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Back to Basis: Eleventh Circuit Limits Conservation Easement Deduction

By: Ezra Dyckman and Charles S. Nelson

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A taxpayer who donates a conservation easement to a qualified organization is generally allowed a charitable deduction equal to the fair market value of the easement, which is typically measured as the difference between the value of the property before and after the easement is granted. The IRS has for years aggressively challenged these deductions, particularly in the context of syndicated transactions, and has frequently succeeded in doing so. In a recent unpublished decision, *Mill Road 36 Henry, LLC v. Commissioner* (11th Cir. 2026), the Eleventh Circuit affirmed a Tax Court decision that not only significantly reduced the claimed value of an easement, but also limited the taxpayer's deduction to its basis in the property, on the ground that the property was held as dealer property. While the valuation holding is largely a product of the particular facts, the dealer property holding has wider implications.

The case involved a group of real estate professionals in Georgia who regularly bought and sold land. In December 2014, the group purchased a 117-acre undeveloped tract of land and in August 2015, transferred 40 acres of it to a newly formed LLC taxed as a partnership, Mill Road, which held the parcel as its sole asset.

The group engaged a civil engineering firm to prepare a "concept plan" for an assisted-living facility on the 40 acres, and submitted an application for zoning approval for the facility, which was later withdrawn. At the same time, the group was having similar concept plans prepared for other tracts.

The group then obtained an appraisal of a conservation easement on the land, which valued the easement at approximately $9 million, assuming a highest and best use as an assisted-living facility. After the appraisal was obtained, an investment firm specializing in syndicated conservation easements formed a new entity that solicited investors with the promise of $4.25 in tax savings for every dollar invested. In September 2016, the new entity acquired a 97.99% interest in Mill Road for $1 million. Mill Road then donated an easement over 33 of its 40 acres to a qualified organization and claimed a $9 million deduction, reporting a basis in the property of approximately $400,000. It appears that the reason Mill Road made the contribution itself, rather than the syndicated partners directly, was to take advantage of Mill Road's long-term holding period, which was required to claim a deduction for the easement's fair market value rather than its basis.

The IRS disallowed the deduction and asserted a 40% gross valuation misstatement penalty, which applies where the value claimed on a tax return is 200% or more of the correct value. At trial, the IRS's expert valued the easement at approximately $900,000, based primarily on comparable land sales. The Tax Court agreed and sustained the gross valuation misstatement penalty. In addition, the Tax Court concluded that the property was held primarily for sale to customers in the ordinary course of business, and thus the charitable deduction was limited to the property's tax basis of approximately $400,000.

On appeal, the Eleventh Circuit rejected the taxpayer's valuation arguments and affirmed the Tax Court's determination of the value of the easement at $900,000 and the corresponding penalty, noting in particular that syndicated investors acquired a 97.99% interest in the LLC owning the property for $1 million in an arm's-length transaction.

The more significant aspect of the decision concerns the limitation of the deduction to basis. If donated property was held primarily for sale to customers in the ordinary course of a trade or business (so-called "dealer property"), the deduction for a charitable contribution of the property is limited to the taxpayer's tax basis in the property. (Although the Eleventh Circuit conflated dealer property with "inventory," the same rules apply to both dealer property and inventory.)

Whether property is dealer property is a question of fact. The Eleventh Circuit applies a three-part test derived from *Suburban Realty Co. v. United States*, 615 F.2d 171 (5th Cir. 1980), which considers (1) whether the taxpayer was engaged in a trade or business and, if so, what business; (2) whether the taxpayer was holding the property primarily for sale in that business; and (3) whether the contemplated sales were "ordinary" in the course of that business.

Notably, the Tax Court's analysis focused not on Mill Road itself but on its partners. The court found that those partners, and the individuals behind them, were in the business of buying and selling land, that they acquired the tract in furtherance of that business, and that they sold an interest in the Mill Road property to the syndicate in the ordinary course of that business. The Tax Court therefore limited the deduction to Mill Road's approximately $400,000 basis. The Eleventh Circuit affirmed, pointing to testimony that the group's purpose in buying the tract was to sell it for a conservation easement transaction and the group's history of land sales. Selling land was the sole object of the partners' business, and they effectively sold the property shortly after acquiring it without ever using it for any other purpose.

The case illustrates that the dealer status of the persons who contribute property to a partnership can follow the property into the partnership and limit the partnership's deduction, even where the partnership engages in no development or sales activity. Although the Eleventh Circuit did not cite it, this result is consistent with the partnership rules, under which property that was an inventory item in the hands of a contributing partner generally retains its ordinary character for five years after the contribution.

In sum, Mill Road is another in a long line of losses for taxpayers in syndicated conservation easement cases, which are also now subject to statutory limitations enacted in 2022 and to specific reporting requirements. The transaction at issue was clearly abusive, and thus the court's conclusion was not surprising. However, because gain from the sale of dealer property is taxed at ordinary income rather than capital gain rates, the court's holding that the property was dealer property could have much wider implications for taxpayers who buy and sell land. This case also

serves as a reminder that the IRS carefully scrutinizes deductions for noncash charitable contributions and will use every tool available to it to disallow or limit such deductions.

Ezra Dyckman and Charles S. Nelson are partners of Roberts & Holland LLP.

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