CONSERVATION EASEMENTS AND THE PENSION PROTECTION ACT OF 2006

> **It was the best of times, it was the worst of times,**
> **it was the age of wisdom, it was the age of foolishness,..**
> **it was the season of Light, it was the season of Darkness,**
> **it was the spring of hope, it was the winter of despair,**
> **we had everything before us, we had nothing before us,**
> **we were all going direct to Heaven, we were all going direct**
> **the other way--**

Charles Dickens, A Tale of Two Cities

I. INTRODUCTION

For conservation easement donors and the land trust community, the last ten years have been in Mr. Dickens' phrase, "the best of times and the worst of times."

At an increasing pace, landowners have contributed conservation easements to protect open space and natural habitat, with enhanced income and estate tax incentives enacted in 1997 and 2001. But in 2004, the IRS issued a "yellow light" cautionary notice for bargain sales by donors to land trusts, explaining that land trusts, taxpayers, appraisers, and promoters could be liable for taxes, penalties, and excise taxes. Also, beginning in 2004, the Senate Finance Committee held hearings on general charitable abuses, particularly those of The Nature Conservancy on the Eastern seaboard, as reported by The Washington Post. In January of 2005, the US Congress' Joint Committee on Taxation issued a report seeking to cut (presumably with a meat axe) all conservation donations by two thirds. Yet, wrestling victory from the jaws of defeat, on August 17, 2006, the land trust community achieved enhanced tax incentives in The Pension Protection Act of 2006 expanding deduction limitations for tax years 2006 and 2007, increasing deduction limitations from 10% to 100% for closely held agricultural C corporations and from 30% to 50% for individual, non-agricultural taxpayers.

These materials provide a general background of IRC Section 170(h), the charitable income tax section governing conservation easements and the amendments to Section 170 under The Pension Protection Act of 2006. The materials also discuss state law considerations governing conservation easement donations, and, more generally, valuation issues governing appraisals, as well as practical issues in negotiating conservation easements with land trusts. Finally, the materials discuss current developments and tax court cases, including IRS Commissioner of Exempt Organizations Steven T. Miller's remarks on conservation easement appraisal abuses and questionable conservation donations.

II. FEDERAL TAX TREATMENT OF LAND CONSERVATION TRANSACTIONS

A. Preliminary Considerations

Any practitioner advising clients on the tax treatment of a particular land conservation transaction must consider five factors: (1) The nature of the grantor, as individual, corporation or other business entity, (2) the type of conservation value to be protected, (3) the organization (i.e., land trust or governmental agency) to which the grantor might grant the easement and its unique requirements, (4) the timing of the transaction and the scope of the property to be impacted by the grant, and (5) the tax and charitable reasons motivating the transfer. As explained below, these factors are critical to realizing tax benefits under federal and state laws.

B. Income Tax Treatment of Charitable Contributions

Conservation easements occupy a corner of the broad field of charitable contribution deductions under § 170 of the Internal Revenue Code.[1] While conservation easements remain popular, many landowners—as well as land trusts and other qualified organizations—frequently seek advice regarding the tax treatment of these broader transactions. Advising these clients requires an understanding of the fundamental requirements for deductibility under § 170.

To qualify for an income tax deduction under § 170, a land conservation transaction must meet the requirements for a charitable contribution. Section 170(c) defines "charitable contribution" as "a contribution or gift to or for the use of" particular donees.[2] Supplementing this definition, the IRS explained that "[a] contribution for purposes of section 170 . . . is a voluntary transfer of money or property that is made with no expectation of procuring a financial benefit commensurate with the amount of the transfer."[3] The following materials explore these elements further.

1. Transfer

"[I]n every contribution or gift, there are two essential elements; first, that the maker or donor part with something, and second, that the donee receive something."[4] Failure to comply with first element has resulted in denying of a deduction in certain circumstances.[5] Compliance with the second element generally depends on state law, which typically focuses on whether actual dominion or control has passed to the donee.[6]

In addition to these elements, the Regulations include provisions relating to conditional gifts. These provisions distinguish between gifts subject to a condition precedent and those subject to a condition subsequent. In the words of Regulation 1.170A-1(e):

> If as of the date of a gift a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable *unless the possibility*

> *that the charitable transfer will not become effective is so remote as to be negligible*. If an interest in property passes to, or is vested in, charity on the date of the gift and the interest would be defeated by the subsequent performance of some act or the happening of some event, *the possibility of occurrence of which appears on the date of the gift to be so remote as to be negligible*, the deduction is allowable.[7]

Regardless of the condition's nature, the donee must accept both the gift and condition before the donor is allowed a deduction and should acknowledge acceptance to guarantee the finality of the donor's contribution.[8]

2. Property

Section 170 does not define "property." Indeed, the Code itself generally relies on state law definitions. As the Supreme Court noted over fifty years ago, "State law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed."[9]

That said, courts have established certain requirements with which donors seeking a deduction under § 170 must comply. An owner must relinquish dominion and control over the property to characterize the gift as a "payment" and thus receive a charitable deduction under § 170.[10] Where an owner transfers the owner's entire interest in real property to a charitable organization, the gift is complete when the donor delivers an executed deed to the organization or its agent.[11] This applies to the transfer of an owner's entire undivided interest as well.[12]

Where an owner grants an option to purchase property to a charitable organization, the owner is not allowed a deduction for the year in which the owner grants the option.[13] Instead, the deduction is allowed for the year in which the organization exercises the option.[14] The amount of the deduction equals the excess of the fair market value of the property on the date the organization exercises the option over the exercise price.[15]

The materials below discuss both contributions of partial interests in property and the use of options in greater detail.

3. Permissible Donees

In relevant part, § 170(c) allows an individual to deduct charitable contributions "to or for the use of"[16] the following organizations:

(1) A State, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.[17]

(2) A corporation, trust, or community chest, fund, or foundation—

(A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States;

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals;

(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office. A contribution or gift by a corporation to a trust, chest, fund, or foundation shall be deductible by reason of this paragraph only if it is to be used within the United States or any of its possessions exclusively for purposes specified in subparagraph (B). Rules similar to the rules of section 501(j) shall apply for purposes of this paragraph.

Section 170(c) also allows a deduction for charitable contributions to or for the use of veterans' organizations,[18] fraternal organizations[19] and cemetery companies.[20]

4. Donative Intent and Receipt of Consideration

As above, "[a] contribution for purposes of section 170 . . . is a voluntary transfer of money or property that is made with no expectation of procuring a financial benefit commensurate with the amount of the transfer."[21] Implicit in this definition are the twin issues of donative intent and receipt of consideration. As explained here and discussed further below, these issues frequently arise in the context of land conservation transactions.

a. Donative Intent

In the absence of statutory guidance, courts have developed two tests to determine whether donors possess the requisite intent to qualify their contributions for deduction. The first asks whether the transfer is motivated by "detached and disinterested generosity."[22] Although this test arose in the context of determining whether the receipt of an automobile should qualify as a gift excludable from gross income under § 102, courts have applied it in the context of charitable contributions under § 170.[23]

The second test asks whether the donor received or expected to receive a *quid pro quo* in exchange for the transfer.[24] This inquiry looks to the "external features" of a transaction, thereby "obviating the need . . . to conduct imprecise inquiries into the motivations of individual taxpayers."[25]

From a distance, these tests appear distinguishable along subjective-objective lines. As one commentator noted,

> The *Duberstein* test concentrates on the motivation of a donor in making a transfer. In contrast, the *quid pro quo* test focuses on the nature and extent of any benefits received by the taxpayer as part of the transaction. The *Duberstein* test is considered the more subjective test, whereas the *quid pro quo* test is more objective.[26]

Notwithstanding, courts have failed to apply the tests consistently.[27]

b. Partial Consideration

"The *sine qua non* of a charitable contribution is a transfer of money or property without adequate consideration."[28] Assuming a donor possesses the requisite intent and receives no benefit or consideration in connection with their contribution, the donor may deduct the full amount of the contribution subject to the remaining provisions of § 170. However, if a donor receives any benefit or consideration in connection with the donor's contribution, the deductibility of the contribution depends on the nature and value of the benefit received:

- If the donor receives a benefit incidental to or indistinguishable from the benefit to the general community, the contribution is fully deductible subject to the remaining provisions of § 170.[29]

- If the donor receives a greater-than-incidental benefit, Regulation 1.170A-1(h) governs the extent to which the contribution is deductible. The Regulation prohibits a deduction for any part of a donor's contribution to or for the use of a qualified organization that is in consideration for goods or services unless the donor (i) intends to make a payment in an amount that exceeds the fair market value of the goods or services and (ii) in fact makes a payment in an amount that exceeds the fair market value of the goods or services.[30] The Regulation limits the deduction for these contributions to the excess of "[t]he amount of any cash paid and the fair market value of any property (other than cash) transferred by the taxpayer to an organization described in section 170(c) over [t]he fair market value of the goods or services the organization provides in return."[31]

- If the donor receives a greater-than-incidental benefit having a value that equals or exceeds the amount of the contribution, a deduction is disallowed entirely.

c. Development-Connected Transfers

Donative intent and partial consideration often arise in the context of development-connected transfers. Using the example of a developer who donates a parcel of land to a local conservancy and shortly thereafter receives approval for a zoning variance on the property from the city planning council, Professor William Hutton explains the scenario:

> If the 'gift' is made with an expectation of personal benefit – generally, the approval of a governmental agency – it will very likely be disallowed in its entirety, although a few cases would allow the developer the opportunity to demonstrate that the value of the property conveyed exceeds the return benefit, thus allowing a deduction for a portion of the property's value. These cases involve questions of fact, and if the developer can demonstrate that the gift was made sufficiently in advance of any contemplated governmental action, or conversely, well after the conclusion of the administrative proceedings which resulted in development approvals, and was entirely independent of those proceedings, the deduction should (at least in theory) be allowed.[32]

As Professor Hutton notes, the donative intent and partial consideration rules "may be exceedingly difficult to meet. In most real life scenarios, a developer is unwilling to play his 'donation' card until assured of the necessary approvals, and the city or land trust will not want to take its chances with an after-the-fact, no-strings-attached conveyance."[33]

d. Bargain Sales

The partial consideration rules also arise in the context of bargain sales to qualified organizations. The Regulations treat bargain sales in part as sales or exchanges and in part as charitable contributions.[34] The amount deductible as a charitable contribution equals the difference between the fair market value of the property and the sale price. Note that contribution still must meet the requirements of § 170(c)—including the donative intent and partial consideration rules—for deductibility.[35]

Sections 1001 and 1011 govern the sale portion of a bargain sale. Under § 1001, the gain from the sale portion equals the difference between the amount realized and the adjusted basis.[36] Under § 1011(b), if the bargain sale qualifies for deduction under § 170, the adjusted basis for determining the gain from the sale portion equals "that portion of the adjusted basis which bears the same ratio to the adjusted basis as the amount realized bears to the fair market value of the property."[37] Under the applicable Regulations, the amount of gain treated as ordinary income or long-term capital gain equals "that amount which bears the same ratio to the ordinary income (or long-term capital gain) which would have been recognized if the entire property had been sold by the donor at its fair market value at the time of the sale or exchange as the amount realized on the sale or exchange bears to the fair market value of the entire property at such time."[38]

To illustrate, assume Jane Doe purchased undeveloped ranchland for $50,000 as an investment in 1970. In 2006, she sold the property—with a fair market value of $100,000—to the State of Montana for $60,000. Under the bargain sale rules, the gift portion of the sale equals $40,000 ($100,000 fair market value – $60,000 sale price). As discussed below, contributions of appreciated capital gain property to States are subject to a

50% limitation. Assuming Jane's contribution base[39] for 2006 was $100,000, she may deduct the full $40,000 because the amount does not exceed the applicable $50,000 limitation ($100,000 contribution base multiplied by 50% limitation). Because the bargain sale qualifies for deduction under § 170, § 1011(b) applies to calculate the adjusted basis for determining gain on the sale portion. Under § 1011(b), Jane's basis in the sale portion equals her adjusted basis ($50,000) multiplied by the ratio of the amount realized ($60,000) over the fair market value ($100,000). In other words, Jane's basis equals 60% of $50,000, or $30,000. Subtracting this amount from the $60,000 amount realized, Jane's realizes a $30,000 capital gain.

Where the donor transfers property subject to a mortgage or other indebtedness, the Regulations treat the amount of the indebtedness as part of the amount realized.[40] In the example above, assume Jane's property is subject to a $20,000 mortgage. Under the bargain sale rules, the gift portion of the sale equals $20,000 ($100,000 fair market value – $80,000 amount realized [60,000 sale price + $20,000 mortgage]). Because the bargain sale qualifies for deduction under § 170, § 1011(b) applies to calculate the adjusted basis for determining gain on the sale portion. Under § 1011(b), Jane's basis in the sale portion equals her adjusted basis ($50,000) multiplied by the ratio of the amount realized ($60,000 sale price + $20,000 mortgage) over the fair market value ($100,000). In other words, Jane's basis equals 80% of $50,000, or $40,000. Subtracting this amount from the $80,000 amount realized, Jane's realizes a $40,000 capital gain. Note that if Jane had *contributed* (rather than sold) the property subject to the $20,000 mortgage, the bargain sale rules would still apply. Thus, her amount realized would have been $20,000, her contribution $80,000,[41] her basis in the sale portion $10,000 and her capital gain $10,000.

Bargain sales involving § 170(e) property raise additional considerations. Section 170(e) requires donors to reduce the amount of contributions of certain types of appreciated property by the amount that would have ordinary income or long-term capital gain if the property had been sold rather than contributed.[42] In applying these rules to the contributed portion of the property in a bargain sale, the donor must allocate to the contributed portion "that portion of the adjusted basis of the entire property that bears the same ratio to the total adjusted basis as the fair market value of the contributed portion of the property bears to the fair market value of the entire property."[43] In addition, the donor must allocate to the contributed portion "the amount of gain that is not recognized on the bargain sale but that would have been recognized if such contributed portion had been sold by the donor at its fair market value at the time of its contribution to the charitable organization."[44]

An example provided in the Regulations illustrates the rule:

> In 1970, F, an individual calendar-year taxpayer, sells for $4,000 to a private foundation not described in section 170(b)(1)(E) property to which section 1245 applies which has a fair market value of $10,000 and an adjusted basis of $4,000. F's contribution base for 1970 is $20,000, and F makes no other charitable contributions in 1970. At the time of the bargain sale, F has used the property in his business for more than 6 months. Thus F makes a charitable contribution of $6,000 ($10,000-$4,000 amount realized), which is

> 60% of the value of the property. The amount realized on the bargain sale is 40% ($4,000/$10,000) of the value of the property. If the property had been sold by F at its fair market value at the time of its contribution, it is assumed that under section 1245 $4,000 of the gain of $6,000 ($10,000-$4,000 adjusted basis) would have been treated as ordinary income and $2,000 would have been long-term capital gain. In applying section 1011(b) to the bargain sale, adjusted basis in the amount of $1,600 ($4,000 adjusted basis x 40%) is allocated under § 1.1011-2(b) to the noncontributed portion of the property, and F's recognized gain of $2,400 ($4,000 amount realized less $1,600 adjusted basis) consists of $1,600 ($4,000 x 40%) of ordinary income and $800 ($2,000 x 40%) of long-term capital gain. Under paragraphs (a) and (c)(2)(i) of this section, F's contribution of $6,000 is reduced by $3,000 (the sum of $2,400 ($4,000 x 60%) of ordinary income and $600 ([$2,000 x 60%] x 50%) of long-term capital gain) (i.e., the amount of gain that would have been recognized on the contributed portion had the property been sold). The reduced contribution of $3,000 consists of $2,400 ($4,000 x 60%) of adjusted basis and $600 ([$2,000 x 60%] x 50%) of long-term capital gain not used as a reduction under paragraph (a)(2) of this section. Under sections 1012 and 1015(a) the basis of the property to the private foundation is $6,400 ($4,000+$2,400).[45]

e. State Tax Credits

The donative intent and partial consideration rules may arise where the donor receives a state tax credit related to his charitable contribution. Though the IRS has yet to provide guidance on the issue, a recent General Counsel Memorandum identified it as a "key question" in considering Colorado's conservation easement tax credit.[46] As the Memorandum explained:

> [W]e will need to consider the fact that the tax benefit of a federal or state charitable contribution *deduction* is not viewed as a return benefit that reduces or eliminates a deduction under § 170, or vitiates charitable intent. The question is whether a program such as Colorado's is distinguishable. If there is a return benefit, we need to determine whether a taxpayer, at least in some circumstances, can satisfy the requirements of *United States v. American Bar Endowment* . . . to show that the taxpayer knowingly contributed an easement in excess of the value of the state credit received in return. For example, do the external features of a transaction demonstrate donative intent to the extent a taxpayer arranges to sell the credit to a third party for a discounted amount before transferring the easement to a charity? [47]

The Memorandum also considered whether the benefit of the state conservation easement tax credit is an amount realized from the easement's transfer under § 1001.[48]

5. Contributions of Partial Interests

Section 170(f)(3) generally disallows deductions for contributions of partial interests in property.[49] However, § 170(f)(3)(B) excepts certain partial interest contributions, provided they meet the requirements discussed below.[50] The exceptions include contributions of a remainder interest in a personal residence or farm, contributions of an undivided portion of the taxpayer's entire interest in property and qualified conservation contributions. The following materials discuss the first exceptions briefly before addressing the last in greater detail.

a. Remainder Interest in a Personal Residence or Farm

Section 170(f)(3)(B)(i) allows a deduction for a contribution not in trust of an irrevocable remainder interest in a personal residence or farm which is not the donor's entire interest in the property.[51] The Regulations define "personal residence" as "any property used by the taxpayer as his personal residence even though it is not used as his principal residence."[52] They define "farm" as "any land used by the taxpayer or his tenant for the production of crops, fruits, or other agricultural products or for the sustenance of livestock."[53]

The contribution must consist of a remainder interest in the personal residence or farm itself rather than in the proceeds of the sale of the property.[54] The donor may retain an interest in the property, measured either by a term of years or the life or lives of one or more persons.[55] In determining the value of the remainder interest, § 170(f)(4) requires the donor to account for depreciation (computed on the straight line method) and depletion (computed on the cost depletion method).[56] Where the remainder interest consists of both depreciable and nondepreciable (or depletable and nondepletable) property, the fair market value of the property at the time of the contribution is allocated between the depreciable and nondepreciable (or depletable and nondepletable) property.[57]

b. Undivided Portion of Donor's Entire Interest in Property

Section 170(f)(3)(B)(ii) allows a deduction for the value of a charitable contribution not in trust of an undivided portion of a donor's entire interest in property.[58] The undivided portion "must consist of a fraction or percentage of each and every substantial interest or right owned by the donor in such property and must extend over the entire term of the donor's interest in such property and in other property into which such property is converted."[59] In other words, the donee organization must receive a "vertical slice." The Regulations allow a deduction to a qualified organization where the organization receives "the right, as a tenant in common with the donor, to possession, dominion, and control of the property for a portion of each year appropriate to its interest in such property."[60] However, they disallow a deduction for contributions "in perpetuity of an interest in property not in trust where the donor transfers some specific rights and retains other substantial rights."[61]

c. Qualified Conservation Contribution

Section 170(f)(3)(B)(iii) allows a deduction for a qualified conservation contribution as defined under the Regulations.[62] Despite a 1964 ruling allowing a deduction for a restrictive easement "to preserve the scenic view afforded certain public properties,"[63] Congress did not enact § 170(f)(3)(B)(iii) until 1976.[64] The provision allowed the deduction of charitable contributions made "exclusively for conservation purposes" and represented both the first express statutory authority for the deductibility of conservation easement donations and the first adoption of the "conservation purposes" test.[65]

Faced with a 1981 sunset provision included in the Tax Reduction and Simplification Act of 1977, the Tax Treatment Extension Act of 1980 revised § 170(f)(3)(B)(iii) to eliminate the sunset date and added subsection (h).[66] As the Report of the Senate Committee on Finance explained:

> The committee believes that the preservation of our country's natural resources and cultural heritage is important, and the committee recognizes that conservation easements now play an important role in preservation efforts. The committee also recognizes that it is not in the country's best interest to restrict or prohibit the development of all land areas and existing structures. Therefore, the committee believes that provisions allowing deductions for conservation easements should be directed at the preservation of unique or otherwise significant land areas or structures. Accordingly, the committee has agreed to extend the expiring provisions of the present law on a permanent basis . . . .[67]

With minor amendments,[68] the current rules concerning qualified conservation contributions mirror those enacted in 1980.

