

## Tax-Exempt Organizations Alert

### Substantiating Donations of Conservation Easements: Why Substantial Compliance May Not Be Enough and What Steps Your Organization Should Take to Ensure Compliance

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Organizations that accept donations of conservation easements have an obvious interest in ensuring that their donors receive charitable contribution deductions for those easements. In this regard, a recent Tax Court memorandum opinion may provide encouragement to donee organizations, as it suggests a departure from the strict application of substantiation requirements imposed in the context of qualified conservation easement contributions. In *Simmons v. Comm’r*, (T.C. Memo 2009-208), the court applied the substantial compliance doctrine, discussed in more detail below, to uphold a donor’s claimed charitable contribution deduction for a façade easement despite the donor’s failure to comply strictly with the charitable contribution substantiation requirements imposed by the Internal Revenue Code (the “Code”) and applicable Treasury Regulations. The opinion on its face appears to be inconsistent with other recent cases in which courts have declined to apply the substantial compliance doctrine and have disallowed the donor’s charitable contribution deduction where the donor failed to meet the applicable substantiation requirements to the letter. Because courts are not always consistent in their application of the substantial compliance doctrine, and the Internal Revenue Service’s auditing position has been to insist on strict compliance, it is imperative that donee organizations understand and comply with the recordkeeping and substantiation requirements for donations of conservation easements. Failure to do so could cost a donor his or her tax deduction and lead to fewer future contributions to the organization.

#### Substantiation Requirements for Donations of Conservation Easements

The substantiation rules for noncash contributions vary according to the value of the specific contribution. Generally, the threshold amounts for the various substantiation and recordkeeping requirements are \$250, \$500, and \$5,000, and the requirements are cumulative. For example, a contribution valued at more than \$5,000 must meet the rules associated with donations of \$250 or more as well as the requirements for contributions exceeding \$500 and \$5,000. While both the donor and the donee organization have substantiation obligations, for the most part, it is the **donor’s** responsibility to maintain the necessary paperwork in order to support a claimed charitable contribution deduction.

For noncash contributions with a value of more than \$5,000, which is the likely threshold applicable to qualified conservation contributions, the Code and the relevant Treasury Regulations impose a number of requirements.<sup>1</sup> First, the donor must maintain “reliable written records” that include: (i) the name and address of the donee organization; (ii) the manner and date of acquisition of the easement; (iii) the date of the contribution; (iv) a description of the easement; (v) the fair market value (“FMV”) of the easement; (vi) the cost or other basis of the easement; (vii) any terms or conditions placed on the easement; and (viii) additional information relating to the easement (including, for example, the total amount of the current deduction and any deductions taken in prior years relating to the same property). The donor must also include in his or her federal income tax return a description of the donated easement.

In addition to the above recordkeeping requirements, the Code requires the donor to obtain a “qualified appraisal” for donated easements valued at more than \$5,000.<sup>2</sup> The regulations set forth in detail the

requirements an appraisal must meet to be a “qualified appraisal.”<sup>3</sup> Generally speaking, to be a “qualified appraisal,” an appraisal must: (i) not be made any earlier than 60 days before the contribution, or later than the due date of the return (including extensions); (ii) be signed by a “qualified appraiser,” as defined in the regulations; (iii) include certain information, such as a description of the easement, date of the contribution, qualifications of the appraiser, a statement that the appraisal was prepared for income tax purposes, and the appraised FMV of the donated conservation easement; and (iv) not involve a fee arrangement that is based on a percentage of the appraised value of the easement.

In cases of donations of conservation easements valued over \$5,000, the regulations further require the donor to attach to his or her return an appraisal summary, found on Form 8283 (“Noncash Charitable Contributions”). Donors must fill out Form 8283 if the amount of their deduction for all noncash gifts is more than \$500. Section B of the Form 8283 contains the appraisal summary and requires donors to provide information relating to donations of more than \$5,000. Donors must identify the donated property as a qualified conservation contribution and must provide the following information: (i) a description of the donated easement; (ii) condition of the easement; (iii) appraised FMV; (iv) date and manner acquired by the donee organization; (v) the donor’s basis; and (vi) for bargain sales, the amount received by the donor. Form 8283 requires the qualified appraiser to sign a declaration contained on the form and provide his or her address and identifying number.

Form 8283 also requires the **donee organization** to sign an acknowledgment on Part IV of the form, whereby the donee organization acknowledges that it is a qualified organization under section 170(c) and that it received the conservation easement described on the form. The person signing the acknowledgment must be an official authorized to sign the tax returns for the donee organization or a person specifically designated to sign Form 8283. Note that the donee organization is not required to make any statements regarding the value of the donated conservation easement or regarding the appraisal of the easement. This is the donor’s responsibility.

