

CONSERVATION EASEMENTS: DESIGN FLAWS, ENFORCEMENT CHALLENGES, AND REFORM

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I. INTRODUCTION

The conservation easement is exceptional.¹ As a property right, it is a creature of modern invention, a curiosity not recognized at common law. Initially, courts were reluctant to validate this negative, in-gross easement. It hinders alienability, may be perpetual, and is owned in absentia, not appurtenant to the restricted land. In part for these reasons, the Uniform Conservation Easement Act² was needed to rescue the conservation easement from an uncertain future and give it legitimacy. Still, the conservation easement might have been merely a limited development in the law of real property but for the federal income tax laws.³

In 1980, Congress established a permanent charitable deduction for contributions of conservation easements.⁴ Special legislation was needed because normal rules do not allow deductions for contributions of a partial interest, which include most conservation easement contributions.⁵ The special deduction then paved the way for extraordinary change. Almost immediately there was a dramatic rise in the number of land trusts—the organizations that accept and hold donated conservation easements on behalf of the public⁶—and millions of acres became

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¹ Even the terminology is exceptional. Whether “easement” really is the right term is not clear. See Michael Allen Wolf, *Conservation Easements and the “Term Creep” Problem*, 2013 UTAH L. REV. 787, 33 UTAH ENVTL. L. REV. 101 (2013).

² UNIF. CONSERVATION EASEMENT ACT, 12 U.L.A. 165 (2008), available at http://www.uniformlaws.org/shared/docs/conservation_easement/ucea_final_81%20with%2007amends.pdf.

³ The rules for the federal tax incentive for a conservation easement are found principally in I.R.C. § 170(h) (2006) and Treas. Reg. § 1.170A-14 (2009).

⁴ An Act to Extend Certain Temporary Tax Provisions, and for Other Purposes, Pub. L. No. 96-541, § 6(b), 94 Stat. 3204, 3206–08 (1980) (codified as amended at I.R.C. § 170(h)).

⁵ I.R.C. § 170(f)(3).

⁶ Nancy A. McLaughlin, *Increasing the Tax Incentives for Conservation Easement Donations—A Responsible Approach*, 31 ECOLOGY L.Q. 1, 3 (2004).

encumbered. Many states followed federal law, providing additional state-based tax incentives for easement contributions.⁷ Far from being mostly of academic interest, the conservation easement became a critical functional tool to protect land from private development and preserve landmarks, habitats, and open spaces for the benefit of the public.

But the conservation easement story has not been entirely successful. The continued growth has created serious problems. Doubts about the public benefit conveyed by conservation easements and significant enforcement difficulties—both as a matter of tax and property law—have led to increased scrutiny of land trusts and to a growing chorus of calls for reform of the tax benefit and state laws governing easements.

The easement deduction also has become expensive. According to Internal Revenue Service (“IRS”) statistics, on average over \$1.5 billion are claimed in easement contributions each year,⁸ and this does not include corporate contributions, which likely are considerable. In terms of lost federal income tax revenue, a rough estimate over the eight-year period from 2003–2010 for individual contributions (again not including corporate contributions) is in the range of \$4.2 billion.⁹ States with tax credits for conservation easements add to the amount of indirect public expenditure.

This Essay is an effort to put the conservation easement, and especially the tax benefit, into the context of its aberrant nature. The Essay argues that it is largely because the tax incentive was born as an exception to the normal charitable

⁷ Debra Pentz, *State Tax Credit Summary*, PRIVATE LANDOWNER NETWORK, <http://www.privatelandownernetwork.org/library/article.aspx?id=210> (last visited Aug. 8, 2013).

⁸ This number was derived by totaling and averaging the amount claimed from 2003 through 2010 for easement donations, including conservation and façade easements. Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2010*, STAT. INCOME BULL., Winter 2013, at 64 [hereinafter Liddell & Wilson, 2010]; Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2009*, STAT. INCOME BULL., Spring 2012, at 62, 64; Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2008*, STAT. INCOME BULL., Winter 2011, at 76; Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2007*, STAT. INCOME BULL., Spring 2010, at 52; Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2006*, STAT. INCOME BULL., Summer 2009, at 67; Janette Wilson, *Individual Noncash Contributions, 2005*, STAT. INCOME BULL., Spring 2008, at 68; Janette Wilson & Michael Strudler, *Individual Noncash Contributions, 2004*, STAT. INCOME BULL., Spring 2007, at 77; Janette Wilson & Michael Strudler, *Individual Noncash Contributions, 2003*, STAT. INCOME BULL., Spring 2006, at 58.

⁹ See Roger Colinvaux, *The Conservation Easement Tax Expenditure*, 37 COLUM. J. ENVTL. L. 1, 10 (2012). The \$4.2 billion number in the text is updated from the \$3.6 billion number cited in the article to include amounts claimed in 2009 and 2010, assuming a 35% marginal tax rate of donors. See Liddell & Wilson, 2010 *supra* note 8, at 64, 65 (reporting amount claimed of \$765,539,000 in 2010 and \$1,018,173,000 in 2009). This does not include any revenue lost due to the estate and gift tax benefits.

deduction rules that many of the problems have resulted, and from which the many calls for reform may be understood. Quite simply, the legal framework and enforcement scheme of the charitable deduction were not built to accommodate a targeted tax subsidy for conservation purposes and a fundamental rethinking of the incentive is necessary.