Section § 170(h)(1) defines "qualified conservation contribution" as a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes.[69] The Regulations note that the conservation purpose must be protected in perpetuity to qualify for deduction.[70] Those advising prospective donors must understand these terms as they negotiate and draft the deed of easement to entitle the donor to deduction. The following materials explore these elements in detail.

(1) Qualified Real Property Interest

Under § 170(h)(2), a "qualified real property interest" includes (A) the entire interest of the donor other than a qualified mineral interest, (B) a remainder interest and (C) a restriction (granted in perpetuity) on the use which may be made of the property.[71]

The Regulations define "a qualified mineral interest" as "the donor's interest in subsurface oil, gas, or other minerals and the right of access to such minerals."[72] If "the property in which the donor's interest exists was divided prior to the contribution in order to enable the donor to retain control of more than a qualified mineral interest or to reduce the real property interest donated," the Regulations disallow a deduction.[73] However, they allow the donor to transfer minor interests, such as rights-of-way, that will not interfere with the conservation purpose of the donation prior to the contribution.[74]

The Regulations define a "perpetual conservation restriction" as "a restriction granted in perpetuity on the use which may be made of real property."[75] The restriction may be in the form of an easement, restrictive covenant, equitable servitude or similar real property interest recognized under state law.[76] The Regulations ascribe the same meaning to the terms "easement," "conservation restriction" and "perpetual conservation restriction,"[77] and require any rights reserved by the donor in the donation of a perpetual conservation restriction to conform to the requirements discussed below.[78]

(2) Qualified Organization

Under § 170(h)(3) and the Regulations, "qualified organizations" include:

(A) A State, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.

(B) A corporation, trust, or community chest, fund, or foundation—

(1) created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States;

(2) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals;

(3) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office. A contribution or gift by a corporation to a trust, chest, fund, or foundation shall be deductible by reason of this paragraph only if it is to be used within the United States or any of its possessions exclusively for purposes specified in subparagraph (B). Rules similar to the rules of section 501(j) shall apply for purposes of this paragraph.

(C) A charitable organization described in § 501(c)(3) that meets the public support test of § 509(a)(2).

A charitable organization described in § 501(c)(3) that meets the requirements of § 509(a)(3) and is controlled by any of the three types of organizations just described.[79]

These organizations must have a commitment to protect the conservation purposes of the donation and the resources to enforce the restrictions.[80] Groups organized or operated primarily for "conservation purposes" automatically meet this requirement.[81]

In addition to allowing deductions only for contributions to qualified organizations, the Regulations condition deductibility on the transfer and future use of the donated easement.[82] Though not included in the Code, the Regulations allow a deduction only where the instrument of conveyance prohibits the donee organization from subsequently transferring the qualified real property interest unless the subsequent donee, as a condition of the transfer, agrees to carry out the conservation purposes intended by the original contribution.[83] In addition, the Regulations restrict subsequent transfers to the qualified organizations describe above.[84]

If a later unexpected change in the conditions surrounding the property makes the continued use of the property for conservation purposes impossible or impractical, the Regulations allow a deduction only if the property is sold or exchanged and the donee organization uses the proceeds in a manner consistent with the conservation purposes of the original contribution.[85] Where the donor contributing the qualified real property interest "reserves rights the exercise of which may impair the conservation interests associated with the property," the donor must agree to notify the donee in writing before exercising these rights.[86] In addition, the terms of the donation must provide the donee with a right to enter the property at reasonable times to inspect and ensure compliance with the terms of the donation and enforce the conservation restrictions by appropriate legal proceedings.[87]

(3) Permitted Conservation Purposes

Under § 170(h)(4) and the Regulations, permitted "conservation purposes" include:

The preservation of land areas for outdoor recreation by, or the education of, the general public;

The protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem;

The preservation of open space (including farmland or forest land) where such preservation is for the scenic enjoyment of the general public or pursuant to a clearly delineated Federal, State, or local governmental conservation policy, and will yield a significant public benefit; and

The preservation of an historically important land area or a certified historic structure.[88]

The qualified conservation contribution may satisfy two or more of these purposes.[89] The particular requirements of each purpose are discussed below.

(a) Outdoor Recreation or Education of the General Public

First, § 170 and the Regulations allow a deduction for donations of qualified real property interests to preserve land for the outdoor recreation or education of the general public.[90] Examples of this conservation purpose include the preservation of water areas for boating or fishing, or a nature or hiking trails.[91] The recreation or education must allow for the substantial and regular use of the general public.[92]

(b) Protection of Natural Habitat or Ecosystem

Second, § 170 and the Regulations allow a deduction for donations of qualified real property interests "to protect a significant relatively natural habitat in which a fish, wildlife, or plant community, or similar ecosystem normally lives."[93] Examples of significant habitats and ecosystems include (a) habitats for rare, endangered or threatened species of animal, fish or plants, (b) natural areas that represent high quality examples of a terrestrial community or aquatic community, such as islands that are undeveloped or not intensely developed where the coastal ecosystem is relatively intact and (c) natural areas which are included in, or which contribute to, the ecological viability of a local, state, or national park, nature preserve, wildlife refuge, wilderness area or other similar conservation area.[94] The Regulations allow a deduction even where "the habitat or environment has been altered to some extent by human activity . . . if the fish, wildlife, or plants continue to exist there in a relatively natural state."[95] Because this provision seeks to protect the natural character of these areas, limitations on public access do not preclude deductibility.[96]

The United States Tax Court, in *Glass v. Commissioner*, recently provided some insight into the definition of "natural habitat" as it applies to the determination of whether a donation includes an appropriate conservation purpose.[97] The case involved conservation easements that taxpayers contributed to a conservation organization to protect the shoreline of their vacation property from future development.[98] The trial court upheld the taxpayers' deduction based on their stated purpose of "the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem."[99] The government argued that the taxpayers did not demonstrate a conservation purpose within the boundaries as described in the examples set forth in the regulations for a "significant natural habitat or ecosystem."[100] The Court stated that the legislative history indicates the conservation purposes requirement will be met if the conservation easement donation "will operate to protect or enhance the viability of an area or environment in which a fish, wildlife, or plant community normally lives or occurs."[101]

The Court also made reference to the testimony of the grantee land trust's executive director indicating that the land is a known roosting spot for bald eagles and that it is a "proper and normal environment for Lake Huron tansy, pitcher's thistle, and bald eagles" in holding that the taxpayers adequately proved the their stated conservation purpose.[102] This case provides useful commentary in clarifying what is required for a taxpayer to prove that a conservation easement donation protects a natural habitat.

The Tax Court decision was recently upheld by the Sixth Circuit Court of Appeals on December 21, 2006, in Glass, et al v. Comm'r of Internal Revenue, No.06-1398; the opinion is a thorough discussion of the definition of "significant relatively natural habitat," permissible prohibited and permitted uses under a "natural habitat" conservation easement, and whether retained uses vitiate the conservation purpose of the natural habitat easement under the facts of the Glass case.[103]

(c) Open Space Preservation

Third, § 170 and the Regulations allow a deduction for donations of qualified real property interests to preserve open space (including farmland and forest land) where the preservation is (a) pursuant to a clearly delineated Federal, state or local governmental conservation policy and will yield a significant public benefit, or (b) for the scenic enjoyment of the general public and will yield a significant public benefit.[104] As discussed below in the materials concerning inconsistent use, it should be noted that the Regulations disallow deductions for the preservation of open space "if the terms of the easement permit a degree of intrusion or future development that would interfere with the essential scenic quality of the land or with the governmental conservation policy that is being furthered by the donation."[105]

This purpose's broad scope results in detailed descriptions of its material terms. As explained by the Regulations:

> The requirement that the preservation of open space be pursuant to a clearly delineated Federal, state, or local governmental policy is intended to protect the types of property identified by representatives of the general public as worthy of preservation or conservation. A general declaration of conservation goals by a single official or legislative body is not sufficient. However, a governmental conservation policy need not be a certification program that identifies particular lots or small parcels of individually owned property. This requirement will be met by donations that further a specific, identified conservation project, such as the preservation of land within a state or local landmark district that is locally recognized as being significant to that district; the preservation of a wild or scenic river, the preservation of farmland pursuant to a state program for flood prevention and control; or the protection of the scenic, ecological, or historic character of land that is contiguous to, or an integral part of, the surroundings of existing recreation or conservation sites. For example, the donation of a perpetual conservation restriction to a qualified organization pursuant to a formal resolution or certification by a local governmental agency established under state law specifically identifying the subject property as worthy of protection for conservation purposes will meet the requirement of this paragraph. A program need not be funded to satisfy this requirement, but the program must involve a significant commitment by the government with respect to the conservation project. For

> example, a governmental program according preferential tax assessment or preferential zoning for certain property deemed worthy of protection for conservation purposes would constitute a significant commitment by the government.[106]

The Regulations note that acceptance of an easement by an agency of the Federal Government or by an agency of a state or local government tends to establish the requisite clearly delineated governmental policy.[107] However, mere acceptance is not enough; the governmental agency must establish a sufficiently thorough review process to evaluate the contribution.[108] "The more rigorous the review process by the governmental agency, the more the acceptance of the easement tends to establish the requisite clearly delineated governmental policy."[109] The Regulations provide the example of an Environmental Trust established by a state legislature to accept gifts to the state which meet certain conservation purposes and which undergo a review that requires the approval of the state's highest officials.[110] In that case, acceptance of a gift by the Trust tends to establish the requisite clearly delineated governmental policy.[111] However, the Regulations caution that "if the Trust merely accepts such gifts without a review process, the requisite clearly delineated governmental policy is not established."[112] Limited public access does not result in the disallowance of a deduction "unless the conservation purpose of the donation would be undermined or frustrated without public access."[113]

The Regulations also elaborate on the preservation of open space "for the scenic enjoyment of the general public":

> Preservation of land may be for the scenic enjoyment of the general public if development of the property would impair the scenic character of the local rural or urban landscape or would interfere with a scenic panorama that can be enjoyed from a park, nature preserve, road, waterbody, trail, or historic structure or land area, and such area or transportation way is open to, or utilized by, the public.[114]

In evaluating "scenic enjoyment," all pertinent facts and circumstances germane to the contribution must be considered. While "[r]egional variations in topography, geology, biology, and cultural and economic conditions require flexibility in the application of this test," these variations "do not lessen the burden on the taxpayer to demonstrate the scenic characteristics of a donation."[115] Relevant factors include:

The compatibility of the land use with other land in the vicinity;

The degree of contrast and variety provided by the visual scene;

The openness of the land (which would be a more significant factor in an urban or densely populated setting or in a heavily wooded area);

Relief from urban closeness;

The harmonious variety of shapes and textures;

The degree to which the land use maintains the scale and character of the urban landscape to preserve open space, visual enjoyment, and sunlight for the surrounding area;

The consistency of the proposed scenic view with a methodical state scenic identification program, such as a state landscape inventory; and

(8) The consistency of the proposed scenic view with a regional or local landscape inventory made pursuant to a sufficiently rigorous review process, especially if the donation is endorsed by an appropriate state or local governmental agency.[116]

In terms of access, visual rather than physical access to or across the property satisfies the requirement of scenic enjoyment by the general public.[117] The terms of an open space easement on scenic property need not allow visual access to the entire property to qualify for deduction.[118] That said, the donation may be insufficient to qualify for deduction if only a small portion of the property is visible to the public.[119]

Whether "pursuant to a clearly delineated governmental policy" or "for the scenic enjoyment of the general public," a contribution of a qualified real property interest for the preservation of open space "must yield a significant public benefit."[120] Relevant factors include:

(1) The uniqueness of the property to the area;

(2) The intensity of land development in the vicinity of the property (both existing development and foreseeable trends of development);

(3) The consistency of the proposed open space use with public programs (whether Federal, state or local) for conservation in the region, including programs for outdoor recreation, irrigation or water supply protection, water quality maintenance or enhancement, flood prevention and control, erosion control, shoreline protection, and protection of land areas included in, or related to, a government approved master plan or land management area;

(4) The consistency of the proposed open space use with existing private conservation programs in the area, as evidenced by other land, protected by easement or fee ownership by organizations referred to in § 1.170A-14(c)(1), in close proximity to the property;

(5) The likelihood that development of the property would lead to or contribute to degradation of the scenic, natural, or historic character of the area;

(6) The opportunity for the general public to use the property or to appreciate its scenic values;

(7) The importance of the property in preserving a local or regional landscape or resource that attracts tourism or commerce to the area;

(8) The likelihood that the donee will acquire equally desirable and valuable substitute property or property rights;

(9) The cost to the donee of enforcing the terms of the conservation restriction;

(10) The population density in the area of the property; and

(11) The consistency of the proposed open space use with a legislatively mandated program identifying particular parcels of land for future protection.[121]

Recognizing that both categories of contributions to preserve open space must yield a significant public benefit, the Regulations explain the interrelationship. In the case of a clearly delineated governmental policy, they note that the requirements may be related despite the stipulation that they be met independently.[122] Put simply, "[t]he more specific the governmental policy with respect to the particular site to be protected, the more likely the governmental decision, by itself, will tend to establish the significant public benefit associated with the donation."[123] In the case of scenic enjoyment, the Regulations explain that, "since the degrees of scenic enjoyment offered by a variety of open space easements are subjective and not as easily delineated as are increasingly specific levels of governmental policy, the significant public benefit of preserving a scenic view must be independently established in all cases."[124] Notwithstanding, the Regulations provide that "[d]onations may satisfy more than one test."[125]

In May, 2006, the U.S. Tax Court, in *Turner v. Commissioner,* rejected a conservation easement deduction, basing its analysis in large part on the donor's failure to establish a "conservation purpose" sufficient to warrant an income tax deduction.[126] Turner owned a development company that sought to develop approximately twenty-nine acres of land, half of which was located in a floodplain that was zoned for a maximum of thirty residences.[127] The company falsely claimed that it could construct up to sixty-two residences in the development corridor for which the deduction was claimed, and represented that it would voluntarily agree to limit development to thirty residences.[128] Turner claimed a charitable deduction for the value of the donation based on its relinquishment of the right to develop the remaining thirty-two residences.[129]

The Court found that the developer overvalued the easement's development potential because development was already restricted in part by historic zoning.[130] The Court supported its decision by citing specific examples from the legislative history that focus on the preservation of the "natural state of land" including:[131]

> the preservation of …[land] as a public garden…(1) the preservation of farmland pursuant to a State program for flood prevention and control; (2) the preservation of a unique natural land formation for the enjoyment of the general public; (3) the preservation of woodland along a Federal highway pursuant to a government program to preserve the appearance of the area so as to maintain the scenic view from the highway; and (4) the preservation of a stretch of undeveloped oceanfront property located between a public highway and the ocean so as to maintain the scenic ocean view from the highway.[132]

The portion of the property that was to be developed under Turner's plan did not include restrictions on open space for those residences. And, the floodplain property could not be developed anyway because of the zoning restrictions.[133] Therefore, the Court rejected the deduction claimed by Turner, and further upheld a twenty percent accuracy-related penalty imposed on Turner for negligence in relying on an appraisal containing false assumptions to substantiate his claimed charitable deduction.[134]

(d) Historically Important Land Area or Structure

Finally, § 170 and the Regulations allow a deduction for donations of qualified real property interests to preserve an historically important land area or a certified historic structure.[135] "Historically important land areas" include (1) independently significant land areas (including related historic resources) such as archaeological sites or a Civil War battlefield with related monuments, bridges, cannons, or houses) that meet the National Register Criteria for Evaluation, (2) land areas within a registered historic district including any buildings on the land area that can reasonably be considered as contributing to the significance of the district and (3) land areas (including related historic resources) adjacent to a property listed individually in the National Register of Historic Places (but not within a registered historic district) in a case where the physical or environmental features of the land area contribute to the historic or cultural integrity of the property.[136] "Certified historic structures" include any building, structure or land area (1) listed in the National Register or (2) located in a registered historic district and certified by the Secretary of the Interior as being of historic significance to the district.[137]

The deductibility of contributions to preserve historically important land areas or certified historic structures depends considerably on public access. As with contributions for the scenic enjoyment of the general public, the easement must allow the public "some visual access to the donated property."[138] For historically important land areas, the entire property need not be visible.[139] However, if only a small portion of the property is visible, the public benefit may be insufficient to allow deduction.[140] Where the historic land area or certified historic structure is invisible from a public way (for example, where a wall or shrubbery blocks the structure or the easement protects the structure's interior characteristics and features), the Regulations require that the easement allow the public to view the characteristics and features of the property on a regular basis to the extent consistent with the nature and condition of the property.[141]

In determining the type and amount of required public access, relevant factors include:

The historical significance of the donated property;

The nature of the features that are the subject of the easement;

The remoteness or accessibility of the site of the donated property;

The possibility of physical hazards to the public visiting the property (for example, an unoccupied structure in a dilapidated condition);

The extent to which public access would be an unreasonable intrusion on any privacy interests of individuals living on the property;

The degree to which public access would impair the preservation interests which are the subject of the donation; and

The availability of opportunities for the public to view the property by means other than visits to the site.[142]

(4) Exclusively for Conservation Purposes

Under § 170(h)(5) and the Regulations, the contribution "must be exclusively for conservation purposes."[143] This requirement frequently poses problems for both donors and donee organizations. Accordingly, the following materials address it in some detail.