In the case of donations of conservation easements with a claimed value of more than \$5,000, the donee organization must also agree that in the event it sells, exchanges, or otherwise disposes of the easement within three years after the date of receipt, it will file a Form 8282 (“Donee Information Return”). The donee organization must file the Form 8282 within 125 days after the date the donee organization disposed of the easement (or if the donee organization had no reason to believe the substantiation requirements applied to the donor, then it must file the form within 60 days after the date it becomes aware that the substantiation requirements applied). The donee organization must keep a copy of the Form 8283 in its records, and if filing a Form 8282, the donee organization must not only maintain a copy of that form but also provide a copy to the original donor.

Finally, the Code requires that for contributions valued at \$250 or more, the donor must obtain a contemporaneous written acknowledgment from the donee organization. Code section 170(f)(8) requires that the acknowledgment contain: (i) a description of the easement contributed (as well as the amount of any cash donated), (ii) whether the donee organization provided any goods or services in consideration for the contribution (in whole or in part); and (iii) a description and good faith estimate of the value of such goods or services provided. To be “contemporaneous,” the acknowledgment must be provided to the donor on or before the date the donor files his or her return, or the due date of the donor’s return, whichever is earlier. As a legal matter, it is the donor’s responsibility to obtain the contemporaneous written acknowledgment. However, donors typically expect a donee organization to provide an acknowledgment that meets all of the foregoing requirements. As discussed below, if a donee organization fails to meet all of the requirements, a donor may lose his or her charitable contribution deduction. This will obviously result in donor-relations issue specific to the challenged deduction, but also can ruin the reputation of the donee organizations with respect to other potential donors.

## Substantial Compliance vs. Strict Compliance

Courts have taken different positions with respect to enforcing the substantiation and recordkeeping requirements listed above—either applying a strict construction of the requirements or permitting taxpayers to take a charitable contribution deduction despite failing to meet the specific substantiation requirements. In *Simmons*, the taxpayer donated façade easements to a section 501(c)(3) organization. The contributions were memorialized in two separate deeds, and the taxpayer hired appraisers to calculate the values of the easements, resulting in claimed deductions of \$162,500 and \$93,000 respectively. After challenging the donations on the grounds that the easements did not meet the criteria for qualified conservation contributions as required under Code section 170(h), the IRS argued that the donor failed to properly substantiate her deductions.

The IRS argued for a strict application of the qualified appraisal and contemporaneous acknowledgment requirements. Specifically, the IRS argued that the appraisals were not qualified because they did not: (i) contain an adequate description of the easement; (ii) identify the method of valuation; (iii) provide a statement that the appraisals were prepared for income tax purposes; and (iv) provide the dates of the contributions. The taxpayer countered that even if the appraisals did not meet each specific requirement, she substantially complied with the requirements and therefore the deductions should be allowed.

The Tax Court looked at other cases analyzing the qualified appraisal requirements and noted that the court had previously found these requirements to be directory rather than mandatory. See *Bond v. Comm’r*, 100 T.C. 32 (1993). In *Bond*, the court found that although the taxpayers failed to provide the qualifications of the appraiser, they had nonetheless substantially complied with the qualified appraisal requirements. The court compared the *Bond* opinion with that in *Hewitt v. Comm’r*, 109 T.C. 258 (1997), in which the taxpayers argued for substantial compliance with respect to the qualified appraisal requirements. Unlike *Bond*, the court in *Hewitt* found that the taxpayers had provided none of the required information, and thus were not entitled to relief under the substantial compliance doctrine.

Taking these cases together, the *Simmons* court stated that the two cases “provide a standard by which we can consider whether [the taxpayer] provided sufficient information to permit [the IRS] to evaluate [her] reported contributions, as intended by Congress.” The court then found that the appraisals adequately described the donated easements and the method of valuation used. Even though the appraisals did not contain explicit statements explaining that they were prepared for income tax purposes, as required by the regulations, they did contain statements that the owner was contemplating a donation. Additionally, although not contained in the appraisal itself, the Form 8283 contained the date of the contributions. The court held that taken together this constituted sufficient compliance with the substantiation requirements.<sup>4</sup>

The *Simmons* court also discusses whether the taxpayer satisfied the section 170(f)(8) contemporaneous acknowledgment requirement. The court found that the deeds used to memorialize the easement contributions satisfied the requirements of a contemporaneous acknowledgment. The opinion did not specifically address whether the deeds included language identifying whether any goods or services were provided in return, and if so, a good faith estimate of those goods or services. Rather, the opinion states only that the deeds were signed by the donee organization, contained a description of the contributed easements, and were obtained before the donor’s tax returns were due. Thus, it is unclear whether the court, in finding that the deeds satisfied the contemporaneous acknowledgment requirements, relied on the substantial compliance doctrine in this context. Nonetheless, the court’s reliance on the deeds does suggest that the contemporaneous acknowledgment requirement can be satisfied by documents other than the standard gift acknowledgment letter typically relied on by donors.