II. EXCEPTIONAL BENEFITS, HISTORY, RULES, AND CHALLENGES

A. *Brief History: The Problem of the Partial Interest*

Incredibly, charitable contributions of conservation easements are treated more favorably than any other kind of charitable contribution.¹⁰ This is surprising given the history of the tax benefit. In 1964, when the conservation easement was still on shaky footing as a matter of property law, the IRS concluded that a charitable contribution of a conservation easement should be treated like any other contribution of property, and thus was deductible at the fair market value of the interest.¹¹ Shortly thereafter, however, Congress reconsidered the rules for property contributions.

In the Tax Reform Act of 1969,¹² Congress was concerned with property contributions on many levels, one of which was a donor's contribution of a partial interest in property. With a partial interest contribution, a donor gives away part of what is owned while retaining the rest. This is problematic mainly for two related reasons. First, a partial interest is difficult to value. Because a donor has not given away the full "bundle of sticks," it is less clear than with an entire interest how to value what is given away. This valuation problem is made more acute if the donor continues to control and to enjoy benefits relating to the gifted (and retained) property.

Second, a partial interest contribution represents a de facto conflict of interest. With two owners of the same property, donor and donee might not always agree on the use of the property. A donor's interest might take precedence over the donee's,

¹⁰ Special, albeit temporary, rules allow farmers and ranchers, including corporate farmers, to offset their entire income for up to sixteen years with an easement donation. *See* S. 526, 113th Cong. § 1 (2013). I.R.C. § 170(b)(1)(E), -(b)(2) (allowing for a fifteen-year carryover of excess contributions, which, when added to the initial contribution year, makes sixteen). These same temporary rules allow all donors to offset more of their income than is usually allowed for other property contributions, and to use any excess contributions for fifteen instead of the usual five years. *Id.* Separately, benefits under the federal estate tax allow for a generous reduction in the value of the estate if a conservation easement contribution is made. *See* I.R.C. §§ 2031(c), 2522(d).

¹¹ Rev. Rul. 64-205, 1964-2 C.B. 62.

¹² Tax Reform Act of 1969, Pub. L. No. 91-172, § 201, 83 Stat. 487, 556 (1970).

leaving the (charitable) donee with less than what was promised or expected.¹³ Accordingly, Congress decided in 1969 that contributions of partial interests were not allowed as charitable contributions.

A conservation easement contribution, however, violated this partial interest ban. This left the nascent conservation easement movement in limbo. Although it took eleven years, in 1980 Congress codified an exception to the partial interest rule and allowed a charitable deduction for conservation easements on a permanent basis.¹⁴ Importantly, this exception was enacted over the objections of the Treasury Department, which voiced concerns stemming directly from the reason partial interest contributions were barred in the first place: valuation difficulties and conflicts of interest—both of which, the Treasury Department believed, would cast doubt on the public benefit conveyed by the incentive.¹⁵

B. Design Flaws and Enforcement Challenges

That the easement deduction was born as an exception to the partial interest rule is critical to its design. Congress could simply have waived the partial interest rules and left conservation easements to be treated like any other contribution of real property. Then the rule would have been just as before 1969: A donor could arrange for a conservation easement on property and contribute the easement to any charity for any reason, and a fair market value deduction would be available. This is, after all, how it normally works—with the oversight role of the IRS generally limited to checking value.

But, aware of the Treasury Department's concerns, Congress took a different approach and adopted a number of special rules intended to address potential (and anticipated) problems. Here, there are three principal rules. The easement donation must be (1) to a qualified organization,¹⁶ (2) for a conservation purpose,¹⁷ and (3) in perpetuity.¹⁸ Each of these rules arguably was necessary to justify the partial interest exception, but as discussed below, each one, along with the necessity of valuing a negative restriction, has presented enforcement challenges that the IRS is neither well-suited nor equipped to address.

¹³ See Daniel Halperin, *Incentives for Conservation Easements: The Charitable Deduction or a Better Way*, LAW & CONTEMP. PROBS., Fall 2011, at 29, for additional discussion.

¹⁴ See McLaughlin, *supra* note 6, at 14.

¹⁵ *Miscellaneous Tax Bills: Hearing on H.R. 3874, 4103, 4503, 4611, 4634, and 4968 Before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means*, 96th Cong. 12 (1979) (statement of Daniel I. Halperin, Deputy Assistant Secretary of Tax Policy, Department of the Treasury).

¹⁶ I.R.C. § 170(h)(3) (2006).

¹⁷ *Id.* § 170(h)(4).

¹⁸ *Id.* § 170(h)(1)(C), (h)(2)(C), (h)(5)(A).

1. *To a Qualified Organization*

The requirement that an easement contribution be to a qualified organization seems the most innocuous of the three special rules. Reading the Internal Revenue Code (the “Code”), it is merely a technical rule that generically describes eligible donee organizations. These are any § 501(c)(3) organization or government entity, not including most private foundations.¹⁹ On its face, therefore, the qualified organization rule means simply that only a certain subset of charities may accept deductible easement contributions.