(a) In General

In general, the Regulations provide that "[a] deduction will not be denied . . . when incidental benefit inures to the donor merely as a result of conservation restrictions limiting the uses to which the donor's property may be put."[144] However, the Regulations disallow a deduction "if the contribution would accomplish one of the enumerated conservation purposes but would permit destruction of other significant conservation interests."[145] The Regulations qualify this "inconsistent use" prohibition by noting that "[a] use that is destructive of conservation interests will be permitted only if such use is necessary for the protection of the conservation interests that are the subject of the contribution."[146] The Regulations also allow donors to continue preexisting uses of the property[147] and retain rights with respect to future uses that do not conflict with the conservation purposes of the contribution.[148]

(b) Perpetuity Requirement

In addition to restrictions on inconsistent uses, contributions of qualified real property interests must be protected in perpetuity.[149] To facilitate this requirement, "[a]ny interest retained by the donor (and the donor's successors in interest) must be subject to legally enforceable restrictions (for example, by recordation in the land records of the jurisdiction in which the property is located) that will prevent uses of the retained interest inconsistent with the conservation purposes of the donation."[150] Where the donor contributes a remainder interest, the Regulations disallow a deduction if the life or term tenants can use the property in a manner that diminishes the conservation values of the contribution.[151] In the case of a "remote future event," the Regulations reiterate the language of 1.170A-1(e) and provide that "[a] deduction shall not be disallowed . . . merely because the interest which passes to, or is vested in, the donee organization may be defeated by the performance of some act or the happening of some event, if on the date of the gift it appears that the possibility that such act or event will occur is so remote as to be negligible."[152]

(c) Property Subject to a Mortgage

Property subject to a mortgage receives special treatment. For contributions made after February 13, 1986, the Regulations disallow a deduction "unless the mortgagee subordinates its rights in the property to the right of the qualified organization to enforce the conservation purposes of the gift in perpetuity."[153] For contributions made before that date, they allow a deduction "only if the donor can demonstrate that the conservation purpose is protected in perpetuity without subordination of the mortgagee's rights."[154]

(d) Retention of a Qualified Mineral Interest

Property in which the donor retains a qualified mineral interest likewise receives special treatment. As above, "qualified mineral interest" means the donor's interest in subsurface oil, gas, or other minerals and the right of access to such minerals."[155] Where the donor retains a qualified mineral interest, the Regulations generally disallow a deduction "if at any time there may be extractions or removal of minerals by any surface mining method."[156] Where the donor contributes the qualified mineral interest itself, the Regulations disallow a deduction "if any method of mining that is inconsistent with the particular conservation purposes of a contribution is permitted at any time."[157]

As with many deduction restrictions, the Regulations carve out exceptions to the general prohibitions just described. For example, they allow a deduction for "certain methods of mining that may have limited, localized impact on the real property but that are not irremediably destructive of significant conservation interests."[158] In addition, they allow a deduction for contributions made after July 18, 1984 that meet the following requirements:

> The ownership of the surface estate and mineral interest were separated before June 13, 1976, and remain so separated up to and including the time of the contribution;
>
> The present owner of the mineral interest is not a person whose relationship to the owner of the surface estate is described at the time of the contribution in section 267(b) [describing relationships resulting in the disallowance of deductions for losses from the sale or exchange of property] or section 707(b)

[describing relationships between partners and partnerships resulting in the disallowance of deductions for losses from the transfer of property]; and

The probability of extraction or removal of minerals by any surface mining method is so remote as to be negligible. Whether the probability of extraction or removal of minerals by surface mining is so remote as to be negligible is a question of fact and is to be made on a case by case basis. Relevant factors to be considered in determining if the probability of extraction or removal of minerals by surface mining is so remote as to be negligible include: Geological, geophysical or economic data showing the absence of mineral reserves on the property, or the lack of commercial feasibility at the time of the contribution of surface mining the mineral interest.[159]

Notwithstanding these exceptions, "[i]f the ownership of the surface estate and mineral interest first became separated after June 12, 1976," the Regulations allow a deduction only if "surface mining on the property is completely prohibited."[160]

Examples provided in the Regulations illustrate these provisions:

Example 1: K owns 5,000 acres of bottomland hardwood property along a major watershed system in the southern part of the United States. Agencies within the Department of the Interior have determined that southern bottomland hardwoods are a rapidly diminishing resource and a critical ecosystem in the south because of the intense pressure to cut the trees and convert the land to agricultural use. These agencies have further determined (and have indicated in correspondence with K) that bottomland hardwoods provide a superb habitat for numerous species and play an important role in controlling floods and purifying rivers. K donates to a qualified organization his entire interest in this property other than his interest in the gas and oil deposits that have been identified under K's property. K covenants and can ensure that, although drilling for gas and oil on the property may have some temporary localized impact on the real property, the drilling will not interfere with the overall conservation purpose of the gift, which is to protect the unique bottomland hardwood ecosystem. Accordingly, the donation qualifies for a deduction under this section.

Example 2: Assume the same facts as in example (1), except that in 1979, K sells the mineral interest to A, an unrelated person, in an arm's-length transaction, subject to a recorded prohibition on the removal of any minerals by any surface mining method and a recorded prohibition against any mining technique that will harm the bottomland hardwood ecosystem. After the sale to A, K donates a qualified real property interest to a qualified organization to protect the bottomland hardwood ecosystem. Since at the time of the transfer, surface mining and any mining technique that will harm the bottomland hardwood ecosystem are completely prohibited, the donation qualifies for a deduction under this section.[161]

(e) Changed Conditions

As discussed above in relation to transfers by qualified organizations, subsequent unexpected changes in the conditions surrounding the contributed property do not necessarily result in the disallowance of a deduction. If the changed conditions "make impossible or impractical the continued use of the property for conservation purposes, the conservation purpose can nonetheless be treated as protected in perpetuity if the restrictions are extinguished by judicial proceeding and all of the donee's proceeds . . . from a subsequent sale or exchange of the property are used by the donee organization in a manner consistent with the conservation purposes of the original contribution."[162] The Regulations allow a deduction if, at the time of the contribution, the donor agrees "that the donation of the perpetual conservation restriction gives rise to a property right, immediately vested in the donee organization, with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction at the time of the gift, bears to the value of the property as a whole at that time."[163] This proportionate value must remain constant.[164] Unless state law provides otherwise, when changed conditions extinguish a perpetual conservation restriction, the Regulations entitle the donee organization "to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction."[165]

(f) Conservation Easement Amendments

The issues of perpetual protection and changed circumstances frequently arise in the context of conservation easement amendments. As one commentator correctly observed, "[i]t seems irresponsible to promote perpetual restrictions without commensurate attention to means of adjusting them to inevitable future changes."[166] That said, the materials below discuss conservation easement amendments in light of the provisions above.

Conservation easement amendments require consideration of federal, state and local laws, as well as provisions of the easement itself. Complying with provisions of the easement generally poses few problems due to typical amendment language. For example, the Land Trust Alliance's *Model Conservation Easement* allows the donor and donee organization to amend the easement jointly, provided the amendments are (1) consistent with the purposes of the easement, (2) do not affect the status or qualification of the easement or the easement holder under applicable laws, including federal income tax laws, and (3) do not affect the perpetual duration of the easement.[167]

Complying with state law requires careful consideration of the relevant real property and tax provisions. Thankfully, many states have adopted the Uniform Conservation Easement Act ("UCEA"), thereby eliminating concerns raised by common-law constraints. Put simply, the UCEA allows an owner of a fee interest in land to transfer a conservation easement to a land trust or governmental entity that the land trust, governmental unit or third party can enforce whether or not they have an interest in the property.[168] In addition, it enables the land trust or governmental agency to enforce any affirmative obligations (such as maintenance for an historical façade easement) undertaken by the donor notwithstanding the common law's reluctance to enforce such obligations.[169] It also permits the donee organization to enforce the easement against any subsequent owner of the fee interest in the property, even though the easement is not attached to the property as an appurtenant easement.[170]

While the UCEA does not contain specific provisions concerning amendments, it does provide that conservation easements may be "assigned, released, modified, terminated or otherwise altered or affected."[171] A recent article summarizes the amendment requirements under various state laws.[172] In relevant part, it notes that:

> [A]ll states require the recording of a conservation easement [and] it can be inferred that recording of an amendment is also required. Some states have only de minimus legal restrictions on amendments other than recording, requiring only that the amendment be in writing and executed by the current owner of the protected property and the holder of the conservation easement, or any governmental body or charitable organization given third party enforcement under the original agreement. In contrast, several states require review of all conservation easements (as well as amendments) by a public agency. . . . Other states have enacted additional requirements to ensure that conveyances are executed for legitimate conservation and preservation purposes. . . . In addition to [these] procedural requirements, a few states impose substantive requirements upon a conservation easement amendment. . . . Several states have a[173] similar [substantive requirement] for the termination of easements, yet omit requirements for amendments; again, a court may choose to infer that [these] requirements [were] intended for amendments. . . . A minority of states require a court's supervision to modify and/or terminate an easement, unless expressly provided for in the document. Land trusts prefer to stay out of judicial proceedings, due to the time, cost and publicity involved. Notwithstanding, the UCEA and the majority of states provide that courts may modify conservation easements according to principals of law and equity.[174]

As this summary indicates, practitioners advising clients seeking to amend a conservation easement must consider applicable state laws carefully.

In addition to state laws, charitable trust law may limit conservation easement amendments. "Generally speaking, charitable trust law aims to ensure that the public benefits of charitable contributions are enforced to accomplish their intended purposes."[175] The National Conference of Commissioners on Uniform State Laws recognized charitable trust law's potential application in drafting the UCEA. According to one Commissioner:

> [A] charitable type of relationship is invoked, and is necessarily invoked when you define a [holder of a conservation easement, and] any court which is going to be confronted with a modification or termination problem has got to consider not only the law of easements with respect to modification or termination, but also trust implications, such as cy-pres.[176]

A recent REAL PROPERTY, PROBATE AND TRUST JOURNAL article includes these comments in analyzing the relationship between conservation easement amendments and charitable trust law.[177] Following is a brief summary of its conclusions.

First, the article notes that a charitable trust interpretation may allow courts to invoke the cy pres doctrine when modifying or terminating conservation easements. As the article explains,

> The term cy pres is a shorthand form of the phrase '*cy pres comme possible,*' meaning literally 'as near as possible,' and the corresponding legal doctrine provides that a charitable trust may be reformed to approximate the settlor's general charitable intent if the trust as originally set out 'has become impossible, unlawful or impracticable.' The doctrine of cy pres is 'peculiar to charitable trusts,' but both the *Restatement (Third) of Property* and comment to the UCEA recommend application of the cy pres doctrine for modification or termination of conservation easements.[178]

The article explores the arguments for and against invoking the cy pres doctrine, but concludes that, "[u]nfortunately, because the references to cy pres in the UCEA and the *Restatement (Third) of Property* provide little supporting analysis, courts and practitioners may regard these references as merely normative recommendations to expand the equitable powers of the courts."[179]

Second, the article explains that a charitable trust interpretation grants the state attorneys general "standing to enforce the easement terms even if the state conservation easement statute or the easement deed provides no provision for third party enforcement."[180] While land trusts may welcome this "enforcement assistance," the article cautions that situations like Maryland's *Attorney General v. Miller* (commonly known as the "Myrtle Grove case") may place attorneys general and donee organizations on opposite sides.[181]

Finally, the article identifies "three other substantive implications of a charitable trust interpretation . . . ."[182] These include (1) the likelihood that such an interpretation will "limit the ways in which a conservation easement can be amended or released," (2) the possibility that, "where a charitable trust is established, a successor owner of the servient estate . . . will not receive the benefit if a conservation easement is extinguished," and (3) the "added measure of assurance that a conservation easement will survive and be enforced, even in cases where the original holder has ceased to exist, gone bankrupt, or breached the trust."[183]

(g) Private Inurement

Application of charitable trust law aside, ensuring that conservation easement amendments comply with the Internal Revenue Code requires careful consideration of the Code's "inurement" pitfalls. As above, these pitfalls apply to donors and donee organizations alike. For donors, conservation easement amendments are "qualified conservation contributions" under §§ 170(f)(3)(B)(iii) and (h).[184] Accordingly, the

Regulations disallow a deduction "[i]f, as a result of the donation of a perpetual conservation restriction, the donor or a related person receives, or can reasonably expect to receive, financial or economic benefits that are greater than those that will inure to the general public from the transfer."[185]

Tax-exempt donee organizations face similar pitfalls.[186] For an organization to qualify under § 501(c)(3), no part of its net earnings can inure to the benefit of any private shareholder or individual.[187] Thus, where an organization receives a qualified conservation contribution, it must ensure that both the contribution and any subsequent amendments do not jeopardize its ability to hold the easement and retain its tax exempt status. As the IRS explains, "any private benefit arising from a particular activity must be 'incidental' in both a qualitative and quantitative sense to the overall public benefit achieved by the activity if the organization is to remain exempt."[188]

Avoiding these pitfalls may allow donors an additional charitable deduction for conservation easement amendments. In *Strasburg v. Commissioner*, for example, the United States Tax Court allowed a deduction where an amendment further reduced value of the encumbered property.[189] The case involved an easement donated to the Montana Land Reliance in 1993.[190] Under the easement, the landowner reserved the right to divide the property into two parcels and construct two additional single-family residences.[191] In 1994, the landowner amended the easement and relinquished the right to build one of the residences.[192] Concluding that the amendment was a "qualified conservation contribution" under §§ 170(f)(3)(B)(iii) and (h), the Court allowed a deduction for the amendment's fair market value.[193] The Court disagreed with the IRS appraiser's summary conclusion that a "restriction to one additional residence is not . . . significant," concluding that "[i]t seems self-evident that such a restriction on such a large property is significant."[194]

d. Valuation of Qualified Conservation Contributions

Under the Regulations, the type of qualified real property interest contributed determines the valuation method used.[195] The following materials examine each method.

(1) Entire Interest Other than a Qualified Mineral Interest

Where a donor contributes his entire interest in the property other than a qualified mineral interest, the value of the contribution equals "the fair market value of the surface rights in the property contributed."[196] The contribution is valued "without regard to the mineral rights."[197] For example, assume A owns Goldacre, a property adjacent to a state park. A wants to donate Goldacre to the state to be used as part of the park, but A wants to reserve a qualified mineral interest in the property, to exploit currently and to devise at death. The fair market value of the surface rights in Goldacre is $200,000 and the fair market value of the mineral rights in $100,000. To ensure that the quality of the park will not be degraded, restrictions must be imposed on the right to extract the minerals that reduce the fair market value of the mineral rights to $80,000. Under the Regulations, the value of the contribution is $200,000 (the value of the surface rights).[198]

(2) Remainder Interest

Where a donor contributes a remainder interest in property, the value of the contribution equals the fair market value of the remainder interest.[199] The Regulations provide that the value must account for depreciation and depletion under § 1.170A-12.[200] In addition, it must account for "any pre-existing or contemporaneously recorded rights limiting, for conservation purposes, the use to which the subject property may be put."[201] Examples provided in the Regulations illustrate these provisions:

> In 1984 B, who is 62, donates a remainder interest in Greenacre to a qualifying organization for conservation purposes. Greenacre is a tract of 200 acres of undeveloped woodland that is valued at $200,000 at its highest and best use. Under § 1.170A-12(b), the value of a remainder interest in real property following one life is determined under § 25.2512-5. Accordingly, the value of the remainder interest, and thus the amount eligible for an income tax deduction under section 170(f), is $55,996 ($200,000 x .27998).
>
> Assume the same facts as above, except that Greenacre is B's 200-acre estate with a home built during the colonial period. Some of the acreage around the home is cleared; the balance of Greenacre, except for access roads, is wooded and undeveloped. However, B would like Greenacre to be maintained in its current state after his death, so he donates a remainder interest in Greenacre to a qualifying organization for conservation purposes. At the time of the gift the land has a value of $200,000 and the house has a value of $100,000. The value of the remainder interest, and thus the amount eligible for an income tax deduction under section 170(f), is computed pursuant to § 1.170A-12.
>
> Assume the same facts as above, except that at the time of the donation of a remainder interest in Greenacre, B also donates an easement to a different qualifying organization for conservation purposes. Based on all the facts and circumstances, the value of the easement is determined to be $100,000. Therefore, the value of the property after the easement is $100,000 and the value of the remainder interest, and thus the amount eligible for deduction under section 170(f), is $27,998 ($100,000 x .27998).[202]

(3) Perpetual Conservation Restriction

(a) In General

Where the donor contributes a perpetual conservation restriction, the value of the contribution equals "the fair market value of the perpetual conservation restriction at the time of the contribution."[203] The Regulations prescribe two methods for determining the restriction's fair market value. If a substantial record of sales of easements comparable to the donated easement exists, the fair market value of the donated easement is based on the sale prices of those easements.[204] If no substantial record of comparable sales exists, the fair market value generally (but not always) equals the difference between the fair market value of the property before the granting of the restriction and the fair market value of the encumbered property after the granting of the restriction.[205] The “before” value is based on the highest and best use to which the property could be put on the valuation date.[206] For example, assume B, who is 62, donates a conservation easement in Greenacre, a 200-acre tract of undeveloped woodland valued at $200,000 at its highest and best use, to a qualifying organization for conservation purposes. The fair market value of Greenacre after the donation is reduced to $110,000. Accordingly, the value of the easement, and thus the amount eligible for a deduction under section 170(f), is $90,000 ($200,000 less $110,000).[207]

The Regulations impose certain requirements on the use of the “before and after” valuation method.[208] First, the fair market value of the property *before* the contribution must account not only for “the current use of the property but also an objective assessment of how immediate or remote the likelihood is that the property, absent the restriction, would in fact be developed, as well as any effect from zoning, conservation, or historic preservation laws that already restrict the property’s potential highest and best use.”[209] Second, the fair market value of the property *after* the contribution must account for “the effect of restrictions that will result in a reduction of the potential fair market value represented by highest and best use but will, nevertheless, permit uses of the property that will increase its fair market value above that represented by the property's current use.”[210] The existence of transfer restrictions on the easement “designed solely to ensure that the conservation restriction will be dedicated to conservation purposes” does not reduce the easement’s value.[211]

(b) Timing

In addition to these requirements, note that easements donated within one year of the property’s purchase trigger the ordinary income rules of § 170(e). As the Tax Court recently explained, “[t]he allowable charitable contribution deduction for ordinary income property is limited to the basis of the property donated. Because the [easement at issue] does not satisfy the long-term capital gain holding period, i.e., petitioner donated the easement . . . less than a year after she purchased the property . . ., the [easement at issue] is treated as ordinary income property. Therefore, the amount of petitioner’s charitable contribution deduction is limited by her adjusted basis in the [easement].”[212] This limitation applies regardless of the difference between the highest and best use of the property and the appraiser’s determination of the reduction in value caused by the easement.[213]

(c) “Enhancement”

The valuation methods above assume that the contributed easement reduces the value of the underlying property. However, this is often not the case, as the Regulations recognize and address. Where a conservation easement contribution has no material effect on the value of the property or enhances the value of the property, the Regulations disallow a deduction.[214] Moreover, where the easement allows *any* development on the protected property, the fair market value of the property after contribution of the easement must account for the development’s effect.[215] Where the Regulations condition the easement’s deductibility on some form of public access, the fair market value of the property after contribution of the easement must account for the amount of such access permitted by the terms of the easement.[216]

(d) Contiguous Property

Contributions of easements "covering a portion of the contiguous property owned by a donor and the donor's family" merit special consideration. In general, the amount of the deduction equals "the difference between the fair market value of the entire contiguous parcel of property before and after the granting of the restriction."[217] However, if the easement increases the value of *any other property owned by the donor or a related person*, the amount of the deduction must be reduced by the amount of the increase in the value of the other property, *whether or not such property is contiguous*.[218] No deduction is allowed if the donor or a related person "receives or reasonably can expect to receive financial or economic benefits greater than those that will inure to the general public from the transfer."[219] However, if the donor or related person demonstrates that the benefit, though substantial, is less than the amount of the transfer, the Regulations allow a deduction for the excess of the amount transferred over the amount of the benefit.[220]

(e) Basis Adjustments

In addition to determining the value of the donation, donors making qualified conservation contributions must reduce their adjusted basis in the retained property by the amount "properly allocable" to the donated easement.[221] The amount "properly allocable" to the donated easement bears the same ratio to the total basis of the property as the fair market value of the donated easement bears to the fair market value of the property before the granting of the qualified real property interest.[222] For example, assume D owns property with a basis of $20,000 and a fair market value of $80,000. D donates to a qualifying organization an easement for conservation purposes that is determined under this section to have a fair market value of $60,000. The amount of basis allocable to the easement is $15,000 ($60,000/$80,000=$15,000/$20,000). Accordingly, the basis of the property is reduced to $5,000 ($20,000 minus $15,000).[223] Since the easement covers a portion of E's land, only the basis of that portion is adjusted. Therefore, the amount of basis allocable to the easement is $22,400 ((8 x $3,000) x ($112,000/$120,000)). Accordingly, the basis of the eight acres encumbered by the easement is reduced to $1,600 ($24,000-$22,400), or $200 for each acre. The basis of the two remaining acres is not affected by the donation.[224]

6. Valuation of Charitable Contributions of Property

a. In General

In general, the amount of a charitable deduction for a contribution of property equals the property's fair market value reduced under the provisions of § 170(e)(1) relating to appreciated property.[225] Under the Regulations, "fair market value" means "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."[226] Elaborating on this definition, the Tax Court noted that "fair market value is not to be determined in a vacuum. To the contrary, it must be determined with respect to the particular property in question at the time of the contribution, subject to any conditions or restrictions on marketability."[227]

b. Appreciated Property

Section 170(e) and the Regulations govern the charitable deductions for contributions of appreciated property. The Taxpayer Relief Act of 1969 added § 170(e) to restrain the exceedingly favorable treatment realized by donors contributing appreciated property under the former Code. Prior to 1969, donors contributing appreciated property to a charitable organization could deduct the fair market value of the property at the time of the contribution and avoid any tax on the appreciation in the property's value. Section 170(e) adjusted this treatment as discussed below.