Regardless of what the *Simmons* opinion may or may not stand for in the contemporaneous acknowledgment context, other cases make clear that compliance with the requirements of Code section 170(f)(8) is mandatory. For example, in *Bruzewicz v. United States*, 604 F. Supp. 2d 1197 (N.D. Ill. 2009), the court found that the substantial compliance doctrine did not apply to the taxpayer's donation of a qualified conservation easement. The donors relied on *Bond*, as cited in the *Simmons* case above, arguing that while they did not comply with the regulations, they were still entitled to the deductions because they substantially complied with the requirements. The donor submitted a letter from the donee organization that included a list of the donor's cash contributions and a reference to an easement contribution. The letter did not include a description of the easement or a statement of whether any services or goods were provided by the donee organization. The court first noted that *Bond* was not binding on its decision and then focused on the express language of Code section 170(f)(8). The court found the statute to be clear on its face and that the contemporaneous acknowledgment was critical to substantiating the claimed deductions. Consequently, the court held that the donor's failure to comply with the contemporaneous acknowledgment requirement, as well as certain requirements relating to the qualified appraisal, required the court to disallow the donor's deduction. See also *Smith v. Comm'r*, T.C. Memo 2007-368 (finding no substantial compliance for donors who, among other things, failed to attach appraisal summaries to their tax returns); [Gomez v. Comm'r](#), T.C. Summary Op. 2008-93 (disallowing deductions based on the donor's failure to meet the contemporaneous acknowledgment requirements); *Ney v. Comm'r*, T.C. Summary Op. 2006-154 (noting that the requirement that the donee organization sign the Form 8283 appears to be mandatory and finding that the donor did not substantially comply with the substantiation requirements).

## Practical Considerations

Because courts are inconsistent in their treatment of the substantiation requirements, it is important that both donee organizations and their donors understand and satisfy the substantiation and recordkeeping requirements discussed above. While donee organizations may not be required to substantiate records to the same extent as donors, it is imperative that donee organizations be proactive in terms of substantiation and recordkeeping so as to ensure that their donors receive deductions, which, in turn, encourages future donations. Specifically, donee organizations should consider the following:

- For each donation of a conservation easement, a donee organization should maintain records adequately describing the contributed easement, the date of the contribution, whether any goods or services were provided in consideration for the donation, and whether such donated easement was sold, exchanged, or disposed of within three years of receipt by the donee organization.
- For each donation, a donee organization should send a letter containing the following information: (i) a description of the easement contributed (as well as the amount of any cash contributed); (ii) a statement explaining whether the donee organization provided any goods or services in consideration, in whole or in part, for anything the donor contributed; and (iii) a description and good faith estimate of the value of any goods or services provided by the donee organization. Delay in sending out this letter could result in a donor being unable to deduct his or her donation of a conservation easement on his or her federal income tax return.
- For contributions valued at more than \$5,000, the donee organization should maintain a record of whether it has signed the donee acknowledgment on the donor's Form 8283. The donee organization should maintain a copy of each Form 8283 that it signs.
- If the donee organization sells, exchanges, or otherwise disposes of the donated easement within three years of receipt, it must fill out a Form 8282 and provide a copy of this form to the donee organization.



If your donee organization has additional questions concerning these or other substantiation and recordkeeping requirements for qualified conservation contributions, including conservation easements, please contact us at (202) 626-5800.

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<sup>1</sup> This alert discusses the substantiation and recordkeeping requirements for conservation easement contributions valued at more than \$5,000. This alert does not address the additional rules, which were added to the Code in the Pension Protection Act of 2006, that apply to contributions of a qualified real property interest that is a restriction on the exterior of a building (i.e., a façade easement). See I.R.C. § 170(h)(4)(B).

<sup>2</sup> For those easements valued at more than \$500,000, Code section 170(f)(11)(D) requires that the donor attach the appraisal to his or her return.

<sup>3</sup> In August 2008, the Treasury Department issued proposed regulations, which provide new detailed rules relating to appraisals, including new definitions of “qualified appraisal” and “qualified appraiser,” as well as specific references to the Form 8283 and the donee organization’s signature on that form. The regulations impose additional standards on donors, but do not otherwise affect donee organizations in the context of noncash contributions such as conservation easement donations. These regulations have not yet been finalized.

<sup>4</sup> Note that for charitable contributions made after June 3, 2004, section 170(f)(11) was amended to provide an exception to the qualified appraisal requirements. Code section 170(f)(11)(A)(ii)(II) states that such a deduction will not be denied if it is shown that the failure to meet the substantiation requirements is due to reasonable cause and not willful neglect.

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