The Treasury regulations, however, go further by requiring that a qualified organization not merely bear the correct label but also “have a commitment to protect the conservation purposes of the [easement] donation, and have the resources to enforce the restrictions.”²⁰ This seems a sensible construction of the qualified organization rule. A conservation easement has value only if it is enforced by the donee. If the easement is changed or dishonored, the promise of conservation is broken. Thus, an otherwise eligible donee without a commitment to enforcing easements or the resources to do so should not be allowed to accept deductible easement contributions.

Yet, the commitment and resources test of the regulations turns out not to be a new or even a substantive requirement. The regulations are explicit that an organization need not set aside funds for future enforcement.²¹ Instead, “[a] conservation group” will satisfy the commitment and resources test if it is “organized and operated primarily or substantially for one of the conservation purposes” laid out in the Code.²² But using such an “organized and operated” test as the measure of an organization’s resources and commitment to conservation is simply to restate the standard used to determine a donee’s tax-exempt status.²³ In other words, this is not a new test but rather a reiteration of an existing one that bears little relation to the problem of resources and commitment.

This is because the “organized and operated” test requires only that the organization be a conservation organization for the exemption purposes of § 501(c)(3). Typically, in considering whether an organization is organized and operated for an exempt purpose, the IRS does not, and is not expected to, assess the viability of an organization’s operations—measured either in terms of resources or commitment. Rather, the IRS checks the organizing documents for appropriate language, and then ensures in a broad sense that the organization operates consistent with its purpose. Thus, by taking refuge in the familiar through

¹⁹ *Id.* § 170(h)(3).

²⁰ Treas. Reg. § 1.170A-14(c)(1) (2009).

²¹ *Id.* Requiring the setting aside of funds, however, *would* be a measurable and meaningful test of resources and commitment.

²² *Id.*

²³ In order to qualify as a § 501(c)(3) organization, an organization must be “organized and operated exclusively” for an exempt purpose. I.R.C. § 501(c)(3).

utilization of the “organized and operated” test, the regulations rely on the law of tax exemption to enforce the qualified organization rule. But, without more, the exemption-level “organized and operated” test is inadequate to police whether a donee has the resources and commitment to enforce an easement.

In short, normally there are no special limitations on donees to accept a deductible charitable contribution, apart from qualifying under § 501(c)(3). But imposing a “qualified organization” rule as a condition of the charitable deduction for easements and coupling it with a resources and commitment test distinguishes easement donees from other charitable donees. This raises the enforcement bar on the IRS at the level of the qualified donee’s exempt status. But the qualified organization rule dissolves into the standard test for tax exemption, adding little. So although more is expected (even if not technically required) of qualified organizations than for other § 501(c)(3) organizations, these expectations are not matched with enforcement tools.

2. *For a Conservation Purpose*

The second special rule imposed on conservation easements is the requirement that the easement be for a conservation purpose. As articulated in § 170(h)(4)(A) of the Code, one of four purposes must be satisfied:

(i) the preservation of land areas for outdoor recreation by, or the education of, the general public, (ii) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem, (iii) the preservation of open space (including farmland and forest land) where such preservation is (I) for the scenic enjoyment of the general public, or (II) pursuant to a clearly delineated Federal, State, or local governmental conservation policy, and [in each case] will yield a significant public benefit, or (iv) the preservation of an historically important land area or a certified historic structure.²⁴

Normally, however, there are no purpose restrictions on charitable contributions.²⁵ Contributed property can be for any purpose and put to any use by the donee.²⁶ As a result, for charitable contributions other than conservation

²⁴ I.R.C. § 170(h)(4)(A).

²⁵ There is an exception for gifts to a government entity (state or federal), which must be “made for exclusively public purposes.” *Id.* § 170(c)(1).

²⁶ Under normal rules, a donee’s use of contributed property can affect the amount of the deduction but not whether a deduction is available. *See, e.g., id.* § 170(e)(1)(B)(i)(I). Thus, for purposes of determining the deduction amount (of tangible personal property), the IRS is supposed to check whether the property is for a “related use” of the donee. If so, then the donor is allowed a deduction equal to the property’s fair market value. If not, then

easements, the IRS's enforcement role generally is limited to confirming the value of contributed property (to make sure the right amount of the deduction is claimed)²⁷ and checking whether the contribution is properly substantiated.²⁸ The IRS does not inquire about the substantive purpose of the contribution.²⁹

The issue then is what the conservation purpose requirement demands of the IRS. On its face, the requirement appears to task the IRS with evaluating the language of each easement contribution to make sure that it meets one of the four conservation purposes. Although this seems sensible, even necessary, this is little more than a formality, easy to satisfy. The confusion then comes from expectations that conservation purpose, like the qualified donee rule, actually be a substantive test. But as such, it is riddled with problems.

As an initial matter, the conservation purposes outlined in the Code are not only open-ended (making challenges difficult), but generally are outside of the IRS's expertise to assess. Determining conservation purpose may involve scientific or biological judgments about species or environmental protection, or the value of "open space." In addition, it is implicit that conservation purpose is capable of assessment at the time of the contribution. But then it amounts to little more than a guess about whether the easement terms will in fact secure a conservation benefit. In other words, conservation purpose cannot be measured by what happens after the contribution.

Further, because the word "purpose" is used as part of the test, it is easy to assume that the test falls within IRS competencies to enforce. This is because "purpose" is a familiar concept for the IRS and exempt organization law. But it is familiar in the context of assessing the purpose of a donee to qualify for tax exemption—something the IRS does as a matter of course—and not the purpose of

the donor is allowed only a deduction of the donor's cost basis, that is, the amount the donor paid for the property, not including the property's appreciation.

