A PROPOSAL FOR GREATER ACCESSIBILITY TO CHARITABLE DEDUCTIONS FOR CONSERVATION EASEMENT DONATIONS

Comment

I. INTRODUCTION

A conservation easement is a gift from a landowner to an organization that grants the organization the right to prevent anyone, including the landowner, from using the land in ways inconsistent with a particular conservation purpose.[1] Common law in the United States and England has not historically favored conservation or negative easements that obligate landowners to refrain from using their land in certain ways.[2] Under nineteenth-century English common law, a negative easement was valid only if the easement prevented a landowner from restricting light, air, support, or water flow from a manmade stream.[3] These easements are typically held in gross.[4] Under United States common law, equitable enforcement of easements held in gross was disallowed so negative easements have been disfavored for much of American history.[5]

In 1976, Congress began granting tax deductions to landowners who agreed to donate conservation easements to qualified conservation organizations.[6] Section 170(h) of the Internal Revenue Code imposes the requirements a landowner must fulfill to obtain a charitable deduction for donating qualified conservation easements.[7] Under § 170(h)(2), if a landowner's conveyance is less than a possessory interest or remainder interest, the landowner does not qualify for a charitable deduction unless the landowner imposes a perpetual restriction on land use.[8] Courts and the Commissioner of the Internal Revenue Service (IRS) apply state law to determine the nature of the landowner's conveyance, and they apply the Revenue Code to determine the tax consequences of the conveyance.[9] The landowner must donate a conservation easement that is valid under applicable state law.[10] To qualify for a § 170(h) deduction, landowners must convey a real

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1. Nancy A. McLaughlin, *Increasing the Tax Incentives for Conservation Easement Donation - A Responsible Approach*, 31 ECOLOGY L.Q. 1, 4 (2004) [hereinafter McLaughlin, *A Responsible Approach*].

2. JEREMY SHEFF, OPEN-SOURCE PROPERTY: A FREE CASEBOOK, 903–11 (2017) (ebook).

3. *Id.* at 894.

4. *Id.* An easement in gross is a right created in a person to use the land of another, which the owner of that easement may enjoy even though he does not own or possess a dominant estate. *Id.* at 87.

5. *Id.* at 894.

6. Zachary A. Bray, *Reconciling Development and Natural Beauty: The Promise and Dilemma of Conservation Easements*, 34 HARV. ENVTL. L. REV. 119, 131 (2010).

7. I.R.C. § 170(h) (Westlaw through P.L. 115-223).

8. *Id.* § 170(h)(2)(C) (Westlaw).

9. *See id.* § 170(h)(4) (Westlaw).

10. *See id.*

property interest[11] to a qualified organization exclusively for conservation purposes.[12] The donor must include a provision in the instrument of conveyance that prohibits the donee from transferring its interest to a party that is not a qualified conservation organization.[13] A donation is not exclusively for conservation purposes under the Revenue Code "unless the conservation purpose is protected in perpetuity."[14] But, a deduction will not be denied where a subsequent event could divest a donee's interest as long as the possibility of the subsequent event is so remote as to be negligible on the date of the donation.[15] The value of a § 170(h) deduction donation is equal to the value of the conservation easement.[16]

The requirements for a qualified conservation easement have given rise to numerous disputes between landowners and the IRS.[17] Valuation of conservation easements and conflicts between the Revenue Code and state law have also been extensively litigated.[18] State legislatures began to recognize conservation easements shortly after the United States Congress.[19] The requirements for a valid conservation easement vary among the states, and some state statutes conflict with the Revenue Code's requirements.[20]

Private parties own a substantial majority of the land in the United States.[21] Private land ownership effectively discourages

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11. *See id.* § 170(h)(1)(A) (Westlaw) (clarifying a real property interest includes the entirety of the donor's interest other than a mineral interest, a remainder interest, or a restriction on how the donor's real property can be used.

12. *See id.* § 170(h)(1)(C) (Westlaw) (explaining conservation purposes include "preservation of land areas for outdoor recreation or education of the general public, protection of a relatively natural habitat, protection of a relatively natural habitat, preservation of open space for the scenic enjoyment of the general public or pursuant a clearly delineated government conservation policy."

13. *See* Treas. Reg. § 1.170A-14 (1999), WL 26 C.F.R. § 1.170A-14 (elaborating on each requirement for a qualified conservation easement).

14. I.R.C. § 170(h)(5)(A) (Westlaw).

15. Treas. Reg. § 1.170A-14(g)(3).

16. *Id.* § 1.170A-14(g)(6)(ii).

17. *See infra* Part II.

18. *See infra* Part II.A.2.

19. *See Conservation Easements: The Evolution of Conservation Easements*, THE NATURE CONSERVANCY, https://www.nature.org/about-us/private-lands-conservation/conservation-easements/evolution-of-conservation-easements.xml (last visited Oct. 22, 2018) (noting the state statutes that allow conservation easements generally resemble the 1981 Uniform Conservation Easement Act drafted by the National Conference of Commissioners of Uniform State Laws).

20. *See infra* Part II.A.2.

21. CAROL HARDY VINCENT ET AL., FEDERAL LAND OWNERSHIP: OVERVIEW AND DATA 1–2 (Cong. Research Serv., Report R242346, 2017), https://fas.org/sgp/crs/misc/R42346.pdf. (explaining that the federal government owns about 28% of the total acreage of the United States).

many destructive land uses that would arise in a commons because rational landowners will use their land in a way that yields the highest expected payoff.[22] However, it does not eliminate the possibility of land use that is ultimately harmful to the planet.[23]

Environmental conservation is essential to the continued existence of life on this planet, but land use that is most beneficial to environmental preservation is usually not the most profitable.[24] Maximizing profits too often means developing previously undeveloped land and destroying natural habitats.[25] This is particularly true in densely populated areas. For example, the owner of undeveloped land in a densely populated area can expect to generate more income from building and renting apartments than from allowing the public to use the undeveloped land as a private park.

