of a conservation easement at just over $41 million. (Again, one might ask: Why would an informed seller sell a $43 million property for $15 million?)

There is a 32-page opinion letter associated with this transaction. The opinion letter comments favorably on all of the complicated tax issues, as with Lowland Plantation Holdings, and it also notes that because the value of the conservation easement involves a ''subjective determination'' by the appraiser, ''We cannot opine on whether the value determined'' in the appraisal ''accurately reflects the fair market value of the Conservation Easement.''

E. Unknown

A person with experience in the conservation easement field sent the following to me. This was one of those deals, he said, that ''sounded too good to be true,'' and he wanted to run it by me. He said the interests were being sold by smaller ''wealth advisor'' firms in the Southeast. He omitted many identifying details, but he sent me this information:

- investors contribute $7 million to an existing LLC;
- LLC owns 350+ acres of ''undeveloped land'';

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- $3.7 million is used to distribute to or buy from the existing owner approximately 93 to 95 percent of the LLC interests;
- plans have been prepared for the development of the property; and
- an appraisal values a conservation easement on the property at more than $30 million.

F. Saving the Best for Last: Piney Woods

I do not think there were any takers on this transaction, the ''offering materials'' for which were sent to me from a family office in Atlanta. The email from the fellow in that office noted, in part, ''What is this? I guess the trick is in the appraisal.''

The material was four pages, sent around by a ''CPA, JD'' in Atlanta. The property was a 21,000-acre rural property in Georgia. The purchase price was $100 million. Some of my colleagues in Georgia told me that they thought the price was a bit overstated to begin with. The offering material noted that the ''appraised value of deductions for grant of conservation easement'' was $300 million.

G. Similar 'Tax Shelter' Results, Different Facts

More than a decade ago, a client came to me with this situation: He owned a property, in an LLC, worth say $6 million, and he had an $800,000 mortgage on the property. He had hit a rough patch, was essentially out of cash, and the bank was threatening foreclosure.

He said he wanted to find four investors who would each buy from him a 20 percent interest in the LLC for $250,000. That would give him enough cash to pay off the mortgage, with a little left over. A conservation easement on the property was appraised at $5 million. The LLC would convey a conservation easement on the property and would flow through a $1 million deduction to each of the five 20 percent owners (the client and the four investors).

The deal never came together, and I advised him that even though this was a ''business'' deal, I was afraid the IRS would find some way to recharacterize the transaction so it wouldn't work the way he hoped it would. As one example, I suggested, the IRS might assert that for a purchase price of $250,000, an investor would acquire a 5 percent interest in the LLC, rather than a 20 percent interest, and each investor would get 5 percent of the $5 million deduction, rather than 20 percent. And, of course, this situation was clearly in the nature of a ''distress'' sale, so the purchase price of the interests was just as clearly not FMV. Without going into the many other issues concerning the structure and tax consequences of that proposed transaction, the point is that my legislative proposal could have allowed the deduction as long as the donation happened more than 18 months after the investors acquired their interests.

XI. Why a Legislative Fix Is Needed

Today's syndication-of-conservation-easement-deductions situation is remarkably similar to how things were pre-1986.

Promoters, advisers, appraisers, and investors are making a lot of money, and these transactions are rampant. Opponents of these transactions are ignored. The Land Trust Alliance, the umbrella association for land conservation organizations around the country, has spoken out and warned its members to stay away from these syndicated transactions. But the Land Trust Alliance has no enforcement authority, and some organizations accept these easements either because they aren't paying attention or they don't care.

The IRS is outnumbered and surrounded. Even if the IRS succeeds in tying up some transactions in audits, it takes years for the IRS to win in court, and that certainly does not shut down any similar transactions currently being marketed. It is also known that over the years, the IRS has been given names of promoters, advisers, appraisers, and even donee organizations that have been actively involved in selling these transactions, and those promoters, advisers, appraisers, and donee organizations are still actively involved in selling these transactions. And, of course, in transactions that are being marketed now, promoters and advisers distinguish any adverse law and wait for the checks to come in.

Therefore, the only way to stop the bleeding is to change the tax code.

XII. Target the Legislative Fix

I have been heavily involved and working in this field for more than 30 years. I have heard a lot about inflated appraisals, and when the real estate market was hot in 2007, I did indeed see a lot of them. But most appraisal abuse I see today is coming via these syndicated transactions. Targeting them with a legislative fix will probably eliminate 90 percent of the inflated appraisal problems and will eliminate 90 percent of the abuse in this area. That is not to say that there are not weak appraisals associated with easement donations by individuals, but those are few and far between.

Some have proposed limiting deductions for all gifts of appreciated property to the donor's basis. For many philanthropic and conservation-minded landowners and families, that kind of a change would be contrary to the fundamental premise behind the existing easement-deduction incentive: to provide a tax deduction for forgone value for

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landowners who protect in perpetuity important conservation values, rather than selling property for development. It is not the good donations that need more regulation. The transactions that must be stopped are those that occur when the inflated deduction is sliced up into individually sized, digestible pieces and sold off in syndications.

Some have suggested creating an IRS Conservation Easement Valuation Panel, like the IRS Art Advisory Panel, so donors who wish to go through that process can get advance certainty about the value of their gift. That is a fine idea, and some serious donors would take advantage of such a panel, but this report is not about that. This report is about amending the code to shut down syndicated easement deductions.

Once again, my proposal would amend the code in the following way: first, if a taxpayer has owned an interest in property that is the subject of a conservation easement donation (or in the entity through which the deduction flows) for less than 18 months; and second, if the claimed deduction is greater than 250 percent of the taxpayer's basis in the investment, the taxpayer's deduction for the donation should be limited to the taxpayer's basis.

There is no magic to the 18-month holding period requirement and no magic to the 250 percent number. But if you have read this far, you get the gist.

XIII. I Despair

I had originally intended to submit this report for publication in the fall of 2015. Two people who share my view of these transactions and are knowledgeable in the ways of Capitol Hill told me this:

"Don't publish this now. Give us a few months; there may be a tax bill before the end of the year and maybe we can slip something like this into the bill. If you publish this now, all the promoters and advisers who are making a lot of money from these transactions will hire lobbyists and the lobbyists will get up on the Hill and kill the idea."

Isn't that perverse? It's sad to me that going public with an idea that will shut down rampant tax abuse and raise revenue is likely to kill that very idea. But here it is, anyway.

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