(1) Ordinary Income Property and "Dealer" Status

Section 170(e) considers both the nature of property and type of donee in determining any reduction from fair market value required in calculating the deduction for contributions of appreciated property. For contributions of ordinary income property, § 170(e) and the Regulations require reduction by the amount of gain that *would not have been* long-term capital gain if the donor had sold the property at its fair market value at the time of contribution.[228] The Regulations define "ordinary income property" as "property any portion of the gain on which would not have been long term capital gain if the property had been sold by the donor at its fair market value at the time of its contribution to the charitable organization."[229] Examples of ordinary income property described in the Regulations include "property held by the donor primarily for sale to customers in the ordinary course of his trade or business, a work of art created by the donor, a manuscript prepared by the donor, letters and memorandums prepared by or for the donor, a capital asset held by the donor for not more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977), and stock described in section 306(a), 341(a) [collapsible corporations], or 1248(a) [foreign corporations] to the extent that, after applying such section, gain on its disposition would not have been long-term capital gain."[230]

Property held by the donor primarily for sale to customers in the ordinary course of their trade or business raises the issue of whether the donor is a "dealer" in land. The issue poses potential problems as "a dealer in land may not take a charitable deduction for the amount by which property has appreciated in [their] hands if [they] held the land for sale to customers in the ordinary course of business."[231] Instead, § 170 and the Regulations limit the dealer's deduction to their basis in the property.[232]

Parsing the statutory language exposes the issue. Dealers hold property primarily for sale to customers in the ordinary course of their trade or business. In other words, land held by dealers is "ordinary income property," not a capital asset.[233] Because property held by dealers is not a capital asset, any gain realized on its sale is not long-term capital gain. Under

§ 170(e)(1)(A), dealers must reduce the amount of their charitable contribution by the amount of gain they would have realized by selling the property at is fair market value. Subtracting the gain from fair market value yields adjusted basis. Thus, § 170 and the Regulations limit the dealer's deduction to their basis in the property.

The Internal Revenue Service ordinarily will not issue rulings or determination letters concerning "any matter dealing with the question of whether property is held primarily for sale to customers in the ordinary course of trade or business."[234] Notwithstanding, courts have interpreted the individual terms of the clause in determining its purpose.

Section 1221(a)(1) excludes property held by the taxpayer "primarily" for sale to customers in the ordinary course of his trade or business from capital asset treatment.[235] Neither the Code nor Regulations define "primarily." However, in *Malat v. Riddell*, the United States Supreme Court held that the term means "principally" or "of first importance."[236] The Court noted that § 1221(a)(1) sought to distinguish between "profits and losses arising from the everyday operation of a business" and "the realization of appreciation in value over a substantial period of time."[237] Generally, "the determination of the purpose for which the property is held is made at the time of sale, not during the period before the sale. Therefore, even though a taxpayer has held property as an investment for many years, if the taxpayer begins a process of selling all of the property he holds, he may then be deemed to be holding the property primarily for sale."[238]

Courts have developed a series of factors to determine whether donors hold property primarily for sale to customers "in the ordinary course of a trade or business." These include:

The purpose for which the property was acquired;

The purpose for which it was held;

The extent of improvements made to the property by the taxpayer;

The frequency, number and continuity of sales of the property;

The extent and substantiality of the disposition of the property;

The nature and extent of the taxpayer's business;

The extent of any advertising of the property; and

The listing of the property for sale directly or through a broker.[239]

Courts recognize that no single factor, or combination of factors, necessarily controls the determination.[240] Moreover, they acknowledge that objective factors carry more weight than a taxpayer's subjective statements of intent.[241]

Relying on these factors, the Court in *DuVal v. Commissioner* held that property donated to a county for a public library constituted a capital asset not subject to the limitations of § 170(e)(1)(A).[242] *DuVal* involved a developer who purchased property zoned for agricultural use in Virginia.[243] To facilitate development after the seller refused to divide the tract, the developer submitted a rezoning request for residential designation on the rear tract and mixed-use designation on the front.[244] While his rezoning application was pending, the county approached the developer to donate land for a new library.[245] The developer agreed and the county approved his rezoning request.[246] When the developer claimed a deduction for the donation, the IRS denied that the donated property qualified for a charitable deduction and determined a deficiency.[247] The IRS also determined that, if the property did qualify as a charitable contribution, § 170(e)(1)(A) would limit the deduction to the developer's basis in the property.[248] The Court disagreed, finding that the developer had not held the donated property in the ordinary course of his business.[249] The Court reasoned that the developer had not wanted to buy the commercial-type property, treated it separately on his books, and did not develop it, or even advertise it for sale, during the time that he owned it.[250]

(2) Tangible Personal Property

For contributions of tangible personal property that the donee organization will use for a purpose unrelated to the purpose allowing its exemption under § 501,[251] § 170(e) and the Regulations require reduction by the amount of gain that *would have been* long-term capital gain if the donor had sold the property at its fair market value at the time of contribution.[252] Examples in the Regulations illustrate "unrelated uses":

> If a painting contributed to an educational institution is used by that organization for educational purposes by being placed in its library for display and study by art students, the use is not an unrelated use; but if the painting is sold and the proceeds used by the organization for educational purposes, the use of the property is an unrelated use. If furnishings contributed to a charitable organization are used by it in its offices and buildings in the course of carrying out its functions, the use of the property is not an unrelated use. If a set or collection of items of tangible personal property is contributed to a charitable organization or governmental unit, the use of the set or collection is not an unrelated use if the donee sells or otherwise disposes of only an insubstantial portion of the set or collection. The use by a trust of tangible personal property contributed to it for the benefit of a charitable organization is an unrelated use if the use by the trust is one which would have been unrelated if made by the charitable organization.[253]

The Regulations allow donors contributing tangible personal property to treat the property as not being put to an unrelated use by the donee where (1) the donor establishes that the property is not in fact put to an unrelated use by the donee or (2) at the time of the contribution or at the time the contribution is treated as made, it is reasonable to anticipate that the property will not be put to an unrelated use by the donee.[254]

(3) Appreciated Long-Term Capital Gain Property to or for the Use of a Private Foundation

For contributions of appreciated long-term capital gain property to or for the use of a private foundation,[255] § 170 and the Regulations likewise require reduction by the amount of gain that *would have been* long-term capital gain if the donor had sold the property at its fair market value at the time of contribution.[256] For example, assume B, an individual, contributes land to a private foundation not described in § 170(b)(1)(E). The land, which B has held for more than one year, has a fair market value at the time of contribution of $60,000 and an adjusted basis of $10,000. B's deduction is limited to $10,000 ($60,000 fair market value minus $50,000 [100 percent of the amount that would have been long term capital gain had B the sold the land at the time of contribution]).

(4) Combinations

For contributions of property whose sale would have resulted in both ordinary income and long-term capital gain, § 170 and the Regulations may require reduction under both subsections (e)(1)(A) and (e)(1)(B). For example, assume that on April 1, 1998, D, an individual, contributes property to which §1245 applies to a private foundation not described in Section170(b)(1)(E). The property has a fair market value of $60,000 and an adjusted basis of $10,000. At the time of the contribution, D has used the property in his business for more than one year. If D had sold the property at its fair market value at the time of the contribution, it is assumed that under §1245, $20,000 of the $50,000 gain would have been treated as ordinary income and $30,000 would have been long-term capital gain. D's contribution is reduced by $50,000 (100% of the ordinary income of $20,000 and 100% of the long-term capital gain of $30,000).

7. Percentage Limitations

Section 170(b) and the Regulations limit the amount that individual donors may deduct for charitable contributions to a percentage of their "contribution base."[257] The definition of "contribution base" is the donor's adjusted gross income computed without regard to any net operating loss carryback to the year of the contribution.[258] In relevant part, § 170(b)(1) and the Regulations limit donors' deductions to 30 or 50 percent of their adjusted gross income. The applicable limitation depends on the type of organization to which the donor contributed property and the type of property contributed. The following materials examine these requirements.

a. Fifty Percent Limitation

Section 170(b) and the Regulations limit a donor's deduction for aggregate contributions to public charities, private operating foundations, and certain private nonoperating foundations to 50 percent of the donor's contribution base for the tax year.[259] In computing the limitation, contributions to public charities are considered before contributions to semi-public charities and private foundations, as well as contributions "for the use of" any organization. Section 170 and the Regulations allow individuals to carry over contributions to public charities in excess of the 50 percent limit for five succeeding taxable years.[260]

b. Thirty Percent Limitation

Section 170(b) and the Regulations limit a donor's deduction for contributions to semipublic charities and private foundations and contributions "for the use of" any charitable organization to 30 percent of the donor's contribution base for the tax year.[261] This limitation also applies to contributions of capital gain property to public charities.[262] The maximum deduction allowable for these contributions equals a sum totaling the lesser of (1) 30 percent of the donor's contribution base or (2) the amount of the donor's 50 percent limitation remaining after the taxpayer's contributions to public charities are considered.[263] However, this limitation only applies where the donor elects to deduct the fair market value of the property.[264] The donor may elect to deduct only his or her basis in the property, in which case the 50% limitation will apply.[265] As above, § 170 and the Regulations allow individuals to carry over contributions in excess of the 30 percent limit for five succeeding taxable years.[266]

8. Increased Deductions for 2006 and 2007 under the Pension Protection Act of 2006

The Pension Protection Act of 2006 has brought welcome relief for individual and corporate taxpayers making contributions made from January 1, 2006 through December 31, 2007. The deductions can now be carried over for Fifteen (15) years after the date of the contribution. Historically, many conservation easement deductions for gifts of long term capital gains property have been used only to the extent of Thirty (30) or (50) Percent of an individual taxpayer's gross income (or "contribution base") and only Ten (10) Percent of a corporate taxpayer's net taxable income. In addition, Subchapter S corporation shareholders faced a reduction of the stock basis in the amount of a charitable deduction effectively rendering the conservation easement charitable deduction unavailable to them. These limitations proved unworkable for many agricultural taxpayers, especially those doing business in corporate form.

<u>Recently-passed tax legislation makes changes to the law relative to deductible donations of conservation easements. Changes are included as Exhibit A, attached hereto. These changes will insert a new subparagraph 170(b)(1)(E) and redesignate subparagraphs (E) and (F) as (F) and (G), respectively. All references in this section will be made according to the new section numbers.</u>

a. Contributions by Individual Taxpayers Using Agriculture or Livestock Production Raised to One Hundred Percent of Contribution Base.

The act creates a special rule for contributions by individual taxpayers of long term capital gain property using agriculture or livestock production.[267]

(1) The term "capital gain property" means any capital asset or property used in the taxpayers trade or business which, if sold, would result in long term capital gain.[268]

(2) The individual must be a "qualified farmer or rancher" for the taxable year in which the contribution was made.[269]

(3) The term "qualified farmer or rancher" means a taxpayer whose gross income from the trade or business of farming (within the meaning 2032A(e)(5)) is greater than 50% of the taxpayer's gross income for the taxable year.[270]

IRC Section 2032A(e)(5) defines farming purposes as:

> (A) Cultivating the soil or raising or harvesting any agricultural or horticultural commodities (including the raising, sheering, feeding, caring for, training, and management of animals) on a farm.
>
> (B) Handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its manufactured state, but only if the owner, tenant, or operator of the farm regularly produces more than _ of the commodity so treated; and
>
> (C) (i) The planting, cultivating, caring for, or cutting of trees, or
>
> (ii) The preparation (other than milling) of trees for market.

(4) For an individual who is a qualified farmer or rancher, the qualified conservation contribution shall be allowed to the extent of 100% of the taxpayer's "contribution base" over the amount of all other charitable contributions.[271] The term "contribution base" means adjusted "gross income" computed without regard to any net operating loss carryback to the taxable year.[272] "Gross Income" is undefined in Section 170.

(5) This provision allowing a deduction of 100% of the taxpayer contribution base for a qualified farmer or rancher is not available for contributions of property made after August 17, 2006 unless property continues to be used for purposes of agriculture or livestock production (or remains available for such production) or *is subject to a restriction that such property remain available for such production*.[273].

b. Contributions by Corporate Taxpayers Using Agriculture or Livestock Production Raised to One Hundred Percent of Contribution Base.

(1) The Pension Protection Act of 2006 also creates a new class of qualified conservation contributions by certain corporate farmers and ranchers.[274]

(2) Generally, the corporation must:

(a) Derive greater than 50% of its gross income from the trade or business of farming (within the meaning of Section 2032A(e)(5) as set out above), <u>and</u>

(b) The stock must not be "readily tradable on an established securities market at any time during the year."[275]

(3) The contribution of property which is used in agriculture or livestock production (or available for such production) must be *<u>subject to a restriction</u> that such property <u>remain available</u> for such production*.[276]

(4) The aggregate amount of the contributions may be carried over for a Fifteen (15) year period after the date in which the contribution is made.[277]

c. Relief for SubChapter S Stockholders making contributions of Long-Term Capital Gain Property.

The Pension Protection Act of 2006 also amended IRC § 1367(a)(2) to provide relief for Subchapter S corporations such that the amount of the shareholder's basis reduction in the stock (which under former IRC § 1367(a)(2)(B) was reduced by the stockholder pro rata amount of the charitable contribution) *<u>is now equal to the stockholder's pro rata share of the adjusted basis of the contributed property</u>*. The provision terminates on December 31, 2007.

d. Relief for Nonagricultural Taxpayers Making Qualified Conservation Easement Contributions.

Subparagraph (i) of IRC 170(b)(1)(E) states: "Any qualified conservation easement as defined in [170(h)(1)] shall be allowed to the extent the aggregate of such contributions does not exceed the excess of 50 Percent of the taxpayer's contribution base over the amount of all other charitable contributions allowable under this paragraph."

e. Ordering of Conservation Easement Deductions and Other Deductions.

If a donor has made contributions other than these new conservation contributions during the year, those contributions are "used up" first against the existing limitations after those contributions are used to the maximum extent allowable, then the conservation contributions are taken into account. As stated by the Joint Committee on Taxation:

> For example, assume an individual with a contribution base of $100 makes a qualified conservation contribution of property with a fair market value of $80 and makes other charitable contributions subject to the 50-percent limitation of $60. The individual is allowed a deduction of $50 in the current taxable year for the non-conservation contributions (50 percent of the $100 contribution base) and is allowed to carryover the

excess $10 for up to 5 years. No current deduction is allowed for the qualified conservation contribution, but the entire $80 qualified conservation contribution may be carried forward for up to 15 years.[278]

C. Estate Tax Treatment of Charitable Contributions

In general, three estate tax provisions in the Internal Revenue Code impact land conservation transactions. The first—§ 2031(c)—concerns an exclusion from the gross estate of the value of land subject to a qualified conservation easement. The second—§2032A—concerns the special use valuation for certain farm and closely-held business property. The third—§ 2055—concerns deductions from the gross estate for bequests, legacies, devises or transfers for public, charitable and religious uses. The materials below discuss each of these provisions individually, in relation to the income tax provisions just discussed and in relation to one another.

Section 2031(c) Exclusion of the Value of Land Subject to a Qualified Conservation Easement

a. In General

Section 2031(c) allows an executor to elect to exclude a portion of the value of land subject to a qualified conservation easement from the decedent's gross estate.[279] Admittedly, this simple synopsis belies the complex requirements necessary to realize the exclusion. Nonetheless, familiarity with § 2031(c) allows estate planners to assist clients and their families in achieving both their conservation goals and significant estate tax savings.

Section 2031(c) applies only to "land subject to a qualified conservation easement."[280] The land must be "located in the United States or any possession of the United States"[281] and "have been owned by the decedent or a member of the decedent's family at all times during the 3-year period ending on the date of the decedent's death."[282] Under § 2031(c), the term "qualified conservation easement" has the same meaning as above, with two exceptions. First, an easement granted for the preservation of an historically important land area or a certified historic structure does not qualify.[283] Second, the restriction on the use of the qualified real property interest must prohibit "more than a de minimis use for a commercial recreational activity."[284] Importantly for estate planners, *the decedent need not have granted the qualified conservation easement during life*. Indeed, § 2031(c) allows the decedent, a member of the decedent's family, the executor of the decedent's estate or the trustee of a trust, the corpus of which includes the land to be subject to the qualified conservation easement, to grant the easement,[285] provided they do so prior to the date for filing the estate tax return.[286] Assuming the easement meets these requirements, the executor must elect the exclusion under § 2031(c) on or before the due date (including extensions) for filing the estate tax return and include the election on the return.[287]

Computing the amount of the exclusion begins with a determination of the land's value for federal estate tax purposes.[288] As Stephens, *et al.* explain:

> If the easement has been placed on the land prior to the date of decedent's death, the value of the land is reduced for gross estate inclusion purposes by the value of the qualified conservation easement at the date of decedent's death. If the qualified conservation easement is placed on the land at or subsequent to the death of the decedent, then the value of the land included within the gross estate is not reduced by the value of the qualified conservation easement; instead, the date of death value of the land without regard to the easement is determined, and then that value is reduced by the amount of any Section 2055 deduction allowed to the estate for the qualified conservation easement.[289]

This valuation method ensures against "the possibility of both a gross estate exclusion and an estate tax charitable deduction for the value of the qualified conservation easement."[290]

Section 2031(c) also reduces the land's value to the extent that it is "debt-financed property."[291] "Debt-financed property" means "any property with respect to which there is an acquisition indebtedness . . . on the date of the decedent's death."[292] Acquisition indebtedness includes the unpaid amount of "the indebtedness incurred by the donor in acquiring such property, the indebtedness incurred before the acquisition of such property if such indebtedness would not have been incurred but for such acquisition, the indebtedness incurred after the acquisition of such property if such indebtedness would not have been incurred but for such acquisition and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition, and the extension, renewal, or refinancing of an acquisition indebtedness."[293]

Finally, § 2031(c) reduces the land's value by the value of any retained development right.[294] "Development right" means "any right to use the land subject to the qualified conservation easement [where] such right is retained for any commercial purpose . . . not subordinate to and directly supportive of the use of such land as a farm for farming purposes."[295] Section 2031(c) allows for termination of any development rights impacting the easement's valuation "[i]f every person in being who has an interest (whether or not in possession) in the land executes an agreement to extinguish permanently some or all of any development rights retained by the donor on or before" the deadline for filing the estate tax return.[296] The executor must file this agreement with the estate tax return.[297] Failure to implement the agreement within two years of the date of decendent's death or before the sale of the land subject to the easement (whichever occurs first) exposes the estate to liability for the tax that would have been due on the retained development rights without an agreement.[298]

Once the land's value is determined, the amount of the exclusion totals *the lesser of* "the applicable percentage of the value of land subject to a qualified conservation easement, reduced by the amount of any deduction under section 2055(f) with respect to such land" or "the exclusion limitation."[299] The materials below explain each of these provisions.

The "applicable percentage" totals 40 percent, reduced (but not below zero) by 2 percentage points for each percentage point (or fraction thereof) by which the value of the qualified conservation easement is less than 30 percent of the value of the land.[300] The value of the land is determined without regard to the value of the easement and reduced by the value of any retained development right.[301]

Compared with the "applicable percentage" requirements, the "exclusion limitation" is relatively simple. The limitation depends of decedent's date of death. For decedents dying in 2001, the limitation is $400,000. For decedents dying in 2002 and later, the limitation is $500,000.