To increase the expected payoff to landowners who preserve natural habitats on their land, the United States Congress grants tax deductions to land owners who commit their land to conservation purposes.[26] Through tax deductions, the government shifts some of the burden of environmentalist work to private parties by encouraging environmentally responsible decision-making without directing how landowners can use their land.[27]

Congress achieves § 170(h)'s purpose of encouraging eco-friendly land use by facilitating the creation of as many conservation easements as possible. Unfortunately, courts have not always applied the Revenue Code provisions in a way that advances this purpose.[28] Section 170(h) is less effective as a way to increase the expected payoff to landowners if the probability of receiving tax benefits are low.

Section 170(h) would more effectively incentivize land donations if the Revenue Code and tax courts allowed landowners and charitable organizations to more freely develop easements. Landowners and conservation charities would have more freedom to form effective contributions if Congress terminates the perpetuity requirements, expressly allows deductions for charitable contributions where both parties consent to subsequent

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22. *See generally* Garrett Hardin, *The Tragedy of the Commons*, 162 Sci 1243 (1968) (explaining ways the governments can prevent wasteful uses of land).

23. *See id.* at 1243–45.

24. *See id.* at 1244–45.

25. *See id.*

26. *See* I.R.C. § 170(h) (Westlaw through P.L. 115-223); *see also* Roger Colinvaux, *The Conservation Easement Tax Expenditure: In Search of Conservation Value*, 37 COLUM. J. ENVTL. L. 1, 2 (2012).

27. *See* I.R.C. § 170(h) (Westlaw).

28. *See infra* Part II.

alterations in easement boundaries, and allows deductions where the easement is conditioned on the landowner obtaining the tax deduction.

Instead of a perpetuity requirement, Congress should expressly require conservation easements to last a minimum of either forty years or, if applicable state law imposes a time limit on conservation easements less than forty years, the state-prescribed limit. Congress should also grant landowners deductions where both parties agree to permit subsequent alterations. To prevent abuse, Congress should require a written agreement between the donor and donee to name a third party environmental conservation that must approve proposed changes. Congress should also require an agreement provision that permits subsequent alterations where there is mutual consent between the donor and donee.

Congress should also explicitly allow easements that permit subsequent boundary alterations to qualify for § 170(h) deductions if the agreement meets certain conditions. The Revenue Code should address agreements that allow boundary alterations with a separate subsection because land substitutions are more likely than other agreement modifications to affect the monetary value of the easement. Under the proposed rule, a provision authorizing substitutions must require mutual consent for substitutions and must forbid alterations that would harm the character of the original easement.

The proposed changes would make § 170(h) deductions more accessible, would more closely align the courts' application of § 170(h) with the legislative intent of encouraging ecologically friendly land use, and would simplify the requirements for a conservation easement qualifying for § 170(h) deduction.[29] These changes should make easements less susceptible to IRS challenges leading to an increase in donations. Additionally, the proposals would greatly reduce expenditures associated with IRS challenges to claimed deductions by eliminating the possibility of disputes on issues that have produced the most litigation in this area of law.[30] Landowners and conservation agencies should be able to negotiate easement terms that most effectively serve the conservation purpose without disqualifying the easement for a deduction. Finally, the proposed changes would provide adequate safeguards

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29. *See* McLaughlin, *A Responsible Approach*, *supra* note 1, at 18 (citing OFFICE OF TAX ANALYSIS, U.S. DEP'T OF THE TREASURY, A REPORT TO THE CONGRESS ON THE USE OF TAX DEDUCTIONS FOR DONATIONS OF CONSERVATION EASEMENTS (1987)).

30. *See infra* Part III.

against abuse without undermining the safeguards already in place.

Part II of this comment discusses how courts apply § 170(h). Part III.A. discusses the deficiencies of the perpetuity requirements and how the proposed alterations will improve the effectiveness of § 170(h). Part III.B. discusses issues arising from the lack of statutory guidance on land substitutions and the benefits of adding a provision explicitly addressing land substitutions.

II. COURT APPLICATION OF IRC §170(H)

Conservation easements have produced extensive litigation over each § 170(h) requirement. Of the three elements for a qualified conservation easement under § 170(h), the subsection requiring donations of qualified real property interests in perpetuity and the subsection requiring donations exclusively for conservation purposes have been particularly contentious.

A. The perpetuity requirements in § 170(h) have been the greatest roadblock to qualification for § 170(h) deductions.

The IRS Commissioner and tax courts often deny landowners § 170(h) deductions because they conclude the landowner did not grant an otherwise qualified conservation easement in perpetuity.[31] The perpetuity requirements have become a familiar point of contention, and tax courts have extensively developed and applied the perpetuity requirements.[32]

Two subsections of the Revenue Code impose perpetuity requirements. Section 170(h)(2)(C) requires landowners to impose perpetual restrictions on future use of the property.[33] Under § 170(h)(5), a conservation easement, as a whole, must be capable of protecting its purpose in perpetuity.[34] Historically, many courts combined their discussion of the two perpetuity requirements, but courts have applied each perpetuity requirement individually in more recent decisions.[35]

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31. *See generally* Bray, *supra* note 6, at 120–36.

32. *Id.* Disputes between the Commissioner and landowners concerning the perpetuity requirements are more likely to lead to litigation than the other requirements discussed in this comment.

33. I.R.C. § 170(h)(2)(C) (Westlaw through P.L. 115-223).

34. *See id.* § 170(h)(5) (Westlaw).

35. *Compare* Ten Twenty Six Inv'rs v. Comm'r, 113 T.C.M. (CCH) 1516, at *12 (T.C. 2017) (applying both I.R.C. §§ 170(h)(2)(C) and 170(h)(5)), *and* Belk v. Comm'r, 140 T.C. 1, 12 (2013) (applying both I.R.C. §§ 170(h)(2)(C) and 170(h)(5)), *aff'd*, 774 F.3d 221 (4th Cir.

Tax courts do not require landowners to prove with absolute certainty their conservation easements will eliminate all possibility of future property development.[36] Easement agreements are unlikely to last forever no matter how well the parties construct and execute the agreement.