²⁷ For property contributions generally, a deduction of fair market value is allowed. Fair market value is the "price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts." Treas. Reg. § 1.170A-1(c)(2).

²⁸ I.R.C. §§ 170(f)(8), -(11).

²⁹ As noted *supra* note 26, for some contributions, whether the property is for a "related use" of the donee is relevant to the amount of the deduction. However, a "related use" inquiry is qualitatively different from a "conservation purpose" inquiry. Determining whether property is for a related use does not involve a substantive assessment. Rather, it occurs at the level of concluding whether contributed property is used by the donee in its exempt programs. For example, if the contributed property is a work of art, the question generally is whether the artwork will be displayed in an exhibit, or held for sale and not displayed. By contrast, deciding whether an easement is for a conservation purpose invites an assessment as to whether the language of the easement and the type of restrictions it imposes serve the ends of conservation. In other words, the IRS is invited to second-guess the donee organization on the merits of the easement.

a contribution, a qualitatively different inquiry. Donee purpose, unlike conservation purpose, clearly is not intended to be a substantive test.³⁰

Moreover, the term “conservation purpose,” as used in § 170(h)(4)(A), becomes confused with these other uses of “purpose” and so takes on dual meanings. One example is in the commitment and resources test of the qualified organization rule. This test depends on whether the donee is organized and operated for a conservation purpose, as “specified in section 170(h)(4)(A).”³¹ But the § 170(h)(4)(A) purposes are not set out as donee purposes; rather they are contribution purposes. This creates an implication that contribution purposes and donee purposes are synonymous—that is, the requirement that a contribution be for a conservation purpose may be satisfied (or at least viewed favorably) if the donee is organized and operated for a conservation purpose. This, however, denudes the conservation purpose test of independent meaning.

This conflation of the two different ideas is reinforced by the fact that “purpose” is already relevant as a condition of the charitable deduction. In general, to be deductible, a gift must be to a donee that is organized and operated for an exempt purpose, as described in § 501(c)(3).³² Thus, as a general matter, the IRS polices eligibility for charitable contributions at the level of tax exemption through the initial and ongoing recognition of § 501(c)(3) status based on a donee purpose test.³³ This bears on enforcement generally because continuing eligibility to receive deductible contributions then is monitored through enforcement of the purpose and other cardinal rules of § 501(c)(3).³⁴ But these standard enforcement tasks have nothing to do with assessing conservation purposes.

³⁰ Exemption law avoids putting the IRS in a position of assessing the quality of exempt purposes. This is simply not seen as the job of the tax administrator. *See* Roger Colinvax, *Charity in the 21st Century: Trending Toward Decay*, 11 FL. TAX REV. 1, 8–18 (2011) (discussing the absence of affirmative requirements in the law of § 501(c)(3) organizations).

³¹ Treas. Reg. § 1.170A-14(c)(1). *See* discussion *supra* text accompanying notes 25 and 26.

³² I.R.C. § 170(c)(2)(B). The language used here—“organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes”—is identical to the language used in § 501(c)(3). Charitable contributions may also be made to other organizations. *Id.* § 170(c).

³³ Once an organization satisfies the purpose test under § 501(c)(3), the organization is automatically eligible to receive deductible contributions. *Id.* §§ 170(c)(2)(B), 501(c)(3). The “organizational” component requires the proper language in the organizing documents. The “operational” requirement requires not running afoul of few operational constraints.

³⁴ Namely, the organization must not benefit insiders, compensation must be reasonable, there should be no political activity or substantial lobbying, the organization must not become too commercial, and so forth. I.R.C. § 501(c)(3); *see also* John D. Colombo, *Commercial Activity and Charitable Tax Exemption*, 44 WM & MARY L. REV. 487 (2002).

What this means for the conservation purpose test is that in theory it imposes a new legal sense of “purpose” onto longstanding enforcement approaches and capabilities with respect to “purpose.” As in the case of the qualified organization rule, the purpose requirement appears to invite ongoing IRS enforcement. But this falls outside the normal role for the IRS in assessing continued eligibility for section 501(c)(3) status, and there are no distinct enforcement tools to disallow deductions (or punish donees) when easements fail in fact to satisfy conservation purposes.

In sum, the conservation purpose requirement as a condition of easement deductibility is an anomaly, which seals its doom. At the level of allowing or denying a deduction, the purpose of the contribution normally is not relevant; rather, value and substantiation are the focus. At the level of tax exemption, a generic commitment by the organization to an exempt purpose is what matters and not the purpose of the property held. The conservation purpose requirement seems to contemplate crossing the line between good intentions and actual results and ushers in an entirely new role for the IRS in enforcing the charitable deduction and relatedly, the tax exemption of qualified donees. But these expectations are not made concrete in the law.³⁵

3. *In Perpetuity*

The third special rule is that the contributed easement be in perpetuity. The Code makes clear that in order for a conservation easement to be “exclusively for conservation purposes” it must be “protected in perpetuity.”³⁶ There is an extensive debate on the meaning and even utility of the perpetuity requirement.³⁷ In a nutshell though, from a tax enforcement perspective, the issue is whether perpetuity is enforced mainly at the time of contribution or whether an ongoing enforcement role (i.e., in perpetuity) is appropriate.

