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TAX MATTERS

Conservation easements are deductible despite reimbursement provision

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The Tax Court upheld charitable donations of conservation easements in a bargain sale, despite a requirement that, in the event of a later disposal of the property and extinguishment of the easements, the donee organization use the proceeds to reimburse the government agencies that funded the purchase. The court determined that the reimbursement provision did not violate the perpetuity requirement of Regs. Sec. 1.170A-14(g) because the donee organization was entitled to an amount at least equal to its proportionate share of the proceeds from any disposition of the properties.

Irby Ranches LLC operated a family-owned cattle ranch in Colorado. In 2003 and 2004, Irby Ranches conveyed conservation easements encumbering two parcels of land to Colorado Open Lands (COL), a qualified charitable organization, in bargain sale transactions. The purchase portion of the transactions was funded with grants from three government agencies. The appraiser hired by COL and the Irbys determined that the easements were worth 60% of one tract's unencumbered value and 63% of the other's. Under the terms of the conveyance, COL was entitled to that share of any proceeds should the properties ever be disposed. A reimbursement provision, however, obligated COL to remit most of the proceeds from a disposition to the government agencies as repayment for their funding, leaving COL with 25% of the proceeds.

The IRS disallowed the charitable contribution deduction, arguing that because of the reimbursement provision, the conservation purpose of the easements was not protected in perpetuity. It further contended that the appraisal report was not qualified because it did not state that it had been prepared for income tax purposes. Last, it asserted that Irby Ranches had not obtained contemporaneous written acknowledgment from COL of the contribution, as required by statute.

Generally, a charitable contribution deduction is not permitted for a contribution of less than a donor's entire interest in property. Sec. 170(f)(3)(B)(iii) provides an exception for a qualified conservation contribution, which must be a qualified real property interest given to a qualified donee organization exclusively for conservation purposes. Regs. Sec. 1.170A-14(g) further requires that the donee organization's interest must be protected in perpetuity from use inconsistent with the conservation purposes of the donation. In the event future conditions make it impractical to continue the use of the property for conservation purposes, the donee organization must be entitled to a portion of the proceeds from a subsequent disposition at least equal to the proportionate value of the perpetual conservation restriction.

Additional requirements for a deductible charitable contribution in Regs. Sec. 1.170A-13(c) state that certain property valued at $5,000 or more must be appraised by a qualified appraiser whose report must include, among other things, a description of the property, the appraisal dates, the valuation method, the basis for valuation, and a statement that the appraisal was prepared for income tax purposes. A contribution of $250 or more must also be substantiated by a contemporaneous written acknowledgment from the donee organization.

The Tax Court sided with Irby Ranches on all three issues. According to the court, the funding obtained by COL from the government agencies established the validity of the easements' conservation purpose. Each of the agencies served a conservation purpose consistent with that of COL, and the terms of the grants and reimbursement provision were not negotiable. Further, any extinguishment of the easements and disposition of the properties would result in the proceeds going to COL and, in turn, the government agencies, not Irby Ranches. As such, the reimbursement provision, rather than defeating the conservation purpose of the easements, enhanced the ability of the agencies to conserve and protect more land, since any reimbursed funds would be used for that purpose. The court consequently found that the reimbursement provision was consistent with the requirements of Regs. Sec. 1.170A-14(g).

The court also determined that a discussion in the appraisal report of the purpose of the transaction—to value the donation of conservative easements pursuant to Sec. 170(h)—satisfied the requirement that the report contain a statement that the appraisal was prepared for income tax purposes. Last, the court concluded that a variety of documents, deeds, agreements, and tax forms, taken in their totality, satisfied the requirement of a contemporaneous written acknowledgment.

- *Irby*, 139 T.C. No. 14 (2012)

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