In accordance with income tax regulations, tax courts will not deny a landowner a § 170(h) deduction simply because the conservation easement may subsequently fail if a certain condition is met.[37] A tax court may grant a deduction to a conditional easement where the possibility of satisfaction of a condition that will defeat the easement is so remote as to be negligible.[38] The court interprets the phrase "'so remote as to be negligible' as a chance which persons generally would disregard as so highly improbable that it might be ignored with reasonable safety in undertaking a serious business transaction."[39] Conservation easements must meet the perpetuity requirements at the time the conservation is executed by the parties.[40] For example, a tax court will not grant a § 170(h) deduction to a landowner if the donated conservation easement satisfies the perpetuity requirements at the time of trial or any other time after the easement's formation but failed to satisfy the perpetuity requirements at the easement's inception.[41]

Tax courts do not consider a condition remote simply because the condition will not be met for a long period of time.[42] If a condition will certainly be met in a thousand years, such as a case involving an easement with a one thousand-year term, tax courts will not consider the condition remote.[43] Tax courts and the Commissioner apply the "so remote as to be negligible" standard to all conservation easements to determine whether an easement is truly granted in perpetuity.[44] However, tax courts applying this standard have developed several sub-rules to resolve recurring issues.

2014), *with* Comm'r v. Simmons, 646 F.3d 6, 9–10 (D.C. Cir. 2011) (applying I.R.C. § 170(h)(5)(A)).

36. *See, e.g.*, Wachter v. Comm'r, 142 T.C. 140, 147–50 (2014).
37. *Id* at 148.
38. Treas. Reg. §1.170A-14(g)(3) (as amended 2018), WL 26 C.F.R. § 1.170A-14.
39. *Wachter*, 142 T.C. at 148 (quoting 885 Inv. Co. v. Comm'r, 95 T.C. 156, 161 (1990)).
40. *Id.*
41. *Id.*
42. *See id.* at 148–49.
43. *See id.*
44. *See, e.g., id.*

1. Tax courts and the Commissioner do not grant landowner deductions for conservation easements conditioned on the landowner obtaining a § 170(h) deduction.

Graev v. Commissioner is influential precedent on conservation easements conditioned on the landowner obtaining a § 170(h) deduction.[45] In *Graev*, Mr. Graev, the owner of property in a historic preservation district in New York, granted a façade conservation easement to the National Architectural Trust (NAT).[46] The NAT agreed to send Graev a side letter promising to terminate the conservation easement if the IRS did not grant a § 170(h) deduction.[47] The Commissioner denied Graev a deduction because the charitable contribution was subject to the occurrence of subsequent events.[48] After considering the circumstances, the court concluded that the possibility that the Commissioner would deny Graev a § 170(h) deduction was not so remote as to be negligible, and therefore, the donation did not qualify.[49] The tax court ultimately affirmed the Commissioner's decision to deny Graev a § 170 deduction.[50]

2. When state law and § 170(h) conflict, tax courts may deny § 170(h) deductions to landowners whose donations comply with state law on land conveyances but fail to satisfy a perpetuity requirement.

Prospective land donors must draft conservation easements that comply with the respective state's laws on land conveyances.[51] Conflicts between the Revenue Code and state laws often create obstacles to landowners seeking § 170(h) deductions.[52] In fact, landowners' attempts to comply with state laws can disqualify their easements for failure to satisfy the perpetuity requirements of § 170(h) deduction. *Wachter v. Commissioner* arose as a result of a North Dakota law forbidding easements from exceeding

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45. 140 T.C. 377, 380 (2013) (involving a conservation easement to preserve a historic building).

46. *Id.* at 383.

47. *Id.*

48. *Id.* at 387.

49. *Id.* at 394–96, 409 (concluding that the possibility the Commissioner would deny a deduction was not remote because at the time of the easement's formation, the IRS had already announced that it intended to more carefully scrutinize façade easements).

50. *Id.* at 409.

51. *See* Wachter v. Comm'r, 142 T.C. 140, 146 (T.C. 2014).

52. *See* Jessica Owley, *Changing Property in a Changing World: A Call for the End of Perpetual Conservation Easements*, 30 STAN. ENVTL. L.J. 121, 164–65 (2011).

ninety-nine years.[53] In *Wachter*, the landowners claimed a charitable deduction for bargain sales of conservation easements.[54] The claimed deduction was the difference between the sale price and the appraised value of the property.[55] Under the applicable state law of North Dakota, an easement "on the use of real property must be specifically set out, and in no case may the duration of any interest in real property regulated by this section exceed ninety-nine years."[56] The IRS argued that the North Dakota statute prevented the landowners from granting a qualified easement because the landowners could not legally convey a conservation easement in perpetuity.[57] The landowners argued that the ninety-nine year statutory limit did not disqualify the easement for a deduction because termination ninety-nine years after the easement's creation was a remote future event.[58] The court applied the "remote future event" standard of section 1.170A-14(g)(3) and decided easement termination after the ninety-nine year limit was not a remote future event because the easement would inevitably divest after the ninety-ninth year.[59] The court did not attribute any weight to temporal remoteness.[60] The tax court then concluded the landowner's conservation easement did not qualify for a deduction because the easement was not a perpetual restriction of real property.[61]

Under *Wachter*, landowners cannot benefit from § 170(h) deductions for donations of land located in North Dakota.[62] If other tax courts follow *Wachter*, state laws throughout the United States could prevent landowners from donating conservation easements that qualify under § 170(h).

State law can invalidate otherwise qualified conservation easements if the parties to an easement fail to comply with state recording acts.[63] *Ten Twenty Six Investors v. Commissioner*, like

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53. *See Wachter*, 142 T.C. at 140.

54. *Id.* at 143.

55. *Id.* at 143–44.

56. *Id.* at 147 (citing N.D. CENT. CODE ANN. § 47-05-02.1 (West 1999 & Supp. 2013) (noting North Dakota's ninety-nine year limitation applied to easements created after July 1, 1977).

57. *Id.* at 147–48.

58. *Id.* at 147.

59. *Id.* at 149.

60. *See id.* at 148–49.