Again it is helpful to compare the promise of perpetuity in the easement context with the normal approach to charitable contributions. For normal contributions, there is no perpetuity requirement per se. But there is a promise that

³⁵ *But see, e.g.,* Turner v. Comm’r, 126 T.C. 299 (2006) (involving a donation that failed to satisfy either the open space or historic preservation conservation purposes tests); Herman v. Comm’r, 98 T.C.M. (CCH) 197 (2009) (involving a donation that failed to satisfy historic preservation conservation purposes test).

³⁶ I.R.C. § 170(h)(5)(A).

³⁷ *See generally* Julia D. Mahoney, *Perpetual Restrictions on Land and the Problem of the Future*, 88 VA. L. REV. 739, 744 (2002); Nancy A. McLaughlin, *Rethinking the Perpetual Nature of Conservation Easements*, 29 HARV. ENVTL. L. REV. 421 (2005); Jessica Owley, *Changing Property in a Changing World: A Call for the End of Perpetual Conservation Easements*, 30 STAN. ENVTL. L.J. 121, 151 (2011); Colinvaux, *supra* note 9 at 52–56 (discussing debate).

the contributed assets will be “dedicated to an exempt purpose.”³⁸ The promise is made by the organization as a condition of tax exemption through its dissolution clause.³⁹ In this way, the promise of a charitable contribution can be kept.⁴⁰ Assets, or their value, once dedicated to charitable purposes, so remain.

The main enforcer of this rule is the attorney general of the state in which the organization is formed, and not the IRS. The IRS has only limited sanctions to enforce the diversion of exempt assets for nonexempt purposes. The IRS can take the drastic step of revocation of tax-exempt status, or possibly impose excise taxes if the benefits inure to an insider of the organization.⁴¹

The perpetuity requirement of conservation easements is similar in that, upon contribution, the intent is a permanent dedication for exempt purposes. It is also similar in that the state attorney general is the main enforcer. But a perpetual easement is different in important respects, again contemplating an unusual role for the IRS. Because perpetuity is imposed as a condition of a deduction, not a condition of exemption, the implication is that if an easement turns out to be non-perpetual through modification, termination, or sale, there should be a consequence bearing on deductibility, not exemption.

In addition, the requirement that assets be dedicated to an exempt purpose generally applies to the value of the assets. That is, absent a conditional gift or specific donor intent to the contrary, assets in the hands of the donee are fungible and alienable. Not so with easements. The perpetuity requirement applies with respect to an identifiable asset. The donee organization generally is not permitted to sell the easement or modify the easement, but rather is the guardian of the easement terms and the conservation promise it represents. But again, if the donee breaks its promise through non-enforcement, the IRS lacks the necessary enforcement tools. As with the qualified donee and conservation purpose rules, more is expected than the IRS is equipped to deliver.⁴²

4. Valuation and Public Benefit

A final exceptional challenge presented by the deduction for conservation easements is the need to value a negative restriction. In general, valuation is within

³⁸ Treas. Reg. §§ 1.501(c)(3)–1(b)(4) (2009).

³⁹ In order to satisfy the “organizational test” of § 501(c)(3), the organization must have a dissolution clause in its organizing document, which provides that the organization’s assets will be distributed for exempt purposes upon dissolution. *Id.*

⁴⁰ In other words, once again, the charitable deduction generally is enforced through the law of tax exemption.

⁴¹ I.R.C. § 4958.

⁴² The IRS can ensure that deductible conservation easements are drafted in such a way that they prevent holders from selling or otherwise transferring the easements, Treas. Reg. § 1.170A-14(c)(2), and are extinguishable only in special circumstances. *Id.* § 1.170A-14(g)(6). Enforcement of those terms then falls to the state attorney general.

the realm of normal IRS enforcement. For many charitable contributions, a deduction equal to the fair market value of the contributed property is allowed.⁴³ The IRS must check the claimed value of contributions in order to prevent excess deductions and to preserve the integrity of the deduction. Even in the normal case, checking the value of a charitable contribution can be difficult because there is no arm's-length transaction between the parties, and the interests of donor and donee can align in favor of a high valuation.

The valuation problem is worse in the easement context, however. For easements, there will rarely be a sales market for comparables and each easement is unique to the burdened land. Significant expertise is required to perform an appraisal of easements, including knowledge of local real estate law, zoning rules, the surrounding property, the easement's terms, and scientific understanding of the conservation purposes protected, among other things.⁴⁴ Valuation challenges are resource-intensive and often pit the IRS in a battle of dueling experts. Concerns about the retained interest of the donor (say by continuing to use the affected property as a residence or a working farm) also raise the issue of whether the donor has actually given up anything, especially since many easement donors likely value conservation and are not inclined to develop the property in any event.⁴⁵ The hundreds of cases litigated by the IRS—many of which turn on valuation⁴⁶—indicate the commitment of resources and the belief by administrators that the conservation easement deduction is rife with widespread valuation abuse.

Apart from valuation challenges, the fair market value deduction for conservation easements also turns out to be exceptional in another way. Because “fair market value” is determined by calculating the extent to which the easement reduces the value of the underlying property,⁴⁷ the “value” typically captured by the deduction represents the lost economic development value of the property. Unfortunately, the lost economic development value bears no relation to the

⁴³ *Id.* § 1.170A-1(c)(1).