The following examples illustrate the provisions described above. Assume Roger Rancher owns land valued at $1,000,000. In 2002, Roger donates an easement to a qualified organization that reduces the value of the land to $700,000. Assuming the donation qualifies under § 170(h), Roger may take a $300,000 income tax deduction in 2002. In 2004, Roger dies. For estate tax purposes, the value of Roger's land equals $700,000. Under § 2031(c), Roger's executor may elect to exclude an additional $280,000 of the land's remaining value calculated as follows:

> 40 percent of the value of land subject to a qualified conservation easement (40% x $700,000 = $280,000) reduced (but not below zero) by 2 percentage points for each percentage point (or fraction thereof) by which the value of the qualified conservation easement ($300,000) is less than 30 percent of the value of the land determined without regard to the value of the easement ($1,000,000) and reduced by the value of any retained development right (none here). Since the value of the conservation easement is 30 percent of the value of the land without regard to the value of the easement and no retained development rights exist, no reduction from the 40 percent is required. Moreover, since Roger died in 2004 and the applicable percentage of the value of land subject to a qualified conservation easement is less than the $500,000 exclusion amount, Roger's executor may elect to exclude the entire $280,000 of the land's remaining value.

Now assume the donated easement reduces the value of Roger's land to only $900,000. While the value of the land for estate tax purposes equals $900,000, § 2031(c) prohibits Roger's executor from electing to exclude any additional value calculated as follows:

> 40 percent of the value of land subject to a qualified conservation easement reduced (but not below zero) by 2 percentage points for each percentage point (or fraction thereof) by which the value of the qualified conservation easement ($100,000) is less than 30 percent of the value of the land determined without regard to the value of the easement ($1,000,000) and reduced by the value of any retained development right (none here). Since the value of the conservation easement is 10 percent of the value of the land without regard to the value of the easement, § 2031(c) requires the executor to reduce the

applicable 40 percent by 40 percent (2 percentage points for each percentage point by which 10 percent is less than 30 percent). Thus, Roger's executor may not elect to exclude any additional value.

b. Relationship with Income Tax Provisions

The relationship between § 2031(c) and the income tax provisions extends beyond the deduction allowed for qualified conservation contributions under § 170(h). Under § 1014(a)(4), property excluded from the decedent's gross estate under § 2031(c) takes a carryover rather than stepped-up basis for federal income tax purposes.[302] Depending on "who granted the easement when," this rule affects the basis differently.[303]

To use the example above, assume Roger Rancher purchased the land valued at $1,000,000 for $500,000. Whether Roger himself donated the easement or a family member donated the easement with Roger holding the encumbered property at death, the income tax basis remains the same. As described above, the value of the land after the easement donation ($700,000) would have a $350,000 adjusted basis prior to Roger's death ([700,000/1,000,000] x 500,000)[304] and would qualify for a $280,000 exclusion. Under § 1014(a)(1), the basis of the $420,000 included in Roger's gross estate would equal $420,000 (i.e., "the fair market value of the property at the date of decedent's death"). Under § 1014(a)(4), the basis of the $280,000 excluded under § 2031(c) would equal $140,000 ([280,000/700,000] x 350,000). Thus, the total basis of the property would equal $560,000.

Now assume that Roger's executor donated the easement at or after his death. Does the executor determine the total basis for the property then allocate a portion to the contribution or make the contribution and allow the retained portion to absorb all of the carryover basis? Using the figures above, if the executor chooses the former option, the total basis of the property equals $860,000 ([$720,000 for the land included in Roger's gross estate] + $140,000 for the portion excluded under § 2031(c) [280,000/1,000,000 x 500,000]). The executor would apportion the $860,000 between the easement and the property encumbered by the easement according to their relative fair market values. The basis of the property encumbered by the easement would equal $602,000 ([700,000/1,000,000] x 860,000). If the executor chooses the latter option, the retained value of the property equals $700,000 and receives a stepped-up basis of $420,000, and the remainder receives a $140,000 carryover basis, for a total basis of $560,000.

Finally, assume that Roger's family member donates the easement after distribution of Roger's estate but prior to the executor's filing the estate tax return. Assuming the same $280,000 exclusion under § 2031(c) as above, the basis of the property in the hands of Roger's family member equals $860,000 (720,000 + 140,000). On the donation of the easement, that basis is allocated between the retained and donated portions of the property[305] and the basis of the encumbered property equals $602,000 ([700,000/1,000,000] x 860,000). However, if the § 2031(c) exclusion amount equals $400,000, the total basis of the property equals \$800,000 (\$600,000 + \$200,000) and, on donation of the easement, 70% of that basis (\$560,000) is allocated to the retained property.

c. Relationship with § 2032A

The relationship between § 2031(c) and § 2032A is somewhat murky. In general, the executor's election to exclude a portion of the value of land subject to a qualified conservation easement from the decedent's gross estate under § 2031(c) does not prevent an election to value the property under § 2032A.[306] Moreover, the donation of a qualified conservation contribution is not a "disposition" subjecting the estate to additional tax under § 2032A(c)(1)(A).[307] Beyond these provisions, however, the relationship becomes uncertain. As Stephens, *et al.* explain:

> [The] problems between the two sections involve the issue of the extent to which one section is taken into consideration in satisfying the qualification requirements under the other section. A chicken and egg type Section 2031(c) – Section 2032A interrelationship problem occurs when real property that is potentially eligible for a Section 2032A reduction in value is also potentially eligible for a Section 2031(c) exclusion and an executor elects the application of both sections. It is unclear which section is applied first.[308]

Because neither section addresses the impact of the other, "[t]he question is best resolved by assuming that the other section is applicable in determining qualification under each section, i.e., measuring the amount of the Section 2031(c) exclusion by using Section 2032A valuation and testing Section 2032A qualification by applying the Section 2031(c) exclusion."[309]

If the executor values the easement-encumbered property under § 2032A, they should use this valuation in determining the amount of the exclusion under § 2031(c). Conversely, if the executor elects the exclusion under § 2031(c), the executor must account for this election in determining the property's qualification for valuation under § 2032A.

Property acquired from the decedent by a qualified heir which, on the date of the decedent's death, was used for a qualified use[310] must satisfy two tests to qualify for valuation under § 2032A.[311] First, 50 percent or more of the adjusted value of the gross estate must consist of the adjusted value of real or personal property which (i) on the date of the decedent's death was being used for a qualified use by the decedent or a member of the decedent's family, and (ii) was acquired from or passed from the decedent to a qualified heir of the decedent.[312] Second, 25 percent or more of the adjusted value of the gross estate must consist of the adjusted value of real property (i) acquired from or passed from the decedent to a qualified heir of the decedent which (ii) for periods aggregating 5 years or more during the 8-year period ending on the date of the decedent's death was owned by the decedent or a member of the decedent's family and used for a qualified use by the decedent or a member of the decedent's family in which the decedent or a member of the decedent's family materially participated.[313]

Under both tests, the adjusted value of the gross estate (i.e., the denominator of the fraction) is determined without regard to § 2032A.[314] Accordingly, the executor's election to exclude a portion of the value of land subject to a qualified conservation easement from the decedent's gross estate under § 2031(c) should reduce the denominator of both fractions. The adjusted value of any real or personal property (i.e., the numerator of the fraction) is likewise determined without regard to § 2032A.[315] However, the effect on qualification for § 2032A valuation is less clear. As Stephens, *et al.* explain:

> If the land subject to the easement is not a part of the special valuation property, Section 2031(c) has no effect on the numerators. If the land is a part of the special valuation property, then the nature of the Section 2031(c) exclusion becomes relevant. If, as is likely, the nature of the Section 2031(c) is effectively a reduction for estate tax purposes in the value of specific land, the n the exclusion would reduce the numerators of both of the fractions. In the alternative, if the nature of the Section 2031(c) exclusion is related to a dollar amount and not a specific asset, then the numerators of neither fraction would be reduced by the Section 2031(c) exclusion.[316]

III. CURRENT DEVELOPMENTS: LAND TRUSTS, TAXPAYERS, APPRAISERS AND PROMOTERS UNDER SCRUTINY.

As a part of much broader concerns about abuses in the charitable tax community, Congress and the Internal Revenue Service have begun to scrutinize the use of conservation easement transactions.[317]

In response to perceived abuses, on June 30, 2004, the Internal Revenue Service published Notice 2004-41 warning that it will impose penalties for overstated deductions on conservation easement transactions on taxpayers, promoters and appraisers. *See* copy of IRS Press Release announcing Notice 2004-41 attached as Exhibit B. The notice provides no new substantive law but places increased focus on a taxpayer's need for a qualified appraiser and the need for strict adherence to IRC 170(h) code and regulations.

In a speech before the land trust community on March 28, 2006, Commissioner Steven T. Miller discussed Notice 2004-41, problems with open space easements, non uniform appraisal standards, and the new reporting requirements under Forms 1023, 990, and 8283.[318] A copy of his speech is attached as Exhibit C and should be reviewed by tax advisors representing a taxpayer contemplating a conservation easement transaction of any significant size. The comments set forth the IRS's increasing concern over the following areas: valuation and appraisals; disqualification of appraisers against whom penalties have been assessed, abuses of open space easements; conservation buyer programs; perceived abuses of natural habitat easements and the decision by the IRS to appeal the *Glass* case; and the increased reporting requirements for both the taxpayer and the land trust community.

The IRS has responded to these concerns by instituting stronger reporting requirements and imposing penalties on donors and appraisers for valuation abuses.

A. Update on New Reporting Requirements of Forms 1023, 990, and 8283

1. Forms 1023 and 990

The IRS has made small changes in Forms 1023 and 990. The IRS has modified Form 1023, the application for tax-exempt status, to identify better the organizations that accept conservation easement donations; and has also modified Form 990, the annual reporting return for exempt organizations, to identify that an organization has accepted a conservation easement donation that year.[319]

2. Form 8283

The IRS has published a new Form 8283 and new instructions that require additional information to be provided to them when claiming a noncash charitable contribution in an amount exceeding $500. The new Form 8283 and instructions are attached hereto as Exhibit D. Conservation easement donors who have not yet filled out their Form 8283 for deductions claimed in 2005 should use the new form.

The new form requires that conservation easement donors attach a statement to their 8283 that identifies the conservation purposes furthered by the donation. Further, the new form includes requirements that conservation easement donors substantiate their deduction claims by attaching statements from both the donor and appraiser that "if before and after valuation is used, the Fair Market Value of the underlying property before and after the gift." This statement must also include whether the donation was made to get a permit or other approval from a governing authority, whether the appraiser or a related person has an interest in property nearby, and must include the method of valuation and the specific basis for the valuation.

Further, the new instructions provide that "[t]he donee must be a qualified organization as defined in section 170(h)(3) and must have the resources to be able to monitor and enforce the conservation easement or other conservation restrictions." The new rules provide that the donor must give the donee documents such as maps and photographs that establish the property's condition at the time of the gift.

The U.S. Tax Court recently released a summary opinion which offers some clarification and boundaries on the topic of whether a claimed charitable contribution deduction should be disallowed for failure to meet the substantiation requirements under the tax regulations.[320] The petitioners claimed a deduction for conservation easement donations made on two parcels of property in 2001. They attached Form 8283, Noncash Charitable Contributions, to their 2001 income tax return. The taxpayers did not identify their contribution as a bargain sale or acknowledge payment received from the donee foundation, as required by the form's instructions. Also, the petitioners' Form 8283 was not signed by a representative of the donee foundation and was not signed by an appraiser. Three years later, the IRS examined the 2001 tax return and sent the petitioners a request for the donee foundation's signature and a complete qualified appraisal. Petitioners responded by filing

Form 8283 signed by a representative of the foundation, but did not include an appraiser's signature. Thereafter, the IRS issued a notice of deficiency, disallowing the claimed deduction in full. Petitioners then had an appraisal conducted in 2005, and submitted it in 2006, signed by the appraiser.

The Court relies in part on the provisions of the Deficit Reduction Act in its opinion, stating that "DEFRA section 155 instructs the Secretary to prescribe heightened substantiation requirements for certain noncash charitable contributions."[321] This Act provides that the regulations must require the taxpayer to obtain a qualified appraisal of the property, attach an appraisal summary to the tax return, and include any information as the Secretary may prescribe.[322]

The Court adheres strictly to the definitions of "qualified appraisal" and "appraisal summary" as set forth in the tax regulations, and emphasizes that the petitioners had not demonstrated "substantial compliance" with those definitions or the requirements of Form 8283's instructions.[323] The Court further explains that petitioners' would not prevail with an argument rooted in the substantial compliance doctrine when they had failed to have a timely appraisal, to include an appraiser's signature with their original return, and to indicate that they received payments from the donee foundation.[324] The Court confirms that the "qualified appraisal" requirement is mandatory, and that failure to obtain one means that the petitioners cannot take advantage of the substantial compliance doctrine.[325]

In summary, the Tax Court provided that it is not a court of equity, and does not have power to relieve taxpayers from the deadlines fixed by legislatures, even if the result is at times harsh to taxpayers.[326] The lesson to be taken away from this opinion is that donors must be very thorough in providing adequate reporting to the IRS when claiming a conservation easement deduction.

B. The Increased Burden on Appraisers

The new law seeks to prevent abusive overvaluation of conservation easement donations by providing strong tax incentives for the donation of conservation easements and strong disincentives in the form of steep penalties for the inflation of value by appraisers of these easements and the donors who rely on them. The IRS has essentially shifted much of the task of regulation of claimed conservation easement donations from their own department to the conservation easement appraisers, while maintaining what it considers to be an important provision of the code that encourages this type of philanthropic behavior. Steven T. Miller recently revealed part of the IRS's reasoning behind this approach of the new law in a speech, stating, "There are those who see [regulation of appraisers] as key to curtailing some of the problems in the area of conservation easements."[327] He further states that, "One of Commissioner Everson's strategic goals is to increase our review of professional standards—and this area is directly impacted. So we are looking at appraisals and appraisers very carefully.[328]

Under the Pension Protection Act of 2006, the definition of "qualified appraiser" is now provided by statute, and requires appraisers to have certain objective credentials. The thresholds for underpayment on which taxpayer penalties are based have been lowered. Also, Code Section 6695A provides penalties against appraisers involved in overvaluation of conservation easement donations.

From a tax perspective, the new benefits available for conservation easement donors in the wake of the Pension Protection Act of 2006 ("Act") have never been better. However, the provisions of the Act have increased the risk to appraisers in making conservation appraisals, and appraisals will continue to be carefully scrutinized by the IRS for accuracy. The penalties for what the IRS considers to be inaccurate appraisals are now larger and the thresholds for error lower. It is important that appraisers doing conservation work have a solid understanding of the new requirements set forth by the Act as well as the risks involved. The IRS will likely work with the large appraisal organizations to form more detailed valuation guidelines for appraisers during this period of transition. In the meantime, the IRS has issued transitional guidance on compliance with new provisions until regulations are issued.

C. Summary of New Deduction Parameters

Adjustment to Deductions Limitations and Carry-Forward Period. For conservation contributions made between January 1, 2006 and December 31, 2007, the Act has significantly increased an individual taxpayer's deduction limitation for contributions of capital gain property by increasing the deduction limitation to 50% of an individual's contribution base. A qualified farmer or rancher may tax a deduction of up to 100% of his contribution base. Further, deductions may be carried over for 15 years after the contribution year.

A "qualified farmer or rancher" is an individual whose gross income from the trade or business of farming exceeds 50% of the taxpayer's gross income for the taxable year. The definition of trade or business of farming includes cultivating the soil or raising or harvesting agricultural or horticultural commodities (including animals); handling, drying, packing, grading, or storing agricultural or horticultural commodities in their manufactured state, if the operator regularly produces over half of the product as treated; and the planting, cultivating, caring for, cutting, or preparing of trees for market.

As you can see, many non-incorporated farmers and ranchers have an opportunity to benefit substantially from this new legislation. However, the Act also includes similar benefits for corporate farmers and ranchers (that are not publicly traded) who derive over half of their gross income from the trade or business of farming as described above. While the income tax deduction for property held by C-corporations has been 10% in the past, there has been a 90% swing in the allowable deductibility of easement donations on this property, if the C-corporation makes over 50% of its income as a "qualified farmer and rancher" as defined in the preceding paragraph. This will be an incredibly valuable tool for large family ranches. This income tax deduction will continue even after a shareholder passes away because the corporation as an entity lives on. Because the size of the deduction limitation is now so expansive, a disgruntled taxpayer with a gross or substantially misstated appraisal who has been penalized by the IRS will be quite motivated to pursue the appraiser for penalties and other damages incurred in reliance on the appraisal.

D. Discussion of New Qualification Requirements under the Act

Under the Act, the definition of "qualified appraiser" is now provided by statute, including objective credentials. This definition raises the bar on the qualifications that must be fulfilled for an appraiser to be eligible to perform these appraisals. On November 13, 2006, the IRS issued Notice 2006-96 as transitional guidance on the definitions of "qualified appraisal" and "qualified appraiser" regarding substantial or gross valuation misstatements post-Pension Protection Act of 2006.[329] Taxpayers may rely on the contents of this notice until new regulations are issued under § 170(f)(11). This guidance applies to all returns filed after February 16, 2007.

1. Definitions of "Qualified Appraiser" and "Qualified Appraisal"

To claim a charitable deduction for conservation easement valued at over $5,000.00, a taxpayer must obtain a "qualified appraisal" from a "qualified appraiser" pursuant to IRC § 170(f)(11). Under the old law, if an appraiser held himself out to the public as an appraiser and regularly performed appraisals, and had some subjectively adequate credentials, this was sufficient for the appraiser to be considered a "qualified appraiser." The new provision under the Act specifies that an appraiser must meet specific and objective indicators of valuation competency to be eligible to perform tax-related appraisals.

Qualified Appraiser. The new definition defines a "qualified appraiser" as an individual who (1) has either earned "an appraisal designation from a recognized appraiser organization" or has met "minimum education and experience requirements;" (2) regularly performs appraisals and is compensated for them; (3) can demonstrate verifiable education and experience in valuing the type of property for which the appraisal is being performed; (4) has not been prohibited from practicing before the IRS by the Secretary at any time during the three years preceding the appraisal; and (5) is not excluded from being a qualified appraiser under applicable Treasury regulations. The appraiser must also meet other requirements that the Treasury Secretary may set.

Notice 2006-96 provides that an appraisal designation from a recognized professional appraiser organization is sufficient if it is "awarded on the basis of demonstrated competency in valuing the type of property for which the appraisal is performed.[330] Further, Notice 2006-96 provides that an appraiser will be treated as having demonstrated verifiable education and experience in valuing the type of property subject to the appraisal if the appraiser makes a declaration in the appraisal that, "because of the appraiser's background, experience, education, and membership in professional associations, the appraiser is qualified to make appraisals of the type of property being valued.[331]

Qualified Appraisal. Prior to the Act, an appraisal was considered a "qualified appraisal" as long as it included a description of the method of valuation used to determine the fair market value. Now, a "qualified appraisal" is defined as an appraisal prepared "in accordance with generally accepted appraisal standards…". The new law does not specifically mention the Uniform Standards of Professional Appraisal Practice (USPAP), but in Notice 2006-96 the IRS recognized USPAP as the appropriate standard for determining the fair market value for auditing taxpayer appraisals.