61. *See id.* (citing 26 C.F.R. § 1.170A-14(g)(3) (as amended in 2018)) (construing § 1.170's "so remote as to be negligible" as synonymous to "a chance which persons generally would disregard as so highly improbable that it might be ignored with reasonable safety in undertaking a serious business transaction").

62. *Wachter*, 142 T.C. at 151.

63. *See* Mecox Partners LP v. United States, No. 11 Civ. 157 (ER), 2016 WL 398216, at *1, *3–4 (S.D.N.Y. Feb. 1, 2016).

Graev, concerned a façade easement landowners granted to the NAT.[64] The court explained that the laws of the state where the encumbered land is located determine the nature of the conveyed interest and whether the landowner conveys a valid real property interest.[65] In New York, an easement has no legal effect until the easement is recorded.[66] NAT did not record the deed of easement for nearly two years after the alleged transfer.[67] The court determined whether the easement met the perpetuity requirements by evaluating the easement at the date of the transfer.[68] At the time the landowner conveyed the easement to NAT, successors of NAT would have been unable to enforce the easement.[69] Additionally, a subsequent sale could have defeated the easement if the buyer recorded the subsequent sale before the easement was recorded.[70] The court determined that the potential occurrence of these events was not so remote as to be negligible at the time of the transfer.[71] The court then concluded the easement did not qualify for a deduction for failure to satisfy the perpetuity requirements.[72]

The perpetuity requirements greatly limit § 170(h)'s scope. Either failure to comply with state law or failure to strictly comply with the perpetuity requirements can easily disqualify easements for § 170(h) deductions.[73] Prospective conservation easement contributors must carefully draft agreements to avoid including conditions the Commissioner or tax courts may not find sufficiently remote.

B. Tax courts construe §§ 170(h)(1)(A) and 170(h)(2)(C) strictly by denying charitable deductions when landowners reserve the right to alter the easement agreement.

The real property interest requirement has also been a contentious element of § 170 due to both the plain text of § 170(h) and tax courts' application of the Revenue Code. Tax courts have denied deductions to landowners whose conservation easements

64. 113 T.C.M. (CCH) 1516, at *1 (T.C. 2017).
65. *Id.* at *2.
66. *Id.* at *3–4 (citing N.Y. ENVTL. CONSERV. LAW § 49-0305(4) (McKinney 2017)).
67. *See id.* at *2–3.
68. *Id.* at *8–9.
69. *Id.* at *9.
70. *Id.* at *11–12.
71. *Id.*
72. *Id.* at *12.
73. *See id.* at *8–9; *see also* Wachter v. Comm'r, 142 T.C. 140, 151 (T.C. 2014).

permit alterations in easement boundaries by subsequent mutual agreements.[74]

Belk v. Commissioner is among the notable precedent of narrow application of § 170(h)(1)(A). In *Belk*, the landowner executed a conservation easement covering about 184 acres.[75] The landowner reserved the right to substitute parts of encumbered land with other parts not previously subject to the easement.[76] The easement agreement barred the landowner from exercising the right unless the donee agreed that land proposed to replace a portion of the easement "is of the same or better ecological stability," that the substitution will not adversely impact the conservation purpose of the easement, and that the fair market value of the substitute property is at least equal to the fair market value of the property originally encumbered by the conservation easement.[77] Additionally, any alterations or substitutions could not decrease the overall size of the conservation easement.[78] Under the agreement, the donee conservation charity could not unreasonably withhold agreement to a substitution of property subject to the easement.[79]

The IRS denied the landowner's deduction and the resulting dispute reached the Fourth Circuit.[80] The Fourth Circuit closely read § 170(h)(2)(C), and the court ultimately concluded the plain language of § 170 required the instrument conveying the easement to impose restrictions on a defined piece of real estate.[81] The Fourth Circuit concluded that Congress's use of the article "the" before "real property" in § 170(h)(2)(C) indicates that a landowner must impose a restriction on a particular piece of real property to qualify for a charitable deduction.[82] Because the agreement between the landowner and the charity in *Belk* permitted the parties to substitute part of the easement with previously unencumbered land, no single piece of land was subject to the restriction.[83] The court interpreted the easement as an agreement between the parties to preserve 184 acres of land within a larger parcel, while not requiring either party to preserve any specific

74. *See* Belk v. Comm'r, 774 F.3d 221, 225 (4th Cir. 2014).

75. *Id.* at 223.

76. *Id.* at 223–24.

77. *Id.* at 223.

78. *Id.* at 224.

79. *Id.* at 223.

80. *Id.* at 224.

81. *Id.* at 225–26; I.R.C. § 170(h)(2)(C) (Westlaw through P.L. 115-223) (defining a qualified real property interest as "a restriction (granted in perpetuity) on the use which may be made of the real property.").

82. *Belk*, 774 F.3d at 225–26.

83. *Id.* at 226.

part of the land.[84] According to the Fourth Circuit, if Congress intended to grant deductions for restrictions attached to interchangeable parcels of land, § 170(h)(2)(C) would not have included the word "the" before "real property."[85]

Other circuits have cited *Belk* as a persuasive interpretation of § 170(h); however, courts have not universally applied *Belk* when faced with similar facts.[86] Recently the Fifth Circuit refused to apply *Belk*.[87] In *BC Ranch II*, the landowner donated a large perimeter within its property to a qualified conservation organization.[88] A few five-acre residential parcels within the larger perimeter of the conservation easement were not subject to easement restrictions.[89] The easement agreement allowed the donor to shift the boundaries of the five-acre residential parcels.[90] The court concluded the provision that allowed boundary alterations on the five-acre parcels did not disqualify the easement from a § 170(h) deduction because the alterations could not be made without consent from both parties, the alterations could not affect the overall acreage of the easement, and the boundary alterations could not affect the outer perimeter.[91]

III. ANALYSIS

The proposed changes to § 170(h) focus on minor details, but these alterations could substantially impact § 170(h)'s effectiveness as an incentive for landowners to donate. Since Congress began granting land donors charitable deductions for qualified conservation easements, land donations have substantially increased.[92] The continuous increase in encumbered

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84. *Id.*

85. *Id.* at 225–26.