⁴⁴ For a discussion of the challenges of valuing easements, see JEFF PIDOT, REINVENTING CONSERVATION EASEMENTS: A CRITICAL EXAMINATION AND IDEAS FOR REFORM 28–29 (2005), available at https://www.lincolnst.edu/pubs/dl/1051_Cons%20Easements%20PFR013.pdf; Colinvaux, *supra* note 9, at 11–15.

⁴⁵ Josh Eagle, *Notional Generosity: Explaining Charitable Donors' High Willingness to Part with Conservation Easements*, 35 HARV. ENVTL. L. REV. 47, 47 (2011).

⁴⁶ See, e.g., Nancy A. McLaughlin, *Perpetual Conservation Easements in the 21st Century: What Have We Learned and Where Should We Go From Here?*, 2013 UTAH L. REV. 687, 33 UTAH ENVTL. L. REV. 1 (2013) (explaining that in just over 30% of the 36 deduction cases handed down since 2005, valuation was an issue, and in each of those cases the courts determined that the taxpayer had overstated the value of the easement, often by a significant percentage, and the IRS has indicated there are approximately 200 additional cases in the litigation pipeline).

⁴⁷ This is the “before and after” method of valuation, and the default method under the regulations in the absence of market-place sales. Treas. Reg. § 1.170A-14(h)(3)(i).

conservation value of the easement,⁴⁸ meaning that the appraised fair market value does not provide a proxy for the public benefit of the contribution.⁴⁹

This creates problems because, to a considerable degree, the perception of charitable contributions is that the amount of the contribution is the same as the public benefit.⁵⁰ When this is not the case, however, the public benefit is more obscure and not transparent or well understood. In short, not only do conservation easements present exceptional valuation challenges, but even if the value is accurately calculated for tax purposes, little to nothing is learned about the public benefit from the contribution.

III. PROPOSED TAX REFORMS

In light of the above discussion, it is perhaps not surprising that in recent years there have been many calls for tax reform of the charitable deduction for conservation easements. Reform proposals run the gamut of eliminating the deduction to making only minor modifications, but most are focused on one thing: better conservation outcomes.⁵¹ Importantly, most can also be traced to the design flaws discussed in Part II and a related desire to shore up the weak qualified-organization requirement, ensure perpetual protection, secure a meaningful conservation benefit (as opposed to a conservation “purpose”), and fix valuation problems.

A. Tax Reforms Relating to the Qualified-Organization and In-Perpetuity Requirements

There are several options for improving the regulation of qualified donee organizations, all of which generally are intended to bolster the perpetuity requirement.⁵² Most involve providing the IRS with additional enforcement tools. For example, the IRS could be empowered to revoke the tax-exempt status of a

⁴⁸ For additional discussion, see Colinvaux, *supra* note 9, at 19–23.

⁴⁹ Fair market value is also a poor measure for public benefit with respect to other contributions of property. See Roger Colinvaux, *Charitable Contributions of Property: A Broken System Reimagined*, 50 HARV. J. ON LEGIS. 263 (2013).

⁵⁰ This is so in the typical case of a cash contribution where the contribution value and public benefit generally are the same.

⁵¹ It is beyond the scope of this Essay to identify all reform proposals. The purpose here mainly is to identify categories of reform proposals made by government entities and others and show how the reforms often are the result of the design flaws discussed in Part II. For an excellent overview of many reforms in both tax and property law, see PIDOT, *supra* note 44.

⁵² The Land Trust Alliance has responded to concerns about donee quality and the prospect of legal changes by establishing a substantial accreditation program for land trusts. See LAND TRUST ALLIANCE, 2010 NATIONAL LAND TRUST CENSUS REPORT 5 (2011), available at <http://www.landtrustalliance.org/land-trusts/land-trust-census/census/>.

qualified donee for failure to enforce easement terms.⁵³ Such special authority would be required because normally the IRS will revoke exempt status only in fairly egregious cases, and usually because charitable assets are being diverted for non-charitable purposes. The failure to enforce an easement, though an omission that leads to abuse of charitable assets, is distinct from an affirmative act on behalf of private interests and so is not likely to result in revocation under current law.⁵⁴

Another approach would impose excise taxes on officers of the donee organization for failure to enforce an easement, or for making impermissible modifications to, or transfers of, easements.⁵⁵ Yet another would be to honor the plain meaning of the current “resources and commitment” test of the regulations by requiring a plan for enforcement at the exemption application stage, a set-aside of funds on an ongoing basis, and, importantly, providing that if a qualified donee repeatedly fails to enforce its easements or does not have a sufficient reserve for enforcement, the donee would cease to be qualified to accept additional deductible easement contributions.⁵⁶ Still another would be to develop standardized provisions to be required in easement agreements that provide for restrictions on transfer, easement extinguishment, and use of any resulting proceeds.⁵⁷ As Professor McLaughlin argues, standardization of such key provisions would facilitate taxpayer compliance and IRS and court review, and promote consistency in interpretation and enforcement among the states.