IRC § 170(f)(11) provides that for donated property with a value exceeding $5,000.00, a "qualified appraisal" document is required to be attached to the taxpayer's tax return. Treas. Reg. 1.170A-13(c)(3) states that a "qualified appraisal" means an appraisal that, among other things, (1) relates to an appraisal that is made not earlier than 60 days prior to the date of contribution of the apprised property and not later than the due date of the return on which a deduction is first claimed under § 170; (2) is prepared, signed, and dated by a qualified appraiser; (3) includes a description of the property appraised, the fair market value of the property on the contribution date as well as the specific basis for the valuation, a statement that such appraisal was prepared for income tax purposes, the qualifications of the qualified appraiser, and the signature and taxpayer identification number of such appraiser; and (4) does not involve an appraisal fee that violates certain prescribed rules. Notice 2006-96 provides that for returns filed after February 16, 2007, this declaration must include an addition statement "that the appraiser understands that a substantial or gross valuation misstatement resulting from an appraisal of the value of property that the appraiser knows, or reasonably should have known, would be used in connection with a return or claim for refund, may subject the appraiser to a civil penalty under §6695A".[332]

2. Increased Taxpayer Penalties and Appraiser Accountability and Penalties

Some of the new provisions of the Act are meant to promote greater accuracy by appraisers conducting tax-related appraisals, and also to increase the accountability of appraisers by including lower thresholds and stiff penalties for what the IRS determines to be erroneous appraisals. The Act provides greater accountability on appraisers making tax-related valuations by providing lower thresholds for what the IRS considers errors in valuation, increased penalties for valuation misstatements, and imposition of standards of practice before the IRS that are now imposed on tax practitioners. These new provisions will apply to returns and appraisals prepared for returns filed after August 17, 2006.

a. Penalties on Taxpayers for "Substantial" and "Gross" Valuation Misstatements

The tax code provides a threshold percentage for accuracy within which an appraisal would be considered acceptable for income and estate and gift tax purposes. The Act has tightened these thresholds significantly.

<u>Income Tax</u>. For income tax purposes, IRC § 6662(e) now provides that there is a "substantial" valuation misstatement when the claimed value of property is 150% or greater of the amount determined to the correct value.[333] Further, a "gross" valuation misstatement occurs when the claimed value of property is 200% or greater of the amount determined to be the correct value.[334]

Estate and Gift Tax. For estate and gift tax purposes, IRC § 6662(g) provides that a "substantial" valuation misstatement exists when the claimed value of property is 65% or less of the amount determined to be the correct value.[335] A "gross" valuation misstatement exists when the claimed value of property is 40% or less of the amount determined to be the correct value.[336]

In general, the penalty assessed to the taxpayer is 20% of the underpayment of tax due to a "substantial" valuation misstatement and 40% for a "gross" valuation misstatement.[337]

b. Penalties on Appraisers for Valuation Misstatements

The new Act includes stiff penalty provisions for appraiser found in violation making valuation determinations found to be outside of the stated thresholds. Under IRC § 6695A(b), penalties assessed will be the greater of $1,000.00 or 10% of the amount of tax attributable to the misstatement up to a maximum of 125% of the gross compensation received for the appraisal.[338] An exception in the new provision provides that a penalty will not be imposed if the appraiser shows that the appraised value was "more likely than not the property value."[339]

c. Disciplinary Action against Appraisers

The new provision eliminates the requirement that the Secretary assess a civil penalty for "aiding and abetting" an understatement of tax before disciplinary action may be taken by the Department's Office of Professional Responsibility. Now, the Secretary is authorized to discipline appraisers for violating standards of practice applicable to all tax practitioners. The disciplinary action may include suspension or disbarment from preparing or presenting appraisals on the value of property to the Department of Revenue (the "Department") or the IRS; appearing before the Department or the IRS to offer opinion evidence on the value of property or other assets; and providing that the appraisals of an appraiser who has been disciplined have no probative effect in any administrative proceeding before the Department or the IRS.

3. The Need for Careful Communication between Taxpayers and Appraisers

There has been much discussion about how much an appraiser should be involved before the donation with the taxpayer in making an estimate as to the deduction that a taxpayer may get for donation of a conservation easement. Considering the new provisions available, appraisers are sure to become involved in this process more closely by providing conservation easement valuation estimates to landowners considering this option. Therefore, it is important that appraisers are fully informed about the risk that they face in the event that a taxpayer for whom they have conducted a conservation easement appraisal is audited by the IRS in regard to the claimed donation. As you know, going through an audit is a costly process for a taxpayer, as taxes, interest, and penalties must be paid up-front unless the taxpayer elects to pay the tax and sue in Federal District Court for a refund. It is important taxpayers also be informed appropriately regarding additional fees that will be charged to the taxpayer in preparing a defense of the appraisal in question.

IV. State law and Practical Drafting Considerations

Without question, practitioners advising conservation-minded clients must possess a working knowledge of state law real property issues underlying the conservation easement document, in addition to the federal income, estate and gift tax provisions described above. Further, practitioners must take into account the applicable state conservation easement law when designing a conservation easement to qualify for Federal income tax deductibility to meet the "conservation purposes" requirement.[340] With that in mind, the following materials offer a brief outline of state real property issues and some real-world drafting examples.

A. State Enabling Statutes and the Uniform Conservation Easement Act

State enabling statutes play a key role in conservation easement donations. It is crucial that conservation easement practitioners consider state law in addition to the federal requirements to achieve successful conservation easement donations. These statutes eliminate for conservation easement donors a variety of common law impediments undermining the easement's validity. The following materials provide a brief overview of these impediments and explain how the Uniform Conservation Easement Act ("UCEA") removes them.

The common law disfavored conservation easements for several reasons. First, it considered conservation easements "easements in gross." As such, they were not "appurtenant easements" with benefited and burdened estates, could not be assigned and did not "run with the land."[341] Second, it viewed conservation easements as "negative easements" that imposed restrictions on the use and enjoyment of the property, which were disfavored at common law.[342] Third, it assumed non-landowners holding a conservation easement, such as charitable organizations or government agencies, lacked privity because they essentially had no tangible real estate interest in the easement property. Finally, it questioned whether third parties, such as a land trust or governmental agency holding the conservation easement, had standing to enforce easement violations by injunctive relief.[343] State enabling statutes seek to remove the conceptual limitations of the common law as applied to conservation easements.

State enabling statutes seek to remove the conceptual limitations of the common law. As Exhibit E illustrates, a majority of states have enacted enabling statutes and many have adopted the UCEA verbatim. Given this fact, and because a survey of the various state enabling statutes would exceed the scope of these materials, the following paragraph briefly summarizes the UCEA provisions.

In general, the UCEA enables the owner of a fee interest in land to grant a conservation easement to a nonpossessory land trust, charitable organization or governmental agency with the power and authority to enforce the easement terms, regardless of the nature of the party's interest in the property.[344] The UCEA allows these organizations to enforce the affirmative obligations undertaken by the easement's grantor. In contrast, the common law limited these third parties' enforcement abilities based on their status as nonpossessory parties.[345] These affirmative obligations may include maintenance for a historical façade easement.[346] More importantly, the entity or organization holding the conservation easement may enforce the easement's terms against any subsequent owner in fee of the property, regardless of the "in gross" nature of the easement.[347] The UCEA enables the entity or organization holding the conservation easement to transfer these enforcement rights to a third party.[348] Although not part of the UCEA, several states enacting it have adopted the following section that expressly requires the consideration of a conservation easement by a local tax assessor: "For valorem tax purposes, real property that is burdened by a conservation easement must be assessed and taxed on the basis that reflects the existence of the easement."[349]

B. Practical Drafting Considerations

As donors become more sophisticated, their need for comprehensive advice concerning the tax treatment of complex and often confusing scenarios increases. Though each scenario is unique, the following list describes some issues and questions that frequently arise in conservation easement transactions:

1. Perpetual means forever. A conservation easement is a recorded grant of a real property interest but the grant is perpetual, if so allowed under applicable state law (only North Dakota limits conservation easements temporarily to ninety-nine years).[350]

2. Who or what is the grantor? The grantor is typically the fee owner of the property. If not an individual or pass through entity, the charitable deduction income tax deduction may be severely limited.[351]

3. Timing is important. The grant should occur no earlier that one year after the initial acquisition of the property to maximize the charitable deduction, unless the grantor has made a conscious decision to use his basis as the "before value."[352] If the grantor's land is mortgaged, negotiations with the grantor's lender for a subordination agreement should be initiated.

4. Who is the land trust? The grantee must be authorized under the applicable state's conservation easement statute and must be a qualified organization under Regulation 1.170A-14(c), usually either a governmental agency or 501(c)(3) corporation-land trust established locally. The grantor should compare land trusts, know their enforcement, inspection and amendment policies, and review easement language from other easements used by the prospective land trust. The conservation objectives of land trusts may vary. To determine whether a particular land trust is appropriate for the donor, it is important for the grantor to be informed about the mission of the land trusts under consideration.

5. Get the appraiser involved early. An independent appraiser will need to appraise the property to establish the value of the conservation easement granted. This appraisal must be filed by the regular due date with the taxpayer's return.[353] Selecting an appraiser with comparable conservation easement data on file and a familiarity with conservation easement appraisals is critical, especially since the grantor may be required to pay for the appraisal.[354]

6. Is public access necessary? The grantor should consider the conservation value to be protected in light of the requirement of public access. Conservation easement grantors may be dissuaded from granting conservation easements because they mistakenly believe that an open space easement requires public access. Public access is not required for an open space easement granted pursuant to a clearly delineated government policy, nor is it required for a natural habitat easement.[355] In contrast, a scenic enjoyment easement requires visual (rather than physical) access to or across the property by the general public.[356] However, the grantee under such an easement, upon prior notice to the grantor, has rights to enter upon the property to inspect the same and to monitor the grantor's compliance with the terms of the easement.

7. What will the restrictions really be? The Grantor should consider the conservation value to be protected in light of clearly identifiable goals to avoid future problems with inspections and enforcement with the land trust. The easement should not be vague and open to subjective interpretations. Nor should the easement include rigid, inflexible resource management guidelines.

8. Coordinate with local planning authorities on an open space easement. The recitals of an open space conservation easement often state that the conservation easement is consistent with a local county comprehensive plan to preserve open space in agricultural lands in the area. To ensure compliance with the Regulations, some recitation of the clearly delineated federal, state or local government policy should be inserted.[357] Regulation 1.170A-14(d)(4)(iv) sets out the criteria to be used in developing the government policy. Practically, a simple meeting with local county commissioners or municipal planning authorities who resolve to accept the easement as part of the comprehensive plan of the city or county can achieve the clearly delineated government policy.[358]

9. Read the prohibited and permitted uses paragraphs closely. Uses expressly prohibited under open space conservation easements typically include subdivision, mineral exploitation, and the establishment of commercial or industrial facilities. The governing principle underlying this section of the conservation easement is set forth in Regulation 1.170A-14(e), which requires that the easement be contributed "exclusively for conservation purposes. Any use that is destructive of the conservation easement will be permitted only if the use is necessary for the protection of the conservation interest that it is

subject to the contribution."[359] Prohibited uses obviously vary depending on the particular transaction involved, as well as the collective philosophy and mission of the land trust or governmental agency that will "hold" the easement. Understanding the standards and practices of the individual land trust or governmental agency and reviewing other conservation easements accepted by that land trust or governmental agency is critical in negotiating the prohibited and permitted uses section of the easement. Exhibit F includes a comprehensive set of prohibited and permitted uses typically provided in conservation easements granted to the Montana Land Reliance.

10. What is the grantor's land use plan today and fifty years from now? Prior to expending considerable time in drafting the permitted uses provision of the easement, the grantor should consider what land may not be a necessary part of the conservation easement grant. Alternatively, the grantor should consider the retention of a "development envelope" for building or other purposes before granting the easement. The land trust may be concerned about activity occurring on inholdings surrounded by easement-encumbered property that jeopardize the conservation values to be protected under the easement.

11. How important is the estate tax exclusion? The permitted uses provisions of an open spaces conservation easement may jeopardize the estate tax exclusion under § 2031(c) as those permitted uses can be characterized as retained development rights under § 2031(c)(5)(D). That section defines the term "development right" as any right to use the land subject to the qualified conservation easement in which such right is retained for any commercial purposes which is not subordinate to and directly supportive of the use of such land as a farm for farming purposes within the meaning of § 2032(a)(e)(5). The statute is unclear. No regulations implement it and only one private letter ruling has interpreted this provision.[360] Broad permitted uses retained by the conservation easement grantor which are not "subordinate to and directly supportive of the land for farm purposes" can be characterized as retained development rights under the existing statutory definition of § 2031(c)(5)(D). Fortunately, the easement grantor's personal representative or executor can excise the retained development rights post mortem and obtain the estate tax exclusion. The election must be made by the time of the filing of the federal estate tax return.[361]

12. How flexible will the land trust be on amendments? The grantor should understand the land trust's amendment policy before granting the easement. Conservation easement donors often want to modify the easement for uses not contemplated at the time of the original grant (e.g., development, gravel extraction, additional building sites or countless other uses that may or may not materially affect the conservation values protected). The inquiry is not limited to whether the use will materially affect the conservation values protected. Rather, the amendment must be consistent with the conservation purpose of the easement, must not affect its perpetual duration, and must

enhance, or have no effect on, the conservation values protected by the easement. Private inurement is again the underlying principle. That is, the public benefit must outweigh the private benefit retained or conferred.[362] In response to difficulties encountered in seeking permission to amend a conservation easement, the conservation easement donor must exercise foresight at the time of the original grant. Refraining from conveying all of the grantor's property under a conservation easement, with the idea of later encumbering that property in exchange for an amendment to the original easement, may help prevent the grantor from being at the mercy of the land trust's board which may take an unduly restrictive interpretation of private inurement. Likewise, relinquishing unneeded commercial activities under the permitted uses provision of an existing conservation easement, which enhance the conservation values to be protected, may facilitate amendment of the original conservation easement.

13. What is the cost of receiving a state tax credit? In states offering conservation easement tax credits,[363] the grantor should be aware of the possible claim that the receipt of this consideration may jeopardize the income tax deduction pending outcome of IRS consideration.

14. Coordinate with the Estate Planner. Coordinate holding requirements under IRC 170(e) (the one year holding requirement to achieve the highest deduction) with estate tax planning and the funding of family limited partnerships, limited liability companies and other limited liability entities. Consider granting the easement before funding the limited liability entity.

15. Retain independent counsel. The grantor should be independently represented at the time of the original grant and not rely on and accept without independent scrutiny conservation easements drafted by the land trust, government agency or their counsel.

C. State Real Property Tax Considerations

By limiting the use and development potential of land, conservation easements generally reduce the value of property and thus the amount of real property tax assessed against property.[364] At least twenty four states have enacted legislation expressly requiring that conservation restrictions be considered in establishing the value of land for property tax purposes.[365] According to one study conducted in Massachusetts, assessed values range from thirteen to ninety five percent of fair market value.[366] Though not part of the original UCEA, several states enacting it have adopted the following section that expressly requires the consideration of a conservation easement by the tax assessor:

> For valorem tax purposes, real property that is burdened by a conservation easement must be assessed and taxed on the basis that reflects the existence of the easement.[367]

In addition, statutes in several non-UCEA states require property tax relief or income tax credits attributable to conservation easements.[368] Practitioners should consult local appraisal policies.

D. Like Kind Exchanges of Conservation Easements

In several recent Private Letter Rulings, the IRS has concluded that the exchange of a perpetual conservation easement encumbering one property for a fee interest in another property constitutes a like kind exchange for purposes of § 1031.[369] Regulation 1.1031(a)-1(b) provides generally that, as used in § 1031(a), the words "like kind" refer to the nature or character of the property and not to its grade or quality. One kind or class of property may not be exchanged for property of a different kind or class. The fact that any real estate involved is improved is not material, as that fact relates only to the grade or quality of the property and not to its kind or class. Unproductive real estate held by one other than a dealer for future use or future realization of the increment in value is held for investment and not primarily for sale. The key consideration is whether a conservation easement is considered a real property interest, as opposed to a contract interest, under applicable state law. Though somewhat beyond the scope of these materials, it should be noted that land trusts may apply for funds under the Farm Security and Rural Investment Act of 2002 to purchase conservation easements on farmland.[370] Using these funds in a like-kind exchange allows the landowner to defer capital gains taxes and acquire additional property for business, trade or investment.[371]

Special Problem: Opportunities under the New Deduction Limitations under the PPA of 2006

Fred and Joan Wills, ages 70 and 67, have a 15,000-acre ranch in Big Horn County, near Hardin, Montana. They run a 700-head cow/calf and bull herd which they have built up for the last twenty years. The current value of the herd is $800,000, including the calf crop for 2006. Their ranch is a Sub-S Corporation with 4,000 acres bordering, or in close proximity to the Big Horn River. In addition to being a working cattle ranch, the property also has native deer, antelope, sage hen, and other natural habitat. Their basis in the ranch real estate is $20 per acre, but Fred and Joan have no basis in the stock in the corporation, having used losses against their income for many years in the 1980's.

Fred and Joan have heard about conservation easements and spoken to Lefty Smith, a new appraiser in the area about the potential tax benefit to them if they restrict the development of their property. Fred and Joan have approached the Great Plains Land Trust which has recently established an office in Billings, and they have agreed to accept the land under easement protection. The staff at Great Plains has informed Ted and Jane that no other development, subdivision or surface mining will be allowed and commercial development will be restricted to home-based businesses on four designated homesites. Full agricultural uses will continue to be permitted on the property.

Fred and Joan have been approached by Jay Ray who would like to purchase and develop 1,920 acres of river front property to sell in twelve 160-acre parcels. Jay Ray will offer them to Billings sportsmen for $4,000 per acre, or $640,000 per parcel, with one homesite per parcel. Each parcel would have river access through common easements. Jay Ray has offered to purchase the property from Fred and Joan for $3,000 per acre.

Apart from the riverfront property which Jay Ray wants to purchase, Fred and Joan have identified four future homesites that they would like to provide for their grandchildren. They have decided to limit divisions of the ranch to two 5,000-acre units and one 13,080-acre unit, which excludes the 1,920-acre tract to be sold to Jay Ray for development.

Lefty has determined that the value of the retained ranch will be reduced by Forty Five Percent or by Five Million Seven Hundred and Sixty Thousand Dollars ($5,760,000) with a conservation easement.

On the ranch property targeted by Jay Ray, Great Plains staff is aware of Ray's idea of developing three sections of riverfront property. The staff is aware of an individual in the Big Horn Planning office who may even be willing to assist in getting minor plat approval for more than one transferable homesite on each 160-acre parcel, provided the remainder of the development will remain in open space and natural habitat protection. Ray believes this will allow pricing in the range of $7,000 per acre and may increase his offer to Fred and Joan to $4,000 per acre on this property. Great Plains may be willing to place a portion of each 160-acre parcel into conservation protection if approached by Jay Ray or his buyers. Ray is interested in marketing to conservation easement buyers and has heard about the 2006 tax provisions. Also, Great Plains staff and board are interested in significant cash contributions.

Here is a chart Lefty has prepared:

Land Classification	Acres	Price Per Acre	Total on Retained Property before Conservation Easement	Total after Conservation Easement
Improved Grassland	8,000	$400	$3,200,000	
Cropland	3,000	$1000	$3,000,000	
Riverfront (retained)	2,080	$4000	$8,320,000	
Riverfront (sold)	1,920	$3000 (or $7000) $5,760,000 (or $13,344,000)		
Total Value of Retained Acreage, per Lefty Smith			$14,520,000	$7,986,000
Conservation Easement Donation				6,534,000

What planning opportunities exist in 2006 or 2007 for Fred and Joan? Can they sell the cattle herd, carve out the Jay Ray sections and sell them, sign the conservation easement, and retire to Sedona, Arizona?