86. *Compare* BC Ranch II, L.P. v. Comm'r, 867 F.3d 547, 552–54 (5th Cir. 2017) (concluding that the potential for slight alterations in the boundaries of land subject to an easement does not necessarily make the landowner ineligible for a deduction for the conservation easement), *vacating sub nom.* Bosque Canyon Ranch, L.P. v. Comm'r, 110 T.C.M. (CCH) 48 (T.C. 2015) (concluding that a provision permitting subsequent boundary alterations violated the perpetuity requirements of § 170(h)), *with* Balsam Mountain Invs., LLC v. Comm'r, 109 T.C.M. (CCH) 1214 (T.C. 2015) (denying deduction to a landowner because the easement agreement allowed the landowner to alter the boundaries of the land subject to the easement).

87. *See BC Ranch II*, 867 F.3d at 552–53. (distinguishing the facts of *BC Ranch II* rather than expressly refusing to follow *Belk* as persuasive authority although the facts were substantially similar to *Belk*).

88. *Id.* at 551–52.

89. *Id.* at 550.

90. *Id.*

91. *Id.* at 552–54.

92. *See* Bray, *supra* note 6, at 124. Qualified Conservation easements conserve over 25 million acres. *Conservation Easements and the National Conservation Easement*

acres since 1976 demonstrates § 170(h)'s effectiveness as an incentive for prospective land donors.[93] The proposed modifications to the criteria for a qualified conservation easement will likely encourage more landowners to donate conservation easements.

Conservation easements substantially contribute to land preservation efforts, but they can also be quite costly. Charitable deductions for qualified conservation easements prevent the IRS from collecting a significant source of revenue.[94] Revenue loss from charitable deductions is to be expected, and expenditures on IRS enforcement and litigation arising from taxpayer challenges to IRS decisions are also necessary. However, the latter can and should be kept to a minimum.

Under the current rule, the IRS incurs excessive litigation expenses associated with challenges to claimed deductions. IRS and tax courts' efforts to ensure landowners comply with the Revenue Code can undermine legitimate conservation attempts. Courts often impose unnecessary and costly burdens on prospective land donors attempting to claim deductions.[95] Many impediments to deductions are imprudent because easement agreements that most effectively serve land preservation efforts do not necessarily resemble the conventional easement prescribed by the current text of § 170(h).[96]

The remainder of this section discusses proposed modifications to statutory provisions that have been particularly troublesome to conservation efforts and efficient administration. A common theme among the proposed changes is a shift towards more accessible § 170(h) deductions and greater freedom to customize easement terms. The following changes would clarify the rules for government officials applying § 170(h), and the proposed statutory provisions would provide potential contributors a simpler guide to crafting qualified conservation easements. The proposed amendments would ultimately provoke far less litigation. Additionally, the amended provisions would

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Database, NATIONAL CONSERVATION EASEMENT DATABASE, https://www.conservationeasement.us/storymap/index.html (last visited Nov. 8, 2018).

93. *See* McLaughlin, A *Responsible Approach*, *supra* note 1, at 18–22.

94. *See* Gerald Korngold et al., *An Empirical Study of Modification and Termination of Conservation Easements: What the Data Suggest About Appropriate Legal Rules*, 24 N.Y.U. ENVTL. L.J. 1, 14–16 (2016) (discussing the tax expenditure resulting from charitable deductions for qualified conservation easements).

95. *See* Barton H. Thompson, Jr., *The Trouble with Time: Influencing the Conservation Choices of Future Generations*, 44 NAT. RES. J. 601, 609–11 (2004).

96. *See generally* Owley, *supra* note 52, at 163–70 (discussing ecological drawbacks of conservation easements with perpetual terms and the ecological benefits of easements subject to subsequent alterations).

maximize the environmental benefits of § 170(h) deductions by encouraging more landowners to donate conservation easements.

A. Congress should remove the perpetuity requirements in § 170(h) to ensure § 170(h) best serves its purpose.[97]

As environmental researchers make discoveries about the climate, the precise terms of an easement may become less relevant or the restrictions may less effectively advance the easement's conservation purpose. New environmental problems arise over time due to shifts in the climate. The advanced pace of scientific discoveries and ecological developments continue to change our understanding of the environment. New developments may render certain preservation efforts obsolete or even harmful. Consequently, some commentators believe conservation easements would most effectively advance their original purposes if easements had expiration dates or were subject to periodic alterations.[98]

1. Perpetual restrictions are not the most effective means to preserve land, and requiring perpetual restrictions can obstruct conservation efforts.

Perpetual conservation easements are not necessarily beneficial because the environment and our understanding of the environment continue to change.[99] Section 170(h)'s perpetuity requirements undermine Congress's intent to permit charitable deductions for conservation easements. The perpetuity requirements make it more difficult for landowners to successfully claim a § 170(h) deduction. It not only encourages landowners to donate less impactful easements,[100] but it can also lead to extensive litigation.[101] Landowners are less likely to donate land if they believe it will be difficult to obtain a deduction. In many cases, the perpetuity requirements allows courts to disqualify non-

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97. *See generally* Julia D. Mahoney, *Perpetual Restrictions on Land and the Problem of the Future*, 88 VA. L. REV. 739, 786–87 (2002) (stating that many commentators have questioned the effectiveness of perpetual restrictions as tools to preserve land). *See* 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, 722–23 (2013) [hereinafter McLaughlin, *Perpetual Conservation Easements in the 21st Century*]; Owley, *supra* note 52, at 122–24.

98. *See* Mahoney, *supra* note 97, at 786–87; Owley, *supra* note 52, at 122–24. *But cf.* Korngold et al., *supra* note 94, at 12–16.

99. *See* Mahoney, *supra* note 97, at 753–63.

100. *See* McLaughlin, *A Responsible Approach*, *supra* note 1, at 60.