B. Tax Reforms Relating to Valuation and the Conservation Purpose Requirement

There have been a variety of proposals to reduce valuation abuses. For example, one area of focus has been on donations of easements that protect an existing historic structure from change, known as façade easements. The main issue relates to a failure of donors to take into account existing legal restrictions on the development of historic properties when valuing an easement. Thus, donors might claim that an easement that restricts changes to a property’s façade reduced the value of the underlying property by a considerable amount, even though local

⁵³ STAFF OF S. COMM ON FIN., 109TH CONG., REP. OF STAFF INVESTIGATION OF THE NATURE CONSERVANCY (VOLUME I), at executive summary, 10 (Comm. Print 2005).

⁵⁴ That said, if a failure to enforce, or agreement to modify or partially extinguish, an easement confers a significant private benefit on a landowner, the exempt status of the conservation organization could be in jeopardy.

⁵⁵ U.S. DEP’T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION’S FISCAL YEAR 2007 REVENUE PROPOSALS 96 (2006).

⁵⁶ See Colinvaux, *supra* note 9, at 56 (discussing such a rule in the context of a credit); see also Halperin, *supra* note 13, at 37 (suggesting that a qualified donee must have a substantial number of easements and sufficient staff to oversee compliance).

⁵⁷ See Nancy A. McLaughlin, *Extinguishing and Amending Tax-Deductible Conservation Easements: Protecting the Federal Investment after Carpenter, Simmons, and Kaufman*, 13 FL. TAX REV. 1 (2013).

zoning rules already had the same effect as the easement.⁵⁸ This, and concerns about the retained use of the property as a residence by the donor, led the staff of the Joint Committee on Taxation to conclude that no deduction should be allowed for such façade easements.⁵⁹ Another approach is to mandate a zero value for easements that provide for development protections substantially similar to those already provided by public law.⁶⁰ Along the same lines—but narrower—the Treasury Department has proposed that no deduction be allowed with respect to any loss in value attributed to an easement that represents “the foregone upward development above an historic building.”⁶¹

Valuation concerns have also led to other broader-based proposals. These range from elimination of the deduction if the conserved property is also used as a private residence of the donor,⁶² to a deduction based on a set percentage (e.g., 67%) of the appraised easement value,⁶³ to changing the measure of the deduction away from the fair market value of the easement to a (low) percentage of the fair market value of the underlying fee interest.⁶⁴ Congress’s preferred solution so far has been to focus on the standards for appraisals and appraisers,⁶⁵ but some commentators believe that this will not be sufficient to address the problem.⁶⁶ Additional reforms of this nature could be to make easement appraisals public, establish an IRS expert review board to review select easement donations, and require an independent second appraisal (reviewing the first) for large donations.⁶⁷

Concerns about valuation often overlap with, and may serve as a proxy for, doubts about the conservation purpose of an easement. Because the present law conservation purposes are broad and open-ended, private parties have significant

⁵⁸ See, e.g., Joe Stephens, *For Owners of Upscale Homes, Loophole Pays: Pledging to Retain the Façade Affords a Charitable Deduction*, WASH. POST, Dec. 12, 2004, at A01.

⁵⁹ STAFF OF JOINT COMM. ON TAXATION, 109TH CONG., *OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES* 282 (Comm. Print 2005). In response to abuses of façade easements, Congress in 2006 imposed special substantiation rules for façade easements in registered historic districts and required that a deductible easement must preserve the “entire exterior of the building (including the front, sides, rear, and height of the building).” I.R.C. § 170(h)(4)(B) (2006).

⁶⁰ See Colinvaux, *supra* note 9, at 49–50.

⁶¹ U.S. DEP’T OF THE TREASURY, *GENERAL EXPLANATIONS OF THE ADMINISTRATION’S FISCAL YEAR 2014 REVENUE PROPOSALS* 162 (2013).

⁶² STAFF OF JOINT COMM. ON TAXATION, *supra* note 59, at 282.

⁶³ *Id.*

⁶⁴ See Colinvaux, *supra* note 9, at 38–41.

⁶⁵ See I.R.C. § 170(f)(11)(E)(iii)(I) (2006) (requiring that a “qualified appraiser” must be one who “demonstrates verifiable education and experience in valuing the type of property subject to the appraisal”).

⁶⁶ See Halperin, *supra* note 13, at 44.

⁶⁷ See PIDOT, *supra* note 44, at 29–30.

leeway in determining the scope of permitted conservation purposes.⁶⁸ Accordingly, some reforms would require that all easements (and not just non-scenic open space easements as required currently)⁶⁹ be pursuant to a clearly delineated government conservation policy.⁷⁰ Alternatively, or in addition, the donee could be required to certify publicly the public benefit from each easement in relation to the tax benefit.⁷¹ Further, a special type of appraisal could be developed for conservation easements that would assess not monetary value, but rather the expected conservation benefits of an easement based on the strength of the donee organization, state and local law protections, and the easement's terms.⁷² The Treasury Department also has proposed not allowing deductions for easements relating to golf courses.⁷³

C. Comprehensive Reforms

Given the design flaws and enforcement problems of current law, comprehensive reform of the easement program has also been suggested. One approach is to convert the deduction for conservation easements into a direct spending program. Instead of funding private donations to private land trusts, the federal government would use appropriated funds to acquire (or directly fund the acquisition of) conservation easements, in whole or in part.⁷⁴ Under this approach, the government would be involved in determining which conservation projects should be funded. The arbiter of the term "conservation" would shift from private parties to the government—with the government able to decide in advance whether a project should go forward. This is in stark contrast to the current role of the IRS, which is to police contributions after they are completed. Further, decisions would not have to be made by the IRS—which is expert in tax collection and

⁶⁸ For example, in *Kiva Dunes Conservation, LLC v. Commissioner*, 97 T.C.M. (CCH) 1818 (2009), the IRS challenged the valuation and conservation purpose of an easement placed on a golf course. The donor claimed the easement served three of the four conservation purposes (preservation of open space, protection of a natural habitat, and preservation of a land area for recreation). The IRS conceded conservation purpose in its brief and focused its challenge on value.