ENDNOTES

[1] Unless otherwise noted, all references in these materials are to the Internal Revenue Code of 1986, as amended, and the regulations thereunder.
[2] IRC § 170(c).
[3] Rev. Rul. 83-104, 1983-2 C.B. 46.
[4] Adler v. Commissioner, 5 B.T.A. 1063, 1066 (1927).
[5] *See, e.g.,* Christensen v. Commissioner, 40 T.C. 563 (1963) (denying a deduction for amounts credited to separate accounts in the names of two charities on the taxpayer's personal books) and Nehring v. Commissioner, 131 F.2d 790 (7th Cir. 1942) (denying a deduction under similar circumstances over the taxpayer's argument that he had effected contributions by crediting accounts and informing the donee of the credits).
[6] *See, e.g.,* Pauley v. United States, 459 F.2d 624 (9th Cir. 1972).
[7] Treas. Reg. 1.170A-1(e) (emphasis added).
[8] PLR 7906042.
[9] Morgan v. Commissioner, 309 U.S. 78, 80 (1940).
[10] *See* Pauley, *supra*, note 6.
[11] Johnson v. United States, 280 F.Supp. 412 (1967).
[12] *See* Treas. Reg. 1.170A-7(a)(2) (allowing a deduction "for a contribution of a partial interest in property if such interest is the taxpayer's entire interest in the property").
[13] Rev. Rul. 82-197, 1982-2 C.B. 72.
[14] *Id*. (reasoning that "a promise to pay money or to sell property in the future is not itself a 'payment' for purposes of deducting a contribution under section 170 of the Code.").
[15] *Id.*
[16] Treas. Reg. 1.170A-8(a)(2) defines "to or for the use of." The distinction bears on the percentage limitations under § 170(b) and applicable Regulations addressed below.
[17] IRC § 170(c)(1) includes Indian tribes qualifying for "treatment as states" status. *See* IRC § 7871(a)(1)(A). *See also* Indian Tribal Governmental Tax Status Act of 1982, P.L. 97-473, 96 Stat. 2605 (1983), as amended by the Social Security Amendments Act of 1983, P.L. 98-21, 97 Stat. 65 (1983) (allowing Indian tribes to be treated as states or political subdivisions thereof for certain tax purposes, including charitable contributions, for 1983 and 1984); Rev. Rul. 86-17, 1986-1 C.B. 550 (deleting the two-year limitation); and Rev. Rul. 86-44, 1986-1 C.B. 376 (declaring obsolete a series of rulings based on the assumption that Indian tribes were neither states nor political subdivisions of states for certain tax purposes, including charitable contributions).
[18] IRC § 170(c)(3).
[19] IRC § 170(c)(4).
[20] IRC § 170(c)(5).
[21] Rev. Rul. 83-104, 1983-2 C.B. 46.
[22] Commissioner v. Duberstein, 363 U.S. 278 (1960)
[23] *See, e.g.,* Howard v. Commissioner, 39 T.C. 833 (1963); Ruddell v. Commissioner, 71 T.C.M. 2419 (1996).
[24] *See, e.g.,* Hernandez v. Commissioner, 490 U.S. 680 (1989).
[25] *Id.*; *see also* McLennan v. United States, 24 Cl. Ct. 102, *aff'd* 994 F.2d 839 (1993) (concluding that donors possessed the requisite donative intent where property value maintenance and tax savings in part motivated their grant of a conservation easement).
[26] Kirschten & Freitag, *Charitable Contributions: Income Tax Aspects*, 521-2d T.M. (2002) (emphasis added).
[27] *See, e.g.,* Saba v. Commissioner, 40 T.C.M. 446, 452 (1980) (finding the *quid pro quo* test appropriate for determining the deductibility of land transferred to a state but noting that the grantor's subjective attitude at the time of transfer was a relevant consideration) and Graves v. Commissioner, 68 T.C.M. 1445 (1994) (noting both the existence of a *quid pro quo* and inquiring into the donors' "disinterested and detached motives").
[28] United States v. American Bar Endowment, 477 U.S. 105, 118 (1986).
[29] Citizens & Southern Nat'l Bank v. United States, 243 F.Supp. 900 (W.D.S.C. 1965).
[30] Treas. Reg. 1.170A-1(h)(1). The Regulation defines "goods or services" to include "cash, property, services, benefits, and privileges." *Id.* (citing Treas. Reg. 1.170A-13(f)(5)). It considers a payment to be made "in consideration for" these goods or services if, at the time of payment, the donor "receives or expects to receive goods or services in exchange for that payment." *Id.* (citing Treas. Reg. 1.170A-13(f)(6)).
[31] Treas. Reg. 1.170A-1(h)(2)(i).

[32] William T. Hutton, *Tax Strategies in Land Conservation Transactions* 2-5 (Land Trust Alliance Rally 2001). For cases allowing a charitable deduction, *see* Toole v. Tomlinson, 63-1 USTC ¶ 9267 (M.D. Fla. 1963) (allowing deduction for transfers of land to city for street and sewer improvements); Scheffres v. Commissioner, 28 T.C.M. 234 (1969) (allowing deduction for developer's transfer of land to a school board resulting in necessary zoning change on grounds that the school board could have obtained the land through eminent domain); Allen v. United States, 541 F.2d 786 (9th Cir. 1976) (allowing deduction for developers' transfer to city of 9.2 acres of redwood trees as a condition of city's approval of taxpayers' subdivision plans); Morton v. Commissioner, 39 T.C.M. 621 (1979) (allowing deduction for transfer of farmland to city for use in drilling wells for city's water supply); Elrod v. Commissioner, 87 T.C. 1046 (1986) (allowing deduction for transfer of land to state to improve access to hospital); and Connell v. Commissioner, 51 T.C.M. 1657 (1986) (allowing deduction for a right-of-way transfer to county in the absence of evidence that the transfer increased the possibility of a loop being built through the taxpayer's property or influenced the taxpayer's zoning request). For cases disallowing a deduction, *see* Perlmutter v. Commissioner, 45 T.C. 311 (1965) (disallowing deduction for developer's land transfers to school and recreation districts to secure approval for development); United States v. Transamerica Corp., 392 F.2d 522 (9th Cir. 1968) (disallowing deduction for transfer to city of private road leading to donor's business where transfer relieved donor of responsibility for maintaining the road); Ackerman Buick, Inc. v. Commissioner, 32 T.C.M. 1061 (1973) (disallowing deduction for road transfer to city to secure zoning change); Petit v. Commissioner, 61 T.C. 634 (1974) (disallowing deduction for transfer of right-of-way to a township to obtain approval for development); Saba v. Commissioner, 40 T.C.M. 446 (1980) (disallowing deduction for land transfer to state in exchange for state's deed of other land to donor to clear donor's title to other land); Conforte v. Commissioner, 74 T.C. 1160 (1980) (disallowing deduction for transfer of a bridge and part of a roadway to county, who assumed responsibility for maintaining property as a public right of way, where donors benefited from improved access to their business); Ottawa Silica Co. v. United States, 82-1 USTC ¶ 9308 (Ct. Cl. 1982) (disallowing deduction for land transfer to school district where donor expected that construction of school access roads would enhance the value of their remaining property); Osborne v. Commissioner, 87 T.C. 575 (1986) (disallowing deduction for transfer of drainage facilities and related easements to city to extent it increased the value of donor's property but allowing deduction to extent that value of the facilities easements exceeded the enhancement); and Elrod v. Commissioner, 87 T.C. 1046 (1986) (disallowing deduction for land transfer to state for highway interchange and access road where interchange road would provide access to donor's shopping center).
[33] Hutton, *supra*, note 32 at 2-5 and 2-6.
[34] Treas. Reg. 1.170A-4(c)(2)(ii).
[35] *See, e.g.,* Waranch v. Commissioner, 58 T.C.M. 584 (1989); Connell v. Commissioner, 51 T.C.M. 1657 (1986); Stark v. Commissioner, 86 T.C. 243 (1986).
[36] IRC § 1001(a).
[37] IRC § 1011(b).
[38] Treas. Reg. 1.1011-2(b).
[39] *See* Treas. Reg. 1.170A-8(e) (defining "contribution base" for purposes of § 170 as "adjusted gross income under section 62, computed without regard to any net operating loss carryback to the taxable year under section 172.").
[40] Treas. Reg. 1.1011(2)(a)(3).
[41] *Accord* IRC § 170(f)(5)(A) (requiring reduction for interest on indebtedness "(i) which has been paid (or is to be paid) by the taxpayer, (ii) which is attributable to the liability, and (iii) which is attributable to any period after making the contribution.").
[42] *See* Treas. Reg. 1.170A-4(a).
[43] Treas. Reg. 1.170A-4(c)(2).
[44] *Id.*
[45] Treas. Reg. 1.170A-4(d), Example (8).
[46] G.C.M. 200238041 (July 24, 2002).
[47] *Id.*(citations omitted).
[48] *Id.*
[49] IRC § 170(f)(3)(A).
[50] IRC § 170(f)(3)(B).
[51] IRC § 170(f)(3)(B)(i); *see also* Treas. Reg. 1.170A-7(b)(3) and (4).

[52] Treas. Reg. 1.170A-7(b)(3) (providing further that "personal residence" may include a donor's vacation home or stock owned by the donor in a cooperative housing corporation).
[53] Treas. Reg. 1.170A-7(b)(4) (defining "livestock" as "cattle, hogs, horses, mules, donkeys, sheep, goats, captive fur-bearing animals, chickens, turkeys, pigeons, and other poultry" and providing that "[a] farm includes improvements thereon.").
[54] Rev. Rul. 77-305, 1977-2 C.B. 59; *but see* Rev. Rul. 83-158, 1983-2 C.B. 159 (allowing a deduction for estate tax purposes "for the value of a charitable remainder interest in the proceeds from the sale of a decedent's personal residence if, under local law, the charity has the option to take the residence instead of the sale proceeds.").
[55] Treas. Reg. 1.170A-7(b)(3) and (4); *see, e.g.,* Rev. Rul. 73-297, 1973-2 C.B. 67 (allowing a deduction for a remainder interest in farm property donated to the United States for use as a national park by a donor corporation which reserved to itself an estate for the life of a husband and wife or either of them as survivor).
[56] IRC § 170(f)(4); *see also* Treas. Reg. 1.170A-12(a)(1).
[57] Treas. Reg. 1.170A-12(a)(2).
[58] IRC § 170(f)(3)(B)(ii); *see also* Treas. Reg. 1.170A-7(b)(1).
[59] Treas. Reg. 1.170A-7(b)(1)(i).
[60] *Id.*
[61] *Id.*
[62] IRC § 170(f)(3)(B)(iii); *see also* Treas. Reg. 1.170A-14(a).
[63] Rev. Rul. 64-205, 1964-2 C.B. 62 (concluding that "[a] gratuitous conveyance to the United States of America of a restrictive easement in real property to enable the Federal Government to preserve the scenic view afforded certain public properties, is a charitable contribution within the meaning of section 170 of the Internal Revenue Code of 1954. The grantor is entitled to a deduction for the fair market value of the restrictive easement in the manner and to the extent provided in section 170 of the Code; however, the basis of the property must be adjusted by eliminating that part of the total basis which is properly allocable to the restrictive easement granted.").
[64] Tax Reform Act of 1976, Pub. L. 94-455, § 2124(e)(1).
[65] POWELL ON REAL PROPERTY § 34A.04[1] (Matthew Bender & Co., Inc., Rel. 91—6/00).
[66] Tax Treatment Extension Act of 1980, Pub. L. 96-541, §§ 6(a) and (b).
[67] S. Rep. No. 96-1007, 96th Cong., 2d Sess. 9 (1980) (*reprinted in* Stephen J. Small, THE FEDERAL TAX LAW OF CONSERVATION EASEMENTS C-30 (1986)).
[68] *See* Tax Reform Act of 1984, Pub. L. 98-369, § 1035(a) (amending § 170(h)(5)) and Taxpayer Relief Act of 1997, Pub. L. 105-34, § 508(d) (amending § 170(h)(5)).
[69] IRC § 170(h)(1); *see also* Treas. Reg. 1.170A-14(a).
[70] Treas. Reg. 1.170A-14(a).
[71] IRC § 170(h)(2).
[72] Treas. Reg. 1.170A-14(b)(1)(i).
[73] Treas. Reg. 1.170A-14(b)(1)(ii) (referring to Treas. Reg. 1.170A-7(a)(2)(i)).
[74] Treas. Reg. 1.170A-14(b)(1)(ii).
[75] Treas. Reg. 1.170A-14(b)(2).
[76] *Id.*
[77] *See, e.g.,* Schwab v. Commissioner, 67 T.C.M. 3004 (1994) (allowing a deduction for the contribution of an agricultural open space easement to the American Farmland Trust); Rome I, Ltd. v. Commissioner, 96 T.C. 697 (1991) (allowing a deduction for the contribution of a façade and conservation easement on a historic building to the Georgia Trust for Historic Preservation).
[78] Treas. Reg. 1.170A-14(b)(2).
[79] IRC § 170(h)(3); Treas. Reg. 1.170A-14(c)(1).
[80] Treas. Reg. 1.170A-14(c)(1) (noting that the organization "need not set aside funds to enforce the restrictions that are the subject of the contribution.").
[81] *Id.*
[82] Treas. Reg. 1.170A-14(c)(2).
[83] *Id.*
[84] *Id.*
[85] *Id.*

[86] Treas. Reg. 1.170A-14(g)(5)(ii) (providing "the right to extract certain minerals which may have an adverse impact on the conservation interests associated with the qualified real property interest" as an example).
[87] *Id.* (noting that "appropriate legal proceedings" include "the right to require the restoration of the property to its condition at the time of the donation.").
[88] IRC § 170(h)(4); *see also* Treas. Reg. 1.170A-14(d)(1).
[89] *See, e.g.,* PLR 9603018 (allowing a deduction for the contribution of an easement on farmland and undeveloped property in a National Historic Landmark where the contribution preserved open space and an historically important area).
[90] Treas. Reg. 1.170A-14(d)(2)(i).
[91] *Id.*
[92] Treas. Reg. 1.170A-14(d)(2)(ii).
[93] Treas. Reg. 1.170A-14(d)(3)(i).
[94] Treas. Reg. 1.170A-14(d)(3)(ii).
[95] Treas. Reg. 1.170A-14(d)(3)(i) (explaining that "the preservation of a lake formed by a man-made dam or a salt pond formed by a man-made dike would meet the conservation purposes test if the lake or pond were a nature feeding area for a wildlife community that included rare, endangered, or threatened native species.").
[96] Treas. Reg. 1.170A-14(d)(3)(iii).
[97] Glass v. Commissioner, 124 T.C No. 16, 124 T.C 258 (2005). *Also see* IRC § 170(h)(1)(c).
[98] *Id.*
[99] *Id* at 281; *See also* IRC § 170(h)(1)(c).
[100] *Id* at 281; *See* also Treas. Reg. 1.170A-14(d)(3)(ii).
[101] *Id.*at 281, *citing* S. Rep.No. 96-1007*,* at 10 (1980), 1980-2 C.B. at 604.
[102] *Id at 281, Also see* IRC § 170(h)(4)(A)(ii).
[103] Glass v. Commissioner, No. 06-1398, WL 3740797 (6th Cir, December 21, 2006). See also, December 19, 2006 letter from IRS Senior Technical Reviewer, Karin Goldsmith Gross defining "relatively natural habitat" as a valid conservation purpose under IRC 170(h)(4)(A)(ii) and Treas. Reg. 1.170A-14(d)(3)(ii) even where there is no evidence of a rare or endangered species.
[104] Treas. Reg. 1.170A-14(d)(4)(i).
[105] Treas. Reg. 1.170A-14(d)(4)(v).
[106] Treas. Reg. 1.170A-14(d)(4)(iii)(A).
[107] Treas. Reg. 1.170A-14(d)(4)(iii)(B) (including for purposes of the rule "a commission, authority, or similar body duly constituted by the state or local government and acting on behalf of the state or local government.").
[108] *Id.*
[109] *Id.*
[110] *Id.*
[111] *Id.*
[112] *Id.*
[113] Treas. Reg. 1.170A-14(d)(iii)(C).
[114] Treas. Reg. 1.170A-14(d)(4)(ii)(A).
[115] *Id.* (explaining that "[t]he application of a particular objective factor to help define a view as 'scenic' in one setting may in fact be entirely inappropriate in another setting.").
[116] Treas. Reg. 1.170A-14(d)(4)(ii)(A)(1)-(8).
[117] Treas. Reg. 1.170A-14(d)(4)(ii)(B).
[118] *Id.*
[119] *Id.*
[120] Treas. Reg. 1.170A-14(d)(4)(iv)(A).
[121] Treas. Reg. 1.170A-14(d)(4)(iv)(A)(1)-(11) (advising that "[p]ublic benefit will be evaluated by considering all pertinent facts and circumstances germane to the contribution. Factors germane to the evaluation of public benefit from one contribution may be irrelevant in determining public benefit from another contribution. No single factor will necessarily be determinative.").
[122] Treas. Reg. 1.170A-14(d)(4)(vi)(A).
[123] *Id*. (explaining that, "while a statute in State X permitting preferential assessment for farmland is, by definition, governmental policy, it is distinguishable from a state statute, accompanied by appropriations, naming the X River as a valuable resource and articulating the legislative policy that the X River and the relatively natural quality of its surrounding be protected. On these facts, an open space easement on farmland in

State X would have to demonstrate additional factors to establish "significant public benefit." The specificity of the legislative mandate to protect the X River, however, would by itself tend to establish the significant public benefit associated with an open space easement on land fronting the X River.").

[124] Treas. Reg. 1.170A-14(d)(4)(vi)(B).

[125] Treas. Reg. 1.170A-14(d)(4)(vi)(C).

[126] Turner v. Commissioner, 126 T.C. No. 16, 126 T.C. 299 (2006).

[127] *Id.* at 304.

[128] *Id.* at 303.

[129] *Id.* at 309.

[130] *Id.* at 315.

[131] *Id.* at 313

[132] *Id* at 313*., citing* S. Rep.No. 96-1007*,* at 12 (1980), 1980-2 C.B. 599, 605.

[133] *Id* at 315..

[134] *Id* at 321.

[135] Treas. Reg. 1.170A-14(d)(5)(i) (noting that "[w]hen restrictions to preserve a building or land area within a registered historic district permit future development on the site, a deduction will be allowed under this section only if the terms of the restrictions require that such development conform with appropriate local, state, or Federal standards for construction or rehabilitation within the district.").

[136] Treas. Reg. 1.170A-14(d)(5)(ii).

[137] Treas. Reg. 1.170A-14(d)(5)(iii) (defining "structure" as "any structure, whether or not it is depreciable. Accordingly easements on private residences may qualify under this section. In addition, a structure would be considered to be a certified historic structure if it were certified either at the time the transfer was made or at the due date (including extensions) for filing the donor's return for the taxable year in which the contribution was made.").

[138] Treas. Reg. 1.170A-14(d)(5)(iv)(A); *see also* Treas. Reg. 1.170A-14(d)(5)(iv)(C) (noting that "[t]he amount of access afforded the public by the donation of an easement shall be determined with reference to the amount of access permitted by the terms of the easement which are established by the donor, rather than the amount of access actually provided by the donee organization. However, if the donor is aware of any facts indicating that the amount of access that the donee organization will provide is significantly less than the amount of access permitted under the terms of the easement, then the amount of access afforded the public shall be determined with reference to this lesser amount.").

[139] *Id.*

[140] *Id.*

[141] *Id.*

[142] Treas. Reg. 1.170A-14(d)(5)(iv)(B).

[143] Treas. Reg. 1.170A-14(e)(1).

[144] *Id.*; *see also* Treas. Reg. 1.170A-14(h)(3)(i).

[145] Treas. Reg. 1.170A-14(e)(2) (explaining that "the preservation of farmland pursuant to a State program for flood prevention and control would not [meet the conservation purposes test] of this section if under the terms of the contribution a significant naturally occurring ecosystem could be injured or destroyed by the use of pesticides in the operation of the farm." The Regulations further note that "[t]his requirement is not intended to prohibit uses of the property, such as selective timber harvesting or selective farming if, under the circumstances, those uses do not impair significant conservation interests.").

[146] Treas. Reg. 1.170A-14(e)(3) (explaining that "a deduction for the donation of an easement to preserve an archaeological site that is listed on the National Register of Historic Places will not be disallowed if site excavation consistent with sound archaeological practices may impair a scenic view of which the land is a part. A donor may continue a pre-existing use of the property that does not conflict with the conservation purposes of the gift.").