101. McLaughlin, *Perpetual Conservation Easements in the 21st Century*, *supra* note 97, at 710–13.

perpetual easements when more malleable easement terms would more effectively preserve land.[102]

Tax courts applying the perpetuity requirements have produced several sub-rules that disqualify entire classes of easements from § 170(h) deductions.[103] Congress enacted § 170(h) to encourage private land preservation,[104] but Congress also sought to provide adequate safeguards against abuse.[105] By gradually narrowing the availability of § 170(h) deductions, tax courts and the IRS Commissioner have undermined the purpose of § 170(h) and produced questionable results.

Under the current rule, conservation easements located in any state that imposes time limits on easements cannot qualify for a § 170(h) deduction.[106] This rule makes § 170(h) inoperative in several states, and some of these states, like Montana, are substantial contributors to land conservation efforts.[107] The current rule clearly fails to incentivize land donations in certain states because it is impossible for landowners in those states to create qualified conservation easements under § 170(h).[108]

The perpetuity requirements impose unnecessary administrative burdens on the IRS and the court system. The IRS incurs costs from examining conservation easements to ensure agreements impose perpetual restrictions.[109] The Commissioner and tax courts incur substantial litigation costs when taxpayers challenge § 170(h) deduction denials.[110] However, costs are not limited to litigation over disputed IRS decisions. Landowners eager to claim §170(h) deductions may impose perpetual restrictions on land use when they would otherwise avoid perpetual easements. In situations where parties do not fulfill the perpetual promise, because it is impossible or because the

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102. *See* Nancy A. McLaughlin, *Tax-Deductible Conservation Easements and the Essential Perpetuity Requirements*, 37 VA. TAX REV. 1, 4–5, 8 (2017).

103. *See supra* part II.

104. *See* McLaughlin, *A Responsible Approach*, *supra* note 1, at 14.

105. *See* H.R. REP. NO. 95-263, at 295 (1977) (Conf. Rep.).

106. *See* Wachter v. Comm'r, 142 T.C. 140, 146, 151 (T.C. 2014) (denying a landowner a § 170(h) deduction for failure to satisfy the perpetuity requirement because a North Dakota state law did not allow easements to exceed ninety-nine years).

107. Owley, *supra* note 52, at 164 (noting states that have enacted statutes limiting the duration of easements include Kansas, Alabama, Montana, West Virginia, California, Florida, and Hawaii).

108. *See, e.g.*, *Wachter*, 142 T.C. at 151.

109. McLaughlin, *Perpetual Conservation Easements in the 21st Century*, *supra* note 97, at 695 ("[E]nforcing compliance with § 170(h) has been a very costly, time consuming, and difficult task for the Internal Revenue Service . . . .").

110. *See id.* at 710–13 (discussing the extent of litigation arising from § 170(h) deductions).

landowner has no intention to honor it, the court system will likely bear much of the burden of dissolving these agreements.[111]

Congress has a legitimate interest in placing reasonable restrictions on § 170(h) deductions. Congress should deny landowners' § 170(h) deductions when landowners create easements that are not beneficial to an environmental cause. The Revenue Code should also provide prospective donors with a guide to drafting conservation easements that most effectively preserve real property.

2. Section 170(h) should prescribe a minimum term for qualified conservation easements, but Congress should still permit landowners and conservation organizations to agree to impose perpetual restrictions.

Congress should remove the perpetuity requirements of § 170(h) and grant deductions to donors as long as the easement imposes restrictions for at least forty years or the maximum term under applicable state law, whichever is shorter. A forty-year restriction is long enough to prevent the donor from benefitting financially from land development for a major portion of his or her life, and the duration is short enough to allow future owners the ability to construct new agreements or adjust the original easement to more efficiently serve the current ecological needs.

Granting landowner deductions for easements with a shorter term, between forty years and the state prescribed maximum, ensures deductions apply to easements in all states. A prescribed easement term is also simpler than both the perpetuity requirements and the absence of any kind of required time length. Without a fixed requirement, tax courts, which are not environmental experts, would be tasked with determining the most appropriate duration for each proposed conservation easement. Courts can more easily determine whether an easement imposes restrictions for a particular term of years. Under the proposed rule, courts would no longer have to speculate as to whether an easement can serve its purpose in perpetuity.

Congress should expressly grant land donors § 170(h) deductions for conservation easements that include provisions authorizing the parties to periodically adjust the terms throughout the easement's lifetime, but only if the agreement allows adjustments that would be prudent in light of future scientific

111. *Cf.* Bray, *supra* note 6, at 140–41 (explaining that because permanent conservation easements are potentially extinguishable, future generations will bear the burden of extinguishing them in court).

discoveries. To qualify for a § 170(h) deduction under the proposed revision to § 170(h), the easement agreement must contain a provision stating that as a precondition to alterations, a named independent third party environmental conservation organization must acknowledge that the proposed alterations will not undermine the original easement's purpose and that the proposed alterations are prudent in light of a scientific discovery.[112] The proposed addition would also include an express provision requiring mutual consent between the donor and the donee for any changes.

The proposed changes to § 170(h) would allow landowners to more freely craft conservation easements, while also providing adequate safeguards against abuse. Although § 170(h) would grant deductions to easements that permit subsequent alterations, the requirement that donors and donees obtain approval for modifications from a third party conservation agency ensures unprejudiced experts are involved in the subsequent changes. The mutual consent requirement creates another reasonable roadblock to subsequent changes because one party may not unilaterally make a change.

3. Without the perpetuity requirements, § 170(h) would better incentivize landowners to contribute conservation easements, would be more compatible with state law on easement conveyances, and would decrease litigation costs from challenges to IRS decisions.

Section 170(h) would better serve its purposes of encouraging land donations and encouraging impactful conservation easements without perpetuity requirements. Removing the perpetuity requirements would also bring an end to the paradoxical rule denying deductions to conservation easements conditioned on the landowner receiving a § 170(h) deduction.[113] This rule undermines the purpose of incentivizing land donations. It may be difficult to sympathize with landowners who care little about the environment and who merely seek to benefit from a tax deduction, but Congress intended to encourage this kind of behavior.[114] Section 170(h) serves as motivation for landowners who would otherwise refrain from restricting their land use. The

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112. Under the proposed amendment to § 170(h), the IRS will decide whether the conservation agency contained in the easement agreement is acceptable and whether the agency is subject to some sort of bias.