⁶⁹ I.R.C. § 170(h)(4)(A)(iii)(II).

⁷⁰ STAFF OF JOINT COMM. ON TAXATION, *supra* note 59, at 282.

⁷¹ *See* Halperin, *supra* note 13, at 42.

⁷² *See* Colinvaux, *supra* note 9, at 58.

⁷³ U.S. DEP'T OF THE TREASURY, *supra* note 61, at 161. This proposal has been incorporated into legislation as a way to help pay for making permanent some of the special rules conservation easements receive. *See* The Rural Heritage Conservation Extension Act of 2013, S. 526, 113th Cong. (2013); discussion *supra* notes 12–14 and accompanying text.

⁷⁴ Such spending programs already exist. *See, e.g.*, U.S. FOREST SERV., U.S. DEP'T OF AGRIC., FOREST LEGACY PROGRAM IMPLEMENTATION GUIDELINES (2003), available at http://www.fs.fed.us/spf/coop/library/flp_guidelines.pdf.

accounting—but instead by a government agency with experience in conservation, such as the Bureau of Land Management. In addition, government involvement in easement acquisition would introduce far greater control over valuation abuses through negotiated acquisitions and over the specific terms of the easements. This would help ensure that reserved rights do not undermine the purpose of the easement and that holders are constrained from later improperly transferring, modifying, or terminating the easement. And as a direct spending program, there would also be a cap on overall spending that would bring discipline and competition into project selection.⁷⁵

Another comprehensive-style reform would be to keep the easement program as a tax incentive, but change it from a tax deduction to a tax credit. In general, the main reason to switch to a credit would be to provide some of the benefits of a direct spending program while retaining parts of the private aspect of the current deduction. As a credit, the benefit could be capped at a certain dollar amount (like a direct spending program) thus creating competition and selectivity for a limited funding source. This is in contrast to a deduction, which is limited only by the number of donors willing to make contributions and land trusts and government entities willing to accept them. The credit could be administered solely by the IRS or jointly with another agency experienced in conservation policy, thereby enabling more involvement by non-tax government experts. A credit is also versatile enough so that project selection could be made by a quasi-public entity established (and privately run) to screen conservation projects and award credits.⁷⁶ This would preserve the role of private actors in fostering conservation priorities.

A credit is also more flexible than a deduction, which could provide for a more thoughtful incentive. A credit would operate independently of the tax rate structure, meaning that the amount of the benefit would no longer be tied to the tax rate of the donor or to whether the donor itemized deductions. This would not only make the tax benefit more equitable by providing equal benefits to all contributors, but could also allow for multiple credit rates depending on the conservation benefit served.⁷⁷ This is in contrast to a deduction which, because it is tied to the rate structure, is harder to target as a matter of tax policy.⁷⁸

⁷⁵ For additional discussion advocating replacing the deduction with a capped spending program run by a specialized government agency, see Halperin, *supra* note 13.

⁷⁶ This would be a similar concept to the new market's tax credit, which relies on "community development entities" to pick community development projects from applications and award the credits. I.R.C. § 45D (2006).

⁷⁷ For example, ecosystem protection could receive a higher credit rate (and therefore a larger tax incentive) than other conservation values (which would still be favored, just not as much).

⁷⁸ For additional discussion of the reasons for and outlines of a conservation tax credit, see Colinvaux, *supra* note 9, at 41–60.

IV. CONCLUSION

The charitable deduction for conservation easements gives rise to exceptional enforcement challenges. The promise is of a conservation benefit, lasting forever.⁷⁹ The tax incentive is intended to help produce such benefits. The principal problem with the tax incentive, however, is that it does not facilitate a substantive, enforceable definition of conservation. The result is that valuation uncertainties can be used to benefit donors, often for questionable conservation benefits, and the IRS does not have the enforcement tools it needs, leaving it to fight valuation battles that ultimately provide little to no sense of the public benefit provided.

The qualified donee, conservation purpose, and perpetuity requirements each in their own way are intended to protect the conservation promise, but each fail because the existing legal framework simply does not contemplate an ongoing enforcement role for the IRS to police contribution use or donee effectiveness, either at the level of the charitable deduction or at the level of tax exemption. These flaws have thus led the way to a retinue of wide-ranging reform proposals. At bottom, however, the proven challenges of using the charitable deduction for partial interest conservation contributions suggest that a comprehensive reform is appropriate.

⁷⁹ Treas. Reg. § 1.170A-14(g)(6)(i) (2009) (contemplating extinguishment of an easement in a judicial proceeding if a subsequent unexpected change in the conditions surrounding the property makes impossible or impractical the continued use of the property for conservation purposes and a payment of proceeds to the holder in such event to be used for similar conservation purposes).