[147] Treas. Reg. 1.170A-14(f), Example (2) (explaining that "[a] qualified conservation organization owns Greenacre in fee as a nature preserve. Greenacre contains a high quality example of a tall grass prairie ecosystem. Farmacre, an operating farm, adjoins Greenacre and is a compatible buffer to the nature preserve. Conversion of Farmacre to a more intense use, such as a housing development, would adversely affect the continued use of Greenacre as a nature preserve because of human traffic generated by the development. The owner of Farmacre donates an easement preventing any future development on Farmacre to the qualified

conservation organization for conservation purposes. Normal agricultural uses will be allowed on Farmacre. Accordingly, the donation qualifies for a deduction under this section.").

148 *See, e.g.,* PLR 9632003 (allowing deduction where donor retained rights to conduct ranching and agricultural activities and construct related buildings); PLR 9318017 (allowing deduction where donor retained rights to create hiking trails and install and maintain water systems and utility lines); *see also* Treas. Reg. 1.170A-14(g)(5) (requiring donors reserving rights "the exercise of which may impair the conservation interests associated with the property" to provide the donee organization with "documentation sufficient to establish the condition of the property at the time of the gift," as well as the right to enter and inspect the property and enforce the conservation restrictions by appropriate legal proceedings).

149 IRC § 170(h)(5)(A); *see also* Treas. Reg. 1.170A-14(g)(1).

150 Treas. Reg. 1.170A-14(g)(1).

151 *Id.*

152 Treas. Reg. 1.170A-14(g)(3) (explaining that "a state's statutory requirement that use restrictions must be rerecorded every 30 years to remain enforceable [does] not, by itself, render an easement nonperpetual.").

153 Treas. Reg. 1.170A-14(g)(2).

154 *Id.*

155 Treas. Reg. 1.170A-14(b)(1)(i).

156 Treas. Reg. 1.170A-14(g)(4)(i).

157 *Id.*

158 *Id*. (explaining that "a deduction will not be denied in a case where production facilities are concealed or compatible with existing topography and landscape and when surface alteration is to be restored to its original state.").

159 Treas. Reg. 1.170A-14(g)(4)(ii)(A); *see also* IRC § 170(h)(5)(B)(ii).

160 Treas. Reg. 1.170A-14(g)(4)(ii)(B).

161 Treas. Reg. 1.170A-14(g)(4)(iii), Example (1) and (2).

162 Treas. Reg. 1.170A-14(g)(6)(ii).

163 *Id.*

164 *Id.*

165 *Id.*

166 Karen Marchetti-Kaiser, *Recent Easement Amendment Survey Findings*, THE BACK FORTY ANTHOLOGY 3.69 (1995).

167 William P. O'Connor, *Amending Conservation Easements: Legal and Policy Considerations*, LTA *Exchange* (Vol. 18, No. 2 1999).

168 Unif. Conserv. Easement Act § 3(a)

169 *Id.* at § 1

170 *Id.* at § 4

171 *Id.* at § 3.

172 Amy Humphreys-Chandler, *Amendments to Conservation Easements: How & Why to Develop a Policy*, 8 THE BACK FORTY 1, 3-4 (March/April 1999).

174 *Id.*

175 O'Connor, *supra* note 167.

176 *Proceedings of the Committee of the Whole, Uniform Conservation Easement Act of the National Conference of Commissioners on Uniform State Laws* 32 (Aug. 4-5, 1981) (remarks of Commissioner Rupert Bullivant, UCEA Drafting Committee Chair) (*quoted in* Alexander R. Arpad, *Private Transactions, Public Benefits, and Perpetual Control Over the Use of Real Property: Interpreting Conservation Easements as Charitable Trusts*, 37 REAL PROP. PROB. & TR. J. 91, 93 (2002)).

177 Alexander R. Arpad, *Private Transactions, Public Benefits, and Perpetual Control Over the Use of Real Property: Interpreting Conservation Easements as Charitable Trusts*, 37 REAL PROP. PROB. & TR. J. 91 (2002).

178 *Id.* at 124 (citations omitted).

179 *Id.*

180 *Id.* at 143.

181 *Id.* (explaining that "[i]n the Myrtle Grove case, the Maryland Attorney General's office filed suit to block amendments to a conservation easement held by the National Trust for Historic Preservation. The National Trust had given preliminary approval to a subdivision plan for a property under easement, but later decided the

subdivision plan would violate the terms of the original gift, and the successor owner of the property brought suit to 'enforce terms of the alleged conservation easement amendment.' The Maryland Attorney General's collateral suit asserted 'that the amendments . . . would violate a charitable trust for the benefit of the citizens of Maryland.' Both cases were settled in December 1998, with the National Trust agreeing to pay a substantial settlement to the successor of the property subject to the easement.").

[182] *Id.* at 145.

[183] *Id.*

[184] Strasburg v. Commissioner, T.C. Memo 2000-94, 79 T.C.M. 1997 (2000).

[185] Treas. Reg. 1.170A-14(h)(3)(i) (noting, however, that "if the donor or a related person receives, or can reasonably expect to receive, a financial or economic benefit that is substantial, but it is clearly shown that the benefit is less than the amount of the transfer, then a deduction under this section is allowable for the excess of the amount transferred over the amount of the financial or economic benefit received or reasonably expected to be received by the donor or the related person.").

[186] *See* Treas. Reg. 1.170A-14(c)(1)(iii).

[187] IRC § 501(c)(3).

[188] General Counsel Memorandum 39862.

[189] *Strasburg*, *supra* note 184.

[190] *Id.*

[191] *Id.*

[192] *Id.*

[193] *Id.* (concluding that the fair market value of the amendment equaled the additional reduction in value as determined by the landowner's appraiser).

[194] *Id.*

[195] *See generally* Treas. Reg. 1.170A-14(h); *see also* Treas. Reg. 1.170A-14(h)(4) (providing that valuation must account for the restrictions concerning reductions in the amount of charitable contributions of appreciated property and percentage limitations on charitable deductions for individuals where appropriate).

[196] Treas. Reg. 1.170A-14(h)(1).

[197] *Id.*

[198] Treas. Reg. 1.170A-14(h)(4), Example (1).

[199] Treas. Reg. 1.170A-14(h)(2).

[200] *Id.*

[201] *Id.*

[202] Treas. Reg. 1.170A-14(h)(4), Examples (2), (3) and (6).

[203] Treas. Reg. 1.170A-14(h)(3)(i).

[204] *Id.*

[205] *Id.*

[206] Syminton v. Commissioner, 87 T.C. 892, 896 (1995).

[207] Treas. Reg. 1.170A-14(h)(4), Example (4).

[208] Treas. Reg. 1.170A-14(h)(3)(ii).

[209] *Id.*

[210] *Id.*

[211] *Id.*

[212] Strasburg v. Commissioner, T.C. Memo. 2000-94.

[213] *Id.*

[214] Treas. Reg. 1.170A-14(h)(3)(ii).

[215] *Id.*

[216] *Id.*

[217] Treas. Reg. 1.170A-14(h)(3)(i).

[218] *Id.*

[219] *Id.*; *see also* McLennan v. United States, 24 Cl. Ct. 102, *aff'd* 994 F.2d 839 (1993).

[220] Treas. Reg. 1.170A-14(h)(3)(i).

[221] Treas. Reg. 1.170A-14(h)(3)(iii).

[222] *Id.*

[223] Treas. Reg. 1.170A-14(h)(4), Example (9).

[224] Treas. Reg. 1.170A-14(h)(4), Example (11).

[225] Treas. Reg. 1.170A-1(c)(1).
[226] Treas. Reg. 1.170A-1(c)(2).
[227] Cooley v. Commissioner, 33 T.C. 223 (1959).
[228] IRC § 170(e)(1)(A); *see also* Treas. Reg. 1.170A-4(a)(1).
[229] Treas. Reg. 1.170A-4(b)(1).
[230] *Id.*
[231] Anthony L. Francois, *Real Property Donations and the Perils of I.R.C. Sec. 170(e)(1)(A)*, 8 THE BACK FORTY 13 (March/April 1999).
[232] IRC § 170(e)(1)(A).
[233] *See* IRC § 1221(a).
[234] Rev. Proc. 83-22, 1983-1 C.B. 680.
[235] IRC § 1221(a)(1).
[236] Malat v. Riddell, 383 U.S. 569 (1966).
[237] *Id.* at 572.
[238] Rothman, et al., 561-T.M., *Capital Assets* (*citing* Continental Can Co. v. U.S., 442 F.2d 405 (Ct. Cl.), *cert. denied*, 400 U.S. 819 (1970)).
[239] DuVal v. Commissioner, T.C. Memo 1994-603 (*citing* Graves v. Commissioner, 867 F.2d 199, 202 (4th Cir. 1989).
[240] *Id.*
[241] *Id.* (*citing* Guardian Indus. Corp. v. Commissioner, 97 T.C. 308, 316 (1991), aff'd without published opinion 21 F.3d 427 (6th Cir. 1994)).
[242] *Id.*
[243] *Id.*
[244] *Id.*
[245] *Id.*
[246] *Id.*
[247] *Id.*
[248] *Id.*
[249] *Id.*
[250] *Id.*
[251] Or, for governmental units, to any purpose or function described in § 170(c).
[252] IRC § 170(e)(1)(B)(i).
[253] Treas. Reg. 1.170A-4(b)(3)(i).
[254] Treas. Reg. 1.170A-4(b)(3)(ii).
[255] As defined in § 509(a), other than private foundations described in § 170(b)(1)(E).
[256] IRC § 170(e)(1)(B)(ii).
[257] IRC §170(b)(1); see also Treas. Reg. 1.170A-8
[258] IRC § 170(e)(1)(F).
[259] IRC § 170(b)(1)(A); *see also* Treas. Reg. 1.170A-8(b).
[260] IRC § 170(d)(1); *see also* Treas. Reg. 1.170A-10(b)
[261] IRC § 170(b)(1)(B); *see also* Treas. Reg. 1.170A-8(d).
[262] IRC § 170(b)(1)(C).
[263] *Id.*
[264] IRC § 170(b)(1(C)(iii); *see also* Treas. Reg. 1.170A-8(d)(2).
[265] *Id.*
[266] IRC § 170(b)(1)(D)(ii); see also Treas. Reg. 1.170-8(d)(1).
[267] *See* IRC § 170(b)(1)(E)(iv).
[268] *See* IRC § 170(b)(1)(C)(iv); *also see* discussion of dealer versus inventory status herein at Section II, Paragraph 6.b.1.
[269] IRC § 170(b)(1)(E)(iv)(I).
[270] IRC § 170(b)(1)(E)(v).
[271] IRC § 170(b)(1)(E)(iv) and (v).
[272] IRC § 170(b)(1)(A); *see also* Treas. Reg. 1.170A-8(b).
[273] IRC § 170(b)(1)(E)(iv)(II)
[274] IRC § 170(b)(2).

[275] IRC § 170(b)(2)(B)(i)(I).
[276] IRC § 170(b)(2)(B)(i)(II).
[277] IRC § 170(b)(2)(B)(ii).
[278] Joint Committee on Taxation, *Technical Explanation of H.R. 4, the "Pension Protection Act of 2006," as Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006* (JCX-38-06), August 3, 2006.
[279] IRC § 2031(c)(1).
[280] IRC § 2031(c)(1).
[281] IRC § 2031(c)(8)(A)(i).
[282] IRC § 2031(c)(8)(A)(ii).
[283] IRC § 2031(c)(8)(B).
[284] *Id.*
[285] IRC § 2031(c)(8)(C).
[286] IRC § 2031(c)(8)(A)(iii).
[287] IRC § 2031(c)(6).
[288] FEDERAL ESTATE AND GIFT TAXATION 4-63 (Stephens, et al., eds.) (Warren, Gorham & Lamont 8th Ed. 2002).
[289] *Id.* (citations omitted).
[290] *Id.*
[291] IRC § 2031(c)(4)(A).
[292] IRC § 2031(c)(4)(B)(i).
[293] IRC § 2031(c)(4)(B)(ii).
[294] IRC § 2031(c)(5)(A).
[295] IRC § 2031(c)(5)(D) (citing IRC § 2032A(e)(5), which defines "farming purposes" as "[a] cultivating the soil or raising or harvesting any agricultural or horticultural commodity (including the raising, shearing, feeding, caring for, training, and management of animals) on a farm; [b] handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its unmanufactured state, but only if the owner, tenant, or operator of the farm regularly produces more than one-half of the commodity so treated; and [c] the planting, cultivating, caring for, or cutting of trees, or the preparation (other than milling) of trees for market.").
[296] IRC § 2031(c)(5)(B).
[297] *Id.*
[298] IRC § 2031(c)(5)(C).
[299] IRC § 2031(c)(1).
[300] IRC § 2031(c)(2).
[301] *Id.*
[302] IRC § 1014(a)(4).
[303] This portion of the materials borrows heavily from Stephens, et al., *supra* note 288, at 4-72-74. As the editors explain, in each of the situations described "one can concoct other possible results in determining the basis for the property. Therefore, regulatory guidance will be welcomed."
[304] Treas. Reg. 1.170A-14(h)(3)(iii).
[305] *Id.*
[306] S. Rep. No. 105-33, 105th Cong., 1st Sess 47 (1997), reprinted in 1997-4 CB (Vol. 2) 1067, 1127.
[307] IRC § 2032A(c)(8).
[308] Stephens, et al., *supra* note 288, at 4-68-69.
[309] *Id.* at 4-69.
[310] IRC § 2032A(b)(2) (defining "qualified use" as "the devotion of the property to . . . use as a farm for farming purposes or use in a trade or business other than the trade or business of farming.").
[311] IRC § 2032A(b)(1).
[312] IRC § 2032A(b)(1)(A).
[313] IRC § 2032A(b)(1)(B).
[314] IRC § 2032A(b)(3)(A).
[315] IRC § 2032A(b)(3)(B).
[316] Stephens, et al., *supra* note 288, at 4-70; *see also* Stephens, et al., *supra* note 288, at 4-67-68 and accompanying notes.

[317] *See generally*, the Senate Finance "white paper" on general charity abuses and proposed solutions at: http://finance.senate.gov/hearings/testimony/2004test/062204stfdis.pdf (last visited October 5, 2006).
[318] *Supra* note 103.
[319] For more information, see www.irs.gov/pub/irs-tege/miller_speech_3_28_06.pdf (last visited October 5, 2006).
[320] *Marina v. Ney*, T.C. Summary Opinion 2006-154 (2006); *also see* IRS § 1.170A-13(c)
[321] *See* Deficit Reduction Act of 1984, Pub. L. 98-369, 98 Stat.691.
[322] *Id.*
[323] Treas. Reg. § 1.170A-13(c)(2)(i)
[324] The substantial compliance doctrine is designed to avoid hardship in cases where a party does all that can reasonably be expected of him, but he nonetheless has failed to comply with the requirements of a statutory provision. *See Estate of Chamberlain v. Commissioner*, T.C. Memo. 1999-181, affd. 9 Fed. Appx. 713 (9th Cir. 2001).
[325] *Supra note* 320 at 17.
[326] *Supra* note 320 at 21.
[327] *Supra* note 103.
[328] *Id.*
[329] *See* www.irs.gov/irb/2006-46_IRB/ar13.html (last visited on January 14, 2007).
[330] *Id.*
[331] *Id.*
[332] *Id.*
[333] IRC § 6662(e)(1).
[334] IRC § 6662(h)(2).
[335] IRC § 6662(g)(1).
[336] IRC § 6662(h)(2)(C).
[337] IRC § 6662(a); IRC § 6662(h)(1).
[338] IRC § 6695A(b).
[339] IRC § 6695A(b).
[340] IRC § 170(h)(4).
[341] John L. Hollingshead, *Conservation Easements: A Flexible Tool for Land Preservation*, 3 ENVTL. LAW 319, 326 (1997) (citing Restatement of Property, §§ 451, 453-454 (1944)); *see also* POWELL ON REAL PROPERTY, *supra* note 65, at § 34A.01.
[342] *Id.*
[343] *Id.*
[344] UCEA § 3(a)
[345] UCEA § 1(2)(i)(ii)
[346] *Id.*
[347] UCEA § 4
[348] UCEA § 3(a)(3); *see also* UCEA § 1(3) (defining "third-party right of enforcement" as "a right provided in a conservation easement to enforce any of its terms granted to a governmental body, charitable corporation, charitable association, or charitable trust, which, although eligible to be a holder, is not a holder.").
[349] *See, e.g.,* S.C. CODE ANN. § 27-8-70 (2006); *see also* IND. CODE § 32-5-2.6-7. (2006), IDAHO CODE § 55-2109 (2006) and VA. CODE ANN. § 101.1-1011 (2006).
[350] *See* N.D. CENT. CODE § 55-10-08 (1983).
[351] *See, e.g.,* IRC § 170(b).
[352] *See* IRC § 170(e)(2); *see also Strasburg v. Commissioner*, T.C.Memo 2000-94.
[353] *See* Form 8282
[354] *See, e.g.,* Strasburg v. Commissioner, T.C. Memo 2000-94.
[355] *See* Treas. Reg. 1.170A-14(d)(4)(i) and (iii).
[356] Treas. Reg. 1.70A-14(d)(4)(ii)(B).
[357] *See* Treas. Reg. § 1.170A-14(d)(4)(iii); *see also* PLR 199952037 and PLR 20002020
[358] *See* Anne Senti-Willis, *Internal Revenue Service Interpretation of Clearly Delineated Federal, State, or Local Governmental Conservation Policy*, 7 THE BACK FORTY 1 (March/April 1997).
[359] *See* Treas. Reg. 1.170A-14(f), Examples (1) through (5).
[360] PLR 200014013.

[361] *Id.*
[362] *See* GCM 39862; *see also* McLennan v. United States, 24 Cl. Ct 102, 106, aff'd 994 F.2d 839 (1993).
[363] States with conservation easement tax credits include California, Colorado, Delaware, Maryland, North Carolina, New Jersey, South Carolina and Virginia.
[364] John L. Hollingshead, *Conservation Easements: A Flexible Tool for Land Preservation*, 3 ENVTL. LAW 319, 359-60 (1997); *see also* Daniel C. Stockford, *Property Tax Assessment of Conservation Easements*, 17 B.C. ENVTL. AFF. L. REV. 823, 827 (1990).
[365] Hollingshead, *supra* note 338, at 360.
[366] Stockford, *supra* note 377 (*citing* Russell R. Sicard, *Note:Pursuing Open Space Preservation: Massachusetts Conservation Restriction*, 4 ENVTL. AFF. 481, 497 (1975)).
[367] *See, e.g.,* S.C. CODE ANN. § 27-8-70 (2006); *see also* IND. CODE § 32-5-2.6-7. (2006), IDAHO CODE § 55-2109 (2006) and VA. CODE ANN. § 101.1-1011 (2006).
[368] *See, e.g.,* COLO. REV. STAT. § 39-22-582 (2006); FLA. STAT. ANN. § 193.501 (West 2006); GA. CODE ANN. § 44-10-8 (2006); MONT. CODE ANN. § 76-6-208 (2006); N.Y. REAL PROP. TAX § 543 (2006); TENN. CODE ANN. § 66-9-308 (2006); UTAH CODE ANN. § 57-18-7 (2006).
[369] *See* PLR 98-51039; PLR 96-21012; PLR 96-01046; PLR-92-32030; PLR 92-15049.
[370] *See* Farm Security and Rural Investment Act of 2002, Pub. L. No. 107-171, §§ 2001, *et seq.* (2002).
[371] *See* PLR 9215049 (providing that a conservation easement is an interest in real estate and thus treated as such); PLR 9232030 (concluding that a conservation easement payment may be used in a like-kind exchange); Thomas L. Daniels, *Like-Kind Exchanges & Escrow Accounts: Leveraging Land Protection* (Land Trust Alliance Rally 2002).