113. *See supra* Part II.A.1.

114. *See* McLaughlin, *A Responsible Approach*, *supra* note 1, at 18.

environmental benefits arise from these donations regardless of the donor's motives. The proposed rule would also allow landowners in all fifty states to benefit from § 170(h) deductions.

Removal of the perpetuity requirements would eliminate the costs from taxpayer challenges and easement agreement dissolutions. The IRS would no longer have to deny landowners § 170(h) deductions for failing to impose perpetual restrictions, and litigation arising from taxpayer challenges to those decisions would no longer occur. Removing the perpetuity requirements would eliminate the need for courts and the Commissioner to investigate the precise conditions at the time the parties executed the easement to determine whether the parties' promises constitute perpetual restrictions at that time. Additionally, landowners would be less likely to impose perpetual restrictions they cannot or will not honor.

Although perpetual conservation easements are not necessarily the most effective way to preserve ecosystems, § 170(h) should still grant deductions for perpetual easements. Conservation easements imposing perpetual restrictions may be warranted under special circumstances. If, for example, restricted land is located on valuable real estate in an urban area and ownership is likely to change hands frequently, a perpetual easement would perhaps better serve the easement's purpose. The costs associated with cancelling perpetual conservation easements are much greater than the costs of cancelling similar conservation easements that are not perpetual.[115] Parties to a conservation easement cannot ensure the easement lasts forever, but they can impose perpetual restrictions to dramatically increase the probability that the easement lasts much longer than a typical easement.[116] The costs associated with terminating perpetual easements would discourage buyers from purchasing land with the intent to ignore the easement.

B. Congress should grant deductions to conservation easements that allow subsequent boundary alterations because § 170(h) currently disqualifies many easements which would most effectively achieve their conservation goals by having malleable boundaries.

Tax courts do not have a unified stance on whether easement agreements permitting boundary alterations qualify for charitable

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115. Bray, *supra* note 6, at 140–45 (discussing the different ways a perpetual conservation easement may be terminated and the related costs).

116. *See id.* at 141–44.

deductions.[117] Section 170(h) does not directly address such agreements.[118] Tax courts have applied the perpetuity requirements when deciding whether a conservation easement permitting substitutions qualifies for a § 170(h) deduction.[119] Courts emphasizing the Revenue Code's text have found agreements permitting subsequent boundary alterations to be inconsistent with the statute's requirement for each donation to constitute a defined parcel of real property.[120] The Fifth Circuit emphasized the impact subsequent boundary alterations have on the overall purpose of the agreement.[121]

The Fifth Circuit distinguished the facts of *BC Ranch II* from *Belk*, but did not reject *Belk*'s application of § 170(h) to substitution provisions.[122] In *BC Ranch II*, the court concluded that the facts were sufficiently distinct from *Belk* to warrant different results because the disputed easement did not allow alterations to the exterior boundaries and the substitution provision was limited to subsequent boundary shifts of five-acre residential tracts.[123] Despite these minor discrepancies, the facts of the two cases are qualitatively similar. Both agreements allowed the parties to subsequently discharge land of easement restrictions and impose the same restrictions on land not previously subject to the easement.[124] In *BC Ranch II*, the ability to substitute was the key characteristic that gave rise to the IRS challenge.[125] The facts of the two cases are sufficiently similar to allow future Commissioners and courts to ultimately lead to inconsistent § 170(h) application.

Courts have developed two conflicting interpretations of § 170(h) as a result of the lack of guidance within § 170(h) on conservation easements allowing subsequent land substitutions.[126] The resulting uncertainty is troublesome because landowners may be reluctant to impose conservation easements on their land if they are unable to determine whether the IRS will grant the deduction. The absence of a subdivision that clearly

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117. *See supra* Part II.B.

118. *See* I.R.C. § 170(h) (Westlaw through P.L. 115-223); *supra* Part II.

119. *See* Belk v. Comm'r, 774 F.3d 221, 226 (4th Cir. 2014).

120. *Id.* at 226–27.

121. *Compare* BC Ranch II, L.P. v. Comm'r, 867 F.3d 547, 553–54 (5th Cir. 2017) (distinguishing the facts from *Belk* and emphasizing that alterations under the agreement would not undermine the easement's conservation purpose), *with Belk*, 774 F.3d at 225–26 (emphasizing the plain language of I.R.C. § 170(h)(1) (Westlaw)).

122. *See BC Ranch II*, 867 F.3d at 553–54.

123. *Id.* at 553.

124. *Compare BC Ranch II*, 867 F.3d at 549–50, *with Belk*, 774 F.3d at 223–24.

125. *BC Ranch II*, 867 F.3d at 522.

126. *See supra* note 86 and accompanying text.

addresses substitution provisions prevents § 170(h) from reaching its full potential as an incentive for landowners to voluntarily preserve their land.

By failing to include a subsection addressing substitutions, Congress has neglected a conservation easement classification that is essential to legitimate preservation efforts. Easement agreement terms most favorable to a given conservation goal vary with the characteristics of a particular tract of real property.[127] Conservation initiatives—such as efforts to preserve an endangered species population—are usually best served when boundaries of easement property are malleable.[128]

1. Congress should add a subsection to § 170(h) expressly permitting deductions where landowners and conservation charities agree to allow subsequent alterations to the boundaries of encumbered property upon mutual consent.

Congress should resolve the ambiguity surrounding conservation easement land substitutions by adding a subdivision expressly authorizing substitutions if the easement agreement meets certain conditions. A statutory provision directly addressing land substitution provisions is necessary because the absence of an appropriate statutory provision has produced inconsistent results and has given rise to a circuit split.[129] If Congress removes the perpetuity requirements, a new subsection addressing substitutions will become even more essential because courts have applied the perpetuity requirements to resolve disputes over substitution provisions.[130]

First, Congress should clearly state that easement agreement provisions permitting subsequent substitutions do not disqualify landowners from successfully claiming deductions where the provision authorizing the substitution (1) requires consent of both parties to any boundary alterations, (2) forbids boundary alterations that reduce the total acreage of easement land, (3) forbids alterations that reduce the value of the easement, and (4)

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127. *See generally* Korngold et al., *supra* note 94.

128. *See id.* at 17–21; Bray, *supra* note 6, at 137–40. For example, a landowner may want to restrict activities on a portion of land in an attempt to qualify for a deduction and preserve a habitat for an endangered migratory bird. If the migratory birds are known to occupy different portions of the property from year to year, the conservation easement would best protect the birds if the boundaries of encumbered property followed the birds. Under the majority of tax court decisions, an easement allowing boundary alterations to ensure migratory bird protection would not qualify for a deduction.

129. *See supra* Part II.B.

130. *See, e.g.*, *Belk*, 774 F.3d at 223–24.

forbids substitutions that undermine the purpose of the conservation easement.[131] The deduction should only be allowed if the substitution provision contains all four elements.[132] However, a substitution provision meeting these requirements may ultimately fail if the Commissioner concludes that, given the circumstances, a substitution would necessarily frustrate the purpose of the easement.

2. The proposed statute would prevent needless litigation and encourage landowners to impose easements with more appropriately tailored terms.

While the proposed statute would allow land substitutions, it should not require that land substitutions be necessary for the particular conservation goal of the easement. A necessity requirement would provoke needless challenges and litigation. The Commissioner would also prevail in most challenges to claimed deductions if substitution provisions are necessary for the conservation goals. Under a rule requiring necessity, a conservation easement would not qualify for a § 170(h) deduction, even though the subsequent alteration would improve the easement. The Commissioner could easily succeed in challenges to § 170(h) deductions by simply arguing that a conservation easement could possibly serve its purpose without the subsequent substitution, and deductions would be denied where a substitution would make the easement more effective. Consequently, a necessity requirement would discourage many landowners from drafting the most beneficial conservation easements. Congress should not impose a necessity requirement in the proposed addition because the absence of one would provide landowners a

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131. The proposed rule resembles the reasoning in *BC Ranch II*; however, it differs slightly because the proposed statutory provision would grant deductions to easements that include land substitution provisions that allow alterations to exterior boundaries of the easement. The Fifth Circuit did not hold that the inclusion of substitution provisions allowing alterations to exterior boundaries would disqualify an easement for a deduction, but the fact that the substitution provision did not allow changes to the exterior boundaries influenced the court's decision to grant the deduction. *See BC Ranch II*, 867 F.3d at 552–53.

132. The evidentiary standard and burdens of typical challenges to IRS decisions would remain intact with this addition to the Revenue Code. Tax courts would apply a preponderance of the evidence standard when deciding factual issues on the substitution provision. The party contesting the Commissioner's decision to deny the party a deduction would bear the burden of proving the Commissioner's determination was erroneous. The burden may shift to the Commissioner only if the taxpayer presents evidence permitting a deduction, presents evidence of the Commissioner's error, complies with substantiation requirements of the Revenue Code, retains all records the Revenue Code requires taxpayers to keep, and cooperates when the Commissioner requests information. *See* Fakiris v. Comm'r, 113 T.C.M. (CCH) 1555 (T.C. 2017).

wider array of acceptable tools to create effective conservation easements that qualify for § 170(h) deductions.

Additionally, the proposed rule is unlikely to encourage abuse because the elements of the proposed provision provide adequate safeguards. Taxpayers attempting to abuse § 170(h) are likely seeking the financial benefit of a tax deduction, while avoiding the costs associated with placing restrictions on property. The preconditions to a valid substitution provision under the proposed addition prevent landowners from improperly employing substitutions to benefit from a windfall. A necessity requirement does not prevent more abuse than the proposed statutory elements. However, by removing the necessity requirement, landowners can draft easement agreements that best suit their land and conservation goals.

The proposed addition to the Revenue Code does not undermine the Commissioner's power to disqualify a deduction based on a substitution provision. The Commissioner may still deny landowners § 170(h) deductions despite satisfaction of the preconditions if the Commissioner concludes that a substitution would necessarily frustrate the easement's purpose. The proposed statute expressly encourages the Commissioner to consider the easement as it relates to the conservation purpose. This will deter the Commissioner from applying one test to all situations. For example, the proposed subsection would discourage the Commissioner from requiring the benefits of an easement in a city to match the benefits of an easement in a rural area.

The proposed subsection would also resolve the emerging circuit split on application of the perpetuity requirements to substitution provisions.[133] The proposed subsection provides a simple list of elements that landowners must follow to prevent disqualification from a § 170(h) deduction. These elements provide prospective donors with a clear guide for drafting substitution provisions. Additionally, the proposed substitution provision elements will be easier for tax courts and the Commissioner to apply than the perpetuity requirements. Disputes are likely to arise less frequently, and therefore, the IRS and taxpayers will expend less resources confronting challenges to the Commissioner's decisions.

Finally, the proposed subsection advances § 170(h)'s general purpose of incentivizing land donations by granting § 170(h) deductions to more types of environmental efforts.[134] Increased accessibility of § 170(h) deductions would likely encourage more

133. *See supra* Part II.B.

134. *See* McLaughlin, *A Responsible Approach*, *supra* note 1, at 18.

landowners to donate. The amended rule would permit landowners to draft conservation easement agreements that best serve easement conservation purposes.

IV. CONCLUSION

The proposed changes are intended to make charitable deductions for conservation easements more accessible. Both the perpetuity requirements and the inability to alter boundaries place unnecessary burdens on prospective donors, the administrative bodies that evaluate easements, and tax courts. The proposals also advance the purposes of § 170(h) deductions. With more freedom to contract and obtain tax deductions, landowners can draft agreements that best serve the ecosystems on their property. Without the perpetuity requirements and strict restrictions on boundary alterations, landowners can more easily qualify for § 170(h) deductions, and therefore, will be more likely to impose conservation easements on their land.

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